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TAXTALK

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EDITOR'S NOTE

Tax Reform (or whatever you want to call it) is in full swing as this edition of Tax Talk goes to press. The House has passed H.R. 1 and the Senate Finance Committee has approved its own version of the Tax Cuts and Jobs Act (the "TCJA"). A vote in the Senate is scheduled for the week after Thanksgiving, and, if we get that far, a House-Senate conference on the legislation will follow. Comparing the House and Senate bills, there are a number of areas of agreement, with some of the highlights being:

- Both bills include a participation exemption for dividends paid to a U.S. corporation from a 10% or more owned foreign corporation;
- Both bills include deemed repatriation provisions for offshore corporate earnings accumulated through the end of 2017;
- Both bills would significantly limit (or eliminate) an individual's deduction for state and local income and property taxes;
- Both bills would limit the deduction for home mortgage interest (although the Senate Finance Committee bill's limit is close to current law);
- Both bills would give business income earned through a partnership favorable treatment either through a reduced rate (25% in HR 1) or through a partnership-level deduction; and
- Both bills would limit corporate interest expense to 30% of "adjusted taxable income."

There is obviously a lot more in these bills, and much could change even over the next few weeks. To keep tabs on the legislative activity, we have set up a free website (http://www.mofotaxreform.com/) where you can find all the publicly available information on tax reform that's not copyrighted!

Also, in this Tax Talk we cover a District Court ruling invalidating anti-inversion regulations due to lack of notice and comment, the extension of the phase in for certain aspects of the section 871 regulations, new proposed regulations concerning instruments in registered form, and more.

CHAMBER OF COMMERCE: DISTRICT COURT HOLDS ANTI-INVERSION REGULATION INVALID ON PROCEDURAL GROUNDS

On October 16, 2017, a United States District Court in Texas invalidated temporary Treasury Regulations that target so-called "serial inverters" (i.e., foreign acquiring corporations that have acquired domestic corporations in the past) (the "Serial Inversion Rule"). The plaintiffs argued that the Serial Inversion Rule violated the Administrative Procedures Act (the "APA") because the Internal Revenue Service (the "IRS") lacked statutory authority to issue the Serial Inversion Rule, the Serial Inversion Rule was arbitrary and capricious, and the IRS failed to provide adequate notice and opportunity for comment. The court ultimately invalidated the Serial Inversion Rule on the basis that the IRS failed to provide adequate notice and opportunity for comment as required by the APA.

Temporary Treasury Regulation section 1.7874-8T,[1] which was published on April 8, 2016 applied to domestic entity acquisitions completed on or after April 4, 2016, operated to discount the value of the foreign acquirer to the extent it included the value of domestic corporations acquired in the thirty-six months prior to the signing date of a binding agreement regarding the domestic entity acquisition at issue. Application of the Serial Inversion Rule caused the domestic entity acquisition at issue to be more likely to fall within the scope of the punitive inversion taxation regime.

The Serial Inversion Rule, effective upon issuance, was issued simultaneously with identical provisions in proposed Treasury Regulations that would not become effective until they were issued in temporary or final form. Because the Serial Inversion Rule was effective immediately, the IRS failed to comply with the APA's requirement to provide affected parties with a thirty-day notice period and an opportunity to comment. The IRS did not argue that it had complied with the notice-and-comment requirement but argued that the Serial Inversion Rule was excused from the requirement because it was (a) a temporary regulation and (b) an interpretive regulation. The court held that even temporary Treasury Regulations were subject to the notice-and-comment requirement of the APA. The court also held that the Serial Inversion Rule was a legislative or substantive regulation that created law rather than an interpretative regulation that merely advised the public of the IRS's interpretation of a statute. As a result, the court held that the issuance of the Serial Inversion Rule violated the APA.

Although a seeming victory for the plaintiffs, the court's holding was narrow and upheld the substantive provisions of the Serial Inversion Rule. The court determined that the IRS did not exceed its statutory authority in issuing the Serial Inversion Rule. The Code grants broad authority to the Secretary to prescribe regulations to determine whether a corporation has inverted, including regulations "to treat stock as not stock," and to prevent the avoidance of the purposes of section 7874.[2] The court held that the Serial Inversion Rule was within Congress' grant of authority "to treat stock as not stock." The court also determined that the Serial Inversion Rule was not arbitrary and capricious because it plausibly addressed Congress' concern regarding inversions.

The IRS had moved to dismiss the case on two grounds, which the court ultimately decided in favor of the plaintiffs. The IRS had argued that the plaintiffs, the Chamber of Commerce of the United States of America and the Texas Association of Business, lacked standing to sue. The court determined that the plaintiffs had associational standing because Allergan, plc, a member of the Chamber of Commerce, would have had standing to sue in its own right on the basis that Allergan was prevented from engaging in transactions that the Serial Inversion Rule would have caused to be subject to the inversion rules, and that the IRS targeted Allergan in its promulgation of the Serial Inversion Rule. The IRS had also argued that the plaintiffs' claims were barred by the Anti-Injunction Act, which prohibits lawsuits that restrain the assessment or collection of a tax. The court determined, however, that the enforcement of the Serial Inversion Rule involved neither the assessment nor the collection of a tax.

