Taxation Law Section Newsletter

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Chair's Column

by Farah N. Ansari

This past year has been quite exciting for members of the NJSBA Taxation Law Section. The 2017 Tax Act has resulted in significant and comprehensive changes to many areas of federal income tax law. At the same time, various proposals put forward by Governor Phil Murphy and the New Jersey Legislature are anticipated to trigger additional state-level tax law changes, including S-1893 enacted on May 4, which is intended to preserve the deductibility of property taxes for federal income tax purposes. So, while tax lawyers are never at a loss for material on which to prepare articles and presentations, the recent changes have given us even more opportunities to put pen to paper and speak in front of colleagues and allied professionals.

The NJSBA provides an excellent platform for lawyers to not only meet and connect with other tax lawyers, but also to stay informed of recent developments, and educate, mentor and speak to each other about important issues arising in their practice. At the same time, participating in the section helps broaden one's business network.

There are many ways to become involved in the NJSBA Taxation Law Section. For example, the section has eight different committees, including state practice and international taxation, all of which are seeking new members. Each committee hosts its own meetings where continuing legal education credit is often provided. Section members also are encouraged and invited to speak at committee meetings and to submit articles for this newsletter.

All of this requires an investment of time, but with great professional reward.

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The opinions of the various authors contained within this issue should not be viewed as those of the Taxation Law Section or the New Jersey State Bar Association.

Tax Cuts and Jobs Act 2017—Provisions Relevant for International Taxpayers

by Patrick J. McCormick

The Tax Cuts and Jobs Act made significant modifications in the international realm, most directly to the treatment of United States shareholders of foreign corporations. The most discussed modification has been the implementation of a deduction for foreign-sourced dividends received by domestic corporations from specified 10-percent owned foreign corporations, a move that brings the United States closer to a territorial tax system. Deemed repatriation of deferred foreign income also is a part of the act, as are new rules targeting income generated by intangible assets. A summary of major provisions of the act relevant in the international context follows; a brief overview of macro-level rules for the taxation of international business transactions is provided first to contextualize the changes made.

Background on Taxation of International Transactions

Two general realms exist for international business activities and United States taxation of associated transactions: foreign entities with United States operations (inbound transactions) and United States entities with foreign operations (outbound transactions). Unlike United States-resident taxpayers, foreign entities with United States income are not taxed on their worldwide income; rather, they are taxed only on gains sourced to the United States. The two primary umbrellas under which U.S.-sourced income falls are income effectively connected with a United States trade or business (effectively connected income, commonly referenced as ECI) and fixed or determinable annual or periodic gains (FDAP income).

Generally, a foreign corporation engaged in trade or business within the United States during a taxable year is taxable on income effectively connected with the conduct of that trade or business. Neither the code nor the regulations specifically define what is considered a United States trade or business; however, under well-established case law, profit-oriented activities that are regular, substantial, and continuous constitute a trade or business. FDAP income can include interest, dividends, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodic gains, profits and income. Importantly, income that is effectively connected with a United States trade or business is classified as effectively connected rather than FDAP income (even if it falls under the scope of the FDAP rules). Of note, foreign entities conducting United States business activities through branch operations can also be subject to a branch profits tax.

Foreign corporations engaged in a United States trade or business are subject to the regular United States corporate tax, with deductions available to offset income (so long as a timely return is filed). Conversely, FDAP income is subject to a 30 percent gross-based tax, with no deductions available and tax generally required to be withheld by the payor. Statutory rules related to both ECI and FDAP income can be modified where a foreign entity is a resident of a country with which the United States maintains an income tax treaty.

The above rules regarding inbound transactions remain largely unchanged under the act. The international provisions of the act have a more direct impact on outbound transactions. Generally, United States-resident taxpayers are taxable on worldwide income from whatever source—whether from within the United States or outside the country's borders. Where a United States taxpayer conducts operations overseas through a foreign entity (*i.e.*, a foreign subsidiary), tax generally is not imposed by the United States until a "repatriation" of the income occurs to the United States taxpayer (usually by way of a dividend payment). Exceptions to this rule exist; one such exception is for Subpart F income, a concept with significant relevance in the realm of the act.

Subpart F of the Internal Revenue Code imposes a direct tax on a "U.S. shareholder" of a "controlled foreign

corporation" (CFC) as to certain earnings of the CFC. Subpart F essentially treats a U.S. shareholder of a CFC as if he or she actually received the *pro rata* share of the relevant earnings, regardless of whether receipt occurred. For Subpart F purposes, the term U.S. shareholder historically has encompassed United States persons (a United States citizen, resident, domestic partnership, domestic corporation, or any non-foreign estate or trust) owning at least 10 percent of the foreign corporation's voting stock (with changes to this definition under the act noted below). Such a foreign corporation is a CFC for a particular year if on any day during such year U.S. shareholders own more than 50 percent of total combined stock (measured either by voting power or value).

New Rules Under the Act: Deduction for Foreign-Sourced Dividends

New Section 245A of the code provides that, as to any dividend received from a specified 10-percent-owned foreign corporation by a domestic corporation that is a United States shareholder with respect to the foreign corporation, a deduction is permitted for the foreign-source portion of such dividend. A 'specified 10% owned foreign corporation' is any foreign corporation with respect to which any domestic corporation is a United States shareholder other than a passive foreign investment company that is not also a CFC. The foreign-sourced portion of any dividend is an amount that bears the same ratio to the dividend as the undistributed foreign earnings of the specified 10-percent-owned foreign corporation bears to the total undistributed earnings of that specified 10-percent-owned foreign corporation. In accordance with the committee report to the act, the dividend-received concept is to be interpreted broadly, with regulations expected to be forthcoming to further clarify what the term encompasses in this context.

While the Section 245A deduction will have enormous impact on transactions falling within its scope, it is important to clarify its application. The deduction is available only to C-corporations that are not registered investment companies or real estate investment trusts; the deduction is not available to non-corporate taxpayers. For non-covered taxpayers, the longstanding worldwide taxation system is unchanged by Section 245A's passage.

Additional limitations apply to the Section 245A deduction. No deduction is available for 'hybrid' dividends—dividends for which the foreign entity received a deduction or other tax benefit from a foreign country. The Section 245A deduction is available only for United States shareholders who have held shares of the foreign corporation for more than 365 days during a 731-day period beginning one year before the date on which the shares become ex-dividend with respect to the dividend. As one would expect, no foreign tax credit or deduction is permitted for dividends to which Section 245A is applicable.

