TAX ALERT

DEPARTMENT OF TREASURY ISSUES NOTICE 2017-38, INTENDS TO REVIEW TAX REGULATIONS AND RECOMMEND ACTIONS TO MITIGATE BURDENS

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Pursuant to Executive Order 13789, the U.S. Department of Treasury ("Treasury") released Notice 2017-38 (the "Notice"), which contains an interim list of eight tax regulations that possibly impose an undue financial burden on U.S. taxpayers or add excessive complexity to the Federal tax laws.

Background

On April 21, 2017, President Trump signed Executive Order 13789 (the "Order"), which directed Treasury to examine all "significant tax regulations" issued on or after January 1, 2016 that met the criteria outlined in the Order. Treasury was to submit an interim report identifying regulations that:

(i) Imposed an undue financial burden on U.S. taxpayers;
(ii) Added undue complexity to the federal tax laws; or
(iii) Exceeded the statutory authority of the Internal Revenue Service ("IRS").

The Notice states that between January 1, 2016 and April 21, 2017, there were one hundred and five temporary, proposed, and final regulations issued by Treasury and the IRS. Treasury has identified eight regulations that meet at least one of the first two criteria mentioned above.

On or before September 18, 2017, Treasury will be submitting a final report to the President recommending specific actions to mitigate the burdens imposed by these tax regulations. The Order states that Treasury should take "appropriate steps" to delay or suspend the effective date of the identified regulations, and to modify or rescind the regulations.

The Eight Regulations Identified for Burden Reduction

1) Proposed Regulations under Section 103 of the Internal Revenue Code on the definition of a "Political Subdivision" (REG-129067-15; 81 F.R. 8870) that is eligible to issue tax-exempt bonds for governmental purposes.

   Commenters stated that the longstanding "sovereign powers" standard was settled law and had been endorsed by Congress, and additional limitations were unnecessary.

2) Temporary Regulations under Section 337(d) on Certain Transfers of Property to Regulated Investment Companies (RICs) and Real Estate Investment Trusts (REITs) (T.D. 9770; 81 F.R. 36793).

   These temporary regulations amend existing rules on transfers of property by C corporations to REITs and RICs generally. Commenters expressed concern that the REIT spinoff rules could result in over-inclusion of gain in some cases, particularly where a large corporation acquires a small corporation that engaged in a Section 355 spinoff and the large corporation subsequently makes a REIT election.

3) Final Regulations under Section 7602 on the Participation of a Person Described in Section 6103(n) in a Summons Interview (T.D. 9778; 81 F.R. 45409).

   These regulations allow outside economists, engineers, consultants, or attorneys to receive books, papers, records, or other data summoned by the IRS and to participate fully in the interview of a person who the IRS has summoned as a witness to provide testimony under oath.

   Commenters objected to the IRS's ability to contract with outside attorneys and permit them to question witnesses under oath, and the U.S. Senate Finance Committee approved legislation in 2016 that would prohibit the IRS from delegating to third-party contractors the authority under Section 7602.

4) Proposed Regulations under Section 2704 on Restrictions on Liquidation of an Interest for Estate, Gift and Generation-Skipping Transfer Taxes (REG-163113-02; 81 F.R. 51413).

   Section 2704(b) of the Internal Revenue Code provides that certain noncommercial restrictions on the ability to dispose of or liquidate family-controlled entities should be disregarded in determining the fair market value of an interest in that entity for estate and gift tax purposes.

   Commenters expressed concern that the proposed regulations would eliminate or restrict common discounts, such as minority discounts and discounts for lack of marketability, which would result in increased valuations, and transfer tax liability that would increase financial burdens. Commenters were also concerned that the proposed regulations would make valuations more difficult and that the proposed narrowing of existing regulatory exceptions was arbitrary and capricious.

   See prior Mazars USA tax alert on Section 2704: *Taxpayers with Interests in Family Held Entities Urged to Consider Transfer Tax Planning While Discounts Remain Available*, *August 23, 2016*

5) Temporary Regulations under Section 752 on Liabilities Recognized as Recourse Partnership Liabilities (T.D. 9788; 81 F.R. 69282).