Although notable for invalidating an existing regulation in the controversial area of inversions, the court's decision does not necessarily signal the end of the Serial Inversion Rule. The IRS is not barred from issuing the same provisions in finalized Treasury Regulations because the court upheld their substance. In addition, the IRS may appeal the decision. Moreover, tax reform proposals currently being considered in Congress would generally make inversions less attractive.

1 All references are to the Internal Revenue Code of 1986, as amended (the "Code"), and the Treasury regulations promulgated thereunder.

2 §§ 7874(c)(6); 7874(g).

NOTICE EXTENDS PHASE-IN OF SECTION 871(M) REGULATIONS

On August 4, 2017, the IRS released Notice 2017-42 (the "Notice")[3] which further extends the phase-in of regulations under section 871(m) of the Code (the "Regulations"). Section 871(m) is the Code provision that treats "dividend equivalents" paid under certain contracts as dividends from sources within the United States and therefore subject to U.S. withholding tax if paid to a non-U.S. person. We have followed the evolution of the rules in several prior Client Alerts.[4]

The Notice extends effective dates found in certain provisions of (a) IRS Notice 2016-76, (b) amendments to the Regulations pursuant to Notice 2016-76, and (c) the final Qualified Intermediary Agreement. The extensions are as follows:

- ***Phased-in Application for Delta-One and Non-Delta-One Transactions.*** The Notice provides an extension to the phased-in application of the Regulations to potential section 871(m) transactions[5] that do not have a delta of one (as determined under the Regulations). Now, the Regulations will not generally apply to non-delta-one transactions entered into before January 1, 2019. The Regulations will continue to apply to any potential section 871(m) transaction that has a delta of one entered into on or after January 1, 2017, including combined transactions, but the Notice states that now both 2017 and 2018 will be phase-in years[6] for such transactions.
- ***Phase-in Year for Qualified Derivatives Dealers.*** The Notice extends three portions of the QDD rules.
    - First, previous guidance provided that a QDD will not be subject to tax on dividends and dividend equivalents received in the QDD's equity derivatives dealer capacity until January 1, 2018, which the Notice extends to January 1, 2019.
    - Second, previous guidance provided that a QDD will be required to compute its section 871(m) tax liability using a "net delta" approach beginning in 2018; the Notice extends this effective date for the net delta approach to begin in 2019.
    - Finally, the final QI Agreement provides that a QDD must perform certain periodic reviews with respect to its QDD activities, but only beginning on January 1, 2018. The Notice extends this to January 1, 2019.
- ***Simplified Standard for Determining Whether Transactions Are Combined Transactions***. Notice 2016-76 and the subsequent final regulations provide for a simplified standard for withholding agents to determine when two or more transactions should be combined in order to determine whether the transactions are subject to section 871(m), but the simplified method only applied for transactions entered into in 2017.[7] The Notice extends the period during which this simplified standard applies to 2018.

Looking Ahead

On February 24, 2017, President Trump issued Executive Order 13777, which directed U.S. agencies to reduce the regulatory burdens created by such agencies. The Notice states that pursuant to that executive order, the Treasury Department and IRS will continue to evaluate the Regulations and consider possible agency actions that may reduce unnecessary burdens imposed by the Regulations. On October 2, 2017, the U.S. Department of the Treasury delivered a report to President Trump that proposes substantial revisions to eight sets of U.S. federal income tax regulations. While the section 871(m) regulations were not one of the eight, the report states that the Treasury is considering possible reforms to the Regulations.[8] Additionally, on October 26, 2017, the IRS published corrections to the Regulations; these corrections were generally non-substantive in nature.[9] Finally, Dana Trier,

[3] The Notice is available at https://www.irs.gov/pub/irs-drop/n-17-42.pdf.

[4] For a more detailed discussion of the development of the Regulations, see our various publications: our Client Alert on the 2015 final regulations, available at https://media2.mofo.com/documents/150921dividendequivalent.pdf; our Client Alert on Notice 2016-76, available at https://media2.mofo.com/documents/161206-irs-guidance-871m.pdf; a discussion of Rev. Proc. 2017-15 containing the final QI Agreement in Vol. 9 Issue 4 of our quarterly publication, Tax Talk, available at https://media2.mofo.com/documents/170210-tax-talk.pdf; and a discussion of the 2017 amendments to the Regulations in Vol. 10 Issue 1 of our quarterly publication, Tax Talk, available at https://media2.mofo.com/documents/170508-tax-talk.pdf.

[5] *See* section 1.871-15(a)(12). A "section 871(m) transaction" is any securities-lending or sale-repurchase transaction, specified NPC, or specified ELI. A "potential Section 871(m) transaction" is any securities-lending or sale-repurchase transaction, NPC, or ELI that references one or more underlying securities.

[6] Under the Regulations, when enforcing the section 871(m) regulations for the applicable phase-in years, the IRS will afford relief to taxpayers or withholding agents who have made a good faith effort to comply with the regulations. Relevant considerations for the determination of good faith include whether a withholding agent made a good faith effort to: (i) build or update its documentation and withholding systems to comply with the Section 871(m) regulations, (ii) determine whether transactions are combined, (iii) report information required under the Section 871(m) regulations, and (iv) implement the substantial equivalence test.

