Current Developments Panel

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Overview

- Administrative Guidance Issues
- Cases
- Selected Technical and Compliance Issues
- Q & A

Administrative Guidance Issues

Regulations relief

Regulations Relief

- On January 30, 2017, President Trump signed *Executive Order ("EO") 13771* on Reducing Regulation and Controlling Regulatory Costs.
  - Generally requires agencies to identify to withdraw two existing regulations for every new regulation proposed.
  - Rulemaking process required for withdrawing existing regulations.

- On April 21, 2017, President Trump signed *Executive Order 13789* on Identifying and Reducing Tax Regulatory Burdens requiring Treasury to review regulations issued on or after January 1, 2016.
  - EO requires Treasury to identify regulations that (1) impose undue financial burden; (2) add undue complexity, and (3) exceed statutory authority of the IRS.
    - - On July 7, 2017, Treasury issued interim report (*Notice 2017-38*) identifying eight regulations that should be withdrawn, modified, or revoked.
    - On October 4, 2017, Treasury released second report recommending specific actions with respect to the eight identified regulations.

Regulations identified for burden reduction (Notice 2017-38 & Treasury 'Second Report')

Regulation	Recommendation
Treatment of certain interests in corporations as stock or indebtedness (Section 385)	Consider revoking and revising documentation regulations (with a prospective effective date)
Income and currency gain or loss with respect to a Qualified Business Unit (Section 987)	Consider substantially revising
Treatment of certain transfers of property to foreign corporations (Section 367)	Consider substantially revising
Treatment of partnership liabilities (Sections 707 and 752)	Consider revoking in part
Certain transfers of property to Regulated Investment Companies (RICs) and Real Estate Investment Trusts (REITs) (Section 337(d))	Consider substantially revising
Restrictions on liquidation of an interest for estate, gift, and generation-skipping transfer taxes (Section 2704)	Withdraw
Definition of a political subdivision (Section 103)	Withdraw
Participation of a person described in Section 6103(n) in a summons interview (Section 7602)	Consider revoking in part

Regulations Relief – Sections 367, 385, and 987

Section 367

- Treasury plans to propose relief for outbound transfers of foreign goodwill and going concern value attributable to a foreign branch under non-abusive circumstances.

Section 385

- Treasury plans to (i) propose revoking the documentation regulations and replacing them with streamlined rules, (ii) retain the distribution regulations pending tax reform, and (iii) re-assess the distribution regulations if tax reform does not eliminate the need for these regulations.

Section 987

- Treasury plans to (i) immediately issue guidance permitting deferred application to until at least 2019, (ii) propose election of a simplified section 987 method subject to limitations on timing of loss recognition, and (iii) propose alternative transition rules.

Are tax regulations special?

Tax Exceptionalism

- *Mayo Foundation for Medical Education and Research v. United States*, 562 U.S. 44 (2011): the Supreme Court rejected tax exceptionalism and held that the provisions of the APA apply to administrative actions by the IRS.
  - Section 706(2)(C) of the APA provides that a reviewing court shall hold unlawful and set aside any agency action found to be "in excess of statutory jurisdiction, authority, or limitations, or short of statutory right."

- *Chevron USA Inc. v. Natural Resources Defense Counsel Inc.*, 467 U.S. 837 (1984): when confronted with a validity challenge to a regulation, a court shall ask:

  (i) "[W]hether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter," and

  (ii) If a court determines that the statute is silent or ambiguous on the relevant issue, the court should then ask "whether the agency's answer is based on a permissible construction of the statute."

Tax Exceptionalism – State Farm Considerations

- *Motor Vehicle Mfrs. Ass'n of United States, Inc. v. State Farm Mut. Auto Ins. Co*., 463 U.S. 29 (1983): the Supreme Court held that an **agency's action may be found to be arbitrary and capricious if not based on reasoned decision-making**.
- *Reasoned decision-making*: requires that the process by which an agency reached its result is logical, rational and takes into account all relevant factors.
  - To engage in "reasoned decision making," the agency "must examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made'".
  - "The failure to respond to comments is significant only insofar as it demonstrates that the agency's decision was not based on a consideration of the relevant factors."
- Are the *Chamber of Commerce* and *Altera* (discussed below) recent examples of courts rejecting tax exceptionalism? Do they indicate evolving jurisprudence with respect to tax regulations?
- Are all regulations vulnerable?
  - If so, will taxpayers rely on specific guidance (PLR, Rev. Rul., etc.) and will courts defer to those pronouncements?