Associated rules have been instituted under the act largely to facilitate and act in conjunction with Section 245A. The first relates to the sale of foreign corporations: Under amended Section 1248(j), where a sale or exchange of stock in a foreign corporation held for one year or more occurs after 2017, any amount received by the United States parent treated as a dividend for purposes of Section 1248 is also treated as a dividend for purposes of Section 245A. Under new Section 91(a), where a domestic corporation transfers substantially all of the assets of a foreign branch to a specified 10-percent-owned foreign corporation, the domestic corporation includes in its gross income the post-2017 net losses incurred by the foreign branch with respect to which a deduction was allowed.

Repatriation of Deferred Foreign Income

Modified Section 965(a) provides that Subpart F income of a foreign corporation is increased in the last year beginning before Jan. 1, 2018 by accumulated post-1986 deferred foreign income of the corporation determined as of either Nov. 2, 2017 or Dec. 31, 2017, (whichever is greater). The rate of tax on the inclusion amounts is 15.5 percent for cash and cash equivalents and eight percent for other assets. Importantly, this provision can apply to all parties classified as U.S. shareholders, not just United States corporations.

Repatriation was a long-speculated part of tax reform; proposals centered around voluntary repatriation incentivized by reduced tax rates (a repatriation holiday) and mandatory inclusion of accumulated earnings and profits (the deemed repatriation). The act adopts the latter approach; rather than permitting repatriation to occur if a taxpayer so chooses, the act creates an automatic recognition event for deferred earnings (even if those earnings are not actually repatriated). Given the shift to a more territorial system through Section 245A, the deemed repatriation approach permits

the United States to address previous earnings on which tax had been deferred under the prior system.

A few special rules should be noted in the deemed repatriation context. U.S. shareholders are permitted to pay the net tax liability over eight years, with eight percent of the net tax paid in each of the first five years, 15 percent in the sixth year, 20 percent in the seventh year, and 25 percent in the final year. Tax payment can be accelerated by the IRS where there is an addition to tax for a failure to make a payment, a liquidation or sale of substantially all the taxpayer's assets, a cessation of business by the taxpayer, or other similar circumstances. For S corporations that are U.S. shareholders, each shareholder of the S corporation can elect to defer payment of their liability until a triggering event occurs for the liability (with triggering events including cessation of S corporation status, cessation of the S corporation's activities, or a transfer of stock by the shareholder). A six-year statute of limitations is applicable to assessment of the deemed repatriation tax.

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

Rules have been added under the act intended to address income earned from the use of intangibles. These rules are designed to act in tandem with each other, incentivizing domestic entities to hold intangible assets in the United States rather than locating them in a foreign jurisdiction.

Under new Section 951A, each U.S. shareholder of a CFC must include in their current gross income the shareholder's share of global intangible low-taxed income (GILTI) of the CFC for the tax year. GILTI is defined as the excess of the shareholder's net CFC-tested income for the tax year over the shareholder's net deemed tangible income return for the tax year, with net CFC income generally encompassing the gross income of the CFC with certain exclusions (such as ECI). The net deemed tangible income return is the excess of 10 percent of the aggregate of the shareholder's share of the qualified business asset investment (QBAI, the average of the CFC's aggregate adjusted bases in specified tangible depreciable business property) of each CFC over the amount of interest expense taken into account in determining the shareholder's net CFC-tested income.

For U.S. shareholders, the GILTI regime essentially requires current inclusion of income (as a deemed dividend) that exceeds a 10 percent rate of return for tangible business assets of a CFC. For domestic corporations, GILTI is taxed at an effective 10.5 percent rate (after factoring in an available 50 percent deduction), with foreign tax credits available up to 80 percent of the amount of the income. Tax on individual U.S. shareholders is imposed at regular individual rates.

New Section 250 modifies rules for domestically held intangibles that generate income from serving overseas markets. Section 250 allows a deduction to domestic corporations in an amount equal to 37.5 percent of the foreign-derived intangible income (FDII) of the domestic corporation for the tax year. FDII is the amount that bears the same ratio to the corporation's deemed intangible income as its foreign-derived deduction eligible income bears to its deduction-eligible income. Deemed intangible income is the excess of the deduction-eligible income of the domestic corporation over the deemed tangible income return of the corporation, with the deemed tangible income return generally being an amount equal to 10 percent of the corporation's QBAI.

As with GILTI, FDII assumes a rate of return for tangible business assets, then taxes income over that expected rate of return at specified rates. For C corporations, FDII is taxed at an effective 13.125 percent rate (after application of the aforementioned 37.5 percent deduction), reducing the normal 21 percent tax rate that would otherwise apply to the domestic corporation's income.

Deduction amounts for both GILTI and FDII decrease in tax years beginning after 2025.

Additional Changes

A few additional changes have been made in the Subpart F realm. For Subpart F purposes, the term 'U.S. shareholder' is now expanded to include United States persons who own 10 percent or more of the total value of shares of all classes of stock of a foreign corporation. Previously, for Subpart F inclusion to exist, a foreign corporation was required to be a CFC for an uninterrupted period of 30 days or more during the tax year. That requirement has been eliminated.

A base erosion minimum tax has been created to prevent companies from 'stripping' earnings out of the United States through deductible payments to foreign affiliates. The tax applies both to deductible payments to foreign affiliates from domestic corporations and to foreign corporations with income effectively connected

to the United States. The base erosion minimum tax provision applies to corporations that have average annual gross receipts of at least $500 million for the three-year tax period ending with the preceding tax year.

The act codifies that, if a nonresident alien individual or foreign corporation owns an interest in a partnership that is engaged in any trade or business in the United States, any gain or loss on the sale or exchange of the interest is treated as effectively connected with the conduct of the trade or business (subject to certain limitations). This confirms the service's traditional view of inclusion, which recently had been challenged by a tax court decision (*Grecian Magnesite Mining, Industrial & Shipping Co., SA v. Com'r*, 149 T.C. No. 3 (2017)) holding that gain recognized by a nonresident alien partner on the redemption of a United States partnership interest was not taxable by the United States.

