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Tax Insights

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IRS Issues FAQs on Government Shutdown

The IRS issued FAQs (https://www.irs.gov/newsroom/irs-activities-following-the-shutdown) about the effects of the recent government shutdown on audits, collections and Tax Court operations. The IRS noted that its employees returned to work on Jan. 28 and began to review mail, voice messages, and audit and collection files, and to complete other administrative tasks necessary to resume operations.

IRS Provides Relief for Failure to Make Estimated Income Tax Payments

On Jan. 16, in Notice 2019-11 (https://www.irs.gov/pub/irs-drop/n-19-11.pdf), the IRS announced that the penalty for failure to make estimated income tax payments for the 2018 tax year is waived for any individual whose total withholding and estimated tax payments made on or before Jan. 15, 2019, equal or exceed 85 percent of the tax shown on that individual's return for the 2018 tax year. The IRS has now issued 2018 Form 2210, Underpayment of Estimated Tax by Individuals, Estates, and Trusts (https://www.irs.gov/pub/irs-dft/f2210--dft.pdf), and the instructions (https://www.irs.gov/pub/irs-pdf/i2210.pdf) for the form.

IRS Issues Form 8996 for Qualified Opportunity Funds

IRS has issued Form 8996 (https://www.irs.gov/forms-pubs/about-form-8996), which must be completed annually by qualified opportunity funds (QOFs) to invest in certain low-income communities. (See our prior coverage here (https://www.stradley.com/insights/publications/2018/10/tax-insights-october-24-2018) and here (https://www.stradley.com/insights/publications/2018/10/tax-insights-october-31-2018).) Corporations or partnerships that are organized and operated as a QOF must file Form 8996 annually with their regular income tax return. A corporation or partnership uses Part I of Form 8996 to certify that it is organized to invest in qualified opportunity zone property. A corporation or partnership uses Part II to annually report information regarding the 90 percent investment standard of Section 1400Z-2, Part III to determine if it fails to meet the investment standard and Part IV to determine the amount of penalty for any such failure. (Section references are to the Internal Revenue Code of 1986, as amended (Code).)

US District Court Defines 'Financial Interest' for FBAR Purposes

The U.S. District Court for the District of Maryland issued an opinion in *Horowitz* (123 AFTR 2d ¶2019-362 (DC MD 1/18/2019) (https://www.stradley.com/-/media/files/publications/2019/02/horowitz-opinion.pdf?la=en&hash=2001F815B795809CA97666D0456228B5)) that includes an assessment of the statute of limitations for assessing penalties for a Report of Foreign Bank and Foreign Accounts (FBAR) and adds color to the definitions of various FBAR terms, including the term "financial interest."

IRS Releases Additional International Practice Units

The IRS released two new international practice units. One practice unit (Preparatory and Auxiliary Treaty Exception to Permanent Establishment Status (https://www.irs.gov/pub/irs-utl/tre_t_016_07_03.pdf)) focuses on whether an activity has a preparatory or auxiliary character for purposes of determining whether a foreign enterprise has a U.S. permanent establishment, addressing the meaning of permanent establishment

under the U.K.-U.S. income tax treaty. The other practice unit (Creation of a Permanent Establishment (PE) through the Activities of a Dependent Agent in the United States (https://www.irs.gov/pub/default_path_no_value/tre_t_016_07_02.pdf)) examines whether a U.K. company has a U.S. permanent establishment because a dependent agent enters into binding contracts on its behalf in the United States.

GILTI and FDII Guidance Released by Pennsylvania

The Pennsylvania Department of Revenue has issued guidance (https://www.revenue.pa.gov/GeneralTaxInformation/TaxLawPoliciesBulletinsNotices/TaxBulletins/CT/Documents/ct_bulletin_2019-02.pdf) on the Pennsylvania tax treatment of global intangible low-taxed income (GILTI) and foreign-derived intangible income (FDII).

The 2017 Tax Cuts and Jobs Act (TCJA) added Section 951A and Section 250 to the Code. Section 951A subjects certain U.S. taxpayers to tax on their GILTI for tax years beginning on or after Jan. 1, 2018, and Section 250 allows taxpayers reporting GILTI to claim a deduction for a portion of their GILTI income. Section 250 also provides a deduction for taxpayers with FDII. Section 959(a) provides that, to prevent double taxation, amounts attributable to Subpart F inclusions are treated as previously taxed income (PTI) and are excluded from gross income when actually distributed. Section 951(A)(f)(1) treats GILTI income as Subpart F income for purposes of Section 959. Therefore, deemed income from GILTI should not be taxed a second time when actually distributed.

