June 11, 2024

Office of Associate Chief Counsel (Corporate)
Internal Revenue Service
CC:PA:01:PR (REG-115710-22)
Room 5203, P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Comments in Response to REG-115710-22

The National Foreign Trade Council (the "NFTC") is writing to provide comments on REG-115710-22 (the "Proposed Regulations") on matters regarding the Stock Repurchase Excise Tax (the "Excise Tax") under section 4501[1], as enacted by the Inflation Reduction Act of 2022 ("IRA") released by the Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS") on April 9, 2023.

The NFTC, organized in 1914, is an association of 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. Our members support establishing and maintaining international tax norms that provide certainty to enterprises conducting cross-border operations.

While NFTC members have an array of concerns and comments on the Proposed Regulations, we only address issues with an international tax nexus in our comments. We thank Treasury and the IRS for adopting our previous comments to Notice 2023-2 on estimated payments and the modifications to the Funding Rule. As provided below in more detail, the NFTC requests additional modifications to the Funding Rule and changes to the Foreign Certification Rule included in the Proposed Regulations.

Background

Section 4501 imposes an excise tax on covered corporations equal to 1% of the fair market value of any of the corporation's own stock that the corporation repurchased after January 1, 2023. The general rule in section 4501(b) only applies to covered corporations, that is, a domestic corporation, the stock of which is traded on an established securities market. Stock acquired by a specified affiliate of a covered corporation, from a person who is not the covered corporation or a specified affiliate of such covered corporation, is also treated as a repurchase of the stock of the covered corporation by the covered corporation as described in section 4501(c)(2). A specified affiliate of a covered corporation is any corporation more than 50% of the stock of which is owned (by vote or by value), directly or indirectly, by such corporation, and any partnership more than 50% of the capital interests or profit interests of which is held, directly or indirectly, by a covered corporation.

Section 4501(d)(1) further applies in the case of an acquisition of stock of an applicable foreign corporation (*i.e.,* any foreign corporation, the stock of which is traded on an established securities market) by a specified affiliate of the corporation (other than a foreign corporation or a foreign partnership, unless

[1] All section references are to the Internal Revenue Code of 1986, as amended, and the Treasury regulations thereunder.

the partnership has a domestic entity as a direct or indirect partner, *i.e.*, an "applicable specified affiliate") from a person who is not the applicable foreign corporation or a specified affiliate of the applicable foreign corporation. Accordingly, under the plain language of section 4501(d)(1), the acquisition of stock of an applicable foreign corporation gives rise to excise tax liability only to the extent the stock is actually acquired by a U.S. corporation or U.S. partnership to which it is related.[2]

Funding Rule

On January 17, 2023, Treasury and the IRS published Notice 2023–2, 2023–3 I.R.B. 374 (the "Notice"), to provide initial guidance regarding the application of the Excise Tax. Section 3.05(2)(a)(ii) of the Notice introduced a "Funding Rule" under which an applicable specified affiliate would be treated as acquiring the stock of an applicable foreign corporation if (i) the applicable specified affiliate funds by any means (including through distributions, debt, or capital contributions) the repurchase or acquisition of stock of the applicable foreign corporation by the applicable foreign corporation or a specified affiliate that is not also an applicable specified affiliate, and (ii) such funding is undertaken with a principal purpose of avoiding the Excise Tax (the "Notice Funding Rule"). The Notice Funding Rule also provided that such a principal purpose is deemed to exist if the funding (other than through distributions) occurs within two years of the funded entity's repurchase or acquisition of stock of the applicable foreign corporation (the "Per Se Rule").

In response to comments, the Proposed Regulations modify the Notice Funding Rule in several ways. First, the principal purpose standard is modified in two ways: (1) the principal purpose test is treated as met if a covered funding has as a principal purpose of funding the share repurchases of a related "applicable foreign corporation" by such foreign corporation or other foreign affiliate; and (2) under an ordering rule, covered share repurchases are sourced first to the U.S. fundings. Second, the Per Se Rule is replaced with a rebuttable presumption that applies in limited circumstances to "downstream" fundings (*e.g.*, payments by an applicable specified affiliate (*e.g.*, a U.S. subsidiary) to a controlled foreign affiliate, which in turn acquires applicable foreign corporation (*i.e.*, foreign parent)).

Scope of Section 4501(d)(1)

NFTC appreciates the responsiveness to our prior comments about the Notice Funding Rule, particularly the elimination of the Per Se Rule. However, we remain concerned about the Funding Rule, including the modifications in the Proposed Regulations, in light of the plain language of section 4501(d)(1) limiting the application of the Excise Tax to actual purchases of foreign parent stock by a U.S. subsidiary.

