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United Kingdom—Corporate Interest Restrictions

By John Buckeridge and David Jervis

As part of the OECD Base Erosion and Profit Shifting (BEPS) project, the UK Government is proposing legislation to restrict the ability of companies to deduct interest costs. The draft legislation (which is due to come into effect retrospectively on April 1, 2017 and remain in effect until its likely final enactment in about July) aims to limit tax base erosion involving interest deductions and other financial payments. Essentially, it does this by providing a ceiling on the amount of interest (and economically similar) payments that can be deducted in a company’s computation of its profit for corporation tax purposes. The ceiling is on a group basis (not company by company) and is related to the group profit before interest, tax and certain other deductions.

Existing rules such as transfer pricing and thin capitalization will continue to apply and the BEPS restriction will be applied, if at all, to the otherwise allowable payments.

Broadly speaking (and subject to a minimum allowance of £2 million), the rules will limit deductions in the UK for the relevant interest and other expenses to 30% of the UK group companies earnings (profit) before interest, tax, depreciation and amortization are deducted (EBITDA) and capped to the total net interest and other relevant expenses of the worldwide group, if that is less. Alternatively, if that can give a better result, to the same percentage of EBITDA (up to 100%) as incurred in the worldwide group as a whole, in which case the cap is limited to the net interest and other relevant expenses of the worldwide group, excluding any expenses due to related parties.

There are some exceptions including, most notably, one for companies specializing in public benefit infrastructure that has been widened in the most recent draft to include providing commercial or residential buildings for rental occupation.

The OECD “BEPS Action 4” report on which the legislation is based can be found here.

The UK legislation is currently in draft form and may be subject to changes in its passage through parliament as part of the Finance Bill 2017. Many other OECD member jurisdictions either already have or are planning to enact similar legislation including all other EU member states.

Update on Opinions & Confirmations Issued by the Irish Revenue Commissioners

By Niamh Caffrey

In January, the Irish Revenue Commissioners (“Revenue”) published a statement in eBrief No. 08/17 outlining that all opinions/confirmations issued by it will be valid for a maximum of five years, or such shorter period as it may have specified when providing the opinion/confirmation.

The effect of this announcement is that taxpayers who received an opinion or confirmation from the Revenue prior to January 1, 2012, and who wish to continue to rely on that opinion/confirmation, must apply to their Revenue District for a renewal/extension of it, and submit a copy of the original written Revenue opinion/confirmation, on or before June 30, 2017. This statement follows on from previous Revenue statements issued in 2016 and, amongst other things, will facilitate Revenue meeting its obligations under the new exchange of information requirements mentioned below.

While Ireland does not have a system of binding tax rulings per se, in certain limited circumstances, the Revenue will provide an opinion or confirmation on the application of tax law to particular transactions, events or activities. These opinions are not legally binding on the taxpayer or on the tax administration, but the Revenue will generally abide by them where it can be shown that all relevant information was disclosed at the time the opinion was sought, and the information disclosed to it is consistent with the actual facts of the case.

Companies and entities operating in Ireland should review any previous opinions/confirmations received from the Revenue outside the last five years to establish whether or not they wish to seek a renewal or extension of that opinion/confirmation. Where prior opinions/confirmations were sought based on clarification on a technical matter which is no longer uncertain, a renewal/
extension may not be required. In other situations, action may be required. In addition, companies and entities should note that such opinions/confirmations may be exchanged with foreign Revenue authorities under the new exchange of information requirements where they were provided in respect of relevant taxes and where they come within the definition of an advance cross-border ruling or an advance pricing arrangement (APA) as provided for by Council Directive (EU) 2015/2376 or under the OECD framework.

Poland: Changes in tax law that increase the tax burdens on businesses

From January 1, 2017, a number of changes in tax regulations entered into force, including new income tax rules. The unfavorable changes include new rules governing the tax consequences of in-kind contributions to companies. Also, the tax neutrality of an exchange of shares is now dependent on the existence of justified economic grounds. A presumption has been introduced that if a merger, division or share exchange is not conducted for justified economic grounds, it will be deemed that the main goal, or one of the main goals, is tax avoidance. No definition is provided for “justified economic grounds.”

