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MIAMI OFFICE

December 6, 2019

FEDERAL EXPRESS # 7771 8419 2867
Internal Revenue Service
CC:PA:LPD:PR (REG-104223-18)
Room 5203
Post Office Box 7604
Ben Franklin Station
Washington, DC 20044

RE: Comments to the Proposed Regulations Concerning the Modification of Section 958(b).

Dear Sir or Madam:

On behalf of the Tax Section of the Florida Bar, we mailed to you on December 2, 2019 comments to the Proposed Regulations Concerning the Modification of Section 958(b) (the "Comments"), a copy of which is enclosed herewith as **Exhibit A**. We mistakenly failed to include an article written by Tax Notes that we reference in the conclusory paragraph of the Comments, a copy of which is enclosed herewith as **Exhibit B**. As such, we have enclosed as **Exhibit B** the article for your consideration when reviewing the Comments.

Please do not hesitate to contact me if you have any questions.

Best regards,

PACKMAN, NEUWAHL & ROSENBERG

/s/ CHRISTOPHER R. CALLAHAN

CHRISTOPHER R. CALLAHAN, ESQ.

CRC/gbf
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Enclosures

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December 2, 2019

Internal Revenue Service
CC:PA:LPD:PR (REG-104223-18)
Room 5203
Post Office Box 7604
Ben Franklin Station
Washington, DC 20044

RE: Comments to the Proposed Regulations Concerning the Modification of Section 958(b)

Dear Sir or Madam:

I am pleased to submit The Florida Bar Tax Section's comments to the Proposed Regulations concerning the repeal of Section 958(b)(4).

Principal authors for these comments were Christopher Callahan, Paul O'Quinn, and Shawn Wolf.

Although the members of The Florida Bar Tax Section who participated in preparing these comments may have clients who would be affected by the proposed regulations, no such member has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of these comments.

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The Florida Bar Tax Section is comprised of approximately 2,000 members.

As always, we will be pleased to provide additional commentary as requested. If you have any questions regarding our comments, please do not hesitate to contact us.

Sincerely,

Janette M McCurley

Janette M. McCurley, Chair

)00/61088

1. **Legislative history of the portfolio interest exemption.**

The Tax Cuts and Jobs Act of 2017's ("TCJA") repeal of Internal Revenue Code ("IRC") Section 958(b)(4) - effective for the last taxable year of foreign corporations beginning before January 1, 2018 – has unintentionally frustrated Congress' purpose for enactment in 1984 of certain laws aimed at stimulating foreign investment into the United States. In particular, frustrated by the TCJA, the Tax Reform Act of 1984 (Title I of the 1984 Deficit Reduction Act, hereinafter referred to as the "TRA") introduced the portfolio interest exemption (the "PIE") to provide U.S. businesses with direct and more efficient access to the international financial markets (in particular, the Eurobond market).[1] Prior to the TRA, U.S. businesses wishing to utilize international financial markets were incentivized from a U.S. tax perspective to use international finance subsidiaries; however, these subsidiaries were inefficient and wrought with inherent tax risk (which affected U.S. businesses' bottom lines).[2] The PIE was designed by Congress to remove the underlying obstacle altogether, thus making the international finance subsidiaries obsolete and strengthening U.S. businesses as a result.

Despite its desire to help U.S. businesses access the Eurobond (and other international) financial markets, however, "Congress did not believe it appropriate to allow foreign corporations controlled by U.S. taxpayers to enjoy both (1) exemption from U.S. withholding tax and (2) deferral of taxation on passive interest income (at the U.S. shareholder level)...Congress believed that controlled foreign corporations should benefit from [the PIE] only to the extent that their income that benefits from [the PIE] is currently taxed to their U.S. owners and retains its source and character in the hands of those U.S. owners". As such, Congress enacted certain limitations to curtail such perceived abuses. As discussed below, some of these limitations intersect with the recent repeal of IRC Section 958(b)(4) to frustrate Congress' design for the PIE to provide U.S. businesses with more efficient access to international financial markets.

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[1] See *Staff* of the *Joint Committee on Taxation*, General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984, *98th Cong, 2d Sess.* 387-398 (1984); see also S. Prt. 98 - 169 , Vol. I, pp. 416-24 (April 2, 1984); see also H. Rep. 98-861, Pt. 2, pp. 936-38 (June 23, 1984); see also H. Con. Res. 328, 130 Cong. Rec. S8944-45, H7526 (June 29, 1984).

