WASHINGTON TAX UPDATE: CONGRESS, TREASURY, GLOBAL

January 2019 **Susan Rogers**

Congress returned to work on January 3rd, with the **Democrats taking over control of the House** and Nancy Pelosi (D-CA) as the likely Speaker of the House. She appears to have garnered enough support among Democrats in the House to win confirmation, in part by agreeing to relinquish her leadership post in 2020 (after the 116th Congress) unless she receives the support of two-thirds of the Democratic Caucus to continue as Speaker. This procedure will also apply to the other two senior leaders of the Democratic party in the House, Congressman Hoyer (D-MD), who will likely become House Majority Leader, and Congressman Clyburn (D-SC), who will likely become House Majority Whip.

Due to the fact that **2019 will bring a divided government to Washington**, the expectation is that there may be more investigating than legislating.

House Democrats will make an important change to House rules with respect to tax legislation by dropping the GOP rule that requires a three-fifths supermajority vote to pass legislation that would increase tax rates. The rules package also includes the **PAYGO rule**, and it eliminates the use of **dynamic scoring**. In general, PAYGO rules require that any new spending increase or tax cut legislation be offset by accompanying spending cuts or tax increases. **Dynamic scoring** is a forecasting technique for government revenues, expenditures, and budget deficits that incorporates predictions about the behavior of people and organizations based on changes in fiscal policy, usually tax rates. House rules can be waived by a simple majority vote during the consideration of legislation.

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> ***The outcome of the mid-term elections played out to a large extent the way many Washington experts expected with the Republicans retaining control of the Senate and the Democrats retaking control of the House – with a margin of control in the latter case that was larger than expected.***
>
> ***Susan Rogers***

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Spending Bills & Government Shutdown Update

Congress failed to approve a continuing resolution to fund the government into January of 2019, so the **government shut down** on December 22nd due to the fact that the President would not agree to sign a funding bill that did not include money for a border wall. Although Congress is continuing to negotiate, it is unclear when this issue will be resolved. The shutdown affects 25% of the government and 9 federal departments.

House Ways & Means Committee

Congressman Richard Neal (D-MA), who has been in Congress for 30 years and is a close ally of Pelosi, was approved to be **Chairman of the House Ways & Means Committee** by the House Democratic Steering and Policy Committee. His appointment must be confirmed by the full House Democratic caucus, but a vote has not yet been scheduled. Neal has historically been viewed as a business-friendly Democrat with the ability to work in a bipartisan fashion should his party be inclined to let him do so. Republicans lost 10 members of the Committee to retirements and defeat, but they may lose seats due to the shift in ratios of control in the House.

Senate Finance Committee

Senator Chuck Grassley (R-IA), who will become the Chairman of the Senate Finance Committee in the next Congress, **outlined his tax legislative priorities** in a speech on the Senate Floor. With respect to the Tax Cuts & Jobs Act (TCJA), he said that he would support "legitimate efforts to perfect" it, but that efforts to "undermine the strength of the American economy for the sake of ideology" would be opposed indicating he will not go along with proposed tax hikes. Other items he noted as important include: (1) a permanent extension of the 2017 tax cuts for individuals and small businesses; (2) overhauling the retirement savings rules; (3) modernizing the IRS and protecting taxpayer rights; (4) increasing the competitiveness of US businesses; and (5) identifying and cracking down on improper tax shelters. He expressed interest in bipartisan activity on tax issues involving education, renewable and alternative energy, and health care. Two new Democrats were appointed to the SFC – Senator Cortez-Masto of Nevada and Senator Hassan of New Hampshire. There will also be two new Republican members of the panel, but they have not yet been named.

Joint Tax Committee

The **Joint Committee on Taxation (JCT) issued its general explanation of the TCJA, commonly known as the Blue Book**, with a summary of all the changes made to the tax code by the TCJA and an explanation of prior law. The Blue Book identifies over 70 provisions of the TCJA that require a technical correction in order to achieve the intent of Congress, covering issues such as the effective date of new rules governing the treatment of net operating losses, the depreciation period for qualified improvement property, and the treatment of installment overpayments under the new repatriation tax. The Blue Book was prepared by the JCT in consultation with the staffs of the House Ways & Means Committee and the Senate Finance Committee.