There are other changes that also increase the tax burdens on businesses. A definition of “beneficial owner” has been introduced under which a foreign company receiving license fees or interest must be the beneficial owner in order for the exemption from taxation at the source on interest and license fees paid by Polish entities to be applicable.

Moreover, the types of income that will be deemed to have a source in Poland by non-residents in Poland, and consequently taxable in Poland, has been extended. The limit for cash transactions has been lowered from EUR 15,000 to PLN 15,000, and exceeding the new limit prevents the taxpayer from deducting the cash expenditures as revenue-earning costs for tax purposes.

The scope of taxpayers’ duties with respect to transfer pricing has also been significantly expanded, and the scope of the tax exemption for investment funds has been narrowed.

From 2017, some companies will be entitled to pay a reduced corporate income tax of 15%. This favorable regulation applies to “small” taxpayers as well as other taxpayers for the tax year when they began operations. But there are a number of restrictions where the main CIT rate of 19% will be retained.

Italian Non-Domiciled Tax Regime

2017 Budget Law introduces a special tax regime for high-income individuals, who move their tax residency in Italy (so called “Italian non-domiciled tax regime”).

The new regime allows the disapplication of the general rule on worldwide taxation of income, providing for a substitutive flat tax equal to Euro 100,000 to be applied on income sourced abroad by the new resident in Italy.

A further Euro 25,000 is payable for any family member of the non-domiciled that applies for the new regime.

In addition, the regime provides for an exemption in Italy from certain mandatory returns and taxes due (e.g. when it comes to financial activities and immovable properties held abroad). The non-domiciled may choose to apply the new regime only with reference to income sourced in specific countries (so-called “cherry picking clause”); the income sourced in countries excluded from the new regime are taxed according to the ordinary regime.

In order to apply for the new regime, the following requirements have to be met by the individuals:
• they have to transfer their tax residency in Italy;
• they have not been resident in Italy for at least 9 out of the last 10 years; and
• they have to obtain the approval of the Italian Tax Authorities.

In case of a positive outcome of the ruling, the new regime applies starting from such fiscal year. The ruling under point iii) has to be filed within the expiration date for the submission of the annual tax return relative to the fiscal year in which the taxpayer becomes a tax resident in Italy.

The Italian Tax Authorities have 120 days to respond to the ruling (an extension of 60 days is allowed in certain circumstances). If approved, the arrangement is effective for 15 years but can be revoked at any time.

In the case of non-payment of the flat tax, the regime ceases to have effect starting from the year in relation to which the flat tax is not paid.

Towards a New Incentive for Innovation—The Belgian Innovation Box

By Ignaas Behaeghe

In 2007, the Belgian legislator introduced a preferential tax regime resulting in a tax deduction equal to 80% of a company’s gross revenues obtained from (i) patents or supplementary protection certificates (“SPCs”), or, (ii) improvements of patents, SPCs or license rights, provided that, in both cases, certain conditions were met (“Patent box”). Following several criticisms on the Patent box, the Belgian Government decided to abolish the existing regime by Act of August 3, 2016 and to replace it by a new and broader system that will retroactively enter into force as of July 1, 2016. Recently, the draft Act on the new innovation income deduction (“Innovation box”) was released and is following the legislative process in the Belgian Parliament.

With the Innovation box, the Belgian Government clearly wants to provide an answer to one of the main criticisms on the Patent box (i.e. the narrow scope of application). However, it is not the intention to extend the new regime to all IPRs. Only rights that (i) bring innovation through R&D and (ii) are (co-)owned by the company or on which the company has usufruct, license rights or other rights (“Innovation Box Rights” or “IBRs”) will benefit from the Innovation box.

