

WASHINGTON TAX NEWS



Potomac Law Tax Newsletter— November 2018

Susan Rogers

With both the House and Senate adjourned in order to campaign ahead of the November 6th mid-term elections, **no further legislation will be addressed until a lame duck session**. Both chambers are scheduled to return to Washington on November 13th. The outcome of the elections will likely have an effect on what issues will be addressed in the lame duck session including whether any tax legislation will advance.

If Democrats retake control of the House, they may decide to consider making deals with Republicans on some issues in the lame duck session, such as the **new NAFTA agreement** reached by the US, Canada, and Mexico, and drug pricing. Senate Majority Leader McConnell, however, has commented that he does not expect the revised NAFTA agreement to be scheduled for Senate consideration this year, although he does view it as a priority for 2019. Any legislation that adds to the deficit is likely a non-starter, such as the proposed infrastructure package despite the fact that there is bipartisan support.

Congress will have to deal with the **seven outstanding FY 2019 spending bills** that were not completed prior to adjournment or face the prospect of acting on another stopgap funding bill or a government shutdown in December. Prior to adjournment, both the House and Senate approved a five-year reauthorization of the Federal Aviation Administration bill, which is noteworthy because it was one of the few must-pass bills in 2018 that could have served as a vehicle for tax legislation because it had a tax title.

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

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Tax Reform 2.0

Prior to adjournment, the **House passed the centerpiece of Tax Reform 2.0, which would permanently extend all the individual TCJA provisions including the lower individual tax rates and the 20 percent deduction for pass-through income** (set to expire in 2025). The House also passed two additional bills that complete the Tax Reform 2.0 package – the Family Savings Act of 2018 and the American Innovation Act. Although supporters cite this as a good first step, the Senate is unlikely to take up any of this legislation in a lame duck session because there won't be 60 votes for approval.

President Trump floated the idea of a **10 percent tax cut targeting the middle class**, which he stated was being discussed by House Speaker Paul Ryan (R-WI) and Ways & Means Committee Chairman Kevin Brady (R-TX). Although the President indicated that this proposal would be considered in November, it is unlikely to be reviewed until after the mid-term elections on November 6th since both the House and Senate are currently in recess.

Chairman Brady has said that he will work with the Administration on this new tax proposal if Republicans maintain control of both the House and Senate. SFC Chairman Hatch (R-UT) has not made the same commitment yet stating that he has not seen the details of the proposal and he has not spoken to Senate Majority Leader McConnell about scheduling a vote on it.

Technical Corrections & Tax Extenders Legislation

With Congress out of session until after the mid-term elections, **no action is expected on either technical corrections or tax extenders until Members return for a lame duck session**, and the outcome of the mid-term elections will likely affect what, if any, tax legislation advances. GOP leadership has indicated a willingness to talk about legislation that would cover both of these sets of issues in the lame duck session, but in order to get the Democratic support that would be needed in the Senate, there would need to be some agreement to address issues of interest to Democrats. Senator Wyden (D-OR), who is the SFC Ranking Member, has not specifically said what issues his members would like addressed other than the **retirement legislation** that he has cosponsored with SFC Chairman Hatch (R-UT).

Democratic Tax Agenda?

If Democrats regain control of the House, they may be reluctant to move on tax legislation in a lame duck session, preferring to wait until a new Congress when they could pursue some of their tax priorities including raising rates on wealthy individuals and increasing the estate tax.

Should they be in a position to control the tax agenda at least in the House in 2019, it is expected that their list will include **middle class tax cuts and infrastructure legislation**, both of which will create revenue losses. Thus, the expectation is that they would turn to the TCJA to revisit some of the cuts enacted in that law including, e.g., the corporate tax rate, individual tax rates for the wealthy, the alternative minimum tax, the estate tax, and the treatment of carried interest.

The Administration – Budget Deficit Results

Treasury and the Office of Management and Budget released **details of the FY 2018 final budget results**. The deficit in FY 2018 was \$779 billion, which was \$113 billion more than the prior year and the highest deficit since 2012. The decline in corporate tax revenue due to the tax cuts in the TCJA contributed to the deficit increase, although the Administration stated that increased federal spending was the reason for the increase.