[7] Under the Regulations, in 2017 a short party may presume that transactions are not entered into in connection with each other if either (i) the long party holds the transaction in separate accounts and the short party does not have actual knowledge that the accounts were created separately to avoid section 871(m), or (ii) the transactions were entered into two or more business days apart. Notice 2016-76 and the Regulations provided that for 2017, a broker may presume that transactions should not be combined for section 871(m) purposes unless they are over-the-counter transactions that are priced, marketed, or sold in connection with each other.

[8] For a more detailed analysis of this report, please see our Client Alert, available at https://media2.mofo.com/documents/171011-treasury-report-tax-regulations.pdf.

[9] A copy of the published corrections is available online, at https://www.gpo.gov/fdsys/pkg/FR-2017-10-26/pdf/2017-22830.pdf.

Department of Treasury deputy assistant secretary for tax policy, suggested at a District of Columbia Bar Taxation Community luncheon that section 871(m) could potentially be limited to delta-one transactions only.[10]

The Notice states that taxpayers are permitted to rely on it until the Regulations and the final QI Agreement are amended to reflect the extensions provided for in the Notice.

IRS MAY END SOME CORPORATE RULINGS

Earlier this year, the IRS released Notice 2017-52, which announced a pilot program to expand the IRS' letter ruling policy with respect to transactions intended to qualify under section 368(a)(1)(D) and 355.[11] Despite the allowance for new rulings, on October 13, 2017, the IRS announced that it was reconsidering its views regarding certain issues as to which it has previously provided favorable rulings under these Code sections. The announcement states that the IRS is studying these issues, and new guidance may be issued. In the meantime, the statement provides that the IRS will process ruling requests in accordance with the following guidelines.

First, in connection with a worthless stock loss under section 165(g)(3)(B), the IRS will no longer rule on whether the character of gross receipts received by a consolidated group member in an intercompany transaction may be redetermined by reference to the character of the source funds possessed by the counter party to the intercompany transaction.

Second, if in connection with a section 355 transaction, a distribution to the distributing corporation's shareholders or creditors is substantially delayed, the IRS will continue to rule on whether the delayed distribution is tax-free under section 355 or section 361. However, in addition to the length of the delay, such ruling will be based on substantial scrutiny of the facts and circumstances (including the circumstances of the delay), full consideration of the legal issues, and the effects of a ruling on federal tax administration. However, in determining whether retention of stock or securities is in pursuance of a plan having a principal purpose of tax avoidance, the IRS will continue to follow the guidelines in Appendix B of Rev Proc. 96-30, even though it has been superseded by Rev Proc 2017-52.

Third, the IRS will increase its scrutiny and analysis of "drop-spin-liquidate" and similar transactions. In connection with such a transaction, the IRS will base its ruling on substantial scrutiny of the facts and circumstances, full consideration of the legal issues, and the effects of a ruling on federal tax administration. However, this increased level of scrutiny will not apply if the distributing corporation or the controlled corporation and its successor are not related before the acquisition; instead, the IRS will rule in accordance with prior its practice.

Finally, the IRS will increase its scrutiny and analysis of potential reorganizations that result in transfers of a portion of a subsidiary's assets to its corporate shareholder, if the transfer does not qualify under section 332 or section 355 but is intended to be tax-free.

The announcement also states that private letter rulings issued previously on the above items are not affected, so changes are not likely to be retroactive.

PROPOSED REGULATIONS ON "REGISTERED FORM"

On September 19, 2017, the IRS published proposed guidance that would expand circumstances under which loans are treated as being in "registered form" for U.S. federal income tax purposes.

Generally, debt obligations are classified as either in registered form or bearer form for U.S. federal income tax purposes. Bearer debt may be subject to a variety of penalties to holders (ordinary gain upon a sale, denial of portfolio interest withholding exemption) and issuers (denial of interest deduction, excise tax) if the obligation is a "registration-required obligation." The proposed regulations make significant changes to when an obligation is a "registration-required obligation," and when an obligation is treated as in registered form for tax purposes.

A "registration-required obligation" is defined to include all obligations except those that (1) are issued by a natural person, (2) are not of a type offered to the public, or (3) have a term not more than 1 year. Existing guidance provides that whether an obligation is not of a type offered to the public is based on whether the similar obligations are in fact publicly offered or traded. The proposed regulations clarify when an obligation is not of a type offered to the public by looking to whether the obligation is "traded on an established market" under the OID regulations.[12] These regulations generally look to whether price quotes are available for the obligation. The proposed regulations also include "pass-through certificates" in grantor trusts, partnerships and disregarded entities as registration-required obligations if the entity primarily holds debt instruments, and the certificates otherwise meet the definition of a registration-required obligation, without regard to whether the underlying debt instruments are registration-required obligations. For instance, a trust that holds student loans issued by natural

[10] *See* Stephanie Cumings, Treasury Reconsidering Dividend Equivalent Rules, 2017 TNT 211-3 (November 2, 2017).
[11] A copy of Rev. Proc. 2017-52 is available online, at https://www.irs.gov/pub/irs-drop/rp-17-52.pdf.

