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# Washington Dispatch

December 2018, Volume 22, Issue 12

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## Legislation

### Congress fails to enact year-end tax bill

The Republican-dominated Congress failed to enact year-end tax legislation as 2018 came to a close, leaving a new, divided 116th Congress to address - at least in theory - *Tax Cuts and Jobs Act* (TCJA) technical corrections, tax extenders and other tax-related legislation.

The US 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, TCJA technical corrections, IRS reform provisions, and disaster relief. The Senate did not take up the bill, however, which would have required Democratic support for passage.

Congress also failed to enact certain necessary spending bills in late December, forcing the federal government to enter into a partial government shutdown beginning at midnight on 21 December. As the year closed, the federal government remained in partial shutdown as the Trump Administration and congressional Republicans sparred with congressional Democrats over border security funding.

It remained unclear if ongoing OMB review of TCJA regulations would be affected by the partial government shutdown. The OMB Office of Information and Regulatory Affairs is currently reviewing proposed regulations under Section 250 on the deductions for foreign-derived intangible income (FDII) and global intangible low-taxed income (GILTI), as well as final regulations on the Section 965 transition tax.

### JCT issues 'Blue Book' on Tax Cuts and Jobs Act

The Congressional Joint Committee on Taxation (JCT) on 19 December 2018 released the eagerly-anticipated "[Blue Book](#)" general explanation of the *Tax Cuts and Jobs Act* (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 Ways and Means Committee and the Senate Finance Committee.

In addition to a general explanation of the tax reform provisions, the JCT Blue Book identifies numerous TCJA measures that require technical corrections.

## Treasury and IRS news

### IRS proposed regulations provide guidance on the base-erosion and anti-abuse tax under Section 59A

On 13 December 2018, the government issued proposed regulations ([REG-104529-18](#)) under Section 59A, providing guidance on the application of the base erosion and anti-abuse tax (BEAT). The proposed regulations include provisions addressing:

- ▶ The identification of applicable taxpayers subject to the BEAT under the statutory aggregation rules
- ▶ Application of the BEAT to partnerships and consolidated groups
- ▶ Treatment of non-cash payments as base erosion payments
- ▶ Application of various exceptions from base erosion payments in certain circumstances
- ▶ Accounting for net operating loss (NOL) carryforwards when computing modified taxable income

The proposed regulations would apply to tax years beginning after 31 December 2017. Until the regulations are finalized, however, taxpayers may rely on the proposed regulations if they and all related parties consistently apply the regulations to all tax years ending before the date on which final regulation are published.

In general, the BEAT applies to a corporation (other than a RIC, REIT, or S corporation) that is subject to US net income tax and has (i) average annual gross receipts of at least \$500 million for the three-year period ending with the preceding tax year (the gross receipts test), and (ii) a "base erosion percentage" of 3% (2% for a taxpayer that is a member of an affiliated group with a domestic bank or registered securities dealer) or more (the base erosion percentage test). A corporation subject to the BEAT is an "applicable taxpayer."

The proposed regulations address certain of the outstanding questions under Section 59A, and provide some much-needed guidance on the application of the gating thresholds and computational matters.

In particular, the proposed regulations would clarify which entities are to be aggregated in order to evaluate the gross receipts test and base erosion percentage. Within this aggregate group framework, the regulations provide the Effectively Connected Income (ECI) Exception, with the result that amounts subject to US tax as ECI would be excluded as base erosion payments.

The guidance also confirms that the Services Cost Method (SCM) exception applies to the cost component of a service for which a markup is charged (assuming certain requirements are satisfied), settling some interpretive disagreement in the taxpayer's favor. Further, based on the aggregate group approach, payments between group members would not be included for purposes of applying the gross receipts test. The proposed regulations would also clarify that the generally applicable lower 2% threshold does not apply to an aggregate or consolidated group that has de minimis bank or registered securities dealer activities.

The proposed regulations will, however, likely mean some additional complexity for taxpayers in terms of gathering data and tracking certain items going forward.

Although the proposed regulations are comprehensive, they do not address a number of issues. For instance, although the proposed regulations address how BEAT provisions interact with treaty-based determinations generally (e.g., in the context of income attributable to a permanent establishment, the Preamble does not mention Treasury's view on whether the BEAT provisions are congruent with the Nondiscrimination and Relief from Double Taxation provisions of current US tax treaties, a subject that has been much discussed by EU member governments. Similarly, they do not address the treatment of payments made under an Advance Pricing Agreement.

