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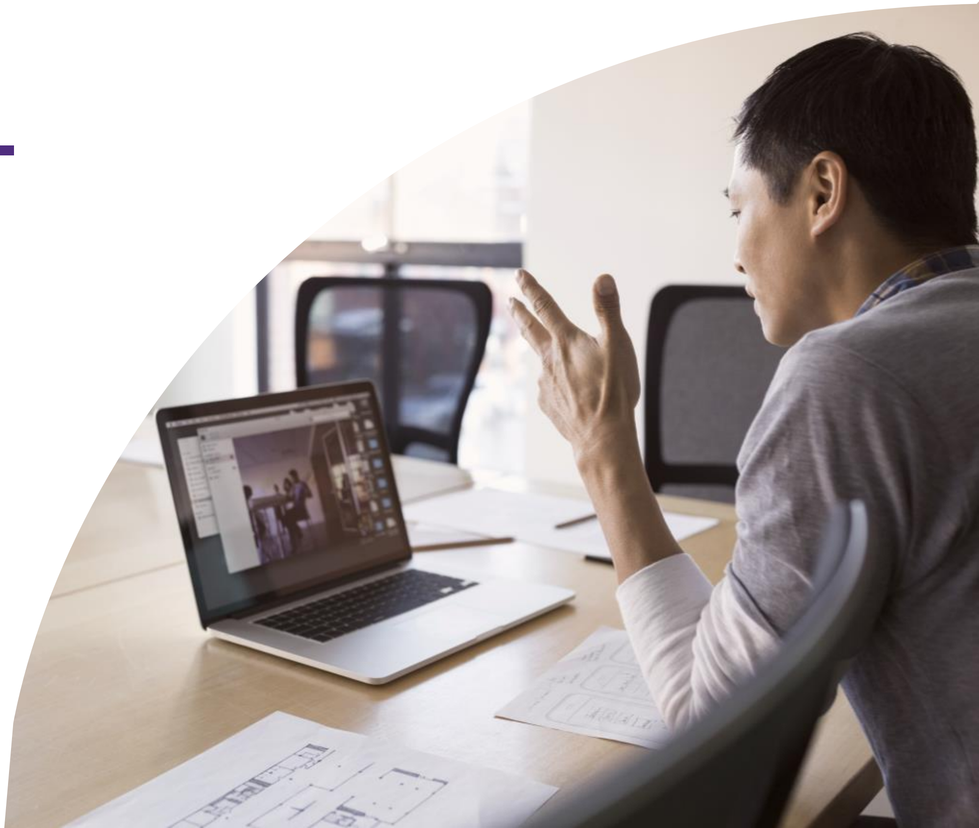
Tax Accounting Quarterly Update – December 2018

December 19, 2018

3:00 PM – 4:30 PM ET



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Learning Objectives

1. Identify updates in federal tax matters
2. Recognize significant state tax developments
3. Describe significant international tax developments
4. Apply relevant FASB, SEC and other accounting updates
5. Explain compensation and benefits developments

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Agenda

1. Federal Tax
2. State and Local Tax
3. International Tax
4. Accounting
5. Human Capital Services

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Agenda

1. **Federal Tax**
2. State and Local Tax
3. International Tax
4. Accounting
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Federal Tax Updates

1. IRS Proposes to Remove Sec. 385 Documentation Requirements
2. IRS Clarifies Deductibility of Certain Meal Expenses
3. IRS Issues Final Regulations On Allocation of Costs Under Simplified Sec. 263A Methods
4. IRS Issues Proposed Sec. 163(j) Regulations
5. IRS Provides Procedures to Change Methods of Accounting to Comply with Sec. 451(b)
6. Congress contemplates year-end tax legislation

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IRS Proposes to Remove Sec. 385 Documentation Requirements

October 2016	April 2017	October 2017	September 2018
Final and temporary regulations issued under section 385 including documentation requirements that ordinarily must be met for certain related-party debt issued on or after Jan. 1, 2018 to be treated as indebtedness for U.S. federal income tax purposes	**Executive order issued to review all significant tax regulations issued after Dec. 31, 2015 that:** • Impose undue financial burden • Add undue complexity • Exceed the statutory authority of the IRS **Section 385 regulations were identified in an interim report issued in June 2017**	**Treasury Department and the IRS announced that changes to the documentation requirements are being considered, following the issuance in July 2017 of Notice 2017-36 announcing a one-year delay in the effective date to interests issued or deemed issued on or after Jan. 1, 2019**	**The IRS filed a notice of proposed rulemaking to remove the documentation requirements** **The Treasury Dept. and the IRS will continue to study the issues and may propose a simplified and streamlined version with a prospective effective date**

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IRS Clarifies Deductibility of Certain Meal Expenses

Under Notice 2018-76 (Oct. 3, 2018), taxpayers may deduct 50% of an otherwise allowable business meal if:

- The expense is an ordinary and necessary expense under section 162(a) paid or incurred during the taxable year in carrying on any trade or business
- The expense is not lavish or extravagant under the circumstances
- The taxpayer, or an employee of the taxpayer, is present at the furnishing of the food or beverages
- The food and beverages are provided to a current or potential business customer, client, consultant or similar business contact, and
- In the case of food and beverages provided during or at an entertainment activity, the food and beverages are purchased separately or are separately stated

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IRS Issues Final Regulations on Allocation of Costs Under Simplified Sec. 263A Methods

On Nov. 19, 2018, the IRS released final regulations under the uniform capitalization rules in Section 263A that:

