

# Here Come the Regulations: Treasury Releases Proposed Regulations on Repatriation Tax

## Introduction

Since late last year when President Trump signed the Tax Cuts and Jobs Act (TCJA) into law, the US Treasury Department and the Internal Revenue Service (IRS) have been working to draft regulations that will assist taxpayers in complying with the new law. On August 1, 2018, the Treasury issued [proposed regulations](#) under Section 965 (the Proposed Regulations) to provide guidance on calculating and reporting the one-time tax on multinationals' previously untaxed foreign earnings. This release follows the Treasury's guidance on this so-called "repatriation tax" or "transition tax" over the last several months, including Notices 2018-07, 2018-13, 2018-26 and Revenue Procedure 2018-17 (collectively, the Prior Guidance).

The Proposed Regulations adopt almost all of the Prior Guidance, with minor modifications. The Treasury chose to incorporate only a small number of comments submitted by taxpayers. The Proposed Regulations now enter the public comment period, whereby written or electronic comments and requests for a public hearing must be received within 60 days after publication of the Proposed Regulations in the *Federal Register*, which is scheduled for August 9, 2018.

The below summary provides an overview of the key issues addressed in the Proposed Regulations, identifies those items on which the Treasury has invited further comment, and details what we should expect next from Washington DC for potential tax legislation and upcoming regulations.

## Summary of the Proposed Regulations

Section 965 requires certain US taxpayers (including certain individuals) to pay tax on all previously untaxed post-1986 corporate earnings held offshore in "specified foreign corporations" (SFCs).<sup>1</sup> The rates of tax for corporate taxpayers are 15.5% on liquid assets (e.g., cash) and 8% on illiquid assets (e.g., property used in the trade or business). Taxpayers may elect to pay the tax immediately or *pro rata* over an eight-year period.

## 1.965-1 – Definitions

While the majority of definitions are consistent with Prior Guidance, below is a summary of some of the key terms.

### Post-1986 Earnings and Profits (E&P)

The Proposed Regulations clarify that all deficits, including hovering deficits carried forward from certain offshore reorganizations, related to post-1986 E&P, are taken into account for purposes of determining the post-1986 E&P of an SFC, but this rule is only for purposes of Section 965. One comment requested that taxpayers be allowed to use alternative methods for determining post-1986 E&P and cash positions since most SFCs do not track E&P under US tax principles. The Treasury chose to not adopt this comment because audited financial statements can be used as a starting point for the calculation. Furthermore, the same standard is used in other code provisions, so the Treasury determined it was inappropriate to create a different standard solely for Section 965 purposes. This reasoning is interesting given that it specifically noted the definition of post-1986 E&P as defined in the Proposed Regulations is only for purposes of Section 965.

### Cash Measurement Dates

The Treasury and IRS determined that cash measurement rules defined in previous guidance are appropriate and so did not provide any additional rules. Prior Guidance indicated that the amount of an SFC's earnings that are treated as cash or cash equivalents (and, therefore, subject to the higher 15.5% rate) is equal to the greater of the cash position determined on the last day of the foreign corporation's taxable year for which the one-time inclusion occurs (the "final cash measurement date") or the average cash positions of the foreign corporation determined on (i) the last day of the foreign corporation's taxable year that ended before November 2, 2017 (the "second cash measurement date"), and (ii) the last day of the foreign corporation's taxable year that ended before November 2, 2016 (the "first cash measurement date").

### Accounts Payable

In determining the "cash" amount, the net accounts receivable amount is taken into account. The Proposed Regulations state that "the term 'accounts payable' is not defined in the statute, and Treasury and the IRS have determined that the definition in the proposed regulations is consistent with the ordinary meaning of accounts payable" and did not need to be modified. Not surprisingly, the Treasury did not adopt a comment requesting to expand the definition of "accounts payable" to include items such as those related to intellectual property and payables to employees, which would have likely allowed some companies to reduce their overall inclusion amount.

<sup>1</sup> A "specified foreign corporation" means: (1) any controlled foreign corporation (regardless of whether there is a domestic corporate shareholder) and (2) any foreign corporation with respect to which one or more domestic corporations is a US shareholder (10% corporation). (Sec. 965(e)(1)).

## Short-Term Obligations

Short-term obligations held by an SFC are treated as “cash.” In determining whether a demand loan should be treated as a short-term obligation, the “Treasury Department and the IRS have determined that any facts-and-circumstances test would not be administrable, particularly to the extent that the test required a determination of a subjective intent with respect to the payment of the loan.” Treasury rejected comments requesting to include case-by-case exceptions for demand loans or loans that must be repaid on the demand of the lender (or within one year of such demand). It did, however, include a comment to clarify that an instrument’s short-term nature is determined by the terms in effect upon issuance.

## 1.965-4 – Disregard of Certain Transactions

Section 965 contains a broad grant of authority for the issuance of regulations to address certain transactions undertaken to avoid the repatriation tax. Utilizing this authority, the Proposed Regulations clarify that the application of the anti-avoidance rules in Section 965 is based on whether there is a “change in the amount of a section 965 element” rather than a change in the Section 965 tax liability. Many comments requested that the anti-avoidance rules be narrowed, include *de minimis* exceptions, not apply if another provision of the code would be applied in place of Section 965, and not apply to accounting method changes that were made to move from an impermissible method to a permissible method. The Treasury did not adopt these comments, noting that it determined (along with the IRS) that “any reduction in tax imposed by reason of section 965 through tax avoidance strategies occurring after November 2, 2017, is inconsistent with congressional intent and should not be respected.” As taxpayer comments were largely ignored in this section, we expect similar comments to again be noted during this upcoming 60-day comment period.

## 1.954-5 and 1.954-6 – Foreign Tax Credit Rules

These rules clarify a number of items related to foreign tax credit utilization with respect to amounts subject to tax under Section 965, including key terms, the circumstances in which a deduction or credit is allowed, the computation for deemed paid taxes, and the allocation and apportionment of expenses. In addition, the Treasury has invited comments on whether additional guidance is needed with respect to the Section 904 limitation.

## Treasury’s Request for Comments

Although in the Proposed Regulations, the Treasury and IRS have responded to several comments received before the Proposed Regulations were released, they have requested further comments on “all aspects of the proposed regulations,” as well as several specific areas, as highlighted below.

- **Post-1986 E&P:** Comments have been requested on whether additional rules are needed to address the treatment of hovering deficits that reduce post-1986 E&P of a deferred foreign income corporation (DFIC). For example, how should use of a hovering deficit affect foreign tax credits (FTC) and certain basis adjustments?

- **E&P Deficit Foreign Corporation:** The Treasury and IRS are considering other rules and welcome comments with respect to the definitions of post-1986 E&P, accumulated post-1986 deferred foreign income and specified E&P deficits.
- **Pro Rata Share:** Comments are requested regarding whether there are circumstances in which a specified E&P deficit should be allocated to shareholders of an E&P deficit foreign corporation’s preferred stock and, if so, how to allocate between shareholders of common stock and shareholders of preferred stock, as well as among shareholders of preferred stock.
- **Allocation and Apportionment of Expenses:** The Treasury and IRS request comments on what rules may be appropriate for purposes of determining FTC availability, including whether the rules under §1.861-12(c)(2) should be modified. Further, the Treasury and IRS also request comments on whether more guidance is needed with respect to the assignment of Section 965(a) inclusion and the related taxes to a separate category or categories of income. In addition, comments are requested on whether additional rules are needed for determining the amount of the increase in the Section 904 limitation with respect to distributions of Section 965(a) previously taxed E&P and Section 965(b) previously taxed E&P, taking into account the Section 965(c) deduction and the disallowed foreign taxes under Section 965(g).
- **Determination of Aggregate Foreign Cash Position:** The Treasury and IRS welcome comments with respect to the definition of cash position of a specified foreign corporation.
- **Adjustments to Basis by Reason of Section 965(a) and (b):** Comments have been requested as to the appropriate amount of basis adjustment with respect to a DFIC where a Section 962 election is in effect.
- **Regulatory Planning and Review:** This proposed rule has been designated a “significant regulatory action” under Section 3(f) of Executive Order 12866 and the Memorandum of Agreement (MOA), Review of Tax Regulations under Executive Order 12866 (April 11, 2018). Accordingly, the proposed rule has been reviewed by the Office of Management and Budget. The Treasury requests comment on this designation.
- **General:** In addition to the above, comments are specifically requested concerning:
  - Whether the proposed collection of information is necessary for the proper performance of the duties of IRS, including whether the information will have practical utility
  - The accuracy of the estimated burden associated with the proposed collection of information (including underlying assumptions and methodology)
  - How the quality, utility and clarity of the information to be collected may be enhanced
  - How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology
  - Estimates of capital or start-up costs and costs of operation, maintenance, and purchases of services to provide information

The Treasury also solicits comments on the assumptions and appropriateness of the methodology used to calculate the compliance costs imposed by the Proposed Regulations relative to the baseline.

## On the Tax Reform Front: What Legislative and Regulatory Actions Do We Expect Next?

While the implementation of the TCJA is making progress, with the Treasury focused on issuing guidance as soon as possible, a similar level of activity should not be expected on Capitol Hill. Though the House Ways and Means Committee published its "Tax Reform 2.0" outline on July 24, 2018, prospects of that plan becoming law this year are fairly low. The Committee's broad outline focuses on (1) making certain temporary provisions in TCJA permanent, (2) bolstering savings and (3) fostering innovation. That said, given the uphill battle the legislation would face in the Senate, the outline mostly serves as a messaging exercise for House Republicans in advance of the mid-term elections fewer than 100 days away.

Though chances of any new tax legislation becoming law this year are remote, more proposed regulations are expected in the coming months. In particular, we expect the Treasury and IRS to issue guidance related to the global intangible low-taxed income (GILTI) and the base erosion and anti-abuse tax (BEAT) provisions by the end of the year, as well as proposed regulations related to Section 163(j) (interest expense limitation) in the next several weeks. The Treasury recently provided draft regulations under Section 199A (pass-through deduction) to the Office of Management and Budget (OMB), and those regulations were released by the Treasury August 8, 2018. We will provide a separate update on those regulations in the coming days.

OMB's review of the Proposed Regulations was a first under its new agreement with the Treasury to jointly consider rules implementing the details of TCJA provisions. While the OMB made no substantive changes to the Proposed Regulations, it remains uncertain whether a similar precedent will hold for review of other proposed regulations. It also means that the release of regulations will be at a somewhat slower pace than in recent years due to the additional level of review now required.

As for the Proposed Regulations, the Treasury may hold a hearing to discuss any comments received during the comment period. It will then consider the comments and draft final regulations, as well as more proposed or temporary regulations if it feels it necessary to address items that were not addressed in the Proposed Regulations. Prior to the release of final regulations, the OMB will have one more chance to review them. We expect the final regulations to closely resemble the Proposed Regulations in areas where the Treasury has noted it already considered comments, and any changes are likely to be in areas where the IRS has specifically requested comments. Given the above process, we expect it will be some time before the Proposed Regulations are issued in final form.

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