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The Honorable David J. Kautter
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1500 Pennsylvania Ave., N.W.
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The Honorable Charles Rettig
Commissioner
Internal Revenue Service
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The Honorable William Paul
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Internal Revenue Service
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Re: Proposed Section 163(j) Regulations (106089-18)

Dear Sirs:

On behalf of the National Foreign Trade Council ("NFTC"), I would like to express our appreciation to the U.S. Department of the Treasury ("Treasury") and the Internal Revenue Service ("Service") for your efforts in developing the recently issued proposed section 163(j) regulations (the "Proposed Section 163(j) Regulations").

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 and the NFTC therefore seeks to foster an environment in which U.S. companies can be dynamic and effective competitors in the international business arena. The NFTC's emphasis is to encourage policies that will expand U.S. exports and enhance the competitiveness of U.S. companies by eliminating major tax inequities in the treatment of U.S. companies operating abroad. To achieve this goal, American businesses must be able to participate fully in business activities throughout the world, through the export of goods, services, technology, and entertainment and through direct investment in facilities abroad. Foreign trade is fundamental to the economic growth of U.S. companies.

The Proposed Section 163(j) Regulations are highly complex and would have a very significant impact on U.S. income tax administration and compliance. In light of that complexity, and the significant number of issues that we have with the Proposed BEAT Regulations, we urge the Treasury and the Service to revise the Proposed Section 163(j) Regulations as discussed below.

The Definition of Interest

The Proposed Section 163(j) Regulations broadly define "interest" to include not only amounts treated as interest for U.S. federal income tax purposes, but also many other types of payments that the Preamble describes as having similar effects to interest, even if such payments are not otherwise treated as interest for tax purposes. As discussed more fully below, this expansion of the term "interest" far exceeds Congressional intent and unnecessarily creates significant complexity and burdens without meaningfully improving the policy behind the section 163(j) limitation rules.

The definition of "interest" in the Proposed Section 163(j) Regulations is inconsistent with both the statute and the Congressional record. The statutory language (enacted by Congress in December 2017) gives no indication that the term "interest" as used in section 163(j) encompasses payments significantly different from those generally treated as interest for U.S. federal income tax purposes. Similarly, the legislative history does ***not*** include any directions or statements that "interest" should be interpreted in a significantly different manner for section 163(j) purposes. Further, the Joint Committee on Taxation's explanation of Section 163(j) provides only that "[a]ny amount treated as interest for purposes of the Code is interest for purposes of the provision."[1]

The Preamble cites Treas. Reg. Secs. 1.954-2 and 1.861-9T as examples of regulations that treat amounts closely related to interest as "interest," and the Preamble notes that the Proposed Regulations draw on the rules in these regulations. However, Treas. Reg. Sec. 1.954-2 was issued pursuant to specific statutory authority: section 954(c)(1)(E) explicitly contemplated interest equivalent amounts. Unlike section 954(c)(1)(E), the statutory text of section 163(j) does not explicitly contemplate interest equivalent amounts – anywhere.

Similarly, Treas. Reg. Sec. 1.861-9T treats interest equivalents in the same manner as interest, but those temporary regulations were supported by Congressional intent that items economically similar to interest should be included.[2] And, Treas. Reg. Sec. 1.861-9T(b)

1 *See* Joint Committee on Taxation, General Explanation of Public Law 115-97 (2017) at 174.

2 "Congress did not intend that labels control whether expenses are interest expenses for [purposes of

includes interest equivalents solely for purposes of determining how items should be allocated and apportioned between different categories of income under section 861. Items not explicitly listed in section 861 are sourced by analogy to similar items for which there is an explicit sourcing rule[3] Thus, interest equivalents are not treated as interest in section 861, they are treated in the same manner as interest purely for sourcing purposes.

By expanding the definition of "interest" in such an extensive manner, the Proposed Section 163(j) Regulations create unnecessary complexity and administrative burdens for taxpayers. While the Preamble suggests that the definition is consistent with definitions developed and administered in Treas. Reg. Secs. 1.861-9T and 1.954-2, the definition of "interest" in the Proposed Section 163(j) Regulations is even broader than the definition in those provisions.[4] As a result, the Proposed Section 163(j) Regulations would force taxpayers to evaluate all expenses paid and accrued as interest equivalents and would require taxpayers to maintain multiple sets of records for what is and is not treated as interest for purposes of section 163(j) (as compared to other Code provisions). Additionally, because the definition is written so broadly, there is considerable uncertainty regarding what is, and what is not, to be treated as interest under the Proposed Section 163(j) Regulations. The Preamble suggests that Treasury expanded the definition of interest to create certainty for taxpayers, but, to the contrary, it has the opposite effect – companies (and their advisors) continue to struggle with what the expansive definition means. The additional complexity and administrative burden of such evaluations and recordkeeping are unreasonable given the statutory text and legislative history.

