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Treasury, OMB announce agreement on tax regulatory review process

The US Treasury Department and the Office of Management and Budget (OMB) on 12 April 2018, released a Memorandum of Agreement (MOA) creating a new framework for the review of tax regulations that is intended to increase the economic analysis and review of tax rules while preserving timely tax guidance for taxpayers.

Certain IRS regulations were previously exempt from oversight by the OMB Office of Information and Regulatory Affairs (OIRA). The announcement followed calls in recent months, including some by members of Congress, to undo this exemption. As a Treasury press release noted, an agreement adopted in 1983 and reaffirmed in 1993 subjected some Treasury regulations to a review process different from other regulations issued by most executive agencies, and was interpreted to exempt essentially all tax regulations.

"The MOA announced today replaces the 1983 agreement with a new review process tailored to tax regulations – it focuses on reducing regulatory burdens while providing timely guidance to taxpayers," the press release stated. "Under the MOA, OIRA will review a subset of tax regulatory actions and provide expedited review for these actions."

In April 2017, President Trump directed Treasury and OMB to "review and, if appropriate, reconsider the scope and implementation of the existing exemption for certain tax regulations from the review process set forth in Executive Order 12866."

IRS and Treasury Notice offers some clarity on Section 163(j) business interest expense limitation

In Notice 2018-28, the IRS and Treasury announced their intent to issue proposed regulations under Section 163(j), as amended by the *Tax Cuts and Jobs Act* (TCJA). The Notice describes several issues that the proposed regulations will address. Importantly, the Notice clarifies that prior to the issuance of such proposed regulations, taxpayers may rely on the rules described in sections 3 through 7 of the Notice. While the Notice provides much needed guidance, it nevertheless leaves many questions unanswered.

As general background, new Section 163(j) limits the deduction for business interest expense for tax years beginning after 31 December 2017. Specifically, for any taxpayer subject to the provisions, Section 163(j)(1) limits the amount of business interest expense that may be deducted in a tax year to the sum of: (1) the taxpayer's business interest income, as defined in Section 163(j)(6), (2) 30% of the taxpayer's adjusted taxable income (ATI, as defined in Section 163(j)(8)), and (3) the taxpayer's floor plan financing interest, as defined in Section 163(j)(9).

For purposes of Section 163(j), business interest expense is interest that is paid or accrued on indebtedness that is properly allocable to a trade or business.

Treatment of tax attributes generated under prior Section 163(j)(1)(A)

Proposed regulations are expected to address the treatment of tax attributes that relate to rules under prior Section 163(j)(1)(A) (Prior Law). Namely, interest expense disallowed under Prior Law may be carried forward as business interest to the taxpayer's first tax year beginning after 31 December 2017, and subject to potential disallowance under Section 163(j) in the same manner as any other business interest paid or accrued in a tax year beginning after 31 December 2017.

Proposed regulations will further provide that a business interest carried forward under Prior Law, will be subject to Section 59A (which treats interest paid to a related foreign person as a base erosion payment) in the same manner as business interest paid or accrued in tax years beginning after 31 December 2017.

Corporate business interest expense and business interest income

Proposed regulations are expected to clarify that, solely for purposes of Section 163(j), all interest paid or accrued by a C corporation will qualify as business interest within the meaning of Section 163(j)(5), and all interest on indebtedness held by the C corporation that is includible in gross income will be business interest income within the meaning of Section 163(j)(6). This proposed regulation will not apply to an S corporation.

Consolidated groups

Proposed regulations will address the application of the Section 163(j)(1) limitation to consolidated groups. The regulations are expected to clarify that the limitation in Section 163(j)(1) on the amount allowed as a deduction for business interest applies at the level of the consolidated group.

Notice 2018-28 also addresses earnings and profits and partnerships and S corporations.

Notice 2018-26 announces anti-avoidance rules and other regulations on the transition tax provision in Section 965

In [Notice 2018-26], the IRS and Treasury announced their intention to issue new regulations under Section 965 on determining the amount of gross income recognized by US shareholders as an inclusion of deferred foreign income (transition tax). This is the third notice issued by the IRS on the transition tax, which was enacted by the *Tax Cuts and Jobs Act* (TCJA).