- Provide a new definition of section 471 costs
- Provide rules for the treatment of negative adjustments related to certain costs required to be capitalized to property produced or acquired for resale
- Provide a new simplified method of accounting, the modified simplified production method, for determining the additional section 263A costs that must be capitalized to ending inventory or other property on hand at the end of the year
- Redefine how certain types of costs are categorized for the simplified methods of determining the additional section 263A costs that must be capitalized to ending inventory or other property on hand at the end of the year

The regulations are effective for taxable years beginning on or after Nov. 20, 2018, but may be applied to the taxpayer's first taxable year ending on or after Nov. 20, 2018

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IRS Issues Proposed Sec. 163(j) Regulations

The proposed regulations provide guidance including but not limited to:

- What constitutes interest for purposes of section 163(j) interest expense limitation
- Computation of adjusted taxable income (ATI) including the impact of the section 250(a)(1) deduction related to global intangible low taxed income (GILTI) and foreign-derived intangible income (FDII)
- Ordering and operating rules to address the interaction of the section 163(j) limitation with other provisions of the Internal Revenue Code
- The application of section 163(j) to consolidated groups, partnerships, S corporations, controlled foreign corporations, foreign persons with effectively connected income, among others
- Election by a real property trade or business or a farming business to opt out of the section 163(j) interest limitation
- Allocating interest expense, interest income and other tax items when the taxpayer conducts a trade or business that is not subject to section 163(j) as well as a trade or business that is subject to it

IRS Provides Procedures to Change Methods of Accounting to Comply with Sec. 451(b)

Reminder

The TCJA amended section 451 relating to the timing of the recognition of income for accrual method taxpayers

- The all-events test with respect to any item of gross income (or portion thereof) shall not be treated as met any later than when such item (or portion thereof) is taken into account as revenue in the taxpayer's applicable financial statement (AFS), or such other financial statement as the Treasury Secretary may specify
- Section 451(b), as revised by the TCJA, is generally effective for tax years beginning after Dec. 31, 2017

On May 28, 2014, the FASB and IASB announced new accounting standards for revenue recognition (ASC 606)

- Publicly-traded entities, some not-for-profit entities and employee benefit plans are required to adopt these new standards for years beginning after Dec. 15, 2017
- All other entities are required to adopt ASC 606 for years beginning after Dec. 15, 2018
- The IRS previously issued an automatic method change for taxpayers that are implementing changes related to ASC 606

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IRS Provides Procedures to Change Methods of Accounting to Comply with Sec. 451(b)

Rev. Proc. 2018-60

- On Nov. 29, 2018, the IRS provided automatic procedures for accrual method taxpayers with applicable financial statements (AFS) to change methods of accounting to comply with section 451(b), as revised by the TCJA
- With the issuance of these procedures, most changes in revenue recognition due to ASC 606 and the TCJA are at least temporarily automatic
- However, special accounting methods not subject to section 451(b) remain non-automatic
- The procedures generally apply to taxable years beginning after Dec. 31, 2017, or Dec. 31, 2018, in the case of income from a debt instrument having original issue discount

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Congress contemplates year-end tax legislation

House and Senate tax-writing committees are working on year-end tax packages

- On Nov. 26, 2018, House Ways and Means Committee Chairman Kevin Brady introduced H.R. 88, which included, among other provisions, tax extenders, expansion of retirement savings, temporary relief for victims of natural disasters, and several technical corrections to the TCJA (see next slide)
- Senate looking to pre-conference and find areas of agreement for "skinny version" that could be added to year-end spending bill

Although possibility remains of attaching to a longer-term spending bill, substantial hurdles exist including:

- The estimated $54 billion cost to the Brady bill
- Differences between House and Senate versions of the IRS administration and retirement proposals
- Democratic resistance to TCJA technical corrections, which may prevent getting to 60 votes in the Senate to overcome procedural roadblocks inasmuch 9 Democratic votes may be needed

Unlikely a large package is enacted by year-end given these hurdles and the compressed time period, though there is broad support for extenders and may be room for some compromise

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Five TCJA technical corrections included in the Brady bill

1. The section 199A pass-through deduction for qualified REIT dividends applies to both direct holders of REIT stock and indirect shareholders of REITs through mutual funds
2. Qualified improvement property is 15-year property under the modified accelerated cost recovery system (MACRS), which also would make such property eligible for 100% bonus depreciation
3. The 2-year NOL carryback for refunds is available for NOLs arising in a fiscal year beginning before Jan. 1, 2018
4. Attorney's fees related to sexual harassment or abuse cases are deductible by victims
5. Any overpayments of tax for years including the section 965 inclusion can be refunded or applied to next year's taxes rather than against future section 965 installment payments as the IRS is currently requiring

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5. Human Capital Services

State & local tax updates

1. **Legislative income tax developments**
2. Non-legislative income tax developments
3. Non-income tax developments

Tax accounting effects - reminder

The effect of a tax law change is reported as a discrete item in continuing operations in the period of enactment

- The effect includes any necessary adjustments to existing deferred tax assets and liabilities

- Since deferred taxes are measured at the enacted tax rate at which the underlying temporary differences are expected to reverse, scheduling the reversal of existing temporary differences may be necessary in some cases

The forthcoming highlights, of both legislative and non-legislative activity, are not intended to be an all-inclusive compilation of state and local tax developments that may affect your company

Enacted changes can significantly impact state deferred tax amounts

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Legislative income tax developments

Massachusetts

In a non-legislative technical bulletin issued on Oct. 4, 2018, the Department of Revenue explained that deemed repatriated income under section 965 is treated as dividend income for Massachusetts corporate excise tax purposes

- The deemed repatriated income is eligible for the 95% dividends received deduction, but the deduction under section 965(c) is not allowed
- Deemed repatriated income is excluded from the numerator and denominator of the sales factor

