IIAC ACCVM
INVESTMENT INDUSTRY ASSOCIATION OF CANADA
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

TD West Tower | 100 Wellington Street West
Suite 1910, PO Box 173 | Toronto, ON M5K 1H6

416.364.2754 | www.iiac.ca

www.iiac.ca

November 28, 2018

The Honorable David Kautter
Assistant Secretary for Tax Policy
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington D.C. 20220

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

William M. Paul
Acting Chief Counsel & Deputy Chief
Internal Revenue Service
1111 Constitutional Avenue, NW
Washington, D.C. 20224

Marjorie Rollinson
Associate Chief Counsel (International)
Internal Revenue Service
1111 Constitutional Avenue, NW
Washington, D.C. 20224

Re: Request for regulatory Relief from the unintended negative consequences created by the Repeal of section 958(b)(4) for multinational financial institutions (Form 1099 Reporting and Portfolio Interest for CFCs)

Dear Sirs and Mesdames:

The Investment Industry Association of Canada (IIAC)[1] is writing to urge the Department of the Treasury (the Treasury) and the Internal Revenue Service (the IRS) to issue guidance providing relief from the negative unintended consequences certain financial institutions would face if considered to be controlled

---

[1] The IIAC is the national association representing the investment industry's position on securities regulation, public policy and industry issues on behalf of our 130 IIROC-regulated investment dealer Member firms in the Canadian securities industry. These dealer firms are the key intermediaries in Canadian capital markets, accounting for the vast majority of financial advisory services, securities trading and underwriting in public and private markets for governments and corporations. See www.iiac.ca for more information.

foreign corporations (CFCs) as a result of the repeal of Internal Revenue Code section 958(b)(4) by the Tax Cuts and Jobs Act of 2017 (TCJA)[2]. Specifically, we are concerned with the impact of CFC status on these financial institutions with respect to: (1) their treatment as "U.S. Payors" and therefore subjected to expanded Form 1099 reporting and backup withholding requirements; and (2) their eligibility for the portfolio interest exemption in certain circumstances.

Overview of the IIAC's Request

The IIAC will provide additional details regarding the negative impact the unintended consequences each of the two concerns listed above could result in and we are therefore urging the Treasury and the IRS to issue guidance as soon as possible clarifying the following:

CFCs created due to the repeal of section 958(b)(4) will not be:

(1) treated as U.S. Payors for the purposes of Form 1099 reporting (chapter 61) and backup withholding (section 3406); and

(2) disqualified from the portfolio interest exemption due to their CFC status, per section 881(c)(3)(C).

Impact of the repeal of section 958(b)(4)

It appears clear based on Section 958 Legislative Intent and comments made by the Chairman of the Senate Finance Committee that the objective of the repeal of section 958(b)(4) was to prevent evasive "de-controlling" transactions made by US shareholders who transfer their stocks in a foreign subsidiary to a foreign person. The U.S. shareholder would have been able to avoid subpart F income as a result of the transaction.

In addition, the Congressional Record noted that members of Congress did not believe it was necessary to provide the intent of the section 958(b)(4) repeal directly into the TCJA, as they believed it was self-evident. It was further expressed that they expected the repeal without the intent language would still be able to "ensure that the stock attribution rules operate consistent with our intent and do not result in unintended consequences."[3]

However, the repeal was not narrow enough to only target those "de-controlling" transactions and will have unintended consequences. IIAC members are concerned about the impact of the repeal causing "downward attribution" on multinational financial institutions that have legitimate corporate structures with subsidiaries both within the U.S. and in foreign jurisdictions, resulting in a foreign subsidiary of a foreign parent, artificially being considered a subsidiary of the U.S. subsidiary[4]. Consequently, the foreign subsidiary would also now become a CFC.

