February 15, 2018

Ms. Brenda Zent, Esq.
Special Advisor on International Taxation
Office of Tax Policy
U.S. Department of the Treasury
1500 Pennsylvania Avenue N.W.
Washington, D.C. 20220

Dear Ms. Zent:

This letter is submitted as a follow up to the January 10, 2017 conference call that you participated in with certain of our members and their counsel (the "January Call"). The purpose of the January Call was to discuss the need to clarify the scope of section 14213 of Public Law 115-97, commonly referred to as The Tax Cuts and Jobs Act (the "TCJA"), which repealed Section 958(b)(4) of the U.S. Internal Revenue Code, based on and consistent with the express intent of the lawmakers as set forth in various Joint Committee on Taxation reports and on statements made on the floor of Congress during congressional consideration of the TCJA. Specifically, we requested that the Treasury Department and the Internal Revenue Service issue a regulation (the "Requested Guidance") under Section 951 providing that:

> A foreign corporation shall not be treated as a controlled foreign corporation with respect to a 'U.S. shareholder' if the foreign corporation is treated as a controlled foreign corporation as a result of constructive attribution under Section 318(a)(3) of stock owned by a person who is not a United States person to a United States person that is not a related person (within the meaning of Section 954(d)(3)) to such U.S. shareholder.

Following the discussion of our concerns and the need for the Requested Guidance, you asked that we consider further the question of the authority under which the Treasury Department and the IRS may issue such guidance. The Treasury Department also requested comments regarding the repeal of Section 958(b)(4) in Notice 2018-13, 2018-6 I.R.B. (Feb. 5, 2018), Section 7. As discussed in more detail later in this letter and in the accompanying Memorandum, we believe that the Treasury Department can exercise its rulemaking authority

under Section 7805(a) to issue the Requested Guidance. Such an issuance would be firmly supported by administrative practice and Supreme Court precedent.

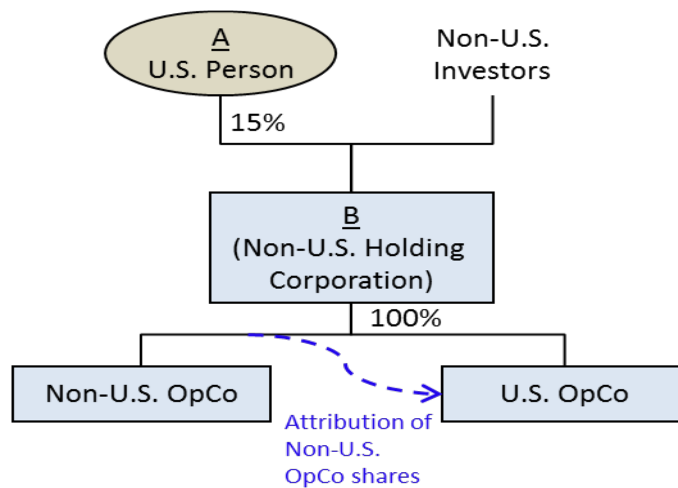
Before addressing that specific question any further, we want to restate what Senate Finance Committee Chairman Hatch referred to as the "unintended consequences" that could result from the repeal if the Requested Guidance is not issued. (Primary materials referenced herein to the legislative history of the repeal are attached to this letter as Appendix I.)

Requested Guidance is Necessary to Avoid Unintended and Inappropriate Consequences

Prior to the passage of the TCJA, Section 958(b)(4) prevented "downward attribution" of stock ownership from a foreign person to a U.S. person for purposes of determining, among other things, whether a foreign corporation was a controlled foreign corporation ("CFC"). With the repeal of Section 958(b)(4), Congress made clear in the Conference Report that it was targeting foreign stock ownership structures where a U.S. corporation retained some stock ownership but sought to "decontrol" enough such stock ownership to avoid CFC status of the foreign corporation by passing sufficient stock ownership to a related foreign person. Similarly, the Senate Finance Committee explanation expressly states that the repeal of Section 958(b)(4) "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…" (the "Section 958 Legislative Intent"). In a colloquy with Senator Perdue (attached as Appendix II), Senator Hatch – in his capacity as Chairman of the Senate Finance Committee and as principal sponsor of the Senate Bill – confirmed that an amendment to the TCJA that would have expressly codified the Section 958 Legislative Intent was not adopted because it was not needed to reflect the intent of the Senate Finance Committee or the conferees for the TCJA and that the Treasury Department and the IRS should interpret the stock attribution rules consistent with the Section 958 Legislative Intent.

