TAX EXECUTIVES INSTITUTE – TREASURY DEPARTMENT
OFFICE OF TAX POLICY
LIAISON MEETING
JUNE 5, 2014
MINUTES

On June 5, 2014, a delegation from Tax Executives Institute met with Mark J. Mazur, Assistant Secretary for Tax Policy, and other officials of the Treasury Department's Office of Tax Policy. The following minutes were prepared by Tax Executives Institute, and, although reviewed by the Office of Tax Policy, they have not been formally approved by the Department. The agenda for the meeting was submitted in advance and was published in the July-August 2014 issue of The Tax Executive magazine and on TEI's website.

Department of the Treasury Delegation

Mark J. Mazur, *Assistant Secretary (Tax Policy)*
George H. Bostick, *Benefits Tax Counsel*
Lisa M. Zarlenga, *Tax Legislative Counsel*
Ronald A. Dabrowski, *Special Counsel, Office of International Tax Counsel*
Alexa M. Claybon, *Attorney-Advisor*
Rochelle Hodes, *Attorney-Advisor, Tax Legislative Counsel Staff*
Scott Mackay, *Taxation Specialist*
Tom West, *Deputy Tax Legislative Counsel*
Christina Culver, *Intern, Tax Legislative Counsel Staff*

TEI Delegation

Terilea J. Wielenga, Allergan Inc., *TEI International President*
Mark C. Silbiger, The Lubrizol Corporation, *TEI Senior Vice President*
Charles N. (Sandy) Macfarlane, Chevron Corporation, *TEI Secretary*
Timothy J. Golden, Syngenta Corporation, *TEI Executive Committee*
Robert L. Howren, BlueLinx Corporation, *TEI Executive Committee*
Donald J. Rath, Symantec Corporation, *TEI Executive Committee*
Katrina H. Welch, Texas Instruments Incorporated, *TEI Executive Committee*
Ernest N. Gates, Wal-Mart Stores, Inc., *Chair, TEI IRS Administrative Affairs Committee*
Eli J. Dicker, *TEI Executive Director*
W. Patrick Evans, *TEI Chief Tax Counsel*
Jeffery P. Rasmussen, *TEI Senior Tax Counsel*
Daniel B. De Jong, *TEI Tax Counsel*
Benjamin R. Shreck, *TEI Tax Counsel*

Welcome and Introductions

Ms. Wielenga expressed her gratitude for the open dialogue between TEI members and the Office of Tax Policy during these annual liaison meetings and thanked Mr. Mazur and the members of his staff for taking the time to meet with the Institute's delegation.

2014 Office of Tax Policy Priorities and Challenges

TEI's delegation invited a discussion of the Office of Tax Policy's (OTP) current and upcoming priorities and challenges. Mr. Mazur replied that OTP has approximately 100 staff members, which has remained consistent for the past several years. He noted, however, that their workload has been increasing. In particular, ongoing implementation of the Foreign Account Tax Compliance Act (FATCA) and Affordable Care Act (ACA) has forced OTP to focus their guidance projects on those statutes and away from more general guidance in the benefits and international areas. He noted that while OTP has done much work on tax reform, he does not expect any movement in that area in 2014. Mr. Mazur stated that he is more optimistic for reform in 2015 because of the foundation laid in 2014 by OTP and the relevant congressional committees. He also noted that there will be a new chair of the House Ways and Means Committee.

Capitalization Issues

TEI's delegation inquired about what taxpayers must show to demonstrate that their policies "clearly reflect income," as stated in the preamble to the final capitalization regulations, if they have an agreement with their revenue agents that certain capital expenditures can be expensed at a higher amount than the elective $5,000 AFS *de minimis* rule in Treas. Reg. § 1.263(a)-1(f). Mr. Mackay replied that the expectation is that the regular negotiation between a revenue agent and the taxpayer on audit items will remain as it was before the regulations were issued. The IRS Large Business & International division (LB&I) participated in the development of the regulations and should understand the issue. Ms. Claybon added that the IRS Chief Counsel's office is conducting an education process, noting that the $5,000 *de minimis* rule is a safe harbor and that for items greater than $5,000 the prior approach between taxpayers and revenue agents should apply.

TEI's delegation next asked whether the new tangibles regulations or re-proposed disposition regulations ([REG-110732-15]) supersede executed taxpayer closing agreements. The delegation also asked whether the government expects to make any significant changes to the disposition regulations. Mr. Mackay replied that, as a general matter, the government does not expect taxpayers to reopen closing agreements and that the government will look to apply the new rules prospectively, but he also noted that prior agreements are always at risk when the government amends the regulations. The government expects to make only clarifying changes to the disposition regulations based on comments received, which were primarily from CAP taxpayers. The government expects to release the regulations in the next few months.

