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# Don't Forget About Congress

Since the passage of the law formerly known as the Tax Cuts and Jobs Act (TCJA), the focus of tax policy shifted to the guidance process. Treasury and the Internal Revenue Service (IRS) issued several notices, FAQs and ostensibly a change to a revenue procedure on the transaction tax under section 965. Over the coming months, Treasury will publish a notice that will allow the section 78 gross up for global intangible low taxed income (GILTI) to be included in the GILTI foreign tax credit basket, proposed regulations on section 965, proposed regulations regarding GILTI, and other provisions in the TCJA.

Many taxpayers are spending their time with the various teams at Treasury and the IRS to scope issues and provide potential solutions. Taxpayers will have additional opportunities to comment when Treasury and the IRS publish proposed regulations. However, it is unlikely that Treasury and the IRS will be able to fix all of the known and unknown errors and problems in the TCJA.

Congress devoted significant time to tax policy last year, and it will continue to do so in 2018. There are several points where Congress may consider (and possibly pass) certain types of tax legislation. First, House Committee on Ways and Means Chairman Kevin Brady (R-TX) announced that he and his committee are working on Tax Reform 2.0 (TR 2.0), which may be released as early as the end of August. Chairman Brady is considering the permanent extension of certain provisions of the TCJA as part of TR 2.0, including the permanent extension of current expensing. Some view this provision as helping to grow the economy, and permanent extension could further stimulate long term domestic investment. Other possible candidates include the permanent extension of the individual rates (due to expire at the end of 2025), repeal of the estate tax, and permanent extension of certain business provisions in the TCJA. Chairman Brady has not indicated whether he will include offsets to pay for the proposal.

There will likely be significant press regarding TR 2.0, but it is unlikely that it will be enacted in 2018. The Senate would need 9 Democrats to vote with the 51 Republicans to take up TR 2.0. Additionally, the Senate does not have a reconciliation instruction that would allow for TR 2.0 to be passed on a purely partisan vote. Nevertheless, TR 2.0 could be used as an election issue and become the basis for legislation in 2019 and beyond.

Another issue Congress will address is funding for the Federal Aviation Agency (FAA). The FAA is funded by various taxes and fees that Congress is required to periodically reauthorize. The FAA fund expires by the end of September 2018. Congress will need to act by either passing a temporary patch (possibly to December) or a tax bill that provides years of funding. As of this time, the better money is on a temporary patch.

In the background, the Joint Committee on Taxation (JCT) continues to work on the Bluebook (a summary of tax legislation passed in Congress), with a likely

Upcoming Tax Events

European Tax Conference

Madrid
► June 21, 2018

Asia Pacific Tax Conference

Singapore
► September 20-21, 2018

Doing Business Globally

Seattle, Washington
► October 10, 2018

Dallas, Texas
► October 18, 2018

19th Annual International Tax and Trust Training Program

New York, NY
► October 16, 2018

Miami, FL
► October 18, 2018

release before the end of the year. Additionally, the House, Senate and JCT continue to meet with taxpayers who have identified technical (and nontechnical) issues with the TCJA. It is unlikely that Congress will address technical corrections (and other policy issues) before the election. The likely fixes that could move are to current expensing for restaurants and retail, and the confusion regarding the effective date for the changes to section 172 (net operating losses).

Another opportunity for tax legislation is during the lame duck session, the period after the election and before the new Congress begins (usually around January 3). It is unclear whether one or both houses of Congress will flip, but it is important to note that several members of Congress with a deep interest in tax policy are retiring. For example, Senate Committee on Finance Chairman Orrin Hatch (R-UT) will retire at the end of this Congress. He has repeatedly expressed interest in addressing retirement issues in the tax code, and he may seek to move his legislation before he retires. House Speaker Paul Ryan (R-WI) will also retire at the end of the year.