[2] *Id.* In order to avoid the thirty percent withholding tax on interest, a U.S. debtor would form an affiliated finance corporation [i.e., an International Finance Subsidiary or IFS] in a favorable treaty jurisdiction such as the Netherlands Antilles. The IFS would issue bonds to foreign persons (e.g., on the Eurobond market) and, in turn, would lend the bond proceeds to the U.S. debtor. Interest income derived by an IFS formed in the Netherlands Antilles would be exempt from the thirty percent withholding tax under article VIII of the United States-Netherlands Income Tax Convention (as extended to the Netherlands Antilles) [hereinafter Netherlands Antilles Treaty]. T.D. 5778, 1950-1 C.B. 92, as supplemented by the Protocol of June 15, 1955, 6 U.S.T.3703, T.I.A.S. No. 3367 (extending the Convention to the Netherlands Antilles), modified by the Protocol of October 23, 1963, 15 U.S.T. 1900, T.I.A.S. No. 5665. Furthermore, interest paid by the IFS to its foreign bond holders would not be subject to the thirty percent withholding tax; such payments would be treated as foreign source income that is not effectively connected with a U.S. trade or business. *See* I.R.C. §§ 861(a)(1) and 884(f)(l)(A). The interest earned by the IFS would be subject to such taxation in the Netherlands Antilles, but only after deducting from such income interest owed to the foreign bondholders.

2. **Mechanics of the portfolio interest exemption.**

Generally, a foreign person (the "FP") is subject to U.S. income tax on passive income to the extent such income is sourced within the United States. Interest income arising from debt obligations is generally sourced by the residence of the borrower. Therefore, interest income derived from a loan to a U.S. borrower will be sourced within the U.S. and could be subject to U.S. income tax withheld up front at a flat thirty percent (30%) rate (the "Withholding Tax"). However, there are exceptions to the imposition of the Withholding Tax even when interest income is sourced within the United States. One of these exceptions is the PIE.

The U.S. income tax law provides, in pertinent part, that in the case of any "portfolio interest" received by an FP from U.S. sources, no withholding and no tax shall be imposed.[3] The term "portfolio interest" generally includes any interest which is paid on any obligation: (1) which is "in registered form"; and (2) with respect to which the U.S. borrower who would otherwise be required to deduct and withhold tax on payment of such interest receives a statement from the beneficial owner of such obligation that said owner is not a U.S. person (the "Statement Requirement").[4]

As discussed above, however, Congress created limitations on the PIE, which, when applicable, result in the PIE not being available. The first of such limitations relevant to this discussion is that the PIE does not apply to a loan between "related parties". In this regard, the term portfolio interest does not include any portfolio interest that is received by a ten percent (10%) shareholder. A ten percent shareholder is defined as: (1) in the case of a borrower who is a corporation, any person owning ten percent or more of the total combined voting power of all classes of stock of such corporation entitled to vote; and (2) in the case of a borrower who is a partnership, any person who owns ten percent or more of the capital or profits interest in such partnership.[5]

These rules provide that for the purposes of determining ownership of stock pursuant to § 871(h)(3)(C), the rules of § 318(a) shall apply with certain modifications.[6] Generally, an individual shall be considered as owning the stock owned, directly or indirectly, by or for his spouse and his children, grandchildren, and parents ("individual-to-individual" attribution).[7] In addition, stock owned, directly or indirectly, by or for a partnership shall be considered as owned proportionately by its partners and stock owned directly or indirectly by a corporation will be considered as owned by the shareholders in that proportion which the value of the stock which such person so owns bears to the value of all stock in the corporation ("entity-to-individual" attribution).[8] Moreover, stock owned, directly or indirectly, by or for a partner shall be considered as owned by the partnership and stock owned, directly or indirectly, by a shareholder of a corporation shall be considered as owned by the corporation ("individual-to-entity" attribution).[9] However, stock constructively owned by an individual shall not be considered as owned by such

[3] IRC Sections 871(h), 881(c), 1441(a) and 1442(a); see also Treas. Reg. Section 1.871-14.
[4] IRC Section 871(h)(2)(B). As described in Treas. Reg. Section 1.871-14(c)(2).
[5] See IRC Section 871(h)(3)(B).
[6] IRC Section 871(h)(3)(C).
[7] IRC Section 318(a)(1)(A).
[8] IRC Sections 318(a)(2)(A) and (C).
[9] IRC Sections 318(a)(3)(A) and (C).