In legislation enacted on Oct. 23, 2018, Massachusetts clarified that "dividend" includes but is not limited to amounts included in federal gross income under section 951 (Subpart F income) and section 951A (GILTI)

- An addback also is required for deductions allowed by sections 245A (foreign source portion of dividends received by domestic corporations from specified 10% owned foreign corporations), 250 (GILTI and FDII) and 965(c) (repatriation income)
- The legislation is applicable to a taxpayer's last taxable year beginning before Jan. 1, 2018, and to subsequent tax years

Legislative income tax developments
New Jersey

On Oct. 4, 2018, New Jersey enacted legislation which included amendments to legislation enacted on July 1, 2018

- Allows taxpayers to claim a corporation business tax (CBT) deduction in the amount of the section 250 (GILTI/FDII) deduction claimed by the taxpayer in the tax year to the extent the corresponding amounts of income have not been excluded or exempted under the CBT Act
  - Effective for tax years beginning on or after Jan. 1, 2018
- Amends the effective date of the mandatory unitary combined reporting and market-based sourcing for sales of services from tax years *beginning* on or after Jan. 1, 2019 to tax years *ending* on or after July 31, 2019
- Clarifies that the additional "surtax" imposed on corporations subject to CBT for their next four tax years is imposed on "allocated taxable net income" rather than "allocated net income"
  - Effective for tax years beginning on or after Jan. 1, 2018

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Legislative income tax developments
New Jersey (cont'd)

- Amends the 100% dividends received deduction for dividends paid by 80% or more owned subsidiaries for tax years *beginning* on or before Dec. 31, 2016
  - This provision previously applied to tax years *ending* on or before Dec. 31, 2016
- For tax years beginning after 2016 and before 2019, deemed dividends are specially allocated by either the three-year average of the taxpayer’s 2014-2016 allocation factors or 3.5%, whichever is lower
  - This provision previously used a three-year average of the taxpayer's 2015-2017 allocation factors
- Under the July 2018 legislation the only NOL carryover deduction for losses incurred in tax years beginning prior to Jan. 1, 2018 was the prior net operating loss conversion carryover (PNOLCC), which recomputes NOLs from such earlier years on a post-allocation basis
  - The October legislation changed this provision to losses incurred in tax years ending prior to July 31, 2019 (i.e., pre-combined reporting periods)

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Legislative income tax developments
New Jersey (cont'd)

- Under existing law, for tax years beginning on or after Jan. 1, 2018, NOLs are computed on a post-allocation basis
  - The October legislation changed this to apply to NOLs for tax years ending on or after July 31, 2019
- Adds a new NOL deduction provision when there is a change in 50% or more of the ownership of a corporation and the corporation changes the trade or business giving rise to the loss
  - No NOLs sustained before the changes may be carried over to be deducted from income earned after the changes
  - Effective for tax years ending on or after July 31, 2019

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Legislative income tax developments
New York

On Nov. 13, 2018, an Emergency Metropolitan Transportation Business Tax Surcharge regulation was issued

- Increased the Metropolitan Transportation Business Tax Surcharge (MTA Surcharge) from 28.6% to 28.9% of the rate of the New York State Corporation Franchise Tax, effective for tax years beginning on or after Jan. 1, 2019 and before Jan. 1, 2020
    - The rate will remain the same unless the Commissioner determines a new rate
- Because the Franchise Tax Rate is 6.5%, the MTA Surcharge rate for tax years beginning on or after Jan. 1, 2019 is effectively 1.8785%

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Legislative income tax developments
South Carolina

On Oct. 3, 2018, South Carolina enacted legislation, effective for tax years beginning after 2017, providing that South Carolina:

- Conforms to the IRC as amended through Feb. 9, 2018 (previously, Dec. 31, 2016), but continues to decouple from bonus depreciation
- Expressly decouples from:
  - Section 163(j) (limitation on business interest expense)
  - Sections 381(c)(20) and 382(d)(3) (carryover of limited business interest)
  - Section 250 (GILTI/FDII deduction)
  - Section 199A (pass-through deduction)
- Decouples from sections 951A (GILTI) and 965 (repatriation) because existing law decoupled from sections 944 through 989 (taxation of foreign income)

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State & local tax updates

1. Legislative income tax developments
2. **Non-legislative income tax developments**
3. Non-income tax developments

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Non-legislative income tax developments

Section 965 treatment

In Appendix A, we have summarized non-legislative tax developments occurring since our Sept. 2018 webcast with respect to the state tax treatment of federal section 965 income inclusions

- Click the Resources button to download Appendix A

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Non-legislative income tax developments
California

In *Bunzl Distribution USA, Inc. v. Franchise Tax Board* (Sept. 28, 2018), the California Court of Appeal held that a combined reporting group was required to include the income of its six single member LLCs in the numerator of its UDITPA apportionment formula

- The Court rejected the group's argument that Cal. Rev. & Tax. Code § 18633.5 constitutes an "alternative" tax scheme that allows an otherwise disregarded single member LLC to be taxed for all purposes as a separate, stand-alone entity, so that its income is removed from the apportionment formula of UDITPA, even if it is part of a unitary business
- This statute is limited in scope and was not intended to reduce the tax liability of disregarded single member LLCs that are part of a unitary business
- Paying a tax and fee as a disregarded entity does not exempt a single member LLC from unitary business taxation under UDITPA

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Non-legislative income tax developments