Adjustments have also been made in the context of foreign tax credits. The previous Section 902 deemed-paid credit for dividends received by domestic corporations from foreign corporations has been eliminated, given Section 245A's application. Additionally, Section 960 has been modified so that domestic corporations with Subpart F inclusions from a CFC are deemed to have paid the portion of the CFC's foreign income taxes that are attributable to that income. Under amended Section 904(d), a new foreign tax credit basket has been added for foreign branch income. ■

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Roundup of Significant Corporation Business Tax Cases and Developments in 2017

by Mitchell A. Newmark and Kara M. Kraman

Several significant developments involving the New Jersey corporation business tax (CBT) occurred in 2017. Perhaps most importantly, the New Jersey Tax Court decided several cases addressing CBT issues, including, but not limited to, apportionment, the validity of a regulation, nexus, the addback for intangible expenses, the application of the throw-out rule, and the CBT tax base. In addition, the Appellate Division (in an unpublished decision) affirmed a tax court decision regarding the division's improper application of the throw-out rule. Perhaps equally noteworthy is the fact that of the seven cases mentioned above, all but one was decided in favor of the taxpayer.

A discussion of each case, by topic, as well as a summary of several other notable 2017 New Jersey tax-related developments, follows below.

Apportionment—Calculation of the Factors

The tax court granted a taxpayer's partial summary judgment motion and concluded that the taxpayer did not have enough of an ownership interest in certain sale leaseback assets for the property to be included in its property fraction, or for imputed rental income from the property to be included in its sales fraction.[1]

The taxpayer, a Delaware corporation, engaged in a sale-leaseback transaction with NJ Transit for 843 buses that were located within and outside of New Jersey. The purpose of the transaction was for the taxpayer to retain the federal tax benefits of owning the buses, namely depreciation and amortization deductions, while NJ Transit operated and controlled the buses. On its CBT returns, the taxpayer included income, losses, and deductions relating to the buses in the computation of its entire net income. Further, the taxpayer included the buses in its computation of its property fraction, and imputed rental income from the buses in its sales fraction.

The Internal Revenue Service (IRS) subsequently audited the sale-leaseback transactions. The IRS determined that the taxpayer did not have the genuine attributes of an owner, and re-characterized the NJ Transit sale-leaseback transaction as a loan, which resulted in an increase in federal taxable income. The taxpayer reported its increase in federal taxable income to the director and adjusted its business allocation fractions accordingly. The director accepted the taxpayer's increased income, but rejected the taxpayer's adjustments to its business allocation fractions.

Citing the New Jersey Supreme Court's holding in *Reuben H. Donnelley Corp. v. Director, Division of Taxation*,[2] the tax court held that the buses should not be included in the taxpayer's property factor in a case where the taxpayer has no use for the buses (it is not a transportation company), and the sale-leaseback was entered into solely for the purpose of acquiring the tax benefits of the buses. In reaching its conclusion, the tax court also noted that under the leases, NJ Transit bore all of the risk of loss and had significant responsibilities with respect to the buses. For the same reasons, the tax court concluded that imputed rental income from the buses could not be included in the taxpayer's receipts factor.

Overreaching Regulation

The tax court struck down an amended regulation that disallowed a taxpayer from treating investments in flow-through entities as "other securities" for purposes of determining whether the taxpayer met a 90 percent investment asset test to qualify as an "investment company."[3, 4]

Manheim, a Delaware corporation, owned a 99 percent limited partnership interest in a partnership that was doing business in New Jersey. Manheim did not engage in any other income-producing business activities or own any assets other than its limited partnership interest. Manheim claimed investment company status, which the director denied based on its amended regulation. Manheim subsequently challenged the validity of the director's regulation.

Under the statute, an "investment company" includes any corporation whose business activities are at least

90 percent comprised of investing in "stocks, bonds, notes, mortgages, debentures, patents, patent rights and other securities."[5] The division's regulation,[6] amended in 2006, provided that the phrase "other securities" did not include interests in pass-through entities.

The tax court held that the amended regulation was invalid because the division exceeded its authority by promulgating a regulation that was inconsistent with the legislative intent behind the statute, which, by its plain language, included interests in other securities. The tax court also rejected the division's argument that it had discretionary authority under N.J. Stat. Ann. § 54:10A-10(a) to adjust the taxpayer's income by excluding its interest in the partnership operating in New Jersey as a means of preventing tax evasion. The court held that the division's discretionary authority, which allowed it to adjust improperly or inaccurately reported tax information, must be made on a taxpayer-by-taxpayer basis, and did not "grant...a far-reaching authority to issue regulations that exclude an entire class of taxpayers from receiving preferential treatment."

Nexus—Blurred Lines

The tax court ruled that an out-of-state corporate limited partner had nexus with New Jersey for CBT purposes as a result of its and its parent's commonly owned interest in two partnerships doing business in New Jersey.[7]

Preserve II, Inc., a foreign corporation, owned a 99 percent limited partnership interest in two partnerships doing business in New Jersey. The remaining one percent general partnership interests in those partnerships were indirectly owned by its parent. Pursuant to the CBT regulations, the ownership of a limited partnership interest in a partnership doing business in New Jersey by a foreign corporation that is not otherwise subject to the CBT will not cause that taxpayer to be subject to the CBT.[8] However, a foreign corporate limited partner of a partnership doing business in New Jersey will be subject to the CBT if, among other things, it "takes an active part in the control of the partnership business."[9]

After considering the facts and circumstances in the case, the tax court ruled that Preserve II was not a passive investor in the partnership business because Preserve II and the general partner were actively managed and controlled by the same individuals and "the lines between the partnerships...were completely blurred." As evidence of this, the tax court noted (among other things) that some of Preserve II's officers did not even know of the existence of Preserve II. Accordingly, the tax court held that Preserve II was subject to the CBT via the activities of the general partner and its lack of separation with Preserve II.

Since the tax court found that the lines between the general partner and the limited partner were completely blurred, it also determined that Preserve II was engaged in activity beyond mere passive investor activities, such that it was also not entitled to favorable "investment company" treatment.[10]

Addback of Intangible Expenses

On May 24, 2017, the tax court held that the director erred in determining that payments made by a subsidiary to its parent did not qualify for the "unreasonableness" exception to the addback to income for intangible expenses paid to related parties.[11]

BMC Software, Inc. is a Delaware company doing business in New Jersey, whose principal business is to create and develop computer software programs. BMC entered into a licensing agreement with its subsidiary, which granted the subsidiary a non-exclusive right to license, market and distribute the computer software programs developed and created by the parent. In exchange for the license, the subsidiary paid BMC a royalty equal to 55 percent of the revenue derived from the subsidiary's licensing of the software to third parties.