individual in order to make another individual the constructive owner of such stock.[10] Stock constructively owned by a partnership or corporation shall not be considered as owned by such partnership or corporation in order to make a partner or shareholder the constructive owner of such stock.[11]

The second important limitation is that the term portfolio interest does not include any portfolio interest that is received by a Controlled Foreign Corporation ("CFC") from a related person within the meaning of IRC Section 864(d)(4). For this purpose, IRC Section 864(c)(3)(C) references the attribution rules of IRC Section 267(b). The attribution rules of IRC Section 267(b) are more expansive than those of IRC Section 318 [as modified by section 871(h)(3)(B)]. For example: IRC Section 318 does not result in attribution between siblings whereas IRC Section 267(b) does.[12] Another example is that while IRC Section 318 provides for certain attribution between a partner and a partnership, IRC Section 267(b) has more expansive attribution rules relating to partners.[13] Prior to the repeal of IRC Section 958(b)(4), which prevented the "downward attribution" of stock held by a foreign person to a U.S. person, the only CFCs that would have been caught by this rule were those where U.S. persons controlled the foreign company without attribution from any foreign persons. In this context, and as discussed below, these limitations worked well to achieve their intended goals until the recent repeal of IRC Section 958(b)(4). Now, as discussed herein, the intent of the PIE rules may be frustrated.

As the result of the repeal of IRC Section 958(b)(4), however, a U.S. corporation owned by a foreign corporation may be treated as constructively owning the stock of the foreign corporation that owns the U.S. corporation. This may cause the foreign corporation to be a CFC for U.S tax purposes despite there being no direct (or even indirect) U.S. shareholders. As a result, due to the expanded rules applicable to CFCs with regard to defining a related person for the PIE, loans that would not have been treated as being between related persons prior to the repeal of IRC Section 958(b)(4) may now be treated as related loans that no longer qualify for the PIE.[14]

3. <u>Legislative history of the repeal of IRC Section 958(b)(4).</u>

The TCJA's repeal of IRC Section 958(b)(4) was effective for the last taxable year of foreign corporations beginning before January 1, 2018, and for all subsequent taxable years of foreign corporations, and for the taxable years of United States shareholders in which or with which such taxable years of foreign corporations end.[15] In summary, this made the repeal of section 958(b)(4) retroactive through January 1, 2017.

The legislative intent of the TCJA amendment to IRC Section 958 was "to render ineffective certain transactions that [were] used ... as a means of avoiding the subpart F

[10] IRC Section 318(a)(5)(B).
[11] IRC Section 318(a)(5)(C).
[12] See IRC Sections 881(c)(3), 871(h)(3), 318(a), 864(d)(4) and 267(b).
[13] See Treas. Reg. Section 1.871-14 (g)(2)(ii)(B) which provides that similar rules of ownership attribution applicable to corporations shall be applied for purposes of determining ownership attribution of a capital or profit interest in a partnership.
[14] IRC Sections 864(d)(4) and 267(b)
[15] Pub. L. 115–97, title I, Section 14213(a), Dec. 22, 2017, 131 Stat. 2217.

provisions...", i.e., "decontrol" transactions.[16] Prior to the TCJA's repeal of IRC Section 958(b)(4), a similar proposal was suggested for the same purpose on September 29, 2015,[17] in the Obama Administration's Fiscal Year 2016 Budget Proposal (under a section entitled "Close Loopholes Under Subpart F.")[18] The 2016 Budget Proposal suggested amending the CFC attribution rules, and eliminating the 30-day grace period before subpart F inclusion.[19] The 2016 version of this amendment was introduced in the House of Representatives on May 17, 2016, but did not advance out of the Ways and Means Committee.[20]

The amendment contained in the TCJA is more unforgiving to pre-existing foreign corporations than the proposed 2016 amendment, which would have repealed 958(b)(4) only for foreign corporations whose stock was acquired after May 17, 2016.[21] The "Senate Finance Committee [explained] that the provision is not intended to cause a foreign corporation to be treated as a controlled foreign corporation with respect to a U.S. shareholder as a result of attribution of ownership under section 318(a)(3) to a U.S. person that is not a related person (within the meaning of section 954(d)(3)) to such U.S. shareholder as a result of the repeal of section 958(b)(4)."[22] However, in spite of Congress's apparent narrow intent, the TCJA effectuated a total repeal of IRC Section 958(b)(4). Without any limiting language or subsequent amendments, a literal reading of IRC Section 958(b)(4) results in the unrestrained application of downward attribution rules for foreign corporations.