Maryland

In *Manpower, Inc. v. Comptroller of the Treasury* (Oct. 31, 2018), the Maryland Tax Court held that the Comptroller properly apportioned the income of a human-resources staffing service provider by using an alternative formula approved by Maryland courts which starts with a corporation's royalty revenue received by the corporation's Maryland operating entities

- The taxpayer received royalty payments from its Maryland entities for the use of its intellectual property
- The three-factor formula provided under Maryland law would not reflect actual income attributable to Maryland
- The Comptroller's alternative apportionment formula fairly attributed income to the taxpayer's Maryland-related income-producing activities

Non-legislative income tax developments
Massachusetts

Massachusetts issued a regulation on Nov. 30, 2018, which addresses federal tax reform by amending the classification of "manufacturing corporation" to receive certain tax benefits

- A corporation is engaged in manufacturing if both of the following requirements are satisfied: (i) the activities of the corporation involve manufacturing; and (ii) the manufacturing activities are substantial
- A corporation's manufacturing activities are substantial if one of four tests is met, including the gross receipts fraction equals 25% or more (the denominator of the fraction includes dividends)
- As amended, "dividend" does not include amounts in federal gross income under section 951 (Subpart F income) or section 951A (GILTI)

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Non-legislative income tax developments
Pennsylvania

In Re: Dish DBS Corp., Pennsylvania Board of Finance and Review (Docket No. 1713444, released Oct. 2018), the Board held that the Department of Revenue properly included a satellite television broadcast company's receipts from sales of broadcast television services based on the location of subscribers in the sales factor numerator

- The taxpayer failed to meet its burden of proving that a greater proportion of its income-producing activity occurred outside Pennsylvania, based on costs of performance
- The Board also held that the Department properly included satellite equipment based on the location of subscribers in the property factor numerator

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Non-legislative income tax developments

Texas

In an Oct. 9, 2018 letter ruling (*Letter No. 201810001L*), the Texas Comptroller determined that the receipts from the sale of a single member limited liability company (SMLLC) should be sourced to the payor's location

- The sale of an SMLLC by its sole owner is treated as the sale of a membership interest in the SMLLC, an intangible asset
- An SMLLC is a taxable entity for Texas franchise tax purposes, regardless of whether it is disregarded for federal tax purposes; as a result, a single member of an LLC owns an “interest” in the LLC and is not considered to own the SMLLC's assets directly
- When a taxable entity sells its interest in an SMLLC, the taxable entity has revenue from the sale of an intangible asset, as opposed to a sale of the SMLLC's assets, and should source that revenue to the payor's location

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Non-legislative income tax developments
Utah

In *Utah State Tax Commission v. See's Candies, Inc.* (Oct. 5, 2018), the Utah Supreme Court affirmed a district court decision upholding deductions for royalty payments made to a related party for the use of intellectual property

- In doing so, the Court rejected the Commission's argument that Utah statutes gave it unfettered authority to reallocate income upon a finding of distortion of income for tax purposes
- Instead, the Court found that the Commission's discretion is limited by language outside the statute, specifically the regulations promulgated under section 482 (transfer pricing)

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State & local tax updates

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2. Non-legislative income tax developments
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Non-income tax developments: Financial statement considerations

May create accruals or contingent liabilities for non-compliance

May result in an "above the line" expense (pre-tax income)

May require the adoption of new procedures and controls to ensure the timely collection, reporting, and remittance of the tax

May increase the appetite for software automation to:

- Increase efficiencies
- Minimize risks
- Redeploy resources to move value-added tasks
- Provide visibility to the organization to make accurate tax decisions
- Ensure timely reporting for financial statement purposes

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Non-legislative income tax developments: Impact of *Wayfair*

In our June and September webcasts, we discussed the U.S. Supreme Court decision in *South Dakota v. Wayfair, Inc*. (*Wayfair*)

- The U.S. Supreme Court overruled *Quill Corp. v. North Dakota* because the physical presence rule is “unsound and incorrect” and is not a correct interpretation of the Commerce Clause
- The Supreme Court remanded the case to consider whether the South Dakota statute requiring certain remote sellers to collect and remit South Dakota sales tax could be challenged on an alternative basis under the Commerce Clause

On Oct. 31, 2018, South Dakota Governor Dennis Daugaard announced that the state has entered into a settlement agreement and a stipulation of dismissal in *Wayfair*

- The settlement removes the injunction that prevented the state from requiring the *Wayfair* litigants to comply with the remote seller law
- Because the *Wayfair* litigants will not be challenging the South Dakota remote seller law on grounds other than the substantial nexus argument rejected by the U.S. Supreme Court, the settlement agreement provides *Wayfair* with a new level of finality
- According to the Governor, “[t]his final settlement agreement brings a conclusion to all remaining issues not addressed by the United States Supreme Court”

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Non-legislative income tax developments: Impact of *Wayfair*

- Other states by and large will view the finality of *Wayfair* as further endorsement of the ability to quickly enact economic nexus statutes and policies on remote businesses that substantially align with the dictates of the Supreme Court's decision
- Many states have enacted statutes and/or issued regulations addressing the obligation of remote sellers, who otherwise do not have a physical presence in a state, to collect and remit sales tax

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International tax updates

1. IRS extends basis election due date in proposed section 965 regulations
2. IRS issues proposed regulations that create balance between sections 956 and 245A
3. IRS issues proposed regulations on foreign tax credits
4. IRS issues proposed regulations on base erosion and anti-abuse tax
5. Non-U.S. tax developments

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Notice 2018-78
Section 965 basis election extension

Notice 2018-78 ("The Notice") (Oct. 1, 2018) allows taxpayers 90 days after the final section 965 regulations are published in the Federal Register to make the basis election