Sales & Use Taxation – *Wayfair* case update

The **California Department of Tax and Fee Administration released a special notice** providing that beginning April 1, 2019, a retailer located outside of California is required to collect tax if, during the preceding or current calendar year: (1) the retailer's sales into California exceed $100,000; or (2) the retailer made sales into California in two hundred (200) or more separate transactions. The notice states that an out-of-state retailer reaching either of these sales thresholds is engaged in business in California pursuant to California law and the US Supreme Court's decision in *South Dakota v. Wayfair, Inc*.

House Agenda under Democratic Control

Some Democrats support pairing immigration reform with funding for border security in order to solve the current government shutdown stalemate, but others support a clean bill for government funding.

Democrats will be looking for **bipartisan legislative opportunities**, which may include an infrastructure bill and legislation to lower prescription drug costs. Infrastructure legislation will be popular with many Republicans, but the challenge will be how to fund the legislation. Incoming Ways & Means Committee Chairman Neal is reportedly considering the formation of an infrastructure subcommittee.

Congress will have to deal with **raising the debt limit** this summer, which could be challenging with a divided government. The new House rules package includes the "Gephardt rule" on the debt limit which allows an increase through a joint resolution after the adoption of a House budget resolution without a separate House vote on the increase. The Senate must still vote on the debt limit as a separate issue.

Republican Tax Reform 2.0

Former Ways & Means Committee Chairman Brady (R-TX) gained approval of a tax bill before the end of the year that included IRS reform, some technical corrections to the TCJA, new retirement incentives for businesses and individuals, and a couple of tax extenders. As expected, the Senate took no action on the bill, and it expired at the end of the 115th Congress. House and Senate Democrats opposed the Republican effort including the TCJA corrections by former Chairman Brady from the beginning in part because House Democrats were not included in the drafting process for the 2017 tax act or the technical corrections. They will have greater leverage in the new Congress with incoming W&M Committee Chairman Neal stating that he will hold hearings on technical corrections before moving any legislation.

Democratic Tax Agenda

Incoming Chairman Neal is not expected to reintroduce the Republican bill, but he may look for areas of bipartisan agreement for legislation in the 116th Congress including IRS reform and retirement savings incentives. Neal is also expected to advance technical corrections legislation after Committee hearings including consideration of some of the technical corrections suggested in the JCT Blue Book on the TCJA, but this process may prove to be challenging if Democrats also pursue substantive changes to the TCJA.

House Democrats are expected to consider increasing tax cuts for middle- and lower-income families and individuals, which could be paid for by increasing corporate tax rates to a rate in the range of 25-27 percent. Some Democrats favor **revisiting the cap on state and local tax deductions,** while other issues that could be revisited by the Democrats include the deduction for income from pass-through entities. It is unlikely that Neal will lead an effort to repeal the TCJA, but it is equally unlikely that he will support any expansion of it. Targeted efforts to modify parts of the TCJA are likely as part of a Democratic plan to begin their messaging for the 2020 elections.

Neal has also said that the Committee will consider the **expired tax extenders**, but it is unclear what approach he will favor moving forward. In the past, House Republicans have preferred an approach of making favored extenders permanent rather than a continuing process of approving short-term extensions. There is also an expectation that Neal will undertake some oversight with respect to the TCJA. He led the Democratic opposition to the TCJA and has consistently been in favor of closing tax "loopholes" that allow taxpayers to shelter income abroad.

Neal will have the ability to request **copies of the President's tax returns** under a 1924 law that allows tax-writing committee chairs to request the tax return of any taxpayer. Treasury Secretary Mnuchin has the responsibility of overseeing such a request.

The **Congressional Budget Office released a report summarizing over 100 options for reducing the federal deficit** between 2019 and 2028. The report is released annually by the non-partisan CBO to offer legislators ideas for legislation that will contribute to a decrease in the budget deficit through cuts in mandatory or discretionary spending or raising revenues. The revenue section included 40 proposals including raising tax rates on individuals and corporations. This report will likely be used by the Democrats to provide ideas for tax legislation in the 116th Congress.

Global Tax Issues

The Council of the European Union (EU) released a **proposal for a Council Directive on the common system of a digital services tax on revenues resulting from the provision of certain digital services**. The European Parliament of the EU released a report on this proposal.

The **European Commission** released a report titled **Tax Policies in the European Union, 2018 Survey**. The survey summarizes how EU member states' tax systems help to promote investment and employment, how they are working to reduce tax fraud, evasion and avoidance, and how tax systems help to address income inequalities and ensure social fairness.