Under New Jersey law, a taxpayer must add back otherwise deductible intangible expenses when they are paid or incurred to a related member.[12] However, this rule does not apply in certain cases, including where such an adjustment is "unreasonable."[13]

BMC presented its arguments via summary judgment motion. Before addressing whether the 'unreasonable' exception to the addback applied, the tax court rejected BMC's argument that the payments were not for the license of intangible property at all, but were actually for the purchase of tangible personal property. In reaching its conclusion, the court relied on the "careful and skillful draftsmanship" of the license agreements themselves.

Once it had established the subsidiary's payments to BMC were for the license of intangible property, which were akin to royalties and could be subject to the intangible expense addback, the tax court held that the subsidiary did not have to add the payments back to income because it was entitled to the 'unreasonable' exception to the addback. The tax court determined that it would be unreasonable to require the subsidiary to

add the royalties back to its income because the license agreements were "barely different" than the licensing agreements between BMC and unrelated third parties. As further support for its conclusion, the tax court noted that the subsidiary had substantial business operations—several hundred employees and offices nationwide—and was not a mere shell entity created to shift income among its corporate affiliates.

Apportionment—Application of the Throw-Out Rule

The tax court held, in an unpublished (not precedential) decision, that the division could not apply the throw-out rule to a taxpayer's receipts that were attributable to states that could constitutionally tax the taxpayer's income by imposing a throwback rule.[14] During the relevant period, New Jersey had a "throw-out" rule in effect, under which sales made into foreign jurisdictions where a corporation was not subject to tax were excluded from the denominator of the sales factor. The throw-out rule has since been repealed.[15]

Elan Pharmaceuticals Inc. is a Delaware corporation that does business in New Jersey, as well as in several other states. Elan filed corporate income tax returns in New Jersey, as well as in five other states (California, Colorado, Delaware, Michigan and Tennessee) arising from the presence of inventory in the those states, and claimed P.L. 86-272 protection for the remaining states. On audit, the director removed the receipts attributable to all but the six states in which Elan had filed returns from the denominator, asserting that the remaining states lacked jurisdiction to tax Elan pursuant to P.L. 86-272.

The tax court held that the division's removal of those receipts was at odds with the New Jersey Supreme Court's decision in *Whirlpool Properties, Inc. v. Director, Division of Taxation*.[16] In *Whirlpool Properties*, the New Jersey Supreme Court held that New Jersey's throw-out rule was constitutional, as applied only "when the category of receipts that may be thrown out is limited to receipts that are not taxed by another state because the taxpayer does not have the requisite constitutional contacts with the state or because of congressional action such as P.L. 86-272."[17] The Supreme Court further held that the throw-out rule operates unconstitutionally where the excluded "receipts...are not taxed by another state because the state chooses not to impose an income tax."[18]

Further, the New Jersey Superior Court, Appellate Division and the tax court agreed with the authors in *Lorillard Licensing Company v. Director, Division of Taxation*,[19] that a decision to tax (or not to tax) by another state has no bearing on how the income is generated in New Jersey. The authors' wins in *Whirlpool Properties* and *Lorillard Licensing* established the standard for application of the throw-out rule in New Jersey, and although the throw-out rule has since been repealed, those decisions continue to bear fruit. In applying *Whirlpool Properties* and *Lorillard Licensing*, the tax court ruled that because the six origination states could have enacted throwback rules that would have captured the sales, those origin states could have taxed the sales but decided not to do so, and therefore the throwout rule could not apply.

In another case, the Appellate Division, in an unpublished (not precedential) decision, upheld the tax court's determination, including its determination that the director misapplied the throw-out rule in favor of the taxpayer, "substantially for the reasons expressed" in the tax court's opinion in *Toyota Motor Credit Corporation v. Director, Division of Taxation*.[20]

Toyota Motor Credit Corporation (Toyota Leasing) is a California corporation that operates a vehicle leasing business in New Jersey and elsewhere.

Like the tax court, the Appellate Division rejected the director's attempt to remove the taxpayer's receipts sourced to Nevada, South Dakota and Wyoming from the denominator of the receipts fraction for CBT purposes under the throw-out rule (which has since been repealed) based on the New Jersey Supreme Court's holding in *Whirlpool Properties, supra*.[21] Under *Whirlpool Properties* and *Lorillard Licensing*, only receipts that are not taxed because the other state lacks jurisdiction to tax may be thrown out. Receipts not taxed because another state chooses to not have a corporate income tax may not be thrown out.

For federal income tax purposes, Toyota Leasing deducts the cost of its leased vehicles during the time it owns the vehicles. The downward adjustment of the basis has the effect of increasing Toyota Leasing's gain at the time of sale. The Appellate Division agreed with the tax court that when calculating the net gain from the sale of capital assets for CBT purposes, the taxpayer could increase its federal basis in the capital assets (in this case leased automobiles) by the amount of the federal depreciation deductions that were unused for CBT purposes. The Appellate Division found that the language of the CBT Act and appellate precedent under the Gross

Income Tax Act established that there is a broad state tax policy against the assessment of tax on "phantom income" that would result from depreciation deductions used by the taxpayer for federal purposes, but which are not permitted to be used for New Jersey purposes.

Finally, like the tax court, the Appellate Division held that the plain language of the federal bonus depreciation decoupling statute[22] made it clear that it applied to all assets acquired after Sept. 10, 2001. To the extent the director's regulation purported to limit the decoupling amendment to assets acquired during taxable years beginning on or after Jan. 1, 2002, the Appellate Division determined it was invalid.

Tax Base

In an unpublished (not precedential) decision, the tax court unequivocally held that a taxpayer's tax base for CBT purposes should match its federal taxable income as reported on Line 29 of Form 1120-F.[23] In reaching its decision, the court relied heavily on its published decision in *IBM Corporation/Crestron Electronics, Inc. v. Director, Division of Taxation*,[24] in which the authors successfully argued that under the plain language of the statute, a taxpayer's entire net income (ENI) for CBT purposes is tied to its federal taxable income before net operating losses and special deductions (Line 28 of Form 1120).

Infosys Limited of India was a multinational corporation headquartered in India. For federal income tax purposes, Infosys's income was generally limited to its U.S. source income pursuant to a pre-filing agreement with the IRS and a United States/India tax treaty. On its original CBT returns, Infosys used its worldwide income as its CBT tax base. Infosys later amended its returns to exclude its worldwide income from its tax base, and instead use the federal income it reported on Line 29 of Form 1120-F as its CBT tax base.

