

# Recommendations for the 2018-2019 Department of the Treasury and Internal Revenue Service Priority Guidance Plan Related to the Act

AMERICAN BAR ASSOCIATION SECTION OF TAXATION

*May 24, 2018*

*The Honorable David Kautter  
Assistant Secretary (Tax Policy)  
Department of the Treasury  
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*Re: Recommendations for 2018-2019 Priority Guidance Plan*

*Dear Messrs. Kautter and Paul:*

*The American Bar Association Section of Taxation (the “Section”) welcomes the opportunity to provide recommendations for inclusion in the 2018-2019 Priority Guidance Plan. These recommendations represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or House of Delegates of the American Bar Association and should not be construed as representing the policy of the American Bar Association.*

*Notice 2018-43 (the “Notice”), issued on April 27, makes it clear that the Department of the Treasury (“Treasury”) and the Internal Revenue Service (“Service”) intend to focus on guidance implementing the recently-enacted tax law*

*(the “Act” in the Notice) for the balance of the current plan year and the 2018-2019 plan year. Accordingly, the Section intends to submit two sets of recommendations. The enclosed list contains recommendations for guidance under the Act in the passthroughs, international and corporate areas. The Section intends to send a second set of recommendations and prioritizations which will focus on items the Section considers to be high-priority guidance projects that do not relate to the Act. The Section recognizes Treasury and the Service’s need to focus its resources on those projects of greatest importance to sound and efficient tax administration.*

*The enclosed recommendations were made by members of the following committees within the Section.*

*Affiliated and Related Corporations  
Partnerships and LLCs  
Closely Held Business  
Real Estate  
Corporate Tax  
S Corporations  
Foreign Activities of U.S. Taxpayers  
Transfer Pricing  
Foreign Lawyers Forum  
U.S. Activities of Foreigners & Tax Treaties*

*Although the members of the Section of Taxation who participated in preparing this list have clients who might be affected by the federal income tax principles addressed by these recommendations, no such member or the firm or organization to which such member belongs has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these recommendations.*

*We will be happy to discuss the recommendations with you or your staffs.*

*Sincerely,  
Karen L. Hawkins  
Chair, Section of Taxation*

*cc:*

*Robert J. Neis, Benefits Tax Counsel, Department of the Treasury  
Douglas Poms, Deputy International Tax Counsel, Department of the Treasury  
Thomas West, Tax Legislative Counsel, Department of the Treasury  
Scott W. Dinwiddie, Associate Chief Counsel (Income Tax & Accounting),  
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The Section makes the following recommendations for guidance in Code section order. High priority recommendations are marked with an asterisk (\*). We believe that these guidance recommendations are the most pressing because the underlying statutory provisions either are already effective or raise gating issues (*e.g.*, defining who the taxpayer is). Other priority recommendations are marked with a double asterisk (\*\*). These recommendations are priorities because they would address issues affecting the filing of returns. Finally, the remaining guidance recommendations address important issues, but generally affect future tax years.

### **Section 59A<sup>1</sup>**

- 1.\* Guidance on aggregation in consolidated groups. There is uncertainty over how taxpayers should apply the BEAT aggregation rule in section 59A(e)(3); read literally, the provision effectively nullifies the BEAT. The BEAT regime would profit from consolidated treatment. Given the relatively large number of new tax regimes that need to be coordinated with the consolidated return rules, it may be appropriate to follow a unified theory on when and how consolidated rules are to be applied, and to use existing regulations without change when possible.
2. Guidance on how 3-year average annual gross receipts is computed with respect to members joining and leaving the consolidated group.
- 3.\*\* Guidance on the scope of cost of goods sold for purposes of the BEAT. Such guidance could address, for example, how interest and other items that are capitalized under the UNICAP rules are to be treated and how prices that contain embedded royalties are to be accounted for.
- 4.\*\* Guidance on whether cross-border deductible payments for services that are marked up above cost (*e.g.*, because the foreign tax authority requires that a markup be charged) qualify for the services cost method in the BEAT rules to the extent the charge equals cost.