Nonetheless, read strictly and without the benefit of the Section 958 Legislative Intent, the Section 958(b)(4) repeal could be applied in a manner that results in the taxation of a U.S. shareholder that does not control, alone or together with other U.S. persons, a foreign corporation. Consider the following example:

> A U.S. person ("A") purchases a minority 15% stake in a non-U.S. holding corporation ("B"). B has a non-U.S. operating subsidiary ("Non-U.S. OpCo") and a U.S. operating subsidiary ("U.S. OpCo"). Under the changes to Section 958(b)(4), B's ownership in Non-U.S. OpCo will be attributed to U.S. OpCo, causing Non-U.S. OpCo to be a constructive CFC.



In this example, even though A only has a minority interest in the foreign operating company and does not control it (alone or with other U.S. persons), a strict reading of the TCJA would require a subpart F inclusion under the CFC regime. The Requested Guidance from the Treasury Department and the IRS would make it clear that Non-U.S. OpCo would remain a CFC, but that it would not have CFC status with respect to A, who appropriately would not have a subpart F inclusion and thus would avoid the inappropriate and unintended consequences of Section 958(b)(4) repeal as applied to A. (Additional examples of unintended consequences of the repeal are depicted in Appendix V.)

Incorporating the Section 958 Legislative Intent into guidance under the TCJA would be consistent with the overall intent of the CFC regime. The CFC rules were enacted in 1962 to address certain U.S. tax deferral or avoidance opportunities available to U.S. persons that owned controlling interests in foreign corporations. At the time, there was substantial debate over the appropriate ownership thresholds for determining a "controlling interest" for purposes of the CFC rules. The final legislation provided that the CFC rules only applied to foreign corporations that were "controlled," which was defined as foreign corporations in which more than 50 percent of the stock was owned directly, indirectly, or constructively by 10-percent or greater U.S. shareholders. These ownership thresholds have remained essentially unchanged since their enactment, and there is no evidence in the TCJA or in its corresponding legislative history that

Congress sought to expand the CFC regime to apply to foreign corporations that were not controlled by U.S. persons. Even with the TCJA's change of focus for determining control from voting alone to voting or value, the focus remains on sufficient U.S. ownership to affect control of the foreign corporation's activities.

Authority Under Which the Treasury Department and the IRS May Issue Guidance

After discussing the issue with our counsel and Professor Richard Epstein of New York University Law School (whose qualifications are also attached as Appendix III), we believe multiple sources provide authority for the Requested Guidance, as set forth below. For a more detailed discussion of related issues, please see Professor Epstein's memorandum attached to this letter as Appendix IV (the "Memorandum").

First, Section 7805(a) provides an explicit grant of authority to promulgate the Requested Guidance. Section 7805(a) provides that "the Secretary [of the Treasury] shall prescribe all needful rules and regulations for the enforcement of [the Internal Revenue Code], including all rules and regulations as may be necessary by reason of any alteration of law in relation to internal revenue." Under this delegated authority, "it is up to [the Commissioner] to choose the method that best implements the statutory mandate." *C.I.R. v. Engle*, 464 U.S. 206, 226–27 (1984); *see United States v. Correll*, 389 U.S. 299, 307 (1967) (noting that judiciary's role in reviewing regulations under Section 7805(a) "begins and ends with assuring that the Commissioner's regulations fall within his authority to implement the congressional mandate in some reasonable manner").

The "alteration" of Section 958(b)(4) by the TCJA, and the resulting potential to unintentionally expand the scope of Section 951(a) inclusions to include U.S. shareholders who are not in control or part of a control group, gives Treasury ample "need" under Section 7805(a) to issue the Requested Guidance. That same grant of authority has been used to promulgate all of the current regulations interpreting Sections 318, 951 and 958. The Requested Guidance is "necessary" here to clarify the scope of the Section 958(b)(4) repeal for purposes of applying Section 951 in light of the undisputed legislative intent of the repeal.

During our January Call, you expressed some concern that the repeal of Section 958(b)(4) was not in itself in "need" of interpretation because the repeal (at least in isolation) is unambiguous, and thus that the expression of congressional intent as to its intended scope cannot be read into a repealed statute. As an initial matter, we reiterate that Chairman Hatch believed that the repeal was unambiguous in the *opposite* direction—*i.e.*, that it did not change existing attribution rules in this situation, and that an amendment so stating "was not adopted . . . because

it *was not needed to reflect the intent* of the Senate Finance Committee or the conferees for the Tax Cuts and Jobs Act." Cong. Rec. at S8110 (Dec. 19, 2017) (emphasis added).

