Report on recent US international tax developments – 22 December 2017

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The United States (US) House and Senate approved the *Tax Cuts and Jobs Act* (H.R. 1) Conference Agreement this week, sending the landmark tax reform bill to the President for signature. The legislation is the most significant legislative achievement to date for the Trump Administration and the first major overhaul of the federal income tax in more than 30 years. The President signed the bill into law on 22 December.

The tax reform legislation provides for a complete overhaul of the US international tax regime.

The Law includes a 100% exemption of the foreign-source portion of dividends received by a US corporation from a foreign corporation in which the US corporation owns at least a 10% stake. The provision requires a holding period of more than one year in the stock of the foreign corporation. The Law also includes anti-base erosion rules for intangible income that will impose a tax on a US shareholder's aggregate net controlled foreign corporation (CFC) income that is treated as global intangible low-taxed income (GILTI). The anti-base erosion regime operates like a global minimum tax, with an exemption for certain earnings attributable to a routine return on tangible, depreciable assets.

The final legislation further provides for a mandatory one-time transitional tax on a US 10%-shareholder's pro rata share of the foreign corporation's post-1986 tax-deferred earnings, at the rate of either 15.5% (in the case of accumulated

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earnings held in cash, cash equivalents or certain other short-term assets) or 8% (in the case of accumulated earnings in excess of the amount of the cash, e.g., property, plant and equipment). A foreign corporation's post-1986 tax-deferred earnings would be the greater of the earnings as of 2 November 2017 or 31 December 2017.

Going forward, House Ways and Means Committee Chairman Kevin Brady said this week that he expects there will be more tax reform bills in the future to address "a lot of good provisions [that] got left on the cutting room floor" due to Senate budget reconciliation rules. He was quoted as saying that Republicans would be assessing those proposals to determine which should move forward, and which of those provisions would or would not be enacted through the budget reconciliation process.

On that subject, the Chairman said he was going to recommend "some form of tax reconciliation in future budgets because there are still areas of the tax code I think … can be improved." He also suggested Congress would continue to amend the US international tax rules.

Chairman Brady earlier had indicated that given the magnitude of the changes in the *Tax Cuts and Jobs Act*, he expected there will be a technical corrections bill in 2018. Given the lack of Congressional Democrat support for the tax reform bill, however, it is questionable whether there will be much appetite on the Democratic side to help move technical corrections legislation in the new year.

The Internal Revenue Service (IRS) on 18 December released proposed regulations on the treatment of foreign currency gains and losses of a controlled foreign corporation (CFC) under the business needs exclusion from foreign personal holding company income (FPHCI) under Internal Revenue Code[1] Section 954(c)(1)(D). The proposed regulations also include an election for taxpayers to use a mark-to-market method of accounting for foreign currency gain or loss attributable to Section 988 transactions.

The proposed regulations further permit the controlling US shareholders of a CFC to automatically revoke certain elections concerning the treatment of foreign currency gain or loss. The proposed regulations affect taxpayers and US shareholders of CFCs that engage in transactions giving rise to foreign currency gain or loss under Section 988 and under Section 954. The proposed regulations generally apply to taxable years ending on or after the date the regulations are published as final, but in certain cases taxpayers may be able to rely on the proposed regulations in years prior to finalization.

On 20 December, the US announced it had reached agreement with Spain on a bilateral competent authority agreement (CAA) to exchange Country-by-Country (CbC) reports; the agreement is operative as of 19 December 2017. As a result of the CAA, a US parent company's Spanish subsidiary or permanent establishment (PE) has no obligation to file a CbC report in Spain, so long as the US parent entity has filed a CbC report in the US.

US Multinational Enterprise (MNE) groups with a Spanish subsidiary or PE have been eagerly waiting for this agreement. According to Spanish law, entities residing in Spain that are direct or indirect subsidiaries of a nonresident company (belonging to an MNE group with consolidated net turnover in the preceding fiscal year of at least €750 million) must submit a CbC report locally in Spain with respect to the 2016 reporting year if there is no CAA in place with the nonresident company's country of residence, by year end.

The IRS on 15 December announced it is appealing the US Tax Court's decision in *Grecian Magnesite Mining, Industrial & Shipping Co. SA v. Commissioner*, 149 T.C. No. 3. In that case, the Court refused to follow Revenue Ruling 91-32 in which the IRS treated non-US persons gain from the disposition of a partnership interest as effectively connected to a US trade or business (ECI), when the partnership was engaged in such a US trade or business. Under the Court's conclusion in *Grecian*, non-US taxpayers' gain from dispositions of ECI-generating partnership interests may entirely escape US tax (except to the extent partnerships make US real estate investments). The IRS is appealing the decision to the US Court of Appeals for the District of Columbia.

Endnotes

1. All "Section" references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.

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