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IRS Issues Final Regulations on Colleges/Universities Net Investment Income Excise Tax

The IRS has issued final regulations (TD 9917) for determining the 1.4% excise tax under Section 4968 on the net investment income of certain private colleges and universities and related organizations. (Section references are to the Internal Revenue Code of 1986, as amended.) Section 4968 imposes on each applicable educational institution an excise tax equal to 1.4% of the institution's net investment income, and of net investment income of certain related organizations, for the tax year. An applicable educational institution (AEI) is an eligible educational institution (as defined in Section 25A(f)(2)) which during the preceding tax year had at least 500 tuition-paying students, more than 50% of whom were located in the U.S.; is not a state college or university; and had assets (other than those assets used directly in carrying out the institution's exempt purpose) the aggregate fair market value of which was at least $500,000 per student of the institution. The final regulations adopt, with certain modifications and clarifications, the proposed regulations issued in July 2019 (see our prior coverage here). Highlights of the modification and clarifications include:

- **Definition of student:** The final regulations define the term "student" for Section 4968 purposes as a person who is enrolled and attending a course for academic credit from the AEI and who is being charged tuition at the same rate as students enrolled for a degree.

  Also, the final regulations clarify that the standards for determining whether a student attends part-time or full-time and calculating full-time equivalents and the daily average number of full-time students are determined by each AEI, but may not be lower than the minimum applicable standards established by the Education Department under the Higher Education Act of 1965.

- **Definition of tuition-paying:** The final regulations adopt the definition of "tuition-paying" in the proposed regulations but add that whether a student is tuition-paying is also determined after taking into account federal, state, or local government grants.

- **Definition of located in the U.S.:** The proposed rule contemplated that educational institutions could determine, using any reasonable method, whether a student resided in the U.S. for at least a portion of the time that the student attended the institution during the institution's preceding tax year. The final regulations explicitly state this rule.

- **Assets used directly in carrying out an AEI's exempt purpose:** The general rule under the final regulations is that an AEI evaluates each asset based on all the facts and circumstances to determine whether the asset is used directly in furthering the AEI's exempt purpose.

- **Reasonable cash balance:** The final regulations provide a different safe harbor for a reasonable cash balance than the one in the proposed regulations. The final regulations' safe harbor provides that a reasonable cash balance may be determined by any reasonable method and describe such a method. The final regulations also provide

a facts and circumstances safe harbor under which an AEI can establish a reasonable cash balance citing the amount of cash necessary to cover administrative expenses and other normal disbursements directly connected with the AEI's exempt activity.

IRS Issues PLR Approving RIC's Accounting Method for Foreign Currency Gain or Loss

The IRS issued Private Letter Ruling 202038001 to a regulated investment company (RIC) organized to track the performance of an index that measures, in U.S. dollars, the performance of specified foreign currency denominated bonds after applying a foreign currency hedging method. The currency return on the foreign currency denominated bonds in the index is offset (relative to the U.S. dollar) by rolling one-month forward contracts on those currencies. Consistent with the index provider's foreign currency hedging method and in light of the large number of foreign currency denominated bonds in the index and that are expected to be held by the RIC, in order to determine the appropriate notional amount of forward contracts needed to hedge each relevant currency in its portfolio, the RIC will aggregate the projected market values of all of its bonds that are denominated in that currency. The RIC also will include any foreign currency cash balances held by the RIC as part of the foreign currency exposure being hedged by the monthly forward contracts. Under the authority provided in Treasury Regulation Section 1.988-5(e), which grants the IRS the authority to issue an advance ruling addressing the income tax consequences of a taxpayer's system of hedging its net nonfunctional currency exposure, the IRS granted the RIC permission to use the proposed tax accounting method described in the ruling for determining the timing, character, and amount of foreign currency related gain or loss on the foreign currency denominated bonds and the forward contracts entered into for the purpose of hedging the right to receive foreign currency denominated payments on such bonds.

IRS Issues Final Regulations on Ownership Attribution Rules

The IRS has issued final regulations (TD 9908) related to the ownership attribution rules under Section 958(b). Section 958(b) was modified by the 2017 Tax Cuts and Jobs Act (TCJA). The regulations adopt 2019 proposed regulations issued under Section 958(b) and expand the controlled foreign corporation (CFC) payee rule to apply to all amounts payable to a related foreign person that is a CFC that does not have any Section 958(a) U.S. shareholders. Section 958 sets forth rules for determining direct, indirect, and constructive stock ownership. In general, Section 318 provides rules that attribute the ownership of stock to certain family members, between certain entities and their owners, and to holders of options to acquire stock and Section 318(a)(3) generally attributes stock owned by a person to a partnership, estate, trust, or corporation in which the person has an interest (so-called "downward attribution"). As in effect before repeal, Section 958(b)(4) provided that Section 318(a)(3) was not to be applied so as to consider a U.S. person as owning stock owned by a person who is not a U.S. person (a "foreign person"). Effective for the last tax year of foreign corporations beginning before Jan. 1, 2018, and each subsequent year of the foreign corporations, and for the tax years of U.S. shareholders in which or with which such tax years of the foreign corporations end, Section 958(b)(4) was repealed by the TCJA.

