May 24, 2017

The Honorable Steven Mnuchin
Secretary of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Secretary Mnuchin:

RE: Executive Order 13789 on Identifying and Reducing Tax Regulatory Burdens

President Trump issued Executive Order 13789 on "Identifying and Reducing Tax Regulatory Burdens," on April 21, 2017. In the Executive Order, the President ordered the Treasury Department to review significant tax regulations issued on or after January 1, 2016, to determine if the regulations "impose an undue financial burden on United States taxpayers, add undue complexity to the Federal tax laws, or exceed the statutory authority of the Internal Revenue Service."

To comply with the Executive Order, the National Foreign Trade Council urges the Treasury Department to immediately delay or suspend (to the extent permitted by law) and to then modify or rescind the regulations and notice, described below, and reconsider the provision of the 2016 U.S. Model Income Tax Convention, all of which were issued last year by the Obama Administration. The regulations and notice will otherwise harm the U.S. economy by imposing excessive financial and compliance burdens on global businesses operating in the United States. This will lead to significant consequences that will distort investment and other business decisions to the detriment of U.S. workers.

The NFTC, organized in 1914, is an association of approximately 250 U.S. business enterprises engaged in all aspects of international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial, and service activities. Therefore, the NFTC seeks to foster an environment in which all U.S. companies can be dynamic and effective competitors in the international business arena. To that end, the NFTC encourages policies that eliminate major tax inequities in the treatment of U.S. companies operating abroad, as well as those that expand U.S. exports. These policies free American businesses to participate fully in business activities throughout the world, by exporting goods, services, technology, and entertainment, and by directly investing in facilities abroad. Foreign trade is fundamental to the economic growth of U.S. companies.

In its last year, the Obama Administration issued numerous final, temporary, and proposed regulations and notices. Many of the regulations and notice raise taxes on U.S. businesses via regulatory fiat and likely do not reflect the policy positions of the Trump Administration and Congress. The new rules also make U.S. tax compliance more difficult

National Foreign Trade Council
1625 K Street NW Suite 200 Washington, DC 20006 202-887-0278
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and expensive. In addition, the Treasury Department issued a new Model Income Tax Convention containing several provisions that create additional burdens and uncertainty for taxpayers trying to determine whether treaty benefits apply.

We strongly urge the Treasury Department first to delay or suspend, and then to modify or rescind, the below-described regulations, notice and U.S. Model Treaty. Of particular importance, we request Treasury to delay at once, and then quickly rescind, the onerous documentation requirements under section 385. While the requirements have yet to take effect, companies are spending money today for new systems and procedures in preparation for meeting the regulatory deadline for compliance. Again, we believe the regulations are out of line with President Trump's goal of reducing the cost to comply with onerous regulations so that companies can invest in stimulating economic growth and job creation in America, and he has issued the Executive Order to take action toward that goal.

The Executive Order requires all burdensome regulations issued in 2016, a numerous amount, to be both delayed or suspended and modified or rescinded

Section 1 of the Executive Order stipulates that "numerous tax regulations issued over the last several years have effectively increased tax burdens, impeded economic growth, and saddled American businesses with onerous fines, complicated forms, and frustration." Thus, to be compliant with the Executive Order, Treasury must find numerous tax regulations to be subject to the Executive Order.

Section 2(a) of the Executive Order indicates that the President has identified three criteria for determining if regulations issued on or after January 1, 2016 are contrary to the Administration's tax policy. The criteria are regulations that

(i) impose an undue financial burden,
(ii) add undue complexity to the U.S. tax laws, or
(iii) exceed statutory authority.

The Executive Order mandates that an interim report identify "all" regulations issued in 2016 that meet at least one of those criteria. The NFTC expects Treasury to identify instances of each of the criteria being used as a basis to include regulations in the interim report. It would be unusual for the Administration to have written a surplus, irrelevant criterion in section 2(a) with respect to which no action would be taken.

