99 Problems: Addressing Risk in a Time of Tax Uncertainty

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Agenda

- Key Considerations
- Minimizing Implementation Risks
- Should Procedural Tools be Considered to Secure Greater Certainty
- International Tax Reform with Accounting Method Considerations
- Discussion Topics

Key Considerations with Incomplete Guidance or Statutory Ambiguity

- Companies are finding it more complicated to set the provision; audit firms are taking different approaches regarding how to address
- Uncertainty may affect interactions with the business and non-tax teams
- Management/board may inquire about the value of tax reform to the company. How to quantify while guidance is outstanding?
- Potential impact on SEC disclosures
- Impact on the consideration of internal or external transactions. For example, is the company reluctant to act in the absence of guidance or are things moving forward as before?

Key Considerations with Incomplete Guidance or Statutory Ambiguity

- When decision-making is complicated by uncertainties in the new tax law and/or lack of definitive guidance for such new provisions, companies will want to engage in best practices:
  - Define issues that need to be addressed
  - Document their decision-making process
  - To minimize future controversy
- When is additional guidance required?
  - How do you assess when you need an opinion versus oral advice/memorandum?
  - Do you use second opinions, and in what cases?
  - How important is it that your auditor reach an independent level of comfort outside of advice provided by a legal adviser?

Minimizing Implementation Risks

- Establish and execute a decision-making process
  - Document steps taken, stakeholders to be included in various discussions, and roles and responsibilities of the participants
  - Develop positions supported by some measure of authority, whether explicit or analogous
- Ensure technical positions taken are reflected throughout corporate operations
  - Fully document process and analysis consistent with technical recommendations
  - Maintain robust internal communications concerning analysis and support
- Fully and properly document the process, analysis, decision and implementation of the new provisions
  - Prepare and maintain an “audit-ready” file for each position
  - Internal process
  - Contemporaneous support
  - Operational steps

Risk Minimization Example 1: Lack of Technical Corrections for Qualified Improvement Property (QIP)

– Problem
  - TCJA, and proposed § 168(k) regs, fail to provide 15-year recovery period for QIP, thereby preventing it from qualifying for full expensing

– What can be done?
  - Inform stakeholders of different available positions and correlating risks
  - Document decision-making process and actual decision analysis
  - Maintain robust file in preparation for potential controversy
  - Maintain consistent position with respect to such property throughout the business

Risk Minimization Example 2: Lack of Guidance Regarding Income Recognition under § 451(b) / (c)

– Problem
  - TCJA modified the All Events Test (AET) for income recognition with inclusion not later than for financial accounting purposes
  - TCJA concurrently added § 451(c) to the Code, codifying the Deferral Method under Rev. Proc. 2004-34 and providing for one-year deferral of certain advance payments
  - Unrelated to tax reform, FASB and IASB issued new revenue recognition standards under ASC 606
  - Treasury released proposed regulations which remove Treas. Reg. § 1.451-5, which provided for two-year deferral of certain income
  - No guidance has yet to be released regarding § 451(b) or its interplay with § 451(c)

– What can be done?
  - Document, document, document
  - Maintain consistent positions throughout business lines
  - Detailed analysis of impact of ASC 606 on revenue recognition and indirect impact on income recognition under § 451(b)

Risk Minimization Example 3: Safeguarding Deductibility of Settlement Payments

- Problem
  - TCJA amended § 162(f) of the Code, disallowing a deduction for amounts paid or incurred to, or at the direction of, a government or governmental entity, in relation to the violation of any law or the investigation by such entity into the potential violation of any law
    - Exception to general rule of non-deductibility if taxpayer establishes that amount constitutes restitution and is paid to come into compliance with the law (Establishment Requirement), and the amount is identified as restitution in agreement (Identification Requirement)
  - TCJA enacted § 6050X requiring government entities to report suits or agreements that exceed $600
  - Treasury has yet to issue regulations
  - Notice 2018-23 suspends § 6050X requirement until regulations are released, and provides safe harbor for satisfying Identification Requirement, provided the agreement specifically states that the amount is restitution

- What can be done?
  - Work with government entity involved to **<u>ensure</u>** amount is explicitly labeled as restitution in agreement
  - Comprehensively document all interactions to best position company to "establish" that the amount constitutes restitution

Should Procedural Tools Be Considered to Secure Greater Certainty?