In 2019, the IRS issued proposed regulations regarding the ownership attribution rules under Section 958(b) ("Proposed Regulations"). As a result of the repeal of Section 958(b)(4), Section 958(b) now provides for downward attribution from a foreign person to a U.S. person in circumstances in which Section 958(b) did not so provide prior to its repeal. Thus, U.S. persons that were not previously treated as U.S. shareholders may be treated as U.S. shareholders, and foreign corporations that were not previously treated as CFCs may be treated as CFCs. The proposed regulations provided that an amount, other than interest, that is income of a related foreign person with respect to which the related foreign person is exempt from U.S. taxation on the amount owed pursuant to a treaty obligation of the U.S. is exempt from the application of Section 267(a)(3)(B)(i) (this is referred to as the CFC payee rule and it provides that in the case of any item payable to a CFC, a deduction is allowable to the payor with respect to the amount for any taxable year before the year in which paid only to the extent that an amount attributable to the item is includible during such prior taxable year in the gross income of a U.S. person who owns stock in such corporation under Code Sec. 958(a)) if the related foreign person is a CFC that does not have any U.S. shareholders that owned (within the meaning of Section 958(a)) stock in the CFC. (Such U.S. shareholders are sometimes referred to as "Section 958(a) U.S. shareholders.") Another change made by the proposed regulations was to the PFIC asset test. The proposed regulations modified the definition of a CFC for purposes of the Section 1297(e) PFIC rules to disregard downward attribution from foreign persons. In July 2019, the IRS published other proposed regulations under

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Treasury Regulation Section 1.1297-1. The final regulations adopt the proposed regulations with certain modifications. One such modification is that the final regulations expand the CFC payee rule to apply to all amounts payable to a related foreign person that is a CFC that does not have any Section 958(a) U.S. shareholders. The final regulations generally apply on or after Oct. 1, 2019. For tax years before tax years covered by the final regulations, a taxpayer may generally apply the rules set forth in the final regulations to the last tax year of a foreign corporation beginning before Jan. 1, 2018, and each subsequent tax year of the foreign corporation, and to tax years of U.S. shareholders in which or with which such tax years of the foreign corporation end, provided that the taxpayer and U.S. persons that are related (within the meaning of Section 267 or 707) to the taxpayer consistently apply the relevant rule with respect to all foreign corporations.

IRS Issues Final Regulations Regarding Foreign Persons' Sale/Exchange of Partnership Interests

The IRS has released final regulations (TD 9919) that provide guidance for certain foreign persons that recognize gain or loss from the sale or exchange of an interest in a partnership that is engaged in a trade or business within the U.S. Section 864(c)(8)(A) provides that gain or loss of a foreign transferor (from the transfer of an interest, owned directly or indirectly, in a partnership that is engaged in any trade or business within the U.S.) is treated as effectively connected gain or loss (EC gain or EC loss) to the extent such gain or loss does not exceed the amount determined under Section 864(c)(8)(B). In general, Section 864(c)(8)(B) limits the amount of EC gain or loss to the portion of the foreign transferor's distributive share of gain or loss that would have been EC gain or EC loss if the partnership had sold all of its assets at fair market value (FMV). This is called the "deemed sale limitation." In December 2018, the IRS proposed regulations (REG-113604-18) that illustrate, among other things, how to determine EC gain or EC loss and the deemed sale limitation amount. The final regulations retain the basic approach and structure of the proposed regulations with certain revisions. The final regulations retain the ten-year exception as an exception to the determination of deemed sale EC gain and EC loss under Treasury Regulation Section 1.864(c)(8)-1(c)(2)(i)(A). The ten-year exception provides that gain or loss from the deemed sale of a partnership asset is not treated as EC gain or EC loss if: (1) no income or gain previously produced by the asset was taxable as effectively connected with the conduct of a trade or business within the U.S. by the partnership (or a predecessor of the partnership) during the ten-year period ending on the date of the transfer; and (2) the asset was not used or held for use, in the conduct of a trade or business within the U.S. by the partnership (or a predecessor of the partnership) during the ten-year period ending on the date of transfer. The ten-year exception is intended to remove assets that have no nexus to the U.S. from the deemed sale EC gain and EC loss determination.