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<sup>1</sup>References to a “section” are to a section of the Internal Revenue Code of 1986, as amended (the “Code”) or the Treasury regulations issued thereunder, unless otherwise indicated.

**Section 163(j)**

- 1.\* Guidance on how a taxpayer elects to be exempt from the interest limitation of section 163(j).
- 2.\*\* Guidance on the effect of the election to be exempt from the interest limitation. For example, if a taxpayer makes the election, it is unclear whether the taxpayer's existing property is grandfathered or [or] if the taxpayer must change its depreciation method (and if so, whether such change should be an automatic method change).
3. Guidance on net income allocations. For example, it is unclear given the no-double-counting rule how net interest income allocated in a later year should be treated for purposes of deducting excess business interest (EBI) from an earlier year. Such guidance could address whether interest expense can be deducted to the extent of the interest income; whether interest income loses its character, such that it is treated as excess income from which the interest expense can only be offset at a 30% rate; and whether interest income should be allowed to be used at all to deduct the interest expense.
- 4.\*\* Guidance on how a taxpayer is to apply the interest expense limitation for related and tiered parties.
- 5.\* Guidance on what is a real property trade or business for purposes of section 163(j)(7).
- 6.\* Guidance on how debt and interest expense is to be allocated (*e.g.*, tracing, allocation or a hybrid approach) when there are exempt businesses (*e.g.*, utilities, real property trade or business) and non-exempt businesses.
- 7.\*\* Guidance on whether global intangible low tax income ("GILTI") and Subpart F income count as adjusted taxable income.
- 8.\*\* Guidance on whether the section 163(j) limitation applies in determining the amount of a taxpayer's GILTI.
9. Passthrough issues
  - a.\*\* Guidance on whether interest is characterized at the partnership level as business or investment and then flows through to the partner with the same characterization, including with respect to corporate partners who have only section 162 deductions.
  - b. Guidance addressing basis inequities created by EBI. In particular, a partner is permitted to increase the basis of its partnership interest immediately before a disposition by the amount of the excess (if any) of the amount of the basis reduction (caused by the EBI) over the portion which has previously been treated as paid or accrued by the partner. For example, assume a partner disposes of its interest in year 3, after carrying over \$100 of excess

business interest from year 1 and being allocated \$100 excess taxable income in year 2. What is the proper amount that should be added to the partner's basis upon disposition? The partner's basis was reduced by \$100 of excess business interest, but the partner was only allowed a deduction of \$30 of business interest expense. Should the partner be allowed to add back the \$70 difference to its basis?

- c.\*\* Guidance on how section 163(j) applies with respect to the self-charged interest between a shareholder and an S Corporation or a partnership [partner] and a partnership.
  - d. Guidance on how the carryforward rules under section 163(j) apply to S corporations. Guidance is needed because there are special carryforward rules for partnerships that specifically do not apply to S corporations. In addition, clarification is needed as to whether the limitation applies at the S corporation level.
10. Consolidated group issues
- a.\*\* Guidance on whether and how to allocate excess interest expense to a departing member (*e.g.*, based on the member's separately computed interest expense or value).
  - b.\*\* Guidance on the treatment of non-intercompany debt that becomes an intercompany obligation and, thus, disregarded for 163(j) purposes. For example, are the excess section 163(j) deductions accelerated/lost as a result of the deemed satisfaction and reissuance fiction?
  - c.\*\* Guidance on whether and how to absorb interest expense history/limitation of a joining member, including whether and how the separate return limitation year (SRLY) rules apply.
  - d. Guidance on how Treasury regulation section 1.1502-32 applies to disallowed interest deductions.
  - e. Guidance on how the 3-year average annual gross receipts is computed with respect to members joining and leaving the consolidated group.

