



Building a better
working world

Washington Dispatch

August 2018, Volume 22, Issue 8

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

Treasury and IRS news

2. Treasury Department releases proposed Section 965 regulations
3. Proposed GILTI regs under review by OMB; draft GILTI and FDII forms released
3. IRS announces upgrades to FATCA Registration System, issues updated user guide and new FAQs regarding entity classifications, certifications of pre-existing accounts, and periodic certifications

Courts

3. Tax Court holds upstream loan between CFCs was bona fide debt, subsequent transfer of proceeds to US shareholders was nontaxable return of capital

4. DC Circuit rejects per se bar on bearer shares under Section 883 income exclusion for international shipping and aircraft corporations
4. Ninth Circuit withdraws opinion reversing Tax Court in *Altera*
5. Tax Court rules Section 1446 withholding tax liability is a partnership item

Transfer pricing news

5. Eighth Circuit vacates Tax Court opinion in *Medtronic*, remands to Tax Court for further consideration

OECD news

5. OECD releases fourth batch of peer review reports on Action 14

Treasury and IRS news

Treasury Department releases proposed Section 965 regulations

On 1 August 2018, the Treasury Department issued eagerly anticipated proposed regulations under and related to Section 965. The provision was enacted by the *Tax Cuts and Jobs Act* (TCJA) in December 2017.

New Section 965(a) generally provides that the subpart F income of a specified foreign corporation (SFC) (i.e., a controlled foreign corporation (CFC) and any other foreign corporation that has a 10% corporate US shareholder) in its tax year that begins before 1 January 2018 (inclusion year) is increased by the greater of its accumulated post-1986 deferred foreign income determined on 2 November 2017, and 31 December 2017 (Section 965(a) earnings amount and inclusion dates, respectively). An SFC that has accumulated post-1986 deferred foreign income is referred to as a deferred foreign income corporation or a DFIC.

The recently proposed regulations include, with certain modifications, the provisions announced in three prior IRS Notices (Section 965 Notices), one revenue procedure (Rev. Proc. 2018-17) (issued on 13 February 2018)), various “frequently-asked questions” released by the IRS concerning the payment and reporting of a taxpayer’s Section 965 inclusion and related tax liability, and IRS Publication 5292. (The Section 965 Notices include Notice 2018-07 (issued on 29 December 2017)), Notice 2018-13 (issued on 19 January 2018), and Notice 2018-26 (issued on 2 April 2018).)

The proposed regulations not only implement the rules described in the Section 965 Notices, but also provide additional rules related to:

- ▶ Determinations of foreign tax credits associated with Section 965 inclusions and distributions of previously taxed earnings and profits (E&P) created by Section 965
- ▶ Adjustments to E&P and stock basis
- ▶ Affiliated groups, including affiliated groups that file consolidated returns
- ▶ Transactions, accounting method changes and entity-classification elections to be disregarded for purposes of Section 965
- ▶ Subpart F income otherwise earned by foreign corporations during the inclusion year, and
- ▶ Expense allocation and apportionment

The proposed regulations largely implement the rules described in the Section 965 Notices, but make certain material changes. As a result, taxpayers should reevaluate their Section 965 calculations. In many instances, taxpayers will need to determine the subpart F income of their SFCs as of each E&P measurement date to properly determine their Section 965(a) inclusion amounts.

Foreign tax credit calculations should be revisited in light of the provisions that were not included in the Section 965 Notices and the US shareholders of E&P deficit foreign corporations will want to determine the impact of the basis adjustment election.

Income tax accounting considerations

Those companies that have not yet finalized their accounting for the transition tax using the guidance in Staff Accounting Bulletin No. 118 (SAB 118) may, as a result of the proposed regulations, adjust their estimates of the transition tax accrued in prior periods in order to continue to refine the amounts as new information becomes available as required by SAB 118. As a reminder, any provisional amounts or adjustments to provisional amounts included in a company’s financial statements during the measurement period should be included in income from continuing operations as an adjustment to tax expense or benefit in the reporting period the amounts are determined.

If the proposed regulations were released after the date a company closed its books, but before its financial statements are issued, a company that has accounted for the related provisions of the TCJA as provisional under SAB 118 would generally not be required to adjust the provisional amounts in its current financial statements. However, a company may consider disclosing the effect of significant adjustments related to any guidance issued, but not yet reflected in the company’s financial statements.

