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Global Tax Alert

Report on recent US international tax developments – 21 December 2018

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The House on 20 December approved the *Retirement, Savings, and Other Tax Relief Act of 2018* and the *Taxpayer First Act of 2018*, addressing two-tax extender provisions, retirement policy, *Tax Cuts and Jobs Act* (TCJA) technical corrections, Internal Revenue Service (IRS) reform provisions, and disaster relief. There is no expectation that the Senate will take up the bill, which would require Democratic support for passage. Congressional Democrats have consistently shown little interest in making technical corrections to the TCJA. Prior to the House vote, Chairman Brady predicted that if the bill is not enacted, Democrats would take up elements of the legislation early next year.

The Congressional Joint Committee on Taxation on 19 December released the eagerly-anticipated "Blue Book" general explanation of the TCJA. Congressional staff delivered on promises made earlier in the year that the Blue Book would be released before the end of 2018. The Blue Book is prepared by the Joint Committee Staff, in consultation with the staffs of the House Committee on Ways and Means and the Senate Finance Committee.

In addition to a general explanation of the tax reform provisions, the Blue Book identifies numerous TCJA measures that require technical corrections. Chairman Brady was quoted as saying that draft technical correction language would be released by the end of the year, and would include issues identified in the Blue Book. The draft would allow the public an opportunity to review the

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proposed corrections and "prepare for the next session." Chairman Brady indicated that draft technical corrections would not be introduced in legislative text before the 115th Congress adjourns.

There were more developments in regard to the TCJA international tax guidance this week.

The IRS on 20 December issued proposed regulations implementing Internal Revenue Code[1] Sections 245A(e) and 267A (enacted by the TCJA), regarding hybrid dividends and certain amounts paid or accrued in hybrid transactions or with hybrid entities. The proposed regulations also include rules under Sections 1503(d), 6038, 6038A and 7701.

Generally, the proposed regulations under Section 267A would deny a deduction for interest and royalty payments that are paid to a related party, but not included in the related party's income due to: (i) a hybrid transaction, or (ii) a payment by or to a hybrid entity. The proposed regulations only include rules under Section 245A(e) on hybrid dividends. The IRS indicated that rules that will address other aspects of Section 245A, including the general eligibility requirements for the dividend received deduction under Section 245A(a), will be included in a separate notice of proposed rulemaking.

The TCJA provided that Section 245A, including Section 245A(e), applies to distributions made after 31 December 2017. Section 267A applies to taxable years beginning after 31 December 2017. Consistent with the applicability date of Section 245A and Section 267A, proposed Reg. Section 1.245A(e)-1 applies to distributions made after 31 December 2017. Proposed Reg. Section 1.267A-1 through 1.267A-6 generally apply to specified payments made in taxable years beginning after 31 December 2017.

The Government states that it expects to finalize the proposed provisions by 22 June 2019. If any provisions are finalized after that date, Treasury and the IRS indicated those provisions will apply only to taxable years ending on or after their filing in the Federal Register.

The IRS this week also saw the release of proposed regulations (REG-113604-18) under Section 864(c)(8) on the tax treatment of foreign partners gains on the sale of an interest in a US partnership. New Section 864(c)(8), enacted by the TCJA, treats the portion of gain (or loss) from the sale or exchange of an interest in a partnership that is engaged in a US trade or business as effectively connected income (ECI), to the extent the gain (or loss) from the sale or exchange of the underlying assets held by the partnership would be treated as ECI allocable to such partner. This provision effectively overruled the 2017 Tax Court decision in *Grecian Magnesite Mining, Industrial & Shipping Co. v. Commissioner*.

The proposed regulations apply to transfers occurring on or after 27 November 2017, the effective date of Section 864(c)(8). Again, the proposed regulations state that if any provision is finalized after 22 June 2019, Treasury and the IRS expect that such provision will apply only to transfers occurring on or after the provision's filing in the Federal Register. Section 1446 withholding, which is required of the purchaser of a US partnership interest from a foreign partner, was not addressed in the Section 864(c)(8) package. Treasury and the IRS stated that they intend to issue Section 1446 guidance "expeditiously."

Treasury and the IRS on 14 December released Notice 2019-01, announcing that the Government intends to issue regulations addressing certain issues arising from the TCJA with respect to foreign corporations with previously taxed earnings and profits (PTEP). The notice describes regulations that Treasury intends to issue, including: (i) rules relating to the maintenance of PTEP in annual accounts and within certain groups; (ii) rules relating to the ordering of PTEP upon distribution and reclassification; and (iii) rules relating to the adjustment required when an income inclusion exceeds the earnings and profits of a foreign corporation. It is anticipated that the regulations announced in the notice will apply to taxable years of US shareholders ending after the date of release of the notice and to taxable years of foreign corporations ending with or within such taxable years.

The Office of Management and Budget Office of Information and Regulatory Affairs received proposed Section 250 regulations for review on 14 December. Enacted by the TCJA, Section 250 is part of the Global Intangible Low Taxed Income (GILTI) regime. It also implements the Foreign-Derived Intangible Income (FDII) regime. The section generally permits a corporate US shareholder a deduction equal to (i) 50% of its GILTI inclusion, including a gross-up for deemed-paid taxes (resulting in an effective US federal income tax rate of 10.5%) and (i) 37.5% of its FDII (resulting in an effective US federal income tax rate of 13.125%). Proposed GILTI regulations that were released on 13 September 2018 did not address Section 250.

Endnote

1. All "Section" references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.

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