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IRS Finalizes FATCA Regulations Regarding Requirements for Sponsoring Entities

The IRS issued final regulations (T.D. 9852, https://s3.amazonaws.com/public-inspection.federalregister.gov/2019-05527.pdf) under Sections 1471 through 1474 (the Foreign Account Tax Compliance Act, or FATCA) that provide compliance requirements and verification procedures for sponsoring entities of foreign financial institutions (FFIs) and certain nonfinancial foreign entities. (See our prior coverage of the proposed regulations at https://www.stradley.com/insights/publications/2017/01/tax-insights-january-11-2017) The regulations also explain the certification requirements and procedures for the IRS' review of certain trustees of certain trustee-documented trusts, the procedures for the IRS' review of periodic certifications provided by registered deemed-compliant foreign financial institutions, and the requirements for certifications of compliance for participating FFIs that are members of two consolidated compliance groups. The regulations are effective March 25, 2019.

IRS Finalizes Regulations Relating to Reportable Transaction Penalties

The IRS issued final regulations (T.D. 9853, https://s3.amazonaws.com/public-inspection.federalregister.gov/2019-05546.pdf) on various aspects of computing the amount of the penalty under Section 6707A for failure to disclose on any return or statement information with respect to reportable transactions. Reportable transactions are those identified by the IRS as having a potential for tax avoidance or evasion. The IRS has identified five types of reportable transactions. The penalty is 75 percent of the decrease in tax shown on the return as a result of reportable transactions, with a minimum penalty amount and a maximum penalty amount.

The IRS, in 2015, issued proposed regulations to provide guidance on the amount of the penalty. The final regulations add a rule that clarifies how the penalty is calculated in situations where a transaction becomes reportable after the filing of the return or returns reflecting participation in the transaction. If a transaction becomes a listed transaction or a transaction of interest after the filing of the return or returns reflecting a taxpayer's participation in such transaction, but while the period of limitations on assessment remains open, for any year in which the taxpayer participated in the transaction, Treasury Regulation Section 1.6011-4(e)(2)(i) requires taxpayers to file a single disclosure statement with respect to a subsequently listed transaction or transaction of interest. A taxpayer that first participated in a listed transaction or transaction of interest during a year for which the period of limitations on assessment is closed at the time the transaction becomes reportable, but that also participated in the same reportable transaction during a year for which the period of limitations on assessment remains open at the time the transaction becomes reportable, is required to describe participation in that reportable transaction during years for which the period of limitations is closed at the time the transaction becomes reportable.

Also, Treasury Regulation Section 301.6707A-1(d)(1)(ii) is revised to clarify that, when a taxpayer whose participation in a subsequently identified listed transaction or transaction of interest is reflected on more than one return and that taxpayer fails to file, as required by Treasury Regulation Section 1.6011-4(a), a complete and proper disclosure statement in the time prescribed under Treasury Regulation Section 1.6011-4(e)(2)(i), the amount of the penalty will be calculated by aggregating the decrease in tax shown on each return for which the period of limitations on assessment remains open at the time the transaction becomes reportable, subject to the statutory minimum and maximum penalty amounts. Decreases in tax shown on

returns for years for which the period of limitations is not open at the time the transaction becomes reportable will not be taken into account in calculating the amount of the penalty.

The preamble to the final regulations contains explanations/clarifications of rules contained in the proposed regulations that are unchanged in the final regulations, such as the following:

- When determining the "decrease in tax" upon which the amount of the penalty is calculated, Treasury Regulation Section 301.6707A-1(d)(1)(i) provides that one must consider tax that would result from participation in the reportable transaction and that was not reported on the taxpayer's return.

- A timely amended return that removes the tax benefits claimed with respect to the reportable transaction, but that does not report the benefits of the reportable transaction, does not remedy the failure to which a Section 6707A penalty applies, namely the failure to report participation in the reportable transaction. Therefore, such an action does not belong on the list of factors that applicable Treasury Regulations state that the IRS considers when determining whether to rescind a Section 6707A penalty.