Research Expenditures

Research Credit – Intragroup Gross Receipts

TEI's delegation noted that the IRS and Treasury Department issued a proposed rule in December 2013 creating an "exception" to the "single taxpayer" rule of the research credit regulations. The proposed exception would require U.S. taxpayers to include gross receipts from transactions between U.S. controlled group members and foreign group members in certain circumstances. TEI's delegation invited a discussion of the Treasury Department's view of the proposed regulations, noting that the proposed rules appear contrary to the statute and would overturn court precedent. Ms. Claybon responded that the Treasury Department views the new rules as being consistent with the statute. Clearly, gross receipts are an important factor in research credit determinations, she noted, and the rules attempt to clarify an area where disputes had arisen and level the playing field between fully domestic companies and companies with controlled foreign corporations.

Section 174 Proposed Regulations

TEI's delegation noted the recently proposed "shrinking back" rule under Prop. Reg. § 1.174-2(a)(5). There is a concern that certain language in the rule may be cited by IRS examiners using hindsight to challenge research expenditures incurred to test whether a modified component of a product can be successfully integrated with other components or sub-systems or with the product as a whole. TEI recommended clarifying the rule to include such expenditures, which would minimize controversies especially with respect to unsuccessful expenditures, and invited the Treasury Department's view of such a clarification. Ms. Claybon stated that it should not matter whether the taxpayer is successful or unsuccessful in its endeavor and if the agent is using hindsight in such a manner he or she is misapplying the rules. All expenditures for testing to resolve an uncertainty should be qualifying expenditures, she noted. [Note: On July 18, 2014, the IRS issued final rules clarifying several key examples in the regulations and eliminating references to the term "shrink back" to avoid any inference that expenditures incurred under section 174 to eliminate uncertainty are not qualified research.]

FATCA

Notice 2014-33

TEI's delegation thanked the IRS and Treasury Department for the FATCA transition period provided in Notice 2014-33 for taxpayers who make "good faith" efforts to comply with the rules and inquired if any additional guidance would be forthcoming on what constitutes "good faith" compliance. Mr. Mazur responded that there would be no further guidance defining the term. Mr. Dabrowski noted that the "good faith" approach under the notice is intended to be similar to that undertaken when the Chapter 3 withholding rules were issued.

Asset Test for Defining a "Nonfinancial Group"

TEI's delegation referred to the definition of a "nonfinancial group" in Treas. Reg. § 1.1471-5T(e)(5)(i)(B)(1). The "passive asset" test in the definition provides that "no more than 25 percent of the value of assets held by the expanded affiliated group (excluding . . . assets resulting from transactions between related members of the expanded affiliated group) are assets that produce or are held for the production of passive income . . . ." TEI's delegation asked how such assets should be valued. Mr. Dabrowski replied that Treas. Reg. § 1.1472-1T(c)(1)(iv) may provide some guidance. More broadly, Mr. Dabrowski noted that the government's current focus is on the upcoming July 1, 2014, effective date and that once the effective date passes, additional clarifying changes to the regulations would be considered.

TEI's delegation noted that the definition of passive income includes royalties, dividends, and interest under Treas. Reg. § 1.1472-1(c)(1)(iv)(A). With respect to royalties, TEI asked for the government's view of whether a licensable asset that is nevertheless not licensed to third parties should be treated as passive. Mr. Dabrowski noted that the passive income rules are intended to be similar to the CFC and PFIC rules, which look to the nature of the activities and that the same approach should be taken under FATCA. TEI inquired whether interest on accounts receivable arising from sales of goods to third parties could be excluded from the definition of passive income. Mr. Dabrowski responded that the type of activity that gives rise to such income is not generally targeted by FATCA and that the government would entertain suggestions to clarify the scope of the definition.

TEI's delegation noted that, because dividends are passive income, stock in a subsidiary is likely a passive asset for purposes of the nonfinancial group test and asked whether such stock could be excluded from the passive asset test altogether. Mr. Dabrowski agreed that this is an area that could be clarified. TEI's delegation also noted that the passive/active income distinction works well for defining whether an entity is engaged in an active trade or business, but that it is not well suited for determining whether an entity earns financial or nonfinancial income. The delegation asked whether the Treasury Department would consider changes to this definition for purposes of the nonfinancial group test, such as by excluding royalty income altogether. Mr. Dabrowski replied that the government would welcome the suggestion.