The described regulations include anti-avoidance rules for certain transactions, accounting method changes and elections that occurred (or were made) on or after 2 November 2017, guidance on certain elections, and procedures on reporting. The Notice also provides relief from certain estimated tax requirements and penalties for the transition tax and certain TCJA changes to stock attribution rules.

Anti-avoidance regulations under Section 965

The Notice states that regulations will include an anti-avoidance rule with respect to transactions undertaken with a principal purpose of reducing Section 965 tax liability. Such regulations will provide that a transaction will be disregarded for purposes of determining a US shareholder's Section 965 tax liability if each of the following conditions is satisfied: (1) the transaction occurs, in whole or in part, on or after 2 November 2017 (the specified date); (2) the transaction is undertaken with a principal purpose of reducing the Section 965 tax liability of such US shareholder; and (3) the transaction would, without regard to this rule, reduce the Section 965 tax liability of such US shareholder (the anti-avoidance rule).

By limiting the application of the anti-avoidance rule to transactions occurring in whole or in part on or after the specified date (2 November 2017), the Notice effectively

IRS issues FBAR publication

The Service issued a Foreign Bank and Financial Accounts (FBAR) fact sheet (FS-2018-7) in April that describes the reporting obligations of US individuals and domestic corporations and partnerships that have foreign bank and financial accounts, even if the accounts do not generate any taxable income.

indicates that any transaction that occurred before 2 November 2017, may not be challenged by the IRS under the anti-avoidance rule. However, such transactions could still be challenged under general tax law. The Notice does not define the term "transaction," which may cause some uncertainty among taxpayers and practitioners in the application of the anti-avoidance rule.

The IRS also plans to issue guidance providing that any change in method of accounting made for a "specified foreign corporation's" (SFC's) tax year that ends in 2017 or 2018 will be disregarded if the change would reduce the Section 965 tax liability (e.g., the method change as proposed would result in a negative Section 481(a) adjustment).

The retroactive and sweeping scope of the IRS effort's to preclude only tax favorable method changes in the context of the transition tax is unprecedented. Effectively, the Notice requires certain taxpayers with established E&P methods of accounting to compute E&P for transaction tax purposes using otherwise impermissible accounting methods.

Other rules on the application of Section 965 in certain instances are mostly taxpayer favorable. Instructions on how Section 965 will apply to domestic pass-through entities is especially helpful in clarifying what information needs to be computed and provided by the domestic pass-through entities, and which elections can be made by owners of pass-through entities.

Interestingly, this Notice, and prior notices, have not covered several areas of uncertainty on the application of Section 965. Specifically, there has been limited guidance on foreign tax credits deemed paid by an SFC's US shareholder with the Section 965(a) inclusion or otherwise. There also remains uncertainty on whether any basis adjustments to the shares of an SFC will be required as a result a US shareholder's allocation of its aggregate foreign E&P deficit.

US issues CbC reporting guidance for specified national security contractors

In Notice 2018-31, the IRS set forth modified reporting requirements for Form 8975, *Country-by-Country Report* (CbC report), for US multinational enterprise (MNE) groups that derive more than 50% of their annual revenues from the Department of Defense or other US governmental intelligence or security agencies.

Treasury and IRS intend to amend the CbC reporting regulations under Section 6038 to incorporate the modified reporting requirements described in the Notice, and those amendments would apply to CbC reports and amended CbC reports filed after 30 March 2018.

In general, CbC reporting requirements apply to ultimate parent entities of US MNE groups that have annual revenue for the preceding reporting period of $850 million or more in the preceding accounting period. In December 2015, the IRS issued proposed regulations under Section 6038 on CbC reporting.

The preamble to the proposed regulations requested comments regarding the need for a national security exception to the CbC reporting requirements. The IRS issued final CbC reporting regulations in June 2016, without a national security exception, noting that the Department of Defense would continue to examine the issue.

US MNE groups should take action to determine whether they qualify as specified national security contractors, as that term is defined in the Notice, and are therefore eligible to comply with the modified reporting requirements set forth in the Notice.

