

AN ALERT FROM THE BDO FEDERAL TAX PRACTICE

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SUBJECT

RECENT EXECUTIVE ACTIONS BY TRUMP ADMINISTRATION CAST DOUBT ON TAX REGULATIONS IMPACTING ASSET MANAGEMENT INDUSTRY

SUMMARY

On January 20, 2017, the White House chief of staff communicated President Trump's plan for managing the federal process at the outset of his administration. As part of this plan, the president's appointees or designees are to be provided with sufficient time to review pending regulations. In order to provide sufficient time to complete their review, the Administration requested that pending federal regulations be postponed. Tax regulations covered by the request are effectively frozen and subject to change or withdrawal.

On January 30, 2017, President Trump issued an executive order intended to reduce overall government regulation. Pursuant to this executive order, executive departments and agencies are required to identify at least two existing regulations to be repealed prior to the issuance of a new regulation. The executive order also imposes annual limitations on the incremental costs of new regulations.

The breadth of the regulatory request and executive order is not yet clear. It is therefore unknown if guidelines are limited to Treasury Regulations published in the Federal Register or other regulatory guidance such as Revenue Rulings, Revenue Procedures, and Notices.

A number of tax regulation projects may be impacted by these developments. Particularly relevant to the asset management industry are proposed regulations under the new uniform partnership audit rules and dividend equivalent withholding regulations under Section 871(m) of the Treasury Regulations. These regulation projects are described below.

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DETAILS

Partnership Audit Rules

The Bipartisan Budget Act of 2015 included provisions that fundamentally alter the manner in which partnerships, such as hedge funds and private equity funds, are audited by the IRS. The so-called “TEFRA” rules were replaced with a regime that allows the IRS to make assessments at the partnership level, subject to certain elections to either opt out of the law or push out the assessments to partners. The law is scheduled to be effective for tax years beginning in 2018. There are many complexities and unresolved issues with the law, some of which the asset management industry was hoping would be clarified through technical corrections and regulations. These issues include:

- ▶ Determining whether funds will be required to create ASC 740 (FIN 48) reserves for positions that were previously partner-level as opposed to fund-level – e.g., wash sales;
- ▶ Determining who will be the “partnership representative” for non-U.S. fund managers;
- ▶ Determining how much pressure fund managers will receive from investors to make the opt-out and/or push-out elections;
- ▶ Determining how the push-out election will work in tiered arrangements, such as master-feeder structures; and
- ▶ Adopting and implementing the rules in the States.

The IRS had published regulations on January 24, 2017, but subsequently withdrew them pursuant to the January 20, 2017, freeze order.

Dividend Equivalent Withholding

Over the past decade, Congress and the Treasury Department repeatedly expressed concern over perceived abuses by foreign investors' use of swap contracts and other derivatives to avoid U.S. withholding on dividend income from investments in U.S. stocks. In 2010, Congress enacted Section 871(m) to require U.S. withholding, in certain circumstances, on “dividend equivalents” from “specified” notional principal contracts, as well as “equity linked instruments.” Compliance with these rules is highly complex and costly to the banking and asset management industries.

On President Obama’s last day in office, the IRS released regulations that provide guidance on the rules. Despite the fact that the Section 871(m) regulations were officially published on January 24, 2017, after the January 20, 2017, freeze order, the IRS did not withdraw them. The IRS released a statement indicating that the regulations were approved by the Office of Management and Budget. However, it is unclear whether the IRS received approval from the administration for this action in accordance with the freeze order. It is possible that the IRS may need to withdraw them in the near future.

BDO INSIGHTS

The above regulations may remain in a state of limbo until President Trump assembles a team of tax policy officials that will give direction to the Treasury Department and IRS. There are also larger questions of tax reform and whether the Partnership Audit Rules and Dividend Equivalent Withholding Rules will be targeted for repeal in connection with that reform or other actions of the Trump administration.

BDO's Asset Management team will continue to monitor these issues and keep our clients apprised of future developments.

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