## Section 164

- 1.\*\* Guidance on whether an S corporation can deduct franchise taxes paid to jurisdictions that do not recognize S corporation status (*e.g.*, New York City General Corporation Tax) as a trade or business expense, or whether such taxes flow through to the shareholders as income taxes subject to limitation under section 164(b)(6).
- 2.\*\* Guidance on whether an S corporation takes into account state and local taxes as non-separately stated or as separately stated items.

**Section 168(k)**

- 1.\*\* Guidance on whether section 197 principles should be followed in applying section 168(k). Such guidance could address whether partners are permitted to expense their section 743 adjustments and their section 704(c) remedial items.

**Section 172**

- 1.\*\* Guidance on whether pre-2018 net operating loss (NOL) carryovers are taken into account in computing the 80% limitation of section 172(a)(2).
2. Guidance on how the separate return limitation year (SRLY) register for NOL carryforwards should be computed (*i.e.*, with respect to the full amount or the limited amount).
3. Guidance on the usage and absorption of NOLs when a consolidated group has both NOL carryforwards or carrybacks subject to section 172(b)(1)(C) (NOLs generated by non-life insurance companies) as well as “regular” NOLs.

**Section 199A**

- 1.\* Guidance on the definition of a separate trade or business for purposes of section 199A. This issue raises questions regarding aggregation and disaggregation, related parties, tiered structures issues, and how a taxpayer is to determine the parameters of a trade or business for purposes of section 199A.
  - a. Guidance should address how a trade or business is determined where multiple income streams are generated from related activities. For example, is a vehicle dealership engaged in one or multiple trades or businesses when it sells and leases multiple brands of new cars, used cars and trucks; provides repair and maintenance services; sells warranties; and provides financing? If multiple trades or businesses, how are expenses to be allocated where one person carries on multiple activities?
  - b. Guidance should address whether it matters if the activities are conducted through separate state-law entities or are conducted through only one entity such as a partnership or an S corporation, and whether it matters if all entities are regarded for federal tax purposes or disregarded for federal tax purposes (*e.g.*, QSubs and disregarded entities).
  - c. Guidance should address whether grouping similar to section 469 is allowed, and whether the answer is different under section 163(j).

- 2.\*\* Guidance on the definition of “specified services trade or business” in the context of a larger trade or business. In particular, such guidance should address whether one disaggregates specified services from other activities for purposes of determining qualified business income. For example, how should a veterinarian clinic that also offers boarding and dog walking services be treated? Although the health care services provided by the veterinarian would be specified services, can the boarding and dog walking services be treated as a separate trade or business and the income therefrom treated as qualified business income? Should it make a difference if other less skilled workers provide those services? Should rules similar to those in Treasury regulation section 1.448-1T(e)(3)(ii) apply here?
- 3.\*\* Guidance on the scope of the term “financial services,” given the section 199A reference to section 1202(e)(3)(A) (which includes the phrase “financial services”) but not section 1202(e)(3)(B) (which includes the term “banking”). For example, do S corporation banks qualify for the 199A deduction?
- 4.\*\* Guidance on how a taxpayer determines W-2 wages of a trade or business, particularly when using a payroll company, a common paymaster or a reimbursement arrangement. Guidance should address what are “properly allocable” wages. For example, with respect to taxpayers with multiple S corporations, how will the reasonable compensation calculation work? More generally, when a passthrough entity has more than one trade or business, how must taxpayers allocate wages to each business for those employees providing services to more than one of the businesses?
5. Guidance on how to determine a partner’s allocable share of unadjusted basis in the same manner as the partner’s allocable share of depreciation under section 199A(f)(1)(A), including what share of depreciation is relevant. For example, is it the share of depreciation in the year that the section 199A deduction is being claimed? How is property that is fully depreciated but that still has a “depreciable period” under section 199A(b)(6)(B) treated?
- 6.\*\* Guidance on how the effective date of 199A applies to fiscal year entities. For example, for an S corporation with a November 30 year-end, is all or a portion of the qualified business income eligible for the deduction? Is all or a portion of the shareholder’s share of the W-2 wages taken into account for the limitation?
7. Guidance on how an aggregate qualified business loss from a preceding year under section 199A(c)(2) is taken into account in subsequent years.
- 8.\*\* Guidance on the section 199A deduction when it is limited under section 199A(a)(1)(B), and particularly with respect to the reference to

