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IRS Issues Guidance on Definition of Real Property Under CFC Rules

The IRS issued Notice 2018-46, 2018-21 IRB (<https://www.irs.gov/pub/irs-drop/n-18-46.pdf>), describing regulations that it intends to issue on an exception from the definition of “real property” and providing that taxpayers, pending the issuance of such regulations, can continue to rely on an exception to “U.S. real property” set out in 2015 temporary regulations that were set to expire on May 7, 2018.

Section 951(a) provides that a U.S. shareholder of a controlled foreign corporation (CFC) must include in gross income for the current tax year the shareholder’s pro rata share of certain items attributable to the CFC. This includes “the amount determined under ... [Section] 956.” The amount determined under Section 956 with respect to a U.S. shareholder for the tax year is based on the shareholder’s pro rata share of the average amount of “U.S. property” held by the CFC during the tax year. Section 956(c) defines U.S. property that will cause an inclusion for a U.S. shareholder if held directly or indirectly by the CFC during the tax year. Specific types of property that constitute U.S. property are set out in Section 956(c)(1), and exceptions are provided in Section 956(c)(2). Obligations of a U.S. person generally are considered U.S. property; however, under Section 956(c)(2)(J), obligations of a U.S. person are excepted to the extent that readily marketable securities are posted as collateral (qualifying collateral exception). (Section references are to the Internal Revenue Code of 1986, as amended.)

On May 11, 2012, the IRS published temporary and proposed regulations under Section 956 that excepted from the definition of “U.S. property” certain obligations arising from upfront payments on cleared notional principal contracts (NPCs) with respect to which full initial variation margin was posted. On May 8, 2015, the IRS published temporary and proposed regulations under Sections 446 and 956. These regulations extended the exception to the definition of U.S. property, contained in the 2012 regulations, to certain obligations of U.S. persons arising from upfront payments made with respect to uncleared NPCs if certain conditions relating to full margin or cash collateral were met (the “full margin or cash collateral exception”).

In response to the May 2015 regulations, the IRS received comments regarding uncertainty about the application of the full margin or cash collateral exception, including whether the exception applies when a combination of cash and other property is posted as margin. Commenters requested that the full margin or cash collateral exception apply (1) to the extent that qualifying collateral has been posted as margin in respect of an upfront payment regardless of whether the remainder of the payment is collateralized (similar to the qualifying collateral exception) and (2) without regard to whether the underlying derivative financial instrument is an NPC.

Notice 2018-46 states that the IRS intends to publish regulations that will provide an exception from the definition of U.S. property, similar to the qualifying collateral exception, for an obligation (without regard to whether such obligation arises in connection with a derivative financial instrument that is or is not an NPC) of a U.S. person to the extent the principal amount of the obligation does not exceed the fair market value of cash and readily marketable securities posted or received as margin or collateral for the obligation in the ordinary course of its business by a U.S. or foreign person who is a dealer in securities or commodities. Prior to the issuance of the regulations, taxpayers may rely either on the provisions of Notice 2018-

46 (including with respect to obligations arising before May 4, 2018) or on the full margin or cash collateral exception provided in the 2015 regulations.

IRS Issues Updated List of Automatic Accounting Changes

The IRS issued Revenue Procedure 2018-31, 2018-22 IRB (<https://www.irs.gov/pub/irs-drop/rp-18-31.pdf>), updating a list of accounting method changes to which IRS' automatic change procedures apply.

IRS Issues Automatic Consent to Accounting Method Change for New FASB and IASB Financial Accounting Standards

The IRS issued Revenue Procedure 2018-29, 2018-21 IRB (<https://www.irs.gov/pub/irs-drop/rp-18-29.pdf>), providing a new automatic change in accounting method for taxpayers to use to conform with Financial Accounting Standards Board Topic 606 (Revenue from Contracts with Customers) and the International Accounting Standards Board.

