UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

October 28, 2020

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

**RE: USCIB Comments related to 2020 Proposed Regulations under Section 163(j) (REG-101911-18)**

Dear Commissioner Rettig:

USCIB[1] is pleased to provide comments related to 2020 Proposed Regulations under Section 163(j).

**Sale of Property, Partnership Interest, or Stock DD&A Addback**

Adjusted Taxable Income ("ATI") for purposes of 163(j) business interest limitation includes an addback of depreciation, amortization, or depletion ("DD&A") expense for tax years beginning before January 1, 2022. This addback increases the amount of business interest expense deduction allowable in all cases. The final regulations include an additional adjustment to ATI related to the DD&A addback in subsequent years related to sales of property, partnership interests, or stock. The proposed regulation define this adjustment as a subtraction from ATI for the lesser of: gain on the sale of the property or the DD&A addback on the property sold during tax years after December 31, 2017 and before January 1, 2022 ("Proposed Regulation Adjustments").[2] The preamble explains that the Proposed Regulation Adjustments "were intended … [to] ensure that the positive adjustment for depreciation deductions during the EBITDA period merely defers (rather than permanently excludes) depreciation deductions from a taxpayer's calculation of the section 163(j) limitation".

USCIB believes that the Proposed Regulation Adjustments, as written today, do not align with the intent of Congress that the section 163(j) limitation should be measured against EBITDA because there could be a permanent loss of deductions for interest expense in some cases. Specifically, in the event that the DD&A addback did not increase a taxpayer's ability to deduct interest

[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] Proposed Treasury Regulation § 1.163(j)-1(b)(iv)(E).

expense in the prior year, the Proposed Regulation Adjustments could decrease the amount of interest deduction potentially permanently in the year the property is sold even when the DD&A addback in the prior year did not provide the taxpayer with a benefit (i.e. additional interest expense deduction). The Treasury and IRS specifically explain in the preamble the intent of the Proposed Regulation Adjustment is to correct a timing difference. To ensure the rule only applies to correct timing differences, USCIB proposes an exception to the Proposed Regulation Adjustment, which provides that the rule does not apply to the extent that the prior-year DD&A addback did not increase the amount of business interest expense allowed as a deduction per section 163(j).

**<u>CFC ATI Reduction for Creditable Foreign Income Taxes</u>**

The proposed regulations require CFCs and CFC groups to include, as a deduction, foreign taxes as a component of ATI. This includes foreign income taxes the taxpayer plans to utilize as a credit in the United States. Due to the fact that a section 78 gross-up is excluded when calculating the US shareholder's ATI, this causes a permanent reduction to a taxpayer's section 163(j) allowable interest expense deduction. USCIB has found no indication that Congress intended to penalize taxpayers for paying income taxes in other jurisdictions. This inequity is more pronounced when a CFC operates in a high tax jurisdiction. We request that foreign income taxes not be deducted from ATI, unless the CFC elects to deduct the taxes rather than treat as creditable.

1. <u>Adjusting ATI for Foreign Taxes</u> (Prop. Reg. Section 1.163(j)-7(g)(3))

The preamble to the proposed regulations requests comments regarding adjusting ATI for foreign taxes. In the case of CFCs, it is appropriate to adjust ATI for foreign taxes in order to ensure that CFCs are on a par with domestic corporations in determining the section 163(j) limitation. Notably, the ATI of a domestic corporation is not reduced by U.S. federal income tax, as federal income taxes are not deductible in determining U.S. federal taxable income. To achieve parity with the domestic application of section 163(j), in the CFC context, the ATI should similarly not be reduced for the CFC's national income taxes, i.e., income taxes imposed by the country in which the CFC is organized or tax resident. To note, while section 951A(c)(2)(A)(ii) with cross reference to 954(b)(5) details the required deductions to achieve the net foreign income inclusion in the U.S., the aim of ATI in the section 163(j) context is not to determine the ATI inclusion itself but to determine the level of BIE that is available to offset such an inclusion. If a CFC's foreign taxes reduce its ATI, then CFCs are effectively subject to a greater than 30 percent limitation relative to domestic corporations.[3]

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[3] For example, assume a CFC has $100 of adjusted taxable income, and $30 of net business interest expense. Foreign country taxes CFC's income at a 20 percent rate. Accordingly, CFC has $70 of pre-tax income on which it pays $14 of foreign taxes. If CFC's $14 deduction for foreign taxes were to reduce its ATI, then CFC would only have $86 of ATI, which would mean that only $25.8 of the net business interest expense could be deducted, leaving CFC with $4.2 of excess interest expense. On the same facts, a domestic corporation would have $4.2

Recommendation is to modify the Regulations to state that ATI is not reduced by taxes imposed on the net income of the CFC by the jurisdiction in which it is incorporated or in which it is otherwise tax resident.

