Feedback for REG-104352-18 (Guidance Related to Anti-Hybrid Rules in §§245A[1] and 267A as of 2/22/2019)

PROPOSED REGS SECTION NUMBER	SECTION TITLE	ISSUE	RECOMMENDATION	ADDITIONAL EXPLANATION /QUERIES
Prop. Regs. §1.245A(e)-1(d)	**Hybrid deduction accounts**	Group relief payments between related parties in some foreign jurisdictions	Modify the definition of a hybrid dividend in Prop. Regs. §1.245A(e)-1(b) to include an exception for payments between related parties for the purpose of sharing tax liability under a tax consolidation, fiscal unity, group relief, loss sharing, or any similar regime.	The definition of a "hybrid deduction" in Prop. Regs. §1.245A(e)-1(d)(2) as a deduction or other tax benefit that "relates to or results from" an amount otherwise eligible for §245A(a) treats group relief payments between related CFCs that are tax residents of the same country as hybrid dividends to the extent such payments are deemed dividends under §301. There is no policy reason for penalizing taxpayers that operate in tax regimes where group relief (rather than consolidation) is used to share tax liability among related parties.
		Hybrid deductions attributable to amounts included in income under §§951 and 951A	Amounts included in income under §§951 and 951A should not increase the hybrid deduction account.	Treasury has requested comments on whether hybrid deductions attributable to amounts included in income under §§951 and 951A should not increase the hybrid deduction account, or alternatively, the hybrid deduction account should be reduced by distributions of PTEP. Amounts included in income under §§951 and 951A are included in the U.S. tax base and therefore do not result in a deduction/no inclusion (D/NI) scenario. Accordingly, such amounts should not be treated as hybrid deductions giving rise to an increase in the

[1] Unless otherwise noted, all section references are to the Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder.

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				hybrid deduction account. See also Prop. Regs. §1.267A-3(b)(3), (4) (amounts not treated as disqualified hybrid amounts to the extent included in income under §951(a)(1) or §951A(a)).
	Definition of hybrid deduction	Notional Interest Deduction (NID)	See comment under Prop. Regs. §1.267A-4(b).	
Prop. Regs §1.267A-3(b)	**Certain amounts not treated as disqualified hybrid amounts to extent included or includible in income**	GILTI & Subpart F Exception	The proposed regulations currently exclude amounts that are included in the U.S. tax base under §§ 951 and 951A from the Prop. Regs. §1.267A-2 rules. The final regulations should affirm this exclusion, as amounts treated as subpart F income or tested income under these sections are subject to U.S. tax. Denying a deduction for amounts that are included in the U.S. tax base would lead to double taxation.	
Prop. Regs. §1.267A-4	**Disqualified imported mismatch amounts**	Double taxation of §§951 and 951A income earned by CFCs	Expand the exception for §§951 and 951A income in Prop. Regs. §1.267A-3(b) to cover payments otherwise treated as disqualified imported mismatch amounts.	Prop. Regs. §1.267A-4 has the potential to cause double taxation of §§951 and 951A income earned by CFCs by denying a deduction for interest and royalty payments made to a related party that is fiscally transparent for U.S. tax purposes even though the payments are included in the U.S. tax base. A specified party does not include fiscally transparent entities, therefore interest and royalty payments to fiscally transparent entities that are owned by a specified party have the potential to be treated as a disqualified imported mismatch amount even though they

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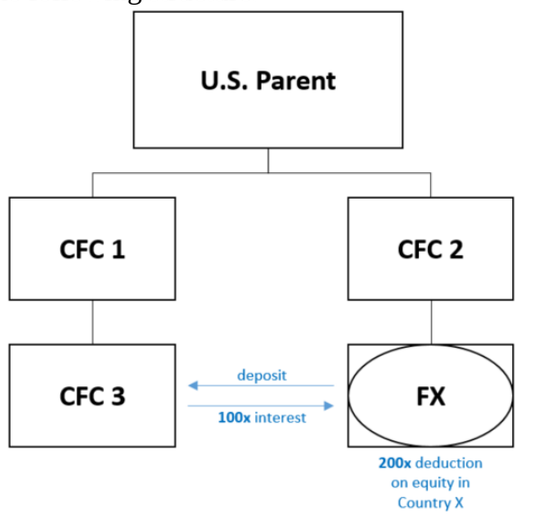
				are subject to tax in the U.S. under §§951 or 951A. Example: Consider a U.S. multinational with the following structure:  ○ FX is wholly-owned by CFC 2 and is taxable in Country X ○ FX is fiscally transparent for U.S. tax purposes but not for purposes of Country X ○ All income earned by FX is either Subpart F or tested income