While the legislative history indicates that the repeal of IRC Section 958(b)(4) was intended to specifically target the "decontrol" transaction (*see* discussion in below), the proposed regulations fall short of limiting the effects of unrestrained downward attribution to the intent expressed by Congress.[23] Instead, the proposed regulations utilize specific grants of authority found in other Code provisions in order to effectuate the situational reinstatement of IRC Section 958(b)(4) (i.e., the proposed regulations do not apply downward attribution only in enumerated instances).[24] While this narrows the scope of IRC Section 958(b)(4) repeal and represents a thoughtful attempt to mitigate some of the unintended consequences of the repealed paragraph, the result of the repeal and the proposed regulations is a patchwork of exceptions that adds additional layers of complexity to numerous situations, and yet it simultaneously falls short of addressing all of the unintended consequences outside of the narrow scope of the targeted decontrol transactions initially described by

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[16] H.R. Conf. Report 115-466, 115th Cong., 1st Sess, p. 633 (Dec. 15, 2017)
[17] The IRS had previously addressed the de-control transaction in part, in Notice 2014-52 (which concerned certain inversion transactions under sections 367 and 7874). This notice addressed the de-control issue by preserving CFC status for the foreign subsidiary, but did not address de-control transactions in a non-inversion context. *See* Notice 2014-52, section 2.03(a).
[18] Description of Certain Revenue Provisions Contained in the President's Fiscal Year 2016 Budget Proposal, JCS-2-15, at pp. 68-7 (September 2015).
[19] The 30-day grace period was also repealed as part of the TCJA. *See* Pub. L. 115–97, title I, Section 14215, Dec. 22, 2017, 131 STAT. 2218.
[20] H.R.5261, sec. 2(d) (114th Congress), "Protecting the U.S. Corporate Tax Base Act of 2016."
[21] *Id.*
[22] Committee Print, Reconciliation Recommendations Pursuant to H. Con. Res. 71, S. Prt. 115–20, (December 2017), p. 378, as reprinted on the website of the Senate Budget Committee, available at https://www.budget.senate.gov/taxreform.
[23] REG-104223-18, 84 FR 52398-52410;
[24] *Id.* [citing IRC Sections 267(a)(3)(B)(ii); 332(d)(4); 367(a); 672(f)(3); 863(d)(1); 863(e)(1)(B)(i); 904(d)(7); 1298(g); 6049(a)]

Congress.[25]

Most notably absent from the patchwork of exceptions is any discussion of or exception for the portfolio interest exemption.[26] The application of downward attribution renders the portfolio interest exemption inapplicable for many corporations. The Treasury, to date, has not provided a proposed regulation that would render the IRC Section 958(b)(4) repeal situationally inapplicable for downward attribution's effect on the portfolio interest exemption, as it has for other affected provisions.

4. **Relief for the PIE and CFCs.**

We suggest that the Treasury may utilize the broad authority granted to it in IRC Section 7805(a) to "prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue."[27] The repeal of section 958(b)(4) results in the very situation that IRC Section 7805(a) was intended to address, the need for rules and regulations resulting from an alteration of law relating to the internal revenue (i.e., subsequent to the repeal the Treasury may issue guidance in determining how to apply IRC Sections 318, 951, and 958).

Under IRC Section 7805(a), the Treasury may promulgate a more effective, broader exception that is tailored to provide relief for all sections affected by the IRC Section 958(b)(4) repeal, while simultaneously ensuring that the effects of downward attribution targeted only the decontrol transaction, as expressly intended by Congress. Issuing regulations under § 958 that incorporated the clear legislative intent of the IRC Section 958(b)(4) repeal would not only be consistent with the Treasury's approach to the issuance of CFC related regulations, it would also prove consistent with regulations previously issued under IRC Section 958.[28]

In the event that the Treasury disagrees with the advantages of broader regulations that targets only the decontrol transactions, then at the very minimum the Treasury should issue an additional "patch" that in effect adds the portfolio interest exception to the enumerated list of exceptions in the recently proposed regulations[29], to which the IRC Section 958(b)(4) repeal does not apply.

