Building a better working world

Washington Dispatch

September 2018, Volume 22, Issue 9

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

Legislation

2. House approves 'tax reform 2.0' bills; no Senate action before mid-term elections

IRS news

2. US government issues proposed GILTI regulations to implement international tax reform changes
4. Treasury and IRS propose removing Section 385 documentation requirements
5. IRS releases draft Form 8991, *Tax on Base Erosion Payments of Taxpayers with Substantial Gross Receipts*
5. IRS grants relief to RICs from Section 4982 excise tax for Section 965 inclusions
6. IRS to delay Section 871(m) regulations effective / applicability date two years
6. IRS issues guidance for REITs on treatment of certain income inclusions from foreign corporations
7. IRS announces new international compliance campaigns

OECD news

7. OECD releases additional guidance on country-by-country reporting and updated exchange relationships

Legislation

House approves 'tax reform 2.0' bills; no Senate action before mid-term elections

The US House of Representatives at the end of September moved forward on the three bills making up "Tax Reform 2.0." On 27 September, the House approved the *American Innovation Act of 2018* (H.R. 6756) and the *Family Savings Act of 2018* (H.R. 6757). On 28 September, the House approved the third tranche of the phase 2 tax reform, the *Protecting Family and Small Business Tax Cuts of 2018* (H.R. 6760), to make permanent individual and small business tax cuts under the *Tax Cuts and Jobs Act* (TCJA) that expire at the end of 2025.

The Ways and Means Committee divided up the tax reform measures into three bills to increase the chance of passage of at least some of the provisions. The House has adjourned until the week of 12 November, and the Senate is not expected to bring the bills for a floor vote before the November mid-term elections.

Senate passage will require 60 votes because Republicans will not have use of the budget reconciliation process afforded to the TCJA last year. Retirement provisions are generally seen as having the best prospects of being enacted, given bipartisan interest in the subject.

Ways and Means Committee Chairman Kevin Brady (R-TX) earlier had said that technical corrections and other changes to the TCJA would not be addressed in Tax Reform 2.0, as lawmakers wait to see Treasury regulations on issues under the bill, particularly in regard to international tax issues. While House Speaker Paul Ryan (R-WI) has said that a bill focusing on fixing aspects of the TCJA's international provisions would be developed after the mid-term elections, it seems unlikely that such a bill will develop as the regulatory process is still ongoing.

Congressional tax staff, led by the staff of the Joint Committee on Taxation, are working on a TCJA explanatory "Blue Book," which is expected before year end. The Blue Book will also likely recommend technical corrections that the relevant staffs have identified by consensus as being necessary and appropriate. It is unclear when a TCJA technical corrections bill will be released and could start to move through the legislative process.

Final GILTI regulations to be released by June 2019

An IRS official in late September was quoted as saying that the final Global Intangible Low-Taxed Income (GILTI) regulations will be released by June 2019 to enable taxpayers to use the guidance for the entire year. This is the first indication of when the Service plans to finalize the rules. Proposed rules on the interaction of the foreign tax credit regime and GILTI are expected to be released before year-end, the official said.

IRS news

US government issues proposed GILTI regulations to implement international tax reform changes

On 13 September 2018, Treasury and the IRS issued highly-anticipated proposed regulations (REG-104390-18) under the global intangible low-taxed income (GILTI) regime. The regulations package also includes proposed amendments and additions to the subpart F income and consolidated return regulations (collectively, the Proposed Regulations). Many of the rules provided by the Proposed Regulations merely implement the statute or clarify ambiguities and, thus, are neither surprising nor unanticipated.

The GILTI regime was enacted as part of the law commonly known as *Tax Cuts and Jobs Act* (the Act) in December 2017. More specifically, the Act added new Code Sections 250 and 951A; it revised Section 960.

Section 951A requires a "United States shareholder" (US shareholder) of any controlled foreign corporation (CFC) to include the US shareholder's GILTI for each tax year—computed based on the CFC's attributes—currently in gross income. The GILTI inclusion is similar in certain respects to an inclusion of subpart F income under Section 951.

Section 250 generally permits a corporate US shareholder a deduction equal to 50% of its GILTI inclusion (resulting in an effective US federal income tax rate of 10.5%). Section 960 treats a corporate US shareholder as paying itself a portion of the non-US income taxes paid by its CFCs, and therefore allows the US shareholder to take those taxes as a credit against its GILTI tax liability under Section 901 (subject to certain other limitations).