Recent court decisions addressing the procedures for the issuance of regulations

Altera Corporation v. Commissioner, 145 T.C. No. 3 (2015)

- Tax Court held that section 482 regulations requiring related parties in a qualified cost sharing arrangement ("CSA") to share stock-based compensation ("SBC") are invalid.
- Applying *State Farm,* unanimously held that the regulations failed to satisfy the reasoned decision making standard and therefore were invalid.
  - The final regulation "lacks a basis in fact."
  - Treasury did not respond to significant comments received, nor did it produce any convincing evidence that parties dealing at arm's length *would* share SBCs.
- The IRS appealed to the Ninth Circuit Court of Appeals on February 23, 2016. The Ninth Circuit argument was held on October 11, 2017.

Takeaways

- *Altera* is not just a transfer pricing case – it is about how far the government can go with interpretive regulations having implications beyond US law.
- When interpreting the arm's length standard, the IRS may not define it by fiat – it needs reasonable evidence of arm's length behavior.

Chamber of Commerce of the U.S. v. IRS, No. 1:16-cv-00944 (W.D. Tex. 29 September 2017)

- Treas. Reg. § 1.7874-8T, issued on April 4, 2016 and immediately effective, changed the computation for determining whether a transaction will be treated as an inversion (the 'serial inverter rule').
- U.S. Chamber of Commerce ("Chamber") and the Texas Association of Business ("TAB") challenged Treas. Reg. § 1.7874-8T as violating the Administrative Procedures Act ("APA") on the grounds that Treasury and the IRS (i) exceeded their statutory authority, (ii) engaged in arbitrary and capricious rulemaking, and (iii) failed to comply with the required notice-and-comment procedure.
- The District Court of the Western District of Texas rejected Chamber's arguments (i) and (ii) but held that the temporary regulation was invalid for failing to comply with the APA's notice-and-comment requirements.

Takeaways

- Potentially implicating other regulations issued simultaneously as proposed regulations and temporary regulations.
- Courts are more willing to scrutinize Treasury regulations' compliance with the APA.
- Considering the number of regulations that may be implicated, it is expected that the government will appeal.

Government response

- Preamble changes already seem to occurred in response to *Altera*
- Changes in the use of Prop./Temp. Regulations?
- Could the *Chamber of Commerce* case be read to apply to Notices or Proposed Regulations with immediate effective dates
- Will a more stringent application of the APA to tax regulations result in fewer regulations?
- New office in IRS CC or an expanded role for ACC (Procedure & Administration)?
  - Budget issues
  - What else would need to be done to make regulations meet standards for legislative regulations?
  - What do people think of potential changes?

Cases

In Sale of Partnership Interest by Foreign Corp Tax Court Rejects IRS Aggregate Approach

- In *Grecian Magnesite Mining v. Comm'r*, 149 T.C. No. 3 (July, 2017), the Tax Court held that foreign corp's sale of its interest in an LLC generally resulted in capital gain from the sale of the interest and was not a sale of its pro rata share of the underlying partnership assets.
- Result: No U.S. tax on foreign seller (except U.S. real property gain). Not U.S. source income and not type of foreign source income treated as ECI.
- In purely domestic context, T.C. reads language of §§736(b)(1), 731, 741 to support treatment of gain as capital gain from disposition of single asset [with exceptions under §751 for gain attributable to partnership's hot assets and under §865(g) FIRPTA gain].

Grecian Magnesite Mining

- Regarding capital gain on sale of partnership interest by foreign corp, question is whether it is "effectively connected with the conduct of a trade or business in U.S." [Pshp's U.S. business attributed to foreign member under §875(l).]
- T.C. rejects Rev. Rul. 91-32 (characterize gain on sale of pshp interest on asset by asset basis)
  - Found Rev. Rul. lacked "power to persuade"
    - Analysis of partnership provisions was "cursory in the extreme"
    - As result, takes middle approach and will not defer to ruling

Grecian Magnesite Mining

- Gain on sale of partnership interest by foreign corp (nonresident) is typically treated as foreign source income under §865(a).
- IRS argues that such gain is re-characterized as U.S. source under §865(e)(2) and automatically "effectively connected income" under §864(c)(3).
- Re-characterization depends on whether the partnership's U.S. office was a material factor in the production of the income and whether the gain was realized in the ordinary course of the partnership's business.