   These temporary regulations generally provide: (i) rules for how liabilities are allocated under Section 752 solely for purposes of disguised sales under Section 707 of the

Internal Revenue Code; and (ii) rules for determining whether "bottom-dollar payment obligations" provide the necessary "economic risk of loss" to be taken into account as a recourse liability.

Commenters stated that the first rule was novel and would unduly limit the amount of partners' bases in their partnership interests for disguised sale purposes, which would negatively impact ordinary partnership transactions. Commenters were concerned that the bottom-dollar payment obligation rules would prevent many business transactions compared to the prior regulations and suggested their removal or the development of more permissive rules.

6) Final and Temporary Regulations under Section 385 on the Treatment of Certain Interests in Corporations as Stock or Indebtedness (T.D. 9790; 81 F.R. 72858).

These final and temporary regulations address the classification of related-party debt as debt or equity for federal tax purposes.

Commenters to the documentation rules criticized the financial burdens of compliance, particularly with respect to more ordinary course transactions. Commenters also requested a longer delay in the effective date of the documentation rules. Commenters to the final transaction rules criticized the complexity associated with tracking multiple transactions through a group of companies and the increased tax burden imposed on inbound investments.

See prior Mazars USA tax alerts on Section 385:
US Treasury Addresses Inversions and Intercompany Debt, April 29, 2016
Treasury Releases Final Debt-Equity Regulations – Part I, October 20, 2016
Treasury Releases Final Debt-Equity Regulations – Part II, October 27, 2016
Treasury Releases Final Debt-Equity Regulations – Part III, November 11, 2016

7) Final Regulations under Section 987 on Income and Currency Gain or Loss With Respect to a Section 987 Qualified Business Unit (T.D. 9794; 81 F.R. 88806)

These final regulations provide rules for (1) translating income from branch operations conducted in a currency different from the branch owner's functional currency into the owner's functional currency, (2) calculating foreign currency gain or loss with respect to the branch's financial assets and liabilities, and (3) recognizing such foreign currency gain or loss when the branch makes a transfer of any property to its owner.

Commenters on the regulations stated that the transition rule in the final regulations imposes an undue financial burden on taxpayers because it disregards losses calculated by the taxpayer for years prior to the transition but not previously recognized. Commenters also stated that the method prescribed by the final regulations for calculating foreign currency gain or loss was unduly complex and costly to comply with, particularly where the final regulations differ from financial accounting rules.

8) Final Regulations under Section 367 on the Treatment of Certain Transfers of Property to Foreign Corporations (T.D. 9803; 81 F.R. 91012).

Section 367 of the Internal Revenue Code generally imposes immediate or future U.S. tax on transfers of property (tangible and intangible) to foreign corporations, subject to certain exceptions. These final regulations eliminate the ability of taxpayers under prior regulations to transfer foreign goodwill and going concern value to a foreign corporation without immediate or future U.S. income tax.

Some commenters stated that the final regulations would increase burdens by taxing transactions that were previously exempt, noting in particular that the legislative history to Section 367 contemplated an exception for outbound transfers of foreign goodwill and going concern value. Commenters also stated that an exception should be provided for transfers of foreign goodwill and going concern value in circumstances that would not lead to an abuse of the exception.

Treasury is requesting public comments on whether these eight regulations should be rescinded or modified. For modification recommendations, suggestions on how burdens and complexity can be reduced should be included. These comments are due by August 7, 2017.

Pursuant to Executive Order 13777, Treasury is also inviting public comment concerning any other regulations that should be modified or eliminated to reduce unnecessary burdens – these comments are due by July 31, 2017.

Insight from Mazars USA

The Notice did not identify any tax regulations that met the third criteria under Executive Order 13789. There is a possibility that additional tax regulations may be identified in the final report that will be submitted to the President on or before September 18, 2017.

For the eight tax regulations identified, Treasury did not specify any particular action steps that should be taken to alleviate their undue financial burden or lessen their complexity. Taxpayers should continue applying the existing regulations (where applicable) until more definitive guidance is provided.

Please contact your Mazars USA tax professional if you have further questions.

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