sifma
Invested in America

June 2, 2017

The Honorable Steven Mnuchin
Secretary of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

RE: Executive Order 13789

Dear Secretary Mnuchin:

The Securities Industry and Financial Markets Association (SIFMA)[1] appreciates the opportunity to provide comments with respect to the Treasury Department's review of recent tax regulations pursuant to Executive Order 13789, issued April 21, 2017.

Section 2(a) of Executive Order 13789 requires the Treasury Department, in consultation with the Administrator of the Office of Information and Regulatory Affairs, to identify in an interim report to the President all significant tax regulations issued on or after January 1, 2016, that "(i) impose an undue financial burden on United States taxpayers; (ii) add undue complexity to the Federal tax laws; or (iii) exceed the statutory authority of the Internal Revenue Service."

In this letter, SIFMA discusses four regulations that meet these parameters and that are of particular concern to SIFMA members: final regulations under Internal Revenue Code (i) Section 871(m) (T.D. 9815), (ii) Section 385 (T.D. 9790), (iii) Section 367(d) (T.D. 9803), and (iv) Sections 1471-1474 (T.D. 9808 & 9809). SIFMA urges the Treasury Department to include these regulations in its interim report and consider actions in these areas to reduce the burdens and complexity for taxpayers.

[1] SIFMA is the voice of the U.S. securities industry. We represent the broker-dealers, banks and asset managers whose nearly 1 million employees provide access to the capital markets, raising over $2.5 trillion for businesses and municipalities in the U.S., serving clients with over $18.5 trillion in assets and managing more than $67 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

I. IRC Section 871(m) Regulations

Final Section 871(m) regulations (T.D. 9815) were published in the Federal Register on January 24, 2017. SIFMA has submitted multiple comment letters on the 871(m) regulations that are available on the SIFMA website.[2]

Section 871(m) was enacted in 2010 in response to concerns over transactions where foreign investors owning U.S. equities avoided U.S. withholding taxes on dividends by entering into swap transactions over dividend record dates. The 2010 statute immediately imposed withholding on certain swaps that closely resembled the transactions of concern, and granted regulatory authority to U.S. Treasury to develop rules to identify any additional derivative transactions that should be subject to withholding from those that would not have the potential for tax-avoidance.

Since 2012, Treasury and the IRS have issued multiple versions of proposed, temporary and final regulations, supplemented by IRS Notices and Revenue Procedures. The January 2017 final 871(m) regulations left in place a January 1, 2017 effective date for withholding on so-called "delta one" transactions, despite industry requests for a delay in light of interpretive questions and implementation challenges. The regulations also require withholding on a broader class of transactions – defined as having a delta of 0.80 or higher – beginning January 1, 2018.

SIFMA believes that the burdens imposed on financial intermediaries by the 871(m) regulations are substantial and costs may exceed the amount of tax that Treasury can expect to collect as a result of the new rules. No effort has been made by Treasury to quantify the direct and indirect costs of the 871(m) regulations. Moreover, the application of the rules is uncertain with respect to many common transactions.

The 871(m) regulations are also lengthy, complex, and ambiguous. The final rule that is the basis for the January 24, 2017 regulations ran to over 29,000 words when it

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[2] Letter from SIFMA to the Hon. Mark Mazur, May 7, 2014; Letter from SIFMA to the Hon. Mark Mazur Requesting Additional Guidance, March 31, 2016 (http://www.sifma.org/issues/item.aspx?id=8589959618) ("March 2016 Letter"); Letter from SIFMA to the Hon. Mark Mazur Urging Implementation Delay, June 24, 2016 (http://www.sifma.org/issues/item.aspx?id=8589961019) ("June 2016 Letter"); SIFMA Letter to Mr. Robert Stack Regarding Notice 2016-42 and Section 871(m), August 1, 2016 (https://www.sifma.org/comment-letters/2016/sifma-submits-comment-to-multiple-agencies-on-the-qi-agreement-published-in-notice-2016-42/) ("August 2016 Letter"); and Letter from SIFMA to the Hon Mark Mazur Urging Implementation Delay in Light of G5 Position Letter, Nov. 14, 2016 (http://www.sifma.org/issues/item.aspx?id=8589963522) ("November 2016 Letter").

appeared in the Federal Register in September 2015.[3] In our March 2016 letter and in three subsequent letters, we highlighted a number of gaps that make the regulations difficult or impossible to interpret with the specificity necessary to design and build compliance systems.[4] We have urged Treasury to provide additional guidance and to give our industry sufficient lead time in advance of the rules' effective date. Lacking such guidance, our members have been forced to adopt inefficient manual and *ad hoc* measures. In some cases, the market's inability to overcome interpretive difficulties and practical obstacles to compliance has reduced the mix of products available to foreign investors. These problems will be far more significant after January 1, 2018, when the delta threshold in the regulations is reduced to 0.80.