To the extent a company has previously disclosed the accounting for enactment date effects of the transition tax as final, the proposed regulations may be evaluated under the uncertain tax position guidance in ASC 740-10-25-6. A change in judgment may result in the subsequent recognition, derecognition, or changes in measurement of a tax position that was previously recognized in a prior annual period (including any interest and penalties). Changes in judgment are generally considered a discrete event recognized in income from continuing operations in the period (interim as well as annual) in which the change occurs.

Proposed GILTI regs under review by OMB; draft GILTI and FDII forms released

IRS proposed regulations on the inclusion of global intangible low-taxed income (GILTI) under Section 951A are under review by the Office of Management and Budget (OMB) Office of Information and Regulatory Affairs (OIRA), suggesting they are close to being released. Section 951A was enacted by the *Tax Cuts and Jobs Act* (TCJA) last December.

According to OIRA, the regulations were received for review on 22 August. Although the general timeline for review is 45 days, under a regulatory review agreement between the two agencies announced earlier this year, the Treasury Department can request that OMB review of TCJA regulations be completed within 10 business days. This timeline may be extended by mutual agreement by Treasury and OMB.

The IRS in August also issued a set of draft forms relating to the GILTI and foreign derived intangible income (FDII) provisions. Note that the draft forms are subject to change. The IRS releases draft forms on www.irs.gov/DraftForms. Final IRS forms are released at www.irs.gov/DownloadForms.

IRS announces upgrades to FATCA Registration System, issues updated user guide and new FAQs regarding entity classifications, certifications of pre-existing accounts, and periodic certifications

The IRS announced upgrades to the *Foreign Account Tax Compliance Act* (FATCA) Registration System on 31 July 2018 and subsequently issued an updated FATCA Online Registration user guide. The IRS also published frequently asked questions (FAQs) regarding FATCA status, certifications of pre-existing accounts (COPA), and periodic certifications. These FAQs announced an extended due date of 15 December 2018, for the COPA and the periodic certifications, which is required for entities that registered their FATCA status on or before 1 January 2015.

The 13 FAQs are located under the "FATCA Certifications" section of the following [website](#).

The FATCA Online Registration user guide is on the following [website](#).

The upgrades to the FATCA Registration System expand the FATCA status options and add COPA and periodic certification capabilities for required entities. The FATCA Registration System will determine certification

Congressional Republicans urge appointment of OECD ambassador

A group of Republican Senators and members of Congress in August wrote President Trump in two separate letters urging him to appoint an ambassador to the OECD, a position that is currently vacant. The congressional Republicans want the envoy to vigorously defend US interests in regard to European digital taxation proposals, as well certain international provisions in the *Tax Cuts and Jobs Act* (TCJA) that are under review by the OECD Forum on Harmful Tax Practices. The OECD Forum is reviewing the TCJA international measures at the request of the European Commission.

requirements for each registered entity based on the combination of the entity's FATCA status and the intergovernmental agreement (IGA) status of its jurisdiction of domicile (generally, only Model 2 jurisdictions and non-IGA jurisdictions have a certification requirement).

It is critical for entities to review and update their FATCA status in the FATCA Registration System in order to display the correct certification requirements and avoid inapplicable certification-related notices.

The extension to 15 December 2018, provides Responsible Officers (ROs) additional time to design and implement a periodic review process that supports their certification. ROs should consider whether their periodic review maps to each of the certification requirements so that evidence gathered during the review directly supports each element of the certification.

Courts

Tax Court holds upstream loan between CFCs was bona fide debt, subsequent transfer of proceeds to US shareholders was nontaxable return of capital

In *Illinois Tool Works, Inc. & Subsidiaries v. Commissioner*, the Tax Court held that a series of transactions involving an upstream loan from a lower-tier controlled foreign corporation (CFC) with current and accumulated earnings and profits (E&P) to an upper-tier CFC with no current or accumulated E&P, and the subsequent distribution of the loan proceeds from the upper-tier CFC to its US shareholders, resulted in no taxable income to the US shareholders.

In a memorandum opinion, the Tax Court found that the upstream loan constituted bona fide debt and that the US shareholders had sufficient basis in the upper-tier CFC to treat the distribution as a nontaxable return of capital.

The case has been closely monitored by taxpayers and practitioners alike because it involved a distribution funded entirely by an upstream loan, thus implicating certain common tax-planning transactions.

