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Legislation

House Republicans release tax reform 2.0 framework; TCJA technical corrections slated for post-mid-term elections

US House Ways and Means Committee Chairman Kevin Brady (R-TX) on 24 July 2018 released a Tax Reform 2.0 framework that, as anticipated, focuses on three areas: making permanent the *Tax Cuts and Job Act*'s (TCJA) individual and small business tax cuts; promoting savings for families and retirement; and spurring innovation by allowing start-ups to write-off more of their initial costs. It did not contain a proposal to index capital gains to inflation, an idea that had been floated in recent months.

The two-page reform framework is intended to be the basis for listening sessions with House Republicans and constituents. Those sessions are expected to last through August. The Chairman was quoted as saying that legislative text and a committee markup will take place in September, to be followed by a House vote on the tax reform 2.0 legislation.

According to the Chairman, the legislation will be divided into three separate bills come fall, addressing each of the focus areas in the outline. The purpose for dividing the legislation into separate reform bills is to increase the chance of Senate passage of at least some of the Republican proposals. Final passage of any tax legislation this fall will require the cooperation of Senate Democrats, something that may prove difficult before the mid-term congressional elections in November.

Earlier in the month, House Speaker Paul Ryan (R-WI) said that an international-focused tax technical corrections bill is likely following the November elections. The Speaker said the delay was necessary to get Democrats' support. "There is no way they [Democrats] are going to do anything to help us with this prior to the election," he said.

House Ways and Means Committee Chairman Kevin Brady (R-TX) also said during a cable television interview that Republican tax writers are receiving comments regarding the international tax provisions in the TCJA and "we're going to be making those changes, fine-tuning the international side to make sure it hits the mark."

Chairman Brady was also recently quoted as saying that the Treasury's release of TCJA guidance this summer and into the fall will help guide the development of technical corrections legislation. He also confirmed that technical corrections would be released in November, or later.

IRS news

IRS issues final anti-corporate inversion regulations

The IRS issued final anti-inversion regulations under Section 7874 on 11 July, which finalized proposed and temporary regulations published on 8 April 2016 (the 2016 Proposed and Temporary Regulations). The 2016 Proposed and Temporary Regulations contained numerous provisions, including the passive assets rule, the serial acquisition rule, the third-country rule and the non-ordinary course distributions rule, and many others.

The final regulations "refine and clarify certain aspects of the proposed and temporary regulations published in 2016." According to the regulations' preamble, the changes made are meant to ensure that the final rules "do not impact mergers that provide market benefits independent of tax avoidance."

The final regulations make a number of changes to the 2016 Proposed and Temporary Regulations including changes to the passive assets rule, the serial acquisition rule, and the third-country rule.

The final regulations generally maintain the same applicability dates as the 2016 Proposed and Temporary Regulations, which in many circumstances were the dates that such regulations were filed with the Federal Register or, in the cases where the regulations were implementing rules included in prior IRS Notices, the date such Notices were published. In particular, certain rules correspond to the issuance of Notice 2014-52 (issued on 22 September 2014), or Notice 2015-79 (issued on 19 November 2015).

As a result, the final regulations are in many circumstances applicable to transactions completed on or after 4 April 2016, and in other circumstances applicable to transactions completed on or after certain earlier dates. Conversely, new rules and changes to the rules in the 2016 Proposed and Temporary Regulations are generally applicable on a prospective basis, although taxpayers may elect to apply such rules consistently on a retrospective basis.

Proposed repatriation transition tax regulations release imminent; Treasury official offers insights on other international projects

The Office of Management and Budget (OMB) completed its review of proposed regulations under the Section 965 repatriation transition tax in late July. Treasury is expected to publish the eagerly-anticipated regulations package in early August. The OMB's Office of Information and Regulatory Affairs received the proposed regulations on 13 July and deemed them to be not economically significant.

A US Treasury official in July also provided some detail as to the soon-to-be-released proposed Section 965 regulations, as well as other upcoming international guidance. Regarding the proposed transition rules, the Treasury official confirmed that the various Section 965 notices that have been released since enactment of the provision will be rolled into the proposed regulations.

Guidance covering the *Tax Cuts and Jobs Act*'s (TCJA) global intangible low-taxed income (GILTI) provision, foreign derived intangible income (FDII), and base erosion and anti-abuse tax (BEAT) are all expected to be released in the fall, the official said. Regarding GILTI, the official said the coming proposed regulations will be comprehensive. He further said Treasury is "leaning toward applying GILTI on a consolidated basis and treating the group as a single US shareholder." Treasury is interested in receiving comments on that approach. The GILTI guidance reportedly will cover foreign tax credits and baskets, the effect of a Section 962 election by an individual US shareholder and the composition of the GILTI base. How to treat GILTI inclusions when domestic partnerships are US shareholders is still under review, the official said.