The Proposed Regulations include provisions:

- Describing the manner of calculating the fundamental elements underlying the GILTI inclusion (e.g., "tested income" and qualified business asset investment (QBAI))
- Revising the definition of "pro rata share," for purposes of inclusions of both GILTI and subpart F income
- Setting out anti-abuse rules in respect of certain basis "step-up" transactions for purposes of the GILTI regime
- Adopting a hybrid "aggregate/entity" approach to US partnerships and their partners for purposes of the GILTI regime
- Generally requiring a consolidated group to compute its GILTI inclusion as a group, rather than member-by-member

The Proposed Regulations do not address Sections 250 and 960; additional forthcoming regulations will do so. The Proposed Regulations also do not address many of the questions left open under the statute regarding the interplay between the GILTI rules and other code sections, although some of these questions are raised in the preamble.

Treasury notes that taxpayers have raised questions on the application of the dividends received deduction under Section 245A, the anti-hybrid rules of Section 267A and the interest limitation in Section 163(j) to the calculation of tested income and tested loss. Rather than resolve these questions in the Proposed Regulations, Treasury has noted that these items will be addressed in future guidance.

Treasury notes in the preamble that it is "anticipated" that future proposed regulations will be issued assigning the Section 78 gross-up attributable to the foreign taxes deemed paid to the GILTI foreign tax credit basket. However, Treasury does not indicate that future guidance will address other foreign tax credit-related issues. For example, the preamble does not indicate whether the look-through rule in Section 904(d) will apply to GILTI.

Neither the Proposed Regulations nor the preamble address whether withholding taxes on GILTI previously taxed income (PTI) distributions will be included in the GILTI basket and subject to the 20% "haircut" in Section 960(d). The Proposed Regulations and preamble are also silent on the treatment of taxes that are "properly attributable" to tested income and are paid in a year other than the year in which the tested income is included in the US shareholder's GILTI inclusion amount.

Comments submitted before issuance of the Proposed Regulations asked Treasury to adopt rules to allow for the carryover of a tested loss similar to the existing rules for NOL carryovers that apply for determining the taxable income of a US corporation. The Proposed Regulations, however, do not adopt such a rule to allow for the carryover of a tested loss.

Consistent with the definition of tested income under Section 951A(c)(2), the Proposed Regulations exclude from tested income any subpart F income of a CFC that is excluded from foreign base company income or insurance income solely by reason of the high-tax exception. Accordingly, the Proposed Regulations do not exclude (or permit an exclusion) from tested income any non-subpart F income that is subject to a high amount of tax.

The Proposed Regulations include a number of important anti-abuse provisions. In particular, the Proposed Regulations implement the QBAI anti-abuse direction of Section 951A(d)(4) with two new anti-abuse provisions. The Proposed Regulations also include a broader anti-abuse rule to deny certain deductions (e.g., amortization) for purposes of calculating tested income and tested loss.

Many of the provisions in the Proposed Regulations add substantially to the compliance obligations of US shareholders of CFCs. For example, complying with the basis adjustment rules for a disposition of a CFC with historic "used tested losses" will create significant new complexities for US shareholders in tracking attributes across their ownership period.

In some respects, the Proposed Regulations are notable for what they do not address (e.g., deemed paid taxes in connection with the GILTI inclusion amount). Accordingly, the consequences of many of the provisions in the Proposed Regulations cannot yet be fully appreciated. Nevertheless, taxpayers that may be adversely impacted by any of the provisions in the Proposed Regulations should consider submitting comments to Treasury during the 60-day comment period.

The Proposed Regulations, when finalized as final regulations, are generally effective for tax years of foreign corporations beginning after 31 December 2017, and to tax years of US shareholders in which or with which such tax years of foreign corporations end.

Treasury and IRS propose removing Section 385 documentation requirements

Treasury and the IRS issued proposed regulations (REG-130244-17) under Section 385 that would remove the minimum documentation requirements that must be satisfied to treat certain financial arrangements among related parties as indebtedness for federal tax purposes (the Documentation Regulations). The Documentation Regulations were issued in temporary and final form in October 2016.

As background, the Documentation Regulations were initially issued in proposed form as part of a Notice of Proposed Rulemaking published in April 2016 (REG-108060-15) and set forth the threshold level of documentation necessary to avoid per se recharacterization as equity (subject to limited exceptions). The requirements under the Documentation Regulations include a binding obligation to repay the funds advanced, a provision of standard creditor's rights, an initial analysis of the borrower's credit, and, if an event of default was waived, an explanation of why a diligent third-party creditor might decide to do so.