TEI's delegation noted that the nonfinancial group test is prone to "foot faults" where minor missteps may cause the entire expanded affiliated group to fail the test, with drastic consequences to the group as a whole. In addition, as companies conduct their internal due diligence they may belatedly discover a financial institution in their group. TEI asked whether the Treasury Department consider a "cure period" or something similar to section 9100 relief to ameliorate the consequences of such a failure. Mr. Dabrowski stated that while section 9100 relief is probably not the appropriate analogy, there may be ways to make the regulations more flexible and invited ideas about how to accomplish that.

Withholdable Payment Exception for Indemnity Payments

TEI's delegation asked whether the Treasury Department would consider creating an exception to the definition of a withholdable payment for indemnity payments. Mr. Dabrowski replied that indemnity payments were not a focus when the rules were written, but the Treasury Department would consider crafting such an exception.

Changing FATCA Status

TEI's delegation asked whether the IRS and Treasury Department are willing to implement a "grace period" for entities or groups that move from one status under FATCA to another (*e.g.*, from a nonfinancial to a financial group) to become compliant under the new status. Mr. Dabrowski noted that the change-in-circumstances rules for foreign financial institutions may be an area to look to for some guidance. In general, he stated, the government would welcome input on what may be a reasonable amount of time to comply after a change in status.

OECD Base Erosion and Profit Shifting Project

General Status of BEPS Action Plan

TEI's delegation noted that the OECD's BEPS project will affect taxpayers in a variety of ways, including increasing the risk of double taxation, exacerbating compliance burdens, undermining the confidentiality of taxpayer information, *etc*. The Institute's delegation invited Treasury's view on the status of the BEPS project, its assessment of where the project is headed, and the likelihood that the OECD would generate a consensus view among the participating jurisdictions. Mr. Dabrowski said it is difficult to predict the content of the work product from the BEPS actions items with September 2015 or later deadlines. The Treasury Department is generally satisfied with the direction of the BEPS project on transfer pricing and, in particular, that the arm's length principle will remain the standard. Treasury is pleased that the revised country-by-country (CbC) reporting template will require taxpayers to report a lesser amount of information than originally proposed. The Treasury Department will urge that such information be shared only through the treaty information exchange process and push to clarify that the information should not be used for formulary apportionment purposes.

Concerning amendments to the OECD model income tax treaty, Mr. Dabrowski noted that the primary challenge is the proposed "main purpose" anti-abuse test, which is favored by non-U.S. delegations over a U.S.-style limitation on benefits test. Other jurisdictions generally do not have their own version of the U.S. anti-conduit financing regulations or economic substance doctrine to act as a backstop to their treaties. Mr. Dabrowski stated that the United States would not endorse incorporating a main purpose in the OECD model treaty and that the Treasury Department will not include such a test in future U.S. treaties. Mr. Dabrowski noted that the multilateral instrument BEPS action item is especially challenging and that a path toward the successful design and implementation of such an instrument is unclear.

TEI's delegation noted that taxpayers are concerned that the OECD is moving too fast on the BEPS action plan given its scope and that the resulting recommendations and guidance might not rise to the OECD's high standards. Mr. Mazur replied that the Treasury Department and IRS have devoted an unprecedented amount of resources to the BEPS project to help ensure the project's success.

Discussion Draft on Transfer Pricing Documentation and CbC Reporting

TEI's delegation noted that the proposed reporting requirements of the CbC reporting template would generally be in addition to, rather than in lieu of, the present transfer pricing reporting and documentation requirements imposed by various jurisdictions. The delegation asked whether the administrability of the differing requirements had been considered and whether the overall utility of the requested information had been assessed. Mr. Dabrowski replied that there was a broad consensus among BEPS participants about the need to improve the information supplied to tax administrators, while minimizing the burden on businesses by asking only for information regularly collected by taxpayers. The utility of the requested information can only be assessed after its collection, he said.

Hybrid Discussion Drafts

TEI inquired about the ability of countries to implement and coordinate the recommendations of the BEPS hybrid discussion drafts because the recommendations will likely impose additional stresses on the mutual agreement procedure. Mr. Dabrowski replied that utilizing the "bottom-up" approach to the definition of a hybrid instrument was one way to ease coordination across jurisdictions. He noted that amending participation exemptions to permit taxation of payments deductible in the payor jurisdiction may eliminate a majority of the hybrid instrument issues described in the discussion drafts. TEI's delegation noted its concern with jurisdictions implementing their own rules without coordination and the attendant double taxation issues that may arise. Mr. Dabrowski acknowledged the concern, but stated that the recommendations provide rules to minimize double taxation where a counter-party jurisdiction has not adopted the rules.