[12] Treas. Reg. 1.1273-2(f).

persons does not hold registration-required obligations, but the trust certificates may be registration-required obligations if interests in the trust are of a type offered to the public.

The proposed regulations also clarify when an obligation is treated as in registered form for tax purposes. Under existing regulations, an instrument is treated as registered if "(1) the obligation is registered as to both principal and any stated interest with the issuer (or its agent) and any transfer of the obligation may be effected only by surrender of the old obligation and reissuance to the new holder; (2) the right to principal and stated interest with respect to the obligation may be transferred only through a book entry system maintained by the issuer or its agent; or (3) the obligation is registered as to both principal and stated interest with the issuer or its agent and may be transferred both by surrender and reissuance and through a book entry system." IRS guidance has addressed certain arrangements such as dematerialized or immobilized bearer instruments and provided that such instruments may be treated as in registered form for tax purposes.[13] The proposed regulations amend the definition of registered form to provide that an obligation is in registered form if a transfer of the right to receive both principal and any stated interest on the obligation may be effected only (i) by surrender of the old obligation and either the reissuance of the old obligation to the new holder or the issuance of a new obligation to the new holder; or (ii) through a book entry system maintained by the issuer of the obligation (or its agent) or by a clearing organization. A book entry system includes a dematerialized book entry system, if ownership of the obligation or an interest in the obligation is required to be recorded in an electronic or physical register maintained by the issuer of the obligation (or its agent) or by a clearing organization. An obligation is also considered to be in registered form if it is "effectively immobilized," which generally means that, although a physical certificate evidencing the obligation exists, the certificate is held by a clearing organization for the benefit of purchasers of interests in the obligations, and arrangements are in place that prohibit the transfer of the physical certificate except to a successor clearing organization. Finally, consistent with previous IRS guidance in Notice 2012-20, the fact that an obligation holder may have a right to obtain physical certificates in bearer form does not cause the obligation to be treated as a bearer instrument, as long as the right to obtain a physical certificate is limited to events in which either (1) the clearing system is terminated without a successor, or (2) the issuer issues physical certificates to avoid an adverse tax consequence upon a change in tax law. If either of these situations actually occurs and the obligation is issued in bearer form, however, the obligation becomes a bearer instrument for tax purposes as of that date.

NOTICE 2017-46: IRS GIVES FINANCIAL INSTITUTIONS MORE FLEXIBILITY FOR FATCA

In December of 2016, the IRS released temporary regulations under the Foreign Account Tax Compliance Act ("FATCA"), which, among other things, generally required financial institutions to essentially re-document all U.S. accounts by the end of 2017 and required withholding agents to receive a withholding certificate that includes an FTIN or date of birth in order for such certificate to be valid. On September 25, 2017, the IRS issued Notice 2017-46 (the "Notice"), which generally loosens rules requiring financial institutions to report certain information with respect to their account holders.[14]

First, the Notice acknowledges that Model 1 FFIs may need additional time to implement practices and procedures to obtain and report required U.S. taxpayer identification numbers ("TINs"). Therefore, the Notice announces that for calendar years 2017, 2018, and 2019, a Model 1 FFI's failure to obtain and report each required U.S. TIN will not be viewed by the IRS as significant non-compliance, provided that the Model 1 FFI (1) obtains and reports the date of birth for each account holder and controlling person whose U.S. TIN is not reported, (2) requests annually from each account holder any missing required U.S. TIN, and (3) before reporting calendar year 2017 information, searches electronically searchable data maintained by the FFI for the missing TINs.

Second, the Notice acknowledges administrative difficulty that withholding agents have had in obtaining and reporting foreign TINs ("FTINs") pursuant to the December temporary regulations. The Notice announces that the IRS intends to amend the temporary regulations to (a) narrow the circumstances in which an FTIN and date of birth are required for a withholding certificate to be valid, (b) provide exceptions from the FTIN requirements for certain account holders, (c) provide a phase-in of the rules for obtaining an FTIN, and (d) provide certain relief from obtaining a date of birth with respect to certain withholding certificates signed before January 1, 2018.

[13] Notice 2006-99; Notice 2012-20.

[14] A copy of Notice 2017-46 is available online, at https://www.irs.gov/pub/irs-drop/n-17-46.pdf.

HANN: COURT OF CLAIMS HOLDS UNDERWRITER'S FEE IN COMBINED STOCK OPTION EXERCISE AND STOCK SALE REDUCED SALES PROCEEDS

The Court of Federal Claims recently held against a former aircraft company executive and his wife, determining that underwriter compensation borne by the couple reduced their amount realized in a stock sale instead of generating a deduction.[15]

The executive, Gregory Hann, had received nonqualified stock options in Wesco, a private aircraft company, in exchange for his services to the company. When the company informed its employees in 2011 that it intended to undertake an IPO and that it would allow certain employee-owned stock to be sold in that IPO, Hann found himself in a position to monetize appreciation in some of his vested options. The vested options had an exercise price of $6.29333 per share, whereas the IPO sale price for Company stock would be $15 per share.[16] Because a lock-up on Wesco stock would restrict Hann from disposing of his options or any Wesco stock for six months after the IPO, he was incentivized to monetize this value through the IPO.