The potential expiration of an FAA patch (and the above mentioned retirements), may require Congress to pass a tax bill. Taxpayers who want changes to the TCJA should being laying the groundwork for including their changes in a year end bill. Like the process for TCJA, the lame duck session will be quick. A tax bill in the lame duck session will require bipartisan support, and it is possible that it will not be revenue neutral.

Thus, it is important to engage with Treasury and the IRS, but it is also important to keep an eye on Congress and begin engaging in the event Congress has a lame duck session.

***By: Josh Odintz and Alexandra Minkovich, Washington, DC***

## Section 355 Developments: Private Letter Rulings 201817001 and 201818010

The IRS recently released two private letter rulings regarding Code Section 355: PLR 201817001 (April 27, 2018) and PLR 201818010 (May 4, 2018). In the first letter ruling, the IRS determined that the taxpayer could use the Net Decrease Methodology (defined below) for the 50-percent-or-greater interest acquisition test under section 355(e) as applied to overlapping shareholders between the acquired and the acquiring corporations. The IRS also ruled that the taxpayer could rely on publicly available information on stock ownership for the test.

In PLR 201818010, the IRS concluded that a distributing corporation passed the tax avoidance purpose test under section 355(a)(1)(D), even though the distributing corporation retained a percentage of controlled corporation's stock.

### PLR 201817001

#### Summary of Facts

In PLR 201817001, Distributing was a publicly traded corporation and the parent of an affiliated group of domestic corporations that filed a US consolidated

federal income tax return and engaged in Business A and Business B through its subsidiaries. The stock of Distributing was divided into: (i) common stock, owned by its public shareholders; (ii) Class A Preferred Stock, owned by Owner A, one of Distributing's subsidiaries; and (iii) Class B Preferred Stock, owned by Owner B, another of Distributing's subsidiaries.

Distributing formed Controlled, which had two classes of common stock (Class A Common Stock and Class B Common Stock), then Distributing contributed Business B and certain other assets to Controlled and contributed Business A and other assets to various other subsidiaries. Distributing distributed the Controlled Class A Common Stock pro rata to its public shareholders and distributed the Controlled Class B Common Stock to Owner A in redemption of all of Owner A's Class A Preferred Stock owned in Distributing. Then, Distributing adjusted the conversion ratio of Owner B's shares of Distributing Class B Preferred Stock to prevent its dilution (collectively, these steps comprised the "Distribution"). The Distribution was represented as a qualifying divisive reorganization under sections 368(a)(1)(D) and 355.

As a part of an integrated plan, HoldCo (an unrelated foreign corporation) then acquired all of the Controlled Class A Common Stock from Controlled's public shareholders, in exchange for voting stock of HoldCo's parent, Merger Partner. HoldCo's subsidiary merged with and into Controlled, with Controlled surviving (the "Combination"). In the Combination, some of the former Controlled public shareholders (i.e., widely held, publicly traded mutual funds) also became Merger Partner shareholders. Through the new Merger Partner stock, the former public shareholders of Controlled retained an indirect interest in Controlled stock that was greater than 50 percent of its vote and value. The Combination was represented as qualifying as a reorganization under section 368(a).

## Section 355(e)

Under section 355(e) (also known as the anti-*Morris Trust* provision), a distributing corporation must recognize corporate-level gain in a spin-off if, pursuant to an integrated plan, one or more persons acquire 50 percent or more of the vote or value of the acquired corporation, which can be either the distributing or the controlled corporations (the "50 Percent Test"). However, section 355(e) has an exception for the overlapping shareholders between the acquired and the acquiring corporations: for purposes of the 50 Percent Test, an acquiring shareholder's acquisition of stock in the acquired corporation is *disregarded* to the extent that the acquired corporation's shareholders' percentage of stock owned in the acquired corporation does not decrease after the transaction (the "Net Decrease Methodology") (*See* section 355(e)(3)(A)(iv)).