- section 1(h) when defining “net capital gain” income. For example, is this test meant to include qualified dividend income in the limitation?
9. Guidance on whether the ordinary income the partner or the partnership is required to recognize under section 751(a) where a partner sells its partnership interest is qualifying business income.
  - 10.\*\* Guidance on whether remedial income or deductions under section 704(c) are considered part of “qualified business income” for purposes of section 199A. For example, does a partner adjust qualified business income to some extent to take into account a basis adjustment under section 743? Similarly, how are a partnership’s basis adjustments under section 734 to be treated?
  - 11.\*\* Guidance on whether section 1231 gain or loss is considered capital gain or capital loss excluded under section 199(c)(3)(B)(i), or whether such gain or loss is distinct and includible in qualified business income.
  - 12.\*\* Guidance on how the section 199A deduction reduces the partners’ income for SECA purposes.
  - 13.\*\* Guidance on how, if at all, losses allocated from a publicly traded partnership impact the section 199A calculation.

### **Section 245A**

- 1.\*\* Guidance on the interaction of section 245A and the holding period requirement under section 246(c).

### **Section 250**

- 1.\* Guidance on aggregation in consolidated groups – single/separate/hybrid. Given how interwoven GILTI is with foreign derived intangible income (FDII), it would appear that the same “single/separate” approach should apply to both provisions.
- 2.\* Guidance on whether the taxable income limitation should be calculated on a single entity or separate entity basis. For example, how does the taxable income limitation apply to a member of a consolidated group that has taxable income and would otherwise be eligible for a section 250 deduction, if the consolidated group has a loss?
- 3.\*\* Guidance on the computation of “domestic corporation’s” “deduction eligible income.” Guidance should address whether, in the context of intermediary sales within a group (*e.g.*, manufacturing member sells to reseller member), the FDII deduction is an attribute of the group that is subject to Treasury regulation section 1.1502-13(c).<sup>2</sup>

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<sup>2</sup> See CCA 201726012 (March 28, 2017) (depreciation and amortization deductions from intercompany sale of partnership interest are attributes).



- 4.\*\* Guidance on whether current Treasury regulation section 1.1502-13 can redetermine the character of intercompany items to qualify for the FDII deduction.

### **Section 267A**

1. Guidance on whether, if a U.S. person pays otherwise deductible interest to a non-hybrid partnership, it is necessary to review the law of each country in which a limited partner resides to determine how the interest is taxed. Base Erosion and Profit Shifting (BEPS) Action Item 2 concluded that this analysis is not required absent (1) a related-party loan or (2) a structured transaction. Such a rule would be administrable here.

### **Section 461**

1. Guidance on whether, if a taxpayer has business losses subject to section 461(l) and less income from other sources than the threshold amounts under that section 461(l), the excess is converted to a net operating loss under 461(l), and if not, what happens to the excess. For example, assuming sections 465 and 469 (and other loss or deduction limitation rules) do not apply, if a taxpayer has \$100,000 of aggregate deductions for the taxable year, which are attributable to trades or businesses, in excess of aggregate gross income or gain attributable to such trades or businesses, but has only \$10,000 of other income, what becomes of the \$90,000 excess loss?

### **Section 864(c)(8)**

1. Guidance on whether section 864(c)(8) applies to nonrecognition transactions, and if not, whether withholding under section 1446(f) is still required.
2. Guidance on how much of the gain on the sale of the partnership interest (assuming the partnership has a U.S. trade or business) is considered effectively connected under section 864(c)(8) where a taxpayer's distributive share of non-separately stated taxable income or loss of a partnership is 0% but the taxpayer's distributive share of items under section 702(a)(1), (2) and (3) is 10% (assuming the allocations that give this result have substantial economic effect under section 704).
3. Guidance on whether, if a partnership must withhold under section 1446(f)(4) and the transferee's entitlement to distributions are [is] less than the amount of the withholding, the partnership may defer the excess to subsequent years and subsequent distributions. If deferral is permitted, will the transferor be entitled to seek a refund for the amount that should have been (and may eventually be) withheld if its tax from the transfer of the partnership interest is less?

