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UNITED STATES OF AMERICA

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Via Federal eRulemaking Portal

RE: Proposed Regulations Under §385 (REG-108060-15)

I. Introduction

The U.S. Chamber of Commerce, the world's largest business federation representing the interests of more than three million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations, and dedicated to promoting, protecting, and defending America's free enterprise system, appreciates the opportunity to provide feedback on the proposed Treasury regulations under §385[1] as published in the *Federal Register* on April 8, 2016. For the reasons articulated below, the Chamber strongly urges withdrawal of these proposed regulations in favor of guidance more carefully targeted at clearly abusive situations. If these proposed rules are not withdrawn, numerous revisions should be made to the regulations as currently proposed.

These comments are the product of extensive conversations with a very wide array of impacted U.S. Chamber members, and distill these conversations down into their most pertinent issues. As such, these comments may be considered as representing some of the most serious issues, but not all the issues concerning U.S. Chamber members as the members themselves are still in the process of understanding the proposed regulations and their effects on their businesses. As such, these comments are neither exhaustive nor categorical, but instead emphasize some of the most pressing concerns of U.S. Chamber members.

Our comment letter is organized as follows:

- Part II of these comments discusses timing problems presented by the procedural timeline for these proposed regulations;
- Part III discusses certain damaging collateral consequences of these proposed rules;
- Part IV discusses certain ordinary course funding mechanisms and transactions that should be removed from the scope of the rules;

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

- Part V discusses why foreign-to-foreign transactions should be exempted from the rules;
- Part VI discusses how the regulations should be amended to mitigate double taxation;
- Part VII discusses issues that should be addressed in general under the rules that treat debt instruments as stock (the "per se stock rules");
- Part VIII discusses issues related more narrowly to the per se funding rule;
- Part IX discusses issues relating to the documentation requirements;
- Part X discusses issues relating to the bifurcation rules; and
- Part XI discusses specialized issues.

II. Procedural/Timing Problems with the Proposed Regulations

A. Finalization Should Not Be Rushed

The Chamber continues to believe that additional time is needed to analyze and review the impact of these rules on both ordinary business operations as well as more extraordinary transactions. The breadth, scope, and consequences of these regulations for Chamber members are vastly greater than ever suggested in prior notices and other guidance. Rather than address base erosion concerns in the context of inversions as suggested in the earlier notices, these regulations impact the use of intercompany debt among all multinational groups, both domestic and foreign, except where those instruments are issued between U.S. consolidated group members. In certain instances, even wholly domestic groups are impacted.

Fully understanding the interaction of these rules with existing Code sections and regulations simply has not been feasible in the 90-day period since the proposed regulations were issued. The breadth of these proposed rules require the application of tax considerations to transactions for which tax was never the object or concern. We believe that significant issues will continue to be identified beyond the July 7th comment deadline, as the business community better understands these regulations and their impact on common business transactions. These more newly identified issues should be considered and addressed with the same seriousness as those identified earlier. Consequently, we urge Treasury to take into account comments that continue to be received after the filing deadline.

It is hard to imagine a regulatory project more far reaching than the proposed regulations. Yet Treasury has taken much longer to finalize proposed regulations of much less significance and breadth. For example, the most recent update of Treasury's 2015-2016 priority guidance plan includes more than 40 items to finalize proposed regulations that were either (i) issued more than a year before they were finalized, or (ii) issued more than a year before March 31, 2016 and had not been finalized as of that date.

We are hopeful Treasury will not rush these regulations to finalization, but will take sufficient time to allow for a comprehensive review of all feedback, for active engagement with the business community as solutions are considered, and for development of proper solutions to the issues raised.

B. All Effective Dates Should Be Delayed

The Chamber has significant concerns about the effective dates of the proposed rules. The bifurcation[2] and documentation[3] rules are proposed to be applicable to debt instruments issued on or after the date the regulations are finalized, while the per se stock rules[4] would become effective 90 days after the regulations have been issued in final form, with respect to debt instruments issued on or after April 4th of this year (but only with respect to distributions or acquisitions that occur on or after April 4th). On such date, the debt issued after April 4th would be deemed to be exchanged for stock having a value equal to the basis in the debt.

The Chamber strongly supports delaying the effective dates of all provisions to give stakeholders and policymakers time to evaluate their impact and reach more appropriate policy outcomes. Further, implementing the systems and internal mechanisms necessary to comply with the proposed regulations will take significant time. As such, if the regulations are not withdrawn, the Chamber believes the effective date of all sections of the regulations should be delayed until taxable years beginning after January 1, 2019. Even if the effective date of April 4, 2016 continues, the application date should be deferred until 2019. Further, an exception from the per se stock rules should be provided for any debt instrument issued after April 4, 2016 pursuant to a financing agreement (e.g., a five-year loan facility) entered into before the regulations are finalized and in connection with a long-term construction project.