In that regard, as a factual matter, our members have identified the regulations and notice listed herein as each imposing an undue financial burden on them or adding undue complexity to the Federal tax laws. Many of the Treasury issuances do both. Because the regulations and notices factually meet the Executive Order's criteria for identification, we anticipate that Treasury will include the regulations and notice in its interim report.

In accordance with section 2(b) of the Executive Order, Treasury must mitigate the burden imposed by the regulations and notice (i) by delaying or suspending their effective dates (to the extent permitted by law) and (ii) by modifying or rescinding them. The NFTC also believes that certain of the listed regulations exceed statutory authority, at least in part.

The regulations listed below are subject to the Executive Order and should be included in the interim report and then should be (i) delayed or suspended and (ii) modified or rescinded

The NFTC identifies the following items issued by the Treasury Department during 2016 as subject to the Executive Order under section 2(a) and therefore to the actions required by the Executive Order under section 2(b):

1. **Final Section 385 regulations on debt documentation and earnings stripping:** These regulations were introduced April 2016 without warning and quickly finalized in October 2016. Although the final regulations are not as onerous as those proposed, they failed to address significant concerns raised in comments to the proposed regulations and impose excessive and unwarranted compliance and financial burdens on businesses operating in the United States. Aspects of the regulations have suspect statutory authority as well.

   With a looming deadline of January 1, 2018, U.S. businesses are scrambling to prepare to comply with the regulations' documentation rules. The rules impose arduous paperwork requirements far out of proportion to any benefit they might provide in a debt-equity determination and are a drag on the financial operations of companies doing business in the U.S. We have heard from some member companies that the cost to comply with documentation requirements alone will be in the millions of dollars. We will never be able to recapture these valuable resources and should instead use them to make productive investments to grow our businesses and create additional American jobs.

   Additionally, companies are now left with the difficult and challenging task of addressing uncertainty surrounding issues left open in the regulations, such as the fate of temporary exceptions for certain types of instruments and cash pooling. The ambiguity combined with concerns surrounding the severe penalties for failing to comply, has already, and will continue to impact capital flows, creating unnecessary hesitation about the United States as location for investment now and in the future.

2. **Section 987 final and temporary regulations on foreign currency:** These regulations deal with the computation of foreign exchange gains and losses of remittances from, and terminations of, qualified business units ("QBUs") of U.S. taxpayers that use a functional currency other than the U.S. dollar. These regulations are among the most complex regulations ever promulgated and will have a significant economic impact on U.S. businesses. The NFTC discussed the proposed regulations with the Treasury and IRS on multiple occasions explaining that the costs associated with the development of database software to track numerous historic items would be extraordinarily expensive (members indicated that the costs of such development could run in the tens of millions of dollars). Putting aside the substantial costs, software vendors have indicated that the requisite database software will take years to develop. It should also be noted that a potential move to a territorial tax system will render much of the impending section 987 compliance burden meaningless, but only after considerable investments in systems have already been made in order to comply with the approaching transition date (January 1, 2018 for calendar year taxpayers). Further, intersecting accounting rules require a new section 987 mark to market tax impact analysis, immediately affecting quarterly SEC filings for currency fluctuations across multiple relevant QBUs for the SEC filer. Finally, the elimination of the deferral transition method causes significant ramp-up time for previously compliant taxpayers, who will have to construct lengthy historic balance sheets across all of their QBUs. Uncovering acquisition dates for all assets on QBU books as of the transition date will be a massive undertaking.

3. **Final Section 367 (a) and (d) regulations on outbound intangibles:** These regulations deal with the transfer of foreign goodwill and going concern value by U.S. persons to foreign corporations in certain outbound section 351 and related transactions. These regulations eliminated the exception for outbound transfers of foreign goodwill and going concern value that existed for decades in the prior version of the regulations.