The taxpayer requesting the ruling sought to determine whether corporate-level gain would be triggered by failing the 50 Percent Test. The 50 Percent Test would exclude the percentage of Controlled stock acquired from the former public shareholders of Controlled after the Combination, if the Net Decrease Methodology applied so that the public shareholders' indirect percentage interest in Controlled did not decrease below 50 percent. Further, the taxpayer sought to determine whether it could use publicly filed documents for calculating the stock ownership percentages of the relevant shareholders.

## IRS Ruling

The IRS ruled that the taxpayer could use the Net Decrease Methodology for the 50 Percent Test with regard to the overlapping shareholders of Controlled and Merger Partner (i.e., the widely held, publicly traded mutual funds that also became Merger Partner shareholders after the Combination). Thus, the taxpayer could ignore Merger Partner's acquisition of stock in Controlled (through HoldCo) to the extent that the overlapping shareholders' percentage of ownership in Controlled immediately before the Combination did not decrease after the Combination. Further, the IRS ruled that, for purposes of calculating the overlapping ownership, Distributing could rely on the latest, publicly available filings regarding stock ownership if it did not have the actual information.

# PLR 201818010

## Summary of Facts

In PLR 201818010, the taxpayer proposed a series of transactions and sought a ruling on whether it would pass the control test under Code Section 355. Distributing was a publicly traded corporation and the domestic parent to an affiliated group of corporations that filed a US consolidated federal income tax return.

The taxpayer proposed that Distributing would form SpinCo and HoldCo. Distributing would contribute HoldCo's common stock and certain other assets to SpinCo in exchange for cash, SpinCo stock, and SpinCo's assumption of Distributing liabilities (the "SpinCo Contribution"). Distributing then would distribute a percentage of SpinCo stock pro rata to its shareholders (the "Distribution") but would retain a certain percentage of the SpinCo stock (the "Retained Stock"). The taxpayer represented that, with the exception of one individual, no directors or officers of Distributing would serve as directors or officers of SpinCo.

The taxpayer proposed that Distributing might transfer the Retained Stock to its creditors to satisfy its debt, or to its shareholders as dividends or in redemption of outstanding Distributing common stock. Alternatively, or in addition, Distributing might dispose of the Retained Stock (including through taxable sales) at any time but no later than five years following the Distribution. Similarly, the taxpayer proposed that if Distributing's subsidiaries received SpinCo stock, they would dispose of the stock no later than five years after the Distribution.

## Section 355(a)(1)(D)

Under section 355(a)(1)(D), a distributing corporation must satisfy the control test with respect to the controlled corporation for a distribution of the controlled corporation to qualify as a tax-free spin-off. The control test is met only if the distributing corporation distributes either: (i) all of its stock and securities in the controlled corporation; or (ii) enough stock to meet the control test under section 368(c), which is at least 80 percent of the total combined voting power and 80 percent of the total number of shares of all other classes of stock

(including any non-voting preferred stock) of the controlled corporation. If the distributing corporation distributes less than 100 percent of the controlled corporation's stock, however, section 355(a)(1)(D)(ii) provides that the taxpayer must establish "to the satisfaction of the Secretary that the retention by the distributing corporation of stock (or stock and securities) in the controlled corporation was not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income tax." Ordinarily, the corporate business purpose for a distribution requires the distribution of all of the stock and securities of the controlled corporation. Treas. Reg. § 1.355-2(e)(2). Thus, if a distributing corporation retains part of the stock or securities in the controlled corporation, it must establish that it retained such stock for non-tax avoidance purposes.

The control test under section 355 is often easily satisfied because distributing corporations typically distribute all stock of a controlled corporation, and thus the retention of a minority interest in the controlled corporation is not an issue. In the private letter ruling at issue, however, Distributing would retain a percentage of SpinCo stock after the Distribution, so the taxpayer sought a ruling to determine whether it would pass the tax avoidance purpose test contained in section 355(a)(1)(D).

## IRS Ruling

The IRS ruled that, according to the terms of the proposed reorganization, which provided that Distributing would dispose of the Retained Stock within five years of the initial Distribution, Distributing's direct and indirect continuing ownership of the Retained Stock would not violate the tax avoidance purpose test under section 355(a)(1)(D)(ii).