In sum, if the proposed rules are not withdrawn, then:

1. The regulations should not be finalized until Treasury has sufficient time to review all feedback (including issues that arise after the comment period), to engage fully with the business community as solutions are considered, and to develop proper solutions to the issues raised; and
2. The effective dates of all provisions of the proposed rules should be delayed until taxable years beginning after January 1, 2019.

III. Certain Damaging Collateral Consequences of the Proposed Rules

A. Certain Damaging Collateral Consequences

As a preliminary matter in preparing these comments, the Chamber has attempted to identify damaging collateral consequences of the proposed regulations and to develop reasonable solutions that could be proposed to address these issues. While some of the issues are identified below, this is by no means a comprehensive list. Compilation of a comprehensive list of impacts and solutions during the 90 day comment period has not been feasible and is one of the reasons the Chamber repeatedly has requested an extension of the comment period.

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[2] Prop. Reg. §1.385-1.
[3] Prop. Reg. §1.385-2.
[4] Prop. Reg. §1.385-3.

The impacts of these regulations are myriad and complex. The proposed regulations would:

- Make it virtually impossible for U.S. companies to efficiently manage global financing needs by raising the potential of imposing severe tax consequences on normal business practices undertaken without any tax motivation whatsoever.

- Hinder repatriation of earnings to invest in the United States. In particular, the limited current year earnings and profits (E&P) exception to the per se stock rules significantly curtails the amount of money that can be repatriated without implicating their adverse consequences.[5] This includes distributions of "previously taxed income" (PTI) in excess of current year E&P.[6]

- Result in the loss of interest deductions for U.S. tax purposes and impose dividend withholding on payments by a U.S. issuer, which could also violate U.S. tax treaties.

- Result in double taxation on payments by a foreign issuer.[7] The recharacterization of debt as equity would likely result in such equity being non-voting preferred shares, leading in many cases to the permanent loss of foreign tax credits when interest and principal payments are made on recast debt instruments issued by direct or indirect foreign subsidiaries of U.S. corporations.

- Adversely impact many ordinary legal entity restructurings well beyond the types of transactions specifically targeted by the per se stock rules (e.g., §304 transactions and certain asset reorganizations) and in ways completely unrelated to earnings stripping. The per se stock rules would affect virtually every provision under subchapter C of the Internal Revenue Code. For example, §351 contributions, §332 liquidations, corporate reorganizations, and tax-free spin-offs could fail relevant control tests, while §332 liquidations (and deemed liquidations) and §355 distributions could result in debt being recharacterized because such transactions are distributions that would be subject to the funding rule.[8]

- Adversely impact equity compensation practices with respect to subsidiary employees because the regulations under §1032 treat the subsidiary as purchasing parent stock, which would be an affiliate stock acquisition under the per se stock

[5] Issues with the current E&P exception and recommended solutions are discussed in VII, A, below.
[6] The PTI issue is discussed in more detail in VII, A, below.
[7] The double taxation/FTC issue is discussed in more detail in VI, below.
[8] The impact of the proposed rules on ordinary entity legal restructurings is discussed in more detail in VII, E, below.

rules. Moreover, a recharge agreement would create a debt instrument subject to the regulations.[9]

- Cause a disregarded entity to be treated as a partnership if a debt instrument issued by the disregarded entity is inadequately documented, which could have a number of other adverse consequences.

- Compounding the adverse effects of the proposed regulations is their cascading application.[10] A recast debt instrument would be treated as an affiliate stock acquisition and interest and principal payments on a recast debt instrument would be treated as distributions, each triggering the application (or re-application) of the per se stock rules.

- Cause many more problems such as increased compliance burdens (from both documentation requirements and the need to track application of the per se funding rule) and the creation of hybrid instruments (which creates adverse U.S. tax consequences under §909 and potentially adverse foreign tax consequences).

It is important to note that all of the adverse consequences associated with the per se stock rules are already significantly impeding the normal business operations of the Chamber's members due to the fact that they are proposed to apply to debt instruments issued on or after April 4, 2016.

B. Addressing Collateral Consequences

As evidenced by this incomplete list of collateral consequences, these proposed rules have such sweeping, far-reaching effects beyond their intended purpose to prevent domestic earnings stripping. They should be withdrawn to allow policymakers to develop more targeted rules.