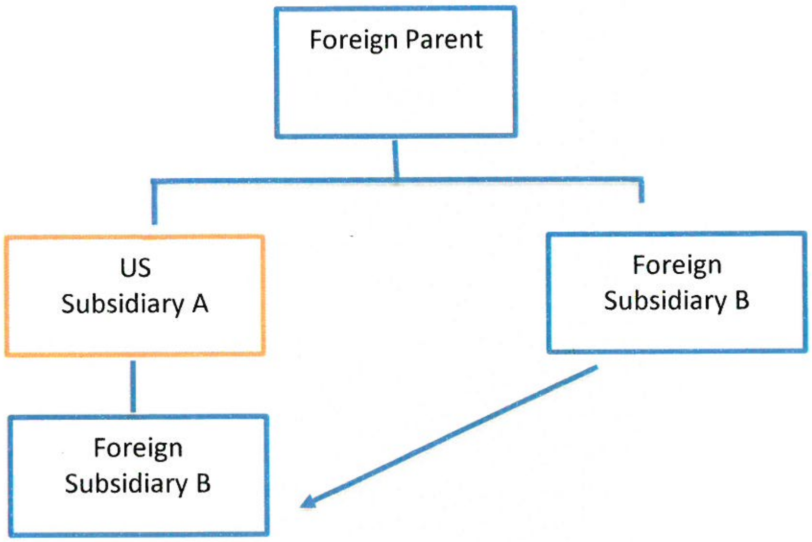
---

[2] Section 14213 of Public Law 115-97.

[3] §8110 Congressional Record – Senate, December 19, 2017.

[4] Assuming there is 50% or greater ownership by the parent, see section 318(a)(3).

<u>Effect of section 958(b)(4) repeal on Corporate Structures</u>



If the foreign parent owns 50% or more of US Subsidiary A and Foreign Subsidiary B, the downward attribution from the repeal of section 958(b)(4) and the effect of section 318(a)(3) would result in Foreign Subsidiary B now becoming a CFC under US Subsidiary A

Unfortunately, despite the clarifying statements noted above, foreign subsidiaries could now be captured unintentionally as CFCs under a strict interpretation of the rule, as we do not have the benefit of the legislative intent being read into the rule to narrow its effect. Consequently, guidance is required to address the negative unintended consequences that will arise.

<u>Unintended Consequences – Expanded Form 1099 reporting and backup withholding</u>

Prior to the repeal of section 958(b)(4), foreign subsidiary B from the example above (Foreign Subsidiary B) was exempt from Form 1099 reporting and associated backup withholding where the foreign subsidiary (as a non-U.S. payor) was making a payment of non-U.S. source income outside of the U.S.[5]. However, as a result of the repeal of section 958(b)(4), Foreign Subsidiary B would be classified as a CFC, and therefore, a U.S. Payor. As such, it would be subject to expanded Form 1099 reporting. This could result in foreign subsidiaries with essentially no connection to the US being required to comply with the same reporting and withholding obligations as actual U.S. companies.

It would be extremely onerous for these foreign companies to be subject to the expanded Form 1099 reporting and backup withholding requirements. Many of these companies that would be subject to this reporting are not currently structured to be able to comply with the expanded Form 1099 reporting and withholding regime. For example: companies may have used different documentation standards for onboarding and do not have sufficient information to complete 1099 reporting requiring new policies to be developed for client onboarding; they may need to develop new systems to identify and monitor what

[5] Treas. Reg §1.6041(a)(2); §1.6042(b)(1)(iv); §1.6049-5(b)(6).

payments are subject to this new reporting; and many companies as previous non-U.S. payors do not have the ability to deposit taxes withheld to the IRS directly. These challenges represent significant costs and use of resources for companies to ensure compliance.

Another concern for foreign subsidiaries, now potentially considered U.S. Payors, is the interplay between their legal obligations under the Foreign Account Tax Compliance Act (FATCA), local Intergovernmental Agreements (IGAs) and under the Form 1099 reporting regime. Currently, as non-U.S. payors, Form 1099 reporting is limited and may not be necessary due to required reporting under FATCA. A major concern for companies is that Form 1099 reporting and backup withholding that is provided directly to the IRS could result in violations of local privacy laws. The foreign subsidiary is then placed in an extremely difficult position in determining how to comply with conflicting legal obligations. In addition, the reporting would complicate and potentially conflict with the objections of numerous IGAs entered into by the IRS and various countries, including Canada.