As examined in more detail in the specific examples below, absent issuing the regulations discussed above (which the Treasury apparently has the authority to do), the overbroad result of the repeal of IRC Section 958(b)(4) would be contrary to the Congressional intent underlying its creation as well as the Congressional intent relating to the PIE. At a minimum, the preamble to the related final regulations should either: (a) make it clear that the PIE is not discussed in this context because the issue needs further government review; or (b) provide a specific explanation as to why the application of the CFC rules to the PIE rules are beyond the scope of the IRS' authority.

[25] H.R. Conf. Report 115-466, 115th Cong., 1st Sess, p. 633 (Dec. 15, 2017).
[26] See IRC Sections 871(h) and 881(c).
[27] IRC Section 7805(a).
[28] See e.g., Treas. Reg. Sections 1.958-1; 1.958-2.
[29] REG-104223-18

5. **Additional relief for withholding agents.**

The U.S. income tax law provides, in pertinent part, that in the case of any "portfolio interest" received by a foreign payee from U.S. sources, no withholding and no tax shall be imposed. However, absent intervention (as discussed above), withholding agents may not be able to determine whether the payee is eligible for the PIE, and thus from a practical perspective, may be forced to withhold (to avoid personal liability for failing to do so). As a result, the payee may be forced to file a refund claim, which could cause unnecessary burden on IRS resources (as such filing may otherwise not be required, and as the IRS would now need to determine if the entity is a CFC). As such, in addition to the relief sought above, additional relief designed to minimize this burden with regard to the withholding agents would be consistent with government policy and increase the efficiency of the related statutes. There are many instances of similar relief granted in the law. Below are two examples.

a. Legislative History Relating to Withholding.

As discussed above, IRC Sections 871(a) and 881(a) impose a 30% tax on certain U.S.-source income of an NRA ("FDAP Income"). To increase the collectability of this tax, Congress determined that payment of this 30% tax is enforced by the withholding of tax at source by the payor under IRC Sections 1441 and 1442[30]. To assist withholding agents to determine who was and was not subject to the withholding procedures, the Treasury promulgated regulations to provide guidance as to such determination. To promote consistently and clarity for the withholding agent, the Treasury's regulations provided (among other things) a safe harbor procedure for withholding agents to be able to rely on information provided by the payee confirming that the payee is a U.S. income taxpayer (and thus not subject to the withholding tax regime under IRC Sections 1441 and 1442). This safe harbor is established where the withholding agent receives from the payee (and reasonably relies upon) a Form W-9.[31] Thus, absent actual knowledge or reason to know otherwise, a withholding agent may rely on a furnished Form W-9 in order to determine whether to treat a payee (or beneficial owner, when applicable) as a U.S. person (not subject to FDAP income withholding).[32]

b. Revenue Procedure 2019-40.

The IRS created Revenue Procedure 2019-40 to provide a safe harbor to a U.S. person that owns an interest in a foreign-controlled CFC. Essentially, so long as the U.S. person does not have actual knowledge or constructive knowledge that the entity is a CFC and makes certain inquiries of the entity, the IRS will accept a U.S. person's determination that the foreign corporation is not a CFC with respect to the U.S. person. Thus, under the safe harbor, a foreign-controlled CFC will not be treated as a CFC with respect to a U.S. person, provided the U.S. person

[30] Although IRC Section 1442 is the applicable law relating to withholding on foreign corporations, Treas. Regs. Section 1.1442-1 incorporates Treas. Regs. Section 1.1441-1 through Treas. Regs. Section 1.1441-9. Thus, for purposes of these comments, IRC Sections 1441 and 1442 may be refenced interchangeably.

[31] Treas. Regs. Section 1.1441-1(b)(2)(i) and (d); TD 8734, 1997-2 CB 109 (Nov. 3, 1997).

[32] Treas. Reg. Section 1.1441-1(d)(1).

satisfies the knowledge, statement, and publicly available information conditions, and, if applicable, makes the necessary inquiries of any top-tier entities. There is no requirement for the U.S. person to otherwise make any inquiries in order for the safe harbor to apply, including inquiries of unrelated persons that own interests in the top-tier entity. In addition, the condition appears to be satisfied by a genuine request for the information; thus, it may not also require, for example, the entity to respond to the request with an appropriate response. Once again, the safe harbor is meant to alleviate an otherwise overly burdensome obligation (in this case a reporting burden, rather than a withholding burden) that may be impractical to satisfy absent the safe harbor. This is particularly welcome relief for U.S. owners of foreign entities that were unable to obtain sufficient information to determine the CFC status of their foreign investments.

c. Request for Relief.