IRS Issues Proposed Regulations Addressing Ownership Attribution Under Section 958 for Purposes of Sections 367(a) and 954(c)(6)

The IRS has released proposed regulations (REG-110059-20) that would modify the ownership attribution rules applicable to outbound transfers of stock or securities of a domestic corporation. The proposed regulations also would narrow the types of foreign corporations that qualify for the Section 954(c)(6) exception to the foreign personal holding company rules.

In general, an outbound transfer is any transfer of property by one or more U.S. persons to a foreign corporation. Such transfers are subject to Section 367, which generally taxes unrealized gains on outbound transfers that might otherwise be nonrecognition transactions. Except as otherwise provided, a transfer of stock or securities of a domestic corporation by a U.S. person to a foreign corporation that would otherwise be subject to Section 367(a)(1) will not be subject to that section if the domestic corporation the stock or securities of which are transferred ("the U.S. target company") complies with certain reporting requirements and other conditions. For purposes of the exception, the attribution rules of Section 318 (as modified by Section 958(b)) apply in determining the ownership or receipt of stock, securities, or other property. Section 954(c)(6)(A) generally provides that dividends, interest, rents, and royalties received or accrued by a CFC from a CFC that is a related person are not treated as foreign personal holding company income to the extent attributable or properly allocable to income of the related person that is neither subpart F income nor income treated as effectively connected with the conduct of a trade or business in the U.S. (the "section 954(c)(6) exception"). The proposed regulations would modify the ownership attribution rules applicable to outbound transfers of stock or securities of a domestic corporation and narrow the types of foreign corporations that qualify for the Section 954(c)(6) exception to the foreign personal holding company rules. The proposed regulations also would revise Treasury Regulation Section 1.367(a)-3(c)(4)(iv) to treat a U.S. person as owning stock that is owned by a foreign person for all purposes of Treasury Regulation Section 1.367(a)-3(c) other than for purposes of determining whether a U.S. person is a 5% transferee shareholder under Treasury Regulation Section 1.367(a)-3(c)(1)(iii). The proposed regulations also would limit the application of the Section 954(c)(6) exception to amounts received or accrued from foreign corporations that are CFCs without applying Section 318(a)(3) to treat a U.S. person as owning stock that is owned by a foreign person.

IRS Announces No Information Returns When PPP Loans Are Forgiven

The IRS issued Announcement 2020-12, which provides that lenders who make Paycheck Protection Program (PPP) loans that are later forgiven under the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) should not file information returns or furnish payee statements to report the forgiveness.

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IRS LB&I Adds New Compliance Campaigns to Active Campaigns List

The IRS Large Business and International (LB&I) division has announced the following new campaigns:

- **Allocation of success-based fees:** Success-based fees (in general, amounts contingent on the closing of an acquisition or merger, e.g., fees paid to an investment banker) paid in transactions under Treasury Regulation Section 1.263(a)-5(a) are presumed facilitative and must be capitalized. These fees may instead be allocated to non-facilitative activities, and currently deducted, if the taxpayer meets the documentation requirements under Treasury Regulation Section 1.263(a)-5(f). The goal of the campaign is to ensure taxpayer compliance with current law.

- **FIRPTA reporting compliance for NRAs:** The Foreign Investment in Real Property Tax Act (FIRPTA) taxes nonresident aliens (NRAs) on the disposition of their U.S. real property interests. Generally, the buyer/transferee is the withholding agent and is required to withhold 15% of the amount realized on the sale, file the required forms, and remit the tax to the IRS. This campaign is intended to increase FIRPTA voluntary compliance through issue-based examinations and external education and outreach.

- **Computation of life insurance reserves under Section 807(d):** The goal of this campaign is to examine Forms 1120-L, U.S. Life Insurance Company Income Tax Return, filed by life insurance companies for their 2017 and/or 2018 tax years (and any related and subsequent year returns) to understand how taxpayers implemented TCJA Section 13517, to ensure compliance, and to identify compliant and noncompliant technical issues. The treatment stream for this campaign is issue-based examinations.

- **Re-computation of life insurance reserves:** The goal of this campaign is to examine original and amended Forms 1120-L filed by life insurance companies for their 2017 and/or 2018 tax years (and any related and subsequent year returns) to ensure compliance and to identify compliant and noncompliant technical issues.

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