The disposition of Hann's (as well as other employees') options was conducted through a custodian arrangement. Pursuant to this arrangement, a custodian holding Hann's options was irrevocably directed to exercise the options in advance of the IPO and immediately sell the corresponding stock to underwriters (without Hann ever taking physical custody of the stock) in exchange for a payment of $14.1375 per share. The $.08625 spread between the $15 per-share IPO price and Hann's $14.1375 per-share proceeds represented the underwriters' fee.

In accordance with section 83 and the Treasury Regulations promulgated thereunder, Hann's Form W-2 for 2011 reflected ordinary income equal to the difference between the fair market value of the stock received pursuant to his options and the exercise price he paid.[17] In the Hanns' initial 2011 return, they treated their disposed-of Wesco stock as having a basis equal to its fair market value at the time of exercise ($15 per share), and the underwriters' fee as a reduction in their amounts realized from selling the stock (i.e., as if they had received only $14.1375 per share). This yielded a short-term capital loss for the Hanns and, combined with their ordinary income inclusion from exercising the options, resulted in a character mismatch. The Hanns sought to ameliorate this mismatch in an amended return by treating the underwriters fee as a deductible expense.

The court rejected each of four arguments made by the Hanns in defense of their amended return, emphasizing the fact that Hann was required to exercise his options – and thereby obtain legal (if not physical) ownership of Wesco stock – in order to participate in the IPO.[18] In light of this fact, the court found it clear that underwriters' fee was a capital expense that all IPO participants had to bear in order to sell their shares. As a result, the fee could not generate a deduction.

PROPOSED REGULATIONS WOULD STREAMLINE 754 ELECTION PROCESS

On October 11, 2017, the U.S. Department of the Treasury and the IRS published proposed regulations that remove a regulatory burden in making an election under section 754 of the Code to adjust the basis of partnership property. Specifically, these proposed regulations would remove the signature requirement contained in section 1.754-1(b) of the Treasury regulations. Generally, section 754 permits partnerships to make an election (a "section 754 election") to adjust the basis of partnership property when it distributes property to its partner or when there is a transfer of a partnership interest. A section 754 election applies to all partnership property distributions and all transfers of partnership interests during the taxable year the election is made and for all future taxable years unless revoked by the partnership.

Under the current regulations, a section 754 election must be made in a written statement (a "section 754 election statement") filed with the partnership return for the taxable year during which the distribution or transfer occurs. The current regulations require that a section 754 election statement (i) set forth the name and address of the partnership making the election, (ii) be signed by any one of the partners, and (iii) contain a declaration that the partnership elects under section 754 to apply the provisions of section 734(b) and section 743(b). Accordingly, under the

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[15] *Hann v. U.S.*, Court of Federal Claims Case No. 15-20T (Aug. 16, 2017).

[16] These prices take into account a stock split undertaken in connection with the IPO; the purpose of the split was to allow for "cashless" exercise of the options. *Id.* at 4.

[17] This amount was taxable as ordinary income at the time of exercise under Treas. Reg. § 1.83-7(a). Hann was not taxed upon his receipt of the nonqualified options (or upon their vesting) because the options lacked a readily ascertainable value at grant. Treas. Reg. § 1.83-7(a).

[18] The Hanns, who proceeded pro se, argued that (1) there was only a single transaction, pursuant to which they disposed of options for the net price of $14.1375 per share, (2) the underwriters fee was deductible as a trade or business expense (with the relevant trade or business being Mr. Hann's role as a Wesco executive), (3) the fee was a necessary cost for exercising the options and therefore should reduce ordinary income recognized from such exercise, and (4) the substance of the transaction was entirely ordinary in nature. The court rejected the first and fourth arguments by noting that exercise of the option was a legal necessity for participation in the IPO, and that Hann had held momentary legal ownership of Wesco stock. It rejected the second argument by noting that the underwriters fee was incurred in Hann's role as a stockholder, and not as a Wesco executive. Finally, the third argument was rejected as factually incorrect: nothing prevented Mr. Hann from paying cash to exercise his options and keeping the corresponding shares.

current regulations, a partnership that files an unsigned section 754 election statement with its partnership return (whether filed electronically or in paper) has not made a valid section 754 election.

Currently, the only remedy for failing to make a proper section 754 election is to request "9100 relief" to make a late Section 754 election either (i) through automatic relief, if the error is discovered within 12 months, or (ii) through a private letter ruling request. The preamble of the proposed regulations states that the IRS has received numerous requests for 9100 relief with respect to unsigned section 754 election statements, especially where returns have been filed electronically. In order to ease the burden on partnerships seeking to make a valid section 754 election and to eliminate the need to seek 9100 relief, Treasury and the IRS are proposing to remove the signature requirement in section 1.754-1(b) of the Treasury regulations. These regulations are proposed to apply to taxable years ending on or after the date final regulations are published in the Federal Register, but taxpayers may rely on the proposed regulations for periods preceding the proposed applicability date. Accordingly, partnerships that have filed a timely partnership return containing an otherwise valid section 754 election statement but for the missing signature of a partner on the statement will not need to seek 9100 relief.