Section 4501 was drafted with the intent for a limited application to only non-inverted, foreign-parented groups. Thus, consistent with the plain language of section 4501(d)(1), it should only apply where a U.S. subsidiary actually acquires foreign parent stock (*i.e.*, the scope should be limited to circumstances where a specified affiliate actually purchases stock of an applicable foreign corporation from a third party). However, the Funding Rule reaches well beyond that limited scope Congress prescribed in the statute to situations where the U.S. subsidiary does not actually acquire – and never intended to acquire – stock.

The Proposed Regulations narrow the Notice Funding Rule in certain respects, in particular by eliminating the Per Se Rule. Nonetheless, even with these modifications, the Funding Rule still reaches beyond the statute and has the potential to implicate common and ordinary-course transactions. Further,

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[2] This comment does not address the treatment of surrogate foreign corporations, *e.g.*, "inverted" foreign-parented groups.

there are administrability concerns related to the Funding Rule's "principal purpose" test. Multinational groups are composed of entities that make a variety of payments back and forth between one another for a multitude of non-abusive reasons. As relevant in the context of a foreign parented group, it is common for the foreign parent to regularly provide management services, intellectual property sublicenses, and other valuable services and property to its global affiliates. At the same time, the foreign parent maintains often long-standing dividend and share buyback programs for the benefit of its shareholders. Notwithstanding the tailoring and narrowing of the Funding Rule as it relates to downstream fundings, the Funding Rule was broadened with its new principal purpose test regarding funding a covered purchase. We remain concerned that the revised standard could inadvertently apply to numerous routine, non-abusive transactions given the fungibility of liquid assets and the challenge of demonstrating the rationale or intent behind each and every such payment (where such payments are already subject to other U.S. taxing provisions including sections 59A, 163(j), 267A, 482, 881, 1442, etc.).

The press release from Treasury on April 9, 2024[3], announcing the Proposed Regulations, indicated that the revised Funding Rule provides "a targeted anti-abuse rule to foreign-parented multinational corporations pay their fair share of the stock buyback excise tax, without ordinary course intercompany funding transactions among their corporate affiliates being inadvertently captured." We believe foreign parented groups ought not to bear this burden, as such groups do not also share in the many benefits of being a U.S parented group, particularly in cases where the foreign parent's stock is not even directly listed on a U.S regulated stock exchange like the NYSE or NASDAQ. Furthermore, as further described below, we believe that, even as proposed to be modified, the Funding Rule may still implicate such ordinary course transactions despite Treasury's stated intent in this press release.

Recommendation

We continue to recommend eliminating the Funding Rule, as it expands the application of the Excise Tax to foreign-parented groups beyond the statute's plain language and intended scope.

If the modified Funding Rule must remain, we strongly encourage Treasury to further narrow the Funding Rule to address the specific abusive transactions that are driving Treasury's concern. As described above, we do not think it is equitable to impute an abusive intent on a given payment merely by observing an intent for a subsidiary to help its foreign parent fund a share buyback that is outside the scope of section 4501. Such a limited rule could include anti-abuse provisions that target probable workarounds intended to avoid the Excise Tax. This more targeted approach would avoid capturing non-abusive transactions that are a matter of ordinary course in everyday business transactions.

In the alternative, Treasury could provide that a payment made by an applicable specified affiliate to an applicable foreign corporation would not be considered to be made with a principal purpose to avoid the Excise Tax to the extent the applicable specified affiliate has a substantial business purpose or purposes for such payment unrelated to funding a covered purchase or otherwise makes the payment without a principal purpose to avoid the Excise Tax.

Further, we make the recommendations discussed in the subsequent two sections below related to the principal purpose test and the definition of "covered purchase."

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[3] *U.S. Department of the Treasury and IRS Release Proposed Guidance on Stock Buyback Excise Tax to Ensure Large Corporations Pay More of Their Fair Share in Taxes*. U.S. Department of the Treasury, April 9, 2024. https://home.treasury.gov/news/press-releases/jy2244.

