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IRS Intends to Issue Regulations Identifying New Foreign Tax Credit ‘Splitter Arrangements’

The IRS issued Notice 2016-52 (<https://www.irs.gov/pub/irs-drop/n-16-52.pdf>) announcing that it intends to issue regulations under Section 909 (section references are to the Internal Revenue Code of 1986, as amended) to address the separation of related income from foreign income taxes paid by a “Section 902 corporation” pursuant to a foreign-initiated adjustment. The regulations will identify two new “splitter arrangements,” one of which involves a change to ownership structure made in anticipation of the foreign-initiated adjustment, and the other of which involves making an extraordinary distribution before paying the adjustment so as to generate substantial amounts of foreign taxes deemed paid without a corresponding U.S. income inclusion.

IRS Issues Ruling on Qualifying Income of PTP

The IRS ruled in Private Letter Ruling 201637007 (https://www.irs.gov/pub/irs-wd/201637007.pdf?_ga=1.232177304.665444381.1445536580) that gross income derived by a publicly traded limited partnership from its fluid management, transportation, disposal, washout and storage services and from selling recovered hydrocarbons collected as part of the disposal process other than to end users at retail level was Section 7704(d)(1)(E)-qualifying income. The ruling did not apply, however, to income derived by the taxpayer from delivery and transportation of water, brine or other injectants where the taxpayer did not also collect and clean, recycle, or dispose of resulting produced water and drilling production waste after use.

IRS Rules on Tax Status of REIT Distributions

The IRS ruled in Private Letter Ruling 201637010 (https://www.irs.gov/pub/irs-wd/201637010.pdf?_ga=1.135182902.665444381.1445536580) that a proposed Section 301 distribution of dividends after the close of its taxable year by the taxpayer, a REIT, was an ordinary distribution in the preceding year and would take priority over Section 302 repurchases made in the preceding year in accessing the taxpayer’s available current earnings and profits.

IRS Rules on CFC’s Measurement of Income

The IRS ruled in Private Letter Ruling 201637005 (https://www.irs.gov/pub/irs-wd/201637005.pdf?_ga=1.59636394.665444381.1445536580) that foreign statement reserves maintained by a CFC with respect to its exempt annuity contracts were an appropriate means of measuring income under Section 954(i)(4)(B)(ii), and thus reserve amounts may be used in determining the CFC’s foreign personal holding company income under Section 954, provided that the assets were marked to market consistent with stated country rules and that reserves included only amounts attributable to policyholder benefits.

IRS Finds That ‘Break Fee’ Is Subject to Capital Loss Limitations

In Legal Advice Issued by Field Attorneys 20163701F (<https://www.irs.gov/pub/irs-lafa/20163701f.pdf>), the IRS has determined that a “break fee” paid upon termination

of a merger agreement gives rise to a capital loss under Section 1234A. Accordingly, the corporation that paid the fee can deduct it only to the extent of capital gains.

SIFMA Comments on Proposed QI Agreement

The Securities Industry and Financial Markets Association has commented on a proposed qualified intermediary withholding agreement (http://www.stradley.com/~media/Files/Publications/2016/SIFMA_Submits_Comment_to_Multiple_Agencies_on_the_QI_Agreement.pdf) included in guidance and has reiterated its request for a delay of the Jan. 1, 2017, implementation date for the Section 871(m) final and temporary regulations.

Pennsylvania Issues Guidelines on 2017 Tax Amnesty Program

The Pennsylvania Department of Revenue has issued guidelines (http://www.revenue.pa.gov/taxamnesty/Documents/tax_amnesty_qa.pdf) for its 2017 tax amnesty program. The program was established under Act 84 of 2016 (L. 2016, H1198) and provides for the waiver of all penalties, and 50 percent of the interest, due on delinquent taxes for which a return is filed and payment of all taxes due plus 50 percent of the interest is made during the amnesty period. (See our prior coverage at <http://www.stradley.com/insights/publications/2016/tax-insights-2016/tax-insights-july-27-2016>.) The guidelines provide an overview of the program, definitions, a list of taxes covered under the program, requirements for participating in the program, return filing requirements, payment requirements, information on extensions and deferred payments plans, and information on post-amnesty enforcement.

