UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

June 4, 2020

Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20044

RE: IRS REG-106013-19 - Guidance Involving Hybrid Arrangements and the Allocation of Deductions Attributable to Certain Disqualified Payments Under Section 951A (Global Intangible Low-Taxed Income)

Dear Commissioner Rettig:

USCIB[1] is pleased to provide comments on the proposed regulations regarding guidance related to certain hybrid arrangements and conduit financing arrangements as provided in the above referenced proposed regulations.

General Comments

The proposed regulations were issued in conjunction with final hybrid regulations. The final regulations were largely based on the OECD's two Action 2 Final Reports.[2] In prior comments[3] on the proposed regulations on which these final regulations were based, USCIB advocated against extending the hybrid regulations to instruments that are not hybrid – both countries treat the instrument as equity – but the other country allows a notional interest deduction with respect to that equity.

The final regulations retain this rule and the preamble, in our view, does not adequately address the concerns we raised in our comment letter. As discussed in more detail in our prior letter, the Action 2 Final Reports were intended to prevent taxpayer from exploiting unintended gaps, rather than taking advantage of deliberate and legitimate tax policy choices of other countries. Notional interest deductions are such a choice. The government argues that NIDs create deduction/no inclusion outcomes – of course they do – the deduction is notional; there is no payment and therefore no recipient that could have an inclusion.[4] Other governments choose to use notional interest deductions to encourage the use of equity, which has a stabilizing effect when there is an economic downturn. That is, when companies are facing

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[1] USCIB promotes open markets, competitiveness and innovation, sustainable development and corporate responsibility, supported by international engagement and prudent regulation. Its members include top U.S.-based global companies and professional services firms from every sector of our economy, with operations in every region of the world. With a unique global network encompassing leading international business organizations, USCIB provides business views to policy makers and regulatory authorities worldwide and works to facilitate international trade and investment.

[2] Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2: 2015 Final Report (October 2015) and Neutralising the Effects of Branch Mismatch Arrangements, Action 2: Inclusive Framework on BEPS (July 2017).

[3] https://www.uscib.org/uscib-content/uploads/2019/02/USCIB_Final_comment_letter_hybrids_2_26_19.pdf

[4] The government does not seem to find the deduction/no inclusion analysis as compelling in other cases. See §1.245(A)(e)-1(d)(2)(ii)(B) which ignores the fact that deductions have been denied in certain hybrid mismatch cases.

liquidity issues, as is of course the case now, they are in a better position to handle those issues when debt/equity ratios are lower. Thus, governments have a legitimate interest in pursuing these policies that will stabilize their economies in downturns and the regulations should not undercut the deliberate policy choices of other countries.

Specific Comments

Expansion of the Conduit Financing Regulations to Cover Equity Instruments for which a Notional Interest Deductions is Available

As discussed above, USCIB disagrees with treating equity on which a notional interest deduction is available as a hybrid instrument under section 245A. We, therefore, disagree with treating an equity instrument on which a notional interest deduction is available as a conduit financing transaction that might link other financing transactions to create a financing arrangement. The preamble of the proposed regulations sets out three possible options for modifying the conduit financing regulations in light of the hybrid rules. The third option is the broadest option and is the one adopted. The first option was a no change option. The second option would have expanded the conduit financing regulations to cover hybrid equity, but not notional interest deductions. USCIB believes that either the no change or narrower option would be more appropriate.

For all the reasons set forth in our earlier letter, we do not believe equity that is entitled to a notional interest deduction should be within the scope of the hybrid rules, so it should not be swept into the conduit financing rules for the same reasons. There are, however, additional reasons not to include equity entitled to notional interest deductions in the scope of the conduit financing regulations.

The government argues that the broader rule "will efficiently, and in a manner that is clear and administrable, prevent inappropriate avoidance of the conduit financing regulations."[5] This is not the case. The conduit financing regulations require a tax avoidance plan. While the burden of proof is not clear, taxpayers may need to demonstrate the absence of a plan. Proving a negative is never easy and adding a requirement to prove the absence of a tax avoidance plan will not be clear and administrable. Further, the deduction is a matter of legislative grace; that is, it might have been adopted long after the other elements of the "financing arrangement" were already in place (presumably there would be no tax avoidance purpose in that case) and may be eliminated by actions outside of the control of the taxpayer – the country may repeal the law permitting the deduction. New investments in companies with activities in a country with a notional interest deduction will in all cases be subject to these rules, subject to the taxpayer's ability to prove a negative, that will not result in a clear and administrable rule.

Further, the application of the conduit financing regulations in this case ignores the possible application of the denial of the underlying interest or royalty deduction under section 267A. Because the final regulations provide rules for disallowing deductions in the case of an imported mismatch, the application of the conduit financing rules is unnecessary. The hybrid transactions outside the US, may be treated as imported into the US and therefore the interest or royalty deduction may be denied. If the conduit financing transactions then apply to same transaction, US withholding taxes at the rate of 30% may also be imposed resulting in an effective rate of US tax of 51%. USCIB believes this outcome is inappropriate in all cases but is especially problematic in the case of notional interest deductions. As stated previously, the other jurisdiction may be exercising it sovereign taxing rights to encourage equity financing by

[5] Proposed regulations, 85 FR 19858 at 19865.

attempting to equalize the distortions between equity and debt. The US should not punish those decisions.

Sincerely,

William J. Sample
Chair, Taxation Committee
United States Council for International Business (USCIB)

Washington Office
1400 K Street, N.W., Suite 525
Washington, DC 20005
202.371.1316 tel
202.371.8249 fax
www.uscib.org