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US Tax Reform: New Game = New Rules

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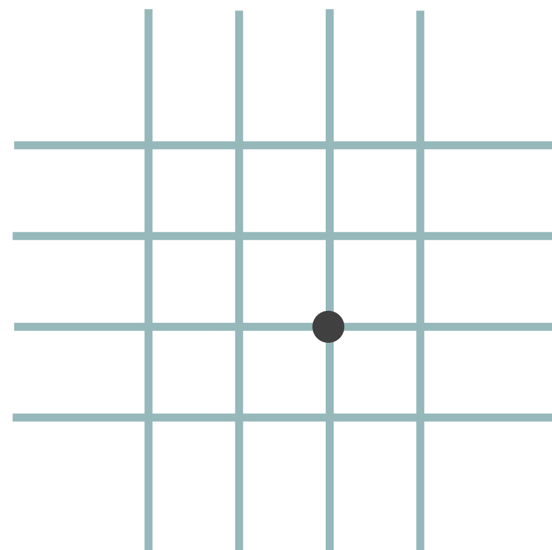
As US Tax Reform (USTR) was unfolding in Congress, we adopted a Chess motif to discuss planning options for multinational businesses (MNCs) (see previous White Papers at http://www.aptisglobal.com/resources). Some strategies a taxpayer might implement from experience and knowledge of the discussions underway. Other situations required advance thinking (Chess puzzles) given that there might be little time to act (the clock was ticking) in the event of a late December passage – which did, in fact, ultimately occur. Time did run out, the clock struck midnight and the game did change, but did the rules?

USTR (Tax Cuts and Jobs Act, Public Law 115-97, signed December 22, 2017) as enacted might be viewed as changing the game from Chess to another ancient strategy game, such as Go. Moving from Chess to Go, the Chess board of 8 x 8 = 64 squares is replaced by the Go board comprised of 19 x 19 gridlines = 361 intersections. In Go, play is on the intersections, not the squares. All Go pieces (stones) have the same value. Play is by adding new stones that do not move once played (although a stone surrounded by opponent stones is removed). The winning player is the one who surrounds the most territory (compare Chess winning by checkmating the opponent's King). Black plays first.

This White Paper cannot address all of the nuances of USTR changes or the Taxpayer impacts. Rather, it is intended to start a dialog with respect to long-term planning in the face of the changed game, albeit with arguably historic rules.



Black played first

Revenue Procedure 2018-17 and Anti-Avoidance Authority

Opening gambit: Following our prior analogy of White as the Taxpayer and Black as the Taxman, Black has indeed played first under USTR. New IRC [Section] 965 changes the game in the middle of play by including in current year (2017 returns) taxable income of US shareholders the accumulated (under prior law) offshore earnings of specified foreign corporations (SFCs) (as defined in IRC 965(e) rather than in IRC 898(b)) (an expanded version of controlled foreign corporations, or CFCs).

White response: Consider using existing IRS procedural rules to change the year ends of SFCs so as to delay by up to 11 months the IRC 965 inclusion, and to change the dates on which some of the IRC 965 computations are based so that increased planning may be undertaken.

Black counter: Revenue Procedure (RP) 2018-17 (released February 13, 2018). RP 2018-17 relies on the authority of IRC 965(o), under which "[t]he Secretary shall prescribe such regulations or other guidance as may be necessary or appropriate . . . to prevent the avoidance of the purposes of this section, including through a reduction in earnings and profits, through changes in entity classification or accounting methods, or otherwise." "Otherwise", in this case, being interpreted (supported by language in the legislative history) to include a change in taxable year in circumstances that previously qualified for automatic approval. Finally, to deal with any foresighted taxpayers that may have seen this coming, the RP 2018-17 change applies to any SFC year that otherwise would have ended on December 31, 2017, even if the change was requested before USTR was enacted.

Moral: Taxpayers should be thoughtful about relying solely on historic technical solutions in their planning under USTR.

For further consideration: The anti-avoidance language of RP 2018-17 doesn't provide an exception for legitimate business planning that coincidentally aligns with tax savings. In other situations, though, a Taxpayer might give thought to business drivers as potentially justifying coincidental tax savings.

Modified IRC 482: Aggregation and Realistic Alternatives

Running with the IRC 965 forced repatriation tax as well as with all the comprehensive changes to future tax computations, it might be easy to overlook a more subtle change in the intercompany transaction statutes. USTR added a complex sentence at the end of IRC 482:

> *For purposes of this section, the Secretary shall require the valuation of transfers of intangible property (including intangible property transferred with other property or services) on an aggregate basis or the valuation of such a transfer on the basis of the realistic alternatives to such a transfer, if the Secretary determines that such basis is the most reliable means of valuation of such transfers.*

Effective for tax years beginning after December 31, 2017. But, per House Report (HR) 115-466: "No inference is intended with respect to . . . the authority of the Secretary to provide by regulation for such application with respect to taxable years beginning before January 1, 2018." A similar change was made to IRC 367, and IRC 936(h) was changed to include an expanded definition of covered intangible property. Also with "no inference" as to the law prior to the January 1, 2018 effective date.

Does a responsible advisor bet that the authors of RP 2018-17 would have any qualms about applying this statute in support of similar IRS positions in existing or future examinations to transactions prior to USTR? Certainly, the concepts of aggregation and realistic alternatives have been floated for decades in litigation, regulations and even proposed legislation. See, e.g., Treasury Decision (TD) 8470, 1993-1 CB 90 (1993)).

Given the volume and scale of litigation history with respect to intangible transfers, the substantive implications of these changes are sure to be extensively addressed in articles and treatises by other authors. The message of this White Paper is that Taxpayers should be considering practical implications, including the following:

- Revised intangibles language in the IRC may create opportunities (or requirements) for revised analyses.

- Any intangibles transaction analysis that does not address (where relevant) the concepts of aggregation and realistic alternatives should be reconsidered.

- IRC 965 calculations of earnings and profits (E&P), intercompany asset/liability accounts and the impacts of actual repatriations or other restructurings are potentially impacted by examination changes to intercompany transactions. The impact of USTR transfer pricing rules potentially applied retroactively to open years should be considered in such computations.

- Treasury Regulations [Section] 1.482-1(a)(3) allows taxpayers to file their timely returns based on corrected transfer pricing in lieu of prices actually charged. This could affect the IRC 965 outcomes now being calculated.

- With the new incentives in USTR, a Taxpayer's most desirable global supply chain structure (taking into account both US and foreign taxes and examination risks) may be substantially different than the one contemplated in original planning. Open transactions and the costs of changing structures should be analyzed in conjunction with revisiting pre-USTR transfer pricing analyses. Bottom line, what is your exit strategy? Many MNEs enter into structures without anticipating the complexities of implementation yet alone the gamut of outcomes on audit and how to address anticipated elements of controversy.

In the span of a full tax career, the playing field is level for the first time for the taxpayers, tax authorities and advisors alike, creating a unique season of challenges ahead for all players. With such challenge also comes opportunity that can either be strategically seized or, unfortunately, neglectfully overlooked. How will you play the game?

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