The IRS did not elaborate on its reasoning that led it to conclude that Distributing's retention of the Retained Stock would not be in pursuance of a plan having as one of its principal purposes the avoidance of federal income tax. Commentators have observed that the policy underlying this tax avoidance purpose test is unclear, and that the retention of a small stake in the controlled corporation seems unlikely to make the distribution more like a dividend or otherwise indicate the avoidance of the policies of Section 355. *See, e.g.*, Bittker & Lokken: *Federal Taxation of Income, Estates, and Gifts*, ¶ 96.7 (Thomson Reuters/Tax & Accounting, 2d/3d ed. 1993-2018).

Prior revenue rulings on this issue provide insights into IRS's thinking on the section 355(a)(1)(D)(ii) tax avoidance purpose test. In Revenue Ruling 75-321, for example, the IRS ruled that the taxpayer satisfied the tax avoidance purpose test even though it retained some of the controlled corporation's stock. The IRS concluded that the following three factors were present in the facts at hand: (i) the distributing corporation would distribute almost all (i.e., 95 percent) of the controlled stock, effecting a genuine separation of the corporate entities; (ii) the distributing corporation would not be able to maintain practical control over the controlled corporation even if it retained the remaining 5 percent interest; and (iii) the distributing corporation established a sufficient business purpose for retaining the 5 percent interest.

The IRS applied these three factors in Revenue Ruling 75-469, in which the distributing corporation retained a controlled corporation's debentures but not stock or securities. The IRS also ruled in the taxpayer's favor in PLR 199909027 (March 8, 1999), in which the taxpayer represented that there was "sufficient business purposes for Distributing's retention of" a percentage of controlled corporation's stock. The taxpayer had also represented that none of the distributing corporation's directors would serve as directors of the controlled corporation while the controlled corporation's stock was retained by the distributing corporation, which facts were mirrored in PLR 201818010 (i.e., no directors or officers of Distributing would serve as directors or officers of SpinCo, with the exception of one person).

Thus, the IRS's revenue rulings and taxpayers' representations in prior letter rulings suggest that a distributing corporation likely passes the tax avoidance purpose test while retaining some controlled stock if the following factors are satisfied: (i) the distributing corporation distributes enough controlled stock to suggest a genuine separation of the corporate entities; (ii) the distributing corporation does not maintain practical control of the controlled corporation (i.e., no overlapping directors between the distributing and controlled corporations); and (iii) the distributing corporation demonstrates a sufficient business purpose for retaining an interest in the controlled corporation.

***By: Mary Yoo, Chicago***

# LB&I New Campaigns Focus on Withholding and International Individual Compliance

## The New Campaigns

On May 21, 2018, the IRS Large Business and International Division (LB&I) announced its identification and approval of six additional compliance campaigns. Previously, the LB&I had announced 29 compliance campaigns: 13 campaigns on January 31, 2017, 11 campaigns on November 3, 2017, and 5 campaigns on March 13 of this year.

Five out of six new campaigns are centered around withholding and international individual compliance, focusing on both return accuracy and information reporting. These five campaigns are as follows:

- F3520/3520-A Noncompliance and Campus Assessed Penalties
- Forms 1042/1042-S Compliance
- Nonresident Alien Tax Treaty Exemptions
- Nonresident Alien Schedule A and Other Deductions
- NRA Tax Credits

The IRS communicated that the LB&I campaigns are the result of its extensive efforts to redefine large business compliance work, to create greater transparency between the IRS and LB&I's taxpayer segment, and to build a supportive infrastructure inside the LB&I. According to the IRS, the LB&I identifies campaigns through data analysis and suggestions from IRS

employees. Through these campaigns, the IRS anticipates improving return selection and focusing on the issues that present the greatest risk of noncompliance. The IRS will implement various treatment streams within each campaign, including examinations, assessment of penalties and outreach/education.