Further, the anti-avoidance rule set forth in Prop. Treas. Reg. Sec. 1.163(j)-1(b)(20)(iv) could have overly expansive application. The Preamble states that this section is intended to prevent taxpayers from avoiding the application of section 163(j) by structuring transactions that are essentially financing transactions. Yet, the anti-avoidance rule (as written) does not establish a requirement that a taxpayer must have an "avoidance" purpose for the rule to apply. This section effectively treats any payment having a time value of money component as an avoidance transaction, regardless of whether the transaction is entered into purely for legitimate non-tax business reasons. This provision is unnecessarily broad, and will create additional

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Section 864(e), but rather] that economic reality govern." *See* Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1986 (1987) at 947-8.

3 *Bank of America v. U.S.*, 680 F.2d 142 (Fed. Cir. 1982), *E.g.*, *Howkins v. Commissioner*, 49 T.C. 689 (1968).

4 For example, Prop. Treas. Reg. Sec. 1.163-1(b)(20)(iii)(E) and (F) are inconsistent with Treas. Reg. Sec. 1.861-9T(b) as neither (E) nor (F) contains a requirement that the payment be incurred substantially in consideration of the time value of money, and guaranteed payments (Prop. Treas. Reg. Sec. 1.163-1(b)(20)(iii)(I)) are not treated as interest under either Treas. Reg. Secs. 1.861-9T(b) or 1.954-2.

uncertainty for taxpayers.

Recommendation

Given the explicit statutory language of the statute, and the lack of legislative history suggesting Congress intended to expand the definition of interest purely for purposes of section 163(j), we believe Prop. Treas. Reg. Sec. 1.163-1(b)(20)(iii) is inconsistent with the intended definition of "interest" for purposes of section 163(j) and should be stricken from the Regulations.

In the alternative, given Treasury's indication in the Preamble that it has considered and rejected the notion of applying section 163(j) consistently with the existing definition of interest, we have also proposed a less expansive definition of "interest" for section 163(j) purposes that would ameliorate the above concerns while still accomplishing the Preamble's stated goal of preventing taxpayers from effectively avoiding the section 163(j) limitation rules without substantial economic difference.

As noted below, our proposed definition includes modifications to Prop. Treas. Reg. Sec. 1.163(j)-1(b)(20)(iii)(E) and (F) that more closely align to the other Code provisions and regulations. The revision to (E) would cover both income and losses incurred by either a lender or borrower in certain hedging transactions.

Our proposed definition also strikes (G), (H), and (I), as these provisions include payments that are not generally treated as interest elsewhere in the Code and regulations, absent explicit statutory language expanding the definition of interest to certain interest equivalents. Further, these sections provide uncertainty to taxpayers as to what fees and costs may be treated as interest, even if those amounts are not incurred in consideration for the time value of money. To the extent a taxpayer structures certain fees or payments, such as guaranteed payments, to avoid the application of section 163(j), such payments should be captured under the anti-avoidance rule set forth in paragraph (iv).

Our proposed definition also clarifies the anti-avoidance rule by explicitly requiring that a taxpayer have as the principal purpose for entering into a transaction the avoidance of section 163(j) in order for the anti-avoidance rule to apply:

(iii) Other amounts treated as interest.

[Sections (A)-(D) are proposed to remain unchanged.]

(E) Hedge amounts. Income, deduction, gain, or loss from a derivative, as defined in section 59A(h)(4)(A), that ~~alters a taxpayer's effective cost of borrowing with respect to a~~

~~liability of the taxpayer~~ is treated as an adjustment to interest expense or income of a taxpayer if such derivative could form an integrated transaction pursuant to §1.988-5(a) or §1.1275-6 with a qualifying debt instrument of such taxpayer (or of a member of the consolidated group of which such taxpayer is a member) regardless of whether identified as such by the taxpayer and without regard to whether the derivative and the debt instrument are held by the same person (so long as both the derivative and the debt instrument are held by members of the same consolidated group). For example, a taxpayer that is obligated to pay interest at a floating rate on a note and enters into an interest rate swap that entitles the taxpayer to receive an amount that is equal to the interest rate on the note in exchange for a fixed amount is, in effect, paying interest expense at a fixed rate by entering into the interest rate swap. Income, deduction, gain, or loss from the swap is treated as an adjustment to interest expense. Similarly, any gain or loss resulting from a termination or other disposition of the swap is an adjustment to interest expense, with the timing of gain or loss subject to the rules of §1.446-4.