At a minimum, however, the scope of the repeal of Section 958(b)(4) is ambiguous when viewed in light of the surrounding sections and the context of the statute as a whole. The Supreme Court has made clear that even a meaning that "may seem plain when viewed in isolation" may "turn out to be untenable in light of the statute as a whole." *King v. Burwell*, 135 S. Ct. 2480, 2492 (2015) (quotations omitted and formatting modified); *see id.* (citing "fundamental canon of statutory construction that the words of a statue must be read in their context and with a view to their place in the overall statutory scheme"). For instance, despite the apparent clarity of the phrase "an Exchange established *by the State*," the Supreme Court held it to be ambiguous as to whether it was intended to encompass an 'Exchange established *by the federal government*' as well. *Id.* Given that ambiguity, the Court deemed it appropriate to look beyond the text and context of the Act to the "broader structure of the Act" and Act's overall purpose. *Id.* at 2492-2493; *see United States v. Yates*, 135 S. Ct. 1074, 1081-1082 (2015) (finding ambiguity in whether a fish was a "tangible object" within meaning of statute, in view of "the specific context in which that language is used, and the broader context of the statute as a whole") (internal citations omitted); *see also Pub. Citizen v. U.S. Dep't of Justice*, 491 U.S. 440, 454 (1989) ("Where the literal reading of a statutory term would compel an odd result, we must search for other evidence of congressional intent to lend the term its proper scope.") (citing, *inter alia*, *Church of the Holy Trinity v. United States*, 143 U.S. 457, 459 (1892)).

Indeed, the *King v. Burwell* example is particularly salient, given that it also involved a significant piece of legislation that was passed expeditiously through reconciliation:

> The Affordable Care Act contains more than a few examples of inartful drafting. . . . Several features of the Act's passage contributed to that unfortunate reality. Congress wrote key parts of the Act behind closed doors, rather than through "the traditional legislative process." And Congress passed much of the Act using a complicated budgetary procedure known as "reconciliation," which limited opportunities for debate and amendment, and bypassed the Senate's normal 60-vote filibuster requirement. As a result, the Act does not reflect the type of care and deliberation that one might expect of such significant legislation.

King, 135 S. Ct. at 2492. Because that paragraph might equally describe the TCJA, *King* strongly suggests that a commensurately careful consideration of latent ambiguities revealed by the structure, context, and purpose of the Tax Cut and Jobs Act is appropriate.

Here, the repeal of 958(b)(4) introduces uncertainties into the scope of other Code provisions relating to controlled foreign corporations, particularly Section 951 (amounts included in gross income of U.S. shareholders and the definition of who is a U.S. shareholder) and Section 957 (the definition of a "controlled foreign corporation"). These sections have long been interpreted to apply in the context of foreign corporations that were controlled by U.S. persons. Although Congress repealed 958(b)(4) as part of a broader overhaul of the foreign taxation regime to close certain loopholes, Congress did not intend to vastly expand the existing scope of Section 951(a) inclusions to include U.S. shareholders who are manifestly not in control, alone or together with other U.S. persons, of any foreign corporation. *See King*, 135 S. Ct. at 2496 ("A fair reading of legislation demands a fair understanding of the legislative plan."). As in *King*, it is "implausible" that Congress intended that repeal to alter the longstanding application of the CFC rules in such an overbroad and unintended manner. *Id.* at 2494 ("It is implausible that Congress meant the Act to operate in this manner."). If Congress had intended to undo more than 50 years of tax policy embodied in the CFC rules by expanding the rules to apply to foreign corporations that were not controlled by U.S. persons (or were not part of decontrolling transactions), it would have done so explicitly. On the contrary, the legislative history is clear that no such expansion was intended. *See* S. Rep. at 383 (Dec. 2017) ("This provision is *not intended*" to cause U.S. shareholders to be shareholders of a CFC as a result of attribution to unrelated persons due to the repeal of Section 958(b)(4)). As Chairman Hatch stated explicitly, any contrary interpretation would result in "unintended consequences."

Second, as discussed at length in the Memorandum, a long tradition of administrative review establishes the proposition that it is permissible, in fact necessary, for an agency to provide guidance regarding statutes whose terms in isolation appear clear, but, viewed in context, lead to unintended, inconsistent, or absurd results. Specifically, even without the Requested Guidance, general principles of statutory construction would support taxpayers reading the repeal in light of the basic structure and purposes of the CFC rules, with the object of limiting the repeal's application to the mischief that it is intended to address. Here, that means reading the repeal and the remaining CFC rules in a manner so that the remaining CFC rules continued to apply to U.S. shareholders of foreign corporations that were "controlled," and not in a manner that would produce the absurd result that U.S. shareholders of foreign corporations, even if not "controlled," could be subject to subpart F inclusions under the CFC regime. This is what the Tax Court did in reaching its decision in *Estate of Nettie Miller v. Comm'r*, 43 T.C. 760 (1965), *non-acq.* 1966-1 C.B. 4, which understood that the imputation of shares in a foreign corporation owned by non-U.S. persons to a relative who was a U.S. resident but held no interest in such foreign corporation would lead to such an absurd result when applied to the decedent and her sister. The Tax Court noted:

When there is an interpretation that accords with the purpose of the act then the

> statute should not be interpreted to produce absurd consequences even though such an interpretation might be within the literal language of the act.