Under New Jersey law, a corporation's tax base for CBT purposes is its ENI. ENI is defined under N.J. Stat. Ann. § 54:10A-4(k), which provides:

> [T]otal net income from all sources, whether within or without the United States, and shall include the gain derived from the employment of capital or labor, or from both combined, as well as profit gained through a sale or conversion of capital assets.
>
> For the purpose of this act, the amount of a taxpayer's entire net income shall be deemed prima facie to be equal in amount to the *taxable income, before net operating loss deduction and special deductions*, which the taxpayer is required to report...to the United States Treasury Department for the purpose of computing its federal income tax. (Emphasis added).

Infosys argued that the statutory language that deems a taxpayer's ENI for CBT purposes to be its "taxable income, before net operating loss deduction and special deductions" unambiguously tied its ENI to Line 29 of Form 1120-F, entitled "taxable income, before net operating loss deduction and special deductions." This is the same principle tying ENI to Line 28 of Form 1120 in IBM/Crestron. The division argued that the language in the first paragraph of the statute defining a taxpayer's ENI as its total net income "from all sources, whether within or without the United States," supported its position that Infosys's worldwide income must be added back to its federal tax base.

The tax court rejected the division's argument and held in favor of Infosys. Citing its decision in *IBM/Crestron*,[25] the tax court held that the statute "unequivocally couples a corporation's ENI for CBT purposes to its federal taxable income with limited exceptions," none of which were applicable in this case. The tax court also explicitly rejected the division's argument that its *IBM/Crestron* decision was undercut by its decision in *Toyota Motor Credit Corp. v. Director, Division of Taxation*,[26] holding that the cases were both distinguishable and reconcilable since *Toyota* was decided under a broad policy directive that prohibits the taxation of phantom income, whereas *IBM/Crestron* focused on the statutory language defining a taxpayer's ENI. The tax court also rejected the division's argument that it should be able to pierce through the U.S./India treaty in light of the express statutory language tying ENI to federal taxable income.

Other Developments

In addition to the cases discussed above, there were also several other notable developments in the CBT realm. On March 1, 2017, the division released the longawaited *New Jersey Manual of Audit Procedures*. The manual provides a comprehensive overview of the

procedures and guidelines available to the division for completing all types of audits (including CBT audits), as well as general guidance for audit staff and taxpayers.

On March 15, 2017, the division released *Technical Bulletin 80*, titled "Addback of Other States' Taxes." The bulletin generally provides that a tax is not required to be added back for CBT purposes if it is measured by the value of the taxpayer's assets or is akin to a property tax, excise tax, payroll tax or sales tax. It clarifies that for purposes of computing the CBT, the taxpayer is only required to add back any taxes paid to other states on or measured by profits or income, or business presence or activity.

Appointments

Although these moves did not technically occur in 2017, it should be mentioned that New Jersey Tax Court Presiding Judge Patrick DeAlmeida was elevated, effective Jan. 16, to be a judge of the New Jersey Superior Court, Appellate Division. Also effective Jan. 16, 2018, New Jersey Tax Court Judge Joseph Andresini was appointed presiding judge of the New Jersey Tax Court. ■

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Endnotes

1. *General Foods Credit Investors #3 Corp. v. Director, Division of Taxation*, Dkt. No. 01130-2015, 2017 N.J. Tax LEXIS 3 (Feb. 22, 2017).
2. 128 NJ 218 (1992).
3. An investment company's tax liability is limited to a measurement of 40 percent of entire net income and 40 percent of entire net worth. NJ Stat. Ann. § 54:10A-5(d).
4. *Manheim NJ Investments, Inc. v. Director, Division of Taxation*, Dkt. No. 015083-2014, 2017 NJ Tax LEXIS 5 (Feb. 27, 2017).
5. NJ Stat. Ann. § 54:10A-4(f).
6. NJ Admin. Code § 18:7-71.15(b).
7. *Preserve II, Inc. v. Director, Division of Taxation*, Dkt. Nos. 010921-2013, 010920-2013, and 010922-2013 2017 NJ Tax LEXIS 16 (Oct. 4, 2017).
8. NJ Admin. Code § 18:7-7.6.
9. *Id*.
10. For investment companies, tax liability is limited to a measurement of 40 percent of entire net income and 40 percent of entire net worth. NJ Stat. Ann. § 54:10A-5(d).
11. *BMC Software, Inc. v. Director, Division of Taxation*, Dkt. No. 000403-2012, 2017 NJ Tax LEXIS 9 (May 24, 2017).
12. NJ Stat. Ann. § 54:10A-4.4(a).
13. NJ Stat. Ann. § 54:10A-4.4(c)(1).
14. *Elan Pharmaceuticals, Inc. v. Director, Division of Taxation*, Dkt No. 010589-2010, 2017 NJ Tax Unpub. LEXIS 12 (Feb. 6, 2017).
15. The throw-out rule was repealed for tax periods beginning on or after July 1, 2010.
16. 208 NJ 141 (2011).
17. *Id*. at 172.
18. *Id*. at 172-173.
19. 2014 NJ Tax LEXIS 31 (2014), *aff'd*., 29 N.J. Tax 275 (App. Div. 2015), *cert. denied*, 226 N.J. 212, 141 A.3d 297 (2016).
20. 28 NJ Tax 96 (Aug. 1, 2014), *aff'd*, 2017 NJ Super. Unpub. LEXIS 2658 (App. Div., Oct. 23, 2017).
21. 208 NJ 141 (2011).
22. NJ Stat. Ann. § 54:10A-4(k)(12)(A).
23. *Infosys Limited of India, Inc. v. Director, Division of Taxation*, Dkt. No. 012060-2016, 2017 NJ Tax Unpub. LEXIS 72 (Nov. 28, 2017).
24. Dkt. Nos. 011630-2008 & 011795-2009, 2011 NJ Tax LEXIS 2 (Jan. 26, 2011).
25. *Supra*, note 22.
26. *Supra*, note 13.

Tax Reform from an Inbound Perspective —The BEAT

by James D. Sipple

The Tax Cuts and Jobs Act of 2017 added a new base erosion and anti-abuse tax or BEAT minimum tax (new IRC §59A). The act is the largest overhaul of the United States tax code in over 30 years. It targets U.S. tax-base erosion by imposing an additional tax liability on certain corporations that make 'base-erosion payments' to related foreign persons.