- Elections previously made may be revoked within the same time frame

The Notice also provides rules to prevent overstating of the aggregate foreign cash position for consolidated taxpayers

Victims of Hurricane Florence who were required to make elections or file transfer agreements pursuant to the section 965 proposed regulations have received relief that postpones the due date of these elections to Jan. 31, 2019

May have implications to "APB 23" position regarding indefinitely reinvested foreign earnings

International tax updates

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Section 956 proposed regulations

Proposed regulations issued on Oct. 31, 2018 promote symmetry between sections 956 and 245A

Effect of the proposed regulations is to treat an "effective" distribution in the same manner as an actual distribution

Accomplished by permitting a U.S. shareholder to reduce its section 956 amount to the extent a deduction would have been allowed under section 245A had an actual distribution been received

Existing limitations under section 245A apply when determining the reduction under section 956 (e.g., holding period requirement, hybrid dividends)

Consider impact on "APB 23" position and foreign tax credit position

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Foreign tax credit proposed regulations

On Nov. 28, 2018, the IRS released proposed regulations implementing changes to the foreign tax credit (FTC) regime brought about by the Tax Cuts and Jobs Act (TCJA)

The package is extensive with over 300 pages of regulations and preamble

Effective dates

- In general, the portions of the proposed regulations that relate to statutory amendments made by TCJA apply to taxable years beginning after Dec. 22, 2017
- Certain other portions not related to TCJA apply to taxable years ending after the date the proposed regulations are published in the Federal Register
- A number of provisions have "special applicability" dates

The proposed regulations provide guidance in a cross section of areas impacting foreign tax credits (e.g., sections 861, 904, 960, 78, 965, 954, etc.)

The rules are very mechanical and contain scores of new operative rules

FTC proposed regulations

Proposed regulations are divided into five sections

- Allocation and apportionment of deductions & calculation of taxable income for section 904(a)
- Foreign tax credit limitation under section 904
- Treatment of subsequent reductions in tax in applying high-tax exception
- Deemed paid taxes under new sections 960 & 78
- Effect of section 965(n) election

Initial FTC takeaways

GILTI relief didn't go as far as many taxpayers had hoped; despite expense allocation and apportionment rules remaining applicable to GILTI, burden of expense allocation was partially relieved

The guidance contains significant, complex computational rules; the breadth is also noteworthy, covering a broad swath of foreign tax credit related topics

Many rules are proposed to be retroactively effective for tax years beginning after Dec. 22, 2017

- In light of the retroactive effective date, taxpayers should carefully assess how the proposed regulations impact their specific tax circumstances including the tax provision impact

Despite extensive guidance, unanswered questions remain which may ultimately lead to unrecognized tax benefits for financial statement purposes

A number of "glitches" were corrected including the sections 245A/78 issue and basketing of the GILTI gross-up

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Highlights of the package

Limited GILTI relief – not full prohibition of expense allocation

GILTI & section 78 gross-up basketing issue fixed

Corrects section 245A/78 glitch

Changes to exempt income and asset rules

Defines foreign branch utilized in the new basket for foreign branch income

Rules for assigning taxes under section 960

Changes to section 960 regulations addressing excess limitation account

Several new anti-abuse rules

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Exempt income and exempt assets

Section 864(e)(3) provides that, for purposes of allocating and apportioning any deductible expense, any tax-exempt asset (and any income from the asset) is not taken into account

The proposed regulations revise the definitions of exempt income and exempt asset to clarify that income or assets are treated as exempt (or partially exempt) only to the extent that the income or the income from the assets are, or are treated as, exempt, excluded, or eliminated

Although section 864(e)(3) contemplates that dividends described in sections 243 and 245(a) are treated similarly to exempt income to the extent of the deductions allowed under those sections, section 864(e)(3) does not apply to the dividend income reduced by the section 245A deduction

- Instead, amended section 904(b)(4) provides for alternative adjustments

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Section 904(b)(4)

Section 904(b)(4) provides special rules for the treatment of dividends for which a deduction is allowed under section 245A

The section was amended to provide that for purposes of calculating section 904 limitation, a taxpayer's income from sources without the U.S. (and entire taxable income) shall be determined without including the foreign source portion of any dividend received and any deductions properly allocable or apportioned to:

- Income (other than amounts includible under sections 951(a)(1) or 951A(a)) with respect to stock, or
- Such stock to the extent income with respect to such stock is other than amounts includible under section 951(a)(1) or 951A(a)

Proposed regulations include rules addressing section 904(d)(4) in the following areas:

- Clarifications and new operating rules
- Rules for disregarded expenses properly allocable to dividend income
- Rules for expenses properly allocable to stock
- Coordination with Overall Foreign Loss (OFL)/Overall Domestic Loss (ODL) rules

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Foreign branch category income

Section 904(d)(1)(B) added a new basket for foreign branch income

Foreign branch income generally includes the gross income of a U.S. person attributable to foreign branches or held directly or indirectly through a foreign disregarded entity

- The rules do not apply to branches of foreign corporations

May include a U.S. person's share of partnership income that is attributable to a foreign branch held directly or indirectly by the partnership

All foreign branch income is aggregated into one category

Foreign branch category income is generally attributable to a foreign branch to the extent reported on the foreign branch's separate books and records

- May require adjustments to conform to U.S. income tax principles

Other highlights on the allocation and apportionment of deductions and Sec. 904

Rules on the allocation and apportionment of the section 250 deduction

Transition rules for carryovers of unused foreign taxes under section 904(c)

Transition and coordination with Overall Foreign Loss (OFL)/Overall Domestic Loss (ODL) rules

