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November 26, 2018

U.S. Department of the Treasury
1500 Pennsylvania Ave. NW
Washington, DC 20220

Internal Revenue Service
1111 Constitution Ave. NW
Washington, DC 20224

Via Online Submission

RE: Proposed Regulations Under Section 951A

Dear Sir or Madam:

On December 22, 2017, Public Law No. 115-97, colloquially known as the Tax Cuts & Jobs Act (the TCJA), was enacted into law. The TCJA represents the most sweeping change to the U.S. Internal Revenue Code (the Code) since the Tax Reform Act of 1986. The numerous additions and modifications to the Code require equally sweeping additions and modifications to the U.S. Treasury Regulations promulgated thereunder.

As part of these newly required regulations, on October 10, 2018, the U.S. Department of the Treasury (Treasury) and Internal Revenue Service (the Service) published in the Federal Register proposed regulations [REG-104390-18] under section 951A (the Proposed Regulations). The Proposed Regulations provide additional detail regarding the calculation of the amount of global intangible low-taxed income (GILTI) that U.S. shareholders of controlled foreign corporations (CFCs) must include in their taxable income in a particular year. Treasury and the Service solicited comments on the Proposed Regulations from interested parties no later than November 26, 2018. On behalf of Tax Executives Institute, Inc. (TEI), I am pleased to respond to the government's request for comments.

<u>TEI Background</u>

TEI was founded in 1944 to serve the needs of business tax professionals. Today, the organization has 57 chapters in North and South America, Europe, and Asia. As the preeminent association of in-house tax professionals worldwide, TEI has a significant interest in promoting tax policy, as well as the fair and efficient administration of the tax laws, at all

levels of government. Our nearly 7,000 individual members represent over 2,800 of the leading companies around the world.

TEI Comments

TEI commends the Service and Treasury for publishing the Proposed Regulations in a timely manner. The Proposed Regulations provide helpful interim guidance to assist taxpayers in managing their business affairs while maintaining compliance with the requirements of section 951A. While the interim guidance is appreciated, it appears the Service and Treasury have left to future guidance many important questions concerning the interaction of section 951A with the foreign tax credit. Considering this apparent decision, we only discuss below issues directly relevant to the Proposed Regulations.

Determination of Qualified Business Asset Investment and temporarily held property

When determining a taxpayer's U.S. shareholder's GILTI inclusion, it is necessary to determine the shareholder's qualified business asset investment (QBAI). For purposes of calculating QBAI, proposed regulation section 1.951A-3(h)(1) (the "temporarily held property rule") provides that temporarily held property acquired with "a principal purpose" of reducing a U.S. shareholder's GILTI inclusion will be disregarded for purposes of calculating a CFC's QBAI. For this purpose, any tangible property held by a CFC for less than a 12-month period that includes at least the close of one quarter during the CFC's taxable year is presumed to have been acquired with a principal purpose to reduce a U.S. shareholder's GILTI inclusion if it in fact does so (the "12-month presumption rule").

TEI recommends eliminating the 12-month presumption rule in final regulations. The rule would impose an immense compliance burden on U.S. taxpayers by requiring asset-by-asset tracking of ordinary course business transactions. Moreover, its retrospective nature creates financial statement volatility and compliance issues by potentially requiring amended returns for each taxable year merely to adjust after-the-fact QBAI calculations for non-abusive transactions. A general anti-abuse rule without an overbroad presumption should give the Service sufficient authority to police any perceived abusive transactions. If Treasury and the Service feel a per se rule remains necessary, the final regulations should at least provide an exemption for asset transfers between related CFCs.

The 12-month presumption rule is overbroad and creates compliance difficulties for taxpayers in its current form. TEI member companies engage in a wide variety of business-driven, ordinary course transactions that would be captured by this rule. The resulting compliance burden would be disproportionate to any perceived abuse, as in a vast majority of cases there is no "principal purpose" to reduce a taxpayer's GILTI inclusion. In addition, the proposed rule creates uncertainty regarding GILTI basis calculations for a full year after any property acquisition. This will cause financial statement volatility over the course of that 12-month holding period by requiring taxpayers who may sell such property within that period to correct their prior reporting. The 12-month presumption rule will also require taxpayers to file amended returns due to ordinary-course dispositions of tangible property acquired by a CFC late in a taxable year.

