STRADLEY RONON

Tax Insights

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IRS Issues Notice on Dividend Equivalent Transition

The IRS released Notice 2016-76, 2016-51 IRB 1 (https://www.irs.gov/pub/irs-drop/n-16-76.pdf) to provide taxpayers with guidance for complying with final and temporary regulations under Sections 871(m), 1441, 1461 and 1473 (collectively, referred to as the Section 871(m) regulations) in 2017 and 2018, and to explain how the IRS intends to administer those regulations in 2017 and 2018. (Section references are to the Internal Revenue Code of 1986, as amended). In response to challenges that taxpayers and withholding agents are expected to face, – which include designing, building and testing new withholding and reporting infrastructure for dealers, issuers and other withholding agents; implementing new system requirements for paying agents and clearing organizations; and enhancing and developing data sources for determining whether transactions are "section 871(m) transactions" – the Treasury Department and the IRS have determined that the phased-in application of certain rules as provided by the notice, in combination with the expected changes to the final and temporary regulations, will allow for the orderly implementation of the Section 871(m) regulations.

Specifically, the Notice provides the following guidance:

- For 2017, the IRS will take into account the extent to which the taxpayer or withholding agent made a good faith effort to comply with the Section 871(m) regulations in enforcing the Section 871(m) regulations for any delta-one transaction.
- For 2018, the IRS will take into account the extent to which the taxpayer or withholding agent made a good faith effort to comply with the Section 871(m) regulations in enforcing the Section 871(m) regulations for any non-delta-one transaction.
- For 2017, withholding agents may remit amounts withheld for dividend equivalent payments quarterly, on or before the last day of that calendar quarter.
- For 2017, withholding agents may rely on a simplified standard for determining whether transactions are combined transactions pursuant to Treasury Regulations Section 1.871-15(n), i.e., withholding agents will be required to combine transactions entered into in 2017 for purposes of determining whether the transactions are section 871(m) transactions only when the transactions are over-the-counter transactions that are priced, marketed or sold in connection with each other, and withholding agents will not be required to combine any transactions that are listed securities that are entered into in 2017.
- For 2017 and following years, the "section 871(m) amount" of a qualified derivatives dealer (QDD) is to be determined by calculating the net delta exposure (measured in number of shares) of the QDD on the date provided in Treasury Regulations Section 1.871-15(j)(2), multiplied by the relevant dividend

amount per share. A QDDs net delta exposure will be determined by aggregating the delta of all physical positions and potential section 871(m) transactions with respect to an underlying security entered into by the QDD in its equity derivatives dealer capacity.

- For 2017, the IRS will take into account the extent to which the QDD made a good faith effort to comply with the QDD provisions in the Qualified Intermediary (QI) agreement when enforcing those provisions.
- Prospective QDDs may apply for QDD status on or before March 31, 2017, and, if accepted by the IRS, be treated as having QDD status as of Jan. 1, 2017.
- Before receiving a QI employer identification number (QI-EIN), QDDs may provide a statement on a Form W-8IMY that the QDD is "awaiting QI-EIN," and withholding agents may rely on this statement, to the extent permitted in the Notice.
- The Section 871(m) regulations will not apply to certain existing exchange-traded notes specifically identified in the Notice until Jan. 1, 2020.

NYSBA Tax Section Submits Report on Proposed RIC Regulations

The New York State Bar Association submitted a report (https://www.nysba.org/Sections/Tax/Tax_Section_Reports/Tax_Reports_2016/Tax_Section_Report_1359.html) commenting on Proposed Regulation Section 1.851-2 (the Proposed Regulations), issued under Section 851(b)(2) (the Good Income Test), which applies for purposes of determining the qualification status of a regulated investment company (a RIC). The NYSBA recommends that the final regulations adopt the rule that would require, for purposes of the Good Income Test, income recognized under Section 951(a)(1)(A)(i) or 1293(a) (Subpart F/QEF Imputations) to be treated as dividends only to the extent that, under Section 959(a)(1) or 1293(c) (as the case may be), there is a distribution out of earnings and profits of the taxable year which is attributable to the amounts so included. Conversely, the NYSBA does not recommend that the Final Regulations adopt the rules which would require, for purposes of the Good Income Test, Subpart F/QEF Imputations and income recognized under Sections 951(a)(1)(A)(ii), 951(a)(1)(A)(iii) or 951(a)(1)(B) to not be treated as other income derived with respect to a corporation's business of investing in such stock, securities or currencies (the Main Proposal). In lieu of the Main Proposal, NYSBA recommends that the final regulations provide that any Subpart F/QEF Imputations and any income recognized under Sections 951(a)(1)(A)(ii), 951(a)(1)(A)(iii) or 951(a)(1)(B) derived with respect to a business of investing in stocks, securities or currencies be treated as qualifying under the Good Income Test regardless of whether the imputed income is distributed. The NYSBA does not comment on whether Rev. Rul. 2006-1, Rev. Rul. 2006-31 and related guidance, which address the treatment of income from certain commodity linked instruments under the Good Income Test and the asset diversification requirement contained in Section 851(b)(3), should be withdrawn.

