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IRS Issues Proposed Rules for Determining CFC Stock Ownership and GILTI

The IRS has issued proposed regulations (<https://www.federalregister.gov/documents/2019/06/21/2019-12436/guidance-under-section-958-rules-for-determining-stock-ownership-and-section-951a-global-intangible>) for determining stock ownership and global intangible low-taxed income (GILTI) for partners of domestic partnerships that are U.S. shareholders of a controlled foreign corporation (CFC). In addition, the proposed regulations address the treatment of a CFC's income that is subject to a high rate of foreign tax under the GILTI rules. A domestic partnership may rely on the proposed regulations with respect to tax years beginning after Dec. 31, 2017, and before the date that the proposed regulations are published as final in the Federal Register, provided that the partnership, domestic partnerships that are related to the partnership, and certain partners consistently apply the proposed regulations.

Proposed regulations issued in 2018 reflected a hybrid approach that treated a domestic partnership that is a U.S. shareholder of a CFC as an entity with respect to some partners, and as an aggregate of its partners with respect to others. Under the hybrid approach, a U.S. shareholder partnership calculates a GILTI inclusion amount, and its partners that are not U.S. shareholders of a CFC owned by a domestic partnership have a distributive share of such amount (if any). However, for partners that are themselves U.S. shareholders of a CFC owned by a domestic partnership, the partnership is treated in the same manner as a foreign partnership, with the result that the U.S. shareholder partners are treated as proportionately owning stock owned by the domestic partnership when determining their own GILTI inclusion amounts. The proposed regulations reject the hybrid approach of the 2018 regulations and provide that, for purposes of Sections 951 and 951A (and for any provision that applies by reference to those sections), a domestic partnership will be treated as an aggregate of its partners when determining whether, and to what extent, its partners have GILTI inclusions. (Section references are to the Internal Revenue Code of 1986, as amended.) Additionally, when determining the stock owned by a partner of a domestic partnership under Section 958(a), the proposed regulations treat a domestic partnership in the same manner as a foreign partnership. Therefore, under the proposed regulations, stock owned directly or indirectly by or for a domestic partnership generally is treated as owned proportionately by its partners for purposes of Sections 951(a) and 951A.

Court of Appeals Rules Foreign Corporation's Disposition of U.S. Partnership Interest Not U.S. Source Income

On June 11, the U.S. Court of Appeals for the District of Columbia Circuit in *Grecian Magnesite Mining, Industrial & Shipping Co., SA* (CA Dist Col 6/11/2019, [https://www.cadc.uscourts.gov/internet/opinions.nsf/5BDD6D9C86D7BCAB8525841600507BFC/\\$file/17-1268.pdf](https://www.cadc.uscourts.gov/internet/opinions.nsf/5BDD6D9C86D7BCAB8525841600507BFC/$file/17-1268.pdf)) 123 AFTR 2d ¶2019-771, affirmed a Tax Court ruling that a foreign corporation's proceeds from the redemption of an interest in a U.S. limited liability company that was treated as a partnership was not U.S. source income and was not effectively connected with a U.S. trade or business. The decision upholds a 2017 decision by the U.S. Tax Court. Prior to the enactment of the 2017 Tax Cuts and Jobs Act (TCJA), there was uncertainty about whether a foreign partner investing in a U.S. partnership engaged in a U.S. trade or business incurred potential U.S. tax exposure if the partner's interest in the partnership was disposed of at a gain.

In Revenue Ruling 91-32, the IRS took an aggregate approach to the taxation of partnerships with income effectively connected with the conduct of a U.S. trade or business. Where a partnership is engaged in a U.S. trade or business through its U.S. fixed place of business, the IRS ruled that

a foreign partner's gain or loss on a transfer of an interest in such partnership will be treated as effectively connected income (ECI), to the extent such gain or loss is attributable to ECI property of such partnership. The U.S. Tax Court, in its decision in *Grecian Magnesite* (<https://www.ustaxcourt.gov/USTCInOP/OpinionViewer.aspx?ID=11322>), rejected the IRS' reasoning in Revenue Ruling 91-32 and held that a foreign partner's gain or loss on a transfer of an interest in the partnership generally should not be treated as ECI unless certain exceptions apply. That was because a partnership interest in the hands of a foreign partner is personal property, and therefore, gain or loss on such interest would be treated as foreign source items pursuant to the source rule applicable to a sale of personal property. Section 864(c)(8) was enacted as part of the TCJA to overturn the result of the Tax Court's decision in *Grecian Magnesite*. It expressly provides that gain or loss of a foreign partner from a transfer of an interest in a partnership generally will be treated as ECI to the extent that such partner would have had ECI if the partnership had sold all of its assets at fair market value as of the date of the transfer. The decision of the D.C. Circuit is important for foreign investors in entities taxed as U.S. partnerships that took a position contrary to Revenue Ruling 91-32 prior to the enactment of Section 864(c)(8).

IRS Compliance Assurance Process Program Seeking Statements of Interest

The IRS released IR 2019-113 (<https://www.irs.gov/newsroom/irs-wants-to-hear-from-large-corporate-taxpayers-interested-in-applying-for-the-compliance-assurance-process>), in which it asks publicly traded corporate taxpayers interested in applying to the Compliance Assurance Process (CAP) in 2020 to provide a statement of interest. The purpose of the CAP, launched in 2005, is to improve federal tax compliance by resolving issues prior to the filing of a tax return through open, cooperative and transparent interactions between the IRS and taxpayers. The CAP has not accepted new applicants since 2015. Additional information about CAP can be found at <https://www.irs.gov/businesses/corporations/compliance-assurance-process>.

JCT Releases Overview of Opportunity Zone Program

The Joint Committee on Taxation (JCT) released an overview of the Qualified Opportunity Zones program (<https://www.jct.gov/publications.html?func=startdown&id=5201>), including investor requirements and tax benefits, qualified opportunity fund locations and requirements, Form 8996, the opportunity zones activity safe harbor, and qualified property.

JCT Provides Overview of EO Transportation Benefit Rules

The JCT summarized (<https://www.jct.gov/publications.html?func=startdown&id=5192>) the rules on tax-exempt



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organizations' unrelated business taxable income from disallowed transportation-related fringe benefits, in advance of a House Ways and Means Oversight Subcommittee hearing.

Pennsylvania Updates List of Taxable and Exempt Items

Pennsylvania has published an updated list (<https://www.pabulletin.com/secure/data/vol49/49-24/909.html>) of property and services that are either exempt from Pennsylvania sales tax or specifically taxable.

Philadelphia Wage and Earnings Tax to Decrease July 1

The Philadelphia Department of Revenue issued a reminder (<https://www.phila.gov/2019-06-13-philadelphia-wage-tax-decreases-on-july-1/>) to Philadelphia businesses and city residents that the rate of Philadelphia wage tax, and the rate of Philadelphia earnings tax, will decrease to 3.8712% for residents and 3.4481% for nonresidents effective July 1. The rate of Philadelphia school income tax mirrors the wage tax, so that rate also will decrease to 3.4481% for residents effective for tax year 2019. Nonresidents are not subject to the school district tax. The rate decreases are part of a long-term plan to make small yearly reductions in the rate of Philadelphia tax.

Massachusetts Treatment of Investments in Qualified Opportunity Zones

The Massachusetts Department of Revenue has issued guidance (<https://www.mass.gov/technical-information-release/tir-19-7-massachusetts-treatment-of-investments-in-qualified>) on how gain from the sale or exchange of property, reinvested in a qualified opportunity zone and deferred under new amendments to the Internal Revenue Code by the TCJA, is treated for Massachusetts income tax purposes.