Careful review of the proposed regulations will be necessary to assess whether and / or to what extent taxpayers may be affected by BEAT, and may result in a redetermination of earlier modeling exercises. Comments are requested on several aspects of the proposed regulations and should provide an opportunity to address certain matters before finalization of the regulations, which is expected to occur in 2019, with the result that the final regulations would be effective for tax years beginning after 31 December 2017.

## IRS issues proposed regulations addressing foreign persons' taxable gain or loss from sale / exchange of interests in partnerships engaged in US business

The government in mid-December 2018 issued proposed regulations ([REG-113604-18](#)) under Section 864(c)(8) on the treatment of gain or loss recognized by foreign persons from the sale or exchange of an interest in a partnership that is engaged in a US trade or business. The proposed regulations include:

- ▶ Rules for determining gain or loss under Section 864(c)(8)(A) and the corresponding limitation under Section 864(c)(8)(B), including the applicability of the "hot asset" rules of Section 751
- ▶ Guidance on coordinating Section 864(c)(8) with the "FIRPTA" rules of Section 897
- ▶ Clarifications with respect to tiered partnerships
- ▶ Guidance on treaties
- ▶ An "anti-stuffing rule" applicable to the Section 864(c)(8) regulations and Section 897

The proposed regulations do not include withholding guidance under Section 1446(f), which will be issued separately.

Section 864(c)(8) enacted by the *Tax Cuts and Jobs Act*, generally provides that gain (or loss) of a non-US person from the transfer of an interest in a partnership that is engaged in a trade or business in the United States is taxable in the US. Specifically, US tax applies to the extent that gain (or loss) from a hypothetical sale or exchange of the underlying assets held by the partnership would be treated as effectively connected with the conduct of a trade or business in the US (ECI) and allocable to the selling partner. This provision is consistent with the IRS's position under Revenue Ruling 91-32, and prospectively overrules the 2017 decision in [Grecian Magnesite Mining, Industrial & Shipping Co. v. Commissioner](#).

The proposed regulations would implement a formulaic approach to calculating the amount of gain or loss that is treated as ECI upon a foreign partner's sale of a partnership interest. Certain aspects of the methodology, however, appear to place a significant burden on partnerships with

foreign partners. For example, deemed-sale gain and loss is calculated on an asset-by-asset basis, which would require an affected partnership to determine the fair market value of each of its assets every time a foreign partner sells an interest.

The proposed regulations are proposed to apply to transfers occurring on or after 27 November 2017, the effective date of Section 864(c)(8). If any provision of the proposed regulations is finalized after 22 June 2019, however, Treasury and the IRS expect that provision to apply only to transfers occurring on or after 27 December 2018 (i.e., the date of publication of the proposed regulations in the Federal Register). For context, Section 7805(b)(2) permits regulations filed or issued within 18 months of the enactment of new statutory provision to apply retroactively to the date of enactment. Section 864(c)(8) was enacted on 22 December 2017.

### **IRS issues proposed hybrid dividends / entities regulations**

The IRS on 20 December 2018 issued proposed regulations implementing Sections 245A(e) and 267A (enacted by the *Tax Cuts and Jobs Act* (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: (1) a hybrid transaction, or (ii) a payment by or to a hybrid entity. The proposed regulations also provide guidance under Section 245A, but only with respect to Section 245A(e), which addresses 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 (DRD) 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, the proposed regulations under Section 245A apply to distributions made after 31 December 2017 and the proposed regulations under Section 267A apply to specified payments made in taxable years beginning after 31 December 2017.

The preamble to the proposed regulations provides that Treasury and the IRS expect to finalize these proposed provisions by 22 June 2019. If any provisions are finalized after that date, those provisions will apply only to taxable years ending on or the date they are filed in the Federal Register.

### **IRS announces future foreign corporate PTEP regulations**

Treasury and the IRS on 14 December 2018 released Notice 2019-01, announcing that the government intends to issue regulations addressing certain issues arising from the *Tax Cuts and Jobs Act* 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 14 December 2018 and to taxable years of foreign corporations ending with or within such taxable years.

### **IRS issues proposed regulations to ease burdens under FATCA and Chapter 3**

Treasury and the IRS in mid-December 2018 issued proposed regulations ([REG-132881-17](#)) on certain requirements under the *Foreign Account Tax Compliance Act* (FATCA) and chapter 3 of the Internal Revenue Code that would:

- ▶ Remove withholding on payments of gross proceeds from the regulations
- ▶ Defer withholding on foreign passthru payments
- ▶ Eliminate withholding on certain insurance premiums
- ▶ Clarify the definition of investment entity
- ▶ Provide guidance for withholding agents on certain due diligence requirements
- ▶ Provide guidance on refunds and credits of amounts withheld

The proposed regulations are generally quite taxpayer-favorable. The removal of gross proceeds from the definition of a “withholdable payment” is most welcome by financial institutions, and the elimination of premiums for term-life and property and casualty insurance from FATCA withholding reduces the burden of FATCA compliance for virtually every US business.