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NYSBA Tax Section Submits Report on Pending FTC Splitter Regulations

The NYSBA also submitted a report (https://www.nysba.org/Sections/Tax/Tax_Section_Reports/Tax_Reports_2016/Tax_Section_Report_1360.html) commenting on Notice 2016-52, which identifies a new foreign tax credit splitter arrangement under Section 909, applicable to specified long-delayed foreign-initiated tax adjustments to foreign subsidiaries of U.S.-parented groups. Under the Notice, according to the report, a new "foreign-initiated adjustment splitter arrangement" (a Section 905(c) Splitter) would exist where foreign-initiated adjustments reflected per Section 905(c) in the taxable year for which the tax is actually paid will be treated as a splitter arrangement subject to the Section 909 mechanics. The NYSBA comments that "the effect of the new splitter arrangement would be to defer any foreign tax credit to the U.S. multinational for those foreign-initiated adjustments until the related income that gave rise to the adjustment is also reflected in the U.S. income of the U.S.-parented group." The NYSBA suggests that in past reports issued by it on Section 909 splitters, it stated that creditable foreign taxes actually paid by foreign subsidiaries of a U.S.-parented group can be permanently disallowed under some transactional patterns and other situations where the U.S. group is unable to substantiate the required tracing of earnings. The NYSBA suggests that the future regulations

embodying the new Section 905(c) Splitter might operate more effectively by using Section 905(c) authority to avoid the splitting of foreign taxes from the related income.

Proposed Regulations Provide Rules on LIFO Inventory Pools

The IRS released proposed regulations (REG-125946-10; 81 F.R. 85450-85455, https://www.gpo.gov/fdsys/pkg/FR-2016-11-28/pdf/2016-28375.pdf) that relate to the establishment of dollar-value last-in, first-out (LIFO) inventory pools by certain taxpayers that use the inventory price index computation (IPIC) pooling method. The proposed regulations provide rules regarding the proper pooling of manufactured or processed goods and wholesale or retail (resale) goods. The proposed regulations would affect taxpayers who use the IPIC pooling method and whose inventory for a trade or business consists of manufactured or processed goods and resale goods.

IRS Rules on Method for Measuring Insurer's Subpart F Income

In Private Letter Ruling 201648016 (https://www.irs.gov/pub/irs-wd/201648016.pdf?_ga=1.4903859.1259906098.1479092544), the IRS ruled that the foreign statement underwriting reserves, loss reserves and policyholder dividend reserves with respect to exempt life insurance and annuity contracts (within the meaning of Sections 953(e)(2) and 954(i)(4)(B)) issued by a controlled foreign corporation (CFC) are an appropriate means of measuring income under Section 954(i)(4)(B)(ii) and may be used in determining the foreign personal holding company income of the CFC under Section 954(i). Similarly, in Private Letter Ruling 201648015 (https://www.irs.gov/pub/irs-wd/201648015.pdf), the IRS ruled the underwriting reserves, loss reserves and policyholder dividend reserves with respect to exempt life insurance contracts (within the meaning of Sections 953(e)(2) and 954(i)(4)(B)) issued by a CFC and as reflected on the annual report that the CFC is required to file with an insurance regulator are an appropriate means of measuring income within the meaning of Section 954(i)(4)(B)(ii) and may be used for purposes of Section 954(i) in determining the CFCs Subpart F income.

IRS Releases Form 8938 Instructions for 2016

The IRS has released the instructions (https://www.irs.gov/pub/irs-pdf/i8938.pdf) for 2016 Form 8938, "Statement of Specified Foreign Financial Assets," noting the requirements for specified domestic entity reporting, revisions to the identifying information section of the form and revisions related to the global intermediary identification number.

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