If these regulations are not withdrawn, their scope should be significantly narrowed to the government's intent stated in Notice 2014-52 and Notice 2015-79 and Part V of the NPRM – "to further limit the benefits of post-inversion avoidance transactions . . . in particular, . . . to address strategies that avoid U.S. tax on U.S. operations by shifting or 'stripping' U.S.-source earnings to lower tax jurisdictions, including through intercompany debt."

At a minimum, each of the issues described in the next sections should be addressed to minimize the disruptive effects that the proposed regulations would have on normal business operations. Even if the scope of these regulations is reduced, it will be difficult to provide solutions to prevent all the harmful collateral consequences that would be caused by the proposed regulations.

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[9] Equity compensation issues are discussed in VII, C, below.
[10] Cascading effects are discussed in VII, D, below.

IV. Certain Ordinary Course Funding Mechanisms and Transactions Should Be Excluded from the Proposed Regulations

A. Ordinary Course Intercompany Funding Should Be Excluded

1. Issue

Companies commonly fund banking needs of affiliates through a centralized treasury center, which essentially functions as an internal bank. Specifically, one or more treasury entities make loans to affiliates, take deposits from affiliates, and enter into foreign currency or interest rate hedging transactions. The treasury center then enters into similar transactions with third-party banks on behalf of the entire affiliated group. Companies commonly have separate treasury entities for domestic and foreign funding. The near universal use of these treasury centers combined with the sheer volume of transactions undertaken daily by these centers are one of the best examples of why these rules should be withdrawn or delayed.

Centralized treasury centers achieve non-tax efficiencies compared to the alternative of having each affiliate enter into such financial transactions with third-party banks. For example, because affiliates commonly have offsetting positions (e.g., excess cash in one affiliate and cash needs in another), transacting through a centralized treasury function reduces a group's bank credit exposure and transaction costs/fees.

A centralized treasury operation may include several kinds of ordinary course funding mechanisms. For example, it may include funding of affiliates under a cash pool, where an affiliate funds its daily cash needs by making draws from the treasury entity while unutilized cash held by affiliates are automatically swept to the treasury entity as deposits periodicially (e.g., daily). Additionally, a treasury center may also provide ordinary course funding of affiliates through other types of loan facilities. For example, a treasury entity may enter into a revolving loan facility (typically two to five years), under which the affiliate may draw funds up to a maximum amount, repay the amounts, and re-draw funds throughout the period of the facility.

Such ordinary-course loan facilities have features that §385 and courts generally have identified as being indicative of debt, as opposed to equity (e.g., obligation to repay a sum certain, short duration, creditor rights). As noted above, this intercompany funding is undertaken by companies as a substitute for multiple third-party banking transactions to achieve non-tax efficiencies. To broadly recharacterize such debt funding as equity under the proposed regulations would greatly interfere with ordinary-course treasury operations without achieving an identified U.S. tax-policy objective (e.g., limiting U.S. earnings stripping).

Note that to the extent the application of the proposed regulations to ordinary-course funding mechanisms gives rise to issues that also impact other transactions, those issues are discussed elsewhere in these comments.[11]

2. Recommendation

The -3 funding rule and the -2 documentation rules should include an exception for all types of ordinary course treasury funding arrangements. In developing this exception, consideration should be given to:

- The function and business rationale of the funding;
- The duration of the loan, with consideration given to the fact that some ordinary course treasury funding facilities may span multiple years, but also consideration to whether a safe harbor for short-term debt instruments (e.g., one year or less) should automatically be exempt from the regulations; and
- An exception for non-interest bearing instruments.

Alternatively, special rules should be applicable to these arrangements that reflect the fact that each transaction is not separately documented or evaluated for credit risk. Consideration should be given to whether some reduced documentation requirements (in lieu of the current -2 documentation requirements) could be complied with and, if satisfied, would then result in the removal of ordinary course treasury funding arrangements from the application of the -3 funding rule. Such a safe harbor could require upfront documentation when a member joins the cash pool or enters the arrangement that includes written provisions outlining terms for depositing/lending funds among affiliates and provide specifics regarding deposits, withdrawals, loans, interest charges, etc. Once the documentation safe harbor is met, deposits and borrowings made pursuant to such arrangements would be exempted from the scope of the funding rule unless the parties fail to abide by the terms of the arrangement or it can be shown that the arrangement results in abuse.

