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August 2018

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While members of Congress traditionally have the month of August off to spend time in their districts and states, August 2018 will unfold a bit differently. The House of Representatives will be out for the full month, but the Senate will not. In June, Senate Majority Leader Mitch McConnell (R-KY) announced that he was canceling all but one week of the August recess.

The move comes as Leader McConnell seeks to address a host of outstanding issues before the Senate. One key priority agenda item will be appropriations. The Senate already approved a package of spending bills—a “minibus”—for Energy-Water, Legislative Branch and Military Construction-Veterans Affairs, sending the appropriations measures to a conference committee with the House. Last week, the Senate disposed of a second minibuss, this one containing appropriations for Interior, Financial Services, Agriculture, and Transportation-Housing and Urban Development. Later in August, the Senate is expected to take up a third minibuss package containing appropriations for Defense and Labor-Health and Human Services.

The relative ease with which the minibuss packages have passed in the Senate is a credit to the bipartisan agreement by Appropriations Chairman Richard Shelby (R-AL) and Ranking Member Patrick Leahy (D-VT) to avoid contentious policy riders being attached to spending measures. This has allowed the Senate to pass seven of the 12 annual appropriations bills with little challenge.

Beyond appropriations, the Senate has quite a few other items that it could address during August. Senators could take action on the Water Resources Development Act reauthorization and/or possibly a package of opioids bills. The Senate also named its conferees to the Farm Bill conference, so work on the final version of the Farm Bill will also be a priority.

In addition to the busy legislative agenda, the Senate will also continue to consider executive and judicial nominations. Chief among these will be the marquee judicial confirmation battle over Judge Brett Kavanaugh to serve as an Associate Justice on the Supreme Court. Nominated by President Trump on July 9, Judge Kavanaugh currently sits on the D.C. Circuit of Appeals. The timing around Judge Kavanaugh’s confirmation hearing remains in flux, but Senate Judiciary Chairman Chuck Grassley announced on August 1 that the hearings are likely to begin in September, with a final vote on confirmation coming in October.

The flurry of activity in the Senate stands in stark contrast to the lack of legislative action that traditionally defines the late summer and fall of an election year. For the Senate, the uptick in activity shows a concerted, cross-party effort to legislate during the coming months and pass bipartisan measures in concert with the House.

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ADMINISTRATION TAKES FURTHER STEPS ON DRUG PRICING

Following up on the release of the President's drug-pricing blueprint in May, the administration in recent weeks has taken a number of actions to address high prescription drug prices. President Trump himself called out several pharmaceutical manufacturers by name on Twitter, criticizing them for recent drug price increases. He later thanked some of them after the companies decided to postpone scheduled price hikes. Department of Health and Human Services (HHS) Secretary Alex Azar has also weighed in, praising another company's decision to reduce prices on some of its products.

On July 19, the Food and Drug Administration (FDA) announced that it would be forming a working group to explore the possibility of drug importation when a sole-source, off-patent drug experiences a significant price increase. While FDA emphasized that such importation would be limited and temporary, the announcement was surprising, given Secretary Azar's previous criticism of importation proposals. FDA also released a Biosimilar Action Plan, expanding on initiatives to promote biosimilar development and competition. In remarks on the plan, FDA Commissioner Scott Gottlieb criticized "rebating schemes or patent thickets that are purely designed to deter the entry of biosimilars."

The Centers for Medicare and Medicaid Services is also taking steps on drug pricing, issuing a July 24 memo to Medicare Part D plans outlining ways they can encourage utilization of low-cost generics. In its calendar year 2019 Physician Fee Schedule Proposed Rule released on July 12, the agency included a proposal that would change how Medicare pays for Part B drugs by reducing the wholesale acquisition cost add-on payment from six percent to three percent, effective January 1, 2019. The Trump administration opined that this policy, which would pay physicians three percent less to administer new drugs, would curb high drug-spending while aligning payments and drug acquisition costs, particularly for drugs entering the marketplace with high launch prices.

Finally, the Office of Management and Budget is now reviewing an HHS Office of Inspector General proposed rule that would both eliminate and create new safe harbor protections related to drug rebates for pharmacy benefit managers. Commissioner Gottlieb and Secretary Azar have both discussed the possibility of reexamining the safe harbors for drug rebates.

More agency action should be expected this year as the administration endeavors to demonstrate its commitment to advancing the President's blueprint. Congress also continues to debate drug pricing proposals as it considers fiscal year 2019 appropriations bills and other pending legislation.

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TAX REFORM IMPLEMENTATION GUIDANCE RELEASED

The Department of the Treasury and the Internal Revenue Service (IRS) are hard at work churning out guidance implementing the Tax Cuts and Jobs Act (TCJA, P.L. 115-87).

