Building a better working world

# Washington Dispatch

June 2018, Volume 22, Issue 6

**NEW!** EY Tax News Update: Global Edition

EY's new Tax News Update: Global Edition is a free, personalized email subscription service that allows you to receive EY Global Tax Alerts, newsletters, events, and thought leadership published across all areas of tax. Access more information about the tool and registration here.

Additionally, EY's weekly and monthly US international tax podcasts are available on iTunes and ey.com:

- Subscribe to iTunes
- Listen on ey.com

## In this issue

# IRS news

## IRS updates Section 965 transition tax FAQs to include late-payment penalty, filing relief

On 4 June 2018, the IRS updated "Questions and Answers about Reporting Related to Section 965 on 2017 Returns" (the FAQs, originally released 13 March 2018). In the new FAQs (FAQs 15-17), the IRS announced that it will waive certain late-payment penalties on estimated tax payments resulting from the application of tax year 2017 overpayments to the transition tax (provided all required estimated tax payments are made by 15 June 2018).

The FAQs also include relief for certain individuals who failed to timely pay the full first installment of the transition tax or failed to timely elect to pay the transition tax in installments.

### FAQ 15: Waiver of late-payment penalties for estimated tax payments

In FAQ 15, the IRS announced that it will waive the penalty for the underpayment of estimated taxes in certain circumstances for taxpayers subject to the transition tax that attempted on their 2017 income tax return to apply a 2017 calculated overpayment to their 2018 estimated tax – provided those taxpayers make all required estimated tax payments by 15 June 2018.

This relief applies only to taxpayers whose first required installment for 2018 was due on or before 18 April 2018. Specifically, the IRS states that it has determined that no addition to tax for an underpayment of estimated taxes under Section 6654 or 6655 will apply if a taxpayer makes an estimated tax payment sufficient to satisfy both the underpayment of the first required estimated tax installment for 2018 and the full amount of the second required estimated tax installment for 2018 on or before the due date for the second installment (i.e., 15 June 2018, for calendar-year taxpayers).

Taxpayers meeting the conditions of this relief that receive a notice of an addition to tax for underpayment of estimated tax under Section 6654 or 6655 should contact the IRS office that issued the notice and request abatement of the addition to tax.

### FAQ 16: Relief for individuals who failed to timely pay first installment

In FAQ 16, the IRS grants relief to certain individual taxpayers subject to the transition tax for their 2017 tax year who timely elect to pay the transition tax in installments and failed to pay all or a part of the first installment by the due date for such payment. The IRS will not apply penalties to the missed payment amount, provided the individual pays the full amount of the first installment (and the second installment) by the 2018 return due date (determined without regard to extensions, i.e., generally 15 April 2019, although later deadlines apply to certain individuals who live and work outside the United States). In addition, the failure to timely pay the first installment will not cause the remaining installment payments to become due immediately under the acceleration provision in Section 965(h)(3). Interest will still be due on the missed payment amount from the due date of the first installment.

This relief is only available if the individual's total transition tax liability for its 2017 tax year is less than $1 million.

### FAQ 17: Relief for failure to make election to pay transition tax in installments

Individuals who already filed a 2017 return without electing to pay the transition tax in eight annual installments may still make such an election by filing with the IRS a 2017 Form 1040X. The amended form must be filed by the due

## Tax reform 2.0 draft outline to be released in early August

US House Ways and Means Committee Chairman Kevin Brady (R-TX) said on 26 June that he does not see tax reform 2.0 as one bill. Rather, he suggested that a "phase 2" reform will be a package of "two, three, or four approaches," with permanency of temporary individual and small business provisions under the Tax Cuts and Jobs Act (TCJA) being one of them. The chairman added that the House is aiming to send the best tax reform 2.0 package possible to the Senate, where Majority Leader Mitch McConnell (R-KY) and other Republicans will choose those areas they have the most interest in moving forward.

As for timing, Chairman Brady said he expects Ways and Means Committee Republicans to begin circulating a draft to House Republicans after the 4 July recess, then listening to concerns about what members want to see in the bill and incorporating changes into a legislative outline to be released in early August. Votes would follow in the fall, depending on when leadership wants to schedule them. The Senate Majority Leader meanwhile this week said that enactment of tax legislation this year would require the support of Senate Democrats, something that may be difficult to achieve.

date of the individual's 2017 return, taking into account any additional time that would have been granted if the individual had made an extension request (i.e., generally by 15 October 2018). The amended form must also comply with all relevant procedures described in the FAQs.