   The legislative history of the "foreign goodwill and going concern" issue is particularly important. In amending the rules under section 367 in 1984, Congress was concerned that certain companies hoped to reduce their U.S. taxable income by deducting their research and development expenses in the U.S. and, at the point of profitability, transferring the resulting intellectual property offshore to defer the U.S. tax on profits generated by that intellectual property. However, Congress recognized that this concern does not apply to the transfer of foreign goodwill and going concern value because they are not the type of assets that give rise to U.S. deductions prior to an outbound transfer. Rather, they are created by generating revenues.[1] Accordingly, as an important caveat to its legislative effort, Congress contemplated that a transfer of goodwill and going concern value would not ordinarily be subjected to section 367(d)'s deemed royalty obligation.

The Senate Finance Committee stated "[t]he committee contemplates that, ordinarily, no gain will be recognized on the transfer of goodwill or going concern value for use in an active trade or business." The House Ways and Means Committee stated that it "contemplates that the transfer of goodwill or going concern value developed by a foreign branch will be treated under [the ATB exception] rather than a separate rule applicable to intangibles." Further, it noted that it "does not anticipate that the transfer of goodwill or going concern value developed by a foreign branch to a newly organized foreign corporation will result in abuse of the U.S. tax system." The Senate Finance Committee made a similar statement and added that it did not anticipate abuse "regardless of whether the foreign corporation is newly organized." Consistent with this legislative intent, the previous, long-standing temporary regulations implemented that policy decision.

In fact, the active trade or business (ATB) exception represents Congressional accommodation for transfers of property used in a foreign business, and the underlying assumption that such transfers are not primarily motivated by tax avoidance considerations. We believe the approach taken by the new section 367 regulations is overly broad and frustrates a clear Congressional intent relating to outbound transfers under section 367.

4. **Section 482 regulations on the aggregation of functions:** On September 14, 2016, the Treasury and the IRS issued temporary regulations under section 482 (along with proposed regulations under section 367). These regulations would, among other things, provide for aggregate valuation of interrelated transactions that are covered in part by section 482 and in part by other code sections (such as section 367). The requirement that arm's-length compensation be consistent with the "value" provided in a transaction between related parties has created confusion because the definition of "value" may be different from the price charged in an

1 See Staff of the Joint Committee on Taxation, General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984 (H.R. 4170, 98th Congress; Public Law 98-369) (Dec. 31, 1984), at 428 ("Goodwill and going concern value are generated by earning income, not by incurring deductions.")

5. arm's-length transaction. Similarly, the "clarification" of when an aggregate analysis is appropriate depends on subjective tests that may be susceptible to differing interpretations, like determining whether transactions are "interrelated" or "economically interrelated," and whether "synergies" are present. The aggregate approach of the section 482 regulations is inconsistent with the asset approach of section 367(d).

6. **Section 901(m) proposed regulations on covered asset acquisitions ("CAAs"):** These regulations address CAAs, which are transactions that create mismatches between U.S. tax basis and foreign tax basis. Section 901(m) disallows U.S. foreign tax credits connected to assets involved in CAAs. The regulations are exceedingly complex despite addressing only a limited set of issues and in places appear to conflict with statutory authority. The regulations are a classic case of regulatory overkill where detailed rules are written for uncommon, arcane abuses and can be understood only by highly specialized tax experts.

   Furthermore, section 901(m) requires a regulatory modification to exempt CAAs in which U.S. tax basis has been appropriately stepped up above foreign tax basis only after the recognition of the U.S. taxable gain that produced the step up. Absent such an exemption, the U.S. taxes income twice, once on the gain and once again by disallowing foreign tax credits—a violation of the bedrock principle of eliminating double taxation and a handicap on the ability of U.S. business to compete with foreign rivals typically operating in lower-tax, territorial systems. Under Section 901(m)(7)'s specific authority to do so, the Treasury should modify the proposed regulations to cure the double taxation caused by section 901(m) and to stop the disallowance of FTCs as of the date of the initial proposed regulations for both completed and future CAAs.

7. **Section 721(c) temporary regulations on outbound transfers*:*** These regulations involve the outbound transfer of appreciated property by a US person to a partnership with a related foreign partner where the US and foreign partner control the partnership. The regulations require the adoption of an allocation method where the built-in gain on the contributed assets by the US person remains within U.S. taxing jurisdiction. These rules were issued with a questionable effective date (retroactive to the date of the related notice) and add considerable complexity given a limited, targeted abuse which can be dealt with under existing partnership anti-abuse regulations.

