

US IRS announcement allowing domestic partnerships and S corporations to file under proposed GILTI regulations has implications for tax year 2018 filings for private equity funds, alternative asset management funds and other private companies

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Executive summary

In [Notice 2019-46](#) (the Notice), published 22 August 2019, the United States (US) Internal Revenue Service (IRS) announced that it will issue regulations permitting certain domestic partnerships and S corporations to apply proposed, rather than final, regulations on determining inclusions of global intangible low-taxed income (GILTI), for tax years ending before 22 June 2019. The Notice also provides penalty relief for a domestic partnership or S corporation that acted consistently with Prop. Reg. Section 1.951A-5 on or before 21 June 2019, but filed tax returns consistent with the final regulations under Treas. Reg. Section 1.951A-1(e).

In addition to penalty relief, the forthcoming regulations would provide relief from possible compliance, administrative and logistical burdens resulting from revising and amending differences between the proposed and final GILTI regulations. They would also provide relief from certain technical issues regarding attributes of a domestic pass-through entity resulting from 2018 GILTI inclusions.

For domestic partnerships or S corporations to apply the relief provided under the Notice, certain notification and reporting requirements must be satisfied. Domestic partnerships and S corporations may rely on the Notice until the forthcoming regulations are issued.

This Alert provides an overview of the notification and reporting requirements set forth in the Notice. For a detailed discussion of the final GILTI regulations, see EY Global Tax Alert, [US final and proposed GILTI and subpart F regulations include favorable and unfavorable provisions for taxpayers](#), dated 21 June 2019.

Detailed discussion

Background

Internal Revenue Code¹ Section 951A, which was enacted as part of the law commonly known as *The Tax Cuts and Jobs Act* (TCJA), introduced the GILTI regime. Section 14201(a) of Pub. L. 115-97 (131 Stat. 2054, 2208). According to Section 951A(a), a US shareholder that owns stock in any controlled foreign corporation (CFC) (as defined in Section 957) for the tax year includes its GILTI inclusion for that year in gross income. Moreover, Section 951(b) defines a US shareholder of a foreign corporation as a United States person that owns, within the meaning of Section 958(a), or is considered as owning by applying the ownership rules of Section 958(b), at least 10% of the total combined voting power or value of stock of the foreign corporation. Finally, Section 1373(a) treats an S corporation as a partnership for purposes of Section 951A.

On 10 October 2018, the IRS published proposed regulations under Section 951A (REG-104390-18, 83 FR 51072) (the Proposed Regulations), which provided a hybrid approach to the treatment of a domestic pass-through entity that is a US shareholder of a CFC (a US shareholder pass-through). Under the approach in the Proposed Regulations, a US shareholder pass-through would determine its GILTI inclusion amount, and its owners would include their distributive share of that amount in income. This meant that owners that indirectly held an interest of less than 10% in a CFC would have a GILTI inclusion. Owners that indirectly held an interest of 10% or more would not include their distributive share of the GILTI inclusion in income; instead, those owners would be effectively treated as directly owning a proportionate share of the CFC's stock within the meaning of Section 958(a).

On 21 June 2019, the IRS published final regulations under Section 951A (T.D. 9866, 84 FR 29288) (the Final Regulations), which did not adopt the hybrid approach contained in the Proposed Regulations. Under Sections 1.951A-1(e)(1) and 1.951A-5 of the Final

Regulations, a US shareholder pass-through does not have a GILTI inclusion amount. As such, no owners of the US shareholder pass-through, including owners that indirectly own less than 10% of the CFC, would have to include their distributive share of the GILTI inclusion in income. Alternatively, for purposes of determining the GILTI inclusion of any owner of a US shareholder pass-through, each owner is treated as proportionately owning the CFC's stock within the meaning of Section 958(a).

Notice 2019-64 provides relief to domestic partnerships and S corporations

To avoid potential penalties under Sections 6698, 6699, or 6722, domestic partnerships and S corporations generally must file a return for the 2018 tax year that is consistent with the Final Regulations and furnish Schedules K-1 accordingly. For domestic partnerships or S corporations that may have applied the rules in the Proposed Regulations under Section 1.951A-5 for tax years ending before 22 June 2019, this means issuing corrected Schedule K-1s in accordance with the Final Regulations. Recognizing the burden this imposes, the Notice permits domestic partnerships or S corporations that applied the rules in the Proposed Regulations for tax years ending before 22 June 2019, to file 2018 tax returns and Schedule K-1s under the Proposed Regulations or under the Final Regulations without being subject to penalties. Additionally, the Notice outlines distribution reporting requirements and the effects of distributing the "proposed regulation GILTI inclusion" when calculating a partner's or shareholder's income.