## IRS announces additional delay of Section 987 foreign currency regulations

On 13 June 2018, Treasury and the IRS announced (Notice 2018-57) that they intend to amend the final regulations under Section 987 (T.D. 9794, the Final Section 987 Regulations), as well as certain related provisions of the temporary regulations under that section (T.D. 9795, the Temporary Section 987 Regulations), to further delay the applicability date of the Final Section 987 Regulations by one additional year.

With the enactment of US tax reform, the additional delay creates immediate US federal income tax considerations for taxpayers, including controlled foreign corporations (CFCs). (See following article in this issue of the *Washington Dispatch*.)

As background, on 7 December 2016, the government released final (T.D. 9794), temporary (T.D. 9795), and proposed regulations (REG-128276-12) under Section 987. The final regulations address how certain branch operations (or qualified business units (QBUs)) that use a functional currency different than that of their tax owner (Section 987 QBUs) compute taxable income or loss (or earnings and profits (E&P), as applicable).

The final Section 987 Regulations also provide rules to determine the timing, amount, character and source of any Section 987 gain or loss arising from a QBU. The Temporary Section 987 Regulations amend the definition of a QBU, provide rules addressing the deferral of Section 987 gain or loss in connection with certain QBU terminations, transactions involving partnerships, use of certain translation conventions, combinations, and separations of Section 987 QBUs and other related elections and special rules for Section 987 QBUs.

On 2 October 2017, IRS Notice 2017-57 announced amendments to delay the application of the final Section 987 regulations and certain related provisions of the Temporary Section 987 Regulations by one year.

### Notice 2018-57

Notice 2018-57 announces intended amendments to further delay the application of the final Section 987 regulations and certain related provisions of the Temporary Section 987 regulations by one additional year.

This means that the final Section 987 regulations now apply to tax years beginning on or after *three years* after the first date of the first tax year following 7 December 2016 (i.e., 1 January 2020, for in-scope, calendar-year taxpayers).

Certain related temporary regulations (scheduled to expire on 6 December 2019) will no longer apply as temporary regulations but will remain in proposed form, unless a taxpayer elects to early adopt the regulations before 6 December 2019. No changes were made to the temporary regulations, which operate to defer the recognition of certain Section 987 gains and losses and certain Section 988 losses.

The Treasury and IRS also reiterated their intent to consider changes to the final regulations to permit taxpayers to elect to apply alternative rules for transitioning to the Final Section 987 Regulations and alternative rules for determining Section 987 gain or loss, but Notice 2018-57 does not provide any details of such alternative rules.

For purposes of Section 987, taxpayers may rely on the provisions of Notice 2018-57 before amendments to the final Section 987 regulations and the related Temporary Section 987 Regulations are issued.

## Delay of Section 987 FX regulations has immediate significance for taxpayers, including CFCs

The amended applicability date of the final Section 987 regulations, subject to further amendments, gives taxpayers additional time to create and implement the complex systems and processes necessary to transition to and comply with the final rules.

Notwithstanding the deferral of the application of the final regulations and certain corresponding provisions by another year, the enactment of new rules as part of US tax reform has immediate US federal income tax significance for US owners and controlled foreign corporation (CFC) owners of Section 987 qualified business units (QBUs).

## Overall Section 987 considerations

Notably, the postponement of the applicability date of the final Section 987 regulations does not change the requirement that in-scope taxpayers transition to the final Section 987 regulations using the fresh start transition method, which, for most taxpayers, may result in the elimination of any unrecognized Section 987 gain or loss under the taxpayer's current Section 987 methodology. Significantly, under the current transition rules, unrecognized Section 987 gain or loss attributable to nonmonetary items of Section 987 QBUs would be permanently disallowed for US federal income tax purposes.

Therefore, taxpayers should identify their Section 987 QBUs, review QBU items, quantify the amount of any unrecognized Section 987 gain or loss under their current Section 987 methodology and consider the consequences of the current transition method, attribution rules and Section 987 gain and loss deferral rules. In addition, taxpayers should consider the treatment of Section 988 transactions of their Section 987 QBUs that are denominated in the owner's functional currency.

