WASHINGTON TAX NEWS

Potomac Law Tax Newsletter— July 2018 **Susan Rogers**

Senate Majority Leader McConnell (R-KY) **cancelled much of the August recess** leaving only the week of July 27th for Senators to return home to their districts. The stated intent is to focus on the need to clear a number of judicial and administrative appointments and complete several spending bills for FY 2019, but the Senate is also expected to work on the FAA reauthorization bill and the defense reauthorization bill with the House having approved their version prior to the July 4th recess.

The cancellation of the Senate recess means that Senators who are running for re-election will be prevented from campaigning in their home states for much of August. Senate Democrats are defending 26 seats, while only 9 Republicans are up for re-election. The House has not changed its recess schedule, so they are expected to be in their home districts the entire month of August.

Senate Majority Leader McConnell (R-KY) plans to have the Senate move quickly to consider the Kavanaugh nomination, resisting calls from Democrats to defer consideration of the nominee until after the fall elections as was done in 2016 when President Obama nominated Merrick Garland to the Court. Senate Republicans will be able to approve the nomination with a simple majority vote because the rules were changed in 2017 to disallow a filibuster in order to get Justice Gorsuch approved.

For more information on these issues, please contact Susan Rogers at srogers@potomaclaw.com or 202.492.3593.

The announcement by Supreme Court Justice Kennedy that he will retire from the Court as of July 31st and the nomination of Brett Kavanaugh to the Court will have a significant impact on the agenda for Congress this fall leading up to the mid-term elections.

Susan Rogers

In This Issue

***South Dakota v. Wayfair* – Online Sales Taxation**

On June 21, 2018, a divided US Supreme Court issued its opinion in *South Dakota v. Wayfair* (*Wayfair*), upholding a South Dakota law requiring **sales tax collection by retailers** with an economic presence in the state. The opinion overturns the long-standing rule in *Quill Corp. v. North Dakota* (*Quill*) and *National Bellas Hess, Inc. v. Dep't of Revenue of Ill.* (*National Bellas Hess*), which required an in-state physical presence before a state could impose such obligations. The case significantly alters the tax rules for retailers making sales in multiple jurisdictions.

One key question from the opinion is what the **new standard for nexus** will be since the physical presence rule is gone and the Court did not articulate a new rule. The Court stated that "[substantial] nexus is established when the taxpayer or collector avails itself of the substantial privilege of carrying on business in that jurisdiction." The Court expressed approval of the South Dakota law with its various thresholds but did not declare them to be the minimum contacts needed to establish presence.

Attention on this issue now turns to the states and to Congress with the possibility of a variety of state tax policies and new compliance challenges for not only online businesses but any business that sells across state lines. Lawmakers from both parties commented after the decision that there is interest in advancing legislation now in part due to the fact that the four dissenting justices said that Congress is better suited to handle the issue. From a practical standpoint, legislation may be needed to assist retailers in determining how to deal with the tax laws in a number of states. A bill called the Marketplace Fairness Act was approved in the Senate in 2013 but never progressed in the House, and with the current political environment, it will be hard to get any legislation through both chambers.

Senator Ron Wyden, who is the Ranking Democrat on the SFC representing Oregon, which does not have a state sales tax, **indicated interest in Congress acting on this issue** by commenting that he will "do everything I can as the top Democrat on the Finance Committee to protect Oregonians – and small business everywhere – from being harmed by this catastrophic decision." **Trade groups were split in their positions on whether legislation is needed** with the National Retail Federation calling for Congress to act to establish a federal standard of compliance, while the Retail Industry Leaders Association and the National Conference of State Legislatures feel the court decision is enough.

In a **dissenting opinion, Chief Justice Roberts** noted that there are over 10,000 jurisdictions that levy sales taxes, each with different tax rates, different rules governing tax-exempt goods and services, different product category definitions, and different standards for determining whether an out-of-state seller has a "substantial presence" in the jurisdiction. The South Dakota law which was the focus of the *Wayfair* decision has specific requirements and procedures which highlight some of the areas Congress will have to address if it moves forward on setting up a national framework to guide what states do. In the past several years, however, Congress has had great difficulty reaching consensus on this issue so action may depend on how aggressively states move to implement tax collection procedures and the impact on small business from the new requirements. One of the trade groups encouraging Congress to act is the National Association for the Self-Employed who want Congress to enact compliance guidelines to help small businesses with what is likely to be a complex, confusing, and costly process.

In addition, **state legislatures across the country must now decide how to proceed** in light of the decision. New Jersey lawmakers have already approved a bill that would levy a 6.625 percent tax on "any out-of-state companies which sell more than $100,000 goods to the state or conduct more than 200 transactions with anyone in the state." In both Wisconsin and Nebraska, the plan is to take advantage of the court's ruling but to offset the tax increases by tax relief of some sort. Several states had already passed legislation with provisions that predicated the laws on a ruling that overturned *Quill.*

Congressional Activity

The House Budget Committee approved a **budget resolution for FY2019** that calls for a permanent extension of the temporary tax relief provisions in the TCJA, while separately setting up a fast-track budget reconciliation process to move major spending cuts. Even if this bill advances in the House, it is unlikely to advance in the Senate and is seen more as an exercise to signal GOP priorities.

The Senate Finance Committee held a hearing on June 28th on the **nomination of Charles Rettig to be Commissioner of the IRS**. In response to a question about the new passthrough deduction, Rettig said, "It would be critical for the IRS to provide clear, timely, succinct guidance as to what the positions are and what the intent of Congress was with respect to each of the provisions."

Tax Court

The Tax Court ruled in *Caselli v. Commissioner* that an **S corporation shareholder may not unilaterally revoke an S corporation's tax election** because it would also affect other shareholders' tax liabilities.