This provision did not receive the fanfare and hype of the reduced tax rates and the favorable cash repatriation provisions for U.S.-based corporations. It may, however, produce a significant tax impact on foreign corporations with income effectively connected with a U.S. trade or business, as well as some domestic corporations with significant foreign operations. There is an exception for corporations with average annual gross receipts of less than $500 million over the three preceding taxable years. The BEAT does not apply to S corporations, regulated investment companies, real estate investment trusts or individuals. If the total amount of deductions added back to compute modified taxable income is less than three percent of total deductions (two percent for certain banks and securities dealers) used in calculating taxable income, the BEAT does not apply.

The BEAT essentially is a minimum tax calculated on a base equal to the taxpayer's taxable income determined without regard to: 1) the tax benefits arising from base erosion payments, and 2) the base erosion percentage (BEP) of any net operating loss (NOL) allowed for the tax year. BEP means for any taxable year, the percentage determined by dividing the aggregate amount of base erosion tax benefits by the sum of the aggregate amount of all deductions (including base erosion deductions), and depreciation/amortization plus insurance payments taken into account under IRC §803(a)(1)(B) or IRC §832(b)(4)(A).

These and other adjustments are made to arrive at the corporation's modified taxable income. Modified taxable income is essentially regular taxable income calculated without the allowance of deductions for amounts paid or accrued to related foreign persons or depreciation or amortization deductions with respect to property acquired from related foreign persons.

The BEAT rate is five percent for tax years beginning in calendar year 2018, 10 percent for tax years beginning in 2019 through 2025, and 12.5 percent for tax years beginning after Dec. 31, 2025. Those BEAT rates increase by one percent for certain banks and securities dealers. The BEAT calculations generally are made on a group basis. As a result, the related-party payments, deductions, and income of affiliated domestic corporations are aggregated. Because the BEAT tax is a minimum tax, companies with high taxable income compared to their deductible payments to foreign affiliates may not be subject to the tax. Ignoring tax credits, the 10 percent BEAT tax will begin to apply when payments to foreign affiliates exceed taxable income by more than 10 percent.

The calculation of a corporation's modified taxable income is determined by adding back to taxable income current year deductions of payments to related foreign persons. Under the BEAT, a foreign person is related if it is treated as owning at least 25 percent of the stock of the taxpayer (by vote or value). Direct, indirect and constructive ownership are considered for purposes of the ownership tests under the BEAT.

Dividends paid to a related foreign party are not subject to the BEAT, since they are not deductible for U.S. tax purposes. Deductible expenses paid or accrued to a related foreign person generally include payments for services, interest, rents and royalties. An exception is provided for services that are eligible for the application of the services cost method under the IRC §482 regulations (the service regs.). For this exception to apply there should be no mark-up component on the service provided. In addition, costs of goods sold (COGS) are generally excluded from the definition of base erosion payments, and so, for example, a U.S. business that imports product for manufacturing and/or resale is

likely to be less effected by a company that pays for services. Effectively, there is an exception for COGS but there is no corresponding exception for cost of sales (*i.e.*, services purchased from a related foreign affiliate).

Deductible expenses paid to a controlled foreign corporation (CFC) are added back in calculating a taxpayer's modified taxable income, even if they are included in the taxpayer's income as Subpart F income. There is no offsetting provision for netting. If the payments to the CFC are significant, it may be advantageous to check the box on the CFC so it becomes a disregarded entity for U.S. tax purposes. The CFC would effectively become a branch of the U.S. corporation and, thus, avoid adding such payments in calculating modified taxable income.

As with payments to CFCs, the legislation does not expressly permit netting of payments if a U.S. company pays a foreign-related person a deductible amount and then charges another foreign-related person for a portion of that amount. Similarly, there is also no specific provision in the legislation for netting payments between a U.S. company and the same foreign-related person. It appears that the BEAT is applied on a gross basis regardless of any offsetting payments. If that is ultimately the case, the legislation can be construed as overreaching its objective of curtailing the erosion of the U.S. tax base through related-party payments. It is reasonable to assume that the U.S. tax base would not be eroded to the extent that a U.S. company and a CFC make offsetting interest payments to each other (*e.g.*, under a cash pooling arrangement). In this situation it would be appropriate to issue guidance to develop some reasonable netting approach to provide relief in situations not involving U.S.-base erosion.

If a base erosion payment is subject to full U.S. withholding tax when made, then it is not added back in computing modified taxable income. Similarly, if a base erosion payment is subject to a reduced U.S. withholding tax rate under a treaty, then the exclusion from modified taxable income is computed proportionately in comparison to the statutory U.S. withholding tax rate.

As noted above, there is no similar exception for cost of sales with respect to services as there is for COGS. It would be expected that the same rationale that supports an exception for COGS of a seller of physical goods would also support an exception for the cost of services provided to a service provider in a situation in which the services are subcontracted to a foreign affiliate (especially in situations in which the subcontracted fees are treated as reducing gross receipts under generally accepted accounting principles). It appears that guidance should be issued so the BEAT is evenly applied across all sectors, with a particular view to ensuring the services sector is not unduly disadvantaged.

Dividends from a foreign corporation for which a 100 percent dividends-received deduction is provided are not added back to regular taxable income in computing the BEAT. The 50 percent deduction for amounts included in income as global intangible low-taxed income (GILTI) is not added back as well.

Once modified taxable income is computed, a 10 percent rate is applied (five percent for 2018 and 12.5 percent for years beginning in 2025). This amount is compared with the regular tax liability of the taxpayer. For this purpose, regular tax liability is generally reduced by credits, including foreign tax credits that reduce U.S. taxes. An exception is provided for research and development (R&D) credits and 80 percent of certain other Section 38 credits. Regular tax liability is increased by the BEP of any NOL allowed under IRC §172 for the taxable year.

Again, this calculation is generally determined on a group basis, taking into account all corporations that would be considered a single employer under IRC §52(a). However, further guidance is needed to determine how to properly account for base erosion payments made by separate members of the same consolidated group.

If the above amount exceeds the regular tax liability (net of certain tax credits), then the excess amount is an additional tax imposed on the corporation. Unlike the former corporate alternative minimum tax provisions, there is no provision for a carryover of the BEAT as a reduction of regular tax liability in future years.