43 T.C. at 767-768.

Finally, issuing the Requested Guidance would be proper under application of general rules of administrative law as a guide and supplement to the congressional enactment, in light of the Treasury Department's longstanding "'gap-filling' authority" in situations where Congress has not spoken directly to a particular issue. *Mayo Found. for Med. Educ. & Research v. United States*, 562 U.S. 44, 57 (2011) (internal quotations omitted). In fact, Chairman Hatch asked "the Treasury Department and Internal Revenue Service" to do just that by "interpret[ing] the stock attribution rules consistent with th[e] explanation . . . released by the Senate Budget Committee." Cong. Rec. at S8110 (Dec. 19, 2017).

The exercise of the Treasury Department's gap-filling role is fully appropriate here. Under *Chevron U.S.A., Inc. v. Natural Resources Defense Council*, *Inc.,* 468 U.S. 837 (1984), courts engage in a two-step process when reviewing an agency's interpretation of a statute it administers. If Congress's intent is clear and unambiguous, then a reviewing court will adopt that unambiguous meaning. *Mayo*, 562 U.S. at 52. But where Congress has not "directly addressed the precise question at issue," it is up to the Treasury Department to promulgate guidance under Section 7805(a). *Id.* That is because "[t]he power of an administrative agency to administer a congressionally created . . . program necessarily requires the formulation of policy and the making of rules to fill any gap left, implicitly or explicitly, by Congress." *Id.* at 55-56. That principle of delegated authority "appl[ies] with full force in the tax context" because, "[i]n an area as complex as the tax system, the agency Congress vests with administrative responsibility must be able to exercise its authority to meet changing conditions and new problems." *Id.* (quoting *Bob Jones Univ. v. United States*, 461 U.S. 574, 596 (1983)).

Because the repeal (at least read in isolation) is in tension with Congress's clear intent on the issue at hand, the Treasury Department could act pursuant to *Chevron* step 2 to resolve the uncertainty or gap by issuing the Requested Guidance. Indeed, the legislative history invites the Treasury Department to do just that.

In summary, it would be fully appropriate for the Treasury Department to effectuate congressional intent by issuing the Requested Guidance in this circumstance, and a reviewing court (should a plaintiff with standing ever file a challenge) would defer to the Treasury Department under the legal doctrines noted above.

Recent Analogous Guidance

In addition to the above, we note that the Treasury Department and the IRS have already issued guidance under the repeal of Section 958(b)(4) in the form of Notice 2018-13. Section 5.01 of the Notice provides that "for purposes of applying [Treasury regulations sections 1.863-8 and 1.863-9], taxpayers may determine whether a foreign corporation is a CFC without regard to the repeal of section 958(b)(4) pending further guidance (which will be prospective…)." For the reasons set forth above, the Treasury Department and the IRS have the authority to issue a similar notice of intent to issue Treasury regulations under section 951-1 consistent with the Section 958 Legislative Intent.

Illustrations of Affected Structures

Attached as Appendix V are illustrations of (1) the "decontrol" abuse that Congress expressly sought to eliminate with the Section 958(b)(4) repeal and (2) an additional scenario where a U.S. shareholder would not expect to be a shareholder of a CFC as a result of the repeal. In addition, in response to your request for comments in Notice 2018-13, we have included another scenario where we believe guidance is needed. In this illustration (3), involving a domestic partnership, the Section 958(b)(4) repeal has unintended consequences and the Requested Guidance would not provide relief. We would appreciate the opportunity to set forth in a subsequent meeting our views on this additional concern.

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We appreciate your consideration of our request and we look forward to discussing with you further at our meeting scheduled for February 16, 2018.

Respectfully submitted,

Jason Mulvihill
General Counsel
American Investment Council

<u>Enclosures</u>
Appendix I: Legislative History
Reconciliation Recommendations Pursuant to H. Con. Res. 71, S. Rep. No. 115-20 (December 2017), at 382-83.
Conference Report, The Tax Cuts and Jobs Act, No. 115-446 (Dec. 15, 2017), at 633-34.
Appendix II: Colloquy between Senator Hatch and Senator Perdue, *Cong. Rec.* Vol. 163, No. 207 (Tuesday, December 19, 2017) at S8110.
Appendix III: Professor Richard A. Epstein *curriculum vitae*.
Appendix IV: Professor Richard A. Epstein, Memorandum, *Why Treasury has the power to issue a regulation that corrects the statutory errors relating to U.S. Shareholders of Controlled Foreign Corporations*.
Appendix V: Illustrations of Affected Structures.

cc: Lafayette "Chip" G. Harter III, Esq.
Douglas Poms, Esq.
Gary Scanlon, Esq.
Jason Yen, Esq.
Lindsay Kitzinger, Esq.
Leni C. Perkins, Esq.