## Campaign Details

Through the F3520/3520-A Noncompliance and Campus Assessed Penalties campaign, the LB&I expects to improve compliance with respect to the timely and accurate filing of information returns reporting ownership of, and transactions with, foreign trusts. The IRS plans to address noncompliance through a variety of treatment streams including, but not limited to, examinations and assessment of penalties when the forms are received late or are incomplete.

The Forms 1042/1042-S Compliance campaign focuses on compliance with the withholding, deposit, and reporting requirements of the withholding agents who make payments of certain US-source income to foreign persons. The IRS intends to address noncompliance and errors through a variety of treatment streams, including examination.

The Nonresident Alien Tax Treaty Exemptions is aimed to increase compliance in nonresident alien individual tax treaty exemption claims related to both effectively connected income and Fixed, Determinable, Annual Periodical income. The IRS observed that some nonresident alien (NRA) taxpayers may either misunderstand or misinterpret the treaties, provide incorrect or incomplete forms to withholding agents or rely on incorrect information returns provided by withholding agents to improperly claim treaty benefits and exempt US source income from taxation. This campaign appears to be closely linked to the Forms 1042/1042-S Compliance campaign which is aimed at the reporting compliance of the payors of US-source income to the NRA taxpayers. The IRS plans to address noncompliance through a variety of treatment streams including outreach/education and traditional examinations.

Similarly, the IRS notes that NRA taxpayers may either misunderstand or misinterpret the rules for allowable deductions of eligible expenses on Form 1040NR. Such taxpayers, according to the IRS, may claim deductions while not meeting all the qualifications for claiming the deduction and/or do not maintain proper records to substantiate the expenses claimed. The IRS plans to address this noncompliance through its Nonresident Alien Schedule A and Other Deductions campaign, and anticipates employing a variety of treatment streams including outreach/education and traditional examinations.

Finally, the IRS expressed concern regarding NRAs improperly claiming certain dependent related tax credits when they do not have qualifying earned income, do not provide substantiation/proper documentation, or do not have qualifying dependents. Additionally, the IRS noted, some NRA taxpayers may also claim education credits that are only available to US persons by improperly filing Form 1040 tax returns. The IRS, through the NRA Tax Credits campaign, plans to address noncompliance using a variety of treatment streams including outreach/education and traditional examinations.

## The Takeaway

The IRS has formulated its issue-based approach as part of its efforts to direct its diminishing resources toward issues that it believes present the greatest risk of noncompliance. Given the focus of the LB&I's new campaigns on withholding and international individual compliance, this area continues to be a hot topic for the IRS. In the process of issue-based examinations, taxpayers should expect to interact with IRS personnel that have been trained to deal with the specific issues of focus in the campaigns. The international taxpayers and the payors of US-source income to foreign persons are well advised to take advantage of the IRS's transparency and assess their compliance and potential risks with respect to the issues identified in the campaigns.

***By: Glenn Fox and Olga Sanders, New York***

# Look Back Approach in Taxability of Earn Out Consideration

## Summary of the Ruling

In a reverse subsidiary merger in which contingent stock rights in parent shares were given to target shareholders ("earn out consideration"), the IRS ruled that the post merger integration planning undertaken by the acquiring corporate group would not cause the earn-out consideration to be taxable to the shareholders of the target corporation.

## Discussion of the Ruling

PLR 201820002 involves a reverse subsidiary merger under foreign law that occurred between a target corporation ("Target") and the merger subsidiary ("Merger Sub") of a publicly traded corporation that is the parent of an affiliated group ("Parent"). Parent wholly owns, either directly or indirectly through disregarded entities, a chain of corporations in which Parent owns 100% of the stock of Corp 1 which in turn owns 100% of the stock of Corp 2, which in turn owns 100% of the stock of Corp 3, which in turn owns 100% of the stock of Corp 4 indirectly through two disregarded entities.

