

# WASHINGTON TAX NEWS



Potomac Law Tax Newsletter—August 2016

Susan Rogers

Congress has adjourned for their **7-week summer recess** and will return in September for a short legislative session prior to adjourning for the November Presidential and Congressional elections. Although the House and Senate continue to work through the **individual appropriations bills**, most of the 12 spending bills have not gained approval in either chamber, and time will be very short when Congress returns. Thus, it is likely that Congress will need to pass a **Continuing Resolution** to fund the government after the start of FY 2017 on October 1<sup>st</sup>. There will be discussion about the length of the CR and whether it should extend into the next year so that the annual spending plan can be completed under a new President or completed before the end of the year with an omnibus spending package.

Public reports on **tax reform in the House and Senate** have been few, although work continues behind the scenes at the two tax-writing committees. Senate Finance Committee Chairman Hatch's corporate integration bill has not been released and is not expected until the fall. Discussion of tax policy currently has been focused on the **Presidential race** with information on the party platforms from the two political conventions and the tax plans released by Presidential nominees Donald Trump and Hillary Clinton.

***Congress is on recess, while campaigning for the Presidential race and Congressional elections takes center stage — with Congress returning in September to face the challenge of funding the federal government when the new fiscal year begins on October 1st.***

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## In This Issue

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### Treasury Regulations on Code section 385 targeting earnings stripping

The House and Senate tax-writing committees met in a closed door session on July 7th with Assistant Treasury Secretary Mark Mazur and Deputy Assistant Treasury Secretary Robert Stack with Joint Tax Committee staff participating. After the meeting, Republican leaders stated that they will continue to look for ways to either block the rule or “improve it,” while Democratic leaders have been less critical, but have raised concerns.

W&M Committee Ranking Democrat Levin sent a letter to Treasury Secretary Lew that warned of “unforeseen circumstances in which the regulations could adversely affect ordinary course business transactions between related parties in the absence of tax avoidance motives.” The letter noted that there are concerns related to various internal cash management practices such as cash pooling, and that the financial services, insurance and utility sectors may encounter unique compliance challenges due to industry-specific regulatory requirements. Several Republican Senate tax writers also wrote to Secretary Lew calling for an extension on consideration of the proposal. Finally, the bipartisan National Governors Association also weighed in with Treasury asking for the comment period to be extended.

The public comment period ended on July 7<sup>th</sup>. The IRS held a public hearing on the proposal on July 14<sup>th</sup>. Despite calls from the business community and Congress, Treasury does not appear to be willing to delay implementation of the rules and has suggested they will be final before the end of the year.

Deputy Assistant Secretary Stack, however, indicated at a business conference that Treasury is looking at four areas where the rules may be too broad, including cash pooling, foreign-to-foreign intragroup loans, the impact on banks and the impact on S corporations. Areas highlighted at the IRS hearing included cash pooling, the effective date and the rule’s retroactive effect, compliance costs and documentation requirements.

Among other groups, the DC Bar, New York Bar and American Bar Association have filed extensive comments with Treasury on the proposal with the DC Bar urging Treasury to reconsider issuing final regulations, while the New York and American Bars called for more targeted guidance.

### Congressional Activity—Miscellaneous

Congress approved legislation that **reauthorizes the Federal Aviation Administration (FAA)** through FY 2017. The authorization extends current FAA spending authority and related excise taxes at their current levels, renews existing FAA programs, and includes several new policy provisions.

Several **alternative energy tax incentives** under section 48 were not included in the FAA reauthorization bill despite the efforts of several Democrats in the House and Senate. SFC Ranking Member Wyden is hopeful that these issues can be dealt with prior to the end of the year, but Ways & Means Committee Chairman Brady has repeatedly voiced his opposition to an extenders package this year, commenting that these energy issues must move on their own or be included in comprehensive tax reform in 2017.

W&M Committee Chairman Brady has stated publicly that he is working with Tax Policy Subcommittee Chairman Boustany to potentially move **several “noncontroversial” tax bills** through the House when Congress returns in September including legislation on health care taxation issues and a bill intended to limit the IRS’s ability to seize property from certain taxpayers suspected of engaging in so-called “structuring” transactions.

The House has approved legislation that would relax some current-law restrictions on the use of **health savings accounts (HSAs)** and would offset the resulting revenue loss with a provision to recapture overpayments of health care tax credit subsidies under the Patient Protection and Affordable Care Act.

### Treasury/IRS

The IRS issued final **country-by-country (CbC) regulations** that will require parent corporations of multinational enterprises (MNEs) (with annual revenue of \$850,000 or more) to annually report information from each tax jurisdiction in which their constituent entities reside.

The IRS proposed new regulations that would make several changes to final regulations under Code section 409A, which covers the **tax treatment of compensation under nonqualified deferred compensation plans**.

The IRS issued proposed regulations that aim to clarify the application of the device prohibition and the active business requirement under **section 355 of the Code**. The IRS also issued Rev. Proc. 2016-40, which provides safe harbors for certain corporate distributions under **section 355**.

The IRS issued Rev. Proc. 2016-39 providing guidance on the **accounting for gains and losses in a money market fund (MMF)** by giving details on how to get the IRS’s automatic approval to change to or from the net asset value (NAV) accounting method in section 1.446-7 of the income tax regulations.



