

Report on recent US international tax developments - 8 March 2019

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The United States (US) Treasury and the Internal Revenue Service (IRS) on 4 March 2019 released eagerly-anticipated proposed regulations ([REG-104464-18](#)) under Internal Revenue Code¹ Section 250 on determining the deduction allowable to a domestic corporation for foreign-derived intangible income (FDII) and global intangible low-taxed income (GILTI). Treasury previously proposed regulations for determining a domestic corporation's GILTI inclusion on 13 September 2018.

The proposed Section 250 regulations provide guidance for determining and substantiating whether a sale or license of property is for foreign use, with different rules provided for tangible property and intangible property. The proposed regulations also offer guidance for determining whether services are provided to a foreign person or with respect to property located outside the US, based on the type of service provided and the type of recipient of the service (e.g., consumers). Other areas covered by the proposed rules include:

- ▶ Value-based and price-based bright-line thresholds to determine whether the statutory "anti-round tripping" rules apply to deny FDII treatment to services provided to related foreign persons
- ▶ Coordination of the Section 250 deduction with domestic corporation deductions in the same tax year, particularly the Section 163(j) interest deduction and Section 172(a) net operating loss deduction

- ▶ Application of the Section 861 allocation and apportionment rules to determine the deductions properly taken into account in determining deduction-eligible income, foreign-derived deduction eligible income, and, by extension, FDII
- ▶ Rules that provide that a domestic corporate partner of a domestic or foreign partnership takes its distributive share of partnership items into account for purposes of computing the partner's FDII
- ▶ Guidance on the application of Section 250 to consolidated groups
- ▶ Threshold reporting requirements

Proposed Reg. Sections 1.250(a)-1 through 1.250(b)-6 apply to taxable years ending on or after the date the regulations are filed in the Federal Register. For taxable years beginning on or before that date, taxpayers may use "any reasonable documentation maintained in the ordinary course of the taxpayer's business" that establishes that a recipient is a foreign person, property is for a foreign use, or a recipient of a general service is located outside the US in lieu of the documentation required by the regulations, if the documentation meets certain reliability requirements.

In other tax reform regulatory developments, the IRS announced it will hold a public hearing on proposed regulations to implement Sections 245A(e) and 267A regarding hybrid dividends and certain hybrid transactions on 20 March 2019. The hybrid mismatch rules ([REG-104352-18](#)) were released on 20 December 2018.

The IRS will also hold a hearing on the proposed Section 59A base erosion and anti-abuse tax (BEAT) regulations ([REG-104259-18](#)) on 25 March 2019. Discussion topic outlines are due on 15 March. Treasury and the IRS issued the proposed regulations on 13 December 2018.

In late February, the IRS Advance Pricing and Mutual Agreement Program (APMA) released a Functional Cost Diagnostic (FCD) Model to be used in reviewing certain Advance Pricing Agreement (APA) requests. The stated purpose is to allow the IRS "to better understand the

controlled taxpayers' contributions to the proposed covered transactions, including the respective contributions each controlled taxpayer makes to the exercise of control over the economically significant risks surrounding the proposed covered transactions."

APMA has indicated that it intends to use the FCD Model in a manner consistent with the revised Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines for both inbound and outbound cases, stressing concepts such as important functions and control. It is not clear, however, how this relates to concepts and principles already embedded in the Section 482 regulations, such as respecting contractual arrangements (including allocation of risks) that have substance, and the appropriate return to risky financing of investments. APMA assures taxpayers that it will use the FCD Model in limited circumstances, only for diagnostic purposes, and its application does not imply that the residual profit split is necessarily the "most appropriate method" under the OECD Guidelines for the covered transactions.²

The IRS has updated the *Foreign Account Tax Compliance Act* (FATCA) frequently asked question (FAQ) [FAQ Q23](#), extending penalty relief for the 2018 calendar year under certain circumstances. It also published new [FAQ Q24](#), addressing the 2018 tax year withholding and reporting requirements for certain partnerships and trusts.

EY on 6 March 2019 submitted comments to the OECD in relation to the public consultation document *Addressing the Tax Challenges of the Digitalisation of the Economy*. Among EY's key comments to the OECD is the critical need for consensus on new rules that represent an agreed solution in this area. In addition, EY urges that any new rules not be considered as an alternative, or addition, to any other actions countries have taken. The OECD will now consider all submissions, with the Task Force on the Digital Economy (TFDE), a subsidiary body of the OECD, due to meet in Paris on 13-14 March.

Endnotes

1. All "Section" references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.
2. See EY Global Tax Alert, [US Advance Pricing and Mutual Agreement Program releases Functional Cost Diagnostic Model to be used in certain APAs](#), dated 6 March 2019.

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