**CFC Group Interest Between Members**

Treasury and the IRS solicited feedback regarding the treatment of interest income and expense between members of the same CFC group, provided that a CFC group election is made. In the current proposed regulations interest income and expenses between members of the same CFC group will be regarded unless entered into "with a principle purpose of avoiding the rules". USCIB requests that in addition to the current anti-avoidance rule, taxpayers be permitted, on an elective basis, to disregard interest between members of the same CFC group. This election would create symmetry in the treatment of intra-group interest between US consolidated groups and CFC groups. Additionally, this election would ease administrative burden by providing taxpayers an avenue to avoid any structures that could invoke the anti-abuse rule.

Given interest is not reversed in the CFC's calculation of earnings and profits, some taxpayers may find it administratively simpler to continue to regard the interest between CFC group members and subject the interest to the anti-avoidance rule. We believe that this optionality is reasonable on an annual basis, since the members of a specified group, and therefore a CFC group, are also determined annually. Accordingly, USCIB requests an annual election to disregard interest between members of the same CFC group.

**CFC Group Ownership Threshold**

In order to make the CFC group election provided in Proposed Regulation § 1.861-7, the proposed regulations require the U.S. shareholder to own 80% of the value of a foreign corporation in order for the foreign corporation to be included in the CFC group for purposes of section 163(j). The proposed regulation cross-references the ownership rules applicable to consolidated groups in section 1504(a). The rationale behind the 80% value threshold is not specified in the preamble, however, it would seem the CFC group election mimics the consolidated return section 163(j) calculation.

USCIB requests that the ownership requirement for identifying a specified group member be reduced from the 80% ownership provided in section 1504(a) to 50% ownership. The 50% ownership requirement is consistent with the use of the term "CFC". For example, both the GILTI regime and subpart F regime apply ownership thresholds of 50% to identify entities subject to the rules. Notably, the preamble cites the § 952 subpart F rules to justify the application of section 163(j) to CFCs. If the Subpart F rules are a justification to apply section 163(j) to CFCs, shouldn't the same ownership rules apply for Subpart F purposes and section 163(j)? A 50% shareholder requirement creates compliance efficiencies and reduces administrative burden, because

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greater limitation and thus no excess interest expense. (This example assumes neither the domestic corporation nor the foreign corporation pays any state or local taxes, which would reduce ATI.)

taxpayers will apply a harmonized definition for CFCs between section 163(j) and the other rules applicable to CFCs in the Code.

**<u>CFC Group Election Timing</u>**

The Treasury and IRS solicited feedback regarding the timing of the CFC group election. Specifically, commentary regarding the initial designation of a CFC group was requested. In the example provided if a taxpayer does not make a group election on the first applicable return they may not do so until 60 months after such date. USCIB recommends there should be no timetable associated with the CFC group election until such time as a taxpayer affirmatively elects to group CFCs.

USCIB's recommendation would create symmetry between the CFC group election and other aspects of the Code (e.g.; check-the-box elections). Further, the section 163(j) regulations are extensive and, in many cases, full compliance requires substantial taxpayer resources. Taxpayers will not fully understand their economic position under the regulations for many months. As such, a timetable that binds a taxpayer on the first day of application is unreasonable and unduly burdensome. As such, USCIB recommends no timetable should begin on the CFC group election until the taxpayer affirmatively elects for the first time.

<u>CFC Grouping Election</u> (Prop. Reg. Sections 1.163(j)-7(c))

USCIB recommends that taxpayers be permitted to make the CFC grouping election each year. In most cases a CFC group election is likely to be favorable to taxpayers. It may, however, be difficult for taxpayers to forecast the impact of a CFC grouping election over a five-year period. There are situations where such an election may not be favorable, including as a result of factual changes and changes in law as described below. An annual election would be consistent with the determination of the safe harbor election under the proposed regulations and with elections made under other parts of the Code and regulations, including the high-tax election for GILTI. In order to address apparent concerns regarding inappropriate tax planning that might be facilitated by allowing annual CFC group elections, restrictions could be placed on the ability to carry forward disallowed BIE if an election is made or revoked within 60 months of a previous revocation or election, as relevant. Taxpayers should not be prevented by such concerns from making or revoking CFC group elections as needed to adjust to changing facts pertaining to their CFC groups or relevant law.

If the 5-year election is maintained, we recommend the regulations clarify that if an election is made for a prior tax year that the 5-year clock begin for the taxable year first elected.

Rationale for an annual election:

- GILTI high tax exclusion election: The CFC grouping election may have a negative impact due to the interaction with the GILTI high tax exclusion election. If a GILTI high-tax exclusion election is made, making the 163(j) CFC group election may affect the interest expense apportioned to different tested units and may flip some from high-tax to not or vice versa, which could help or hurt the GILTI posture.

- QBAI for GILTI: CFC Grouping Election *might* turn tested income entity into tested loss entity. QBAI of a tested loss entity is not included into calculations of U.S. Shareholder's NDTIR (therefore, potentially increasing GILTI inclusion).[4]

- Unintended increased limitation: If the CFC group would be limited under section 163(j) with a CFC group election, making the election could result in CFCs that would otherwise be able to deduct all of their interest expense (because they have plenty of ATI on a standalone basis) being limited under section 163(j). This could result in a net cost if, for instance such a CFC has low-tax subpart F income to which disallowed interest expense would have been apportioned without the election.