There are many non-tax business reasons why recently acquired tangible property would be transferred between a taxpayer's foreign entities. For example, property is often transferred to meet the changing needs of a developing business. An entity with less growth than anticipated may transfer recently-purchased manufacturing equipment or similar property to another CFC whose growth has exceeded projections. Alternatively, a single foreign entity may acquire large amounts of property to qualify for bulk sale discounts, store the property until needed, then transfer it to another CFC in the same or other jurisdictions. Many types of business property must be ordered from vendors well in advance of delivery. During that lag time, the business needs of various foreign entities will often change, in many cases because a particular business is growing at a different rate than anticipated. In none of these cases is a "principal purpose" of reducing a U.S. shareholder's GILTI inclusion present. The Proposed Regulations should not impose additional U.S. tax costs and – of greater concern for TEI members – financial statement volatility and compliance burdens for regular business decisions.

The 12-month presumption rule also would require asset-level tracking for CFC tangible property that has previously had little U.S. tax significance. Large U.S. multinationals acquire hundreds of thousands (if not millions) of items of CFC tangible property every year. These items are currently tracked in the aggregate to determine the depreciation and other relevant U.S. tax items necessary to calculate CFC earnings and profits. Individually tracking every item of CFC tangible property to confirm whether it has been transferred within 12 months of acquisition would be an enormous task. Many taxpayers would need to expend substantial time and resources to develop comprehensive foreign asset tracking systems from scratch for the sole purpose of measuring compliance with the temporarily held property rule. The resulting compliance burden would be disproportionate to the severity of the underlying policy concern, which is at present hypothetical.

Finally, as proposed, the temporarily held property rule would require taxpayers to file amended returns annually to correct their QBAI calculations to reflect transfers of property acquired late in a taxable year. For example, a calendar-year taxpayer generally files its U.S. federal income tax return in October of the following year (and large U.S. corporations strive to finalize their returns well in advance of that date). Because CFC tangible property held for less than 12 months is subject to basis adjustments for GILTI purposes, QBAI reported on an October tax return will necessarily be subject to adjustment for property acquired in October through December of Year 1 and then sold after tax return filings in October through December of Year 2 (i.e., within the 12-month per se abusive window). The application of the rule would place an undue burden on both taxpayers' and the Service's limited resources.

In TEI's view, the policy concerns underlying the temporarily held property rule do not require the use of a 12-month presumption rule capturing many valid business transactions and imposing enormous compliance burdens on U.S. corporate taxpayers. Common law authorities

regarding tax ownership and economic substance should be sufficient to disregard artificial transactions that shuffle tangible property ownership to achieve U.S. tax objectives.[1]

Taxpayers could comply with a primary purpose anti-abuse rule because a taxpayer engaging in business-driven acquisitions of CFC property can determine that all such property is exempt from such a rule, or at a minimum can determine what property the Service may consider subject to such a rule. However, taxpayers engaging in non-tax motivated transactions that are subject to a per se timing rule would lack sufficient information to apply that rule on a timely basis, or at least would lack such information absent substantial expenditures on compliance systems and personnel.

TEI views any 12-month rule as unadministrable for public financial statements and tax compliance purposes. Accordingly, the Service should rely on alternative authority consistent with many other areas of perceived abuse to police such transactions.

As an alternative, TEI recommends the "a principal purpose" rule be replaced or supplemented with a more predictable standard. The current language creates substantial uncertainty as to whether business-driven transactions will be respected in cases where related tax benefits are present. Prior anti-abuse standards provide a fair and administrable precedent. For instance, in the context of section 355(e), Treasury regulation section 1.355-7(d)(1)(i) creates a safe harbor for distributions which are "motivated in whole or substantial part by a corporate business purpose." A "corporate business purpose" is then defined under Treasury regulation section 1.355-2(b) as a "non-federal tax purpose germane to the business of the distributing corporation." TEI suggests a similar safe harbor for acquisitions of tangible property which are "motivated in whole or in substantial part by a non-federal tax purpose germane to the business of the acquiring CFC." With reasonable inquiry, taxpayers can determine whether such evidence exists and determine that safe harbors are met, while "proving the negative" of a lack of any "principal purpose" can be administratively difficult if not impossible in large corporations.