Merger Sub merges into Target under the laws of country A, with Target surviving. The Target shareholders receive Parent stock and cash in exchange for their Target shares. The transaction qualifies as a tax-free merger under Code Section 368(a)(2)(E). After the merger, Parent transfers the shares of Target successively down the chain of its subsidiaries, through Corp 1, Corp 2, and Corp 3 to Corp 4.

As stated in the ruling, the merger agreement provides for the Target shareholders to receive earn out consideration of additional Parent shares and cash if certain achievement milestones are met after the merger. The ruling addresses whether the Target shareholders can receive the additional Parent shares paid as part of the earn out consideration on a tax free basis. The IRS

holds that the portion of the earn out consideration made up of additional Parent shares can be received by the Target shareholders tax-free.

## Mechanics of a Reverse Subsidiary Merger

A reverse subsidiary merger is a triangular reorganization involving a parent corporation ("P"), a merger subsidiary owned by P ("S"), and a target corporation ("T"). S merges into T in a statutory merger with T surviving. The T shareholders receive P stock in exchange for their T stock.

To qualify as a tax-free merger under 368(a)(2)(E), certain requirements must be met:

1. The merger must otherwise qualify as a section 368(a)(1)(A) reorganization except for the fact that P stock is issued rather than S stock;

2. P must acquire section 368(c) control of T, that is 80% of the voting stock of T and 80% of each other class of T shares, in exchange for P shares;

3. T must retain substantially all of its premerger assets after the merger; and

4. S must be a first-tier subsidiary of P.

Although the use of grandparent stock is not permitted under section 368(a)(2)(E), after the merger of S and T, P is permitted to transfer the shares of T down to its section 368(c) controlled subsidiaries under Treas. Reg. § 1.368-2(k).

## What is Earn Out Consideration

Earn out consideration is a contingent future payment provided for in the merger agreement based on the achievement of agreed upon benchmarks. Earn out consideration can be used in the acquisition of a corporation where the parties disagree about the value of the corporation being acquired. There are many forms that earn out consideration may take. The earn out consideration addressed in the ruling is a contingent right on the part of the Target shareholders to both additional Parent stock and cash. Generally, where earn out consideration takes the form of contingent stock rights, the contingent shares are not issued and outstanding, as a matter of local corporate law, until the milestone that triggers the payment of the earn out consideration is reached.

## Implications of the Ruling

As stated above, the ruling permits the portion of the earn out consideration made up of additional Parent shares to be received tax-free by the Target shareholders. This is the case even though at the time the earn out consideration is paid to the Target shareholders, Target is a fifth-tier subsidiary of Parent.

Generally, section 368(a)(2)(E) requires that Target be a first-tier subsidiary of Parent in order to accord the Target shareholder tax-free treatment on the receipt of Parent shares. Thus, the ruling essentially adopts a look back approach in determining whether the Parent shares can be received tax-free by the Target shareholders.

This is a sensible approach so that permissible post merger integration planning under Treas. Reg. § 1.368-2(k) does not cause unintended negative tax consequences for the Target shareholders. If the ruling did not adopt this look back approach, Parent would either have to delay its post merger integration planning until the earn out consideration was paid, potentially a delay of years, or Target shareholders would have to pay tax on the receipt of a portion of their Parent shares in an otherwise tax-free merger.

***By: Amanda Swartz, Houston***

## New Sales Tax Collection Obligations Coming in Québec for Non-Resident E-Commerce Suppliers

The province of Québec has released proposed legislation to implement measures originally announced in the March 27, 2018 Québec budget ("Budget") with respect to Québec Sales Tax ("QST") and e-commerce in Québec, notably registration and collection requirements for non-resident suppliers of "incorporeal movable property" (i.e., intangible property) and services ("E-Commerce Supplies"). The legislation has been introduced as an amendment to an omnibus budget bill (Bill 150).