As for FDII, which has come under some criticism by certain EU countries, the Treasury official said the Administration is confident about defending the measure in the OECD next fall. Treasury believes the provision is fully consistent with the standards of the OECD Forum on Harmful Tax Practices. The EU last spring requested that the OECD Forum on Harmful Tax Practices conduct a "fast track" review of certain of the TCJA's provisions, including FDII, suggesting that some of the measures are discriminatory or in violation of World Trade Organization (WTO) rules.

The official added that BEAT will also likely be determined on a consolidated basis in the proposed regulations.

IRS memo denies DRD to affiliated group by treating swap on a stock index as substantially similar or related property with respect to single issue of stock

The IRS on 9 July 2018 issued Internal Legal Memorandum (ILM) 201827011, concluding that a taxpayer's short positions in notional principal contracts (Swaps) that tracked the value of a stock index (the Index) were substantially similar or related property (SSRP) within the meaning of Section 246 with respect to shares in an exchange-trade fund (ETF) that tracked the Index's performance. As a result, the IRS determined that the taxpayer was not entitled to claim a dividends received deduction (DRD) under Section 246 for dividends received on the ETF shares.

The taxpayer had argued that the issue of whether the short positions in the Swaps were SSRP with respect to the ETF Trust shares, for purposes of Section 246, had to be determined by applying the "portfolio rules" of Reg. Section 1.246-5(c)(1). Using this analysis, the taxpayer argued that the Swaps were not SSRP with respect to the ETF Trust share because there was no overlap between the stock of the ETF Trust and the stocks represented in the Swaps. Therefore, the taxpayer argued, the Swaps were not SSRP with respect to the ETF Trust shares.

The IRS rejected this contention, concluding that whether the Swaps on an Index were SSRP was a facts-and-circumstances determination and, contrary to the taxpayer's argument, the determination was not limited to application of the portfolio rules of Reg. Section 1.246-5(c)(1). The IRS provided that individual stocks on the Index, in the aggregate, reflect the performance of the Index and also the performance of a single company's stock — the ETF Trust. The IRS also noted that the pass-through anti-abuse rule under Reg. Section 1.246-5(c)(6) may also be applied to deny the DRD with respect to the ETF Trust dividends.

In applying the anti-abuse provisions, the IRS did not apply the anti-abuse rule under Reg. Section 1.246-5(c)(1)(vi), which treats "a position that reflects the value of more than one stock as a position in SSRP with respect to the appropriate portion of the taxpayer's stockholdings if" *inter alia*, the value of the position virtually tracks (directly or inversely) "changes in the value of the taxpayer's stock holdings, or any portion of the taxpayer's stock holdings." This may have resulted from the fact that the anti-abuse rule is triggered by "a principal purpose" of avoiding the DRD disallowance, rather than if the transaction is undertaken "with a view" to avoiding disallowance of the DRD.

Treasury FATCA report finds fault with IRS

The Treasury Inspector General for Tax Administration (TIGTA) on 9 July 2018 released a critical report on IRS actions related to FATCA. The report stated that "despite spending nearly $380 million, the IRS has taken limited or no action on a majority of the planned activities outlined in the FATCA Compliance Roadmap." According to the TIGTA, reports filed by foreign financial institutions (FFIs) did not include (or included invalid) Taxpayer Identification Numbers (TIN). This made IRS efforts to match FFI and individual taxpayer data unsuccessful, which in turn affected the IRS's ability to identify and enforce FATCA requirements for individual taxpayers.

The IRS has agreed with four of the TIGTA's six recommendations, including the following: 1) establishing follow-up procedures and initiating action on error notices with the FFIs; 2) continuing efforts to systemically match Form 8966 and Form 8938 data to identify non-filers and underreporting related to US holders of foreign accounts and to the FFIs; 3) informing taxpayers how to obtain global intermediary numbers; and 4) strengthening overall compliance efforts directed toward improving the accuracy of reporting by Form 1042-S filers.

IRS announces additional international compliance campaigns

The IRS Large Business and International (LB&I) Division announced five new compliance campaigns on 2 July 2018, including two addressing the repatriation of foreign earnings. Those two new campaigns will focus on repatriation via foreign triangular reorganizations and the Section 965 transition tax. The stated goal of the former campaign is to "identify and challenge these transactions by educating and assisting examination teams in audits of these repatriations."

A third, virtual currency compliance campaign will address noncompliance related to the use of virtual currency through multiple treatment streams, including outreach and examinations.