Treasury and the IRS

Charles Rettig was sworn in as IRS Commissioner on October 1st after a confirmation process that took nearly 8 months. His term is scheduled to run until November of 2022. IRS Acting Commissioner David Kautter will now hold only the position of Assistant Treasury Secretary for Tax Policy.

The IRS released a statement informing taxpayers of a **study regarding the active trade or business (ATB) requirement under Code section 355(b)** and the possibility of future guidance regarding tax-free spinoffs. The IRS will not issue industry specific guidance but will consider private letter ruling requests regarding the ATB qualification of corporations that have not collected income.

Treasury released its 2019 regulatory plan, which includes a list of regulatory priorities for the IRS and the Treasury's Office of Tax Policy. The plan identifies seventeen regulatory projects regarding implementation of the 2017 tax legislation as their first priority and also includes guidance to further implement the centralized audit regime for partnerships.



IRS Fact Sheet & Web Page

The IRS released a fact sheet summarizing changes from the TCJA that affect business taxpayers and providing resources to help business owners find more details. The summary includes explanations of several of the changes including: (1) the qualified business income deduction, (2) changes to fringe benefit deductions, (3) the employer tax credit for paid family and medical leave; (4) meal and entertainment expenses, (5) the limitation of like-kind exchanges to real estate, and (6) depreciation and expensing. The fact sheet also notes that business taxpayers should re-estimate estimated tax payments to account for changes in the tax liability from the new law. The IRS also launched www.irs.gov/tax-reform, which is a new web page designed to provide information about the TCJA, featuring three areas focused on individuals, businesses, and tax-exempt entities.

State and Local Tax Deductions:

Officials in several states including New York, New Jersey, and Connecticut have asked the IRS to withdraw proposed regulations that would limit the ability of states to work around the \$10,000 cap on state and local tax deductions through the use of charitable donation programs. The officials submitted comments and letters as part of the comment period for the proposed regulations.

Tax Cuts & Jobs Act (TCJA) Guidance from Treasury & the IRS

Global Intangible Low-Taxed Income (GILTI): A Treasury representative said recently at an American Bar Association meeting that **Treasury is likely to narrow the GILTI anti-abuse rule** included in recently proposed regulations stating that they are aware that the language that would negate transactions with the “principal purpose” of reducing Subpart F income could be overly broad and potentially capture transactions that Treasury doesn’t see as abusive. One concern is that the language could negate decades-old restructurings in which US companies distributed their controlled foreign corporation holdings to get out from under the Subpart F regime. Treasury has said that it is looking to clarify and refine the proposed regulations prior to issuing final regulations.

Repatriation Tax: The IRS held a **public hearing on its proposed regulations on the repatriation tax** under Code section 965 on October 22nd. The IRS issued **Notice 2018-78**, announcing that **taxpayers will not be required to make a binding basis election** before its proposed regulations are finalized. Code section 965 imposes a transition tax on the tax-deferred foreign earnings of US corporations since 1986. The IRS says that the delayed basis election “will apply with respect to returns due (determined with regard to any extension) before the date that is 90 days after the date that the final regulations are published and that in such cases the basis election must be made no later than 90 days after the publication.” The final regulations will also provide that “if a basis election was made on or before the date the final regulations are published, the basis election may be revoked no later than 90 days after the publication.”

Opportunity Zones: Treasury and the IRS released **proposed regulations clarifying rules for investments in qualified opportunity zones (QOZs)**, which are an incentive created by the TCJA designed to encourage investment in distressed communities by offering capital gains relief in Code section 1400Z-2. The regulations state that all capital gains qualify for deferral, and corporations, pass-through entities, and individuals may make such investments. The rules also address the requirements for meeting the assets tests, and they allow taxpayers to make the basis step-up election after the expiration of the zone designations through 2047. The guidance states that taxpayers may rely on these rules if the taxpayer applies the rules for the respective subsection in their entirety and in a consistent manner. A public hearing is scheduled for January 10, 2019, and the IRS has noted that it intends to issue additional regulations on other issues including the meaning of “substantially all” and information reporting requirements. The new rules on this incentive program have been well received by the investment community, which sees significant advantages to the tax benefits available.