The basis adjustment rule for used tested losses should be modified

Proposed regulation section 1.951A-6(e) generally requires a corporate U.S. shareholder to reduce its adjusted basis in CFC stock (at the time of a taxable disposition) by the cumulative amount of tested losses that have been used to offset tested income in calculating the shareholder's net CFC tested income. The Preamble to the Proposed Regulations indicates that the proposed basis reduction rules in proposed regulation section 1.951A-6(e) may be necessary to eliminate a potential "duplicative benefit."

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[1] *See, e.g., Higgins v. Smith*, 308 U.S. 473 (1940); *Commissioner v. Ashland Oil & Ref. Co.*, 99 F.2d 588 (6th Cir. 1938) ("[A] transitory ownership of stock is not necessarily of legal significance."); *National Securities Corp. v. Commissioner*, 137 F.2d 600 (3d Cir. 1943) (disregarding the transfer of securities to a subsidiary that subsequently disposed of the securities at a loss); *Barnes Group, Inc. v. Commissioner*, 593 Fed. Appx. 7 (2d Cir. 2014) (denying tax significance to transfers through entities "created solely to facilitate the transfer"); *Wells Fargo & Co. v. United States*, 641 F.3d 1319 (Fed. Cir. 2011) (denying tax benefits with respect to property that the taxpayer did not in substance own).

In some circumstances, the Proposed Regulations require a basis reduction even where there is not a "duplicative benefit." The Proposed Regulations treat a tested loss as a "used tested loss amount" for a given year even if the U.S. shareholder's aggregate, pro rata share of tested income is fully offset by its net deemed tangible income return. Such a U.S. shareholder would receive no U.S. tax benefit from the "use" of any tested losses because the U.S. shareholder's net deemed tangible income return would have fully offset the relevant tested income, even if the tested loss had been zero.

Proposed regulation section 1.951A-6(e) should be amended to provide that, with respect to a U.S. shareholder's inclusion year, none of the shareholder's pro rata share of tested losses are treated as a "used tested loss amount" if the shareholder's net deemed tangible income return equals or exceeds the aggregate of the shareholder's pro rata share of tested losses for that year.

Under sections 951A(f)(1) and 961, a U.S. shareholder may increase its CFC stock basis only to the extent that the U.S. shareholder has a GILTI inclusion for the tax year (that is, the U.S. shareholder's net CFC tested income exceeds its net deemed tangible income return). Similarly, under section 951A(f)(1) (in combination with section 959), GILTI previously taxed income ("PTI") arises only to the extent the U.S. shareholder has a GILTI inclusion.

Thus, a U.S. shareholder's aggregate, pro rata share of tested income gives rise to a basis increase and PTI only to the extent that such tested income exceeds both (i) the shareholder's aggregate, pro-rata share of tested losses, and (ii) its net deemed tangible income return. If these rules require downward adjustments in CFC stock basis with respect to used tested losses, those downward adjustment rules should be consistent with the corresponding rules regarding stock basis increases and PTI.

If a U.S. shareholder's net deemed tangible income return exceeds its aggregate, pro rata share of tested losses for a tax year, the U.S. shareholder has not received any tax benefit for the tested losses. Accordingly, there is no potential "duplicative benefit" in that situation and a decrease in CFC stock basis should not be required.

By excluding QBAI from the basis adjustment determination, a U.S. shareholder is potentially penalized even if it does not have GILTI. That is, even if the U.S. shareholder did not earn tested income over a 10% return on its business assets, it would still be required to reduce the basis of its CFC(s) and potentially recognize gain at the time of disposition.