Pennsylvania's corporate net income tax (CNIT) starts with federal taxable income as reported on the taxpayer's federal income tax return on a separate company basis. Since GILTI is treated in a manner similar to Subpart F income for federal income tax purposes, and Pennsylvania treats Subpart F income as dividend income for purposes of CNIT, Pennsylvania will treat GILTI income as dividend income for CNIT purposes. Therefore, Pennsylvania corporate taxpayers are required to include GILTI in their CNIT base for the year in which the GILTI is recognized for federal income tax purposes (or would be recognized on a separate company basis if the CNIT taxpayer were required to file a separate federal income tax return). When the GILTI is actually distributed, Pennsylvania will follow the federal treatment and treat the distribution as PTI, which means that the distribution will not be subject to CNIT.

Pennsylvania law allows a deduction for corporations that receive dividends from foreign corporations. Because Pennsylvania treats GILTI income as dividend income for CNIT purposes, Pennsylvania will allow a dividends-received deduction with respect to GILTI. The deduction will also apply to any CNIT taxpayer that would have been entitled to such deduction on a separate company basis if it were required to file a separate federal income tax return. The dividends-received deduction might be less than 100 percent, depending on the CNIT taxpayer's ownership interest in the entity generating the GILTI income.

The GILTI and FDII deductions are considered "special deductions" for federal income tax purposes. Pennsylvania's CNIT base is computed without regard to special deductions. Therefore, Pennsylvania CNIT taxpayers will not be entitled to a deduction for GILTI or FDII. Pennsylvania law also specifically excludes dividends from the sales factor for purposes of Pennsylvania apportionment. GILTI income therefore is not included in a CNIT taxpayer's sales factor because Pennsylvania will treat GILTI income as dividend income for CNIT purposes.

For personal income tax (PIT) purposes, Pennsylvania limits taxable income to eight specific classes of income, including dividends. Pennsylvania defines a dividend as a distribution in cash or property made out of current or accumulated earnings and profits (E&P). For federal income tax purposes, GILTI is taxed even though there is no actual distribution of cash or property from E&P. Because this "deemed dividend" does not involve an actual distribution of cash, it is not a dividend for Pennsylvania PIT purposes. GILTI will therefore be subject to Pennsylvania PIT only if and when an actual distribution of cash is made to a PIT taxpayer from E&P. In the event of an actual distribution of GILTI, Pennsylvania PIT taxpayers must report the distribution as taxable dividend income regardless of whether they receive a Form 1099-DIV for the distribution.

Philadelphia Issues BIRT Regulations on Economic Nexus

Philadelphia issued final amended Business Income and Receipts Tax (BIRT) Regulations (https://www.stradley.com/-/media/files/publications/2019/02/birtregulationssection103economicnexus.pdf?la=en&hash=12DF91C23BB44B76EB996CB423F6534F) to provide guidance on activities constituting nexus in Philadelphia in light of the U.S. Supreme Court decision in *South Dakota v. Wayfair* (https://www.supremecourt.gov/opinions/17pdf/17-494_j4el.pdf). Section 103 (What Constitutes Doing Business (Having Nexus) in Philadelphia) of the BIRT regulations was amended to add an economic nexus standard for tax years starting Jan. 1, 2019, and thereafter, wherein a business with no physical presence in Philadelphia will be considered to have nexus

(and therefore will be subject to BIRT) if the business has generated at least $100,000 in Philadelphia gross receipts during any 12-month period ending in the current year, and has sufficient nexus with Philadelphia to establish nexus under the U.S. Constitution. The "active presence standard" for nexus with Philadelphia is also amended to provide that an "active presence" will at least subject the taxpayer to the gross receipts portion of the BIRT, and activity rising to the level of "solicitation plus" will result in the imposition of both the gross receipts and net income portions of the BIRT. Active presence is defined as purposeful, regular and continuous efforts in Philadelphia in the pursuit of profit or gain and the performance in Philadelphia of activities essential to those pursuits. Solicitation plus is where the taxpayer's business activities exceed solicitation.

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