FATCA is found in chapter 4 of the Code (Sections 1471 - 1474). FATCA generally requires US and non-US withholding agents (including foreign financial institutions (FFIs)) to identify who their payees are and the FATCA status of those payees. For FATCA purposes, US withholding agents must withhold tax on certain payments to FFIs that do not agree to report certain information to the US regarding their US accounts (non-participating FFIs) and on certain payments to non-financial foreign entities that do not provide information about their substantial US owners to withholding agents. The US has entered into numerous Intergovernmental Agreements to minimize the impact of FATCA on a foreign-partner jurisdiction's financial institutions.

Chapter 3 of the Code (Sections 1441 - 1446) generally requires withholding at a rate of 30% on US-source fixed or determinable, annual or periodic income paid to nonresident aliens.

### **US Treasury grants another extension of time for reporting signature authority (FBAR, Form 114) over certain foreign financial accounts**

On 10 December 2018, the Financial Crimes Enforcement Network (FinCEN) issued [Notice 2018-1](#), further extending the filing deadline for certain individuals who previously qualified for an extension of time to file a *Report of Foreign Bank and Financial Accounts* (FBAR) with respect to signature authority under Notice 2017-1 and preceding guidance.

### **Puerto Rico enacts tax reform**

On 10 December 2018, Puerto Rico enacted *Act 257-2018*, which includes numerous amendments to the Puerto Rico Internal Revenue Code of 2011.

The most noteworthy features of *Act 257-2018* are amendments to provisions applicable to individuals, corporations and sales and use taxes. In the case of individuals and corporations, *Act 257-2018* places greater reliance on the use of the alternative basic tax and alternative minimum tax and the need to obtain external validation by Puerto Rico licensed Certified Public Accountants (CPAs). *Act 257-2018* also introduces an optional computation that will allow certain individuals and corporations, whose main business activity is rendering services, to meet their tax compliance obligations by making an election to have their taxes withheld at source by the payor.

Other amendments will affect deductions, the filing of returns and source of income rules, among other tax revenue and enforcement measures. A guiding tax policy principle embedded in *Act 257-2018* is revenue neutrality. That is to say, *Act 257-2018* should have no effect on the PR Government's coffers.

The legislative evolution of *Act 257-2018* resulted in tax rate reductions that are less ambitious than originally planned and increased focus on the use of technology and third-party validation to assist the Puerto Rico Treasury Department in its tax enforcement efforts. The statutory mandate of *Act 257-2018* creates greater interdependencies among taxpayers and the information they are obligated to report, which is expected to enable greater oversight and verification of the information being reported to the government.

Among other things, *Act 257-2018* reduces the maximum corporate income tax rates for tax years commencing after 31 December 2018. The reduction is made to the normal tax rate by reducing it from 20% to 18.5%. The surtax rates remain intact.

*Act 257-2018* reduces the alternative minimum tax (AMT) rate from 30% to 18.5% for taxpayers with a volume of business of less than \$3 million. If a taxpayer's volume of business is \$3 million or more, the applicable AMT rate is 23%.

*Act 257-2018* also allows corporate taxpayers engaged in a trade or business in which income is derived substantially from services, and subject to withholding at source, to elect to use a fixed tax rate to determine their income tax liability. The fixed rate will apply to the gross income derived from the rendering of services, ranging from 6% to 20%.

As such, the Notice is only relevant for persons who were previously granted extensions of time to report signature authority under FinCEN Notices 2011-1 and 2011-2, and most recently extended by FinCEN Notice 2017-1. FinCEN Notice 2018-1 grants a further extension of time to file FBARs with respect to signature authority for 2018 and prior years under extension.

Please note, as stated in the *Surface Transportation and Veterans Health Care Choice Improvement Act of 2015*, Public Law 114-41 changed the due date to 15 April, and directed that a six-month extension of the filing deadline to 15 October be made available. As of the date of Notice 2018-1, all filers are granted an automatic extension of time to file calendar year 2018 FBARs without the need to specifically request the extension.

## OECD developments

### OECD publishes tax report to G20 leaders

On 30 November 2018, the OECD issued a [report](#) to the G20 Leaders at their summit in Buenos Aires, Argentina, updating them on progress in key areas of the G20 / OECD's tax work.