B. Ordinary Course Exception to Per Se Funding Rule Should Be Clarified, Expanded, and Extended to the Documentation Rules

1. Issue

The proposed regulations provide an exception to the per se funding rule for debt incurred in the ordinary course of business that relates to "the purchase of property or the receipt

[11] For example, there can be a cascading effect, where chains of loans are recast as equity. If an operating company's excess funds are placed in the cash pool, and the pool header makes a loan that converts to equity, then the operating company pool deposits are arguably recast as equity. The in-house treasury center becomes an equity owner in operating subsidiaries (and vice versa), which can create unexpected profit and loss consequences. This cascading application impacts more than just ordinary course funding mechanisms. As such, a proposed solution to this broader application is discussed in VII, D, below. Likewise, concerns about foreign cash pools are covered by the proposed foreign-to-foreign exception discussed in V, below. Finally, a de minimis exception to the documentation requirement is discussed in IX, C, below.

of services to the extent that it reflects an obligation to pay an amount that is [(1)] currently deductible by the issuer under §162 or [(2)] currently included in the issuer's cost of goods sold [COGS] or inventory." This is ambiguous and requires clarification.

2. Recommendation

To avoid collateral consequences associated with the recharacterization of ordinary course debt into equity, as described below, the IRS should exempt certain ordinary course transactions from the funding rule and the documentation rules entirely by expanding the definition in the exception to the per se funding rule and adding an exception to the definition of an "applicable instrument" [or "expanded group instrument"] in the documentation rules.

a. -3 Rules (Per Se Stock Rules)

The definition of an ordinary course debt instrument contained in the ordinary course exception to the per se funding rule should be clarified and expanded. The Chamber urges the IRS to clarify that there is an absolute rule that any debt instrument that is not issued in exchange for property is not a principal purpose debt instrument (PPDI). The funding rule defines a PPDI as a debt instrument issued "in exchange for property with a principal purpose of funding a distribution or acquisition described [therein]." By referring to debt instruments that are issued "in connection with the purchase of property or the receipt of services," the ordinary course exception creates ambiguity about whether the otherwise clear PPDI definition includes debt instruments issued for other types of non-property, such as accrued intercompany interest expense and royalty payables, each of which generally would not be viewed as being issued in exchange for property but also do not appear to be covered by the ordinary course services exception.

The ordinary course exception should provide that any debt instrument issued in exchange for property is not a PPDI and not subject to the per se funding rule if it results in (i) a currently deductible business expense (under any statutory provision, not just §162); or (ii) an amount reflected in COGS or inventory (or equivalent). This would ensure that debt used to fund ordinary course transactions is within the exception without having to create an exhaustive list of possible business items to which such debt may relate, and avoid any negative inference with respect to a particular type of business expense that is inadvertently omitted from such a list.

The regulations should also clarify that debt that gives rise to a currently deductible business expense is not carved out of the exception simply because such expense is deferred under another statutory provision, such as §267.

b. -2 Rules (Documentation Rules)

The Chamber believes debt instruments arising in the ordinary course of business should also be excepted from the documentation requirements and therefore be excluded from the

definition of an "applicable instrument" (or "expanded group instrument") under the documentation rules.

The definition of ordinary course debt instrument under the documentation rules should be similar to the definition recommended for purposes of the funding rules to cover all debt issued in connection with ordinary business transactions that result in currently deductible expenses (without regard to §267) or an amount reflected in COGS or inventory (or equivalent), but it should also include arrangements that taxpayers enter into among expanded group members, such as clearing house payment systems, paid-on-behalf reimbursements, and non-deductible expenses. Further, payments should not be restricted to currently deductible or inventory items. The concerns around debt being used to conduct general or funding transactions is not present in documentation matters. A taxpayer does not fail to document a payable for a depreciable asset to seek an advantage of any sort.

V. Foreign-to-Foreign Transactions Should Be Exempted from the Regulations

A. Issue

As discussed above, prior guidance stated that Treasury was seeking to promulgate "guidance to address strategies that avoid U.S. tax on U.S. operations by shifting or 'stripping' U.S.-source earnings to lower-tax jurisdictions, including through intercompany debt."[12] However, the proposed regulations are applicable to a much broader swath of transactions, including foreign-to-foreign transactions (e.g., CFC-to-CFC transactions). These transactions do not reduce U.S. tax liabilities, should not be a concern, and should not be caught in the §385 net.

B. Recommendation

The Chamber recommends foreign-to-foreign transactions be exempted from the proposed regulations, subject to limited exceptions necessary to prevent identified potential for abuse (e.g., a transaction involving a U.S. branch of a foreign expanded group member).

VI. Mitigating Double Taxation

The double taxation caused by the proposed regulations due to the loss of foreign tax credits (FTCs) should be addressed.

A. Issue

Section 902 generally provides for an indirect foreign tax credit to certain U.S. corporate shareholders of foreign corporations on payment of dividends. The FTC mechanism is designed to eliminate double taxation of foreign earnings. Under §902, eligibility for the indirect FTC generally requires that a U.S. corporation or a foreign corporation that is a member of a qualified group own at least 10% of the voting stock in the CFC (qualified shareholder).