Among other things, the case solidifies the view that intercompany debt should be respected notwithstanding that the loan terms are not as robust as would be needed in a third-party loan agreement. Instead, as long as the hallmarks of debt are included (i.e., an unconditional promise to pay a sum certain on demand or on a specified date and creditor's rights) and the debtor has the economic ability to support the debt, the debt generally should be respected for US federal income tax purposes.

The decision expressed in the court opinion will become final 90 days from the date the decision is entered unless the IRS files a notice of appeal. If the IRS appeals the case, it will be heard by the Seventh Circuit.

DC Circuit rejects per se bar on bearer shares under Section 883 income exclusion for international shipping and aircraft corporations

In *Good Fortune Shipping SA v. Commissioner*, the Court of Appeals for the District of Columbia held that Treasury regulations under Section 883 concerning the treatment of "bearer shares" were invalid. Section 883(a) provides that certain income derived by a foreign corporation from the international operation of ships and aircraft is excluded from the gross income of that foreign corporation for United States federal income tax purposes, and therefore it is effectively exempt from US tax.

To qualify, a foreign corporation must meet one of three ownership tests, one of which (the qualified shareholder stock ownership test) requires that more than 50 percent of the value of the foreign corporation's stock is directly or indirectly owned by individual residents of jurisdictions that grant a similar exemption. The regulations in question provide that "bearer shares" are not considered for purposes of this test. Bearer shares are shares for which there is no dematerialized or immobilized book entry system such that the physical holder of a share certificate is generally entitled to dividends on the shares and is otherwise treated as the owner of the shares for relevant purposes.

Ninth Circuit withdraws opinion reversing Tax Court in *Altera*

The Ninth Circuit Court of Appeals has withdrawn its opinion in *Altera v. Commissioner* that was issued on 24 July 2018. In the original opinion's 2-1 ruling, the Ninth Circuit reversed the Tax Court's ruling and held that stock-based compensation was a compensable cost under Section 482. In *Altera*, the Tax Court had ruled that a 2003 IRS regulation that required participants in a cost sharing arrangement to treat stock-based compensation costs (SBC costs) as compensable was invalid.

One of the three judges on the panel that had heard the appeal, Judge Stephen Reinhardt, died prior to the issuance of the opinion but after oral arguments and after formally concurring in the majority opinion. On 2 August 2018, the clerk of the court issued an order naming Judge Susan Graber to replace Judge Reinhardt on the panel hearing the case. On 7 August, the Ninth Circuit published an order withdrawing the opinion "to allow time for the reconstituted panel to confer on this appeal."

Second Circuit affirms lower court on statute of limitations for refunds related to foreign taxes

In *Trusted Media Brands, Inc. v. USA*, the US Court of Appeals for the Second Circuit affirmed a district court decision holding that the 10-year statute of limitations period for refunds related to foreign taxes under Section 6511(d)(3) applies only when foreign taxes are claimed as a credit, and not when foreign taxes are claimed as a deduction. Accordingly, the taxpayer's refund claim attributable to net operating losses (NOLs) that came about as a result of deducting rather than crediting foreign taxes was not timely as it was outside the general three-year limitations period for claiming a refund attributable to the carryback of NOLs under Section 6511(d)(2).

Tax Court rules Section 1446 withholding tax liability is a partnership item

The Tax Court in August ruled in *YA Global Investments v. Commissioner* that a Cayman Islands-based partnership's Section 1446 withholding tax liability is a partnership item and, therefore, within the court's authority under Section 6226(f). The court reasoned that because Section 1446 makes the partnership liable for any tax required to be withheld under Section 1446, any tax required to be withheld under Section 1446 is a partnership liability. And the regulations are clear, the court concluded, that partnership liabilities are partnership items.

YA Global, a partnership for US purposes with both US and foreign partners, had argued that withholding tax under Section 1446 is not a partnership item and, therefore, adjustments in the notices of final partnership administrative adjustment relating to withholding tax liability under Section 1446 should be dismissed for lack of subject matter jurisdiction. The IRS argued that withholding tax liability under Section 1446 is a partnership item and that YA Global is a party to the proceeding. The motion to dismiss was denied.