The report contains two parts. Part I provides an update to G20 Leaders on the developments in delivering on the G20's commitments to fight tax evasion and avoidance, advance the tax certainty agenda, and to ensure that developing countries are in a position to leverage international standards to mobilize their own domestic resources. Part II reports on the activities and achievements of the Global Forum on Transparency and Exchange of Information for Tax Purposes, as well as the next steps to be taken to address the remaining and emerging challenges.

At the conclusion of their summit, the G20 Leaders also issued a communiqué. Touching on the topic of digital on some five occasions, the communiqué notes: "We will continue our work for a globally fair, sustainable, and modern international tax system based, in particular on tax treaties and transfer pricing rules" and that "We will continue

to work together to seek a consensus-based solution to address the impacts of the digitalization of the economy on the international tax system with an update in 2019 and a final report by 2020." Both comments reflect language in the report, and are targeted at ongoing discussions on digital tax solutions being discussed at the European Commission.

### OECD releases second annual peer review report on Action 5 on the exchange of tax rulings

On 13 December 2018, the OECD released the second annual peer review [report](#) relating to compliance by members of the Inclusive Framework (IF) on Base Erosion and Profit Shifting (BEPS IF) to the minimum standard on Action 5 for the compulsory spontaneous exchange of certain tax rulings (the transparency framework).

The report covers 92 of the 124 BEPS IF jurisdictions, including all IF members that joined prior to 1 September 2017 and Jurisdictions of Relevance identified by the IF prior to 1 September 2017.

The report assesses the 2017 calendar-year period. This report will be followed by annual reviews performed at least until 2020, which is the end of the current agreed review period.

One of the major conclusions reports that through 31 December 2017 almost 16,000 tax rulings within the scope of the transparency framework had been issued by the jurisdictions under review. By 31 December 2017, around 21,000 exchanges of information had taken place, with almost 14,000 exchanges undertaken during 2017 and over 6,000 exchanges during 2016.

Overall, the report concludes that all the assessed jurisdictions either have implemented, or have undertaken steps to implement, the necessary legal framework for the spontaneous exchange of information on rulings for the year in review. Also, the report highlights that the peer review process itself has proven to be very effective, with 60% of recommendations issued in the first annual report just one year ago already successfully addressed.

**EY Member Firm US Tax Desks**

<b>Australia</b>	Scott Hes, <i>Sydney</i>	scott.hes@au.ey.com
<b>Canada</b>	George Guedikian, <i>Toronto</i>	george.b.guedikian@ca.ey.com
	Emad Zabaneh, <i>Toronto</i>	emad.m.zabaneh@ca.ey.com
	Asif Rajwani, <i>Toronto</i>	asif.rajwani@ca.ey.com
	Ryan Coupland, <i>Calgary</i>	ryan.coupland@ca.ey.com
	George Tsitouras, <i>Montreal</i>	george.tsitouras@ca.ey.com
	Denis Rousseau, <i>Montreal</i>	denis.rousseau@ca.ey.com
<b>China</b>	Nelson Brooks, <i>Vancouver</i>	nelson.brooks@ca.ey.com
	Aaron Topol, <i>Hong Kong</i>	aaron.topol@hk.ey.com
<b>France</b>	Lipeng He, <i>Shanghai</i>	lipeng.he@cn.ey.com
	Diane Juzaitis, <i>Paris</i>	diane.juzaitis@ey-avocats.com
<b>Germany</b>	Tom Day, <i>Munich</i>	thomas.day@de.ey.com
	Andrew Brown, <i>Munich</i>	andrew.brown@de.ey.com
<b>Israel</b>	Amir Chenchinski, <i>Tel Aviv</i>	amir.chenchinski@il.ey.com
	Tal Levy, <i>Tel Aviv</i>	tal.levy@il.ey.com
	Itai Ran, <i>Tel Aviv</i>	itai.ran@il.ey.com
<b>Japan</b>	Takayuki Ohta, <i>Tokyo</i>	takayuki.ohta@jp.ey.com
<b>Mexico</b>	Alberto Lopez, <i>Mexico City</i>	alberto.r.lopez@mx.ey.com
	Manuel Solano, <i>Mexico City</i>	manuel.solano@ey.com
<b>Singapore</b>	Garrett Davidson, <i>Singapore</i>	garrett.davidson@sg.ey.com
<b>Switzerland</b>	Michael Parets, <i>Zurich</i>	michael.parets@ch.ey.com
<b>United Kingdom</b>	Joseph Kledis, <i>Hong Kong</i>	joe.kledis1@uk.ey.com
	Leif Jorgensen, <i>London</i>	ljorgensen@uk.ey.com
	Joseph Toce, <i>London</i>	jtoce@uk.ey.com

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EYG no. 012816-18Gbl

1508-1600216 NY  
ED None

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