**Section 951A**

- 1.\* Guidance on aggregation in consolidated groups – single/separate/hybrid. Should the group be treated as the relevant “United States shareholder,” or should the subpart F pattern of not aggregating U.S. shareholders be followed, and instead the computations be made on a consolidated basis?<sup>3</sup>
- 2.\* Guidance on whether the Net CFC Tested Income is calculated on a separate entity or on a single entity basis. To the extent that Net CFC Tested Income is calculated on a separate entity basis, then the calculation of Net CFC Tested Income is done by reference to each U.S. shareholder. Specifically, there could be a situation in which one chain of controlled foreign corporations (CFCs) owned by a U.S. shareholder is all in a net loss position and another chain is in an income position – the losses of the CFCs are essentially “trapped” under that U.S. shareholder. In contrast, if Net CFC Tested Income is calculated on a single entity basis, then the U.S. Parent (consolidated group) has the ability to offset all of its losses with all of its income, and there is no “phantom” income.
- 3.\* Guidance on whether qualified business asset investment (QBAI) is tested on a separate entity or a single entity basis. The determination of single versus separate entity treatment for QBAI should be the same as for the calculation of Net CFC Tested Income, described above.
- 4.\* Guidance on whether, if a CFC owned by one U.S. shareholder makes [an] interest payment to a CFC owned by [a] different U.S. shareholder within the same consolidated group, that interest payment reduces the net deemed tangible income return of the CFC.
- 5.\* Guidance on whether foreign tax credits are determined on a consolidated basis per Treasury regulation section 1.1502-4(c). For example, how should this rule be integrated with the section 951A limitations on the credit?
- 6.\*\* Guidance on whether the section 78 gross-up is treated as GILTI in the GILTI basket for foreign tax credit purposes.
- 7.\*\* Guidance on whether the GILTI foreign tax credit is subject to section 904(a) and, if so, whether the interest apportionment rules in the section 861 regulations apply to limit the credit.
8. Guidance on how the appropriate basis adjustments are determined where one CFC has positive tested income and another has negative tested income.

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<sup>3</sup> See Rev. Rul. 85-3, 1985-1 C.B. 222 (affiliated group cannot get to 10% threshold by means of stock aggregation rules of Treasury regulation section 1.1502-34) and *First Chicago v. Commissioner*, 135 F.3d 457 (7<sup>th</sup> Cir. 1998)].

**Section 958(b)(4) (Repeal)**

- 1.\*\* Guidance on how “unlimited” downward attribution should apply in the context of inverted companies. For example, X, a U.S. partnership, owns 10% of the stock of FP, the foreign parent of an affiliated group. FP owns 100% of USS, a U.S. sub, and FS, a foreign sub. USS is deemed to own FS, and as a result, FS is a CFC of USS; X is a U.S. shareholder of FS. Should FP also be considered a CFC? Consider Rev. Rul. 74-605, 1974-2 C.B. 97.