Updated look-through rules

Special rule for specified partnership loans

Revision to CFC netting rule relating to hybrid debt

Repeal of Fair Market Value Method and Transition Relief

Among others

Section 960

The package contains complex computational and grouping rules for foreign taxes deemed paid under section 960

Generally, under sections 960(a) and (d), a U.S. shareholder with an inclusion of any item of income with respect to a CFC under sections 951(a)(1) and 951A, respectively, is deemed to have paid the amount of the foreign corporation's tax that can be properly attributed to such income

Section 960(b) and (c) provides rules for taxes in connection with distributions of previously taxed income to either a U.S. shareholder that is a domestic corporation or to a shareholder that is a CFC

Highlight: The proposed regulations provide that no foreign income taxes are deemed paid under section 960(a) with respect to an inclusion under section 956

- If finalized, the prevention of a deemed paid credit being carried by section 956 inclusions would create a significant trap for the unwary; this change would place heightened importance on the section 956 proposed regulations, and may necessitate early adoption of section 956 proposed regulations

Section 78

Correction of a mismatch between the effective dates of the new section 78 and section 245A

- The proposed regulations provide that section 78 dividends relating to taxable years of foreign corporations that begin before Jan. 1, 2018 are not treated as dividends for purposes of section 245A
  - The principal reason for this rule is to ensure that similarly situated taxpayers do not receive different treatment due to a CFC having a fiscal year end, rather than a calendar year end
  - Absent this rule, a U.S. shareholder of a 2017 fiscal year CFC could claim a section 245A deduction with respect to its section 78 dividend, while a U.S. shareholder of a calendar year CFC could not
- The proposed regulations also provide a rule that assigns the section 78 gross-up to the same separate category as the deemed paid taxes
  - This rule resolves taxpayer’s concerns that the section 78 gross-up and the GILTI inclusion may be assigned to different categories

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Section 965(n) election

The proposed regulations contain rules regarding the effect of section 965(n) elections (i.e., to forgo the use of NOLs against the section 965(a) inclusion)

Specifically, the proposed rules prevent taxpayers making the section 965(n) election from not reducing their section 965(a) inclusion by allocated and apportioned expenses for section 904 limitation purposes

Instead, the proposed rules require taxpayers to treat the NOL that is not absorbed as being comprised of a proportionate amount of deductions in each of the respective limitation categories (including those allocated to U.S. source income).

Ultimately, taxpayers with expenses allocated or apportioned to foreign-source income would have to treat those expenses as partially absorbed against the net section 965 inclusion for FTC limitation purposes – therefore, yielding a less than 100% section 904 limitation

- Certain calendar year companies have made the section 965(n) election in their 2017 returns and may have determined their section 904 limitation in a manner different than the clarification set forth in the proposed regulations; if so, consideration should be given to the potential impact the proposed rules may have on their overall Transition Tax, section 965(h) installment payments, and whether amended returns are necessary

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BEAT proposed regulations

The TCJA enacted BEAT, which affects corporate taxpayers which are part of a group with gross receipts of at least $500 million over a 3-year period and have a ratio of base erosion deductions compared to total deductions of 3% or higher (2% or higher for certain banks and securities dealers) for the taxable year

- Modified taxable income is computed without regard to certain deductible payments made to foreign-related parties; the proposed regulations clarify that BEAT is determined under an "add-back" method as opposed to a re-computation method
- The tax is phased in at a rate of 5% for tax years beginning in 2018, 10% for tax years beginning in 2019 through 2025, and 12.5% for tax years beginning after Dec. 31, 2025 (these rates are increased by 1% for certain banks and securities dealers)
- When applicable, the tax is added to the taxpayer's regular tax liability
- The FASB staff (Staff Q&A, Topic 740, No. 4) previously concluded that any incremental tax effects of BEAT are recognized as incurred, with deferred tax assets and liabilities not computed in accordance with the BEAT even if a company expects to be subject to BEAT in future years

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BEAT proposed regulations

On Dec. 13, 2018, the IRS released proposed regulations regarding BEAT, which would apply to tax years beginning after Dec. 31, 2017

Highlights of the proposed regulations include:

- Clarification on which payments qualify for the so-called "SCM exception"
- An exception for payments that are effectively connected income subject to U.S. tax on net basis
- Taxpayer-favorable treatment of pre-2018 NOLs for BEAT purposes
- Application of the aggregate theory to partnerships and partners
- Rules addressing the "applicable taxpayer" definition

BEAT proposed regulations

The proposed regulations provide guidance on, among other items:

- Determination as to whether a taxpayer is an applicable taxpayer to which BEAT may be imposed
- Determination of the amount of base erosion payments
- Determination of base erosion tax benefits arising from base erosion payments
- Determination of the amount of modified taxable income
- Computation of the base erosion minimum tax amount
- Application of the proposed regulations to partnerships and consolidated groups
- Certain rules that are specific to banks, registered securities dealers, and insurance companies
- Anti-abuse rules
- Reporting and record keeping requirements

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International tax updates

1. IRS extends basis election due date in proposed section 965 regulations
2. IRS issues proposed regulations that create balance between sections 956 and 245A
3. IRS issues proposed regulations on foreign tax credits
4. IRS issues proposed regulations on base erosion and anti-abuse tax
5. **Non-U.S. tax developments**

Recent foreign tax law developments

In Appendix B, we have summarized various foreign tax law developments occurring since our Sept. 2018 webcast, which may not capture all developments that may be applicable to your company

- Click the Resources button to download Appendix B
- Certain amnesty/voluntary disclosure programs are included given the potential to reduce accrued interest and penalties related to unrecognized tax benefits recorded for financial statement purposes
- Certain non-income tax developments are also included given they can impact "above the line" earnings

We will selectively discuss developments in both Switzerland the U.K.