A domestic corporation with significant foreign tax credits might become subject to the BEAT, effectively losing the benefit of all or a portion of the credits. Since most income tax treaties require the United States to provide a foreign tax credit to eliminate double taxation of foreign source income, such a result may raise concerns with treaty partners.

Companies with BEAT tax exposure should review their tax situation to determine planning opportunities available to limit their exposure. It may be possible to restructure intercompany transactions so related party payments are made from foreign affiliates to the U.S., rather than from the U.S. to the foreign affili-

ate (subject to potential anti-abuse regulations). Some payments relating to sales of products in the U.S. might properly be accounted for under the inventory method as COGS, rather than as deductible payments. Payments included in COGS reduce BEAT-modified taxable income in the same manner as they reduce regular taxable income. A change of accounting method may be necessary, requiring IRS approval. Some payments to foreign affiliates for administrative services might properly be accounted for at cost, or with only a modest markup, and the cost portion of the payment may qualify for deduction from BEAT-modified taxable income. It may be desirable to restructure operations to cause more income to be subject to U.S. tax, as such additional income may have a low marginal tax rate when the effect of the BEAT tax is taken into account.

It should be noted that Congress has granted Treasury broad regulatory authority to issue regulations and other guidance to prevent the avoidance of the BEAT, including through the use of unrelated foreign persons.

With respect to information reporting, the law adds additional reporting related to BEAT under IRC §6038A, the current regime for Form 5472 reporting. While the specific requirements are not yet identified, reporting will include information that is necessary to determine the base erosion minimum tax amount, base erosion payments, and base erosion tax benefits for the tax year. Penalties related to this reporting have been increased from $10,000 to $25,000 per form.

The BEAT tax may be challenged internationally for favoring domestic companies over foreign companies in potential violation of the World Trade Organization (WTO) Agreement on Subsidies and Countervailing Measures or other international agreements. Regardless of the outcome of such a challenge, the BEAT is part of the U.S. tax law and must be dealt with until Congress changes the law.

The BEAT raises many issues that will require taxpayers to make reasoned interpretations of the law pending Treasury and IRS guidance. Guidance on the BEAT is expected later this year. ■

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Minimizing the Application of the Donor-Advised Fund Excise Tax on Taxable Distributions

by Peter J. Ulrich

The donor-advised fund rules of Section 4966 of the Internal Revenue Code of 1986 (IRC), as amended, can impose excise taxes on sponsoring tax-exempt organizations and their fund managers making distributions from scholarship or other types of grant-making funds if the donor who established the fund has too much control over the actual grants. Section 4966 itself outlines a statutory safe harbor to minimize the potential application of such excise taxes.

A Typical Fact Pattern: A Restricted Gift to Create a Fund

It is not unusual for a charitable organization classified as a public charity to request legal advice with respect to the creation of a scholarship fund or a fund to make grants that could potentially be made to individuals as opposed to other tax-exempt organizations. The donor will likely place certain restrictions on the use of principal and, in an effort to be involved, may request some level of participation in the grant-making process with respect to the potential beneficiaries of the created fund.

The New Jersey Uniform Prudent Management of Institutional Funds Act (UPMIFA)[1] addresses the management and investment by New Jersey nonprofits of institutional funds, which include restricted funds (characterized as endowment funds under UPMIFA). One section of UPMIFA addresses the conditions under which an organization can obtain a release of a restriction imposed by a gift instrument on the use or investment of an institutional fund.[2] Another section, although not mandating a written investment policy like that of New York State's version of UPMIFA, outlines applicable standards regarding management and investment of institutional funds.[3]

The client's accountant should be familiar with the Financial Accounting Standards Board's *Statement of Financial Accounting Standards* (*SFAS*) No. 117 addressing "Financial Statements of Not-for-Profit Organizations," now codified as *Not-for-Profit Entities (Topic 958)* under the *FASB Accounting Standards Codification*. These accounting rules require that three classes of net assets—permanently restricted, temporarily restricted, and unrestricted—be displayed in the statement of financial position (the balance sheet). These rules also require that the organization's net assets and its revenues, expenses, gains, and losses be classified based on the existence or absence of donor restrictions.

Perhaps most critically, however, the client needs to understand that when the funds are expended it may have some exposure to excise taxes under the donor-advised fund provisions of federal income tax law. Although these rules were adopted by Congress as part of the Pension Protection Act of 2006, no regulations under these rules have been issued.

Definition of a Donor-Advised Fund

A donor-advised fund is defined as a fund or account:

- which is separately identified by reference to contributions of a donor or donors;
- which is owned and controlled by a sponsoring organization; and
- with respect to which a donor (or any person appointed or designated by such donor (a donor advisor), has, or reasonably expects to have, advisory privileges with respect to the distribution or investment of the amounts held in such fund or account by reason of the donor's status as a donor.[4]

A sponsoring organization is defined under IRC Section 4966(d)(1) as a Section 170(c) organization[5] that is not a governmental organization (referenced in either Section 170(c)(1) or 170(c)(2)(A)) and not a private foundation, but which maintains one or more donor-advised funds.[6]

Excise Tax on Taxable Distributions

IRC Section 4966(c)(1) imposes a 20 percent excise tax on a sponsoring organization for each taxable distribution the sponsoring organization makes from

a donor-advised fund. It also imposes a five percent excise tax on the agreement of any fund manager of the sponsoring organization to the making of a distribution, knowing that it is a taxable distribution. A fund manager includes any officer, director, or trustee of the sponsoring organization and employees of the sponsoring organization having authority or responsibility with respect to an act or failure to act that knowingly triggers a taxable distribution.

In general, under IRC Section 4966(c), a taxable distribution is any distribution from a donor-advised fund to any natural person, or to any other person if: 1) the distribution is for any purpose other than one specified in Section 170(c)(2)(B), or 2) the sponsoring organization maintaining the donor-advised fund does not exercise expenditure responsibility with respect to such distribution in accordance with IRC Section 4945(h).[7]

To exercise expenditure responsibility under IRC Section 4945(h), a sponsoring organization is required to exert all reasonable efforts and to establish adequate procedures:

- to see that the grant is spent solely for the purpose for which made,
- to obtain full and complete reports from the grantee on how the funds are spent, and
- to make full and detailed reports with respect to such expenditures to the secretary.