Partnerships that are eligible for and elect relief provided in Revenue Procedure 2019-32 may also apply the Notice's rules.² If a partnership elects relief under Revenue Procedure 2019-32, the Schedule K-1 must be consistent with the Final Regulations and must be furnished if the partnership filed Form 1065 consistent with the Final Regulations.

Requirements for the application of Prop. Reg. Section 1.951A-5 and inapplicability of penalties

A partnership or S corporation may rely on the Notice to apply Prop. Reg. Section 1.951A-5 and seek relief from penalties, so long as:

1. The partnership or S corporation provides notice to each partner or shareholder of the partnership or S corporation confirming:

- i. The Schedule K-1 provided to the partner or shareholder is consistent with Prop. Reg. Section 1.951A-5
 - ii. The domestic partnership or S corporation filed a Form 1065 or Form 1120S consistent with Prop. Reg. Section 1.951A-5 or the Final Regulations
 - iii. The notification is being provided in accordance with the notice (the Notice Requirement)
2. The partnership or S corporation separately states the partner's or shareholder's distributive share of the GILTI inclusion in Prop. Reg. Section 1.951A-5 when it is distributed (the Distribution Requirement)

Notification provided to partners and S corporation shareholders under the Notice Requirement must be provided no later than the extended due date of the partnership's or S corporation's tax return (generally, 16 September 2019 for calendar-year 2018 taxpayers). The domestic partnership or S corporation must also attach the notification statement to its tax return.

The notification statement must be provided by reasonable methods such as mail, email, or posting on a website through which the domestic partnership or S corporation would ordinarily provide tax information to its partners or shareholders. If a domestic partnership or S corporation has filed its tax return and has not filed for an extension of time to file its return, it must provide the notification statement by the extended due date, as if the extension had been properly requested. If the tax return was not filed as of the Notice's publication date, the domestic partnership or S corporation should attach Form 8992, reflecting the GILTI inclusion computation under Prop. Reg. Section 1.951A-5, to the return.

Under the Distribution Requirement, a domestic partnership or S corporation that furnished a Schedule K-1 based on Prop. Reg. Section 1.951A-5 must, upon distribution from a CFC, indicate on subsequent Schedule K-1s the portion of the CFC distribution that relates to the owner's prior GILTI inclusion under Prop. Reg. Section 1.951A-5.

Effective date

The Notice indicates that the forthcoming regulations may apply to tax years ending before 22 June 2019. Before the issuance of such regulations, a domestic partnership or S corporation may rely on the rules in the Notice.

Implications

The Notice provides welcome relief for domestic partnerships and S corporations, including private companies, private equity and alternative asset management funds, and fund of funds, that acted consistently with Prop. Reg. Section 1.951A-5 on or before 21 June 2019 but file their tax returns in accordance with the Final Regulations under Treas. Reg. Section 1.951A-1(e). This penalty relief would apply, provided the Notice's Notification and Distribution requirements are met.

Although it is still recommended that domestic pass-throughs revise and re-issue their Schedule K-1s to remove GILTI inclusions in accordance with the Final Regulations, that was not practicable in many cases. Many filings were prepared before the issuance of the Final Regulations; revising and re-issuing Schedule K-1s to remove relatively minor GILTI inclusions would have presented an administrative and logistical burden.

If these pass-throughs decide to avail themselves of the relief provided by the Notice and prepare filings in accordance with the Proposed Regulations, they must comply with the Notification and Distribution Requirements previously outlined. With the 16 September tax filing deadline for calendar-year pass-throughs fast approaching, time is short to prepare and distribute the notification statement to owners. Pass-throughs that have already filed their tax returns may also want to consider filing a superseded tax return with the notification statement to avail themselves of the Notice's penalty protection.

Additional filing considerations

It is unclear whether domestic pass-throughs that have applied the Final Regulations must file Form 8992. Under the exception included in the Final Regulations, partnerships and S corporations are generally not required to file. This exception, however, only applies for tax years of CFCs beginning on or after 3 October 2018. Although domestic pass-throughs do not, under the Final Regulations, have a GILTI inclusion amount, they should consider whether it is appropriate to file Form 8992 with their 2018 income tax returns.

Endnotes

1. All "Section" references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.
2. Revenue Procedure 2019-32 provides eligible partnerships an extension of time to file a superseding Form 1065 and corresponding Schedule K-1 to each of its partners if the partnership has not elected an extension under Section 6221(b).

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