Tools	Does Tool Affect Closed Years?	Apply If Under Exam?	Adjustment Outcome	IRS Approval?
Accounting Method Changes	Yes; changes apply prospectively, but 481(a) adjustment may include amounts from closed years	It depends	New method and section 481(a) adjustment	Required (automatic or non-automatic)
Amended Returns	No	Yes, but not required	Refund	Not immediate
Quickie Refunds	Yes	It depends	Refund/Credit NOL	Immediate
Carryback Claims	Yes; allows adjustments in closed years	Not customary	Refund	Refund available immediately, but subject to IRS adjustment

Tool Example 1: Accounting Method Changes

- Available on a prospective basis only
- Implemented with a Section 481(a) adjustment
  - Thus, takes into account amounts in earlier tax years, including closed years
- Limited to items that are recurring in nature and affect the timing of income and expenses
- Require IRS consent
  - May be available automatically and with audit protection

Tool Example 2: Amended Return

- May be used to correct a mistake made in an originally filed tax return
- May also be used to take advantage of a retroactive statute or IRS procedure
- Serves two key purposes:
  - To modify, supplement or supplant the taxpayer's original return
  - To provide the vehicle for a claim for refund
- Does not require prior approval by the IRS
  - Nonetheless, the IRS routinely examines amended returns to ensure that the taxpayer is entitled to a refund claimed in connection with the amended return
  - Any refunds that exceed the statutory threshold of $2 million ($5 million for C corporations) are also subject to a Joint Committee review process before issuance

Tool Example 3: Quickie Refunds

- Certain tentative refund claims are permitted with respect to:
  - The carryback of a net operating loss (NOL)
  - The carryback of an unused general business credit
  - The carryback of a net Section 1256 contract loss
  - An overpayment of tax due to a claim of right adjustment under Section 1341(b)(1).
- Filed on a Form 1045, Form 1138 or Form 1139
- IRS has 90 days to review the claimed refund
- Available with respect to an amended or original return followed by a tentative carryback refund claim

Addressing International Tax Reform with Accounting Method Considerations

- Base Erosion Anti-Abuse Tax (BEAT)
- Global Intangible Low-Taxed Income (GILTI)

BEAT

- Minimum 10% tax (or 5% in 2018) imposed on taxable income with base erosion payments added back
- Base erosion payments generally include payments giving rise to a deduction
- Excludes
  - Amounts taken into account as cost of goods sold (COGS)
  - Amounts attributable to services eligible for the services cost method (turning off the core business activity exception)
- Planning includes
  - Optimize deductions in 2018 for 5% rate
  - Deferral of expenses with AET to permit time for planning
  - Evaluation of COGS definition
  - Change in customer contracts to permit pass-through treatment

BEAT – Accounting Method Considerations

- Base erosion payments – generally, amounts paid or accrued to a related foreign person that are deductible
  - Does not include COGS or reductions to gross receipts
    - Accounting method changes (Form 3115) may be required in some cases
      - Section 263A: licensing costs (e.g., sales-based royalties)
    - Reverse planning and optional capitalization subject to material distortion standard
  - Includes interest expense – interest disallowed under section 163(j) is allocated first to payments to unrelated persons
  - Includes the acquisition of property that gives rise to a depreciation or amortization deduction
  - Includes payments that are subpart F income
- Enhance R&D credit

GILTI: Tax Accounting Method Issues

– Generally, three categories of CFC income:
  - Exempt income
  - Subpart F income (full inclusion at 21%)
  - “Tested income” included in GILTI (minimum tax at 10.5%)
    - Amount included is excess of net tested income over deemed tangible income return
    - 50% deduction limited by net taxable income
    - Deduction reduced to 37.5% in 2026
    - 80% FTC haircut (increases effective rate to 13.125%), and FTC expense allocation

GILTI: Tax Accounting Method Issues

- Transition issues
  - How are tested income methods adopted and changed?
    - Adopt all new methods?
      - GILTI is an entirely new type of income
    - Method change required?
      - GILTI arises from pre-existing CFC's E&P and such E&P would have been included in taxable income by reason of Section 965 no later than 2017
    - Adoption of new methods where it is permissible for taxable income method to deviate from E&P method?
- Can a CFC file a method change in 2018 to get audit protection for GILTI methods if the E&P method carries over?
  - RP 2015-13 provides exception to audit protection for CFC if, for any prior open year, deemed paid taxes in such year exceed 150% of three prior years

GILTI: Tax Accounting Method Issues

- Method change issues
  - If a change in accounting method is required
    - Is a Section 481(a) adjustment or cutoff approach more appropriate?
    - How does the source and character rule for CFCs in RP 2015-13, section 7.07 apply?
- Should the legacy “materiality” exception for E&P permit use of local books?
  - See TR § 1.964-(a)(2)
    - “No adjustment shall be required unless material”
- Is qualified business investment calculation a method of accounting?

Maintaining Consistency in a Global Business

- What do you do to ensure that you are maintaining consistent positions across tax jurisdictions?
- Has your company been impacted by increased information sharing between tax authorities?
- What role do bilateral APAs and similar agreements play in your analysis?

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