~~(F) Yield adjustments. Income, deduction, gain, or loss from a derivative, as defined in section 59A(h)(4)(A), that alters a taxpayer's effective yield with respect to a debt instrument held by the taxpayer is treated as an adjustment to interest income by the taxpayer.~~

~~(G) Certain amounts labeled as fees—(1) Commitment fees. Any fees in respect of a lender commitment to provide financing are treated as interest if any portion of such financing is actually provided. (2) [Reserved]~~

~~(H) Debt issuance costs. Any debt issuance costs subject to §1.446-5 are treated as interest expense of the issuer.~~

~~(I) Guaranteed payments. Any guaranteed payments for the use of capital under section 707(c) are treated as interest.~~

(J) Factoring income. The excess of the amount that a taxpayer collects on a factored receivable (or realizes upon the sale or other disposition of the factored receivable) over the amount paid for the factored receivable by the taxpayer is treated as interest income. For this purpose, the term factored receivable includes any account receivable or other evidence of indebtedness, whether or not issued at a discount and whether or not bearing stated interest, arising out of the disposition of property or the performance of services by any person, if such account receivable or evidence of indebtedness is acquired by a person other than the person who disposed of the property or provided the services that gave rise to the account receivable or evidence of indebtedness.

(iv) Anti-avoidance rule for amounts predominantly associated with the time value of money. Any expense or loss, to the extent deductible, incurred by a taxpayer in a transaction or series of integrated or related transactions) in which the taxpayer secures the use of funds for a period of time is treated as interest expense of the taxpayer if such expense or loss is

predominantly incurred in consideration of the time value of money ***<u>and the principal purpose of the transaction or series of transactions is to avoid the application of this section</u>.***

<u>Section 163(j) Application to CFCs</u>

The Proposed Section 163(j) Regulations provide that a CFC's business interest expense is subject to the limitation of section 163(j), even if the CFC is not a U.S. taxpayer, but that a CFC may in certain situations be aggregated with other CFCs for purposes of applying section 163(j). The application of section 163(j) to CFCs is inconsistent with Congressional intent and even inconsistent with the principles set forth in the Preamble.

The Proposed Section 163(j) Regulations significantly broaden the scope of section 163(j) with respect to CFCs without any evidence of Congressional intent to do so. Prior to the Proposed Section 163(j) Regulations, the 1991 proposed regulations proposed under "old" section 163(j) carved out from the application of "old" Section 163(j) the interest expense of any foreign corporation (including a CFC) that did not conduct a U.S. trade or business. Congress was well aware that "old" Section 163(j) did ***<u>not</u>*** apply to CFCs for 26 years before Congress enacted "new" section 163(j). Importantly, not withstanding this longstanding policy of no application of section 163(j) to CFCs, Congress made no indication, either in the statute or in the legislative history, that "new" section 163(j) should apply to CFCs – differently from the very recent past.

With the new, broad application of section 163(j) to CFCs, the Proposed Section 163(j) Regulations introduce significant and unreasonable administrative complexity by requiring taxpayers to perform section 163(j) calculations on each of its CFCs. The magnitude of data collection required to meet this obligation is more than excessive. As currently proposed, the regulations require the collection of ledger level detail from each CFC, as well as information to determine adjustments for purposes of calculating ATI. This information must be converted from local accounting standards to reflect US federal tax principles in order to determine each entity's taxable income, adjustments, and the section 163(j) limitation. The limitation must then be tiered up through the structure (in many cases, through hundreds of CFCs) to determine whether excess limitation exists. These calculations are further complicated where there are transactions between CFCs, such as accounts payable and receivable, and where related CFCs engage in cash pooling. This compliance obligation will be in addition to the application of country-specific interest limitation rules. ***<u>IT systems simply do not exist to gather this level of data, map payments between each CFC, determine an entity-by-entity limitation, and allocate the limitation through the structure.</u>*** These rules create an unreasonable compliance burden without justification given the statutory language and lack of express legislative intent. And, by Treasury's own admission, the Proposed Section 163(j) Regulations' rules with respect to

CFCs will not generate meaningful, additional U.S. federal income tax revenue.