- Reminder: the effect of an income tax law change is reported as a discrete item in continuing operations in the period of enactment

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Recent foreign tax law developments

Switzerland: On Sept. 28, 2018, the Swiss Parliament approved the proposed tax reform package, now known as *The Federal Act on Tax Reform and AHV Financing* (TRAF)

- Among other provisions, it would eliminate cantonal status companies (e.g., holding, domiciliary and mixed trading company regimes) and would repeal federal rules on the profit allocation of principal companies and Swiss finance branches
- Swiss tax legislation is considered enacted upon approval by the Parliament but only at the end of the 100-day referendum term following publication of the legislation in the Official Gazette unless a referendum is held
- The deadline for calling the referendum is Jan. 19, 2019; since the referendum seems likely, the legislation could be put in jeopardy

Switzerland: On Nov. 15, 2018, the Swiss Federal Tax Administration announced that it will no longer apply the federal practices on tax allocation for principal companies and Swiss finance branches to new companies, effective as of January 1, 2019

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Recent foreign tax law developments

United Kingdom: On Dec. 11, 2018, the U.K. Parliament was expected to vote on the withdrawal agreement reached with the European Union (EU); however, Prime Minister Theresa May called off the vote on Dec. 10, 2018 after admitting it "would be rejected by a significant margin"

- The U.K. is scheduled to exit the EU on March 29, 2019 (Brexit), following the outcome of a referendum held in the U.K. in 2016
- On Nov. 25, 2018, Prime Minister Theresa May reached a withdrawal agreement with the leaders of the other 27 EU member states (EU27) to provide for a smooth and orderly Brexit with a transition period through December 31, 2020 during which access to markets and regulatory regimes will remain largely unchanged
- The agreement does create what has been called a "blind Brexit" because the detailed future trade relationship between the U.K. and EU will be negotiated after March 2019 and may not be finalized until 2020 or later
- If the agreement is rejected, the U.K. has a compressed time period to work out another agreement with the EU unless an extension is granted

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Recent foreign tax law developments

United Kingdom: On Dec. 11, 2018, the U.K. Parliament was expected to vote on the withdrawal agreement reached with the European Union (EU) (cont'd)

- If no agreement is reached and the UK leaves the EU with "No Deal," businesses would face tremendous challenges conducting business between the U.K. and the remaining 27 EU member states
  - HM Revenue & Customs has estimated the administrative burden of customs and VAT procedures could reach £13 billion annually according to its Dec. 4, 2018 impact assessment; tariffs on EU-U.K. trade will be an additional cost
  - HM Revenue & Customs has provided guidance as to the customs, VAT and excise preparation that businesses must do in the event that the U.K. exits the EU without an agreement in place
  - Companies trading in the U.K. should be quantifying the impact on their business and be ready to mitigate adversity
- A "No Deal" Brexit also creates other tax changes such as inability of U.K. entities to claim relief on losses in subsidiaries in the EU27, withholding tax on payments from subsidiaries, and VAT on intra-group cross-border service charges
- Depending on what transpires, companies may need to evaluate the accounting and financial reporting implications; SEC registrants may need to update their disclosures in management's discussion and analysis and other parts of their SEC filings

Agenda

1. Federal Tax
2. State and Local Tax
3. International Tax
4. **Accounting**
5. Human Capital Services

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Accounting updates

1. SAB 118 Reminder
2. Government Assistance Disclosures
3. Income Tax Disclosures

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SAB 118 Reminder

The SAB 118 measurement period ends on Dec. 22, 2018

SEC Staff Accounting Bulletin (SAB) No. 118 provides a measurement period ending no later than Dec. 22, 2018 for companies to report the enactment-date effects of the TCJA

- The FASB staff previously issued a Staff Q&A stating that the staff would not object to private companies and not-for-profit entities also applying SAB 118

No later than after Dec. 22, 2018, the "reasonable estimate" guidance under SAB 118 can no longer be applied; instead, and even if further IRS guidance is needed to interpret and apply the TCJA provisions, companies must apply the measurement and recognition criteria applicable to uncertain tax positions

- If IRS guidance is subsequently issued, it would constitute new information, potentially triggering a change in judgment with respect to recognition and/or measurement of an uncertain tax position
- If IRS guidance is issued in 2019 but before a company issues its 2018 financial statements, any resulting change in judgment would be a 2019 event

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SAB 118 Reminder

Disclosures are required in the period in which the measurement period ends

- The nature and amount of any measurement period adjustments recognized during the reporting period
- The effect of measurement period adjustments on the effective tax rate
- The accounting for the income tax effects of the TCJA has been completed

Accounting updates

1. SAB 118 Reminder
2. **Government Assistance Disclosures**
3. Income Tax Disclosures

Government Assistance Disclosures

FASB Project

On Nov. 14, 2018, FASB continued redeliberations on proposed Accounting Standards Update, *Government Assistance (Topic 832): Disclosures by Business Entities about Government Assistance*

The FASB directed the staff to draft a final Accounting Standards Update (ASU) and perform additional outreach with stakeholders for consideration in a future Board meeting

FASB decisions become final only after a formal written ballot to issue a final ASU

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Government Assistance Disclosures

FASB Project

Required disclosures	Disclosures applicable to	Disclosures not applicable to
• Nature of assistance received • Financial statement line items and amounts • The accounting policies • Significant terms and conditions of the agreement • Assistance not recognized but may impact future period financial statements	An entity that has entered into a legally enforceable agreement with a government to receive cash, nonmonetary assets, or benefits that reduce or eliminate an entity's expenditures	• Not-for-profit entities • Employee benefit plans • Government assistance within the scope of ASC 740, Income Taxes

