Report on recent US international tax developments – 3 August 2018

The United States (US) Treasury and the Internal Revenue Service (IRS) issued proposed regulations under Internal Revenue Code[1] Section 965 on 1 August, providing eagerly-anticipated guidance on the one-time tax on deferred foreign earnings enacted by the *Tax Cuts and Jobs Act* in December 2017. Section 965 imposes a one-time tax on the accumulated post-1986 deferred foreign income of specified foreign corporations (SFCs) owned by US shareholders. Domestic corporations with foreign earnings held in the form of cash and cash equivalents are generally taxed at a 15.5% rate for 2017 calendar years, with the remaining earnings intended to be taxed at an 8% rate for 2017 calendar years. Taxpayers generally can elect to pay the transition tax in installments over an eight-year period under Section 965(h).

The Government previously issued guidance under Section 965 in Notice 2018-07, Notice 2018-13, and Notice 2018-26, as well as Rev. Proc. 2018-17 and a list of frequently-asked questions and answers (FAQs). As expected, the proposed regulations include and, in many cases expand on, the rules related to Section 965 that are described in the notices.

The proposed regulations are comprehensive, and provide general rules and definitions, as well as rules related to the determination and treatment of Section 965(c) deductions, rules that disregard certain transactions in connection with Section 965, and rules related to foreign tax credits. The proposed regulations also contain rules regarding elections and payments, the application of the Section 965 regulations to affiliated groups, including consolidated groups, rules relating to Section 962 elections, and rules on the application of Section 986(c) in connection with Section 965.

The proposed regulations generally apply beginning in the last taxable year of a foreign corporation that begins before 1 January 2018, and with respect to a US person, beginning in the taxable year in which or with which such taxable year of the foreign corporation ends. The new regulations provide that taxpayers may choose to apply the rules in proposed Reg. Section 1.965-7 (regarding elections and payments) in their entirety to all tax years as if they were final regulations. An EY Thought Center webcast, *New Section 965 regulations: what you need to know*, is scheduled for Monday, 6 August. Register here.

The Ninth Circuit Court of Appeals has reversed the Tax Court's holding in *Altera v. Commissioner*, and upheld a 2003 regulation that requires participants in a cost sharing arrangement (CSA) to treat stock-based compensation costs (SBC costs) as compensable.[2] In a 2 to 1 ruling, the Appellate Court concluded that the regulations were valid under general administrative law principles and that under current law, SBC costs should be treated as shared by participants in a CSA.

The taxpayer has 45 days (7 September 2018) to seek rehearing by the panel or rehearing en banc by the full Ninth Circuit. If no rehearing is sought, the taxpayer has 90 days (22 October 2018) to submit a petition for certiorari with the US Supreme Court. The due date for the petition for certiorari would be extended if the Ninth Circuit considers a petition for rehearing. It is important to note that the Tax Court's taxpayer-favorable opinion is still precedent and authority for taxpayers located in geographical areas outside of the Ninth Circuit's jurisdiction.

The Court of Appeals for the District of Columbia has overturned the Tax Court in *Good Fortune Shipping SA v. Commissioner*, holding in a unanimous opinion that the 2003 "bearer share" regulations under Section 883 were invalid. Under the regulations, bearer shares (i.e., securities owned by whoever holds the physical stock certificates) could not be considered when determining whether a sufficient amount of a foreign shipper's stock was owned by qualifying shareholders.

The IRS *Foreign Account Tax Compliance Act* (FATCA) certification portal is now live. The FATCA Registration System has been updated to allow for the completion and submission of the certification of pre-existing accounts and periodic certifications. The IRS is recommending that all FATCA registered entities should monitor their message board for notifications. The registration system allows for the establishment of an online account for financial institutions to register with the IRS, renew their agreement, and complete and submit FATCA certifications.

Endnotes

1. All "Section" references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.
2. See EY Global Tax Alert, *US Ninth Circuit panel reverses Tax Court opinion in Altera, holding stock-based compensation to be a compensable cost under Section 482*, dated 1 August 2018.

For additional information with respect to this Alert, please contact the following:

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