The regulations are effective for penalties assessed after March 26.

IRS Issues Proposed Regulations on Partnership Transactions Involving Partner's Equity Interests

The IRS issued proposed regulations (REG-135671-17, https://www.federalregister.gov/documents/2019/03/25/2019-05545/partnership-transactions-involving-equity-interests-of-a-partner) to amend final regulations (T.D. 9833, https://www.govinfo.gov/content/pkg/FR-2018-06-08/pdf/2018-12407.pdf) that prevent a corporate partner from using a partnership to avoid recognition of corporate-level gain (see our prior coverage at https://www.stradley.com/insights/publications/2018/06/tax-insights-june-13-2018). Pursuant to T.D. 9833, a corporate partner may recognize gain when it is treated as acquiring or increasing its interest in stock of the corporate partner held by a partnership in exchange for appreciated property in a way that avoids gain recognition under Section 311(b) or Section 336(a). The proposed regulations modify the definition of "stock of the corporate partner" to eliminate the exclusion of attribution rules under Sections 318(a)(1) and (3) from the determination of Section 304(c) control. The expanded definition would be limited to entities that own a direct or indirect interest in the corporate partner.

The proposed regulations also change the definition of "stock of the corporate partner" by removing the affiliated group exception in the final regulations. Treasury and the IRS believe that a partnership held entirely by members of an affiliated group could enter into transactions that permanently eliminate the built-in gain on an appreciated asset that one partner contributes to the partnership.

The proposed regulations also narrow the scope of the value rule, which holds that "stock of the corporate partner" includes interests in any entity to the extent that the value of the interest is attributable to stock of the corporate partner.

Finally, the proposed regulations modify the exception for some dispositions of stock described in Treasury Regulation Section 1.337(d)-3(f)(2). Under the exception, the final regulations do not apply to "stock of the corporate partner" that (a) is disposed of (by sale or distribution) by the partnership before the due date (including extensions) of its federal income tax return for the tax year of the relevant transaction, and (b) is not distributed to the corporate partner or a corporation that controls the corporate partner.

The proposed regulations would be effective on the date the final regulations are published in the Federal Register, but taxpayers generally may rely on the proposed regulations for transactions occurring on or after June 12, 2015, but before final regulations are published.

IRS Issues Revised Proposed Regulations on Corporations' Transfers of Property to REITs

The IRS issued proposed regulations (REG-113943-17, https://www.federalregister.gov/documents/2019/03/26/2019-05682/certain-transfers-of-property-to-real-estate-investment-trusts-reits) that revise guidance and partially withdraw proposed regulations (REG-126452-15, https://www.federalregister.gov/documents/2016/06/08/2016-13425/certain-transfers-of-property-to-regulated-investment-companies-rics-and-real-estate-investment) issued in June 2016 addressing transactions in which property of a corporation becomes the property of a real estate investment trust following some corporate distributions of controlled corporation stock. (See our prior coverage at https://www.stradley.com/insights/publications/2016/tax-insights-2016/tax-insights-june-15-2016)

The IRS issued temporary regulations (T.D. 9770) on some transfers of property to regulated investment companies and REITs on the same day as the 2016 proposed regulations. (See our prior coverage at https://www.stradley.com/insights/publications/2016/tax-insights-2016/tax-insights-june-15-2016) In Notice 2017-38, issued in July 2017, the IRS identified eight regulations, including the 2016 temporary regulations, to which Treasury intended to propose reforms to mitigate the burdens of those regulations. (See our prior coverage at https://www.stradley.com/insights/publications/2017/07/tax-insights-july-12-2017) Based on Notice 2017-38, commentators raised a concern that the temporary regulations could result in over-inclusion of gain in some cases.

