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Stradley Ronon Stevens & Young, LLP
2005 Market Street
Suite 2600
Philadelphia, PA 19103-7018
215.564.8000 Telephone
215.564.8120 Facsimile
www.stradley.com

With other offices in:
Washington, D.C.
New York
New Jersey
Illinois
Delaware

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IRS Issues Proposed Regulations on Business Interest Deduction Limitations

The IRS issued proposed regulations (https://www.irs.gov/pub/irs-drop/REG-106089-18-NPRM.pdf) under Section 163(j). (Section references are to the Internal Revenue Code of 1986, as amended (the Code).) Section 163(j) was added by the 2017 Tax Cuts and Jobs Act (TCJA) and limits the deduction of business interest expense for taxable years beginning after Dec. 31, 2017. For any taxpayer to which Section 163(j) applies, Section 163(j)(1) limits the annual deduction for business interest expense to the sum of (1) the taxpayer's business interest income (as defined in Section 163(j)(6)) for the taxable year, (2) 30 percent of the taxpayer's adjusted taxable income (ATI) (as defined in Section 163(j)(8)) for the taxable year and (3) the taxpayer's floor plan financing interest (certain interest paid by vehicle dealers, defined in Section 163(j)(9)) for the taxable year. "Business interest" means any interest, other than investment interest, paid or accrued on indebtedness properly allocable to a trade or business. "Trade or business" does not include the trade or business of performing services as an employee, an electing real property trade or business, an electing farming business, or certain trades or businesses of regulated public utilities. The Section 163(j) limitation does not apply to a business that in any given year has annual gross receipts of $25 million or less.

The proposed regulations generally provide:

- That any amount of business interest expense that cannot be deducted because of the limitation can be carried forward and treated as business interest expense in future years.
- Rules and procedures for making an election to be treated as an electing real property trade or business or electing farming business.
- Rules for allocating expenses between excepted and nonexcepted trades or businesses.

The proposed regulations contain the following rules with respect to C corporations:

- Interest paid or accrued by a C corporation and interest received or accrued by a C corporation that is includible in its gross income are treated as business interest income, which causes all of a C corporation's interest expense to be subject to the 163(j) limitation (except to the extent such interest expense or interest income is allocable to an excepted trade or business, listed above, under Proposed Regulation Section 1.163(j)-10 or as otherwise provided in the proposed regulations).
- Solely for purposes of Section 163(j), all other items of income, gain, deduction or loss of a C corporation are properly allocable to a trade or business, and such tax items are factored into a C corporation's calculation of its ATI (except to the extent such interest expense or interest income is allocable to an excepted trade or business under Proposed Regulation Section 1.163(j)-10 or as otherwise provided in the proposed regulations).
- Since C corporations are subject to the business interest deduction limitation but not the limitation applicable to the investment interest expense deduction, allocations by a

partnership to a C corporation partner that are allocations of investment interest expense are recharacterized as an interest expense properly allocable to a trade or business of the C corporation. This does not apply to the extent a domestic partnership allocates a share of its gross income inclusions under Section 951(a) (income of controlled foreign corporation shareholders) or Section 951A(a) (global intangible low-taxed income) that are treated as investment income at the partnership level.

- These rules above also apply to a corporation that is subject to the unrelated business income tax.

- A C corporation must deduct current-year business interest expenses in the current year and thereafter may deduct disallowed business interest expense carryforwards in the order of the years in which they occurred, beginning with the earliest.

- A controlled foreign corporation (CFC) applies the rules applicable to domestic C corporations to determine the extent to which the business interest expense is deductible for purposes of computing its Subpart F income and income that is effectively connected with the conduct of a U.S. trade or business. The proposed regulations also provide an alternative method election that can be made by a CFC group that would limit the amount of the business interest expense of a CFC group member to the amount of the member's allocable share of the CFC group's applicable net business interest expense.

The proposed regulations provide for the following with respect to RICs and REITs:

- The rules applicable to C corporations are applicable to RICs and REITs unless otherwise inapplicable pursuant to a provision of Subchapter M of the Code.