TREASURY REPORT GUIDANCE ON SECTION 385 REGS

On October 2, 2017, Treasury delivered a report to President Trump that proposes substantial revisions to eight sets of U.S. federal income tax regulations (the "Report").[19] The Report was prepared in response to Executive Order 13789, which was issued by President Trump earlier this year in April (the "Order"). The Order directed the Secretary of the Treasury to identify tax regulations issued on or after January 1, 2016 that impose an undue burden on U.S. taxpayers, add unnecessary complexity to the federal tax laws, or exceed the statutory authority of the IRS.[20] Following the issuance of the Order, Treasury later prepared a notice in June of this year (Notice 2017-38) that initially identified the eight sets of regulations that are the subject of the Report and that were effectively targeted for potential withdrawal or revision.[21] This part of Tax Talk discusses the potential withdrawal or revision of certain aspects of the highly controversial Section 385 "debt/equity" regulations, one of the eight sets of regulations identified in the Report.[22]

On October 13, 2016, Treasury and the IRS issued final and temporary regulations under section 385 of the Code, which generally impose documentation requirements for certain related-party interests to be treated as indebtedness and automatically treat debt issued in certain related party contexts as equity for federal income tax purposes. These regulations were primarily comprised of (i) rules establishing minimum documentation requirements that ordinarily must be satisfied in order for purported debt obligations among related parties to be treated as debt for federal tax purposes, and (ii) rules that treat as stock certain debt that is issued by a corporation to a controlling shareholder in a distribution or in another related-party transaction that achieves an economically similar result.[23]

Earlier in 2017, Treasury and the IRS released Notice 2017-36 announcing that the application of the documentation rules would be delayed until 2019. The Report states that Treasury and the IRS now believe that some requirements of the documentation regulations would create a substantial burden on corporations attempting to satisfy the tests required by the regulations. Thus, Treasury and the IRS are considering revoking the documentation regulations as issued and developing a revised set of documentation rules, with a prospective effective date that would allow time for comments and compliance, that would be simplified and streamlined to lessen their burden on U.S. corporations while requiring sufficient legal documentation and other information for tax administration purposes. The Report states that particular consideration will be given to the treatment of ordinary trade payables and modifying the requirement of a reasonable expectation of ability to pay indebtedness contained in the documentation regulations. Under the existing regulations, an issuer would have been required to satisfy the documentation regulations even with respect to trade payables and any debt that was needed to finance the issuer's working capital needs.

The distribution regulations address inversions and takeovers of U.S. corporations by limiting the ability of corporations to generate additional interest deductions without new investment in the United States. The regulations were meant to achieve Treasury's policy goal "of leveling the playing field for U.S. businesses, so that they may compete freely and fairly in the global economy, and implementing tax rules that reduce the distortion of capital and ownership decisions through earnings stripping and similar practices." However, the regulations have been

[19] A copy of the Report is available online, at https://www.treasury.gov/press-center/press-releases/Documents/2018-03004_Tax_EO_report.pdf. For a more detailed analysis on the same, see footnote 8 above.

[20] *See* Executive Order 13789, available at https://www.whitehouse.gov/the-press-office/2017/04/21/presidential-executive-order-identifying-and-reducing-tax-regulatory.

[21] A copy of Notice 2017-38 is available online, at https://www.irs.gov/pub/irs-drop/n-17-38.pdf .

[22] In addition to the final and temporary regulations under section 385 discussed here, the Report identified the following seven sets of regulations for potential withdrawal or revision: (1) proposed regulations under section 2704 on restrictions on liquidation of an interest for estate, gift and generation-skipping transfer taxes; (2) proposed regulations under section 103 on definition of political subdivision; (3) final regulations under section 7602 on the participation of a person described in section 6103(n) in a summons interview; (4) regulations under section 707 and section 752 on treatment of partnership liabilities; (5) final regulations under section 367 on the treatment of certain transfers of property to foreign corporations; (6) temporary regulations under section 337(d) on certain transfers of property to regulated investment companies (RICs) and real estate investment trusts (REITs); and (7) final regulations under Section 987 on income and currency gain or loss with respect to a section 987 qualified business unit.

[23] For a more detailed discussion of the same, please see our Client Alert, available at https://media2.mofo.com/documents/161020-irs-debt-equity-regulations.pdf.

criticized for their complexity and breadth. The Report states that Treasury continues to support the goals underlying the distribution regulations, but Treasury believes that tax reform would be a better means of achieving those policy goals. According to the Report, Treasury believes that proposing to revoke the distribution regulations before the enactment of tax reform could exacerbate existing problems; however, the Report states, if tax reform that eliminates the need for the distribution regulations does not come to fruition, Treasury will reassess the distribution regulations and may then propose more streamlined and targeted regulations.