The IBR’s are defined to include patents and SPC’s, plant breeder’s rights, certain orphan medical products and certain data and marketing exclusively granted for plant protection products, medicinal products and copyright protected software.

The following revenues from IBRs will benefit from the Innovation box:

• Royalties.
• Any compensation due to a company when its products are made/services are delivered by or on behalf of the company or are made or delivered by a third party under a license granted by the company.
• Any compensation due to the company when the production process is (i) inextricably linked with IBRs and (ii) is applied by or on behalf of the company or is/would be applied by a third party or under a license granted by the company.
• Any indemnity paid following a court decision or arbitral sentence, an amicable settlement or insurance agreement for infringement of IBRs.
• Any amount received due to the transfer of IBRs that (i) are immovable assets and (ii) are generated as of the last taxable period or acquired within the past 24 months.
• The percentage of the revenues that will be deductible has been increased to 85%. However, contrary to the Patent box, the deduction will apply on net revenues resulting from IBRs. The net revenues will be calculated by deducting the following costs/expenses from the gross revenues resulting from IBRs:
  – R&D costs directly related to IBRs born by the company or paid to third parties for R&D activities
  – Expenses directly related to the acquisition of IBRs

Subsequently, the net revenues will need to be multiplied with the "modified nexus fraction," which is costs incurred on R&D activities/total costs related to R&D.
The Federal Council communicated on February 22, 2017, that the Federal Department of Finance has been instructed to draft the parameters for a revised corporate tax reform III. The original corporate tax reform III was rejected by popular referendum on February 12, 2017 (59.1% of the votes against the reform).

The aim of the corporate tax reform III is to bring the Swiss corporate tax system in line with international standards and, in particular, to participate in the base erosion profit shifting (BEPS) project of OECD. Switzerland promised to the OECD as well as to the EU to abolish special corporate tax treatment for multinational companies. It took almost five years of preparing for a reform of the tax law on the Federal level by the government and the parliament. The goals to keep the attractiveness of Switzerland as a business location, introduce internationally accepted measures, and fiscal neutrality for the Federation, cantons and communes had to be balanced. The result was a relatively complicated tool set with a lot of choice for the cantons. A side effect was that many cantons decided to lower their corporate income tax rates with the reform. The number of cantons in which the effective corporate income tax rates (including Federal, cantonal and communal tax) will be around or even below 12% has grown significantly.

The reform was rejected as a result of different factors. The proposed law contained a complex system of tax reliefs (for example, deductions for research and development or income from patents, interest deduction, etc.) that is difficult to understand for non-tax experts. Furthermore, the referendum committee argued that the new law would lead to a shortfall in corporate tax of almost CHF 3 billion per year, and that there would be a risk of increased tax rates for individuals. The majority of Swiss voters decided to vote against the tax reform, hoping that a better proposal will be presented soon. It is not uncommon in Switzerland for voters to vote on a similar proposal several times until they agree. Switzerland is under time pressure as it promised to the EU to abolish certain tax regimes until 2019.

The Federal Council announced that the key points of a new tax proposal will be presented to the public by mid-2017. It is expected to include the following points:

- Abolishing five tax privileges: holding, mixed company, domiciliary company, finance branch, principal company
- Introduction of patent box: Income from patents and similar rights can be reduced.
- Additional R&D deduction

It seems unlikely that a notional interest on excess equity will be part of the revised corporate tax reform.

For the moment, the existing tax laws stay in force. Existing rulings will be exchanged with other tax authorities as part of the introduced automatic exchange of information as of 2018. Companies may decide to exit existing rulings earlier and opt for normal taxation. In such case, it is possible to ask for a step-up in basis. A tax neutral step-up in asset basis (including goodwill) with the possibility to depreciate the assets over a certain period (typically 10 years for goodwill) can lead to an attractive taxation for several years.