Grecian Magnesite Mining

- T.C. rejected IRS argument that Pshp's office was material factor (office was material to GMM's in production of GMM's gain on deemed sale of Pshp assets and material to increased value that GMM realized on sale) in derivation of the gain.
  - Would require resort to aggregate approach which court rejects
  - In order to be material factor, office must be material to the sale (redemption) rather than in the ongoing regular business operations
  - While value of Pshp's underlying assets increased value of GMM's interest, T.C. finds that gain on sale was not realized from activities of mining at pshp level, but from the distinct sale of pshp interest.
  - Found principles of §864(c)(5) (material factor test on sale of intangibles) instructive, though not on point.
- T.C. rejected IRS argument that GMM's gain was realized in ordinary course of Pshp's business. Partnership not engaged in buying or selling interests in itself and did not do so in ordinary course of its business

Untimely Refund Claim for Overpayment Based on Deduction for Foreign Taxes

- *In Trusted Media Brands v. U.S.*, 120 A.F.T.R.2d (S.D.N.Y., Sept 2017), the District Court dismissed the taxpayer's complaint on the ground that the statute of limitation had expired for claiming a refund for an overpayment created by deduction of carried back foreign taxes.
- Taxpayer carried back a 2002 NOL to 1997. In 2011, TP amended 2002 return to change its election of foreign tax credit to deduction.
- Change increased 2002 NOL which TP carried back to 1997. 1997 return amended to reflect decreased TI. FTC limitation for 1997 decreased as result of carryback and resulted in excess foreign taxes.
- Carryback of 1997 excess foreign taxes to 1995 created alleged overpayment.

Trusted Media Brands

- Was 2011 amended return for 2002 taxable year seeking refund resulting from carryback to 1995 timely filed?
- Not timely filed because 10 year statute of limitations under §6511(d)(3) applies only when TP claims FTC and not deduction.
- Court rejects TP argument that 10-yr s/l applies for claims relating to foreign taxes which are eligible for FTC even if credit not claimed.
- Court holds 10-yr s/l applies only to claims based on FTC allowed, not deductions of foreign taxes for which is allowable.
  - Relied on CCA 201330031 which, though not binding, is based on sound analysis.
  - NOL carryback refund claim must be filed within 3 years after due date for NOL year's return.

Trusted Media Brands

- Court found that even if it were to conclude that 10-yr s/l applied to foreign tax credits and deductions, purported overpayment is not attributable to 2002 refund.
- Court applies narrower reading of term “attributable” and finds that refund sought for 1995 is attributable to carryback of excess foreign taxes from 1997 and not from 2002 change in election.

No Deduction for UK Taxes Paid in STARS Transaction

- In *Wells Fargo & Co. v. U.S.*, 120 A.F.T.R.2d (D. Minn. Sept 15, 2017), the District Court held TP may not deduct UK taxes for which FTC was previously denied (STARS [Structured Trust Advantaged Repackaged Securities] transaction).
- Jury previously determined that STARS transaction consisted of i) a trust and ii) a loan
- Trust portion was determined a sham and no credit allowed for UK taxes paid.
- Court denied untimely argument that taxes were nonetheless deductible because i) WFC waived it by failing to raise it when court asked for final issues to be resolved and ii) even if no waiver, not entitled to deduct taxes

STARS Taxes Not Deductible

- Although TP may claim tax benefits on basis of separate economically substantive elements of sham transaction [e.g., deduction on interest payments on STARS loan], foreign tax payments not separable from sham trust.
- Point of sham transaction doctrine is to disallow a deduction to which TP would otherwise be entitled [§164].
- Carve-outs of deductions in IRC for foreign taxes not eligible for credit don't establish general proposition that deduction should be allowed if credit denied for any reason.
- 2008 TAM not clear on issue & not authoritative/persuasive.

Interest on STARS Loan Transaction Deductible

- Earlier decision in wrap-up of WFC STARS transaction, *WFC v. U.S.*, 119 A.F.T.R. 2d (D. Minn., May 24, 2017), held interest on loan portion deductible [and imposed negligence penalty on underpayment related to disallowance of claimed FTC].
- Court predicts 8th Circuit's approach to two-factor sham transaction test [does transaction have objective economic substance and one subjective non-tax business purpose?] will be flexible two-factor test and not an all or nothing inquiry [i.e., absence of non-tax purpose is not fatal if transaction has real and substantial economic substance].

Interest on STARS Loan Deductible

- WFC loan was not a sham [jury found real substantial, non-tax-related economic effects] and WFC entitled to deduct interest.
- Not changed by fact that WFC would not have entered into loan but for chance to gain unrelated tax benefits.
- Although purpose in entering loan was not to borrow money, but to disguise sham nature of STARS, not economically integral to trust structure and no role in generating abusive FTC.