Transition Tax

Rules around the Section 965 one-time transition tax on deferred income of foreign affiliates were first out of the chute, which makes sense given that it impacts the 2017 tax year. Following the release of three notices ([Notice 2018-7](#), [Notice 2018-13](#) and [Notice 2018-26](#)), Rev. Proc. 2018-17 and a series of Frequently Asked Questions, Treasury issued a 249-page package of proposed regulations on August 1. In addition to providing definitions of elements critical to calculating the transition tax, such as “cash position,” the regulations contain rules disregarding transactions designed to reduce the amount of tax due, rules with respect to foreign tax credits and affiliated groups, and rules regarding elections and payments (among other topics). Businesses should review the regulations with haste, since the clock is ticking on the 60-day comment period. In the meantime, it is likely that a hearing will be requested so that taxpayers have a chance to present publicly their suggested changes to Treasury and IRS officials in person. Given the numerous complex issues raised by the transition tax—and the number of dollars at stake—it may take several months before final regulations are issued.

Bonus Depreciation

Rules implementing the TCJA's new “full expensing” provision under Section 168(k) were released on August 3, after OMB waived its review of the proposed regulations. Among other things, the guidance covered rules around the new application of bonus depreciation to used property, the effect of the statute's retroactive application date to existing contracts and self-created property, and the interaction of the expanded rules in regard to partnerships. However, one of the main issues on which taxpayers have been seeking clarity was not addressed in the proposed regs, which was a drafting error in the law that bars retailers and restaurants from using full expensing when making interior renovations. While the error is on Congress' radar—Sens. Toomey and Thune called for an expeditious fix to the issue in a late July Finance Committee hearing—it is something that will likely have to be fixed through the legislative process.

199A (Pass-through Deduction)

Despite Treasury Assistant Secretary David Kautter saying in June that pass-through deduction regulations could be out “within a couple of weeks,” practitioners are still awaiting the first cut on proposed regulations for the new deduction. They should not have to wait too much longer since “guidance on computations necessary in computing the deduction” was submitted by Treasury to the Office of Information and Regulatory Affairs (OIRA) for review on July 23. This will be the first of three packages of guidance expected on 199A, with the others being centered around “definitional” and “anti-abuse” rules. Among other items, practitioners are hoping that Treasury guidance fleshes out how the 199A calculation works when a taxpayer has multiple businesses, or a single business with multiple sources of income, and further expands on the definition of a “qualified trade or business” and a “specified service trade or business.”

Interest Expense

Preliminary guidance has also been issued on the Section 163(j) limit on the deductibility of net interest expense in excess of 30 percent of pretax earnings for certain businesses. Notice 2018-28 said coming regulations will address, among other things, how the limitation is calculated at the consolidated group level and how partners will not be allowed to interpret Section 163(j) in a way that would double-count a partnership's interest income. However, the American Institute of CPAs and the Tax Executives Institute, among others, are pressing for more detailed guidance on tricky issues, including to what extent excess

interest expense deduction capacity can be passed from a partnership up a tier to corporate owner. Given that the Section 163(j) regulations have not yet been submitted to OIRA, they will be issued after the aforementioned rules, but they are not expected to follow too far behind.

Global Intangible Low-Taxed Income (GILTI)/Foreign Derived Intangible Income (FDII)

Most practitioner focus around the TCJA's new GILTI provision has been on how expenses are going to be allocated to the new GILTI foreign tax credit basket in Section 904. Depending on Treasury's foreign tax credit guidance, GILTI rates could effectively be dramatically higher than the 13.125 percent advertised in the TCJA's Conference Committee report. It is expected that Treasury will release guidance related to GILTI in multiple tranches: a first package as soon as September dealing with computational issues inside of 951A, and then a second package later in the fall dealing with foreign tax credit issues. The guidance on GILTI's domestic counterpart, the FDII deduction, is on a slower timetable and is not expected until later this fall. Taxpayers have asked for further guidance on what qualifies as "foreign use" under the statute, as well as further clarification of how expenses are going to be allocated and apportioned to "foreign-derived" income.

Base Erosion and Anti-Abuse Tax (BEAT)

Rules implementing the TCJA's new BEAT will likely bring up the rear of TCJA rulemaking in 2018, with regulations not expected until the late fall. The BEAT basically acts as a 10 percent minimum tax with "base erosion payments" (i.e., non-cost of goods sold payments to foreign related parties) being added back as a preference item. Practitioners are hoping for guidance around the definition of "applicable taxpayer" (i.e., whether the BEAT calculation is to be made at the consolidated or aggregate level) as well as clarity around the term "base erosion payments" and any accompanying conduit or anticonduit rules, and enumerated exceptions, such as the "derivatives" and "service cost method" exceptions.