Theoretically, the cantons could change their corporate tax laws regardless of the vote on the federal level and bring them on the level of cantonal corporate taxes, in line with the international standards and expectations. They could also theoretically abolish tax privileges like holding and domiciliary companies and introduce new internationally accepted tax regimes like the patent box with reduced income, additional R&D expense, etc. There is a common understanding that it is preferable to reach a broad solution rather than letting the cantons come up with their own regimes.

However, if for any reason the revised corporate tax reform is delayed, the individual cantonal changes could be an intermediate step until agreement is reached overall. The canton of Nidwalden has already introduced a patent box regime with an effective corporate income tax rate of some 8.8%.
Restructuring Decree Declared Void by the German Federal Supreme Tax Court

According the Recapitalization Decree (Sanierungserlass) of the German tax authorities, recapitalization of distressed companies by a “Debt Waiver” or a “Debt-to-Equity-Swap” in Germany did not result in corporate tax or trade tax. The German Federal Supreme Tax Court (Bundesfinanzhof) has now decided that this decree granting a relief from a taxable recapitalization gain violates constitutional rights. The decision was published on February 8, 2017.

By way of background, recapitalization of distressed companies in Germany via a “Debt Waiver” or a “Debt-to-Equity-Swap” in general triggers a gain in full amount of the waived debt, and the waiver of shareholder debt or its conversion into equity triggers a gain in the impaired amount of debt at the level of the recapitalized company that is subject to corporate and trade tax. The German tax authorities realized that the taxation of that gain prevented the recapitalization of distressed companies. Therefore, in 2003, the German Ministry of Finance published the Recapitalization Decree, which provided for tax relief on a recapitalization gain. This tax relief required the recapitalized company to continue carrying on its business as a going concern.

The German Federal Supreme Tax Court has now decided that the German tax authorities were not competent to decree that exemption from the general duty to pay taxes on recapitalization gains. Such exemption would require authority under German tax law that only the German legislator could provide.

A reaction of the German Tax Authorities to this decision is currently outstanding, and no change to German tax law has commenced.

As a consequence, a recapitalization of a distressed company by way of a “Debt Waiver” or a “Debt-to-Equity-Swap” should now be reassessed. For intended recapitalizations, alternative structures should be considered until the German legislator changes the current German tax law in order grant tax relief from recapitalization gains. Alternative structures that may be available depend on the specific facts and circumstances. Such structures, in particular, could include a debt push-up, an assumption of debt by a shareholder without the right of recourse, or a deep subordination of the distressed debt.

Federal Supreme Tax Court on Qualification of Management Participations as Employment Income or Capital Gains

The German Federal Supreme Tax Court (Bundesfinanzhof) has decided that management participations of employees are to be taxed as capital gains. In general, capital gains are subject to a flat rate tax of 25% in Germany. This runs contrary to the practice of the German tax authorities to tax management participations as employment income at a top tax rate of 42 – 45%.

A taxpayer had acquired an equity participation in the holding company of his employer at fair market value by using a German tax-transparent, asset-managing partnership. The following year, the holding was sold at fair market value, and the partnership received a portion of the purchase price. The taxpayer then received a portion of that amount corresponding to his participation. The partnership agreement included exclusion rights in the event of termination of the employment relationship, depending on the reason for the termination, that had an effect on the amount the manager would receive from the purchase price.

In addition, the partnership agreement stipulated a vesting period. The German Federal Supreme Tax Court decided that the taxpayers’ gains must be taxed as income from capital gains. Equity participation qualifies as an independent special legal relationship aside from the employment relationship. The qualification as capital gains in general would require the purchase and sale of the management participation at market price as well as the risk of loss. Even the employment relationship and the exclusion rights in the event of termination of the employment relationship, as well as the vesting period stipulated in the partnership agreement, were not sufficient to qualify the income from the management participation as employment income.
Finland—New Transfer Pricing Documentation Rules Enacted

At the end of 2016, Finnish Parliament passed, as expected, laws to implement the OECD BEPS Action 13 initiative on transfer pricing documentation as well as the corresponding European Union Directive on Administrative Cooperation (DAC). The latter concerns the exchange of information on Country-by-Country (CbC) reporting, cross-border advance rulings and advance pricing agreements (APAs).