Appeal Filed in Outbound Intangibles Transfer Pricing Case

- Notice of Appeal was filed Sept. 29 in *Amazon.Com Inc. v. Comm'r*, 148 T.C. No. 8 (March 23, 2017), joining *Altera* and *Medtronic* cases under appeal.
- Amazon and Luxembourg sub, AEHT, entered into cost sharing arrangement regarding transfer of 3 groups of value intangibles to AEHT (software to operate European websites, marketing intangibles, and customer lists).
- Two issues: i) appropriate buy-in payment to Amazon and ii) what amount of Amazon's intangible development costs (IDCs) are properly considered in determining sub's on-going cost sharing payments.

Amazon Decision Appealed

- IRS used discounted cash-flow (DCF) method to increase buy-in payment under cost sharing arrangement. Court found this in error because expert did not restrict valuation to pre-existing intangibles and included value of subsequently developed intangibles.
- Gov't expert used "aggregation" approach, treating transfer as 'akin to a sale,' and took into account workplace in force, goodwill, or going concern value. Wrong because aggregates pre-existing intangibles with subsequently developed intangibles and takes into account residual business assets that are not pre-existing intangibles under Regs in effect.
- Gov't not saved by realistic alternatives principle in Regs. Court rejects IRS argument that Parent would not have given competitor access to this valuable technology and should use an 'akin to a sale' methodology (don't value specific intangible assets transferred, but deem pre-existing intangibles to have value equal to Sub's enterprise value – e.g., present value of future cash flows from Sub's business). Court found no contention that transaction as structured by Parent lacked economic substance.
- Court found that Govt's DCF methodology was similar to that rejected by the Court in *Veritas Software Corp v. Comm'r* (2009) and is arbitrary and capricious.

Amazon Decision Appealed

- Court found that comparable uncontrolled transaction (CUT) is the best method, but found Parent's valuation not "arm's length."
- Modified valuation by Parent's expert adequately accounted for valuation of marketing intangibles and website technology, leading Court to find appropriate buy-in payment.
- Regarding cost sharing agreement, Parent's revenue-based formula for allocating IDCs in accordance with each participant's share of anticipated benefits was not challenged; only question was cost pool; the larger the volume of IDCs incurred by Parent, the large the cost sharing payment by Sub.

Amazon Decision Appealed

- Court rejected IRS treatment of 100% of technology and content costs to IDCs [increasing the payment], finding Parent's allocation of these costs between IDCs and other activities [with modifications by expert] was on a reasonable basis.
- Stock-based compensation included in IDCs, as required by Regs. §1.482-7(d)(2)(i), but included clawback if Regs ultimately invalidated. Until *Altera* is finally decided, stock-based compensation correctly included in cost pool.

Amazon Decision Appealed – Final Questions

- Was Regs safe-harbor for qualified cost sharing arrangements “a good deed that was punished?”
- With 2011 change in cost sharing Regs, does *Amazon* have continued viability?

Selected Technical and Compliance Issues

Country By Country Reporting Developments

Where to File?

- As of November 3, 2017, 57 countries have implemented BEPS Action 13: CbyC reporting
- Effective dates are either 2016 or 2017 depending on the jurisdiction
- United States is effective for June 30, 2016 but permit voluntary filing (Rev. Proc. 2017-23) with exchange to countries that have a bilateral competent authority agreement in place
  - https://www.irs.gov/businesses/country-by-country-reporting-jurisdiction-status-table
- If no agreement exists between the implementing country and the U.S., multiple other filings may be required depending on other non-U.S. competent authority agreements in place and secondary filing requirements
  - http://www.oecd.org/tax/beps/country-by-country-exchange-relationships.htm

Country By Country Reporting Developments

What to File?

- OECD Model Template

A. Model template for the Country-by-Country Report

Table 1. **Overview of allocation of income, taxes and business activities by tax jurisdiction**