SAVE THE DATE: 10TH ANNUAL SPA & MOFO STRUCTURED PRODUCTS LEGAL, REGULATORY & COMPLIANCE UPDATE

Monday, February 5, 2018, 5:30 p.m. - 8:00 p.m.

The Structured Products Association and Morrison & Foerster are pleased to present this annual Legal, Regulatory & Compliance update to friends, clients and members on February 5, 2018.

Save the date for a timely presentation on what to expect in the new year. This event will be held at Morrison & Foerster's New York office and is traditionally standing-room only. Hors d'oeuvres and cocktails will be served.

To RSVP, please e-mail CMG-Events@mofo.com

MOFO IN THE NEWS; AWARDS – TAX TALK – Q3 2017

GlobalCapital has named us Global Law Firm of the Year at its 2017 Global Derivatives Awards for the second year in a row. For the third year in a row, GlobalCapital named us the Americas Law Firm of the Year at its 2017 Americas Derivatives Awards. We have again been named Best Law Firm in the Americas by StructuredRetailProducts.com at the 2017 StructuredRetailProducts and Euromoney Americas Wealth Management and Derivatives Conference.

- On September 26, 2017, Partner Peter Green and Partner Jeremy Jennings-Mares hosted a PLI webinar entitled "Shadow-Boxing in 2017: An Update on Shadow Banking Reform" to discuss shadow banking developments in the EU. Topics included: Current aspects of shadow banking giving most concern to the G20; money market fund regulation and recent MMF Regulation finalized by the EU; repos and effect of recent reforms; investment funds exposed to shadow banking risks; and impact of crowdfunding and peer to peer lending growth.
- On September 25, 2017, Partner Scott Ashton and Partner Brian Bates were joined by Tarun Sakhrani (Barclays) in hosting an IFLR webinar entitled "Latest Developments in the Global Private Placement Market." The cross-border private placement market has continued to grow, providing issuers with an opportunity to raise capital from US and European financial institutions. This market, which has seen incredibly robust activity this past year, has continued to attract issuers across a myriad of industries and from multiple worldwide jurisdictions. Topics included: The global private placement market and recent trends; market participants; documentation requirements for traditional and structured transactions; financial covenants, "MFLs" and model form provisions; new issuers using the market (social housing trusts, universities, investment trusts, etc.); marketing process with agented and "direct" private placements; and ratings and the NAIC.
- On September 19, 2017, Partner Anna Pinedo hosted a seminar in New York entitled "MoFo Classics: Late Stage Private Placements." Successful privately held companies considering their liquidity opportunities or eyeing an IPO often turn to late stage private placements. Late stage private placements with institutional investors, cross-over investors and strategic investors raise a number of considerations distinct from those arising in earlier stage and venture financing transactions. Topics included: Timing and process for late stage private placements; terms of late stage private placements; principal concerns for cross-over funds; diligence, projections and information sharing; IPO and acquisition ratchets; governance issues; the placement agent's role; and planning for a sale or an IPO.
- On September 19, 2017, Partner Anna Pinedo led a discussion entitled "The Securities and Exchange Commission and a Fiduciary Standard" at the New York State Bar Association's Securities Regulation Committee Business Law Section meeting. In recent months, commentators and practitioners have focused principally on the first phase of the Department of Labor's ("DOL") new fiduciary rule ("Fiduciary Rule") and have speculated about the fate of the rule. Topics included: The SEC's original charge under the Dodd-Frank Act to consider the standard of care applicable to broker-dealers; the SEC study; recent statements by SEC

representatives regarding the DOL Fiduciary Rule; and the actions we might anticipate.