Delaware Enacts Credit for Hiring Individuals With Disabilities

Delaware has enacted a refundable tax credit for employers that hire individuals with disabilities. The credit is allowable against the corporate income tax, the bank franchise tax, the personal income tax, the insurance premium tax and the privilege tax on certain domestic insurers. L. 2016, S221 (c. 400) (<https://legiscan.com/DE/bill/SB221/2015>) is effective for vocational rehabilitation referrals hired after Dec. 31.

California Issues Notice Regarding Expanded 'Doing Business' Definition; Water's-Edge Election

The California Franchise Tax Board (FTB) issued Notice No. 2016-02 (<https://www.ftb.ca.gov/law/notices/2016/2016-02.pdf>) discussing how it will treat an otherwise valid water's-edge election when a unitary foreign affiliate of the water's-edge combined group becomes a taxpayer because it is doing business in California due to Cal. Rev. & Tax. Cd. Section



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23101(b), which for taxable years beginning on or after Jan. 1, 2011, sets forth additional circumstances that constitute doing business in California.

Corporations doing business in California are subject to the franchise tax, i.e., they are taxpayers. A qualified taxpayer may elect to determine its income from or attributable to sources within California pursuant to a water's-edge election, but such an election will be effective only if every member of the self-assessed combined reporting group that is subject to tax, i.e., all taxpayer members of the group, make the election. Because of the enactment of Cal. Rev. & Tax. Cd. Section 23101(b), a unitary foreign affiliate of a water's-edge combined group that at the time of the election was not doing business in California (and thus could not be included in the group) could be doing business in California.

Depending on whether a unitary foreign affiliate is a corporation whose income and apportionment factors would have been properly considered in computing the income of the taxpayers making a water's-edge election, the foreign affiliate may have been required to make an election in order for the election to be effective.

The notice addresses the treatments the FTB will apply in situations in which a unitary foreign affiliate of a water's-edge combined group could not make an election at the time of a water's-edge election because the affiliate was not subject to tax in California, but after the addition of Cal. Rev. & Tax. Cd. Section 23101(b) would have been required to make a water's-edge election in order for the election to remain effective. The FTB will treat the existing water's-edge election as follows: (1) When a unitary foreign affiliate has income derived from or attributable to sources within the United States (United States Income) both before

and after the beginning of a taxable year in which the affiliate becomes a taxpayer solely due to the addition of Cal. Rev. & Tax. Cd. Section 23101(b), the deemed election provisions of Cal. Rev. & Tax. Cd. Section 25113(b)(4) will apply, i.e., the unitary foreign affiliate will be deemed to have made the election with the other members of the combined reporting group; (2) When a unitary foreign affiliate does not have United States Income either before or after the beginning of a taxable year in which the unitary foreign affiliate becomes a taxpayer solely due to the addition of Cal. Rev. & Tax. Cd. Section 23101(b), the affiliate would never have been includable in the water's-edge combined report despite its status as a taxpayer under Cal. Rev. & Tax. Cd. Section 23101(b). However, in order to give effect to the objective intent of the taxpayers' unitary group to maintain an effective water's-edge election, the unitary foreign affiliate will be deemed to have made an election as of the taxable year in which it became a taxpayer. The commencement date of the deemed water's-edge election will be the same as the commencement date of the electing taxpayers of the existing water's-edge combined reporting group. In such circumstances, the foreign affiliate may be included in the

group return of the existing water's-edge combined reporting group for administrative convenience; (3) When a unitary foreign affiliate does not have United States Income before, but has United States Income after, the beginning of a taxable year in which the affiliate becomes a taxpayer solely as a result of the addition of Cal. Rev. & Tax. Cd. Section 23101(b), the unitary foreign affiliate will be deemed to have made an election as of the taxable year in which it becomes a taxpayer. The commencement date of the deemed water's-edge election will be the same as the commencement date of the electing taxpayers of the existing water's-edge combined reporting group.

The notice also sets forth four conditions, each of which must apply in order for the treatment of elections described in (1), (2) and (3) to apply; if all of those conditions apply, the FTB will not seek to terminate the water's-edge election of the water's-edge combined reporting group that is unitary with the foreign affiliate that is now a taxpayer. Also, the deemed election provisions of the notice will apply only to taxable years beginning within 84 months of Sept. 9.

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