Transfer pricing news

IRS publishes new guide on transfer pricing examinations

The IRS recently issued *Transfer Pricing Examination Process* (Publication 5300 (6-2018)), a guide to best practices and processes to assist with the planning, execution and resolution of transfer pricing examinations. The publication, which will be shared with taxpayers at the start of an examination, is intended to be consistent with the Large Business & International (LB&I) *Examination Process* (LEP) (Publication 5125).

The *Transfer Pricing Examination Process* (TPEP) supplants the *Transfer Pricing Audit Roadmap* (Roadmap), a 2014 toolkit designed to provide IRS examiners with audit techniques, advice, links and reference materials that may be helpful in planning, executing and resolving transfer pricing examinations.

In many respects, the TPEP is similar to the Roadmap. For example, it is divided into three parts: Planning, Execution, and Resolution. It also continues to emphasize the early collection of facts, the notion of a working hypothesis, collaboration among team members of different disciplines and reporting chains, and meaningful discussion of the facts and working hypothesis with the taxpayer during the audit. However, the TPEP includes new material related to country-by-country reporting, the new instructions around the Initial Transfer Pricing Documentation Information Document Request, and exhibits related to the recently developed Practice Units.

The TPEP supplements the LEP and applies specifically to transfer pricing examinations. Both documents are intended to enhance audit transparency and provide both taxpayers and IRS examination teams with mutual, shared responsibilities and obligations. Like the Roadmap, however, the TPEP is intended to provide only a framework and lay out best practices for transfer pricing examinations.

Although the TPEP is not mandatory or enforceable, taxpayers can refer to the TPEP in discussing a particular audit with an IRS exam team or elevating an issue within the IRS when an examination departs from the TPEP (or LEP).

OECD news

OECD releases first discussion draft on transfer pricing aspects of financial transactions

On 3 July 2018, the OECD released the first public discussion draft on the transfer pricing aspects of financial transactions (the Discussion Draft). The Discussion Draft, which has been published as follow-up work in relation to Base Erosion and Profit Shifting (BEPS) Actions 8-10, aims to clarify the application of the principles included in the 2017 edition of OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD TPG), covering the accurate delineation of financial transactions and addressing specific issues related to the pricing of financial transactions such as treasury function, intra-group loans, credit ratings, cash pooling, hedging, guarantees, and captive insurance.

The Discussion Draft does not yet represent a consensus position of the OECD, but it does provide insight into the direction of thinking at the OECD.

The OECD is inviting interested parties to send their comments on the Discussion Draft by 7 September 2018.

OECD Secretary-General sends G20 finance ministers annual BEPS progress report, update on IMF/OECD Report on Tax Certainty

On 22 July 2018, the OECD published on its website the OECD's Secretary-General Report (the report) to G20 Finance Ministers and Central Bank Governors. The report was provided to the G20 Finance Ministers and Central Bank Governors at their meeting in Buenos Aires, Argentina on 21-22 July 2018.

Part I is an update of the activities and achievements of the OECD's ongoing tax agenda and future progress needed, in particular through the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS). Part II is a progress report to the G20 by the Global Forum on Transparency and Exchange of Information for Tax Purposes. The report also includes as Annex 1 the text of the *2nd Annual Progress Report of the OECD/G20 Inclusive Framework on BEPS*.

The report further includes, as an annex, a report titled, *UPDATE ON TAX CERTAINTY: IMF/OECD Report for the G20 Finance Ministers and Central Bank Governors* (the updated report, also published separately on the OECD's website). This report, which was co-authored by the OECD and the International Monetary Fund (IMF), provides an update to the March 2017 report on tax certainty, and examined survey responses from 724 enterprises headquartered in 62 different countries and with regional headquarters in 107 different jurisdictions, as well as 25 national tax authorities.

At the end of the G20 Finance Ministers and Central Bank Governors meeting, the G20 also released a Communiqué, among other things confirming their commitment to seeking a consensus-based solution to address the impact of digitalization on the international tax system by 2020, with an update in 2019. This effectively underscores the desire of the G20 that the OECD should continue to lead in addressing this issue.

Global revenue authorities experimenting with CbC data

An IRS Large Business and International Division (LB&I) official recently was quoted as saying that many countries are still trying to figure out what do with the information gleaned from country-by-country (CbC) reports. The official said that global revenue authorities are experimenting with uses for the data, including how to sort and manage the information, as well as its role in risk analysis.

He downplayed its future usefulness for US purposes because of the IRS's experience in data analytics in moving to its compliance campaigns, suggesting that CbC data will ultimately be just another data point in the overall risk analysis process.

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