8. **Section 7602 regulations allowing the IRS to hire outside counsel to participate and take testimony in an exam:** Treasury and the IRS issued the proposed and temporary regulations under section 7602 after the IRS had hired an outside law firm to assist in the conduct of its examination. The regulations were met with some controversy, with members of Congress questioning both the legal

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9. basis for the regulations and the justification for expenditures of Internal Revenue Service and taxpayer resources for the third-party advisors. We believe the proposed and temporary regulations fall short on both policy and procedural grounds. In short, we believe that hiring outside counsel to conduct IRS examinations will lead to a more contentious and costly examination process, instead of promoting sound tax administration.

10. **Notice 2016-73 (retroactive application):** Notice 2016-73 drastically alters the U.S. federal tax consequences of many cross-border triangular reorganizations and inbound nonrecognition transactions. Given the changes announced in the notice, the efficacy of these transactions going forward will be greatly diminished. In fact, in a departure from the general purpose of the 2011 final regulations (i.e., to treat S's purchase of P stock for property in the same manner as if S had distributed the property to P) the 2016 notice leaves taxpayers in a worse position by also requiring P's U.S. shareholders to recognize the gain realized on their exchange of the P stock or securities. Also troubling to taxpayers are the expanded scope and changes to the computation of the "all E&P amount" with respect to inbound nonrecognition transactions. The regulations in this area have historically included only the E&P of the foreign acquired corporation, and not the E&P of any of its foreign subsidiaries. The 2016 notice takes a radically different approach by increasing the all E&P amount to include the E&P of the foreign acquired corporation's foreign subsidiaries when the foreign acquired corporation has "excess asset basis." It appears that the 2016 notice intends to target only excess asset basis resulting from property provided, directly or indirectly, by the foreign subsidiaries. This will create the additional administrative burden of reviewing all historic transactions that affected a foreign acquired corporation's inside asset basis, liabilities, E&P, and/or outside adjusted basis of its stock to determine the cause of such excess asset basis.

11. **2016 U.S. Model Treaty**: On February 17, 2016, the Treasury Department issued a new U.S. Model Income Tax Convention (the 2016 Model), which is the baseline text Treasury will use in negotiating tax treaties. We understand that Treasury is already using the 2016 Model as the baseline for its tax treaty renegotiations with several countries, despite the fact that a technical explanation has not yet been released. The 2016 Model reflects a stark shift in focus by the Treasury in its treaty policy from the goal of encouraging cross-border investment by reducing incidences of double taxation to an overarching concern of preventing the use of income tax treaties to facilitate stateless income. In response to numerous comments, Treasury revised some of the proposals in the May 2015 drafts, however, there are still several instances in which the 2016 Model may restrict treaty access in a manner that is disproportionately burdensome to taxpayers engaging in legitimate business transactions. In particular, the revised limitations on benefits (LOB) article places significant additional restrictions on the LOB tests

12. that likely will make it difficult for many companies to qualify for treaty benefits and, at a minimum, will add additional complexity and uncertainty to nearly all companies' determination of whether they qualify for treaty benefits

We respectfully request and expect the Treasury Department to immediately delay or suspend (as law permits) and to then modify or rescind the regulations and notice described in this letter within the timeframe mandated by the Executive Order. Furthermore, we urge the Treasury Department to reconsider certain provisions of the 2016 U.S. Model Tax Treaty. With each passing day, U.S. businesses are spending time and money dealing with the regulations and notice. The sooner the rules are made compliant with the Executive Order, the less damage they will cause.

Please let us know if we can provide to you with any further information.

Sincerely,

Catherine Schultz
Vice President for Tax Policy

Cc: Thomas West
Justin Muzinich

National Foreign Trade Council
1625 K Street NW Suite 200 Washington, DC 20006 202-887-0278
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