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IRS Issues Guidance on Recovery of State and Local Taxes Previously Deducted

The IRS, in Revenue Ruling 2019-11 (<https://www.irs.gov/pub/irs-drop/rr-19-11.pdf>), provides guidance to taxpayers regarding any current inclusion in gross income for prior year state or local tax deductions. Section 164 permits taxpayers to take a deduction for certain state and local taxes paid during the taxable year. Section 164 was amended by the 2017 Tax Cuts and Jobs Act (TCJA) and limits the amount of the deduction that can be taken by a taxpayer to \$10,000. Section 111, which codifies the tax benefit rule, excludes from gross income any amount recovered during the tax year that was previously deducted, only to the extent it did not reduce the amount of tax imposed. Therefore, if a taxpayer recovers an amount previously deducted, such amount is included in the taxpayer's gross income in the year of recovery if the deduction reduced the taxpayer's tax liability in the previous year. Revenue Ruling 2019-11 provides four examples to assist taxpayers in calculating the appropriate amount that should be included in gross income for state and local taxes that are recovered in the taxable year. The ruling holds that the taxpayer must include in gross income the lesser of (1) the difference between the taxpayer's total itemized deductions taken in the prior year and the amount of itemized deductions the taxpayer would have taken in the prior year had the taxpayer paid the proper amount of state and local tax or (2) the difference between the taxpayer's itemized deductions taken in the prior year and the standard deduction amount for the prior year, if the taxpayer was not precluded from taking the standard deduction in the prior year. (All section references are to the Internal Revenue Code of 1986, as amended.)

IRS Issues Advice on SALT Deduction and Business Expense Deduction

The IRS, in Program Manager Technical Advice 2019-01 (<https://www.irs.gov/pub/iranoa/pmta-2019-01.pdf>) (PMTA), advises about the interplay between the limit on the state and local tax (SALT) deduction in Section 164 and the amounts that are permissible as a deduction for expenses in connection with business use of a home under Section 280A. Section 280A(a) disallows a deduction for expenses incurred relating to the business use of a home unless another subsection of Section 280A excepts that expense from the disallowance. One such exception, under Section 280A(b), applies to expenses that would have otherwise been allowable as individual expenses. The PMTA concludes that if a taxpayer meets or exceeds the state and local tax limitation, or takes the standard deduction instead of itemizing, then none of the taxpayer's state and local taxes relating to the taxpayer's business use of the home are included as expenses under Section 280A(b). On the other hand, if a taxpayer's total individual state and local taxes do not meet or exceed the \$10,000 limitation of Section 164(b)(6) and the taxpayer does not opt to take the standard deduction in lieu of itemized deductions, then the taxpayer can include as expenses under Section 280A(b) the business portion of the state and local taxes up to the difference between the \$10,000 limitation and the amount of individual state and local taxes that the taxpayer actually deducted under Section 164.

IRS Withdraws Continuity of Interest Proposed Regulations

The IRS withdrew proposed regulations (<https://www.federalregister.gov/documents/2019/04/01/2019-06159/corporate-reorganizations-guidance-on-the-measurement-of-continuity-of-interest>) that would have provided guidance on how to determine whether certain transactions satisfy the continuity of interest (COI) requirement under Regulation Section 1.368-1(e), applicable to certain corporate reorganizations described in Section 368. In order for a

reorganization to qualify for tax-free treatment under Section 368, one of the requirements is that a substantial part of the value of the target corporation shareholders' proprietary interests in the target corporation be preserved (the COI requirement). Prior to 2011, the determination of whether the COI requirement is satisfied had been based on the value of the acquiring corporation stock as of the closing date of the reorganization. In final regulations issued in 2011, a special rule was created that would permit valuation on the end of the last business day before the first date there is a binding contract, instead of the closing date. Simultaneously, proposed regulations were issued that identified situations in which taxpayers could use certain average stock valuation methods to measure COI. However, the Treasury Department and the IRS have determined that current law generally provides sufficient guidance to taxpayers with respect to the COI requirement and withdrew the proposed regulations. Taxpayers wishing to use average stock valuation methods can rely on Revenue Procedure 2018-12 (<https://www.irs.gov/pub/irs-drop/rp-18-12.pdf>).

JCT Summarizes TCJA Changes to Income Recognition Rules Under Section 451

The Joint Committee on Taxation (JCT) summarized (<https://www.jct.gov/publications.html?func=startdown&id=5182>) certain changes to the TCJA in an April report. Generally, the report discusses the changes made by the TCJA to Section 451: (1) modifications to the all-events test, which provide that sales, gross receipts and other items are included in income no later than the taxable year in which such income is included as revenue for book purposes, (2) the override of certain special rules for bonds and other debt instruments and provision that such items are instead subject to the all-events test (as modified), and (3) deferral of advance payments only by using the one-year deferral method.



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SIFMA Requests That Treasury Prioritize Foreign Branch Guidance

The Securities Industry and Financial Markets Association (SIFMA) has requested that the Department of the Treasury and IRS prioritize guidance with respect to foreign branches. Specifically, the letter (<https://www.stradley.com/-/media/files/publications/2019/04/sifma-letter-to-treasury-irs.pdf?la=en&hash=3ADA068F8B505D5B350895A7D0989B6F>) addresses branch interest expense, disregarded transactions and global dealing.

Final Chapter 4 Regulation Applicability Dates Corrected

The IRS corrected (<https://www.federalregister.gov/documents/2019/04/04/C1-2019-05527/chapter-4-regulations-relating-to-verification-and-certification-requirements-for-certain-entities>) certain applicability dates from March 26, 2019, to March 25, 2019, in the Chapter 4 Treasury Regulations Relating to Verification and Certification Requirements for Certain Entities and Reporting by Foreign Financial Institutions.