TAX REFORM UPDATE — Second Tax Bill in the Fall?

W&M Committee Chairman Brady has said that new tax legislation will likely not be marked up in the W&M Committee until after the August recess. Committee Republicans and White House personnel are developing a plan, which he plans to discuss with the House GOP conference the week of July 9th and release to the public before the August recess. He has suggested that it is likely to be a package of bills dealing with several subjects with one bill to include permanent extensions of the tax relief provisions for individuals enacted in the TCJA, which are generally set to expire after 2025. Chairman Brady has not said whether the package will include other incentives or whether the revenue losing provisions will be offset with revenue raising proposals. He has stated that he expects to include the package of expiring provisions and possibly new savings incentives such as a new universal savings account.

Despite the activity on the House side, however, this legislation is unlikely to go anywhere in the Senate, since it would need a three fifths majority vote to overcome procedural hurdles (including the filibuster) in a body that has 49 Democrats, who are unlikely to vote in favor of any kind of tax cut legislation.

Technical Corrections

Chairman Brady has said that the W&M Committee is working with the Senate and Treasury to **identify provisions in the TCJA that require technical corrections** and that a future technical corrections bill would reflect what Treasury is unable to address through their regulatory authority. He has not said when he believes this legislation would be considered in the House.

The fight over the Supreme Court nomination may create even more partisanship in the Congress than already exists, affecting the movement of less controversial legislation such as a tax technical corrections bill. Senate Commerce, Science, and Transportation Committee Chairman Thune (R-SD) has indicated that the **Federal Aviation Administration reauthorization bill** could be considered on the Senate Floor in July or August with the current authority expiring on September 30th. In the past, he has said that he does not want this legislation to serve as a vehicle for tax issues such as technical corrections, but recent comments have indicated that he might consider that approach.

TCJA Guidance

Passthrough Deduction rules: The IRS has said that its intention is to release its initial **regulations to implement the passthrough business income deduction** enacted in the TCJA by late July. Acting Commissioner Kautter said that they are focused primarily on aggregation rules, anti-abuse rules, the general rules, and the definition of specified services.

International rules: The IRS also has a long list of regulatory projects in process to implement the foreign income rules in the TCJA. They have already issued guidance on the transition tax on deferred foreign earnings under Code section 965, but there has been no guidance issued yet under the Base Erosion Anti-Abuse Tax (BEAT), and the new tax regimes for foreign-derived intangible income (FDII) and global intangible low-taxed income (GILTI). The IRS has issued a statement that it is **committed to issuing proposed regulations under the majority of the substantial new international provisions in 2018** as early as this summer.

EU Criticism of the TCJA

Several EU officials have argued that certain provisions in the TCJA create subsidies that violate the World Trade Organization (WTO) trade policies. Finance chiefs of Europe's five largest economies sent a letter to Treasury Secretary Mnuchin warning him that the foreign-derived intangible income deduction (FDII) was a subsidy for exports and a possible violation of the WTO rules.

Cecilia Malmstrom, who is the EU commissioner for trade, stated in a response to questions from a member of the EU Parliament that the FDII and the base erosion and anti-abuse tax (BEAT) could create potential inconsistencies with US international obligations in the WTO. Europeans have said that the FDII rules are inconsistent with accepted practice by including branding, market power, and market-related intangibles. They argue that the BEAT provision violates US tax treaties, which don't allow discriminatory treatment between foreign and domestic taxpayers.

Congressman Roskam (R-IL), who is a member of the W&M Committee, responded to these criticisms stating that the US Congress will not change the new law noting that there is no specific ruling from the WTO.

Treasury and the IRS

Treasury and the IRS issued **proposed regulations on how partnership liabilities are allocated for disguised sale purposes** under Code section 707. If finalized, the rulemaking "would replace existing temporary regulations with final regulations that were in effect prior to the temporary regulations."

The IRS issued final regulations on **partnership transactions involving equity interests of a partner** under Code sections 337(d) and 732(f). The regulations will (1) prevent a corporate partner from avoiding corporate-level gain through transactions with a partnership involving equity interests of the partner or certain related entities; (2) allow consolidated group members that are partners in the same partnership to aggregate their bases in stock distributed by the partnership for the purpose of limiting the application of rules that might otherwise cause basis reduction or gain recognition; and (3) may also require certain corporations that engage in gain elimination transactions to reduce the basis of corporate assets or to recognize gain. The final regulations generally adopt rules included in 2015 proposed regulations under Code sections 337(d) and 732(f), but the preamble states that there is consideration of new proposed rulemaking to propose more substantive amendments to the final regulations under Code section 337(d) and to allow for additional public comment with respect to these more substantive proposals, in response to a comment letter to the 2015 proposed regulations, further reflection by Treasury and the IRS, and concerns raised by practitioners.

The IRS issued Notice 2018-57 announcing that the IRS will delay for one year the **effective date of the foreign currency regulations** under Code section 987. The delayed regulations cover the determination of taxable income or loss with respect to a qualified business unit (QBU) subject to Code section 987 and related issues. These final regulations were identified in Notice 2017-38 as significant tax regulations requiring additional review pursuant to Executive Order 13789, which targeted overly burdensome and complex tax rules.

International Issues

The BEPS Multilateral Convention entered into force on July 1, 2018 for five of the jurisdictions that signed onto the agreement in 2017. The Convention updates the existing network of bilateral tax treaties and reduces opportunities for tax avoidance by multinational enterprises. The current number of signatories is 79 covering 81 jurisdictions. The United States is supportive of the project but has not signed onto the Convention. The agreement includes new language to prevent treaty shopping, which is the routing of transactions through countries with tax treaties in order to gain treaty benefits, using a standard that US officials have criticized as being too subjective. The agreement also includes new, broader standards on how to determine a permanent establishment.

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