Recommendation

To address the above concerns, when finalized, the section 163(j) regulations should apply ***only to CFCs with a U.S. trade or business***. In the alternative, the rules for grouping CFCs and for determining the limitation for purposes of Section 163(j) should be radically simplified.

More specifically, the final section 163(j) regulations should provide relief from the administrative burden of complying with section 163(j) calculations on a CFC-by-CFC basis if a certain safe-harbor test is passed. The current proposed rules already provide that if a CFC group has no net business interest expense on an aggregate basis, a U.S. taxpayer need not engage in any further analysis to apply the section 163(j) rules to such CFC group. A similar rule should be provided where, on an aggregate basis, the net interest expense of the CFC group (as determined subject to the comments below) is less than 30 percent of the CFC group's adjusted taxable income. A CFC group should be permitted to calculate its limitation on an aggregate basis similar to the section 163(j) calculation for members of a U.S. consolidated return group. To the extent the group is not limited on an aggregate basis (*i.e*. the CFC group's net interest expense does not exceed the limitation), a taxpayer should be excepted from calculating a limitation on a CFC-by-CFC basis. If CFC group net interest expense exceeds the group's limitation on an aggregate basis, then the taxpayer should apply the current proposed rule of Prop. Treas. Reg. Sec. 1.163(j)-7 (subject to the comments below).

With respect to how a CFC group is defined, the Proposed Section 163(j) Regulations allow grouping only for CFCs that are owned 80 percent or more, by value, either by a single U.S. shareholder or in the same proportion by multiple related U.S. shareholders. Thus, regardless of how closely related the lower-tier CFCs are, if a parent CFC fails this test, none of the CFCs can be grouped. This requirement acts to exclude many situations in which highly related CFCs engage in intercompany loans to support all of the CFCs as a group. For example, consider a CFC financing company that onlends to a group of CFCs, all wholly owned by a single CFC with one 25 percent U.S. shareholder (where the remaining 75 percent of the CFC may be held by an unrelated non-U.S. company with a separate U.S. subsidiary subject to attribution after the repeal of section 958(b)(4)). All of the CFCs are highly related to each other, through their common ownership by the top-tier CFC, and the CFC financing company's borrowings support all of the CFCs. Not grouping the CFCs would result in exactly the inappropriate mismatch of income and deductions that the Preamble states should be avoided. Yet, under the Proposed Section 163(j) Regulations, the CFCs would not be eligible to make a CFC group election.

To maintain the principle of allowing grouping for highly related CFCs, the Proposed Regulations should allow a CFC group election for CFCs sharing 80 percent common ownership under the affiliated group rules of Section 1504(a). The affiliated group concept is a well-tested and well-known 80 percent common ownership threshold that would maintain the principle of limiting CFC grouping to highly related CFCs without the unnecessary requirement that the CFCs also be highly related to a single U.S. shareholder or the same related U.S. shareholders.

With respect to grouping multiple first tier CFCs, in light of the current proposed regulations, we believe the 80 percent threshold should be lowered to 50 percent. In theory, so long as the percentage interests held by the U.S. persons is the same, there does not need to be a bottom threshold, but in the interest of ease of administration, 50 percent is an appropriate threshold and would be more consistent with existing CFC rules, including the rules for determining CFC status. This grouping rule can work in conjunction with the rule described above such that multiple first tier CFCs can be grouped together where each first tier CFC comes with its own 80 percent owned group of CFCs underneath.

Finally, importantly, the final section 163(j) regulations should allow taxpayers to revoke a CFC Group Election after three years.

Prop. Treas. Reg. Sec. 1.163(j)-1(b)(1)(iii)

Prop. Treas. Reg. Sec. 1.163(j)-1(b)(1)(iii) allows for depreciation, amortization, or depletion expense deductions be added back for purposes of computed adjusted taxable income ("ATI").

The use of "deduction" and the distinction of costs capitalized into inventory suggests that DDA which is allocated to production activities and included in COGS would not be eligible for ATI addback. Legislative history does not indicate and intent to treat EBITDA item differently whether above-the-line component of COGS or a deduction from Gross Income.

Recommendation

The final section 163(j) regulations should clarify that the exclusion is limited only to DDA captured in ending inventory regardless of whether or not the expense was above or below the line.

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Again, thank you very much for the opportunity to provide these comments. Please do not hesitate to contact me should you have any questions on the above. We would be glad to meet with you to discuss these comments more fully and hereby formally request a public hearing to present our oral comments on the Proposed BEAT Regulations.

Sincerely,

Catherine G. Schultz
Vice President for Tax Policy

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