While the application of the final Section 987 regulations was delayed, Notice 2018-57 specifically indicates that such amendments do not affect the applicability date of other temporary and proposed regulations, including certain provisions that became effective on 6 January 2017 (or 7 December 2016, in certain cases) and apply more broadly to include taxpayers that are owners of Section 987 QBUs and are not within the scope of the final Section 987 regulations.

These temporary and proposed regulations may defer recognition of Section 987 losses on outbound transfers, gains and losses on certain other terminations and related-party transfers, and may defer recognition of a borrower's foreign currency loss on related-party debt.

## US tax reform impact on US owners of Section 987 QBUs

Before transitioning to the final 987 regulations, US owners of Section 987 QBUs must use a reasonable method to comply with Section 987. For US partners of foreign partnerships, in particular, the delayed application of amendments to the definition of a QBU under Reg. Section 1.989(a)-1(b)(2) means that all partnerships, including partnerships wholly owned by related parties, continue to qualify as QBUs of each of their partners.

Considering that Section 987 determinations directly affect the taxable income of US owners, taxpayers should assess how their current Section 987 methodology interacts with taxable income determinations under new US tax reform provisions, including the so-called BEAT(base erosion and anti-abuse tax) provisions of Section 59A, new interest limitation rules of Section 163(j), and the new Section 904(d) foreign branch income basket rules.

That is, US owners of Section 987 QBUs should evaluate whether to early adopt the final Section 987 regulations and whether to make any of the applicable elections provided in the final and temporary regulations. Owners that are not within the scope of the final Section 987 regulations also should assess whether to make any of the applicable elections, including the annual deemed termination election, in light of the increased relevance of Section 987 determinations as a result of US tax reform.

## US tax reform impact on CFC owners of Section 987 QBUs

Similarly, CFC owners of Section 987 QBUs must use a reasonable method to comply with Section 987 before transitioning to the final Section 987 regulations. For CFC owners, Section 987 determinations potentially affect their E&P. Thus, whether any E&P adjustments were required for Section 987 gain or loss realized in prior years is relevant to computing the one-time transition tax under Section 965(a).

Section 987 determinations and the impact on E&P also are relevant in determining the tested income or loss of CFC owners for purposes of Section 951A (the global intangible low-taxed income tax (GILTI) provisions). While CFC owners may not be required to adjust E&P for Section 987 gain or loss on the basis of immateriality, the GILTI provisions do not appear to provide a materiality threshold in computing tested income or tested loss of a CFC. Thus, CFC owners should calculate Section 987 gain or loss amounts on an annual basis.

Moreover, under the final Section 987 regulations, in computing its annual subpart F income, a CFC's recognized Section 987 gains and losses are included in the foreign currency sub-category of foreign personal holding company income, to the extent attributable to assets that generate subpart F income. For purposes of applying the GILTI provisions, a CFC's tested income is computed without regard to its subpart F income.

Consequently, CFC owners should consider the interaction of the subpart F income rules and the GILTI provisions and whether to early adopt the final Section 987 regulations and make any of the applicable elections provided in the final and temporary regulations. Owners that are not within the scope of the final Section 987 regulations also should consider whether to make any of the applicable elections, including whether to make the annual deemed termination election.

### Income tax accounting considerations

Notice 2018-57 (like Notice 2017-57) sets forth an administrative pronouncement, on which taxpayers can rely, providing a revised applicability date of the Section 987 regulations. There is also an election to apply the regulations early. As such, calendar-year taxpayers not electing to early adopt the regulations before the revised applicability date should consider whether existing deferred tax assets and liabilities will reverse before the revised applicability date of 1 January 2020, when measuring deferred tax assets and liabilities affected by the Section 987 regulations.

A change in the applicability date is similar to a change in judgment, given that Notice 2018-57 provides that the revised Section 987 regulations will allow taxpayers to elect to early adopt the original applicability date or use the revised applicability date. To the extent a change in judgment results in the subsequent recognition, derecognition, or changes in measurement of a deferred tax position that was previously recognized in a prior annual period, it should be considered a discrete event recognized in earnings in the period (interim as well as annual) in which the change occurs.