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				○ CFC 1 and CFC 2 are taxable in Country Y and are 100% owned by U.S. Parent ○ CFC 3 is 100% owned by CFC 1 and is taxable in Country Z ○ FX incurs a 200x deduction on equity in Country X. FX deposits cash with CFC 3 and earns interest income of 100x. FX is a tax resident of Country X but does not meet the definition of a "specified party" in Prop. Regs. §1.267A-5(a)(17) ("an entity that is fiscally transparent for U.S. tax purposes is not a specified party, though an owner of the entity may be a specified party." The 200x deduction by FX would be disallowed in Country X if the tax laws of Country X contained rules substantially similar to those in §267A. The 200x deduction therefore meets the definition of a hybrid deduction in Prop. Regs. §1.267A-4(b). As a result, deductions for interest and royalty payments to FX by a specified party would be disallowed under the proposed regulations to the extent such payments directly or indirectly offset the 200x deduction. CFC 3 is a specified party. See Prop. Regs. §1.267A-5(a)(17). The 100x interest income paid by CFC 3 to FX directly funds the hybrid

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				deduction incurred by FX. The 200x hybrid deduction exceeds the interest income received from CFC 3, therefore CFC 3 would be denied the entire 100x interest deduction for U.S. tax purposes. All income earned by FX, including the 100x interest income from CFC 3 is subject to tax in the U.S. under §§ 951 or 951A. The 200x deduction incurred by FX in Country X does not reduce the Subpart F or tested income of FX that is subject to U.S. tax. Prop. Regs. §1.267A-4(b) includes the 100x interest income paid from CFC 3 to FX in the U.S. tax base twice: first as Subpart F or tested income of CFC 2 and again as a denied deduction by CFC 3.
Prop. Regs. 1.267A-4(b)	**Imported mismatch hybrid deduction**	Notional Interest Deduction (NID)	(1) Amend to state that a notional interest deduction is a "hybrid deduction" only when it results from an "amount paid, accrued or distributed." (2) A conforming amendment should be made to the example in Prop. Regs. §1.245A(e)-1(g)(1)(iii). (3) If (1) and (2) are not taken, Treasury should delay the effective dates or allow grandfathering to enable taxpayers to refinance existing loans that would be impacted by the rule.	Under Prop. Regs. §1.245A(e)-1(d)(2)(B) a "hybrid deduction" must relate to or result from "an amount paid, accrued, or distributed with respect to an instrument issued by the CFC and treated as stock for U.S. tax purposes." The preamble to the proposed regulations recognizes the need for a connection between the tax benefit and the instrument that is stock for tax purposes. Where the accrual or payment of a dividend is not required in order to claim

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				the NID, there is not a connection between the tax benefit and the instrument that is stock for U.S. tax purposes. Rather, the NID is analogous to other deductions, such as accelerated depreciation, that provide for a reduced effective corporate rate of tax in order to encourage investment. In cases where the taxpayer is not required to make a distribution or payment in order to claim the NID, the hybridity elements that are pre-requisite to the application of §267A are not present. Although §267A(e)(5) contemplates that the IRS and Treasury may promulgate: rules for treating the entire amount of interest or royalty paid or accrued to a related party as a disqualified related party amount if such amount is subject to a participation exemption system or other system which provides for the exclusion or deduction of a substantial portion of such amount, under §267A(a) a deduction for a disqualified related party amount is denied only if the amount is paid or accrued pursuant to a hybrid transaction, or by or to a hybrid entity. In the

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				case of a NID that is available regardless of whether any dividends are declared or paid, the requirements of the statute are not present.