LAW360

Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Federal Tax Policies To Watch In 2018

By **Vidya Kauri**

Law360, New York (January 1, 2018, 6:06 PM EST) -- The new year should be intensely laborious for the U.S. Treasury Department since it likely will have to issue guidance for many new features in the Republicans' tax cut legislation while it forges ahead with the Trump administration's deregulatory agenda.

H.R. 1, the Republicans' $1.5 trillion tax cut bill that President Donald Trump signed on Dec. 22, less than two months after it was unveiled, includes multiple ambiguities and errors that need to be interpreted by the Treasury and the Internal Revenue Service or resolved through future technical correction bills.

Meanwhile, the Treasury has embarked on an agenda to cull more than 200 as-yet unspecified regulations that it has deemed to be obsolete, unnecessary or confusing. This is in addition to eight identified Obama-era rules that the Treasury intends to amend or revoke to simplify the tax code.

As tax practitioners eagerly await new guidance, here are some significant policy changes coming down the pipeline in 2018.

Interpreting the GOP's Tax Cut Law

The swift passage of H.R. 1, which lowers corporate and individual tax rates, has resulted in ambiguities and errors that even Republican leaders concede will need to be fixed through technical correction bills.

However, technical corrections can be difficult to pass because Republicans and Democrats on the tax-writing committees in the House and Senate will need to be in unison on whether proposed corrections are actually just that, and not wholesale policy changes.

Devoid of corrective legislation, the Treasury could find itself having to promulgate regulations to prevent the abuse of new statutory rules in complex areas such as the taxation of foreign income and pass-through businesses.

Even something as relatively straightforward as one-time low repatriation tax rates to encourage multinational corporations to bring their offshore profits to the U.S. has raised questions about applicable effective dates.

Another area needing clarification is the new law's provision extending a holding period requirement

before the sale or exchange of a partnership's capital assets — from one year to three years — to qualify for a lower 20 percent tax rate for long-term capital gains. The statute is open to interpretation on what partnership interests it would apply to, what substantial services qualify in an active trade or business, and whether it would apply to the ownership of real estate.

Investors also would be affected by a provision barring the use of unrelated trade or business losses to offset income in another area.

For tax-exempt organizations, so-called unrelated business taxable income is typically earned from investment portfolios that may generate gains and losses in different sectors of the economy. According to Alexander Reid, a tax attorney at Morgan Lewis & Bockius LLP, it is unclear if those losses must be filed separately or not.

"The answer will have a huge revenue effect whether you put them all together or treat them separately, and it's going to be an administrative nightmare to try to track all of that," Reid said.

Debt-Equity Documentation Requirements

In October, pending potential changes from H.R. 1., the Treasury kept complex distribution rules under the contentious Internal Revenue Code § 385 that recharacterize debt as equity.

When those regulations were introduced in April 2016 under the Obama administration, they caused a furor among both Democrats and Republicans and drew the ire of business groups. All said that the rules were overly broad in scope, affected ordinary business transactions that lacked tax-avoidance motives and were beyond Treasury's authority.

The Internal Revenue Service ultimately took the public criticism to heart and scaled back the regulations by introducing exceptions for foreign subsidiaries of U.S. multinationals, S corporations, mutual funds, real estate investment trusts and transactions between banks.

However, experts say the regulations remain complex and contain burdensome compliance and documentation requirements. The Trump administration said the rules were needed to curb corporate inversions aimed at lowering U.S. taxes, but agreed that the documentation requirements had to go.

These requirements will be replaced with a more simplified regime, Treasury said, adding that it will revisit the § 385 rules to determine how they will interact with H.R. 1.

Terminated Business Unit Losses

Substantial revisions can be expected to final and temporary rules dealing with income and currency gains and losses for certain qualified business units.

Issued under IRC § 987, the rules govern the recognition and deferral of foreign currency gain or loss that occurs in certain transactions involving partnerships and when qualified business units are terminated.

The rules disallow the termination of qualified business units that try to achieve selective recognition of losses when the units' assets and liabilities are transferred to a related person. The rationale for deferring § 987 losses will apply equally to gains, the IRS said.

Like the § 385 documentation requirements, the § 987 rules also were the target of a Treasury report that aimed to cut back burdensome regulations.

Treasury and the IRS are expected to issue guidance soon that would permit taxpayers to defer the rules until at least 2019 while the government works on instituting simpler methodology for calculating § 987 gains and losses.

--Editing by Tim Ruel.

All Content © 2003-2018, Portfolio Media, Inc.