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IRS Publishes Final Regulations on U.S. Property Held by CFCs

The Treasury Department and the IRS issued final regulations (T.D. 9792, https://www.gpo.gov/fdsys/pkg/FR-2016-11-03/pdf/2016-26425.pdf) under Sections 954 and 956 regarding the treatment of property held by a controlled foreign corporation (CFC) in connection with certain transactions involving partnerships as "United States property." (Section references are to the Internal Revenue Code of 1986, as amended.) The final regulations largely adopt the 2015 proposed regulations (see our prior coverage at http://www.stradley.com/insights/publications/2015/tax-insights-web-versions/tax-insights-september-9-2015) as final regulations and remove the corresponding temporary regulations. Additionally, the final regulations supplant certain proposed regulations issued in 1988 and 2009, and therefore certain of the proposed regulations are withdrawn (https://www.gpo.gov/fdsys/pkg/FR-2016-11-03/pdf/2016-26424.pdf).

The final regulations add new examples to further illustrate the distinction between funding transactions that are subject to the anti-avoidance rule under Treasury Regulations 1.956-1T(b)(4) and common business transactions to which the anti-avoidance rule does not apply. Further, the coordination rule in proposed Treasury Regulations Section 1.956-1(b)(4)(iii) is expanded in final Treasury Regulations Section 1.956-1(b)(3) to prevent a CFC from being treated as holding duplicative amounts of United States property under the anti-avoidance rule as a result of a partnership obligation, and an additional example is added to illustrate the rule.

The Treasury Department and the IRS have determined that an outside basis limitation should not be incorporated into the rule in proposed Treasury Regulations Section 1.956-4(b)(1), thereby rendering Revenue Ruling 90-112 obsolete, since the revenue ruling provides that the amount of United States property taken into account for purposes of Section 956 when a CFC partner indirectly owns property through a partnership is limited by the CFC's adjusted basis in the partnership.

In contrast to the rule provided in proposed Treasury Regulations Section 1.956-4(b) providing that a CFC partner's attributable share of partnership property is determined in accordance with the CFC partner's liquidation value percentage, proposed Treasury Regulations Section 1.956-4(c) provided that a partner's share of a partnership obligation is determined in accordance with the partner's interest in partnership profits. The final regulations retain the liquidation value percentage method set forth in proposed Treasury Regulations Section 1.956-4(b) and revise the general rule in proposed Treasury Regulations Section 1.956-4(c) to implement the liquidation value percentage method.

However, the Treasury Department and the IRS have determined that special allocations with respect to a partnership controlled by a U.S. multinational group (a controlled partnership) and its CFCs are unlikely to have economic significance for the group as a whole and can facilitate inappropriate tax planning. Accordingly, the Treasury Department and the IRS are proposing a new rule in a notice of proposed rulemaking (REG-114734-16, https://www.gpo.gov/fdsys/pkg/FR-2016-11-03/

pdf/2016-26424.pdf) under which a partner's attributable share of property of a controlled partnership is determined solely in accordance with the partner's liquidation value percentage, without regard to any special allocations.

Rulings Issued on Partnership Divisions and Mergers to Facilitate REIT IPO

The IRS ruled in several similar rulings that a series of steps undertaken by a limited liability company to facilitate a potential initial public offering of stock in an entity that will elect to be treated as a REIT will be treated as a division of the limited liability company under Treasury Regulations Section 1.708-1(d) followed by a merger of the legacy limited liability company and a new operating partnership under Treasury Regulations Section 1.708-1(c) and followed by a distribution of the REIT shares to be treated as a sale of partnership interests by the REIT shareholders under Treasury Regulations Section 1.708-1(c)(4). (See private letter rulings 201643016, https://www.irs.gov/pub/irs-wd/201643016.pdf, https://www.irs.gov/pub/irs-wd/201643017.pdf, 201643017, https://www.irs.gov/pub/irs-wd/201643018.pdf, 201643018, https://www.irs.gov/pub/irs-wd/201643018.pdf, and 201643019, https://www.irs.gov/pub/irs-wd/201643019.pdf.)

IRS Identifies Micro-captive Deals as Transactions of Interest

In Notice 2016-66; 2016-47 IRB 1 (https://www.irs.gov/pub/irs-drop/n-16-66.pdf), the Treasury Department and the IRS have identified a "micro-captive transaction" as a transaction of interest. The Treasury Department and the IRS described the micro-captive transaction as a type of transaction in which a taxpayer attempts to reduce the aggregate taxable income of the taxpayer, related persons or both using contracts that the parties treat as insurance contracts and a related company that the parties treat as a captive insurance company. Each entity that the parties treat as an insured entity under the contracts claims deductions for premiums for insurance coverage. The related company that the parties treat as a captive insurance company elects under Section 831(b) to be taxed only on investment income and therefore excludes from its taxable income the payments directly or indirectly received under the contracts. According to the IRS, the manner in which the contracts are interpreted, administered and applied is inconsistent with arm's-length transactions and sound business practices.

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The Treasury Department and the IRS believe the micro-captive transaction has a potential for tax avoidance or evasion. However, the Treasury Department and the IRS lack sufficient information to identify which Section 831(b) arrangements should be identified specifically as a tax avoidance transaction, and they may lack sufficient information to define the characteristics that distinguish the tax avoidance transactions from other Section 831(b) related-party transactions. In addition to identifying the micro-captive transaction and substantially similar transactions as transactions of interest for purposes of Treasury Regulations Section 1.6011-4(b)(6) and Sections 6111 and 6112, Notice 2016-66 also alerts persons involved in such transactions to certain responsibilities and penalties that may arise from their involvement with these transactions.

U.S.-Kuwait Authorities Sign Arrangement Under IGA for FATCA

The U.S. and Kuwait competent authorities have signed an arrangement (https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Agreement-Kuwait-4-29-2015.pdf) under the two jurisdictions' 2015 intergovernmental agreement to implement the information reporting and withholding tax provisions of FATCA.