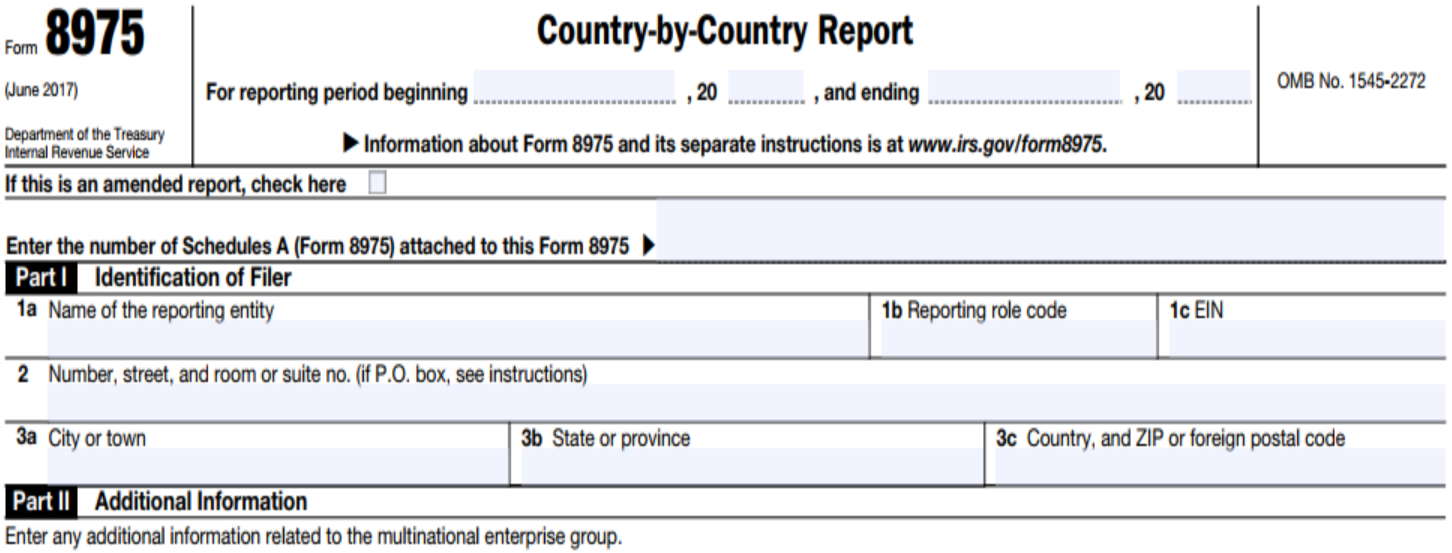
Name of the MNE group: Fiscal year concerned: Currency used:										
Tax Jurisdiction	Revenues			Profit (Loss) before Income Tax	Income Tax Paid (on Cash Basis)	Income Tax Accrued – Current Year	Stated Capital	Accumulated Earnings	Number of Employees	Tangible Assets other than Cash and Cash Equivalents
	Unrelated Party	Related Party	Total							

- OECD Guidance on template content is continually updated, latest update in September 2017

Country By Country Reporting Developments

What to File?

- U.S. implementation via new Form 8975 and Instructions Finalized



Form **8975** (June 2017)

Department of the Treasury
Internal Revenue Service

Country-by-Country Report

For reporting period beginning ..... , 20 ..... , and ending ..... , 20 .....

▶ Information about Form 8975 and its separate instructions is at *www.irs.gov/form8975.*

OMB No. 1545-2272

If this is an amended report, check here ☐

Enter the number of Schedules A (Form 8975) attached to this Form 8975 ▶

Part I Identification of Filer

1a Name of the reporting entity	1b Reporting role code	1c EIN
2 Number, street, and room or suite no. (if P.O. box, see instructions)		
3a City or town	3b State or province	3c Country, and ZIP or foreign postal code

Part II Additional Information

Enter any additional information related to the multinational enterprise group.

- Additional Filings? Which country's rules do you follow?

Country By Country Reporting Developments

When to File?

- U.S. filing permitted after September 1, 2017
- Most country deadlines for 2016 data require filing by December 31, 2017

Key Takeaway: Each jurisdiction's rules must be consulted to understand notification deadlines, filing deadlines, secondary filing requirements, applicable exchange agreements and report content requirements. Jurisdictional implementation still occurring and guidance is continually being issued….in other words, ***an extremely complex administrative environment for taxpayers!***

Puerto Rico Irma and Maria Guidance

- Individuals
  - Notice 2017-56 – Relief for status as a “bona fide resident” of Puerto Rico or the U.S. Virgin Islands because of the dislocation caused by Hurricane Irma and Hurricane Maria. Extends the usual 14-day absence period to 117 days (beginning September 6, 2017 and ending December 31, 2017) for the presence test for residency under the tax rules.
- Businesses
  - Notice 2017-55 – Relief from Section 956 for temporary storage of inventory in the US as a result of Hurricane Irma or Maria
  - Notice 2017—68- Relief from Section 956 for receivables related to the temporary storage of inventory in the US as a result of Hurricane Irma or Maria

Q & A