Business Meal Deductibility: Treasury and the IRS issued **Notice 2018-76** providing transitional guidance and announcing forthcoming regulations on the **deductibility of expenses for certain business meals** under Code section 274. The notice states that taxpayers may rely on it until regulations on this issue become effective, and it invites public input by December 2, 2018. The notice provides that taxpayers may deduct 50% of an otherwise allowable business meal expense under Code section 274 if:

- The expense is an ordinary and necessary expense under Code section 162(a) paid or incurred during the taxable year in carrying on any trade or business;
- The expense is not lavish or extravagant under the circumstances;
- The taxpayer, or an employee of the taxpayer, is present at the furnishing of the food or beverages;
- The food and beverages are provided to a current or potential business customer, client, consultant, or similar business contact; and
- In the case of food and beverages provided during or at an entertainment activity, the food and beverages are purchased separately from the entertainment, or the cost of the food and beverages is stated separately from the cost of the entertainment on one of more bills, invoices, or receipts.

The Wayfair Decision – Online Sales Taxation

HR 6824, the **Online Sales Simplicity and Small Business Tax Relief Act**, which is a bill that is intended to provide some harmonization among states with respect to sales tax collection procedures, is not getting much support from those states which have already moved forward with their procedures despite the fact that some supporters of the legislation believe that states aggressively acting on their own will result in lawsuits and industry concerns about the burden on retailers. California is one of the states that has yet to put in place a new procedure, but the state's taxing authority has said that the state is ready to act on this and expects to notify retailers by the end of the year about collection requirements, which would be prospective. **One of the key issues in California will be the threshold** and whether they adopt the South Dakota threshold of \$100,000 in total sales or 200 separate transactions despite the fact that some have argued that the size of California argues for higher thresholds. The **District of Columbia may move to adopt legislation on an emergency basis** to establish their procedure by January 1, 2019, since permanent bills out of the DC Council are required to go to Congress for a 30-day review before they become law. **The Multistate Tax Commission has a project called the Wayfair Implementation and Marketplace Facilitator Work Group** that helps states design marketplace laws on this issue including what appropriate thresholds are and how to implement enforcement. The **American Catalog Mailers Association** recently wrote to Congress urging them to pass legislation before the end of the year specifically citing the issues of whether states can require collection retroactively and the establishment of orderly phase-in dates for the various state procedures.

International Issues

Australia, France, Japan, and Slovak Republic have deposited their instrument of ratification or acceptance for the **Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting** with the OECD's Secretary General, and thereby have underlined their strong commitment to prevent the abuse of tax treaties and base erosion and profit shifting (BEPS) by multinational enterprises.

The **OECD has identified a list of potentially abusive residence and citizenship by investment schemes (RBI/CBI)**, which are referred to as golden passports or visas and can create the potential for misuse as tools to hide assets held abroad from reporting under the **OECD/G20 Common Reporting Standard (CRS)**. As part of its work to preserve the integrity of the CRS, the OECD has published the results of its analysis of over 100 CBI/RBI schemes offered by CRS-committee jurisdictions, identifying those schemes that potentially pose a high-risk to the integrity of CRS.

The European Union (EU) Council agreed to adopt several proposals from the European Commission (EC) to **reform the current EU VAT system**. Part of the adopted proposals were released by the EC in October 2017 including some quick fixes to the current regime that would apply to improve the functioning of the current VAT system, pending the introduction of the "definitive" VAT system that is still the subject of ongoing discussion. Under the definitive VAT system, cross-border sales of goods within the EU would be taxed in the same way as sales within a single EU member state, i.e. VAT would be imposed on cross-border sales between businesses (which currently are exempt from VAT) under a destination-based system. The new system is expected to significantly reduce VAT fraud in the EU and reduce the number of administrative steps needed when businesses sell to companies in other EU member states.

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

Susan Rogers, Partner

Potomac Law Group, PLLC

One International Place, Suite 1400

Boston, MA 02110

202.492.3593

srogers@potomacclaw.com

Susan Rogers has 30 years of experience in the tax policy field in Washington including several years as Majority Tax Counsel to the House Ways & Means Committee and extensive experience managing global tax issues for a Fortune 100 multinational. Ms. Rogers' practice focuses on providing information and strategic advice to clients on US and international tax policy issues and advice on how to manage tax policy risks.

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