**Section 965**

- 1.\* Installment election under section 965(h) – Guidance regarding the acceleration of payment rules (section 965(h)(3)) in a consolidated group context.
  - a. Section 3.04 of Notice 2018-07, 2018-4 I.R.B. 317, states that Treasury and the Service intend to issue regulations providing that solely with respect to the calculation of the amount to be included in gross income by a consolidated group under section 965(a)(1), all members of the group that are U.S. shareholders of one or more specified foreign corporations will be treated as a single U.S. taxpayer. Assume USP owns S1 and S2, S1 owns CFC1, and a section 965(h) election has been made. Under the Notice, USP and S1 are treated as a single corporation, but solely for purposes of a calculation of an inclusion amount.
  - b. There is no guidance with respect to other questions, including procedural ones.
    - i. For example, are USP and S1 to be treated as a single corporation for purposes of the section 965(h) election and for determination of the “net tax liability under this section” within the meaning of section 965(h)(6)?
    - ii. While USP and S1 may be severally liable for the tax under Treasury regulation section 1.1502-6, if S1 leaves the USP group, will the primary liability stay with the USP group or travel with S1?
    - iii. Will events that might trigger acceleration of the payments be determined with reference to the USP group as a whole, to USP, or to S1? For example, what if S1 merges upstream into USP or sideways into S2 in a tax-free section 332 or 368 transaction? What if S1’s assets represent 20% of the USP group’s assets, and S1 sells substantially all of its assets or USP sells the stock of S1?
- 2.\* Installment elections under section 965(h) – Guidance regarding the “step in the shoes” rule in the second sentence of 965(h)(3). Congress

provided that where an electing taxpayer has sold substantially all of its assets, the installment payments are not accelerated if the buyer enters into an agreement with the Service under which the buyer is liable for remaining installment payments. This laudable provision should be made available for any event that would otherwise trigger acceleration of remaining installments, provided there is a domestic successor (including a section 381(a) or possibly a Treasury regulation section 1.1502-13(j)(2) successor) to the electing taxpayer. Guidance should be provided regarding how taxpayers can enter into such an agreement, as well as the terms of the agreement.

### **Section 1031**

1. Guidance on whether the definition of real property and like-kind real property under section 1031 has changed.
2. Guidance on whether, if replacement property in a personal property exchange is “parked” under Revenue Procedure 2000-37, 200-2 C.B. 308, the section 1031 exchange is grandfathered.

### **Section 1061**

1. Guidance on the extent of investment real estate and whether it includes oil and gas properties before or after they are drilled.
2. Guidance on whether section 1061(a), which applies only with respect to applicable partnership interests that are “held by a taxpayer at any time during the taxable year,” means that if a taxpayer sells a carried interest in 2018 for an installment note payable in 2019, then the provision does not apply with respect to the 2019 gain.
3. Guidance on whether section 1061(a), which applies to recharacterize net long-term capital gain “with respect to” the applicable partnership interest, refers only to gains from the taxable sale or exchange of the applicable partnership interest, or whether it also refers to the distributive share of gains allocated under section 704 to the holder of the applicable partnership interest. If section 1061(a) also applies to the distributive share of gains, how does it apply to section 1231 gain? For example, because paragraphs (3) and (4) of section 1222 do not pick up section 1231 gain, if a taxpayer has held rental real estate for more than one year, is the amount recharacterized always zero?
4. Guidance on whether a taxpayer can sell a carried interest that it has held for more than three years and recognize long-term capital gain notwithstanding that a significant amount of the assets in the partnership have been held for less than three years (where the sale is not to a related person under section 1061(d)), or whether a “look through” rule similar to section 751(a) applies.

5. Guidance on whether section 1061 applies to recharacterize long term capital gains into short term capital gains if a taxpayer that holds an applicable partnership interest is redeemed by the partnership distributing assets in kind and if the assets are sold within three years of the taxpayer receiving the partnership interest (or the assets having been acquired).
6. Guidance on whether, if a taxpayer restructures a partnership in which a person has an “applicable partnership interest” by giving each partner a “straight” interest in the restructured partnership equal to the percentage of the value of the partnership’s assets that the partner would receive if the partnership sold all of its assets at their then fair market values, that restructuring eliminates the possible recharacterization as short-term capital gain under section 1061 no later than the next taxable year. Guidance on what does and does not constitute “portfolio” investments as referred to in section 1061(b). The guidance should also address when a “portfolio investment” is held “on behalf of” third party investors.
7. Guidance on whether a “corporation” referred to in section 1061(c)(4)(A) includes an S corporation.