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DEVELOPMENTS IN THE CONTINUING TRADE WAR

Trade continues to be a very active area for the Trump administration, with developments on several fronts.

Progress on Trade Agreements

The North American Free Trade Agreement (NAFTA) is back in the spotlight as U.S. negotiators aim to reach a deal in principle by late August. The Trade Promotion Authority (TPA) rules under which it is being negotiated require a deal by then if it is to be signed before Mexican President-elect Andrés Manuel López Obrador takes office on December 1, which he has made clear is his strong preference. The administration is negotiating with Mexico in hopes of reaching a deal that Canada will join as well. Negotiators appear to be making significant progress, giving some in Washington optimism that a deal can be struck in time.

On July 25, U.K. Trade Minister Liam Fox announced an intention to begin formal negotiations of a U.S.-U.K. free trade agreement (FTA) the day after Brexit occurs. The United Kingdom is set to leave the European Union on March 29, 2019. In compliance with TPA rules, the Trump administration must notify Congress before the end of the year to begin negotiating a U.S.-U.K. FTA on March 30. In a July 26 senate hearing, Amb. Robert Lighthizer announced that possible FTAs are on the horizon with countries in East Asia and Sub-Saharan Africa.

While no FTA has been announced with the European Union, President Trump and EU Commission President Jean-Claude Juncker agreed to a trade “ceasefire” on auto tariffs and agreed to work toward eliminating tariffs and subsidies on other industrial goods. Tensions remain regarding whether future U.S.-EU trade discussions will address agriculture.

Japan, a member country of the Trans-Pacific Partnership (TPP), has ruled out a bilateral FTA with the United States at this time. However, high-level meetings between USTR Lighthizer and Japan’s Economic Revitalization Minister, Toshimitsu Motegi, are set for August 9 in Washington to discuss increasing “free, fair and reciprocal trade.” It is rumored that Japan may seek a tariff “truce” that is similar to the U.S.-EU deal. In a July 30 trade policy forum at the U.S. Chamber of Commerce, Secretary of State Mike Pompeo unveiled the contours of an economic plan to engage with the Indo-Pacific Region following the administration’s rejection of TPP. Although details are scant, the plan includes State Department and U.S. Agency for International Development-led programs to encourage public-private partnerships to develop digital infrastructure, regulatory policies and cybersecurity throughout the region.

Section 232

The use of Section 232 of the Trade Expansion Act of 1962 continues to be a concern for Congress. In a symbolic vote on July 11, the U.S. Senate passed a nonbinding/technically unenforceable measure that calls for Congress to have a role in issuing Section 232 tariffs. A similar measure was introduced in the House of Representatives before the August recess. On August 1, a group of bipartisan senators led by Sens. Rob Portman (R-OH), Joni Ernst (R-IA) and Doug Jones (D-AL) introduced the Trade Security Act of 2018. The legislation would delegate Section 232 authority to the Department of Defense and allow Congress to disapprove trade actions by passing a joint resolution of disapproval. Congressional concern over the use of Section 232 accelerated after the controversial launch of an investigation to determine the effects of imports of autos and auto parts on the national security of the United States. The Secretary of Commerce is expected to issue that report as early as this month.

The launch of yet another 232 investigation, this time into the effects of imports of uranium on the national security of the United States, was far less controversial. Several members of Congress—including Sens. John Barrasso (R-WY) and John Enzi (R-WY) and Reps. Steve Pearce (R-NM), Liz Cheney (R-WY), Vincente Gonzalez (D-TX), Doug Lamborn (R-CO), Paul Gosar (R-AZ) and Scott Tipton (R-CO)—welcomed the newly launched investigation. Public comments are due September 10.

China

The trade battle with China continues to heat up as the volley of tariffs and retaliatory tariffs continues. To date, the Office of the U.S. Trade Representative (USTR) has proposed three lists of tariffs against China. The first two lists cover \$50 billion of exports and have been matched with retaliatory tariffs. On July 17, the USTR proposed a third list covering \$200 billion of exports at a tariff rate of 10 percent. On August 1, President Trump directed Amb. Lighthizer to consider increasing the tariff rate from 10 percent to 25 percent. As a result, the public comment period for “List 3” has been extended until September 5. In a July 20 interview with CNBC, President Trump commented that he is willing to hit China with a total of \$500 billion in tariffs.

To combat China’s retaliatory tariffs directed at U.S. agriculture exports to China, the U.S. Department of Agriculture announced a \$12 billion aid package. Ironically, as Sens. Brian Schatz (D-HI) and Chris Coons (D-DE) pointed out in a late July hearing, the emergency funds will have to be borrowed from China. Amb. Lighthizer indicated at that same hearing that the trade conflict with China could take years to resolve.