Under the 2016 proposed regulations, if a corporation is the distributing or controlled corporation in a related Section 355

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distribution and the corporation or its successor engages in a conversion transaction involving a REIT, the corporation or its successor will be treated as making a deemed sale election. Commentators suggested that applying that proposed rule to successors could result in recognition of more gain than would have been recognized if the distributing or the controlled corporation had directly engaged in a conversion transaction. The preamble to REG-113943-17 provides an example illustrating the issue, which Treasury and the IRS state creates an inappropriate result. To address these concerns, the new proposed regulations suggest a new limitation to the general rule. Under the new proposed regulations, gain immediately recognized by a corporation engaging in a Section 355 distribution and a later conversion transaction is limited to gain on property traceable to the Section 355 distribution. The limitation applies to a distributing or controlled corporation (and a successor) that engages in a conversion transaction within the 10-year period after a related Section 355 distribution. Under the limitation, if a corporation is treated as making a deemed sale election, but has not actually made that election, the corporation is treated as making the election only for its "distribution property," as defined in the proposed regulations. Property that is not distribution property is subject to Section 1374 built-in-gain treatment. An example illustrating the limitation is provided in the preamble to the new proposed regulations.

Seventh Circuit Court of Appeals Upholds Parsonage Allowance

The Seventh Circuit Court of Appeals issued its decision in Gaylor, et al. v. Mnuchin, et al. (http://media.ca7.uscourts.gov/cgi-bin/rssExec.pl?Submit=Display&Path=Y2019/D03-15/C:18-1280:J:Brennan:aut:T:fnOp:N:2309033:S:0), reversing the district court's decision that Section 107(2)'s income exclusion for housing allowances for "minister[s] of [the] gospel" violated the Establishment Clause. (See our prior coverage at https://www.stradley.com/insights/publications/2017/10/tax-insights-october-18-2017) The appellate court found that the purpose and effect of Section 107(2) (the parsonage allowance) were to provide financial assistance to one group of religious employees without any consideration to similarly situated secular employees. The appellate court found that the three-part Lemon test was clearly met when considering that the government articulated secular legislative purpose(s) for Section 107(2), in the form of eliminating discrimination against or between ministers or religions and avoiding excessive entanglement. The primary effect of Section 107(2) was to neither inhibit nor advance religion on behalf of the government, but rather merely to allow churches to advance the same as was their very purpose. The appellate court also found that Section 107(2) did not, in fact, cause excessive government entanglement, in that it exempted ministers from having to comply with Section 119(a)(2) (relating to lodging furnished for the convenience of the employer) and thereby avoided more excessive church-state entanglement that would result from the application of that provision.

IRS Expands Penalty Relief for Underpayment of Estimated Taxes

The IRS issued Information Release 2019-55 (March 22, 2019) (https://www.irs.gov/newsroom/irs-expands-penalty-waiver-for-those-whose-tax-withholding-and-estimated-tax-payments-fell-short-in-2018-key-threshold-lowered-to-80-percent) and Notice 2019-25 (https://www.irs.gov/pub/irs-drop/n-19-25.pdf) in which it expanded the estimated tax penalty waiver that it previously announced in Notice 2019-11 (see our prior coverage at https://www.stradley.com/insights/publications/2019/02/tax-insights-february-6-2019). The waiver now applies to taxpayers whose total withholding and estimated tax payments are 80 percent or more of their 2018 taxes (this is down from 85 percent). Notice 2019-25 also updates procedures for requesting the waiver and provides procedures for taxpayers who have already paid underpayment penalties but who now qualify for relief to request a refund.

JCT Publishes Overview of Business Interest Deduction Limitation

The Joint Committee on Taxation provided an overview of the Section 163(j) interest deduction limitation (https://www.jct.gov/publications.html?func=startdown&id=5174), which includes background information, present law, definitions, carryforward rules, application to pass-through entities, exceptions, relevant data and partnership carryforward examples.

IRS Issues Practice Unit on Foreign-Initiated Adjustments

The IRS released an international practice unit (https://www.irs.gov/pub/default_path_no_value/isi_p_006_09_03_01.pdf) on the procedures for adjustments made by foreign tax authorities and taxpayer-initiated adjustments concerning the taxable income of U.S. multinationals or their foreign affiliates.