We request that you issue guidelines to the withholding agents relating to IRC Sections 1441 and 1442 that will practically allow business to continue without withholding agents creating stress on the tax system by generally withholding. Absent such guidance, thousands of payee refund tax returns would be filed annually, thus creating a massive administrative burden on the IRS to process them. Just consider for a moment an investment fund with 1000 investors – think about the withholding and refund claim burdens! The Treasury should provide some manner in which the withholding agents can confirm that the payee is not affected by the repeal of IRC Section 958(b)(4) so that withholding does not have be performed to alleviate the withholding agent from personal liability for the IRC Section 1441 and 1442 withholding tax. This could be a new form, an extra box on a Form W-8, a safe harbor rule (similar to those discussed above in Sections 4a and 4b), or some other documentation that the withholding agent could rely upon for these purposes. This way, the withholding agent does not have to impossibly determine a payee's facts seemingly on a daily basis in order to avoid being liable for the related substantive tax that may be owed as a result of the repeal of IRC Section 958(b)(4).

6. **Examples of the above problems caused by the repeal of IRC Section 958(b)(4).**

a. Example 1 – Unrelated Parties.

Facts: NRA1 and NRA2, unrelated parties, have real estate investments in the United States. Both NRA1 and NRA2 own their respective U.S. real property investment through a common holding structure. In that regard, NRA1 owns 100 percent of a foreign corporation ("FC1"), which wholly owns a U.S. corporation ("USCO1"), which wholly owns U.S. real property. Similarly, NRA2 owns 100 percent of a foreign corporation ("FC2"), which wholly owns a U.S. corporation ("USCO2"), which wholly owns U.S. real property. In addition, NR1 wholly owns another foreign corporation ("FC3") through which he has passive investments and sometimes lends money to U.S. persons and/or businesses as investments (whether as loans or by investing in U.S. debt instruments). For this purpose, assume that FC3 is not engaged in a U.S. trade or business. In 2019, FC3 makes a loan to USCO2. Assume FC3 and USCO2 enter into an appropriate registered, non-negotiable loan agreement with stated, non-contingent,

interest. Assume also that FC3 provides USCO2 with a preproperate W-8 series Form in order to establish its foreign status.

Issue: Is this a related party transaction that would disqualify the loan for the benefits of the PIE?

Application to the law: As IRC Section 318 does not result in attribution from unrelated individuals, NRA2 is not attributed a 10% or greater interest in FC3, and thus FC3 is not treated as a related party with regard to USCO2.

Result: This is not a related party loan and qualifies for the PIE and USCO2 would not be required to withhold.

b. <u>Example 2 - Pre-repeal of IRC Section 958(b)(4) Application of the PIE to Section 267 Related Parties who are not Section 318 Related Parties.</u>

Facts: The facts are the same as Example 1, except that NRA1 and NRA1 are siblings and that the loan was made in 2016. Also, to avoid any potential complications, assume that the parents, grandparents and other lineal ascendants of NRA1 and NRA2 are deceased.

Issue: In 2016, is this a related party transaction that would disqualify the loan for the benefits of the PIE?

Application of the law – the PIE: As IRC Section 318 does not result in attribution from unrelated individuals, and as IRC Section 267 is not applicable (as the repeal of IRC Section 958(b)(4) has not yet caused downward attribution to result in the related entity being treated as a CFC), NRA2 is not attributed a 10% or greater interest in FC3, and thus FC3 is not treated as a related party with regard to USCO2.

Application of the law – withholding: As a result of the above, USCO2 would be not be required to withhold on the interest payments made to FC3.

c. <u>Example 3 - Post-repeal of IRC Section 958(b)(4) Application of the PIE to Section 267 Related Parties who are not Section 318 Related Parties.</u>

Facts: The facts are the same as Example 1, except that NRA1 and NRA1 are siblings and the loan is made in 2019. Also, to avoid any potential complications, assume that the parents, grandparents and other lineal ascendants of NRA1 and NRA2 are deceased.