Under the proposed legislation, certain non-resident suppliers with no physical or significant presence in Québec ("Non-Resident Suppliers") generally will be required to register under a distinct specified registration system ("SRS") and will be required to collect and remit QST on E-Commerce Supplies made to "specified Québec consumers". According to the Budget, the effective date for these changes will be January 1, 2019 for Non-Resident Suppliers located outside of Canada.

The proposed legislation is particularly notable as it represents Québec's intention to "go it alone" with respect to registration and collection requirements for Non-Resident Suppliers, as Canada's federal government has not indicated that it will be imposing similar requirements with respect to the Canadian federal sales tax ("GST/HST") in the foreseeable future.

### Specified Registration System

The SRS will deal exclusively with Non-Resident Suppliers. For mandatory registration to apply, the value of considerations for all taxable supplies made by a Non-Resident Supplier in Québec to persons that may reasonably be considered "consumers" (as defined in Québec's QST legislation) must exceed 30,000 Canadian Dollars. SRS-registered Non-Resident Suppliers will be required to collect and remit QST on E-Commerce Supplies made to "specified Québec consumers". For purposes of the SRS, "specified Québec consumers"

will mean a person who is not registered for the QST and whose usual place of residence is in Québec. Thus, the collection requirement is designed to generally apply only to B2C supplies.

The SRS registration requirement also will apply to E-Commerce Supplies made by Non-Resident Suppliers to specified Québec consumers through digital property and services distribution platforms ("Digital Platforms"), where the Digital Platforms control the key elements of the transactions with the specified Québec consumers (e.g. billing, transaction terms and conditions, delivery terms). Digital Platforms will be required to register and in turn collect QST on such E-Commerce Supplies, unless they do not control the key elements of transactions on such E-Commerce Supplies.

Unlike registrants under the standard QST registration regime, Non-Resident Suppliers registered under the SRS will not be entitled to claim input tax refunds in respect of QST paid on property and services acquired in the course of their commercial activities. The proposed legislation permits reporting and remitting in prescribed foreign currency and includes penalties for specified Québec consumers who provide false information to Non-Resident Suppliers to evade payment of QST. In addition to E-Commerce Supplies, Non-Resident Suppliers located in Canada also will be required to register under the SRS and collect QST on supplies of "corporeal moveable property" (i.e., tangible property) made to specified Québec consumers.

## Implementation of Changes

According to the Budget, the SRS will become effective January 1, 2019 for foreign Non-Resident Suppliers and September 1, 2019 for Canadian Non-Resident Suppliers. The Budget specifically acknowledges that major international suppliers of E-Commerce Supplies have "demonstrated a willingness to comply" with similar measures introduced in other jurisdictions and therefore the government expects compliance with the SRS. The Budget states that during the 12-month period following the effective date of the SRS, Revenu Québec will adopt "a practical approach to compliance" and will not impose penalties on Non-Resident Suppliers who have shown that they have taken reasonable measures to meet their new obligations. Existing Québec legislation makes not registering for the QST (where required to do so) an offence for which the guilty person is liable to a fine of up to 25,000 Canadian Dollars per such offence. It appears that Non-Resident Suppliers required to register under the SRS will also be subject to this offence provision.

The authority responsible for administering the QST, Revenu Québec, is in the process of designing an online portal for use by Non-Resident Suppliers to comply with their obligations under the SRS.

## Possible Constitutional Issues

As noted above, this proposed legislation demonstrates Québec's intention to unilaterally move forward with registration and collection requirements in respect of Non-Resident Suppliers of E-Commerce Supplies without corresponding requirements from the federal government for the federal GST/HST. This may

raise constitutional issues as provincial powers with respect to taxation and property are limited to being "within the province" and thus might arguably exclude the ability to impose and enforce registration and collection obligations on non-residents. The approach also may be inconsistent with Québec's Tax Coordination Agreement with the federal government, which requires that the QST be administered in a manner that produces identical results to the GST/HST.