The new transfer pricing documentation requirements will be applicable for accounting periods ending on or after January 1, 2017, and CbC reporting will be required for accounting periods that started on January 1, 2016, or thereafter. A local entity or one of them is required to notify the Finnish Tax Administration of the name, the taxpayer identification number (TIN) and the jurisdiction of tax residency of the CbC reporting entity in the group by the end of the accounting year in question. For accounting years starting in 2016 and ending on May 31, 2017, at the latest, such notification has to be given on or before May 31, 2017, under a transitional rule.

The Finnish Tax Administration is currently preparing local instructions to support the new transfer pricing documentation requirements for Master File, Local File and CbC Reporting. They are expected to follow the OECD Guidelines. The draft covering the first two is expected for comments in early spring 2017. The previous local instructions are from 2007.

United Kingdom—Non-resident Companies Holding UK Real Estate

The proposed new rules for corporate interest reductions in the UK apply to UK corporation taxpayers only and will not, therefore, extend to companies that are subject to UK income tax, such as non-resident companies holding UK real estate.

These can therefore continue, at least for the moment, to gear up as they wish on arm’s length terms, with internal or shareholder debt, to increase operational flexibility and obtain valuable tax deductions, often reducing the effective UK tax rate to well below the headline 20% level.

It seems, however, that this benefit for income tax payers may not last. The UK government has announced that, to ensure fairness, it will be publishing a consultation document around the time of the March budget to consider extending the interest loss restriction rules to income tax paying companies as well; they will also consider more restrictive loss carry forward rules.

While the impact of the changes will vary depending on the property holding structure adopted, we are likely to see scrutiny and re-evaluation as to whether the status quo remains the optimal structure, as any change in the rules may impact tax deductibility and so impact commercial returns. In particular, we are likely to see less use of related party debt.

A major concern to the UK industry is whether these proposals would also mean a withdrawal of the current exemption from UK tax on capital gains. While this rule has effectively been eaten into for certain non-residents investing in residential property, it remains in place for those investing in commercial property. Importantly, while we wait to see, our understanding is that this is not likely to be the case; this important exemption should remain.

As to timing of the potential new changes for non-resident companies with UK income, April 6, 2018, will most likely be the start of the new tax year.
First IRS “Campaigns” Advance Issue-Focused Strategy

By Tom Cullinan and Eric Santos

The IRS Large Business and International Division (LB&I), which is responsible for auditing large taxpayers and those with international operations, released summaries of its first 13 issue-oriented “campaigns” on January 31, 2017. The campaigns are one step in the effort to replace LB&I’s old enforcement strategy, which focused primarily on continuous audits of the largest taxpayers, and to adopt a new approach centered around pressing tax issues. LB&I’s plan is to audit more taxpayers but only for specific, centrally-identified issues. This effort is driven, in part, by the substantial budget reductions suffered by the IRS in recent years. The 13 recently-announced campaigns represent the IRS’s initial focus areas; more campaigns are expected in the coming months. Although LB&I plans to shift most of its enforcement resources to issue-based exams, the introduction of campaigns is unlikely to replace the “a to z” full enterprise audits of the country’s very largest taxpayers. The introduction of campaigns means that LB&I will interact with a wider range of taxpayers, but often in a more limited capacity than a full examination. To prepare for this shift in focus, LB&I spent 2016 changing its organization by consolidating its domestic and international arms and eliminating its industry-specific subdivisions in favor of nine practice areas, each organized around a category of tax issues or a geographic region.