The Council of the European Union (EU) released the **latest compromise text for the proposal for a Council Directive on a Common Corporate Tax Base proposal**.

The **OECD released a report titled "Harmful Tax Practices – 2017 Peer Review Reports on the Exchange of Information on Tax Rulings"** as part of the BEPS project. The report assesses 92 individual jurisdictions' progress in exchanging information on tax rulings in accordance with Action 5 of the BEPS Action Plan.

Treasury and the IRS

TCJA Guidance

Treasury and the IRS have released a significant amount of guidance on the TCJA to date. Rules need to be finalized by June of 2019 in order to allow for guidance to be applied retroactively. Businesses should not delay in submitting comments on proposed rules.

Base Erosion and Anti-Abuse Tax (BEAT): On December 13, 2018, the **IRS issued proposed regulations on the base erosion and anti-abuse tax (BEAT) under Code section 59A**, which was enacted as part of the TCJA. Code section 59A imposes a tax equal to the base erosion minimum tax amount for certain taxpayers starting in 2018. These regulations provide guidance on how to determine if a taxpayer has income taxed by the BEAT and provides the rules for computing a taxpayer's BEAT liability. The regulations cover a number of different issues including: (1) determining whether a taxpayer is an applicable taxpayer on which the BEAT may be imposed; (2) determining the amount of base erosion payments; (3) the rules for computing the base erosion minimum tax amount; (4) application of the rules to partnerships; (5) rules that are specific to banks, registered securities dealers, and insurance companies; (6) anti-abuse rules; and (7) reporting and record keeping requirements.

The TCJA also added **reporting obligations regarding the BEAT for 25-percent foreign-owned corporations** subject to Code section 6038A and foreign corporations subject to Code section 6038C and addressed other issues related to information reporting under those code sections. The preamble of the proposed regulations addresses Notice 2018-28 related to the treatment of business interest carried forward and whether it is a base erosion payment stating that the regulations do not follow the approach in the Notice.

The IRS invited comments on all aspects of the regulations but did not provide a specific deadline for submission of them or the date of public hearing. The IRS stated that if any part of the rule is finalized after June 22, 2019, that provision will apply only to taxable years ending on or after the date it is published in the Federal Register.

Previously Taxed Earnings & Profits: The IRS issued **Notice 2019-1** announcing that Treasury and the IRS intend to issue regulations addressing issues arising from the enactment of the TCJA with respect to **foreign corporations with previously taxed earnings and profits (PTEP)**. These regulations are expected to cover: (1) rules relating to the maintenance of PTEP in annual accounts and within certain groups; (2) rules relating to the ordering of PTEP upon distribution and reclassification; and (3) rules relating to the adjustment required when an income inclusion exceeds the earnings and profits of a foreign corporation. These regulations will be effective for taxable years of US shareholders ending after December 14, 2018 (the date of the Notice). Comments are due by February 12, 2019, and the IRS has noted several issues on which it is specifically requesting feedback.

Parking Expenses for Qualified Transportation Fringes: The IRS issued **Notice 2018-99, which provides guidance to taxpayers on calculating parking expenses for qualified transportation fringes (QTFs) that are nondeductible under Code section 274(a)(4)** with comments due by February 22nd. The Notice also instructs tax-exempt organizations on determining the increase in the amount of unrelated business taxable income (UBTI) under Code section 512(a)(7) attributable to nondeductible parking expenses. The TCJA amended Code section 274(a)(4) so that a deduction for expenses with respect to QTFs provided by taxpayers to their employees is disallowed and amended Code section 512(a)(7) so that a tax-exempt organization's UBTI is increased by the amount of the QTF expense that is nondeductible under Code section 274. The IRS explained that "the Act does not address how to determine that amount of the QTF expense that is nondeductible or treated as an increase in UBTI." The IRS stated that it plans to issue proposed rules that will provide more formal guidance on these issues. The IRS also issued **Notice 2018-100**, which provides penalty relief for the underpayment of estimated tax for tax-exempts due to changes to the tax treatment of certain QTFs.