## Developments at the Federal Level

On April 26, 2018, the Canadian House of Commons Standing Committee on International Trade released a report recommending that the GST/HST apply to tangible and intangible property sold in Canada by foreign sellers, including sales through digital platforms.

While the report is from a committee that is composed primarily of Members of Parliament of the Liberal party – which is the party that holds the majority of seats in the House of Commons and thus, effectively controls the federal legislative agenda – the committee operates outside of the Canadian Cabinet and Department of Finance. The report is inconsistent with previous statements from Prime Minister (and Liberal Party leader) Justin Trudeau, which have generally rejected the idea of requiring Non-Resident Suppliers without a physical presence in Canada to collect GST/HST on E-Commerce Supplies.

In response to the report, the Minister of Finance stated that the federal government is working with other countries around the world on these issues, noting that the OECD has been looking at how countries can coordinate their tax approach for large digital companies, and that the government is expecting a further report in the next year to year and a half "that will inform us on how we can do it together collaboratively to make sure that we do tax these organizations appropriately."

Although these developments at the federal level do not suggest an imminent change to the status quo, the discourse from the federal government appears to be shifting toward an openness to changes to the current tax regime in Canada that would see GST/HST remitted on a broader base of supplies purchased online by Canadian consumers.

Further, the federal government and other provinces that impose their own sales taxes will presumably be keeping a close eye on the upcoming changes in Québec, and could use those changes as a model for implementing similar changes to the federal GST/HST and provincial sales taxes. Accordingly, Non-Resident Suppliers affected by Québec's proposed legislation should pay close attention to its details as well as to the ultimate logistics surrounding the ultimate operation of the SRS.

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## Texas Tax Amnesty Program Runs Through June 29th

On May 1, 2018, the Texas Comptroller of Public Accounts (the "Comptroller") began its first tax amnesty program in six years. The Texas Tax Amnesty Program (the "Program") runs from May 1, 2018 to June 29, 2018 and covers all state and local taxes and fees administered by the Comptroller, including Texas franchise tax and sales/use taxes. The Program applies to all tax reports originally due before January 1, 2018, and is designed to allow participants who are not under audit and have not been notified of an audit to "wipe the slate clean" by filing all past due reports or by amending reports that underreported taxes. Program participants benefit from a 100% waiver of both penalties and interest.

Failure to participate in the Program could result in assessment of taxes, fees, penalties, and interest to the extent a taxpayer is later discovered through audit. Fortunately, unlike certain "carrot and stick" amnesty programs offered by other states in the past, there are no additional penalties specifically designed to punish eligible taxpayers for not participating in the Program. Taxpayers with potential outstanding Texas tax liabilities are encouraged to carefully review their state tax compliance obligations and, if necessary, take advantage of the Program before it ends on June 29, 2018.

For more discussion and insight on the Texas Tax Amnesty Program, please see the SALT Savvy blog post from May 2, 2018, *Texas Tax Amnesty Program Kicks Off May 1st*, available at www.saltsavvy.com.

***By: Stephen Long, Dallas and Drew Hemmings, Chicago***

## Asia Pacific Tax News and Developments: Malaysian Tax Administration Reaction to BEPS

As tax administrations worldwide continue to scrutinize and focus on tax structures implemented by multinational companies, the Malaysian tax administration has also stepped up efforts to ensure that Malaysian tax laws and enforcement are keeping pace with international tax developments. Malaysia has also signed on as a member of the Inclusive Framework of the implementation of the OECD Base Erosion and Profit Shifting ("**BEPS**") action plans. US corporations with businesses in Malaysia may be kept abreast of the latest tax developments by following Baker McKenzie's quarterly tax newsletter and BEPS newsletter series, which provide timely and business-driven updates on changes

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and developments to the Malaysian tax regime affecting multinationals operating in Malaysia. For a more detailed discussion, please see recent publications *Malaysia - BEPS newsletter Series 3* (Distributed June 2018) and Tax Newsletter Volume 1 (Distributed April 2018). Also available at www.bakermckenzie.com/tax.

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