Tax Treaty Update

TEI invited an update on the status of ongoing bilateral tax treaty negotiations with Vietnam and the status of the treaties submitted to the Senate for its consent to ratification. Mr. Dabrowski replied that there will be a fifth round of negotiations with Vietnam in the summer, noting that discussions between the two countries have been very productive. Mr. Mazur noted that the Treasury Department is working with the Senate Committee on Foreign Relations to move the various agreements through the process and that there are a number of items in the agreements that should garner widespread support.

FBAR Filing Requirements

TEI's delegation noted that many employees must personally file FBAR forms (formerly IRS Form TD F 90-22.1, now FinCEN Report 114) solely because of their employment responsibilities. While there are a number of exceptions to this requirement for employees to file the form personally when the form is filed by their employer, these exceptions do not apply in many cases. In addition, the deadline to file the FBAR has been extended several times for certain individuals (going back as far as 2011), which raises the question of whether they will have to file retroactively once the deadline is no longer extended. TEI invited a discussion of these issues. Ms. Hodes stated that FinCEN has assumed administration of the FBAR form and is aware of the filing concerns for employees. She noted that there is a continuing discussion about the efficacy of the current filing requirements, that it is still undetermined whether or to what extent the rules will be revised, and that there is no timetable for a revision. She encouraged businesses to contact FinCEN with their issues and noted that when the Office of Tax Policy has an opportunity to offer recommendations on the FBAR form they voice similar concerns.

Tax Reform

TEI's delegation noted that the recent news of potential corporate inversion transactions has again highlighted the issue of U.S. tax reform and invited the Treasury Department's view of the potential for tax reform in the United States. Mr. Mazur acknowledged that there is a need to reform the U.S. tax code in both the short and long term, but also stated that it is difficult politically and there does not appear to be a clear path to reform. Concerning international issues, Mr. Mazur identified the Administration's budget as a potential way forward. TEI's delegation noted that there had only been discussion of business tax reform, as opposed to both business and individual reform. Mr. Mazur replied that Administration policymakers thought business tax reform would be easier to accomplish and would also establish a framework for overall tax reform. However, the political differences about whether tax reform should be revenue neutral have made even business tax reform unlikely in the near term. He added that the large increase in business income earned through pass-through entities has complicated the picture.

ACA Issues

Furnish Statements Electronically As Default Method

TEI's delegation inquired about making electronic means the default method for issuing ACA-related statements to recipients instead of paper. Mr. Bostick responded that OTP had considered this issue several times and that paper was selected as the default method because (i) it is a document taxpayers use to complete their tax returns, similar to a W-2, and most taxpayers would not be comfortable receiving them electronically, and (ii) electronic delivery of tax reporting information is an issue across all tax-reporting requirements and should be addressed in that context. He noted that OTP would be receptive to comments regarding approaches to make reporting more efficient and less burdensome. Mr. Mazur added that there is certainly a move in the business and financial world toward electronic delivery, but the government is not yet ready to move comprehensively in that direction.

Grace Period for Good Faith Compliance/Delay in Information Reporting Penalties

TEI's delegation expressed appreciation of the one-year delay in imposing the information reporting penalty requirements under sections 6721 and 6722 for taxpayers who make good faith efforts to comply and asked whether OTP would entertain a two-year delay. TEI also inquired whether there was a plan for monitoring the success of matching the relevant information provided by various stakeholders and requested an update on the status of the relevant forms. Mr. Bostick replied that OTP will keep an open mind with respect to applying leniency to taxpayers who make good faith efforts to comply with new information reporting requirements, but stated it is premature to address compliance in 2016 without first seeing results from 2015. He stated that the new forms are far along and should be issued for comment very soon and that OTP understands the needs of taxpayers' information technology departments to have the forms as soon as possible. There has been internal testing of IRS information systems to ensure the IRS will be in a position to match data received from the insurance exchanges and employers.

Clarify Statute of Limitations

TEI's delegation asked whether OTP would consider clarifying when the statute of limitations begins to run for an employer's section 4980H liability and noted that the statute of limitations applicable to information reporting penalties under sections 6721 and 6722 for information returns filed under sections 6055 and 6056 also begins with the filing of those information returns with the IRS. Mr. Bostick replied that OTP is thinking about these issues and thanked TEI for raising them.

Conclusion

On behalf of the TEI delegation, Ms. Wielenga thanked the Treasury Department representatives for their attendance and participation in the meeting. Mr. Mazur stated that the Office of Tax Policy appreciates the dialogue.