Satisfaction of the Documentation Regulations would not guarantee that the obligation would be respected as debt for tax purposes. The obligation would still have to be tested under the common-law rules for distinguishing debt and equity.

As noted earlier, the Document Regulations were published in temporary and final form (T.D. 9790) in October 2016. In finalized form, the Documentation Regulations applied to financial interests issued (or deemed issued) on or after 1 January 2018.

In Executive Order 13789, issued on 21 April 2017, Treasury was called upon to review all "significant tax regulations" issued on or after 1 January 2016, and to identify those regulations deemed to impose undue financial burden, add undue complexity or exceed statutory authority.

In Notice 2017-38, released in July 2017, the IRS identified the Documentation Regulations as among eight regulation packages requiring additional review. Shortly thereafter, Notice 2017-36 announced the delayed application of the Documentation Regulations by 12 months – making them applicable only to financial arrangements issued on or after 1 January 2019. Treasury subsequently announced, in October 2017, its intention to revoke the Documentation Regulations and develop new simplified rules.

Removal of Documentation Regulations

The new proposed regulations would remove the Documentation Regulations and make corresponding conforming amendments, but do not include new modified rules. The Preamble to the proposed regulations states that Treasury and the IRS will continue to consider whether to develop and issue a modified, simplified version of the minimum documentation requirements to be met to characterize related-party financial interests as debt. It adds that any such regulations would have a prospective effective date and would allow taxpayers sufficient time to comply.

As a formal matter, the regulations removing the Documentation Regulations are proposed to be effective when final regulations are published. However, until that date, taxpayers may rely on the proposed regulations to treat the Documentation Regulations as though they had been withdrawn.

The removal of the Documentation Regulations is a welcome development as they were generally perceived as overturning decades of long-standing principles developed by case law and settled expectations as to the facts-and-circumstances analysis applied to determine whether financial interests should be characterized as debt or equity under Section 385.

Treasury's intent underlying promulgation of the Documentation Regulations was to impose discipline on related parties by requiring timely documentation and financial support, which met four factors, similar to the documentation and support created when debt is issued to third parties.

Accordingly, notwithstanding revocation of the rules, a best practice approach for taxpayers would be to prepare similar loan documentation and economic analysis (e.g., cash flow projections, financial statements, relevant financial ratios), supporting the classification of related-party financial interests as indebtedness. The Documentation Regulations also should serve as a warning not to ignore events of default without documenting why a reasonable creditor would have waived an event of default.

Note also that the Recharacterization Rules under Section 385 remain in effect as to related-party debt issued in connection with certain targeted transactions. Their applicability should still be considered in connection with new issuances of related-party debt.

IRS releases draft Form 8991, *Tax on Base Erosion Payments of Taxpayers with Substantial Gross Receipts*

On 5 September 2018, the IRS released a draft of Form 8991, *Tax on Base Erosion Payments of Taxpayers with Substantial Gross Receipts*. Although several clarifications are needed, the draft form provides some insight into the calculation flow and data required to meet the reporting requirements for the Base Erosion and Anti-Abuse Tax (BEAT) under new Section 59A.

The BEAT generally introduces a base erosion minimum tax amount (referred to as BEMTA), which represents an incremental tax imposed on payments to foreign related parties made by Applicable Taxpayers (generally domestic and foreign corporations that file net-basis income tax returns in the US) that both: (1) have substantial gross receipts; and (2) reach or exceed a designated base erosion percentage.

The draft form generally emphasizes a reconciliation approach that requires taxpayers to funnel down from base financial data, while clearly identifying any items that are removed from that data as exceptions. This approach may be challenging for financial services taxpayers to follow in certain areas – e.g., banks that enter into derivatives and broker-dealers that are potentially eligible for the qualified derivative payment (QDP) exception.

Refinements to the draft Form 8991 are expected in light of proposed regulations scheduled for release in late October or November 2018.

Overall, the draft Form 8991 provides a helpful way for taxpayers to readily identify the specific steps in the BEAT process that are problematic for them in terms of insufficient current guidance or data availability. When considering revisions to the form and related guidance, the IRS will need to balance concerns regarding the availability of data with the requirement to produce reliable and consistent calculations for BEAT purposes.

It is expected that the revised Form 8991 would be accompanied by detailed instructions for taxpayers to use as a guide when completing the form. Comments on draft Form 8991 may be submitted here.