In the event that Treasury makes no changes to the Funding Rule and its principal purpose test, then in order to aid with administrability, we continue to recommend that Treasury provide a list of exempt transactions or safe harbors that would not be subject to the Excise Tax because they are categorically not entered into for the purpose of avoiding the Excise Tax. We recommend the list of exempt transactions include at least the following examples:

- Ordinary-Course, Arm's-Length Payments: Payments to purchase inventory, payments for services (including R&D), payments associated with routine treasury functions (including cash pooling, liquidity management, currency translation, and hedging transactions), payments of interest and return of principal, royalties, stock recharge payments to pay for shares for equity compensation, and similar ordinary course payments that meet the arm's-length standard of section 482. These payments are made for the purpose of acquiring property, obtaining the use of property, obtaining the benefit of services, obtaining the use of money, or earning financial returns and should not be challenged as "abusive" means of avoiding section 4501.

- Dividends and Other Distributions from a U.S. Subsidiary to a Foreign Parent: Dividends paid by corporations to shareholders for the purpose of providing shareholders with a return on capital provided in exchange for the corporation's shares. No investor would acquire the shares of a corporation without the expectation of some return on its investment. The Notice excepted distributions from the Per Se Rule, and we believe distributions should be excepted from the Funding Rule altogether.

To the extent the modified Funding Rule remains, and distributions are not categorically excepted from it, we recommend the following exceptions for certain dividends and other fundings:

- Funding Consistent with Pre-Excise Tax Practices: Any ordinary-course, arm's length payments, dividends or other funding that a U.S. subsidiary provides to its foreign parent, where the subsidiary historically engaged in such funding transactions and did not purchase any of its parent's shares for other than an exempt purpose (including in connection with equity compensation arrangements) before the Excise Tax was enacted. For administrative ease, we would suggest a 3-year lookback rule for this purpose.

- Funding to Finance Dividends by Foreign Parent: Any dividends paid by the U.S. subsidiary to its foreign parent that are less than the foreign parent's dividends to its shareholders during the tax year.

- Payments to Parent Companies in Treaty Countries: Any payment paid by a U.S. subsidiary to a foreign parent that is a resident of a treaty country where the treaty provides for a reduced or eliminated U.S. withholding tax rate on such payment. Absent this exception, the Excise Tax could violate the terms of many double-tax treaties that limit the U.S. taxation of such payment to foreign shareholders.

New Presumption in Proposed Regulations

The Proposed Regulations introduce a new unreasonable premise that if a principal purpose of a funding is to fund, directly or indirectly, a covered purchase, then with respect to that funding, there is a principal purpose to avoid the Excise Tax.

U.S. subsidiaries of a foreign parent do not typically acquire foreign parent stock outside of the equity compensation or M&A context, as this would create "hook stock" ownership interests in the foreign parent, which makes it more challenging for the foreign parent to pay dividends to its investors without creating circular cash flows. Therefore, the abuse that the Funding Rule is attempting to solve is quite an uncommon in practice. Fundamentally, it should already be clear that a U.S. subsidiary's funding of a foreign parent, whether or not intending to fund a share repurchase, does not evidence an abusive intent to avoid the Excise Tax, as this suggests the standard transaction that the IRS would expect the U.S. subsidiaries to undertake is the creation of significant hook stock interests.

Given the fungibility of money and the fact that many publicly-traded companies have long-term stock buyback programs in place, the new principal purpose test basically authorizes the IRS to take the position that a covered funding exists anytime there is a transfer of cash from a U.S. subsidiary to its foreign parent that is proximate in time to the parent's stock buyback and make a presumption that the U.S. subsidiary would otherwise have gone to public markets to acquire foreign parent stock instead. Such a position would be disconnected from standard market practice, and far afield from Treasury's stated purpose of preventing avoidance of section 4501(d) (which applies when a U.S. subsidiary actually purchases its parent stock). Per the Preamble, Treasury is concerned about scenarios in which a U.S. subsidiary would actually purchase shares of its parent's stock but, in order to avoid the Excise Tax, instead funds such purchase indirectly. As such, the Excise Tax should never apply unless the U.S. subsidiary intended to avoid the Excise Tax. Intending to finance a foreign corporation's stock buyback simply is not the same as intending to avoid the Excise Tax.

Furthermore, without considering intent, the Proposed Regulations ignores foreign country accounting rules and business practices that guide U.S. subsidiary behavior. Many foreign countries' local accounting rules require subsidiaries to pay dividends of their annual earnings to their parent company, in order to support the parent's dividends to its shareholders. Despite predating the Excise Tax, U.S. subsidiaries with a history of engaging in such practices with their foreign parent company would now be found in violation of the Proposed Regulations new premise. This is not a supportable position. A standard post-Excise Tax dividend which is both consistent with previous practices and the U.S. subsidiaries' earnings clearly does not demonstrate an intent to avoid the Excise Tax. As such, the premise of Prop. Reg. §58-4501-7(e)(1) must be revised.