Transfer pricing news

Eighth Circuit vacates Tax Court opinion in *Medtronic*, remands to Tax Court for further consideration

On 16 August 2018, a three-judge panel of the Eighth Circuit Court of Appeals vacated the Tax Court opinion in *Medtronic v. Commissioner*. The Tax Court had rejected the transfer pricing analysis prepared by both the IRS and Medtronic Inc. and, instead, rendered a decision based on its own determination of the arm's-length result.

The majority Eighth Circuit opinion concluded that the Tax Court opinion failed to provide sufficient factual findings to enable the appellate court to evaluate the Tax Court's determination of the arm's-length result. Therefore, the Eighth Circuit vacated the Tax Court opinion and remanded the case to the Tax Court for reconsideration "in light of the views set forth in this [the Eighth Circuit's] opinion."

OECD news

OECD releases fourth batch of peer review reports on BEPS Action 14

The OECD on 30 August released a fourth round of stage 1 Base Erosion and Profit Shifting (BEPS) Action 14 peer reports on improving tax dispute resolution mechanisms. The reports assess each country's efforts to implement the Action 14 minimum standard.

Reports covering [Australia](#), [Ireland](#), [Israel](#), [Japan](#), [Malta](#), [Mexico](#), [New Zealand](#) and [Portugal](#) were published. They contain over 130 recommendations that "will be followed up in stage 2 of the peer review process." The OECD also released a document that reviews implementation of best practices for each of the jurisdictions that had their best practices assessed. According to the OECD, the peer review reports include mutual agreement procedure (MAP) statistics from 2016 and 2017, with information gleaned from the [MAP Statistics Reporting Framework](#).

Ernst & Young LLP, International Tax Services, Washington, DC

▶ Jose Murillo	+1 202 327 6044	▶ Tyler Arbogast	+1 202 327 6867
▶ Stephen Bates	+1 415 894 8190	▶ Carlos Mallo	+1 202 327 5689
▶ David Canale	+1 202 327 7653	▶ Ben Orenstein	+1 212 773 4485
▶ Doug Chestnut	+1 202 327 5780	▶ Stephen Peng	+1 202 327 7471
▶ Ken Christman	+1 202 327 8766	▶ Dave Peppelman	+1 202 327 6448
▶ Arlene Fitzpatrick	+1 202 327 7284	▶ Trey Whitten	+1 202 327 7419
▶ David Golden	+1 202 327 6526		
▶ Liz Hale	+1 202 327 8070	▶ fax number	+1 202 327 6721
▶ Lilo Hester	+1 202 327 5764		
▶ Stephen Jackson	+1 212 773 8555		
▶ Richard Larkins	+1 202 327 7808		
▶ Richard McAlonan	+1 202 327 7209		
▶ Mike McDonald	+1 202 327 7980		
▶ Martin Milner	+1 202 327 7453		
▶ John Morris	+1 202 327 8026		
▶ Chris Ocasal	+1 202 327 6868		
▶ Al Paul	+1 202 327 7476		
▶ Tom Ralph	+1 202 327 5706		
▶ Joshua Ruland	+1 202 327 7238		
▶ Craig Sharon	+1 202 327 7095		
▶ Allen Stenger	+1 202 327 6289		
▶ Matthew Stevens	+1 202 327 6846		
▶ Julia Tonkovich	+1 202 327 6000		
▶ John Turro	+1 202 327 8019		
▶ Mathew Urbina	+1 202 327 7094		
▶ Thomas Vidano	+1 202 327 7376		
▶ Tim Wichman	+1 312 879 2282		

International Tax Services

Global ITS, **Jeffrey Michalak**, *Detroit*

ITS Director, Americas, **Craig Hillier**, *Boston*

ITS Markets Leader, Americas, **Stephen O'Neil**, *New York*

National ITS Leader, **Jose Murillo**, *Washington*

ITS Regional Contacts, Ernst & Young LLP (US)

Central
Colleen Warner, *Chicago*

Northeast
Jonny Lindroos, *McLean, VA*

Southeast
Scott Shell, *Charlotte, NC*

Southwest
Amy Ritchie, *Austin*

West
Sadler Nelson, *San Jose, CA*

Financial Services
Chris J Housman, *New York*

Canada – Ernst & Young LLP (Canada)
Albert Anelli, *Montreal*

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.

© 2018 EYGM Limited.
All Rights Reserved.

EYG no. 010966-18Gbl

1508-1600216 NY
ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

ey.com