IRS grants relief to RICs from Section 4982 excise tax for Section 965 inclusions

On 6 September 2018, the IRS released Revenue Procedure 2018-47 in response to taxpayers' requests for relief from the application of the Section 4982 excise tax that could otherwise be owed with respect to Section 965 inclusion amounts. The request was due to the administrative burden placed on regulated investment companies (RICs) to obtain the required information, compute the required amounts and make "required distributions" in a brief amount of time.

Revenue Procedure 2018-47 provides the requested relief by stating that the IRS will not challenge a RIC treating its share of a Section 965(a) inclusion (and its related Section 965(c) deduction (together, the "transition amounts")) attributable to a specified foreign corporation with a calendar year-end in the same manner as specified gain (and loss) under Section 4982(e)(5).

Accordingly, a RIC may treat these transition amounts as items of income that are properly taken into account during the portion of the RIC's 2017 tax year that is after 31 October for purposes of Section 4982, and instead may include these amounts in the RIC's excise tax calculation for 2018.

IRS plans informal guidance on TCJA international provisions

An IRS official from the Large Business and International Division was quoted as saying the Service plans to establish separate webpages for the major international tax provisions enacted by the 2017 tax reform to provide informal taxpayer guidance. The webpages will follow a similar format that was adopted by the IRS to offer informal information regarding the *Tax Cuts and Jobs Act*'s (TJCA) transition tax.

Revenue Procedure 2018-47 is welcome news for taxpayers. It clarifies that a RIC's share of deferred foreign income from a specified foreign corporation with a calendar year-end may be treated as arising on 1 January 2018, for excise tax purposes. This affords RICs additional time to make the required distribution under Section 4982; thereby alleviating the impact of the exercise tax on the mandatory inclusion under Section 965.

This is because prior to the issuance of Revenue Procedure 2018-47, any amount includable as subpart F income of a RIC by reason of the Section 965 transition tax could increase a RICs required distribution. Without time to properly determine the RIC's Section 965 inclusion and to make the actual distributions of the increased required distribution amount, a RIC could have faced a 4% excise tax on the Section 965 inclusion.

RICs that have Section 965 transition amounts from a specified foreign corporation with a calendar year-end should consider treating such amounts as arising on 1 January 2018, for purposes of Section 4982. By doing so, the Section 965 transition amounts will be first taken into account in excise tax calculations for 2018.

Note that Section 965 applies only to a single tax year of a deferred foreign income corporation (DFIC) — that is, the DFIC's last tax year beginning before 1 January 2018. Section 965 will not apply to subsequent years. Based on the timing rules for subpart F inclusions, the last RIC tax year in which a Section 965 inclusion could occur is 31 October 2019.

IRS to delay Section 871(m) regulations effective / applicability date two years

The IRS in Notice 2018-72 announced its intention to amend the Section 871(m) regulations to delay the effective / applicability date of certain rules affecting the treatment of dividend equivalent payments by two years. Specifically, government intends to revise the effective / applicability date for Reg. Section 1.871-15(d)(2) and (e) to provide that these rules will not apply to any payment made with respect to any non-delta-one transaction issued before 1 January 2021.

The amendments would also extend the phase-in period provided in Notices 2017-42 and 2018-5 for certain provisions of the Section 871(m) regulations and permit withholding agents to apply the transition rules from Notice 2010-46 in 2020. Notice 2018-72 was released on 20 September.

IRS issues guidance for REITs on treatment of certain income inclusions from foreign corporations

In Revenue Procedure 2018-48, the IRS has determined, under its Section 856(c)(5)(J)(ii) authority, that the subpart F inclusions, passive foreign investment companies (PFIC) inclusions and global intangible low-taxed income (GILTI) inclusions attributable to investment by a real estate investment trust (REIT) in foreign corporations constitute qualifying income for purposes of the 95% income test in Section 856(c)(2).

In addition, the IRS determined, under Section 856(n)(3)(C), that Section 986(c) foreign currency gains recognized with respect to distributions of previously taxed earnings and profits of foreign corporations are excluded from gross income for purpose of the 95% income test.

The IRS previously issued 13 private letter rulings in which it ruled that certain subpart F inclusions and PFIC inclusions constituted qualifying income for purposes of the 95% income test. It was unclear, however, what effect, if any, the character of the underlying subpart F income or PFIC income had on the conclusions. In addition, neither the underlying legislative history nor subsequently issued guidance addressed the REIT income testing treatment of GILTI inclusions, required under Section 951A, which was recently enacted under the *Tax Cuts and Jobs Act*.