Only used tested losses should increase subpart F E&P

Proposed regulation section 1.951A-6(d) increases the earnings and profits of a CFC for purposes of section 952(c)(1)(A) by such CFC's tested loss. The proposed regulation implements section 951A(c)(2)(B)(ii). The statute as implemented by the Proposed Regulations has the effect of preventing all tested losses from offsetting subpart F income. Although the Conference Report does not explain the statutory provision, it appears to have been intended to prevent a single CFC loss from reducing both GILTI and subpart F income. Regrettably, the rule as drafted can eliminate the benefit of any deduction to the extent that a U.S. shareholder incurs tested loss in

excess of tested income in an inclusion year, essentially creating a non-economic income inclusion.

The non-economic inclusion can best be illustrated with the following example:

FC1 and FC2 are wholly-owned foreign subsidiaries of US Corp. For the current year FC1 has tested loss of (100), subpart F income of 40 and an E&P deficit of (60). FC2 has tested income of 20 and earnings and profits of 20. US Corp does not have a GILTI inclusion due to the net tested loss of (80) (FC1 tested loss (100) plus FC2 tested income of 20). However, for purposes of the section 952(c) earnings and profits limitation, FC1's tested loss of (100) is added back to the earnings and profits of FC1.

This example results in FC1 incurring a subpart F inclusion of 40 (FC1 E&P deficit of (60) plus FC1 tested loss of 100) even though FC1's tested loss only reduced US Corp's net tested income by 20.

The final regulations should provide that only "used" tested losses (as defined in proposed regulation section 1.951A-6(e)) will increase a CFC's earnings and profits for purposes of section 952(c)(1)(A). As the heading of section 951A(c)(2)(B)(ii) makes clear, Congress' intent was to coordinate the GILTI rules with subpart F to "deny double benefit of losses." A taxpayer plainly does not benefit from tested losses which do not in fact reduce tested income. The basis reduction rules in proposed regulation section 1.951A-6(e) also target potential double benefits derived from tested losses, and recognize that no duplicative benefit arises where a tested loss does not reduce net tested income. The subpart F coordination rule should incorporate the same concept.

Eliminating the subpart F earnings and profits benefit of an unused tested loss will often result in non-economic subpart F inclusions. Section 952(c)(1)(A) provides that "the subpart F income of any controlled foreign corporation for any taxable year shall not exceed the earnings and profits of such corporation for such taxable year." As is shown in the above example subpart F income loses its earnings and profits limitation when un-used tested losses are added back for purposes of calculating earnings and profits.

<u>The basis reduction rules should apply only to actual transfers of stock</u>

Proposed regulation section 1.951A-6(e) generally provides that CFC stock basis will be reduced by the amount of the CFC's "used tested loss" upon a "disposition" of such stock. "Disposition" is generally defined for this purpose as a direct taxable stock transfer or an indirect disposition resulting from the taxable transfer of upper-tier CFC stock. The preamble to the Proposed Regulations requested comments on this definition and, in particular, whether it should be broadened to include taxable transactions not involving a transfer of stock such as distributions in excess of basis subject to section 301(c)(2). TEI recommends final regulations provide that the basis reduction rules apply only in connection with a taxable transfer of stock because tested losses alone should not cause gain recognition prior to a meaningful change in CFC ownership.

The Proposed Regulations appropriately take a "wait-and-see" approach to basis reduction. To ensure that CFC stock basis is reduced "only to the extent necessary to eliminate the duplicative loss in the stock," U.S. shareholders must reduce their stock basis by the running "net used tested loss" amount maintained for each CFC. Basis reduction on disposition is increased by a CFC's used tested loss and decreased by a CFC's offset tested income.

Reducing CFC stock basis before that stock is transferred in a taxable transaction would prematurely accelerate gain and would result in double taxation to the extent that the same CFC derived offset tested income in a later tax year. The term "disposition" therefore should be limited to transactions involving an actual transfer of stock. For the same reason, the proposed rules should be revised to clarify that a section 304(a)(1) transaction does not constitute a "disposition" for purposes of proposed regulation section 1.951A-6(e) to the extent that the fictional redemptive distribution is treated entirely as a distribution described in section 301(c)(1), or under section 301(c)(2) to the extent that there is sufficient basis without regard to the potential basis adjustment. Since the implicated basis is not yet relevant, it seems appropriate to continue the wait-and-see approach in case the relevant CFC produces enough tested income before any future taxable disposition of the stock.