Issue: In 2019, is this a related party transaction that would disqualify the loan for the benefits of the PIE?

Application of the law – the PIE: As IRC Section 318 does not result in attribution from unrelated individuals, NRA2 is not attributed a 10% or greater interest in FC3, and thus FC3 is not treated as a related party with regard to USCO2.

Due to downward attribution [post repeal of IRC Section 958(b)(4)], however, FC3 would be treated as a CFC, thus requiring the application of the broader attribution rules of IRC Section 267(b) to determine whether the loan is between related parties. In that regard, this would be

considered to be a related party transaction under IRC Section 267(b) because the relevant attribution rules would cause attribution between the siblings. The result, which we believe was not the intention of Congress in repealing IRC Section 958(b)(4), is that IRC Section 864(c) prevents the application of the PIE.

Application of the law – withholding: As a result of the above, USCO2 would be required to withhold on the interest payments made to FC3; however, assuming that NRA2 and/or USCO2 do not know the worldwide holdings of NRA1 (which is not an uncommon occurrence, even in family situations), USCO2 would not be able to conclude that FC3 is a CFC and/or to review the related party rules of IRC Section 267(b). In this regard, without there being a manner in which USCO2 can be provided some form of reliable certification of non-CFC status by FC3, USCO2 may be advised by its U.S. tax advisors to withhold on any payments to FC3 in order to avoid any liability for failing to withhold (if the IRS ever determines that IRC Section 1442 applies due to lack of availability of the PIE). In this situation, such advice would satisfy the substantive tax liability.

d. <u>Example 4 - The Withholding conundrum related to the Application of the PIE to Section 267 Related Parties who are not Section 318 Related Parties.</u>

Facts: The facts are the same as Example 2, except that on December 31, 2019, NRA1 disposes of FC1 and USCO 1.

Issue: In 2017, 2018, 2019 and 2020, is this a related party transaction that would disqualify the loan for the benefits of the PIE?

As a result of the above, the application of the PIE rules are as follows:

2016: see Example 2.

2017, 2018, and 2019: see Example 3.

2020: Because there is downward attribution [post repeal of IRC Section 958(b)(4)] to make FC3 a CFC, the answer is the same as Example 2.

As a result of the above, the application of the withholding rules are as follows:

2016: see Example 2.

2017: see Example 3; however, as discussed above, the repeal of IRC Section 958(b)(4) was retroactive through January 1, 2017. As a result, withholding agents may have been unable to determine whether withholding was required during 2017. Those withholding agents who determine that withholding was required with regard to 2017 transactions may now be liable for the tax (if not withheld or otherwise paid) and potential penalties and interest. Those withholding

agents who cannot make the CFC / related party transaction determination and who did not withhold are open to potential liability for the tax and potential penalties and interest.

2018 and 2019: see Example 3.

2020: USCO2 would not be required to withhold on the interest payments made to FC3; however, assuming that NRA2 and/or USCO2 do not know the worldwide holdings of NRA1 (which is not an uncommon occurrence, even in family situations), USCO2 would not be able to conclude that FC3 is not a CFC and/or to review the related party rules of IRC Section 267(b). In this regard, without there being a manner in which USCO2 can be provided some form of reliable certification of non-CFC status by FC3, USCO2 may be advised by its U.S. tax advisors to withhold on any payments to FC3 in order to avoid any liability for failing to withhold (if the IRS ever determines that IRC Section 1442 applies due to lack of availability of the PIE).

e. Comments on the Examples.

The disparate treatment of the friends in Example 1, and the siblings in Example 2, 3 and 4, demonstrates one of the most concerning pitfalls to the PIE related to the removal of IRC Section 958(c)(4): the impact it could have on investors who are expecting to receive PIE benefits and the related impact it could have on withholding agents that cannot determine CFC / related party status without a review of the detailed facts of each lender. These simple examples only underscore a myriad of issues that may arise in the context of the PIE, especially as a result of the breadth of the IRC Section 267(b) attribution rules. More specifically, and a fact pattern that would require more time to lay out than available in order to meet the submission deadline of these comments, relates to loans by foreign companies to U.S. based funds (or the U.S. entities owned by them), the downward attribution resulting from the repeal of IRC Section 958(b)(4), the manner in which the IRC Section 267(b) rules can apply to partners and the related inability of the withholding agent to determine CFC status. Other more complex examples could also be provided whereby the downward attribution rules of resulting from the repeal of IRC Section 958(b)(4) and the related party rules of IRC Section 267 may result in unanticipated denial of the PIE benefits and burdensome determinations for a withholding agent. Absent the relief requested herein, these types of issues will arise more frequently and will continue to be an issue into the foreseeable future.