- Symmetry: Note that the safe harbor election provided under -7(h)(1) provides electivity for a CFC group that is eligible for the safe harbor. It is an annual election and under -7(j)(3)(i), if the safe harbor election is made, the U.S. shareholder is not permitted to include any CFC inclusions in determining its ATI. Certainly, the effective ability to elect in the safe harbor context provides support for making this election available more generally on an annual basis.

- Uncertainty as to Applicable Facts and Law: A five-year election does not allow taxpayers opportunity to take into consideration potential changes with respect to underlying facts, such as acquisitions or dispositions, or even changes in law. To this latter point, the changes to remove depreciation and amortization from adjustments to ATI in 2022 may significantly change a CFC group profile, and it is difficult to predict at this time the potential implications. The potential impact of unanticipated law changes is even more significant. <u>Definition of interest</u> (Prop. Reg. Section 1.163(j)-1(b)(22))

**<u>Partnership Basis Adjustment for Non-Liquidating Distributions</u>**

The Treasury and IRS solicited feedback regarding basis adjustments to non-liquidating partnership distributions with regard to disallowed interest expense carryforwards. Currently, when a partner sells a partnership interest or receives a liquidating distribution the partner must increase the partner's outside basis by the amount of the interest expense carryforward. Additionally, at that time, the partnership must also increase the basis of the partnership's capital

[4] As an example, before application of 163(j), assume a CFC had income of $100 and $101 of net business interest expense resulting in a taxable loss of $1. Under Section 163(j), the CFC has $100 of ATI ($1 TL + $101 interest expense), limiting interest deductions to $30 (30% of $100 ATI). This means the CFC is in a tested income position ($100 income - $30 interest = $70 TI) allowing for use of QBAI. However, a grouping election that results in no limitation (i.e., because collectively the group's interest expense is less than 30% of ATI) would flip the CFC back into a tested loss.

assets by the same amount. The increase to the partnership's capital assets is not entitled to any form of cost recovery.

USCIB recommends no adjustment should be made the partner's outside basis in the case of non-liquating distributions when a partnership has disallowed interest expense carryforwards. Unless the partnership's adjustment to capital assets is recoverable through amortization or depreciation (which is currently not the case), the potential to deduct the interest expense requires an asset sale rather than being tested against earnings. When the partners remain unchanged we do not believe there is a compelling reason to change the character of the interest expense carryforward to that of a capital asset.

**Look-through for investment funds**

Under Prop. Reg. §1.163(j)-1(b)(22)(iii)(F), taxpayers can treat certain amounts from regulated investment companies ("RICs") as interest income for section 163(j) purposes. The rationale in the preamble hinged on the ability for a RIC to look through to the underlying investments, whereby to the extent the underlying earnings of said RICs were interest, the U.S. taxpayer, may similarly treat their earnings from the RIC as interest. This provision should be extended to include foreign regulated investment and money market funds ("Investment Funds"), where a taxpayer can obtain support that their income earned from such a fund is attributable to interest income earned by such a fund. This will ensure consistent treatment for investments in domestic and foreign regulated funds in the application of section 163(j).

RICs are defined as domestic corporations[5] that are registered under the Investment Company Act of 1940.[6] Foreign corporations are excluded from the definition a RIC, and therefore the aforementioned look-through treatment was not extended to non-RIC holdings, such that foreign dividends, under the current regulations, cannot be considered section 163(j) 'interest dividends'.

In order to bring uniformity to investments in RICs with investments in other Investment Funds, we propose the following:

a. To permit U.S. entities and CFCs to treat earnings from regulated foreign Investment Funds as interest to the extent such earnings can be traced to underlying income of the Investment Fund that is interest. This would provide parity to investments in foreign Investment Funds with U.S. investments in RICs.[7]

b. To expand the definition beyond RIC investment to any regulated foreign MMF that has access to underlying investment detail and require that the fund provide

[5] Section 851(a)

[6] Section 851(a)(1)(A)

[7] The Treasury declined to extend treatment to PFICs on the basis that they do not separately report amounts of interest income for Federal income tax purposes. If a PFIC does in fact report such amounts, we believe that the Taxpayer should be able to treat income from such PFIC as attributable to interest income.

detail sufficient to support the determination that distributions are attributable to interest.

c. Additionally, suggest that 'interest dividend' look-through treatment be permitted for Taxpayers that invest in domestic or foreign regulated funds that invest all but a *de minimis* portion of their assets in interest bearing securities.

2. Use of CFC ETI in U.S. Group (Prop. Reg. 1.163(j)-7(j)):

USCIB requests that the IRS and Treasury provide examples concerning the operation of the rules concerning the U.S. shareholders use of a CFC's excess taxable income.

If you have any questions concerning this submission please contact Carol Doran Klein (cdklein@uscib.org) or Erin Breitenbucher (ebreitenbucher@uscib.org).

Sincerely,

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