

RFA, PRA Changes Followed Subpart F High-Tax Regs OIRA Review

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Eleventh-hour changes to the preamble of the subpart F high-tax exception proposed regs may illustrate an IRS grappling with what and how much information to disclose under the Regulatory

Flexibility Act (RFA) and Paperwork Reduction Act (PRA).

Tax Notes obtained draft versions of the [proposed regs](#) on the subpart F high-tax exception and the [final regs](#) on the global intangible low-taxed income high-tax exclusion that were sent to the Office of Management and Budget's Office of Information and Regulatory Affairs for review before publication. It compared those with the versions of the regs that were published to discover what changes had been made.

Under the RFA section, the draft version of the proposed regs included significant detail about controlled foreign corporation ownership broken down by gross receipts size class. The data was pulled from the 2017 Statistics of Income sample for Forms 1120, "U.S. Corporation Income Tax Return." According to a previously included table, 9.3 percent of businesses with gross receipts between \$20 million and \$30 million had a CFC — a percentage that dropped for those with less gross receipts. That information was omitted in the final published version.

Data on the number of small entities that file Form 5471, "Information Return of U.S. Persons With Respect to Certain Foreign Corporations," were also included in the draft version but are absent from the final version. According to those numbers, in 2017 almost 19,000 small entities, defined as those with gross receipts under \$25 million, filed Form 5471.

"Because it takes significant resources and investment for a business to operate outside of the United States in corporate form, and in particular to own a CFC, the owners of such businesses will infrequently be domestic small business entities," the draft preamble said. "Moreover, only about 46 percent of all U.S. shareholders of CFCs are small business entities. . . . Consequently, the Treasury Department and the IRS project that the proposed regulations are unlikely to affect a substantial number of domestic small business entities, however adequate data are not available at this time to certify that a substantial number of small entities would be unaffected."

Having removed a lot of detail, the final version of the regs nevertheless reaches the same conclusion as the draft version that there will not be a significant economic impact on a substantial number of small entities.

“The proposed regulations are elective, and small entities will likely not avail of the election unless the net benefits in terms of tax liability and any consequent compliance costs are positive,” the added language in the final version states. « [

This is not the first time that OIRA review has resulted in substantive modifications to the RFA section of an international tax reg's preamble. Proposed and final hybrid regs also [significantly altered that section](#). In those cases, however, the preambles ended up offering a more detailed explanation of why small businesses would not be affected by the rules when compared with the draft versions.

PRA Burdens

Both the PRA and RFA are designed with small businesses in mind. Under the RFA, an agency is required to perform an initial and final regulatory flexibility analysis when issuing proposed and final regs. The final analysis, under 5 U.S.C. section 604, must include a statement on the significant issues raised by public comments, a description of the number of small entities to which the rule will apply and their projected reporting and compliance requirements, and a description of the steps that the agency has taken to minimize the economic impact on small entities. There is an exception to the analysis if the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities.

The PRA's purpose is to minimize the paperwork burden for many entities, including small businesses.

For the PRA section, following OIRA review, the regs added a discussion on the reporting burden under prop. reg. section 1.954-1(d)(6)(vii)(A), related to the substantiation requirements, on which comments from the public are “strongly encouraged.”

The final version also added the estimated annual reporting burden of 10 hours each from an estimated 30,000 respondents.

In explaining the PRA estimate of burdens imposed on taxpayers, the draft version included language stating that an estimate was based on taxpayer type rather than a provision-specific basis

because the former “captures burdens related to collections of information that are related to statutory changes, as well as collections of information related to rules issued by the Treasury Department and the IRS under their discretionary authority to issue regulations.” That language was removed in the final version in favor of the terser description that it “most accurately reflects taxpayers’ interactions with the forms.”

Several changes were also made to the final regs on the RFA and PRA sections following the OIRA review process, although they are less significant than the alterations made to the proposed regs. The conclusion in the final regs that the guidance would not have a significant impact on a substantial number of small entities remained unchanged following the review.

Final regs (T.D. 9902) were released July 20 along with new proposed regs (REG-127732-19) under section 954(b)(4) related to high-taxed subpart F income. The rules follow up on proposed GILTI regs (REG-101828-19) released in June 2019. The new guidance seeks to eliminate the disparity between the elections, provides for a single election to exclude high-taxed income, and looks to avoid any incentive that taxpayers may have to plan into using the subpart F exception. While taxpayers had asked for conformity between the rules, practitioners were surprised when the subpart F rules were aligned with GILTI instead of vice versa.

The GILTI high-tax exclusion allows domestic shareholders of a CFC to elect to exclude from gross tested income amounts taxed at 18.9 percent. The proposed regs on the subpart F high-tax exception would modify decades-old rules for the sake of harmonization with GILTI.

Addressing the final regs, American Citizens Abroad previously expressed disappointment at the IRS’s attempts to brush off the requirements of the RFA by stating that the data needed was not available and that taxpayers could simply choose not to apply the election.

Both the RFA and PRA are the subjects of litigation in two cases now before the U.S. District Court for the District of Columbia, in which a taxpayer has challenged both the GILTI regs and the transition tax regs for violating the statutory protections provided for small businesses.