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IRS Issues Final Regulations on Branch Transactions

The IRS, in Treasury Decision 9857 (<https://www.federalregister.gov/documents/2019/05/13/2019-09552/recognition-and-deferral-of-section-987-gain-or-loss>), has issued final regulations on recognition and deferral of foreign currency gain or loss under Section 987, branch transactions. Regulation Sections 1.987-2T, 1.987-4T and 1.987-12T, as revised, are adopted as final regulations; regulation Section 1.987-7T, which provided a liquidation value percentage methodology for allocating assets and liabilities of certain partnerships, is withdrawn. The finalized regulations include rules addressing the combinations and separations of qualified business units (QBUs) subject to Section 987, and the recognition and deferral of foreign currency gain or loss with respect to a QBU subject to Section 987 in connection with certain QBU terminations and certain other transactions involving partnerships. (Section references are to the Internal Revenue Code of 1986, as amended (the Code) and the Treasury Regulations thereunder.)

U.S. Supreme Court Overturns Precedent, Holds States Have Sovereign Immunity From Private Suits Brought in Courts of Other States

The U.S. Supreme Court held in a 5-4 decision in *California Franchise Tax Board v. Hyatt* (https://www.supremecourt.gov/opinions/18pdf/17-1299_8njq.pdf) that the U.S. Constitution bars individuals from bringing suit against a state in the court of another state. This ruling overturned the Court's 1979 decision in *Nevada v. Hall*, which held that such suits were not barred.

Updates from ABA Section of Taxation Annual Meeting

At the American Bar Association (ABA) Section of Taxation Annual Meeting in Washington, D.C., representatives of the Department of the Treasury and the IRS provided the following guidance:

1. Partnerships are allowed to defer capital gains under Section 1231 at the entity level to take advantage of the Opportunity Zone program.
2. Additional Opportunity Zone regulations safe harbors could be added to help businesses meet the requirement for using property within a zone.
3. New Proposed Regulations on “previously taxed earnings and profits” are forthcoming by the end of 2019, as well as several other regulations resulting from the 2017 Tax Cuts and Jobs Act (TCJA).

ABA Recommends Guidance on Section 163(j) and Section 108

In a letter (<https://www.americanbar.org/content/dam/aba/administrative/taxation/policy/051319comments.pdf>) dated May 13, the ABA provided comments to the IRS regarding the proposed regulations under Section 163(j) and its interaction with Section 108's cancellation of debt income. Generally, the letter recommends that the IRS adopt certain approaches to address inappropriate outcomes resulting from the cancellation of interest expense that gives rise to a carryforward under Section 163(j), that cancellation of debt income from the discharge of unpaid interest should be characterized as income from a nonexcepted or excepted trade or business depending on the character of that business when the taxpayer became liable for the interest under the terms of the debt instrument, and that

rules be adopted to coordinate Section 163(j)'s ordering rules with other Code provisions.

Nareit Provides Comments to IRS on Automatic Deemed Sale Rule Under Proposed Regulations

The National Association of REITs (Nareit) provided comments and recommendations ([https://www.reit.com/sites/default/files/Nareit%20Comments%202019%20Proposed%20Section%20337\(d\)%20Regulations%2005-10-2019%20FINAL.pdf](https://www.reit.com/sites/default/files/Nareit%20Comments%202019%20Proposed%20Section%20337(d)%20Regulations%2005-10-2019%20FINAL.pdf)) to the IRS on proposed regulations relating to conversions of entities from, and transfers of assets by, C corporations to real estate investment trusts (REITs) under Section 337(d). The 2016 regulations thereunder required deemed sale treatment under Section 1374 for any C corporation that engages in a conversion transaction within 10 years (i.e., before or after) of a tax-free spinoff that involves the converting C corporation. The 2019 regulations attempted to limit this deemed sale rule to "distribution property," which is generally defined as property owned by a distributing corporation or a controlled corporation (or a member of the separate affiliated group of either corporation) immediately after a tax-free spinoff, and other property the basis of which is determined, directly or indirectly, in whole or in part, by reference to that property. As a result of the limitation, gain immediately recognized by a C corporation engaging in a tax-free spinoff and a later conversion transaction would be limited to gain on property traceable to the tax-free spinoff.

Generally, the letter recommends that the regulations:

1. Are modified so that the automatic deemed sale rule applies only when a conversion transaction occurs in the 10-year period beginning five years before a tax-free spinoff.
2. Adopt an exception to the automatic deemed sale rule when a REIT that acquires property from a C corporation (i) receives a representation that the C corporation (along with specified predecessors and members of the affiliated



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group of which the C corporation is a member) has not engaged in a "related section 355 distribution," within the meaning of Prop. Reg. § 1.337(d)-7(f)(1), and (ii) has no actual knowledge contrary to such representation.

3. Are modified so that the automatic deemed sale rule will not apply if both the distributing corporation and the controlled corporation in a tax-free spinoff transaction are REITs immediately after the transaction, regardless of whether both the distributing corporation and the controlled corporation remain REITs for two years thereafter.

IRS Announces New Corporate Compliance Program

The Large Business and International (LB&I) Division of the IRS announced (<https://www.irs.gov/newsroom/lbi-announces-large-corporate-compliance-program>) the Large Corporate Compliance (LCC) program, which replaces the Coordinated Industry Case (CIC) program. The LCC program utilizes a new application of data analytics and covers compliance oversight for LB&I's largest corporate taxpayers. The LCC program improves LB&I's ability to efficiently focus its resources on noncompliance.