[12] See Notice 2014–52, 2014-42 IRB 712. See also Notice 2015-79, 2015-49 I.R.B. 775.

Debt issued by a foreign group member (e.g., a CFC) that is recharacterized under the proposed regulations will result in non-voting equity. Such recharacterization of debt held by an expanded group member that is not a qualified shareholder to nonvoting equity will result in double taxation of earnings attributable to interest and principal payments that are recharacterized as dividends due to the permanent loss of the related FTCs.

B. Recommendation

To mitigate this double taxation from the permanent loss of FTCs, the Chamber recommends allowing a dividend paid with respect to a recharacterized debt instrument to qualify for the indirect FTC to the extent a dividend would have qualified if paid to expanded group members that were qualified shareholders immediately prior to the recharacterization of debt. This could be accomplished by treating, for purposes of §902, the issuer and holder as members of the same qualified group and the holder as owning at least 10% of the voting stock of the issuer if the issuer and holder are members of a qualified group with respect to the same U.S. corporation. This would allow for E&P and tax pools to be reduced by the recharacterized interest or principal payment and ensure that taxes remain with the related E&P.

VII. Issues Relating to Both the General Rule and Per Se Funding Rule of Prop. Reg. §1.385-3

A. Current-Year Earnings & Profits (E&P) Exception Should Be Expanded

1. Issue

For purposes of applying the general rule and the funding rule of Prop Reg. §1.385-3(b), Prop Reg. §1.385-3(c)(1) provides an exception for distributions (or acquisitions) that do not exceed current-year E&P. Limiting the exception to current E&P creates several concerns:

- There is no conceptual distinction between current and recently accumulated E&P. Further, not permitting the distribution of some amount of accumulated earnings would impose an unwarranted burden on business motivated cash management decisions, which are based on a variety of commercial factors, including cash needs and projections and currency considerations.
- Further, limiting distributions to current E&P is problematic for a number of practical reasons because of, for example, (i) differences between U.S. GAAP, statutory accounting, and E&P, (ii) statutory restrictions on the payment of interim dividends (i.e., in the same year the earnings are earned) in many jurisdictions, and (iii) the inability to accurately forecast current E&P, including as a result of unpredictable business changes. Because companies only truly know their current E&P when the tax return is filed the following year,[13] they must choose between risking a distribution in excess of current E&P or making a smaller distribution, which would result in a portion of current E&P

[13] And perhaps not even then because of subsequent audit adjustments.

each year being converted to accumulated E&P that cannot be distributed without implicating the regulations.

- Additionally, limiting the exception to current E&P would put undue constraints on an expanded group's ability to reallocate capital from an entity with accumulated E&P but a current year loss to other entities within the expanded group.

2. Recommendation

The Chamber believes distributions of all accumulated E&P in addition to current E&P should be excepted from the per se stock rules to allow taxpayers to better anticipate whether a distribution from the group member would trigger application of the general rule or funding rule.

As an alternative, the Chamber recommends, at a minimum, permitting distributions of PTI, current year non-PTI E&P, and undistributed non-PTI E&P from the prior three years determined on a rolling basis.

- This look back period would ensure that taxpayers have at least two years of actual undistributed earnings information to consider in evaluating the amount of distributions that can be made in a particular year without running afoul of the regulations and without permanently converting current earnings into earnings that cannot be distributed because of timing considerations.
- The suggested look back rule would apply upon finalization regardless of whether the E&P was earned prior to or subsequent to the effective date.
- Under this recommended rule, any E&P not distributed by the end of the third taxable year after it is earned would become accumulated for purposes of applying the regulations, and distributions of such long term accumulated amounts would be subject to the per se stock rules.
- Distributions of PTI should also not be subject to either the general rule or the funding rule. Distributions of PTI are not tax motivated – the earnings have already been taxed.

B. A "Double Jeopardy" Safe Harbor Should Be Adopted

1. Issue

Under the funding rule, if a debt instrument is deemed to fund a distribution or acquisition described therein, but an exception applies so that the debt instrument in question is not recharacterized, the same debt instrument could be re-tested against another distribution or acquisition that takes place later. For example, borrowing that is excluded from the funding rule under the E&P exception (or threshold exception) in one year can later be retested and treated as equity as a result of another transaction in a subsequent tax year, significantly reducing or eliminating the value of the those exceptions. This consequence would be overly harsh.