IRS APMA program being restructured

The IRS announced in September 2018 that it will be restructuring the Advance Pricing and Mutual Agreement program (APMA) to consolidate resources and improve internal processes. Among the noteworthy changes, all APMA teams will consist of both team leaders and economists to ensure optimal involvement by economists in the process. Unless notified otherwise, taxpayers are to assume that existing cases will continue to be handled by their current APMA team.

Accordingly, the IRS's determination in Revenue Procedure 2018-48 that subpart F inclusions, PFIC inclusions and GILTI inclusions constitute qualifying income for purposes of the 95% income test is welcome news for REITs and their advisors. It appears that the IRS decided that these inclusions are "dividend-like" income and thus, should be given the same treatment under the REIT income tests as dividend income received from a C corporation.

IRS announces new international compliance campaigns

The IRS Large Business and International (LB&I) division has announced the addition of two new compliance campaigns in the international tax area. The first relates to subpart F foreign base company sales income and the manufacturing branch rules. The IRS's goal is to identify and select for examination returns of US shareholders of CFCs that the Service believes may have underreported subpart F income based on certain interpretations of the manufacturing branch rules.

The second international campaign will focus on certain deductions taken on Form 1120-F: specifically, the determination of the interest expense of a foreign corporation that is allocable to their effectively connected income (ECI), and the amount of home office expense deductions allocated to ECI. According to the Service, the second compliance campaign aims to identify aggressive positions in these areas, "such as the use of apportionment factors that may not attribute the proper amount of expenses to the calculation of effectively connected income."

OECD news

OECD releases additional guidance on country-by-country reporting and updated exchange relationships

The OECD on 13 September 2018 released additional guidance to give greater certainty to tax administrations and multinational enterprise (MNE) groups on the implementation and operation of BEPS Action 13 Country-by-Country (CbC) Reporting (CbCR).

Accordingly, existing guidance on the implementation of CbCR (the Guidance) has been updated to address the following issues: (i) the treatment of dividends for purposes of "Profit (loss) before Income Tax," "Income Tax accrued (current year)" and "Income Tax paid (on cash basis)"; (ii) the use of shortened amounts in Table 1 of CbC reports; and (iii) the number of employees to be reported where the financial data of a Constituent Entity is reported on a pro-rata basis. The updated Guidance also includes a summary table of the existing interpretative guidance for mergers, demergers and acquisitions.

The Guidance marks the eighth release by the OECD regarding practical questions that have arisen concerning the implementation and operation of CbCR. Although some of the new Guidance must be implemented by jurisdictions before it is applicable to taxpayers, it is important to anticipate these changes and understand their impact in the preparation of CbC reports for reporting fiscal year 2017.

The OECD also published additional exchange relationships that have been activated under the Multilateral Competent Authority Agreement on the exchange of CbC reports with respect to Bermuda, Curaçao, Hong Kong and Liechtenstein.

House tax leader urges IRS to issue virtual currency guidance

US House Ways and Means Committee Chairman Kevin Brady (R-TX) has urged the IRS to issue virtual currency guidance that would clarify taxpayers' obligations when using virtual currencies. In March 2016, the IRS issued Notice 2014-21, describing how existing general tax principles apply to transactions using virtual currency. The IRS Commissioner in 2017 described that guidance as preliminary. No other guidance on the topic has been issued by the Service.

In a letter to Acting IRS Commissioner Dave Kautter in September 2018, Chairman Brady wrote: "Despite the issuance of only preliminary guidance on this issue, the IRS has made enforcement of this guidance a priority, undertaking robust enforcement actions on a number of fronts." In July 2018, the IRS Large Business and International division announced five new compliance campaigns, including one focused on non-compliance in the area of virtual currencies.

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

Jose Murillo	**+1 202 327 6044**
Stephen Bates	+1 415 894 8190
David Canale	+1 202 327 7653
Doug Chestnut	+1 202 327 5780
Ken Christman	+1 202 327 8766
Arlene Fitzpatrick	+1 202 327 7284
David Golden	+1 202 327 6526
Liz Hale	+1 202 327 8070
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
Tyler Arbogast	+1 202 327 6867
Carlos Mallo	+1 202 327 5689
Ben Orenstein	+1 212 773 4485
Stephen Peng	+1 202 327 7471
Dave Peppelman	+1 202 327 6448
Trey Whitten	+1 202 327 7419
fax number	+1 202 327 6721

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*

EY | Assurance | Tax | Transactions | Advisory

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. 011230-18Gbl

1508-1600216 NY
ED None