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FOREIGN AFFAIRS: RUSSIA, NORTH KOREA AND CHINA UPDATES

Russia Summit Aftermath

The July 16 U.S.-Russia summit was immediately met with bipartisan criticism, especially from those who viewed President Trump's stance as overly accommodating to President Putin with regard to Russian election interference in 2016. House Minority Leader Nancy Pelosi called Trump's performance a "sad day for America," and Sen. Ed Markey (D-MA) blasted it as a "national embarrassment." On the other side of the aisle, Sen. Bob Corker (R-TN) claimed that the President made the United States "look like a pushover," and Sen. Tim Scott (R-SC) said that the day "was a step backwards." Although the President was quick to claim that the summit would lead to "big results," it is not clear what the two leaders actually discussed in terms of Russia's annexation of Crimea, its support for rebels in Ukraine and for the Assad regime in Syria, nerve agent poisonings in England and other contentious matters. Their meeting was private.

The Senate Foreign Relations Committee and the Senate Banking Committee announced plans to hold a series of Russia/sanctions-related hearings through August, but, because the House is already in recess, congressional action on Russia is effectively postponed until the fall. By then, any action will be handicapped by the partisan atmosphere surrounding midterm elections.

North Korea "Nothingburger?"

On the presidential campaign trail, Trump floated the idea of high-level diplomacy with North Korean leader Kim Jong Un over hamburgers. Ironically, some have critiqued developments in the period post-Singapore Summit and joint statement a lot of "nothingburger."

Since the Summit, there have been a few signs of progress. The major achievement has been an abatement in tension and cessation of nuclear/missile tests. Analyses of commercial satellite imagery taken on July 22 suggest the Democratic People's Republic of Korea (DPRK) may have taken steps to dismantle equipment at its Sohae Satellite Launching Station. Nevertheless, intelligence experts have pointed out that the equipment can be reconstituted quickly, if needed. On July 27, the 65th anniversary of the Korean War armistice, the DPRK met a promise to return what it says are the remains of 55 Americans killed during battle. While a positive step, it is only a drop in the bucket of what could be a many-years-long—and potentially costly—effort.

On the more concerning side, monitoring groups analyzing satellite imagery in early July suggested possible upgrades at North Korea nuclear enrichment sites since the Singapore Summit. At the end of the month, experts concluded the same, noting that North Korea continues to work on new missile construction. Moreover, sanctions against North Korea have begun to dissipate as neighboring powers no longer feel required to maintain "maximum pressure." Contrary to expectations, the momentum of the North Korea talks has seemed to stall, with no further statements by the DPRK regarding denuclearization, no establishment of joint working groups and no direct meeting between Kim Jong Un and Secretary of State Pompeo.

China's Airline Campaign Against Taiwan

Less than three weeks after the United States initiated a trade war by imposing steep tariffs on Chinese imports, and just ahead of a July 25 deadline, several major U.S. airlines agreed to the Chinese government's demand that they refer to Taiwan as a Chinese territory on their websites or face unspecified penalties. While Chinese officials applauded

the “positive developments,” Taiwan condemned the airline campaign, stating “Taiwan is Taiwan.” Although the U.S. State Department advised airlines to remain firm, that would be risky in a market in which roughly 549 million passengers in China took flights last year, compared with 184 million in 2007. In May, the Trump administration called China’s airplane campaign “Orwellian nonsense,” but, so far, Chinese officials have rejected requests from the White House to discuss the issue.

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ENDANGERED REGULATIONS FOR THREATENED SPECIES

On July 25, 2018, the U.S. Fish and Wildlife Service and the National Oceanic and Atmospheric Administration (collectively, the “Services”) published three proposed rules revising the Endangered Species Act (ESA). The first two impact Section 4, including a proposal to remove a “blanket rule” that affords threatened species the same protections as endangered ones. The third seeks to streamline a required consultation with the Services when an agency takes, funds or approves an action that may affect a listed species or its habitat. While these may well be a welcome change to those previously caught in the crosshairs of the ESA, if finalized, they will undoubtedly be hotly litigated.

The most controversial proposal would replace the presumption of protection for threatened species with determinations made on a “case-by-case” basis, with the stated intent of reducing regulatory burdens on farmers, ranchers and others as species recover. The proposal to modify Section 7 would change the way that interagency consultations are conducted, reducing the requirements for consultation with wildlife agencies and others prior to permitting oil and gas and logging operations. Of note, the Services seek input on whether to add deadlines on informal consultation and clarifying when consultations are not required. The Services are accepting comment on the proposals until September 24, 2018.

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