2. Recommendation

The proposed regulations should adopt a double jeopardy safe harbor. A debt instrument issued to an expanded group member (or portion thereof) should only be treated as funding a single distribution or acquisition and if it qualifies for an exception, it should not be retested multiple times with respect to multiple distributions or acquisition transactions. For example, if a debt instrument would have been treated as equity in the year it was issued under the funding rule as a result of a distribution or acquisition entered into in the same year or a prior year, but the E&P exception (or threshold exception) applies to prevent it from being recharacterized as equity, then that same debt should not later be retested and treated as funding another transaction.

C. Equity Compensation Should Be Excluded

1. Issue

The §1032 regulations treat parent stock provided to a subsidiary to be used as employee compensation as purchased by the subsidiary regardless of whether the subsidiary pays for the shares. This deemed purchase appears ensnared by the per se rules because it is an acquisition of expanded group shares by the subsidiary. Moreover, a recharge agreement could give rise to a debt issuance under the regulations.

2. Recommendation

This transaction should be excluded from the regulations in all respects. Use of parent stock to provide compensation to subsidiary employees is a long-standing practice that is used in the ordinary course of business and should not result in adverse tax consequences to the group. Applying the proposed regulations to such a transaction would be inconsistent with the policies embodied in the §1032 regulations, which are intended to facilitate such transactions.

D. A Rule to Prevent Cascading Should Be Adopted

1. Issue

Compounding the adverse effects of the proposed regulations is their potential for cascading effects. A recast debt instrument would be treated as an expanded group stock acquisition and interest and principal payments on a recast debt instrument would be treated as distributions, each triggering the application (or re-application) of the per se stock rules.

2. Recommendation

To prevent the cascading effect of the proposed regulations the Chamber recommends that, for purposes of applying the per se stock rules,

- Recharacterization of a debt instrument as stock should not be treated as an acquisition of expanded group stock; and

- Payments of interest or principal on a recast debt instrument should not be treated as distributions.

E. Ordinary Legal Entity Restructuring Issues

1. Debt Reclassified as Stock Should Be Disregarded for Control Tests and Certain Distributions Should Not Implicate Per Se Stock Rules

a. Issue

Multinational companies frequently restructure their operations to respond to the ever changing global economy. The proposed rules give rise to complicated ownership issues which significantly curtail viable restructuring options and, thus, increase the cost of doing business. Tax-free spinoffs under §355, §351 contributions, §332 liquidations, and other reorganizations could run afoul of relevant control tests if debt is recharacterized as equity under the proposed rules. Likewise, §332 liquidations (and deemed liquidations) and §355 spinoffs are distributions that could be subject to the per se stock rules and cause debt to be recharacterized.

b. Recommendation

The Chamber recommends amending the proposed regulations to provide that debt reclassified as stock under the proposed regulations should be disregarded for purposes of the §§368(c) and 1504 control tests. Additionally, the Chamber recommends modifying the rules to provide that §§332 and 355 transactions are not treated as distributions for purposes of the per se stock rules.

2. An Exception for Transfers of "Old and Cold" Non-Financial Assets Should be Adopted

a. Issue

The funding rule applies to the transactions described therein (funded transactions) regardless of the type of assets transferred in the funded transaction. Treating a related-party cash borrowing as funding a transfer of non-financial assets, such as machinery and equipment or intellectual property, is conceptually inconsistent and overly broad if the non-financial assets are historic assets of the transferor.

b. Recommendation

For purposes of applying the funding rule, the Chamber recommends adding an exception from the definition of funded transactions to exclude transfers of non-financial assets that satisfy certain conditions. The exception could be limited to operating assets or other assets that are not easily converted to cash and also could be limited to "old and cold" assets to address concerns about fungibility. One way to address the latter point would be to apply a test similar to the anti-

abuse rule already in the regulations that would exclude from the exception non-financial assets acquired with a principal purpose to avoid the regulations or acquired within a certain period prior to the transfer.

VIII. The Period of the Per Se Funding Rule of Prop. Reg. §1.385-3(b)(3) Should Be Shortened

A. Issue

The proposed regulations include a funding rule, which treats as stock certain related-party debt instruments with a principal purpose of funding a distribution or an acquisition described in the general rule. These regulations establish a per se rule creating a non-rebuttable presumption that an expanded group debt instrument is issued with such a principal purpose if it is issued within a 72-month period centered on the date that the issuer of the debt undertakes a distribution or acquisition described in the funding rule.

The Chamber believes this is an unworkable time frame. Businesses are dynamic and do not have real-time visibility across such long periods. Further, companies should not be forced to take into consideration a six-year horizon when making routine business decisions. The per se rule is excessively broad, linking transactions from multiple tax years that are factually unrelated.