The 13 campaigns cover a wide range of substantive tax issues, from the repatriation of foreign income to tax issues involving domestic distributors, energy credits, and/or certain deductions claimed by domestic TV broadcasters. They also provide for several different methods of addressing the issues identified. The methods to be employed include: developing new guidance and procedures; issuing “soft letters” that request that a taxpayer voluntarily correct its returns; and conducting issue-based examinations. The first campaigns illustrate LB&I’s new plans for combating noncompliance by focusing on a set of specific tax issues and utilizing a flexible array of procedures to address them. A more complete discussion of the new campaigns is available in a recent Eversheds Sutherland legal alert.

Un-Determined Future: Retirement Plan Sponsors Have to Cope without the IRS Qualified Plan Determination Letter Program

By Allison Wielobob and Ryan Session

Until this year, sponsors of qualified retirement plans have been able to request periodic “determination letters” from the IRS, certifying that their plans continue to meet the requirements for the significant tax benefits associated with tax-qualified status. An updated determination letter would typically have been obtained every 5 years, evidencing required updates and amendments to the plan, and providing a period within which to correct any qualification failures. As of January 1, 2017, the IRS has discontinued this longstanding program as to individually-designed plans, although a small number of plans may still submit applications until the end of 2017. An individually-designed plan is a retirement plan that has not been approved by the IRS and is drafted to meet the specific needs of a single employer or multi-employer group. Individually-designed plans may now only obtain determination letters upon initial plan qualification (e.g., when the plan is first adopted) and in certain other circumstances that have not yet been announced. IRS guidance on this change appears here.

The discontinuance of the determination letter program for individually-designed plans amounts to a sea change and leaves open a multitude of questions about the future of compliance efforts for such plans. As an initial matter, the change creates questions about the timing of compliance efforts. Plans will now be required to adopt required amendments—as detailed in an annual Required Amendments List published by the IRS—within two years following the year a required amendment appears on the list instead of within a five-year period of the associated statutory or regulatory change that has been required until now. Considering the IRS has said that it intends to avoid putting amendments on the list until related guidance has been issued, this could mean substantial delays in plan compliance following the date of a statutory or regulatory change. The change also adds complexity to corporate due diligence processes where transaction parties traditionally require copies of IRS determination letters to confirm the qualified, tax-exempt status of any plans.
On January 19, 2017, the US Treasury Department and the IRS issued temporary regulations that alter the US tax treatment of a US person’s contribution of appreciated property to a partnership (whether domestic or foreign) in exchange for a partnership interest in circumstances in which the partnership includes foreign partners who are related to the US person. The purpose of the temporary regulations is to prevent US persons from shifting pre-contribution gains inherent in contributed property to related foreign partners who are not subject to US tax. If applicable, the temporary regulations cause a US person’s contribution of appreciated property to a partnership to be immediately taxable to the US person, unless, as discussed below, the partnership applies the “gain deferral method” to the contributed property. Thus, in general, the temporary regulations operate to override the general rule of partnership taxation that allows for the nonrecognition of gain on a transfer of property to a partnership in exchange for an interest in the partnership.

Subject to narrow exceptions, the temporary regulations apply when (1) a US person contributes property to a partnership, or a US person is a partner in a partnership that contributes property to another partnership, in which there are foreign partners related to the US person and (2) the US person and related foreign partners own, directly or through attribution, more than 80% of the interests in the transferee partnership. The temporary regulations generally apply to contributions that actually occur as well as to contributions that are deemed to occur for US tax purposes, such as contributions that are deemed to occur in connection with a partnership merger or division or a change in entity classification (e.g., a change in classification from a disregarded entity to a partnership).

Under the temporary regulations, the contribution of appreciated property is not immediately taxable to a US person if the partnership applies the “gain deferral method” with respect to the contributed property. The requirements of the gain deferral method are designed to ensure that the US person is subject to US tax on any pre-contribution gain inherent in the contributed property. The gain deferral method, among other things, requires the partnership (1) to utilize the remedial allocation method to account for the pre-contribution gain inherent in the contributed property and (2) to allocate to the US person the same percentage of all book items of income, gain, loss and deduction with respect to the contributed property. Even if the requirements of the gain deferral method are satisfied at the time of the contribution, the temporary regulations call for the immediate recognition of some or all of the pre-contribution gain when certain “acceleration events” occur following the contribution.