Petition for Certiorari Filed in Pennsylvania Loss Carryover Fight

A petition for certiorari has been filed with the U.S. Supreme Court in a case in which the Pennsylvania Supreme Court upheld the portion of the Commonwealth Court decision holding that the cap on net loss carryover for tax year 2007 violated the Uniformity Clause of the Pennsylvania Constitution, but it reversed the Commonwealth Court's remedy of allowing an unlimited deduction in favor of severing the \$3 million flat dollar cap from the law. The taxpayer had challenged the net loss carryover (NLC) deduction as in effect in 2007 on the basis that the provision limiting the deduction to the greater of \$3 million or 12.5 percent of taxable income violated the Uniformity Clause of the Pennsylvania Constitution by unfairly discriminating against taxpayers with taxable income greater than \$3 million. The state high court found that striking the \$3 million flat cap and keeping the remaining 12.5 percent net loss deduction most closely comported with a clear intent on the part of the legislature to balance the twin goals of encouraging corporate investment through allowing the NLC while ensuring the state's financial health by capping the amount that may be deducted in a given tax year. (*Nextel Communications of the Mid-Atlantic, Inc. v. Commw.*, Pa. S.Ct., Dkt. No. 6 EAP 2016, 10/18/2017, cert. filed U.S. S.Ct., Dkt. No. 17-1506, 05/03/2018.) (See our prior coverage here (<https://www.stradley.com/insights/publications/2015/tax-insights-web-versions/tax-insights-december-2-2015>), here (<https://www.stradley.com/insights/publications/2017/10/tax-insights-october-25-2017>) and here (<https://www.stradley.com/insights/publications/2018/02/tax-insights-february-7-2018>)).

FAQs Provide Guidance on Deadlines for QI/WP/WT Submissions

Frequently asked questions ([https://www.irs.gov/businesses/corporations/frequently-asked-questions-faqs-fatca-compliance-](https://www.irs.gov/businesses/corporations/frequently-asked-questions-faqs-fatca-compliance-legal#CPRQ9)



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[legal#CPRQ9](https://www.irs.gov/legalservices/faq/faq-legal#CPRQ9)) posted to the IRS' website clarify the deadline by which qualified intermediaries (QIs), withholding foreign partnerships (WPs) and withholding foreign trusts (WTs) must select the periodic review year of their certification and the due dates, with automatic extensions permitted by IRS, for submission of QI/WP/WT certifications.

Pennsylvania Commonwealth Court Rules on Untimely Petition for Reassessment

The Pennsylvania Commonwealth Court, in *Kerr v. Commw.* (http://www.pacourts.us/assets/opinions/Commonwealth/out/158fr12_5-7-18.pdf#search=%22kerr%22), dismissed exceptions filed by a taxpayer whose petition for reassessment was filed nearly two years after the Notice of Assessment. A Notice of Assessment was sent to the taxpayer on April 7, 2009, but the taxpayer did not file a petition for reassessment until March 25, 2011. The petition for reassessment was dismissed as untimely, and the taxpayer filed exceptions stating that he never received the Notice of Assessment. The Notice of Assessment was not stamped with a certified mail tracking number, so the Department of Revenue could not prove that it had been sent by certified mail. However, the requirements for a Notice of Assessment are set forth in Pa. Stat. Ann. Title 72 Section 7338(c) and Pa. Stat. Ann. Title 72 Section 7338(d), and neither section requires notice to be sent by certified mail. In addition, the taxpayer's certified public accountant contacted the Department of Revenue regarding the assessment three weeks after the Notice of Assessment was mailed (with a copy of the letter sent to the taxpayer), to which the Department responded and informed the accountant of the taxpayer's right to appeal. The court found that it is well-settled that time limitations under the Tax Code are to be strictly enforced and neither the Board nor the courts have the power to alter the explicit time limitations on equitable grounds (see *Quest Diagnostics Venture, LLC v. Commonwealth*, 119 A.3d 406 (Pa. Commw. 2015), *aff'd*, 148 A.3d 448 (Pa. 2016) and *Phila. Gas Works v. Commonwealth*, 741 A.2d 841, 846-47 (Pa. Commw. 1999), *aff'd*, 757 A.2d 360 (Pa. 2000)).