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Legislation

Tax agenda uncertain in new Congress

The Republican-dominated 115th Congress officially ended in January 2019, ushering in a divided 116th Congress in which House control moved to the Democrats with Republicans maintaining their majority in the Senate. What this new era of divided government means in terms of tax policy remains an open question.

In one of his last acts as House Ways and Means Committee Chairman, Kevin Brady (R-TX) on 2 January published a discussion draft of the *Tax Technical and Clerical Corrections Act*. Provisions in the discussion draft were developed by the Joint Committee on Taxation staff, as well as the staffs of the House Ways and Means Committee, Senate Finance Committee and Treasury.

The draft was meant to provide information to stakeholders and an opportunity to offer feedback on the provisions, including on potential additional technical corrections that might be considered by the new Congress.

The new House Ways and Means Committee Chairman, Richard Neal (D-MA), offered hints as to his tax priorities, as Democrats began the process of organizing the lower chamber. Chairman Neal was quoted as saying he planned to schedule hearings on the impact of the 2017 *Tax Cuts and Jobs Act* (TCJA), possibly before the end of January; as we go to press no hearings had been scheduled.

The Chairman also indicated that the committee would first focus on healthcare. While Chairman Neal had criticized a number of TCJA provisions while he was the ranking minority member on the committee, he has not said what specific tax reform provisions he plans to target.

Chairman Neal was also quoted as saying the committee was considering how to address the left-over issue of tax extenders legislation. He reportedly had not decided whether a tax extenders package would move as stand-alone legislation or as part of a must-pass bill.

Later in the month, the new Senate Finance Committee Chairman, Chuck Grassley (R-IA), who took the reins of the committee following the retirement of former Chairman Orrin Hatch (R-UT), indicated the committee would address tax extenders as the first major piece of tax legislation in the new Congress.

Senate tax leaders reiterate concern over unilateral European digital services taxes

Senate Finance Committee Chairman Chuck Grassley (R-IA) and ranking member Ron Wyden (D-OR) sent a 29 January 2019 letter to Treasury Secretary Steven Mnuchin, reiterating US concerns over unilateral action by some European countries to enact some form of digital services tax. The Senate tax leaders described those efforts as "designed to discriminate against U.S.-based multinational companies." The letter was also sent to the European Council and the European Commission.

The Finance Committee Chairman was quoted as saying that he expected that tax extenders and a separate IRS restructuring bill would move quickly, as they had received bipartisan support in the last Congress. Chairman Grassley did not indicate when extenders legislation would be introduced, nor did he mention technical corrections.

IRS news

Final Section 965 regulations largely follow proposed regulations, but include significant changes

On 15 January 2019, final regulations under Code Section 965 (the Final Regulations) were made available on the IRS website. The Final Regulations are generally consistent with the proposed regulations published on 9 August 2018 (the Proposed Regulations), but make certain modifications. Notable changes include:

- Determining the aggregate foreign cash position of a consolidated group by treating the consolidated group as a single United States (US) shareholder
- Excluding certain commodities from the cash position of a specified foreign corporation (SFC)
- Requiring a US shareholder of an SFC at any point during the inclusion year to include in gross income its pro rata share of a SFC's Section 965 amount, even if the SFC ceases to be an SFC during the transition year
- Treating certain changes in method of accounting (i.e., those that would result in an increase in the Section 965(a) inclusion amount) as regarded for Section 965 purposes

- Clarifying the inclusion ordering rules, including for Section 1248 amounts and amounts paid between SFCs that are disregarded for Section 965 purposes
- Clarifying that Section 965(b) previously taxed earnings and profits (PTI) are treated as included under Section 951 for purposes of Section 1248(d)(1)
- Allowing a US shareholder to limit the basis adjustments required under the basis-shifting election to avoid gain recognition from the election
- Allowing US shareholders to elect to not disregard payments between SFCs occurring between earnings and profits (E&P) measurement dates
- Making foreign taxes associated with a hovering deficit available to the extent of current E&P of the SFC with the hovering deficit
- Taking only actual Section 956 inclusions into account in the "without" calculation when calculating the net tax liability for purposes of the Section 965(h) installment election

Most taxpayers will need to determine the effects of the revisions made from the Proposed Regulations to the Final Regulations on their Section 965 net tax liability. In some cases, these revisions will materially affect a taxpayer's Section 965 net tax liability. As with the Proposed Regulations, the rules provided in the Final Regulations are retroactive and apply to a foreign corporation's last tax year that begins before 1 January 2018 and to a US shareholder's tax year in which or with which the foreign corporation's year ends.