The treasury regulations under Section 4945 provide detailed but practically helpful rules with respect to how to exercise expenditure responsibility with respect to grants to individuals and grants to organizations.[8]

Under IRC Section 4966(c)(2), a taxable distribution does *not* include a distribution from a donor-advised fund to:

- any organization described in Section 170(b)(1)(A) (other than a disqualified supporting organization);[9]
- the sponsoring organization of such donor-advised fund; or
- any other donor-advised fund.

Note that under both IRC Section 4966(c) defining a taxable distribution in general, and more specifically in the exception in Section 4966(c)(2)(A), if the grant is made directly to a tax-exempt public charity, it should not trigger the taxable distribution excise taxes of IRC Section 4966(c). Currently, without regulations on point,[10] it is not clear if a grant by a scholarship fund made directly to a university, college, or other school that the scholarship winner is attending would fall outside of the definition of a taxable distribution. But even if such an approach were available for scholarship grants for institutional studies, it is often not available for other types of grants to individuals.

Excise Tax on Prohibited Benefits

IRC Section 4967 imposes a separate draconian excise tax if a donor, donor advisor, or a person related to a donor or donor advisor of a donor-advised fund (as defined in IRC Sections 4967(d) and 4958(f)(7)) provides advice regarding a distribution that results in any such person receiving, directly or indirectly, a more than incidental benefit. This excise tax is equal to 125 percent of the benefit and is imposed on any person who advises regarding the distribution or who receives the benefit. A separate excise tax of 10 percent of the benefit may be imposed on a fund manager who agreed to the making of such a distribution.

Consistent with its heavy penalty, Section 4967 is intended to apply to egregious situations and should not become applicable in the normal course of charitable grant activities.

Minimizing Exposure to the Excise Tax on Taxable Expenditures

Critically, for all purposes under IRC Section 4966 and including the taxable expenditure excise taxes, and especially relevant to the subject fact pattern, pursuant to a safe harbor in Section 4966(d)(2)(B)(ii), the term donor-advised fund does not include a fund or account:

> with respect to which a donor (or any person appointed or designated by such donor) advises a sponsoring organization as to which individuals will receive grants for travel, study or other similar purposes if:
>
> (I) the donor's, or the donor advisor's, advisory privileges are performed exclusively by such person in the person's capacity as a member of a committee whose members are appointed by the sponsoring organization;
>
> (II) no combination of donors or donor advisors (or related persons) directly or indirectly control the committee; and
>
> (III) all grants are awarded on an objective and nondiscriminatory basis pursuant

to a procedure approved in advance by the sponsoring organization's board of directors, and such procedure is designed to ensure that all such grants meet the requirements of Code Section 4945(g)(1), (2) or (3).[11]

Complying with the Section 4966(d)(2)(B) Safe Harbor

A sponsoring organization that owns and controls a fund that would otherwise be a donor-advised fund and that establishes procedures to meet the expenditure responsibility rules of IRC Section 4945(g) and the Section 4966(d)(2)(B) safe harbor may make a grant or award a scholarship from the fund to a natural person without subjecting the sponsoring organization or its managers to the excise taxes imposed under new IRC Sections 4966 and 4967.

The sponsoring organization will need to make all grants pursuant to a written set of rules in compliance with expenditure responsibility rules of Treas. Reg. Section 53.4945-4(b). It will also need to establish a grant-making committee on which the donor sits, but which the donor does not control, directly or indirectly. The donor's advisory privileges (exercised by the donor or the donor's advisors) must be performed exclusively in such person's capacity as a member of the grant-making committee. The sponsoring organization must appoint all members of the grant-making committee.

To show that members of the grant-making committee are appointed consistent with these requirements, and that the donor does not excise the prohibited control over the committee, the method of appointing the grant-making committee should be in writing and it should be clear that at least a majority of the members of the committee are independent of the donor. Because the risk here is primarily with the sponsoring organization (and its officers and directors), which could be a community trust, there is little appetite by such organizations to take any compliance risks on these issues. One community trust this author has dealt with required the donor be one of six members of the grant-making committee—clearly not in a control position.

In this manner, the described sample fund would not be a donor-advised fund, which, given the 20 percent and five percent excise taxes on taxable distributions, and the potential 125 percent excise tax on prohibited benefits, is probably the simplest and most efficient approach. ■

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Endnotes

1. N.J.S.A. 15:18-15 *et seq.*
2. N.J.S.A. 15:18-30.
3. N.J.S.A. 15:18-27.
4. Code Section 4966(d)(2).
5. Section 170(c) organizations include a broad mix of tax-exempt charities, certain posts or organizations of war veterans and certain related entities, certain charitable funds of a domestic fraternal society, order, or association, operating under the lodge system, and certain cemetery companies.
6. Code Section 4966(d)(1).
7. Code Section 4966(c).
8. *See* Treas. Reg. §53.4945-4 with respect to grants to individuals and Treas. Reg. §53.4945-5 with respect to grants to organizations.
9. Under IRC Section 4966(d)(4), a disqualified supporting organization includes a Type III supporting organization that is not functionally integrated and any Type I, Type II, or functionally integrated Type III supporting organization where the donor or donor advisor (and any related parties) directly or indirectly controls a supported organization of the supporting organization. *See also* IRS Notice 2006-109, I.R.B. 2006-51 (Dec. 18, 2006).

10. The most recent guidance from the Department of the Treasury and the IRS on donor advised funds is Notice 2017-73 (Dec. 4, 2017). Notice 2017-73 addresses approaches that future proposed regulations may take with respect to: 1) treating distributions from a donor-advised fund used to pay for tickets that allows a donor or related person to attend a charity event as more than an incidental benefit and thus triggering an excise tax under IRC Section 4967; 2) characterizing distributions from a donor-advised fund that the distributee charity treats as fulfilling a pledge of the donor as not resulting in more than an incidental benefit under IRC Section 4967; and 3) treating distributions from a donor-advised fund as having been made by the donor, rather than the sponsoring organization, for purposes of applying the public support test rules under IRC Sections 170(b)(1)(A)(vi) and 509(a)(2) to avoid the potential for abuse.
11. IRC Section 4945(g) addresses certain restrictions on the making of individual grants by private foundations that if violated will subject the private foundation to the excise tax on taxable expenditures imposed by IRC Section 4945. Treas. Reg. Section 53.4945-4(b) provides relatively detailed expenditure responsibility rules regarding the procedures by which an organization should make individual grants in order for the organization to establish that the grants are made on an objective and nondiscriminatory basis.