***The Republican and Democratic parties have now both held their political conventions to confirm their party nominees for President. At those conventions, the party platforms for the November elections were also approved, and both parties included a number of principles and policy goals related to tax issues.***

***The Republican platform includes an indictment of the current tax code and an endorsement of comprehensive tax reform, along with a number of specific tax policy changes, including opposition to a carbon tax, marriage tax penalties, and tax policies that deliberately divide Americans or promote class warfare. The platform supports education savings accounts, vouchers and tuition tax credits and removal of the current IRS Commissioner.***

***The Democratic platform on taxes is titled "Making the Wealthy Pay Their Fair Share of Taxes" and includes a number of revenue raisers directed at corporations, specific business sectors and wealthy individuals. The platform includes tax relief for middle class families, rewards for businesses that invest in America and revenue for infrastructure spending, while it would reduce tax breaks for companies that ship jobs overseas, target inversions and end deferral.***

## **The Trump Plan—"Tax Reform that will make America great again"**

### **Tax relief for middle class Americans**

No income tax paid for single taxpayers earning less than \$25,000 or married or filing jointly taxpayers earning less than \$50,000. These taxpayers will use a 1-page form to send the IRS saying, "I win." Other taxpayers will pay according to 3 tax brackets from 0-33 percent.

Repeal the marriage penalty, the Alternative Minimum Tax (AMT) and the estate tax ("death tax")

### **"Doesn't add to our debt and deficit"**

### **Simplification of the tax code**

Reduce or eliminate most deductions and loopholes available to the very rich

### **Grow the American economy by "discouraging corporate inversions, adding a huge number of jobs, and making America globally competitive again"**

No business of any size will pay at higher than a 15% rate on business income.

A one-time deemed repatriation of corporate cash held overseas at a rate of 10%, followed by an end to the deferral of taxes on corporate income earned abroad.

Reduction or elimination of corporate loopholes that cater to special interests as well as deductions made unnecessary by the new lower rate on business income.

Phase in a reasonable cap on the deductibility of business interest expenses.

## **The Clinton Tax Plan**

### **Restore basic fairness to the tax code**

Implement a "fair share surcharge" on multi-millionaires and billionaires

Support the "Buffet Rule" to ensure that the wealthiest taxpayers do not pay a lower tax rate than middle class taxpayers

Close loopholes for the wealthy

Ensure that multi-million-dollar estates pay "their fair share"

### **Close corporate and Wall Street loopholes and invest in America**

Target inversions and impose an "exit" tax on companies leaving the US on their untaxed foreign earnings

Close tax loopholes on Wall Street money managers

Reward businesses that invest in high wage jobs in the US

### **Simplify and cut taxes for small businesses so they can hire and grow**

Provide tax relief to working families with respect to child care, health care, education expenses, and costs related to caring for ill or elderly family.

Pay for ambitious investments in a fiscally responsible way by using proceeds from ensuring the wealthy "pay their fair share"

## International Issues

The OECD issued guidance on the implementation of **Country-by-Country (CbC) reporting** addressing the following: (1) transitional filing options for MNEs (“parent surrogate filing”); (2) the application of CbC reporting to investment funds; (3) the application of CbC reporting to partnerships; and (4) the impact of currency fluctuations on the agreed EUR 750 million filing threshold. The OECD plans to also provide country-specific information on CbC implementation, including “the effective dates of CbC legal frameworks, local filing and surrogate filing mechanisms, and identifying the agreements for exchange of CbC reports that are in effect.”

The first **meeting of the new inclusive framework to address BEPS project issues** including implementation was held in Kyoto on June 30-July 1, 2016, with a total of 82 countries and jurisdictions participating on equal footing in the project. After the meeting, Angola, the Seychelles and Jamaica joined to make it 85 countries, and it is likely that other countries attending the meeting will also join. During the meeting, 5 countries signed the multilateral competent authority agreement for the automatic exchange of CbC reports reaching a total of 44 signatories. This agreement allows all signatories to bilaterally and automatically exchange CbC reports.

The **Platform for Collaboration on Tax**, which is the joint cooperation of the IMF, OECD, UN and the World Bank, released a discussion draft on effective capacity building on tax matters in developing countries. The Platform organizations were seeking public comments with further material to be included in the July G20 Finance Ministers meeting report.

The OECD issued **discussion drafts under its BEPS project on profit splits** (Actions 8-10) and **attribution of profits to permanent establishment (PE)** (Action 7) with comments due on both by September 5, 2016. The first discussion draft provides updated guidance on profit splits in global value chains in an effort to align transfer pricing and value creation. The second discussion draft focuses on the proper attribution of profits to PEs and outlines two fact patterns described by the OECD as “a) dependent agent permanent establishments, including those created through commissionaire and similar arrangements; and b) warehouses as fixed place of business permanent establishments.” This draft is not a consensus document—it raises specific questions for comments from stakeholders.

The OECD also issued a **discussion draft on creation and operation of the group ratio rule** (Action 4) focusing on interest deductions and other financial payments with comments due by August 16<sup>th</sup>. The group ratio rule would “allow an entity in a highly leveraged group to deduct net interest expense in excess of the amount permitted under the fixed ratio rule, based on a relevant financial ratio of its worldwide group.” The draft cites the need for further work on approaches to: (1) calculate a group’s net third party interest expense; (2) define group-EBITDA; and (3) address the impact of losses on the operation of the rule.

The OECD released a standardized format (the “ETR XML Schema”) for **implementing the exchange of tax rulings** between Competent Authorities on topics that could give rise to BEPS concerns with respect to harmful tax practices (Action 5), along with a user guide that provides additional guidance on reporting.

### For additional information and advice on these issues, please contact:

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