UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

February 26, 2019

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

RE: IRS REG-106089-18 – Limitation on Deduction for Business Interest Expense

Dear Commissioner Rettig:

USCIB[1] is pleased to provide comments on the proposed regulations regarding guidance related to the limitation on deduction for business interest expense under section 163(j) (REG-106089-18).

General Comments

The comment period for this 400 plus page regulation is very compressed, especially given the number of other regulations that need to be evaluated and that these regulations interact with each other. Companies will only discover problems as they work with the regulations and apply them to their facts. If the regulations are finalized before problems can be identified, then correcting problems will be more difficult. USCIB is aware that the government would like to meet the 18-month deadline imposed by section 7805(b)(2). Nevertheless, there should be a mechanism to review these regulations (and other TCJA guidance) to correct for unexpected interactions that create distortive results. One option would be to issue the regulations as temporary regulations with a cross-referenced notice of proposed rulemaking. This approach would both permit the regulations to be retroactive under 7805(b)(2) and allow additional comments to be considered as the regulations move from temporary to final.

Specific Comments

1. Definition of Adjusted Taxable Income under Section 1.163(j)-1(b)(1)

Proposed regulation section 1.163(j)-1(b)(1)(i)(D),(E), and (F) permits taxpayers to add back deductions for depreciation, amortization and depletion to determine adjusted taxable income.

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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.

While this provision sunsets for taxable years after December 31, 2021, the sunset was entirely revenue driven. Congress recognized that using EBITDA properly accounted for the beneficial impact of investment and therefore the pre-2022 provisions should be interpreted consistently with those intentions - and with the statutory language. The proposed regulations, however, do not permit taxpayers that capitalize depreciation, amortization or depletion expenses to inventory to add these expenses back in determining ATI. There is no sound basis for distinguishing between these forms of depreciation, amortization or depletion, and in fact doing so will systemically disincentivize manufacturing investment, countering the impact of other provisions with exactly the opposite intent (such as immediate expensing). There is no indication in the legislative history that Congress intended a different outcome in these cases. Therefore, §1.163(j)-1(b)(1)(iii) should be deleted from the final regulations.

2. Definition of Interest under Section 1.163(j)-1(b)(20)):

a. The final regulations should define interest as any amount that is generally treated as interest for all purposes of the Internal Revenue Code. This would be more consistent with the intentions of Congress; there is no indication in the statue or legislative history that transactions that are not debt or that payments that are not generally interest were intended to be covered. There would also be a substantial administrative burden associated with this broad expansion of the definition of interest. A targeted anti-abuse rule could deal with inappropriate tax-planning.

b. Proposed regulation section 1.163(j)-1(b)(20) should be revised by the addition of a subparagraph (v) that itemizes amounts explicitly excluded from interest.[2] Excluded amounts should be those amounts that are clearly not associated with the time value of money such as the following: (i) discounts on prepayments, (ii) guarantee fees, (iii) commitment fees, and (iv) debt issuance costs. These amounts are generally not treated as interest for book purposes, in many cases they relate primarily to credit risk not the time value of money and tracking such amounts for purposes of section 163(j) would impose substantial compliance costs on large taxpayers.

c. The final regulations should allow look-through treatment on earnings from foreign entities such as money market funds (MMF), so that dividends from MMFs would be treated as interest income to the extent the underlying income derived by an MMF was interest.[3]

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[2] New section 1.163(j)-1(b)(20) could read as follows: The term interest means any amount described in paragraph (b)(20)(i),(ii),(iii), or (iv) of this section and not described in 1.163(j)-1(b)(20)(v).

[3] MMFs are regulated, short term, low risk instruments for investors. For US GAAP purposes such short term investments are treated as cash equivalents on the balance sheet and their income is treated as interest. For US tax purposes, generally, a CFC investing in a non-US MMF generates PFIC income. Where certain elections are made, the CFC may instead generate dividend income. As currently written, both income types are included as part of ATI, though the former is in the US, and the latter in the CFC. As a result, CFCs such as cash pool headers that generate interest expenses on loans from their participants may be limited under section 163(j) as a result of investing in MMFs instead of economically similar instruments that generate interest. Consequently, such CFCs may suffer interest expense limitation (even if electing to group), which could lead to unexpected results such as section 952(c) recapture accounts solely generated by 163(j) interest expense limitation.

3. Application of Section 163(j) to Controlled Foreign Corporations

USCIB believes that section 163(j) should not apply at the CFC level to related-party interest. Imposition of a per-CFC limit will inappropriately result in US taxation of non-existent income where interest expense is disallowed in one CFC without a corresponding adjustment to income of the CFC earning the interest. In addition, imposition of the section 163(j) limitation will impose substantial compliance costs on taxpayers without a benefit to U.S. tax collection (other than the inappropriate and unintended taxation of non-existent income discussed above). If the Treasury and IRS do not adopt this suggestion, then the CFC grouping rules should be substantially modified.

4. CFC Grouping Election (Prop. Reg. Sections 1.163(j)-7(b)(3) through 1.163(j)-7(g))

a. Simplifying the grouping election could lead to similar results with a much-reduced compliance burden. One approach would be not to require a CFC group with no net interest expense to do any further calculations.

b. The proposed regulations under §1.163(j)-7(b)(3) provides very little guidance as to how the grouping election is calculated.

c. The final regulations under 1.163(j)-7(b)(5)(iii) should permit taxpayers to revoke a grouping election. The election should be effective for a stated minimum term, such as three years, which is common in other parts of the Code.

d. The computation of excess taxable income under §1.163(j)-7(c)(3) is overly burdensome. The final regulations should make the excess taxable income computation optional or allow alternative ways to compute excess taxable income.[4]

e. Final regulations should clarify §1.163(j)-7(f)(8) to confirm that a CFC that has effectively connected income in one year and is therefore not treated a CFC group member for that year, will be treated as a member of a CFC group in subsequent years if the CFC derives no ECI. The alternative rule that would exclude a CFC with any amount of ECI, in any year from the CFC could have potentially large and long-term impacts on the CFC group calculation and could also increase the risk associated with filing a protective Form 1120F.

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[4] One option for an alternative method would be to allow interest expense limitation at the CFC group level to be aggregated and used by the CFC group. As an example, all CFCs in a group would be treated as though they are directly held by the USP (irrespective of the number of USSH ownership chains), interest expense limit would be aggregated at the parent and reallocated to group members based on each member's business interest expense (not unlike how the limit is allocated in 1.163(j)-7(b)(3)). Other requirements such as percentage ownership considerations prescribed in 1.163(j)-7(c)(3)(i)(B) would be retained. Under this approach none of the limit would tier-up to the US, but instead would remain at the CFC level. Aggregate group interest expense limit in excess of aggregate group business interest expense would not carryforward.

f. The final regulations under 1.163(j)-7(f)(9) should be modified to clarify that members of the financial services subgroup should be determined on an annual basis. This is consistent with the cross-referenced definitions. The alternative result would be distortive of both the CFC group and the financial services subgroup.

Sincerely,

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