The temporary regulations generally reflect rules that were first described in IRS Notice 2015-54. Accordingly, the temporary regulations generally apply to contributions occurring on or after August 6, 2015, and to contributions occurring before August 6, 2015, resulting from an entity classification election filed on or after August 6, 2015. New rules and substantive changes to rules outlined in IRS Notice 2015-54 (as specified in the temporary regulations) generally apply to contributions occurring on or after January 18, 2017, or to contributions occurring before January 18, 2017, resulting from an entity classification election that is filed on after that date. Because the temporary regulations were made effective prior to January 20, 2017, they are not subject to the regulatory moratorium that took effect after inauguration of the new US administration, but they are still within the 60 legislative day period during which a repeal resolution could be passed by Congress under the Congressional Review Act.

By Wes Sheumaker, David Roby, Karl Zeswitz and Eric Santos

affected by the transaction. The extent of due diligence efforts with respect to plans involved in transactions will necessarily increase. To the extent the absence of a determination letter process causes unacceptable impacts, qualified plan sponsors may have to consider turning to third-party compliance assurances or shifting to pre-approved plans.
US estate and gift tax law generally provides an applicable exclusion amount, which is currently $5.49 million per individual or $10.98 million for married couples, and is adjusted annually for inflation. Since 2011, if a married decedent’s estate and taxable gifts are less than the exclusion amount, the tax law allows “portability” of the unused exclusion amount to a surviving spouse. A decedent’s unused exclusion amount does not automatically transfer to a surviving spouse. To claim a decedent’s unused applicable exclusion amount, the executor of the decedent’s estate must file a portability election on a federal estate tax return within 9 months after the decedent’s date of death or the last day of the period covered by an extension. The portability election allows the surviving spouse to add the decedent’s unused exclusion amount to the surviving spouse’s own exclusion amount for federal gift and estate tax purposes. If a decedent died in 2017 having used, for example, $4 million of the $5.49 million exclusion, either during life or as applied to bequests made at death, then the surviving spouse may elect to port the remaining $1.49 million of unused exclusion to the surviving spouse’s estate, which would permit the surviving spouse to make gifts, during life or at death, of up to $6.98 million.

Because an estate whose value is less than the applicable exclusion amount is not required to file a federal estate tax return, many estates of decedents who have used less than their applicable exclusion amount have failed to make timely portability elections, either because the executor was unaware of the procedure or the surviving spouse did not believe the election would be beneficial. In 2014, the IRS issued a revenue procedure providing a simplified method for some estates to obtain an extension to make a late portability election, but the revenue procedure expired at the end of 2014. Currently, if a surviving spouse fails to make a timely portability election, the only mechanism for obtaining relief is a private letter ruling request. Under the Treasury Regulations, a request for relief will be granted when the taxpayer provides evidence to establish to the IRS’s satisfaction that the taxpayer acted reasonably and in good faith and that granting relief will not prejudice the interests of the government. Recently, the IRS has issued numerous private letter rulings permitting estates to file late estate tax returns to make portability elections. In some instances, the IRS determined that the taxpayer acted reasonably and in good faith in relying on a qualified tax professional and that the professional failed to make, or advise the taxpayer to make, the election. But many of the rulings permit estates to file late estate tax returns simply because the executor was unaware of the need to file the return to make the portability election. The greater availability of relief for late portability elections for surviving spouses is a welcome development for smaller estates and permits a married couple to benefit from the full $10.98 million applicable exclusion amount.