## US officials offer TCJA international regulatory update

US government officials in early June offered more insights into upcoming international tax reform guidance. A senior Treasury official was quoted as saying the government is aware of some of the harsher aspects of the new base erosion and anti-abuse tax (BEAT), particularly for the international banking, insurance and service industries. He said Treasury is currently considering to what extent the department has authority to blunt some of the provision's results. The official declined to offer any specifics, including with regard to the services cost method. The official tempered his comments, however, by adding that Treasury is constrained by the statute in terms of how much it can ameliorate certain aspects of the provision.

Regarding allocation issues associated with the global intangible low-taxed income (GILTI) provision, the official conceded the inherent tension between having a separate foreign tax credit basket and having the GILTI serve as an anti-abuse backstop to territoriality. The pragmatic solution, he said, would be a reasonable combination of interest expense allocation rules and look-through rules.

The Treasury official further disclosed that the department is now reviewing a draft of the proposed Section 965 transition regulations, which are expected to be released at the end of July. He said that while the proposed rules will touch on many of the difficult questions, he cautioned they would not tackle all issues and taxpayers in those situations will have to use their best judgment.

And addressing the ongoing digital tax debate, the official said that while the US government agrees that the existing rules on global profit allocation can result in anomalous results when applied to digital business models, the US opposes any excise taxes on gross revenues. He noted that tax regimes that target digital companies would disproportionately fall on US multinationals. At the present time, the US favors broad policy discussions on the issue and is ready to participate in such talks at the multilateral level, including at the OECD.

At a forum later in the month, a government official disclosed that the Service will issue two sets of guidance on the new Section 1446(f) 10% withholding tax. The guidance will be separated into Section 864(c) issues and those related to publicly traded partnerships. Section 1446(f), enacted by the Tax Cuts and Jobs Act, requires the purchaser of a partnership interest to withhold 10% of the amount realized on the sale or exchange of the partnership interest, unless the transferor certifies that the transferor is not a nonresident alien individual or foreign corporation.

## IRS finalizing 2016 proposed FATCA regulations; portal for certifications this summer

The IRS is close to finalizing the 2016 proposed *Foreign Account Tax Compliance Act* (FATCA) regulations that outline the requirements that a "sponsor" of a foreign financial institution (FFI) must meet to assume responsibility for performing due diligence on the FFI's behalf. An IRS official was quoted as saying that while the final rules will generally contain few changes as compared to the proposed regulations, they will take into account taxpayer

comments and industry practices, and will address reporting requirements of sponsoring entities of financial institutions in certain Model 1 jurisdictions.

The IRS also reportedly will deploy the portal for FATCA certifications at the end of July or early August. An IRS official was quoted as saying the Service will notify financial institutions of the certification deadline on the FATCA registration home page several weeks after the FATCA portal goes live. The IRS also plans to issue FAQs for the portal soon.

## Courts

### US Supreme Court overturns physical presence nexus standard; major implications for sales to the United States

The US Supreme Court issued its much-anticipated ruling in South Dakota v. Wayfair on 21 June 2018, overturning long-standing precedent that precluded the states from imposing sales or use tax collection responsibilities on remote sellers, including internet sellers, with no "physical presence" in the state. This decision, which lies firmly within the state taxation area, will likely have a profound impact on all companies that make any sales to the United States, including foreign-based companies. This decision will no doubt be of interest to countries currently evaluating the taxation of the digital economy.

The *Wayfair* case was on appeal from the South Dakota Supreme Court, and involved a challenge to that state's economic presence nexus provision, which was enacted in 2016. That law required remote sellers that sell tangible personal property, electronically transferred products, or taxable services for delivery into South Dakota to register, collect, and remit South Dakota sales taxes on those sales *as if* the seller has a physical presence in the state. Similar provisions have been implemented in at least 11 other states since 2015.

In a 5-4 ruling, the Court majority in *Wayfair* held that the physical presence standard articulated in *Quill v. North Dakota* "is unsound and incorrect" and, as a result, overturned the *Quill* and *Bellas Hess* cases upon which the physical nexus standard was established.

## OECD news

### OECD issues guidance on hard-to-value intangibles, transactional profit split method

The OECD on 21 June released two reports containing *Guidance for Tax Administrations on the Application of the Approach to Hard-to-Value Intangibles*, under BEPS Action 8 and *Revised Guidance on the Application of the Transactional Profit Split Method*, under BEPS Action 10. The new guidance for tax administrations on hard-to-value intangibles (HTVI) is meant to help reach consensus on understanding and practices relating to HTVI. The guidance on the profit split method has been formally incorporated in the OECD Transfer Pricing Guidelines, replacing the previous text on the transactional profit split method. Although it retains the basic premise for when the profit split method should be applied, it expands the guidance including many examples.