Deferral on Income attributable to qualified stock: The IRS issued **Notice 2018-97, providing early guidance under Code section 83(i) and the tax treatment of property transferred in connection with the performance of services**. The TCJA added Code section 83(i), which allows certain employees to defer tax on income attributable to the receipt or vesting of qualified stock. The Notice focused on three areas including: (1) the application of the requirement in Code section 83(i)(2)(C)(i)(II) that grants be made to not less than 80% of all employees who provide services to the corporation in the United States; (2) the application of federal income tax withholding to the deferred income related to the qualified stock; and (3) the ability of an employer to opt out of permitting employees to elect the deferred tax treatment even if the requirements under Code section 83(i) are otherwise met. The IRS indicated that it intends to propose regulations that will incorporate this guidance. Comments are due by February 5th with specific interest in comments on "additional or alternative mechanisms that could be established to ensure the collection of the required income tax withholding in accordance with section 83(i)(3)(A)(ii)."

Hybrid Dividends: The IRS issued **proposed regulations on hybrid dividends** and certain amounts paid or accrued in hybrid transactions or with hybrid entities under Code sections 245A(e) and section 267A, which were both added by the TCJA. The guidance also includes proposed regulations under Code sections 1503(d) and 7701 to prevent the same deduction from being claimed under the tax laws of both the United States and a foreign country. The IRS also explained that "this document contains proposed regulations under sections 6038, 6038A, and 6038C to facilitate administration of certain rules in the proposed regulations. The proposed regulations affect taxpayers that would otherwise claim a deduction related to such amounts and certain shareholders of foreign corporations that pay or receive hybrid dividends."

Treasury and the IRS—Other Issues

The **Senate voted 55-44 to confirm Justin Muzinich to serve as Deputy Treasury Secretary**. His nomination had been approved in August in the SFC but was held up in the Senate based on Democratic opposition tied to Treasury policy that no longer requires 501(c) organizations (except 501(c)(3)s) to disclose names and addresses of donors. The **Senate approved a resolution by a 50-49 vote that would block this guidance,** but the resolution expired at the end of the 115th Congress without House action.

The IRS issued **proposed regulations on the tax implications for foreign persons from the sale or exchange of certain partnership interests** under Code section 864(c)(8) covering the following areas: (1) gain or loss on the transfer of a partnership interest; (2) coordination with Code section 897; (3) tiered partnerships; (4) treaties; (5) anti-stuffing rule; and (6) Code section 1446(f) guidance. Code section 864(c)(8) generally overturned the Tax Court's ruling in *Grecian Magnesite Mining v. Comm'r.*, by providing that gain or loss of a nonresident alien individual or foreign corporation from the sale, exchange, or other disposition of a partnership interest is treated as effectively connected with the conduct of a trade or business within the United States to the extent that the transferor would have had effectively connected gain or loss if the partnership had sold all of its assets at fair market value as of the date of the sale or exchange.

Treasury and the IRS issued **proposed Foreign Account Tax Compliance Act (FATCA) regulations**, which are intended to reduce taxpayer burdens with respect to FATCA requirements by eliminating withholding on payments of gross proceeds, deferring withholding on foreign passthru payments, clarifying the definition of investment entity, and eliminating withholding on certain insurance premiums. The IRS requested comments on the regulations but did not set a deadline for submission.

The IRS issued **Revenue Procedure 2018-60, which provides procedures for certain accounting changes relating to the timing of the recognition of income** for taxable years beginning after December 31, 2017. The guidance "provides the procedures by which a taxpayer may obtain the automatic consent of the Commissioner of Internal Revenue under section 446 and section 1.446-1(e) of the Income Tax Regulations to change a method of accounting to comply with section 451(b)." The revenue procedure also provides procedures for certain qualifying taxpayers to make a method change to comply with Code section 451(b) without filing a Form 3115, Application for Change in Accounting Method.

The IRS issued **Notice 2019-2, which sets the standard mileage rates** used for deducting the costs of operating an automobile for business (58 cents), charitable (14 cents), medical (20 cents), or moving purposes (20 cents) in 2019.

The IRS issued **final regulations on the allocation of costs to certain property produced or acquired for resale under Code section 263A**. The regulations (1) provide rules for the treatment of negative adjustments related to certain costs required to be capitalized to property produced or acquired for resale; (2) provide a new simplified method of accounting for determining the additional costs allocable to property produced or acquired for resale; and (3) redefine how certain types of costs are categorized for purposes of the simplified methods. The IRS also issued **Revenue Procedure 2018-56**, providing procedures by which a taxpayer may obtain automatic consent to change to the methods of accounting described in these regulations.

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