Deemed section 367(d) expense should reduce tested income (Treas. Reg. Section 1.367(d)-1T(c)(2))

When a U.S. person transfers intangible property to a foreign corporation in a non-recognition transaction under section 351 or section 361, section 367(d) may require a deemed royalty payment between the U.S. transferor and foreign transferee. Temporary regulation section 1.367(d)-1T(c)(2) provides that the deemed royalty payment will reduce the foreign corporation's earnings and profits and subpart F income. The regulation goes on to provide explicitly that "[n]o other special adjustments to earnings and profits, basis, or gross income shall be permitted by reason of the recognition of a deemed payment under this paragraph (c)."

Treasury and the Service should update section 1.367(d)-1T(c)(2) to account for the enactment of the GILTI rules and allocate the deemed expense between subpart F and GILTI income in the same manner as any other royalty payment. Unless this change is made, a U.S. transferor who continues as a U.S. shareholder of the transferee CFC will generally be taxed twice on one essentially similar item of income: first, upon receipt of the deemed section 367(d) royalty, and second, upon taking into account its share of the transferee CFC's tested income calculated without regard to the deemed payment. Failing to clarify the rule creates a trap for the unwary because an actual license of intangible property creating royalty payments in form would clearly reduce tested income or subpart F income, as the case may be, while the transferee/licensee entering into an economically similar "deemed" royalty payment under section 367(d) would be potentially estopped from reducing tested income while the transferor/licensor is forced to incur the same income inclusion. These issues are of particular concern in light of the changes by the TCJA to definition of intangible property under section 367(d).

If the treatment of 367(d) deemed royalty payments in light of the enactment of section 951A is intended to be covered under a different regulatory project, TEI recommends that the

preamble to final section 951A regulations clarify that future guidance will address section 367(d) inclusions and permit, where appropriate, a deduction for purposes of determining tested income or tested loss.

Anti-abuse rule of Prop. Reg. § 1.951A-2(c)(5)

Proposed regulation section 1.951A-2(c)(5) disregards certain depreciation and amortization deductions in computing tested income attributable to an increase in basis resulting from taxable exchanges between related companies. In particular, the provision is aimed at taxable exchanges occurring during the period beginning with the measurement date for section 965 inclusions and before the effective date of the GILTI rules. This is an anti-abuse rule that appears to be intended to address a "gap" in the TCJA's statutory provisions that would permit certain GILTI tax planning for corporations depending on their year end. The preamble to the Proposed Regulations states that the government's authority to issue this anti-abuse rule follows from sections 951A(d)(4) and 7805(a).

In TEI's view, the Service and Treasury lack the authority to promulgate such a broad anti-abuse rule that fails to distinguish between abusive and non-abusive transactions occurring in relevant period, whether under section 951A(d)(4) or section 7805(a). Section 951A(d)(4) addresses the computation of a CFC's QBAI, and not the computation of a CFC's tested income. Moreover, The D.C. Circuit recently held invalid a regulation treating bearer shares as insufficient evidence of ownership on the grounds that it was inappropriately broad.[2] For these reasons, this anti-abuse rule should be withdrawn. To the extent the Service views a particular taxpayer's tax planning as abusive or otherwise primarily tax motivated, as noted above it has ample other statutory and common law rules to address the issue.

Conclusion

TEI appreciates the opportunity to comment on the Proposed Regulations. TEI's comments were prepared under the aegis of the Institute's U.S. International Tax Committee, whose chair is Sarah Winters. Should you have any questions regarding TEI's comments, please contact Ms. Winters at 312.424.8116. or sarah.winters@cushwake.com, or Benjamin R. Shreck of the Institute's legal staff at 202.464.8353 or bshreck@tei.org.

Respectfully submitted,
Tax Executives Institute

James P. Silvestri
International President

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[2] *See Good Fortunes Shipping SA v. Commissioner*, 897 F.3d 256 (D.C. Cir. 2018).