7. **Conclusion.**

The portfolio interest exemption resulted from the confluence of the general rules applicable to foreign investment in the United States, the historical development of the international financial markets, initially in Europe and later in Asia, and the transformation of the United States into a major debtor nation. For years, the U.S. regime for taxing interest paid to foreigners acted as an obstacle to foreign financing. Before the enactment of the portfolio interest exemption by the Tax Reform Act of 1984. The portfolio interest exemption was designed to remove the obstacle altogether. The repeal of IRC Section 958(b)(4) eviscerates this design in many scenarios and relief must be granted to alleviate the related burden.

Although we understand that you believe you may not have regulatory authority to be able to address the technical tax aspects of IRC Section 881 (see attached Tax Notes article dated November 14, 2019), we believe you do have such authority. In addition, regardless of whether or not you have such authority, you should be able to issue guidelines to the withholding agents relating to IRC Section 1442 to enable withholding agents to take reasonable steps to alleviate their liability for the withholding tax where CFC status may be difficult or impossible to determine. Doing so will reduce the burden on the withholding agents and result in less refund claims being filed with the government.

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Authority at Issue for Downward Attribution Interest Relief

Posted on Nov. 14, 2019

By Andrew Velarde

The U.S. Treasury Department doesn't believe it has the authority to provide relief from the repeal of downward attribution for portfolio interest.

"We did feel comfortable with our authority to address rules that are either in regulations . . . or in other statutory provisions [where] Treasury was given regulatory authority to make adjustments to the statute," Douglas Poms, Treasury international tax counsel, said at the American Institute of CPAs National Tax Conference in Washington November 13. "[Portfolio interest] is an example where it's a statutory rule, and there's no specific regulatory grant to address that. . . . At this time we aren't comfortable with our authority to fix that."

The Tax Cuts and Jobs Act repealed section 958(b)(4), which had provided rules for determining the constructive stock ownership of a foreign corporation for subpart F purposes. Section 958(b)(4) specified that the downward attribution rule of section 318(a)(3) was not to be applied so that a U.S. person would be regarded as owning stock owned by a non-U.S. person.

The repeal resulted in the creation of potentially far more controlled foreign corporations than had existed previously. Joseph Calianno of BDO USA LLP said that because of the repeal, practitioners examining restructuring must contend with a new layer of complexity in their analysis.

The proposed regs (REG-104223-18), released October 1, focus on changes that would turn off the TCJA downward attribution pivot to ensure operational consistency. Those include changes related to section 267 deductions for payments to related foreign parties, section 332 liquidations of holding companies, the section 367(a) triggering events exception for gain recognition agreements, the section 1297 passive foreign investment company asset test, the section 904 CFC look-through rules and active rents and royalties exception to passive income, and chapter 61 reporting provisions.

The regs were released simultaneously with Rev. Proc. 2019-40, which provides safe harbors — including for determining when a foreign corporation is a CFC, and for determining earnings and profits of a CFC and items of a section 965 specified foreign corporation based on alternative information — as well as modifications to filing requirements for Form 5471.

While the guidance was generally welcomed by practitioners, some were dismayed that it did not go further, pointing to, for example, its failure to provide relief for portfolio interest. Because CFCs are ineligible for the portfolio interest exception, the section 958(b)(4) repeal means many non-U.S. entities do not qualify for the zero rate under the exception.

Given authority concerns, Poms said Treasury views legislative technical corrections as the vehicle to directly address concerns surrounding the repeal. Still, Poms welcomed any

comments to the proposed regs that could offer arguments on where authority did exist for further relief.

"If there are areas that taxpayers feel need fixing that they think we do have the authority to fix, we are very interested in hearing that," Poms said, specifically citing portfolio interest.

Poms also gave a quick preview of coming international guidance projects that Treasury hopes to release in 2020. According to Poms, those include final regs on the foreign-derived intangible income provision, final regs on the high-tax exception for the global intangible low-taxed income provision, and final regs under section 245A. Poms also said that proposed regs on previously taxed earnings and profits should be out by early 2020.

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