- On September 15, 2017, Partner Anna Pinedo spoke on a panel with senior ECM practitioners to discuss the very latest market trends and developments at IFR's "2017 US ECM Roundtable" in New York. Topics included: Overall state of the market; regulatory developments/JOBS Act; risk/block trades and accelerated bookbuilds; and SPACs – Flavor of the day or enduring source of funding?
- On September 15, 2017, Partner Anna Pinedo spoke on a panel entitled "Private Placements and Exemptions" at the New York City Bar's "What You Need to Know about Capital Markets Law: SEC Securities Registration vs. Private Placements, SEC Reporting and SEC Liability" seminar. Topics included: How to identify exemptions and do a private placement; and Reg. D, Reg. A and other exemptions and safe harbors.
- On September 14, 2017, Partner Anna Pinedo hosted a seminar in New York entitled "MoFo Classics: Private Placement Market Developments." Topics included: Increased reliance on Section 4(a)(2) instead of the Rule 506 safe harbor; addressing no registration opinions; bad actor diligence for issuers and placement agents; diligence and the use of "big boy" letters; FINRA Rule 5123 updates; FINRA and SEC enforcement developments affecting private placements; and Nasdaq's 20% rule.
- On September 13, 2017, Partner Jay Baris, Associate Daniel Kahan, Of Counsel Joshua Ashley Klayman and Partner Alfredo B.D. Silva hosted a PLI webinar entitled "SEC Report of Investigation: Implications for Offers and Sales of Blockchain Tokens and Other Digital Assets" to discuss the key implications of new Securities and Exchange Commission Report of Investigation regarding the public offerings of blockchain tokens and other digital assets. Topics included: What are blockchain tokens and what is driving the rapid growth of token markets?; How are token offerings typically structured?; What are the key takeaways from the SEC's investigative report and investor bulletin?; and How will the SEC's investigative report and guidance affect token market participants, including issuers, advisers, and purchasers?
- On September 13, 2017, Partner Lloyd Harmetz was joined by Kashif Zaman (Osler, Hoskin & Harcourt LLP) in hosting a teleconference entitled "Canadian Bail-in and TLAC – Impact on Capital Markets Transactions" to address the proposed Canadian federal rules relating to (a) Bank Recapitalization (Bail-in) Conversion Regulations and (b) Total Loss Absorbing Capacity (TLAC). These rules are expected to have a significant impact on how the major Canadian banks (D-SIBs) offer debt securities in Canada, the U.S. and elsewhere. Topics included: The expected regulatory framework and capital requirements; changes to debt offering programs, including indenture terms and covenants; changes to offering documents delivered to investors; the impact on structured note offerings; and the process for compensating debtholders.
- On September 12, 2017, Partner Oliver Ireland and Partner Anna Pinedo were joined by Elaine Buckberg and Chris Laursen (The Brattle Group) in hosting a seminar in New York entitled "Core Principles for Financial Regulation." Topics included: the Presidential Orders relating to deregulation; the Treasury Department's initial report regarding the core principles of financial regulation; the Financial CHOICE Act and its principal provisions; the areas of regulatory reform as to which compromise may be possible; and the likely path forward for regulatory reform and what you should expect in 2017.
- On September 7, 2017, Partner Anna Pinedo spoke on a panel entitled "Challenges in Running an Equity Crowdfunding Platform" at PLI's Marketplace Lending and Crowdfunding 2017 seminar in New York. Topics included: Crowdfunding under Title II – Solicitation vs. Non-Solicitation; "reasonable steps to verify"; the preexisting relationship and CitizenVC: Myth vs. Facts; working with broker-dealers and other intermediaries; and liquidity and secondary markets including the FAST Act and Section 4(a)(7).
- On July 26, 2017, Partner Peter Green and Partner Jeremy Jennings-Mares hosted a PLI webinar entitled "Packaged Retail and Insurance-based Investment Products: Final Preparations" to discuss the PRIIPs Regulation which will finally become effective at the beginning of 2018 and will herald a new approach for pre-contractual disclosure in the form of a Key Information Document (KID) in relation to retail packaged investment products. Topics included: principal issues in connection with the implementation of the PRIIPs Regulation including its scope; challenges in completing the KID, particularly in relation to complex products; and its impact on secondary sales of relevant products.
- On July 25, 2017, Partner Oliver Ireland and Partner Anna Pinedo were joined by Paul Kupiec

(American Enterprise Institute) in hosting an IFLR webinar entitled "Regulatory Burden Relief: What to Anticipate." Topics included: Presidential Orders relating to deregulation; the Treasury Department's initial report regarding the core principles of financial regulation; the Financial CHOICE Act and its principal provisions; the areas of regulatory reform as to which compromise may be possible; and the likely path forward for regulatory reform and what you should expect in 2017.

- On July 24, 2017, Partner Anna Pinedo was joined by Timothy McCormick (Stikeman Elliott LLP) in hosting a PLI webinar entitled "All Things Canadian: Cross-Border Securities Offerings" to address the rules applicable to U.S. public companies seeking to offer securities into Canada concurrent with undertaking a U.S. SEC-registered offering. The speakers also addressed the framework applicable to Canadian companies that are MJDS filers, as well as the framework applicable to dual-listed (U.S. and Canadian) issuers that seek to undertake a range of financing transactions. In particular, the speakers focused on navigating the rules of the road in the context of structuring and executing the following types of transactions. Topics included: PIPE transactions and private placements; confidentially marketed public offerings; public offerings completed on an agented or best efforts basis; U.S.-style bought deals; and at-the-market offerings.
- On July 13, 2017, Partner Anna Pinedo led a session entitled "Securities Act Exemptions" at PLI's "Understanding the Securities Laws 2017" in New York. Topics included: Exempt securities versus exempt transactions; private placements, including offerings under Rules 504 and 506 of Regulation D; Regulation A+ offerings; "intrastate" offerings, including new Rule 147A ; crowdfunding; employee equity awards; Rule 144A offerings; Regulation S offerings to "non-U.S. persons"; and resales of restricted and controlled securities: Rule 144, Section 4(a)(7) and 4(a)(1½).

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Because of the generality of this newsletter, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations.

ABOUT MORRISON & FOERSTER

We are Morrison & Foerster — a global firm of exceptional credentials. Our clients include some of the largest financial institutions, investment banks, and Fortune 100, technology, and life sciences companies. We've been included on *The American Lawyer*'s A-List for 13 years, and the *Financial Times* named the firm number six on its 2013 list of the 40 most innovative firms in the United States. *Chambers USA* honored the firm as its sole 2014 Corporate/M&A Client Service Award winner, and recognized us as both the 2013 Intellectual Property and Bankruptcy Firm of the Year. Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger.