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# *IRS/Treasury guidance plan will likely affect all companies with global structures*

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## *In brief*

The IRS/Treasury's [2013-2014 Priority Guidance Plan](#) (the business plan) includes international tax regulatory projects which likely will affect companies with cross-border business activities. The annual business plan announces the regulatory projects that the Administration hopes to complete during the plan year, which runs from July 2013 to June 2014.

**Observation:** The 2013-14 business plan project that is likely to have the greatest impact on companies with cross-border activities is the finalization of foreign currency exchange rules under Section 987.

In general, some projects are completed in the first year they appear on the business plan. Others carry over for several years while the Administration addresses other priorities or tries to resolve technical or policy issues. The 2013-14 business plan (released on August 9, 2013) includes 324 projects, up from the 317 projects included on the 2012-2013 business plan. The international tax projects for 2013-2014 number 46, down from 50 projects last year.

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## *In detail*

The IRS annual business plan lists the international tax regulatory projects by area of focus. The discussion below reflects that approach.

### ***Subpart F/deferral***

The 2013-14 business plan includes seven projects under this category, versus six in the previous year. The projects include six sets of regulations under subpart F and regulations on passive foreign investment companies (PFICs). Most of these projects are very broad and general in scope. Most are carry-over projects from prior

year plans or finalize current proposed or temporary regulations.

Under Section 954, the 2013-2014 business plan lists two broadly defined projects. The first promises guidance related to the treatment of transactions involving commodities and non-functional currency. The second simply suggests the IRS will provide guidance regarding foreign base company sales income and services income.

**Observation:** These areas of subpart F still need additional guidance, but the business plan

does not indicate which specific issues may be addressed.

The anticipated guidance lists two projects under Section 956: one new project and one carryover project. The latter will provide regulations on loans by controlled foreign corporations (CFCs) to related foreign partnerships and associated issues.

**Observation:** Previous informal statements by government officials as well as language in the preamble of a 2005 regulation package on Section 954(i) have suggested

that loans by CFCs to related foreign partnerships may be considered Section 956 loans if the related foreign partnership has US partners. However, it is unclear from the business plan how the guidance will achieve this result. In any event, we anticipate that the guidance in this area will be in the form of proposed regulations, thereby offering the public an opportunity to comment on the rules before they are effective and impact any transactions.

The new Section 956 project is final regulations on the treatment of upfront payments on swaps. Temporary and proposed regulations were published on May 11, 2012.

The other three projects in this category generally are carryover items from prior business plans dating several years back:

- The finalization of Section 959 regulations proposed in 2006 on previously taxed earnings and profits.
- Section 964 regulations on accounting method elections.
- A broad reference to regulations with respect to PFICs under Sections 1297 and 1298. Note that guidance under Section 1295 (addressing qualified electing funds) was added to this project.

#### ***Inbound transactions***

The 2013-14 business plan lists eight items in the inbound transactions category, the same number as for 2012-13.

Three items in this category were added to last year's list and remain:

- Guidance under Section 864 implementing Revenue Ruling 91-32, relating to sales of certain partnership interests.

**Observation:** The Administration has proposed codifying Revenue Ruling 91-32. This project may provide an alternative to legislation or perhaps implementing rules if Congress were to enact such legislation.

- Section 882 regulations regarding insurance companies.
- Proposed regulations under Section 6038C on information with respect to corporations engaged in a US trade or business.

Three items in this category involve finalizing temporary and/or proposed regulations:

- Temporary and proposed regulations under Section 871(m) (published on January 23, 2012) governing the treatment of dividend equivalent payments. (See US Inbound Newsalert, [\*IRS releases guidance on Section 163\(j\) excess interest expense limitation and Section 871\(m\) dividend equivalent payment sourcing\*](#))
- Temporary and proposed regulations under Section 892 (published on November 3, 2011). (See US Inbound Newsalert, [\*IRS releases proposed guidance addressing income of foreign governments under Section 892\*](#))
- Temporary and proposed regulations under Treas. Reg. sec.1.6038A-2T (published on June 10, 2011) regarding filing requirements for Form 5472.

Finally, two of the inbound transactions projects in the current business plan, both addressing withholding issues under Section 1441, have appeared in business plans of previous years:

- Guidance updating Rev. Proc. 89-47 on central withholding agreements.
- Guidance related to withholding in connection with certain live events.

#### ***Outbound transactions***

This category has five items for 2013-14, the same number as for 2012-13, and all of the projects overlap the issues on last year's list.

These include final regulations and other guidance under Section 367, as well as regulations under Section 367(d) regarding transfers of intangible property to foreign corporations, including temporary regulations to implement Notice 2012-39. (See US Outbound Newsalert, [\*Notice 2012-39: New rules for outbound reorganizations\*](#))

**Observation:** The rules outlined in Notice 2012-39 would have a significant effect on US companies that transfer business assets to foreign affiliates in the context of business integration and cash management planning. We anticipate that the guidance implementing the rules of Notice 2012-39 will provide exceptions to certain rules announced in the notice regarding the subsequent transfer of stock of an acquiring foreign corporation, and will address some issues left open by the notice, such as the application of the notice's principles to triangular reorganizations.

**Observation:** As noted in previous years, anticipated regulations under Section 367(d) may be of particular interest in light of proposed legislation to narrow taxpayers' ability to make such transfers without being fully taxed on the value of all the intangibles involved. It is unclear whether the IRS and Treasury will address such controversial issues as whether 'workforce-in-place' is part of

'going concern value' or simply update and fix various technical problems with the current regulations. Recent comments by government officials suggest that the regulations will address some of the longstanding and 'tough' issues, and so the guidance may not be issued in the near future.

Two items on the business plan involve guidance clarifying the application of Section 7874:

- Section 7874 regulations implementing Notice 2009-78 regarding 'surrogate foreign corporations.'
- Finalization of temporary and proposed regulations under Section 7874 (published on June 12, 2012) regarding 'substantial business activities.' (See US Inbound Newsalert, [New Section 7874 regulations significantly narrow ability to claim substantial business activities in a foreign country](#))

**Observation:** Both guidance projects have been controversial. Notice 2009-78 has been criticized as overriding a congressional decision to treat private placements differently from public stock offerings, and can have surprisingly harsh results in some cases involving acquisitions of US targets by foreign companies. The temporary regulations similarly have been criticized as overstepping the congressional mandate, by setting thresholds that almost no multinational company can meet. We anticipate that this guidance will create certain exceptions to the rules announced in the notice in the context of acquisitions by unrelated persons.

Finally, the list promises final regulations and other guidance under Section 6038B, specifically including regulations on the failure to file gain recognition agreements (GRAs) and other required filings. The IRS issued

proposed regulations on January 31, 2013. (See US Outbound Newsalert, [New proposed GRA regulations: Failures to file and deficiencies in GRAs and other documents](#))

**Observation:** US persons who either fail to timely file a GRA or related documents under the Section 367(a) regulations, or file such documents with material deficiencies, will face different rules for obtaining relief under the proposed regulations. The proposed regulations also address failures to file (and deficient filings of) certain documents required in the Section 6038B regulations concerning outbound transfers, as well as Form 926.

The current GRA regulations require taxpayers seeking relief to meet a 'reasonable cause' standard. By contrast, the proposed regulations would only require the US person to demonstrate that the failure to file was not 'willful'. On the other hand, the proposed regulations would continue to apply the current 'reasonable cause and not willful neglect' standard to US persons seeking relief from failure to report penalties under Section 6038B.

#### **Foreign tax credits**

This category has one less item for 2013-2014 (six) than the 2012-2013 business plan, which listed seven projects.

Four projects involve finalization of temporary and proposed regulations:

- Proposed regulations under Section 904(f) (published on June 25, 2012) on overall foreign losses. (See US Outbound Newsalert, [Final regulations make minor changes to expired temporary regulations implementing ODL and OFL rules](#))
- Temporary and proposed regulations under Section 901

(published on July 18, 2011) on noncompulsory payments. (See US Outbound Newsalert, [Final regulations limit transactions viewed as FTC generators](#))

- Temporary regulations under Section 905(c) (published in November 2007 and already expired) on foreign tax redeterminations.

**Observation:** The expiration of the temporary regulations in 2010 has created some uncertainty in the application of these rules. We anticipate that the forthcoming guidance will provide a transition rule to bridge the gap between when the temporary regulations expired and the new regulations are issued, and that such rules should provide a safe harbor for those taxpayers who have continued to follow the provisions of the expired temporary regulations.

- Temporary and proposed regulations under Section 909 (published on February 14, 2012) on foreign tax credit splitting events. (See US Outbound Newsalert, [IRS issues final and temporary foreign tax credit splitter regulations](#))

The two other items relate to the 2010 legislation in H.R. 1586 and have appeared in the three previous years' business plans. They involve guidance under the following:

- Section 901(m) on covered asset acquisitions.
- Section 904(d)(6) on the separate application of foreign tax credit limitation to items re-sourced under treaties.

**Observation:** Taxpayers have been waiting for guidance on Section 901(m). Based on informal comments

from IRS officials, many observers believed that a notice providing guidance under Section 901(m) was going to appear about the same time as the Section 909 temporary and proposed regulations. However, that notice has not materialized, and taxpayers continue to operate in an environment of uncertainty with respect to implementation of the statutory provisions.

### ***Sourcing and expense allocation***

This category includes two projects (both on last year's business plan). One project involves finalization of regulations under Section 861. Temporary and proposed regulations were published on January 17, 2012, on interest expense apportionment.

The other item under this category includes regulations under Sections 861, 862, and 863(a) on the source of income from intangible property. (See US Outbound, [\*Temporary regulations under Section 861 make a few targeted changes to the allocation and apportionment of interest\*](#))

**Observation:** In one form or another, this guidance project has been part of the IRS business plan for the past eleven years, reflecting a long-standing need for comprehensive guidance in an area that to date has been addressed chiefly in decades-old, and sometimes inconsistent, rulings and case law.

### ***Treaties***

In the past, this category has contained only generic items, but since two years ago the business plans have added more specificity. There are three items in this category for 2013-2014, all of them essentially the same as in the prior plan:

- Guidance (in the form of a revenue procedure) updating Rev. Proc. 2006-54 on the Competent Authority Program.

- Section 894 guidance on issues under income tax treaties, including the application of various treaty provisions to payments through hybrid entities.
- Miscellaneous announcements, e.g., of Mutual Agreement Procedures (MAPs) and Reciprocal Exemption Agreements.

### ***Other***

The 2013-14 business plan has eleven items listed in this catch-all category of international tax projects, compared to fourteen last year. Many of the items on this year's list have appeared in prior years' business plans.

Following are items that the IRS and Treasury have already addressed to some extent during the last plan year:

- Guidance on Section 988 transactions, including hedging transactions (temporary and proposed regulations published on Sept. 6, 2012).
- Guidance under Sections 1441-1446 and 1471-1474, including proposed regulations under Sections 1471-1474 (published on Feb. 15, 2012) that need to be finalized. On Nov. 19, 2012, the IRS published Ann. 2012-42, regarding timelines and other requirements relating to this area.

Regulations in this category that need finalization include the following:

- The 2006 proposed regulations on Section 987 currency gain or loss.

**Observation:** As noted above, this project is likely to have the greatest impact on taxpayers with global structures. The Administration has signalled that issuance of the regulations may occur at any time. Informal comments from IRS/Treasury

officials suggest that the final regulations will be very substantial and generally follow the approach of the 2006 proposed regulations. These regulations are likely to create an onerous compliance burden for US multinationals with qualified business units that would be subject to the Section 987 rules.

- Temporary and proposed regulations under Section 6038D (published on Dec. 19, 2011), on foreign financial asset reporting.
- Proposed regulations under Section 6039E (published on Jan. 26, 2012) on passport application information.
- Section 1356 regulations concerning core, secondary, and incidental activities under the tonnage tax.
- Regulations on the excise tax under Section 5000C on certain foreign procurement payments by the Federal government.

Other carry-over projects from prior years include the following:

- Guidance under Section 7701 regarding entity classification.
- Section 937(a) regulations concerning the 'presence test' for bona fide residency in US territories.
- Regulations under Sections 6039F, 6048 and 6677 on foreign trust reporting.
- Guidance under Section 3402 for employers on the Military Spouses Residency Relief Act in relation to the US territories.

### ***The takeaway***

The annual IRS/Treasury business plan signals the Administration's intentions to issue administrative guidance, including regulations, in the

international tax area. Some of these projects are broadly defined and essentially constitute placeholders for unspecified projects. Others are very specifically focused and likely to affect a large number of companies. In particular, these focused projects include the finalization of the currency exchange regulations under Section 987 and rules relating to foreign tax credit splitting events, as well as finalization of foreign tax credit

regulations addressing foreign tax redeterminations.

One notable development with the release of this year's business plan is its timing. Under the Obama Administration, the business plan's release has been significantly delayed. Last year's plan was not released until November, which was five months into the plan year. An August plan release fits with the more traditional

timing. Will this more traditional release timing be followed by a more robust issuance of guidance plan projects?

Companies should, to the extent possible, consider how the expected guidance will affect their current or planned operating structure. PwC is ready to assist companies in monitoring the guidance and in modeling potential impacts.

## ***Let's talk***

For a deeper discussion, please contact:

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