Government Assistance Disclosures
FASB Project

Types of assistance in scope

- Grants of assets
- Assistance with taxes, e.g., property, sales and use, payroll
- Low-interest rate loans, loan guarantees and forgiveness of liabilities

Disclosure requirements will be the same for public and nonpublic entities

Transition

- Applied on a modified prospective basis

Effective for fiscal years ending after (1) December 15, 2020 for public business entities and (2) December 15, 2021 for nonpublic business entities

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Accounting updates

1. SAB 118 Reminder
2. Government Assistance Disclosures
3. **Income Tax Disclosures**

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Income Tax Disclosures
FASB Project

On Nov. 14, 2018, FASB continued redeliberations on proposed Accounting Standards Update, *Income Taxes (Topic 740): Disclosure Framework - Changes to the Disclosure Requirements for Income Taxes*

The FASB directed the staff to draft a proposed ASU; the Board will decide whether all the disclosure requirements will be included in the proposed ASU or whether certain previously proposed amendments should be separated and included in a final ASU

FASB decisions become final only after a formal written ballot to issue a final ASU

Income Tax Disclosures
FASB Project

The Board tentatively decided to not require the following disclosures relating to income taxes

- Income taxes paid to any country that is significant to total income taxes paid
- (1) Explanation of change in assertion re: indefinitely reinvested foreign earnings and (2) cumulative amount of temporary differences when a deferred tax liability is not recognized (current requirement)
- Unrecognized tax benefits – (1) settlements through existing deferred tax assets and (2) amount that could change in the next 12 months (current requirement)
- Gross amount of carryforwards (public business entities only)
- Cash, cash equivalents, and marketable securities held by foreign subsidiaries
- Description of an enacted change in tax law that is probable to have an effect in a future period

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Income Tax Disclosures

FASB Project

The Board tentatively decided to require the following proposed disclosures relating to income taxes

Disaggregation, between domestic and foreign, of: (1) pretax income (loss) from continuing operations, (2) income tax expense (benefit) and (3) income taxes paid	Effective tax rate reconciliation consistent with SEC requirement and explanation of year-to-year changes in the reconciling items included in the rate reconciliation (public business entities only)	Disclosure of balance sheet line item (and amount) in which unrecognized tax benefits are presented (public business entities only)
Interim cash taxes paid (for entities issuing interim financial statements)	Valuation allowance associated with tax-effected carryforwards and amount and explanation of the valuation allowance recognized or released during the reporting period (public business entities only)	Credit carryforwards separate from loss carryforwards (nonpublic business entities)

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Agenda

1. Federal Tax
2. State and Local Tax
3. International Tax
4. Accounting
5. **Human Capital Services**

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Human Capital updates

1. Employer family and medical leave tax credit
2. Employer-provided parking

New employer credit
Notice 2018-71 (Sept. 24, 2018)

Provides guidance on new employer tax credit available for wages paid to qualifying employees during family and medical leave

- Timing of leave: Employer’s compliant written policy must be in place before the leave is taken
  - Retroactive effect: Compliant written policies adopted by Dec. 31, 2018 may be effective retroactively, provided that the leave practice is adopted retroactively for the entire period of coverage (including retroactive leave payments)
- Short-term disability: Leave paid under an employer’s short-term disability may qualify for the credit
- Credit claimed by filing Forms 8994 and 3800 with the employer’s tax return
- Employers are generally not aggregated for purposes of these rules

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Human Capital updates

1. Employer family and medical leave tax credit
2. **Employer-provided parking**

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Employer-provided parking

Notice 2018-99 (Dec. 10, 2018)

TCJA enacted section 274(a)(4), which provides that parking expenses for qualified transportation fringes paid or incurred after Dec. 31, 2017 are generally no longer deductible (creates an unfavorable permanent book-to-tax difference for tax provision purposes)

- A variety of parking methods may exist including employer-provided parking at employer-owned or leased parking facilities, employer payments to a third party for parking at the third party's garage, employer-reimbursement of employee's parking costs, or employee-payment on a pre-tax basis through a salary reduction arrangement

TCJA also enacted section 512(a)(7), which requires tax-exempt organizations to increase their unrelated business taxable income by the amount of employee parking expenses that would be nondeductible if they were subject to the same disallowance as taxable entities

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Employer-provided parking

Notice 2018-99 (Dec. 10, 2018)

Notice 2018-99 provides interim guidance

- Total parking expenses paid or incurred to provide parking benefits
    - The deduction disallowed relates to the expense of providing parking benefits and not the value of the parking provided (the value is used to determine the amount excluded from the employees' taxable income under section 132)
    - Parking expenses include, but are not limited to, repairs, maintenance, utilities, insurance, property tax, interest, snow removal, leaf or trash removal, cleaning, landscaping, parking attendant expenses, security, and rent or lease payments (or a portion of rent and lease payments if not separately broken out)
- Exceptions to the disallowance

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Employer-provided parking

Notice 2018-99 (Dec. 10, 2018)

Notice 2018-99 provides interim guidance (cont'd):

- Methodology to determine the nondeductible parking expenses
    - If employer payment is made to a third party for parking spots, the disallowance is calculated as the taxpayer's total annual cost of employee parking paid to the third party
    - If employer owns or leases all or a portion of the parking lot or garage, the disallowance can be calculated based on any reasonable method, and the notice provides a four-step methodology that is considered reasonable
- Specific rules and transition relief for tax-exempt organizations

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Any final questions?

Q&A

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