In PLR 201702048, released on January 13, 2017, the IRS denied a captive insurance company’s claim that it qualified for the exemption from tax under section 501(c)(15) of the Internal Revenue Code for small, non-life insurance companies. The IRS Appeals Office that issued the ruling based its determination on a lengthy report issued by the Exempt Organization Examination group, which ultimately concluded that the captive did not meet the US tax definition of “insurance company.” In reaching that conclusion, the IRS examination report determined that most of the policies the captive issued did not constitute contracts of insurance, both because they did not cover an insurance risk (only an investment or business risk) and because they did not constitute insurance in the commonly accepted sense. The IRS further determined that the captive insurance company did not cover a sufficient number of insureds to achieve an adequate distribution of risk. This is the latest in a string of rulings in which the IRS has denied a company’s claim to tax exemption under section 501(c)(15) based on the IRS’s determination that the policies the company issued were not contracts of insurance for tax purposes.
In Possible US Tax Reform, Details Remain Uncertain

By Robb Chase, Aaron Payne and Caroline Reaves

With Republicans in control of the House, Senate and White House, and tax reform listed as a high legislative priority, change to the US system of taxation of businesses could be imminent, but the details of what may be enacted remain unclear. In June 2016, the House Republicans released the Blueprint, their vision for tax reform. The Senate Republicans have stated that they do not have the votes to pass the House plan as currently constituted and, although the Trump campaign outlined a tax reform proposal, President Trump has said recently that a new tax plan is under consideration. It has been reported that there are divisions within the Administration regarding whether the President’s tax plan will adopt some of the features of the Blueprint. It is not expected that Congress will take up tax reform until after the Affordable Care Act is considered, but the Treasury Secretary has stated that the goal is to have tax reform enacted by the August Congressional recess.

The Blueprint proposes to lower the corporate tax rate to a flat rate of 20%; permit immediate expensing of business investments; deny deductions for net interest expense; and most dramatically, move from a worldwide to a territorial destination-based tax regime through a border adjustment tax. The border adjustment tax would exclude from income revenues generated from exports and deny deductions for imports. The border adjustment tax, as currently formulated, raises the possibility of a World Trade Organization dispute and also may have an effect on the current US double tax treaties. The final shape of tax reform is difficult to predict at this juncture, and the political effort that will be expended with respect to the Affordable Care Act may well delay the August timetable.
Several states have introduced legislation going after Chief Executive Officer compensation. California recently introduced a bill that would eliminate any California corporate tax deductions for compensation paid to a Chief Executive Officer based on commission or meeting certain performance goals, while Connecticut, Minnesota and Rhode Island have introduced legislation to impose a tax on certain publicly traded companies whose Chief Executive Officers are compensated at a high level in comparison to their average employees. This recent surge of proposed legislation results from the City of Portland, Oregon approving such a tax on December 7, 2016.

The City of Portland’s tax is levied on publicly traded companies that report Portland’s Business License Tax – but not necessarily headquartered in Portland—whose Chief Executive Officers earn at least 100 times as much as their median workers. Specifically, for tax years beginning on or after January 1, 2017, a 10% tax on the base Business License Tax liability is imposed if a company, subject to the United States Securities and Exchange Commission (SEC) pay ratio reporting requirement, reports a pay ratio of at least 100:1 but less than 250:1 on SEC disclosures. If the reported pay ratio is 250:1 or greater, a 25% tax is imposed. In 2015, the SEC adopted a pay ratio reporting obligation requiring a publicly traded company to disclose the ratio of its Chief Executive Officer’s compensation to the median compensation of all of its employees beginning in 2017. The Portland Revenue Division estimates there are approximately 550 publicly traded companies that are subject to the new tax, and that the tax will increase revenue to the city by $2.5 million to $3.5 million annually. Portland City Ordinance 7.02.500, as amended; S.B. 5677 Assem. Reg. Session 2017-2018 (Cal. 2017); H.B. 6373 Assem. Jan. Session 2017 (Conn. 2017); H.B. 6101 Assem. Jan. Session 2017 (Conn. 2017); H.F. 65 Assem. Reg. Session 2017-2018 (Minn. 2017); H.B. 5141 Assem. Jan. Session 2017 (R.I. 2017).