In the near term, taxpayers that have elected to pay in installments or defer payment of Section 965 net tax liability and have had acceleration or triggering events occurring on or before 31 December 2018, should have finalized and filed any requisite transfer agreement by 31 January 2019.

Also, US shareholders of SFCs with Section 965(b) previously taxed income (PTI) should consider whether to make or revoke, if already made, the basis adjustment election within 90 days following the date the Final Regulations are published in the Federal Register.

Further, fiscal-year taxpayers that have yet to file their 2017 tax return should consider whether it may be appropriate to file an unfavorable change in method of accounting for the 2017 tax year, given that the final rules no longer disregard such change for the purposes of determining the Section 965 elements. Taxpayers that already filed their 2017 tax return and decided to defer taxpayer-unfavorable changes in method of accounting to the 2018 tax year should consider the effects of the audit protection rules under Section 8.02(5) of Revenue Procedure 2015-13.

Capital markets

Argentine inflation results in US tax considerations for taxpayers and QBUs using the Argentine peso as their functional currency, and certain Argentine peso-denominated transactions

All of the three-year cumulative inflation rates commonly used to evaluate Argentina's inflation exceeded 100% as of 30 June 2018. Consequently, entities with operations in Argentina were expected to begin accounting for Argentina's economy as highly inflationary no later than reporting periods beginning after 30 June 2018 for US GAAP.

For US tax purposes, the determination of whether a currency is hyperinflationary is generally made on a calendar-year basis (e.g., as of 1 January 2019), based on changes in the consumer price index (CPI) as reported by the International Monetary Fund (IMF) for the 36 calendar months immediately preceding the first day of the calendar

IRS releases final Form 8990 and instructions

The IRS on 31 December 2018 posted the final version of Form 8990, "Limitation on Business Interest Expense Under Section 163(j)." Instructions to the form were posted on the IRS website on 3 January 2019. The government released proposed regulations (REG-106089-18) under Section 163(j) on 26 November 2018, which was modified in December 2017 by the *Tax Cuts and Jobs Act*.

year. In certain circumstances, the US GAAP determination regarding hyperinflation may be used in determining whether a currency is hyperinflationary for US federal income tax purposes.

All US taxpayers with subsidiary, partnership, or branch operations in a hyperinflationary environment generally must: 1) use the US dollar as the functional currency for these operations; and 2) account for these operations using the US dollar approximate separate transaction method of accounting (DASTM) as described in Reg. Section 1.985-3.

These requirements are designed to reduce the distortions that can result from operating in a hyperinflationary environment. US taxpayers and their qualified business units must make certain adjustments upon adopting the US dollar and DASTM. These adjustments could affect the recognition of gain or loss under Section 987 and/or Section 988, subpart F income, global intangible low-taxed income (GILTI), earnings and profits (E&P), and foreign tax credits.

In addition, taxpayers with nonfunctional currency transactions denominated in the Argentine peso will need to consider special hyperinflationary currency rules and exceptions contained in the US federal income tax regulations.

The IMF has not reported CPI data for Argentina for the 36 month-period that ended on 31 December 2018, to determine whether the Argentine peso should be considered hyperinflationary for US tax purposes for tax years beginning on or after 1 January 2019.

Given the fact that the Argentine peso is considered highly inflationary for US GAAP and hyperinflationary for IFRS purposes as of July 2018, and assuming the economic environment remains constant or inflation increases through the end of 2018, taxpayers and other qualified business units that have been using the Argentine peso as their functional currency for US federal income tax purposes likely will be required to make complex transition adjustments and begin accounting for their Argentine operations in US dollars under DASTM for tax years beginning on or after 1 January 2019.

