Tax Insights

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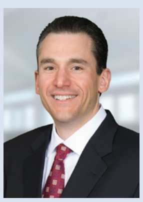

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IRS Rules on Foreign Currency Hedging Transactions of RIC

The IRS issued Private Letter Ruling 201728003 (https://www.irs.gov/pub/irs-wd/201728003.pdf) granting a regulated investment company (RIC) permission under Treasury Regulation Section 1.988-5(e) to use the detailed tax accounting method described in the ruling for determining the timing, character and amount of foreign currency-related gain or loss on foreign currency-denominated bonds and forward contracts entered into for the purpose of hedging rights to receive foreign currencies on such bonds. The regulation permits the IRS to issue an advance ruling addressing the income tax consequences of a taxpayer's system of hedging either its net nonfunctional currency exposure or anticipated nonfunctional currency exposure.

In the ruling, the RIC tracks the performance of an index that measures, in U.S. dollars, the performance of specified foreign currency-denominated bonds after applying a foreign currency hedging method. Under the index's hedging method, the currency return on the foreign currency-denominated bonds in the index is offset (relative to the U.S. dollar) by rolling one-month forward contracts on those currencies. No adjustment is made to the hedge during the month to account for changes in the market value of the constituent bonds in the index. The forward contracts are reset monthly to adjust the index's relative positions in the foreign currency-denominated bonds and forward contracts, including to account for the intra-month changes in market value of the foreign currency-denominated bonds. The hedging method is designed to reduce economic exposure to the foreign currency risk associated with the foreign currency-denominated payments received on the bonds while managing the cost of rolling currency hedges.

For purposes of determining the amount of realized foreign currency gain and loss:

1. The RIC will mark to market all the forward contracts that are outstanding as of year-end. The RIC also will determine gain or loss arising from the foreign currency component of each foreign currency-denominated bond sold during the year by limiting such gain or loss to the overall amount of gain or loss on the sale, applying the netting rule of Section 988(b)(1) and (b)(2) and Treasury Regulation Section 1.988-2(b)(8). (Section references are to the Internal Revenue Code of 1986, as amended (the "Code").)

2. The RIC will determine its net unrealized foreign currency gain and loss in its portfolio by aggregating the unrealized built-in foreign currency gain and loss in its foreign currency-denominated bonds and non-U.S. dollar cash positions held at the end of the year. Each year, for purposes of determining the amount of unrealized foreign currency gain and loss, (a) the RIC determines the gross amount of foreign currency gain or loss (as determined for financial statement purposes) which disaggregates from the bond's other economic components the foreign currency component embedded in each foreign currency-denominated bond retained at year-end, and (b) the RIC does not net the unrealized gain or loss arising from the foreign currency component of a bond against the

unrealized loss or gain arising from the bond's other components. Instead, it will measure the amount of unrealized foreign currency gain or loss on each bond on a gross basis.

3. The RIC then will compare its net realized foreign currency gain or loss with its net unrealized foreign currency gain or loss, and defer any net realized foreign currency gain or loss to the extent of offsetting net unrealized foreign currency loss or gain. The deferred amounts are treated as realized on the first day of the following taxable year (and included in the realized foreign currency gain and loss amount for purposes of that following year's netting calculation). The RIC will treat as ordinary income or loss any excess net realized foreign currency gain or loss that is not offset (deferred) under this calculation and recognize it in the current taxable year.

4. If, in a nonrecognition transaction (e.g., under Sections 311(a) and 852(b)(6)), the RIC disposes of a foreign currency-denominated bond with unrealized foreign currency gain or loss with respect to which realized foreign currency loss or gain has been (or otherwise would be) deferred under the above mechanisms, the RIC will (a) terminate the deferral of (and recognize) the realized foreign currency gain or loss to the extent of the corresponding unrealized foreign currency loss or gain in the distributed foreign currency-denominated bond, and (b) recognize the corresponding unrealized foreign currency loss or gain in the distributed foreign currency-denominated bonds. In calculating the RIC's net realized and unrealized foreign currency gain and loss, the foreign currency component of each item of the foreign currency-denominated bond (whether, for instance, such item is interest, market discount, or gain or loss) is included in the RIC's realized foreign currency gain or loss amount in the year such item is required to be taken into account under applicable realization provisions of the Code.

IRS Rules on Qualifying Income of Publicly Traded Partnership

The IRS issued Private Letter Ruling 201728021 (https://www.irs.gov/pub/irs-wd/201728021.pdf) stating that gross income derived by a taxpayer through affiliated limited partnerships, limited liability companies or disregarded entities principally engaged in the business of: (1) gathering, compressing, treating, processing, transporting, storing and selling natural gas; (2) producing, fractionating, transporting, storing and selling natural gas liquids and condensate; and (3) transporting, storing and selling propane in wholesale markets is qualifying income under Section 7704(d)(1)(E). The ruling involves income the taxpayer derived from its ownership of a natural gas processing plant that received fees for its natural gas processing services.

IRS Issues Regulations Updating Certain Return Due Dates

The IRS has now issued final, temporary (https://www.gpo.gov/fdsys/pkg/FR-2017-07-20/pdf/2017-15209.pdf) and proposed (https://www.gpo.gov/fdsys/pkg/FR-2017-07-20/pdf/2017-15211.pdf) regulations that update the due dates and extensions of time to file certain tax returns and information returns to reflect changes made by the Surface Transportation Act and the Protecting Americans from Tax Hikes Act of 2015 (PATH Act). The regulations affect taxpayers who file Form W-2 (series, except Form W-2G), Form W-3, Form 990 (series), Form 1099-MISC, Form 1041, Form 1041-A, Form 1065, Form 1120 (series), Form 4720, Form 5227, Form 6069, Form 8804 or Form 8870. The final and temporary regulations are effective as of July 20. The Surface Transportation Act included a number of important tax provisions, such as revised due dates for partnership and C corporation returns, as well as revised extended due dates for many returns. See our prior coverage here (http://www.stradley.com/insights/publications/2015/08/tax-advisor-august-2015). The PATH Act, in addition to extending, in some cases permanently, many temporary "tax extender" provisions, also accelerated the due dates for returns and statements relating to employee wage information and nonemployee compensation. See our prior coverage here (http://www.stradley.com/insights/publications/2015/tax-insights-web-versions/tax-insights-december-23-2015).

IRS Releases Fact Sheet on Worker Classification

The IRS released a fact sheet (FS-2017-9 (https://www.irs.gov/uac/newsroom/understanding-employee-vs-contractor-designation)) on how to apply the rules for classifying a worker as an employee or an independent contractor. The fact sheet provides information on making the determination of whether a worker is an independent contractor or an employee as well as information on misclassified workers.

JCT Issues Reports Describing Trump Budget Revenue Provisions, and the Federal Tax System and Tax Reform Considerations

The Joint Committee on Taxation released two reports. One describes and analyzes revenue provisions included in President Donald Trump's fiscal 2018 budget proposal (https://www.jct.gov/publications.html?func=startdown&id=5012), and the other summarizes the main aspects of the federal tax system under current law and discusses the evaluation, for purposes of tax reform, of tax systems through efficiency, fairness and simplicity (https://www.jct.gov/publications.html?func=startdown&id=5015).