B. Recommendation

The Chamber's recommendation is two-fold. First, the Chamber recommends that the per se funding rule either be abandoned entirely or the rule's non-rebuttable presumption be changed to a rebuttable presumption similar to Reg. §1.707-3(c).

Second, if the per se rule is retained, the 72-month period should be shortened such that the total period includes the current tax year and the preceding and succeeding tax years, but in any event at least a 12 month period before or after the current tax year in the case of short tax years. This provides look back and look forward periods each of which would always be at least 12 months and as much as 24 months. Basing these periods on taxable years rather than on particular dates will be more administrable because monitoring and information gathering would be less burdensome.

IX. Issues Relating to the Documentation and Substantiation Requirements of Prop. Reg. §1.385-2

The documentation requirements of the proposed regulations are expensive and impose substantial compliance burdens. They are essentially a trap for the unwary that would ensnare predominantly non-tax motivated intercompany debt. Failure to timely comply with this rule for a debt instrument that in all respects is debt in accordance with generally accepted accounting principles and longstanding tax principles (either under case law and/or IRS guidance spanning

decades) converts that instrument into equity. Effectively, under the proposed rules, debt is not debt unless a company adequately and timely documents it as debt.

This position ignores a basic tenet of contract law that a legally binding contract does not require a written document (other than a few exceptions such as conveyance of real property). In fact, an oral loan agreement is a legally binding loan. The real test as to whether an intercompany loan is a substantive loan would be whether it is respected as debt in bankruptcy proceedings. Bankruptcy precedent respects loans that are documented with a mere journal entry and a pattern of performance (e.g., periodic interest payments). As such, the documentation arising from these requirements does not represent a higher standard of substance, but merely artificial documentation created to support a certain tax treatment. In reality, the additional compliance burdens placed on taxpayers far outweigh any tax policy objective that the proposed regulations are intended to promote.

A. 30 Day Period to Document Not Practicable

1. Issue

The proposed regulations provide 30 days following the issuance of debt for taxpayers to finalize the required documentation to substantiate that such debt should qualify as debt for U.S. tax purposes. In many cases, this period would be an extremely short period for a tax department and/or treasury group to even discover that a transaction had taken place that could require compliance with documentation requirements, let alone in which to comply with major new documentation requirements with respect to each and every related-party debt arrangement entered into by companies that are already juggling limited compliance resources.

2. Recommendation

A taxpayer should be permitted to finalize such documentation by the time it must file the tax return (including extensions) for the year in which the debt is issued. This approach would permit companies to allocate resources more effectively and to address such documentation requirements as part of their annual compliance process [, similar to the process for providing transfer pricing documentation].

B. A De Minimis Exception to Documentation Rules Should be Adopted

1. Issue

A de minimis exception to the documentation rules should be provided to reduce compliance burdens.

2. Recommendation

The Chamber recommends that the proposed rules be amended by adding a minimum loan term exempting loans in existence for less than a year. Another approach could be to exempt loans for which interest is not required to be paid due to Reg. §1.482-2(a)(1)(iii)(B) and (C).

C. It Should Be Clarified That Routine Actions on Existing Debt Do Not Cause Retesting

1. Issue

To reduce compliance burdens under the documentation requirements, a clarification on retesting should be provided.

2. Recommendation

The Chamber recommends that the proposed rules clarify that routine actions on existing debt instruments do not cause retesting of documentation requirements. For example, loan drawdowns should not be subject to requirements with each draw and capitalization of interest should not require additional documentation.

X. Issues Relating to the Bifurcation Rules of Prop. Reg. §1.385-1

As a preliminary observation, it is challenging to provide feedback on the proposed bifurcation rules. As discussed in more detail below, the proposed regulations provide limited details regarding the application of the rules and their consequences, which makes both identifying issues and proposing solutions difficult. As a result of the lack of detail, the Chamber cannot provide comprehensive feedback on this part of the proposed regulations, but notes that the concerns raised under other sections of these rules arising from recharacterizing debt as equity also apply to the bifurcation rules.

A. The Proposed Rules Fail to Provide Criteria That Would Lead to Application of the Bifurcation Rule

1. Issue

The proposed rules currently contain vague language on the application of the bifurcation rule. The rule provides that the IRS can bifurcate an instrument to the extent an analysis concludes that "general federal tax principles result in a determination that the EGI is properly treated for federal tax purposes as indebtedness in part and stock in part."

2. Recommendation

The Chamber requests additional guidance on what criteria would lead to the application of the rule. Taxpayers need to understand the standards by which the IRS intends to make these determinations and by which courts will review IRS decisions.