The transition to DASTM likely will require a recalculation of the 1 January 2019 E&P balance for Argentine-peso CFCs, as well as potential recognition of Section 988 gains and losses related to US dollar-denominated Section 988 transactions, which include: US dollar-denominated cash, accounts payable, accounts receivable, notes payable, notes receivable, and derivatives. This may affect the amount of subpart F income (which includes the Section 965 inclusion) includible from such CFCs, as well as deemed paid credits.

Further, Argentine-peso QBU branches and partnerships likely will be required to adopt DASTM on 1 January 2019, and the result likely will generate Section 987 losses upon the adoption of the US dollar as functional currency. Further, DASTM likely will need to be applied to Argentine-peso QBUs for the 2019 tax year and future years until the Argentine peso is considered non-hyperinflationary for three consecutive years.

Puerto Rico announces qualified retirement plan limits for 2019; affects plan sponsors and record-keepers

In Circular Letter 18-21, Puerto Rico's Treasury Department (PRTD) announced the benefits and contribution limits for qualified retirement plans under Section 1081.01(a) of the Puerto Rico Internal Revenue Code of 2011, as amended (the PR Code), for tax years beginning on or after 1 January 2019. Section 1081.01(h) of the PR Code requires the PRTD to report the applicable limits that are announced by the United States IRS and will apply to plans qualified under the PR Code.

The dollar limitations for qualified retirement and certain non-qualified plans that became effective 1 January 2019, were released by the IRS in Notice 2018-83.

Plan sponsors and/or record-keepers of dual qualified plans and Puerto Rico-only qualified plans need to be aware of these limits to timely reflect the appropriate limitations in their systems for tax years beginning on or after 1 January 2019, and to properly assess and comply with applicable withholding and reporting obligations resulting from distributions from those plans.

OECD news

OECD releases policy note addressing tax challenges of digitalization

The OECD on 29 January 2019 released a press release and Policy Note in relation to its work on *Addressing the Tax Challenges of the Digitalisation of the Economy*. The policy note confirms that a two-pillar approach will be pursued in developing comprehensive changes to international tax policy.

The policy note states that there is now agreement among the 127-jurisdiction strong Inclusive Framework on BEPS to examine proposals involving two pillars which could form the basis for consensus. The first pillar addresses the broader challenges of the digitalized economy and focuses on the allocation of taxing rights among countries, including nexus issues. The second pillar would address remaining BEPS issues. The OECD believes that a two-pillar approach would be effective in recognizing that the digitalization of the economy is pervasive, raises broader issues, and is most evident in, but not limited to, highly digitalized businesses.

In terms of a timeline, a more detailed but still high-level consultation document is expected to be released in February, prior to a public consultation 13-14 March in Paris as part of the meeting of the Task Force on the Digital Economy, which will be co-chaired by US Treasury Deputy International Tax Counsel Brian Jenn. An update is expected to be presented to the G20 during the 8-9 June 2019 finance ministers meeting in Japan. The OECD is aiming for "reaching a consensus-based, long-term solution in 2020."

OECD issues 2018 progress report on preferential regimes

The OECD on 29 January 2019 released *Harmful Tax Practices – 2018 Progress Report on Preferential Regimes* (the 2018 Progress Report), approved by the Inclusive Framework on BEPS which held a meeting during the prior week. The purpose of this document is to provide an update to the 2017 Progress Report and to report the results of the review of all Inclusive Framework members' preferential tax regimes that have been identified.

OECD BIAC issues tax principles for digital economy

The Business and Industry Advisory Committee to the OECD (BIAC) on 21 January 2019 released 11 principles to guide tax reform for the digital economy. According to the BIAC, the recommendations are to ensure that "reforms to existing tax principles are coherent, pro-growth, and do not inhibit the innovation and digitalization that is transforming our world." The BIAC underscored that the OECD BEPS project itself recognized that it would be "difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes," which is one of the BIAC's recommendations.

Among the positions taken, the BIAC says that any tax reform in the context of the digital economy should be based on "well-founded underlying principles of international taxation including taxation of net income, nexus, permanent establishment, and transfer pricing based on the arm's length standard." They add that any revised framework should apply to all digitalizing business and be flexible enough to address future business models. Among other things, the BIAC takes a strong stand against countries taking unilateral action, suggesting that the OECD is the only forum that can garner global support and point to the agreed-to international timeline of reaching consensus by 2020.

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