### Taxpayers participating in OECD ICAP program may face IRS scrutiny

The IRS Commissioner, Large Business and International Division, in June warned taxpayers they may face examination if they participate in the OECD's voluntary International Compliance Assurance Program (ICAP) and have high-risk transfer pricing and permanent establishment issues.

The IRS official said tax administrations participating in ICAP are finding that their greatest challenge is agreeing to what constitutes low-and medium-risk activities. While participants are starting to coalesce around some common views of risk, he said, there is no firm agreement at this time. He also said if the ICAP program is to be made permanent, it will need to be streamlined because it is currently too resource driven.

## OECD not in competition with EU on digital taxation, official says

OECD Secretary-General Angel Gurria told members of the European Parliament in late June that his organization is not in competition with the European Union (EU) in regard to digital taxation, but asked that the EU not create short-term measures that will impede long-term digital tax solutions.

The OECD earlier announced it would release a digital taxation report in 2020, but Gurria indicated the OECD report could be released in 2019.

The European Commission on 21 March released two proposals for new Directives that would provide new ways to tax digitalized forms of business activity. The Commission's controversial proposals included a two-phased approach: an interim solution, referred to as the Digital Services Tax and a longer term *Council Directive laying down rules relating to the corporate taxation of a significant digital presence*.

## EY Member Firm US Tax Desks

| | | |
|---|---|---|
| **Australia** | **Scott Hes**, *Sydney* | +61 2 9248 5013 |
| **Canada** | **George Guedikian**, *Toronto* | +1 416 943 3878 |
| | **Emad Zabaneh**, *Toronto* | +1 416 943 2221 |
| | **Asif Rajwani**, *Toronto* | +1 416 943 2626 |
| | **Ryan Coupland**, *Calgary* | +1 403 206 5405 |
| | **Richard Felske**, *Montreal* | +1 514 874 4428 |
| | **Denis Rousseau**, *Montreal* | +1 514 874 8058 |
| | **Nelson Brooks**, *Vancouver* | +1 604 891 8374 |
| **China** | **Joseph Kledis**, *Hong Kong* | +61 2 9248 5881 |
| | **Aaron Topol**, *Hong Kong* | +852 2675 2980 |
| | **Lilian Liu**, *Shanghai* | +86 21 2228 5395 |
| **France** | **Diane Juzaitis**, *Paris* | +33 1 55 61 10 43 |
| **Germany** | **Tom Day**, *Munich* | +49 89 14331 16549 |
| | **Tom Ralph**, *Munich* | +49 89 14331 22293 |
| **Israel** | **Amir Chenchinski**, *Tel Aviv* | +972 3 568 7124 |
| | **Tal Levy**, *Tel Aviv* | +972 3 568 7151 |
| | **Itai Ran**, *Tel Aviv* | +972 3 623 2739 |
| **Japan** | **Hiroshi Uehara**, *Tokyo* | +81 3 3506 1281 |
| **Mexico** | **Alberto Lopez**, *Mexico City* | +52 55 2122 6438 |
| | **Manuel Solano**, *Mexico City* | +52 55 2122 6437 |
| **United Kingdom** | **Joseph Kledis**, *Hong Kong* | +61 2 9248 5881 |
| | **Andrew Brown**, *London* | +44 20 7197 9333 |
| | **Joseph Toce**, *London* | +44 207 951 0253 |

EY | Assurance | Tax | Transactions | Advisory

**About EY**
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

**About Ernst & Young's International Tax services practices**
Our dedicated international tax professionals assist our clients with their cross-border tax structuring, planning, reporting and risk management. We work with you to build proactive and truly integrated global tax strategies that address the tax risks of today's businesses and achieve sustainable growth. It's how Ernst & Young makes a difference.

The Washington Dispatch is a monthly communication prepared by Ernst & Young LLP's Washington International Tax Services summarizing recent developments and "inside-the-beltway" news pertinent to multinational companies. For additional information, please contact your local international Tax professional.



EYG no. 010040-18Gbl

1508-1600216 NY
ED None



**ey.com**