B. The Proposed Rules Fail to Address the Consequences of Bifurcation

1. Issue

The proposed rules fail to address the consequences of bifurcation. For example, when a payment is made with respect to an instrument that has been bifurcated, how is the payment allocated between the debt and equity pieces?

2. Recommendation

The Chamber recommends that the proposed rules be modified to provide clear rules on the consequences of bifurcation. For instance, regarding the payment issue posed above, clear rules are needed as to whether the payment should be allocated pro rata or to either debt or equity first.

XI. Specialized Issues

A. S Corporation Qualification Concerns Should Be Addressed

1. Issue

If, under the proposed rules, debt is recharacterized as stock, this recharacterization could automatically invalidate an S corporation election since S corporation are allowed only one class of stock. If they have more than one class of stock, the entity classification reverts back to a C corporation.

2. Recommendation

The proposed rules should be amended to disregard debt reclassified as stock under the proposed regulations for purposes of §1361(b)(1)(D). Debt/equity concerns and safe harbors are addressed in existing regulations. If the proposed regulations are not amended to disregard S corporation debt, further regulations are necessary to reconcile the proposed regulations to Reg. §1.1361-1(l)(2) and (4).

B. REIT Qualification Concerns Should Be Addressed

1. Issue

If, under the proposed rules, debt is recharacterized as stock, this recharacterization could threaten a real estate investment trust (REIT)'s status in a number of contexts. For example, it

could increase the REIT's ownership of taxable REIT subsidiaries above the 25% (20% in 2018 under recent legislation) limit.

2. Recommendation

The proposed rules should be amended to disregard debt reclassified as stock under the proposed regulations for purposes of REIT test purposes.

C. Bubbling Partnerships Issue Should Be Cured

1. Issue

Where there is an affiliate loan to a disregarded entity (DRE) (called LLC1), if the loan is recharacterized as equity under the -2 rules, LLC1 will be treated as a partnership (with two owners), rather than a DRE. This newly formed, unintended partnership can cause taxation to the partner exchanging a debt instrument for a partnership interest along with a host of other issues. For example, if the newly formed partnership has a bubbling debt to one of its partners, that new partner may be taxed on its deemed contribution of property to the partnership. Another example is that the new partners and partnerships may have failed to file partnership returns for unanticipated equity issuances resulting from an audit of earlier tax years. Finally, once the loan is repaid, LLC1 will become a DRE again and its status as a partnership will terminate (triggering potential tax consequences).

2. Recommendation

The Chamber recommends that a provision be added that treats the recast debt as equity of the single owner, rather than the DRE, which would be consistent with treatment under the per se stock rules.

D. Consolidated Group Definition Should Be Expanded

1. Issue

There are situations where a U.S. consolidated group would lend funds to a non-consolidated U.S. entity that is an EG member but not a consolidated group member. In this instance, both the interest income and interest expense are subject to tax in the United States, although in separate tax returns. Application of proposed regulations in these instances result in significant administrative complexity while the U.S. tax consequences arising from the indebtedness are not in conflict with any of the material policy goals of the regulations.

2. Recommendation

The Chamber recommends that any domestic expanded group member meeting the ownership tests generally applicable to consolidated groups, but not otherwise eligible under

Reg. §1.1502-1(h) be included in definition of a consolidated group for purposes of the proposed regulations.

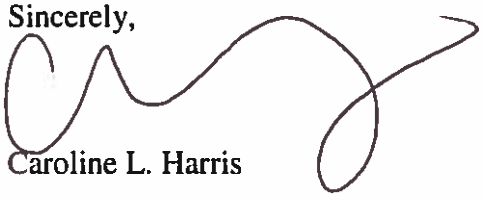
XII. Conclusion

The Chamber appreciates the opportunity to provide feedback on these proposed rules. In sum, the Chamber strongly urges Treasury and the IRS to withdraw the rules so the Treasury, Congress, and the business community can have time to work together to address legitimate issues at stake. In the absence of withdrawal, the Chamber strongly urges Treasury and the IRS to:

- Delay the effective dates of all provisions of the proposed rules until taxable years beginning after January 1, 2019, thereby allowing companies to both understand the impacts of the regulations as well as implement the systems necessary to comply with them.
- Narrow the scope of the proposed rules, and, at a minimum, address the specific issues by making the changes recommended above.

These changes are necessary to prevent unnecessary disruption to normal business operations, creating even more drag on an already struggling U.S. economy, as well as to ensure both that U.S. companies can compete globally and that foreign capital is welcomed within our borders. The Chamber looks forward to working with you to address these issues.

Sincerely,



Caroline L. Harris