Our members are governed by a Model 1 IGA entered into by Canada and the U.S. Pursuant to that IGA, reporting financial institutions provide information regarding U.S. account holders to the Canada Revenue Agency (the CRA). The CRA in turn provides the information to the IRS and thus the IRS receives the desired information without requiring reporting financial institutions to violate local privacy laws. Given that the IRS will receive information regarding U.S. account holders under FATCA, it is not clear how the additional information it would receive under expanded Form 1099 reporting would be reconciled.

Unintended Consequences – Loss of Eligibility for the Portfolio Interest Exemption

A second unintended consequence for companies becoming CFCs as a result of the repeal is the potential loss of eligibility of the portfolio interest exemption, which would negatively impact their ability to arrange intercorporate financing structures.

Historically, Foreign Subsidiary B would generally qualify for a complete exemption from U.S. federal income taxation on portfolio interest income from a U.S. debtor, provided that income is not effectively connected with the conduct of the foreign subsidiary in respect of a trade or business in the U.S.[6]. However, as a result of the Foreign Subsidiary B's new status as a CFC, if the interest is paid from a related U.S. person (i.e. U.S. subsidiary A to Foreign Subsidiary B), the interest does not qualify for the portfolio interest exemption. Instead, there could be withholding of up to 30%, depending on the availability of treaty rates to reduce the total percentage withheld.

The inability to qualify for the portfolio interest exemption would negatively impact multinational corporations in terms of how they arrange and provide intercorporate financing to fund business operations. For example, Singapore and Hong Kong are non-treaty jurisdictions and there would be no reduction on the 30% withholding rate for portfolio interest if the foreign subsidiary was based in those jurisdictions. Consequently, the economics of having a subsidiary in those countries for financing

---

[6] 26 U.S. Code Section 871(h) and section 881(c).

purposes, and operations in the U.S. may not be viable. This would trigger restructurings of complex financing arrangements and result in additional and unnecessary costs for these companies.

The original intent of the portfolio interest exemption was to encourage investment in the U.S. and to end the practice of "treaty shopping". If multinational corporations are denied the portfolio exemption due to certain of their subsidiaries having CFC status, it may reintroduce the problems associated with "treaty shopping" and negatively impact investment in the U.S. as well as impacting the economies of other countries.

Impact of the Effective Date

The repeal of section 958(b)(4) would be effective January 1, 2017 for calendar year foreign corporations. As a result of the repeal and its effective date, companies have immediate exposure to the IRS for penalties and withholding liabilities. There has been no transition time provided and as we have noted above, companies would need to make substantial changes to their systems, policies, and corporate structures to ensure that they are compliant. It is crucial that guidance is provided to avoid these negative unintended consequences.

Request for Relief from the Treasury and the IRS

The American Investment Council outlined the various sources of authority that the Treasury has to issue guidance on this matter under section 7805(a) and as a result of Supreme Court precedent[7]. In addition, the Treasury and IRS have already exercised similar authority through Notice 2018-13, when announcing their intention to issue regulations for determining the amounts included in gross income under section 951(a)(1) by reason of section 965.

We believe it is appropriate for the Treasury to exercise its rulemaking authority to issue the requested guidance on the repeal of section 958(b)(4) clarifying that:

1. CFCs due to the repeal of section 958(b)(4) will not be considered U.S. Payors; and

2. CFCs due to the repeal of section 958(b)(4) will not be disqualified from the portfolio interest exemption due to their CFC status.

We greatly appreciate the ongoing work and dialogue with the industry on these matters. If you have any questions with respect to the foregoing, we kindly ask that you contact the undersigned.

Yours sincerely,

Adrian Walrath
Assistant Director

[7] See American Investment Council letter dated February 15, 2018 at https://www.investmentcouncil.org/wp-content/uploads/2018-02-15-aic-letter-to-treasury-section-958b4-repeal-final-without-appendix-2.pdf