- Special rules apply for purposes of determining the effect of a deduction on earnings and profits. For example, the earnings and profits of RICs and REITs generally would not be reduced by a disallowed business interest expense deduction in the year it is disallowed or by any excess business interest expense allocated from a partnership.

- The ATI of a RIC or REIT does not reflect the deduction for dividends paid, but the ATI of a RIC or REIT would be increased by the amounts of special corporate deductions – like the dividends-received deduction and the deductions under Section 250 in respect of foreign-derived intangible income and global intangible low-taxed income – that increased its taxable income.

With respect to partnerships and S corporations, the proposed regulations provide as follows:

- If a partnership's business interest expenses are less than or equal to the limitation in Section 163(j), then such business interest expenses lose their character for purposes of determining the partner's Section 163(j) calculation.

- For other purposes, however, the business interest expenses retain their character at the partner or S corporation shareholder level.

- The IRS, as noted in the preamble to the proposed regulations, is reserving guidance on (1) certain lending transactions, (2) tiered partnerships and (3) partnership mergers or divisions.

IRS Issues Proposed Regulations on Foreign Tax Credit Limitation

The IRS issued proposed regulations (https://www.irs.gov/pub/irs-drop/reg-105600-18.pdf) providing guidance on the changes to the foreign tax credit and related foreign tax credit limitation enacted under the TCJA for tax years beginning on or after Jan. 1, 2018. Generally, a taxpayer that pays taxes to a foreign country is permitted to take either a deduction of the taxes from its gross income or credit such taxes against its U.S. income tax liability on the foreign source income. The TCJA made several changes to the foreign tax credit rules, and the proposed regulations mainly provide guidance on the new separate items on income categories: (a) any amount of global intangible, low-taxed income under Section 951A (other than passive category income); (b) foreign branch income; (c) passive category income; and (d) general category income. Generally, the proposed regulations provide transition rules for the four new categories, treatment of pre-2018 carryforwards and carrybacks of unused foreign taxes, and rules to determine how certain types of income should be categorized.

IRS Provides Additional Guidance on Automatic Consent to Accounting Method Change

The IRS issued Revenue Procedure 2018-60 (https://www.irs.gov/pub/irs-drop/rp-18-60.pdf), which modifies Revenue Procedure 2018-31, and provides new automatic method changes for taxpayers with an applicable financial statement and modifies existing accounting method change rules. A taxpayer that files IRS Form 3115, Application for Change in Accounting Method, in compliance with Revenue Procedure 2018-60 may receive audit protection for the change, however, a taxpayer that uses the streamlined method provided therein does not receive audit protection.

IRS Updates FATCA FAQs Regarding Qualified Intermediary Mergers

The IRS updated its list of general frequently asked questions (FAQs) (https://www.irs.gov/businesses/corporations/frequently-asked-questions-faqs-fatca-compliance-legal) under the Foreign Account Tax Compliance Act. The "Provisions for 2017 QI Agreement" portion of the FAQs now addresses the steps that

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must be followed when a qualified intermediary (QI) merges into an entity operating as a non-QI or, in certain instances, when a QI redomiciles in another country.

Ohio Permits Taxpayers to Pay State Taxes With Cryptocurrency

Ohio becomes the first state to allow taxpayers to pay certain Ohio state tax bills with cryptocurrency. Currently, only businesses operating in Ohio are able to pay for certain Ohio business-related taxes using the new online payment system (https://ohiocrypto.com/). Additionally, only Bitcoin is being accepted for payment, but other cryptocurrencies may be accepted in the future.

Christopher C. Scarpa

Jacquelyn Gordon

For more information, contact Christopher C. Scarpa at 215.564.8106 or cscarpa@stradley.com or Jacquelyn Gordon at 215.564.8176 or jgordon@stradley.com.

Stradley Ronon's Tax Practice Group

Name	Phone	Email
Todd C. Vanett, Chair	215.564.8070	tvanett@stradley.com
Zachary P. Alexander	215.564.8043	zalexander@stradley.com
Dean V. Krishna	215.564.8707	dkrishna@stradley.com
Jacquelyn Gordon	215.564.8176	jgordon@stradley.com
William R. Sasso	215.564.8045	wsasso@stradley.com
Christopher C. Scarpa	215.564.8106	cscarpa@stradley.com

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