Recommendation

For this reason, the presumption that a principal purpose to fund, directly or indirectly, a covered purchase equals a principal purpose to avoid the Excise Tax should be eliminated from the regulations. In the alternative, as noted above, a payment should not be considered to be made with a principal purpose to avoid the Excise Tax if the taxpayer has a substantial business purpose(s) for the payment unrelated to funding a covered purchase or avoiding the Excise Tax. At the very least, Treasury and the IRS should provide taxpayers with examples and/or safe harbors of how a U.S. subsidiary could establish that amounts it pays (as dividends, interest, or otherwise) to its foreign parent, which parent has a stock buyback program in place, are not paid with a principal purpose to fund the parent's stock buyback or avoid the Excise Tax.

Definition of "Covered Purchase"

Foreign subsidiaries of publicly traded parents (both U.S. and foreign) often enter into stock recharge agreements with their parent in order to provide equity compensation to their employees. In these arrangements, typically, the parent agrees to issue equity compensation directly to the employees, and the

foreign subsidiary employer makes a recharge payment to compensate the parent for the value of this stock. Under the Funding Rule's new rebuttable presumption, if a "downstream relevant entity" (*i.e.*, a 25% U.S.-owned foreign subsidiary) participates in a stock recharge arrangement, it appears that the recharge payment to its foreign parent would be considered a "covered purchase," with the result that the rebuttable presumption applies to any funding provided by the U.S. affiliate within the prior or subsequent two years. This is the case even where the downstream relevant entity solely acquires stock in the "covered purchase" that is used as equity compensation and issued directly to its employees.

There is nothing abusive about a foreign subsidiary engaging in a recharge arrangement with its parent to provide equity compensation to employees. In fact, in drafting the general netting rule of section 4501(c)(3) and the netting rule in section 4501(d)(1)(C), Congress made a clear policy choice that the issuance of shares to employees as compensation is an appropriate use of repurchased shares. Where a downstream relevant entity's only "covered purchases" relate to shares used for equity compensation, it would be administratively burdensome to require taxpayers to file (and the IRS to audit) Excise Tax returns rebutting the presumption of abuse for every ordinary course payment made to the downstream relevant entity under these facts.

Recommendation

Treasury should exempt from the definition of a "covered purchase" any acquisitions of foreign parent stock by a downstream relevant entity in which stock is issued entirely to the downstream relevant entity's employees as compensation. Such an exemption for this non-abusive but common situation would save time and compliance costs for both taxpayers as well as Treasury and the IRS.

If Treasury is unwilling to consider such an exemption, then as an alternative, we reiterate a recommendation that was made in the prior NFTC letter in response to the Notice. In situations like the above where the Funding Rule applies, the netting rule should include stock issued by the foreign affiliate to its employees (*i.e.*, the netting rule should be applied without regard to the limit in section 4501(d)(1)(C)).

<u>Foreign Shareholder Certification</u>

A statutory exception is provided in section 4501(e)(6) for share repurchases treated as dividends under the Code. Share repurchases by U.S. companies from foreign shareholders could trigger dividend treatment if the foreign person's shareholding is not sufficiently reduced under section 302(b)(2).

The Proposed Regulations continue to require shareholder certification of dividend treatment in order to use the dividend exemption under the Excise Tax, which provides that a corporation "(B) obtains certification from the shareholder that the repurchase constitutes a redemption treated as a section 301 distribution under section 302(d), or that the repurchase has the effect of the distribution of a dividend under section 356(a)(2), including evidence that applicable withholding occurred if required."

Recommendation

This requirement is excessively burdensome for multinational entities. As a practical matter, multinational entities will find it extremely difficult, if not impossible, to obtain certification from a foreign shareholder who does not file U.S. tax returns and otherwise has no U.S. tax nexus. Shareholders typically will not respond to requests for such a certification. Our prior comment recommending that the rules allow the U.S. company to provide Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding,

showing payment of a dividend instead of a certification from the foreign shareholder was rejected. We understand that Form 1042-S was not created for this purpose and may not encompass all required situations. However, we suggest that the Form 1042-S approach be permitted in situations that do not present the potential for inappropriate treatment and that other ways to simplify this burdensome requirement are considered.

Conclusion

We appreciate your consideration of our comments and are happy to provide additional information or clarifications. Please contact Anne Gordon, Vice President for International Tax Policy, at agordon@nftc.org.