If a Form 8975 has been filed for a prior reporting period, those US MNE groups eligible for the modified reporting requirements set forth in the Notice should follow the instructions in the Notice to file amended CbC reports and meet the deadlines of 20 April 2018, if filing on paper, or 25 May 2018, if filing electronically. Based on the modified reporting requirements set forth in the Notice, no constituent entity information for jurisdictions other than the US and "Stateless" would be reported, so the US would not exchange those CbC reports.

IRS issues interim guidance under new Section 1446(f) for sales of interests in non-publicly traded partnerships

In Notice 2018-29, the IRS issued interim guidance under the new Section 1446(f) withholding rules for dispositions of interests in non-publicly traded partnerships that would generate gain treated as effectively connected with the conduct of a trade or business in the US under Section 864(c)(8).

The Notice generally does not suspend or delay the new Section 1446(f) withholding rules, which apply to sales, exchanges or dispositions of partnership interests occurring after 31 December 2017. The Notice suspends, however, a partnership's obligation to withhold when the transferee fails to withhold, and includes rules designed to facilitate implementation of Section 1446(f) and minimize over-withholding. The suspension of withholding for sales of interests in publicly traded partnerships under Notice 2018-8 remains in place.

IRS is considering BEAT aggregation rules as applied to control groups

A senior IRS official in April was quoted as saying that guidance on applying the base erosion anti-abuse tax (BEAT) enacted by the *Tax Cuts and Jobs Act* is a major priority for the agency. The official said the government is particularly interested in providing guidance related to the BEAT aggregation rule as applied to controlled groups. The official added that the aggregation rule for purposes of gross receipts and the base erosion percentage is either unclear or provides anomalous results.

The BEAT applies to corporations (other than RICs, REITs, or S-corporations) that are subject to US net income tax with average annual gross receipts of at least $500 million and that have made related-party deductible payments totaling 3% (2% for banks and certain security dealers) or more of the corporation's total deductions for the year. The "base erosion percentage" for any tax year is generally the aggregate amount of base erosion tax benefits for the year divided by the aggregate deductions allowable under Chapter 1 for the year including base erosion payments.

Puerto Rico extends automatic extension period for filing a 2017 tax return from three months to six months

The Puerto Rico Treasury Department (PRTD) has extended (Administrative Determination 18-07 (AD 18-07)) the automatic extension period for filing a 2017 tax return from three months to six months.

The six-month filing extension will apply to tax years beginning in 2017. Even though the six-month extension will automatically apply, taxpayers needed to file the automatic extension request no later than the date established for filing the 2017 income tax return (i.e., 17 April 2018, for calendar-year taxpayers; Editor's note: that date was extended to 25 April). Taxpayers receiving the six-month automatic extension will not be granted an additional three-month extension, as their total extension period may not exceed six months.

The automatic extension request does not extend the payment due date. Taxpayers must pay any tax due at the time they file the automatic extension request.

Tax withheld under Section 1446(f) must be paid to the IRS and reported on IRS Forms 8288 (U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests) and 8288A (Statement of Withholding on Dispositions by Foreign Persons of U.S. Real Property Interests) until other forms are issued for this purpose; the Notice provides special instructions for filing. Withholding tax generally must be paid and the forms filed within 20 days of the date of disposition. All withholding tax properly submitted by 31 May 2018, will be deemed to be timely paid and filed.

The Notice states that the IRS will not accept any application to obtain a certificate from the IRS to reduce or eliminate withholding until regulations are issued. However, interim self-certifications can be provided to relieve withholding in certain situations when withholding might exceed the transferee's ultimate tax liability. The Notice also clarifies that sellers of interests in partnerships may certify that they are US taxpayers that are exempt from withholding on IRS Form W-9 as well as on an affidavit of non-foreign status.

The 20-day withholding requirement gives rise to informational issues when a partnership makes distributions that may cause a partner to recognize gain, and partnership-level liabilities are includible in the amount realized on a disposition of a partnership interest. The Notice indicates that a partnership may rely on its books and records, or a certification received from the distributee partner, to determine whether a distribution exceeds a partner's basis in its partnership interest and, as such, whether withholding is required.

Notice 2018-29 also provides that the amount of withholding required does not exceed the selling partner's amount realized, less the selling partner's share of partnership liabilities (in order to ensure the amount required to be withheld does not exceed the cash proceeds).

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