Even if the regulatory gaps our members are most concerned about could be addressed, the 871(m) rules are extraordinarily complex and novel. They rely on mathematically intensive "delta" and "substantial equivalence" calculations that have never been used in federal tax regulations, and they impose future tax liabilities on flows of phantom dividends that must be tracked by financial firms and chains of intermediaries. Five foreign governments have raised questions about United States jurisdiction to impose withholding tax on such phantom income in transactions between foreign counterparties outside the United States.[5]

Without basic guidance on interpretive questions that is needed to determine how to design and build new withholding systems to meet the approaching January 1, 2018 effective date, our members and their clients will continue be at risk for over or under-withholding or designing systems that fail to capture Treasury's intent.

SIFMA Position

SIFMA supports clear, targeted rules that address tax-avoidance and has provided extensive comments to the Treasury Department throughout the rulemaking process. However, SIFMA believes the final regulations go beyond what is necessary to address abuse and have created substantial administrative and compliance challenges for the industry. We believe the government should consider continuing to apply the statutory withholding rules that were in effect until December 31, 2016 until the current administration has the opportunity to consider whether the current 871(m) regulations go too far. The September 2015 and January 2017 regulations should be withdrawn or substantially modified.

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[3] Dividend Equivalents from Sources Within the United States, 80 Fed. Reg. 56,866 (2015).
[4] See supra note 2, "March 2016 Letter."
[5] See supra note 2, "November 2016 Letter."

II. IRC Section 385 Regulations

Final Section 385 regulations (T.D. 9790) were published in the Federal Register on October 21, 2016. SIFMA filed a comment letter on the impact of the Section 385 regulations on the financial services industry when they were in proposed form.[6] While Treasury made numerous changes to the rules that we believe were necessary to avoid a severe impact on our member firms and the economy, there are a number of recommendations we would still urge Treasury to adopt.

Enacted in 1969, Section 385 authorizes the Treasury Department to issue regulations setting forth factors to be taken into consideration when distinguishing between debt and equity in particular factual circumstances. Prior to 2016, no such regulations were in effect.

In April 2016 Treasury proposed a broad set of regulations under Section 385 that would recharacterize related party debt as equity in a wide variety of circumstances, a principal purpose of which was to prevent tax inversions and other tax-motivated transactions. In reality, the impact extended well beyond such purpose to ordinary course intercompany loans and payables that are central to the effective management and operation of liquidity and capital in any global financial service institution. The October 21, 2016 final regulations significantly narrowed the proposed rules as they apply to financial institutions, but they retained the rule that recharacterizes related-party debt arrangements as equity if certain documentation requirements are not satisfied. Given that funding is the basic operating need of a financial institution, SIFMA members are impacted more significantly than other industries given the volume of ordinary course intercompany funding transactions that exists among a member's affiliated organization.

SIFMA believes that the documentation rules, which are scheduled to take effect January 1, 2018, create substantial administrative burdens for SIFMA members. Implementing such rules by a complex global financial services firm requires considerable time, effort and expense. Significant lead times are needed to develop and then maintain the additional systems, processes and procedures necessary to administer the high volume of intercompany funding that occurs with high frequency and regularity among the affiliates of a global financial institution. The documentation rules introduce yet another point of friction to the otherwise free flow of liquidity. Furthermore, SIFMA believes that the consequences of failing to meet the documentation requirements (e.g., loss of related interest deductions, creation of new

[6] Letter from SIFMA to the Hon. Mark Mazur Regarding IRS REG-108060 (Proposed Regulations Under Section 385), July 6, 2016 (http://www.sifma.org/issues/item.aspx?id=8589961304).

classes of equity ownership) are overly harsh and out of proportion to the concern Treasury said the rule is intended to address. The preamble to the proposed regulation explained the rationale for enhanced documentation requirements as follows: "The absence of reasonable diligence by related-party lenders can have the effect of limiting the factual record that is available for additional scrutiny and thorough examination." 81 Fed. Reg. at 20915 (Apr. 8, 2016). We believe these objectives could be achieved with far less burdensome means.

SIFMA Position

Financial services firms have already diverted significant time, resource and capital away from other productive activities to ensure compliance with the rules by their effective date of January 1, 2018. In addition, SIFMA believes the general rule and the funding rule in the Section 385 regulations are overbroad and impose significant burdens on taxpayers. Therefore, SIFMA urges not only that the Section 385 regulations be withdrawn under E.O. 13789, but that immediate relief be provided to the firms already engaged in compliance efforts for the documentation rules. We would urge Treasury to immediately announce a delay in the effective date of the documentation rules beyond January 1, 2018, pending completion of a thorough review under E.O. 13789.

III. IRC Section 367 Regulations

Final Section 367 regulations (T.D. 9803) were published in the Federal Register on December 16, 2016.

Section 367(a) provides a general exception from gain recognition for outbound transfers of property for use in an active trade or business. The final regulations remove foreign goodwill and going concern value from property eligible for the active trade or business exception.

The final regulations can impose financial burdens – i.e., tax liability on triggered gains – on SIFMA members that are reorganizing foreign branches as corporations. These reorganizations are often undertaken in response to changes in the regulatory landscape and are not motivated by tax considerations. Further, many commenters have noted that the legislative history reflects an intent to exclude foreign goodwill and going concern value from taxation under Section 367.

The final regulations fail to take into account the unique circumstances faced by U.S. financial services companies, the nature of the operations of their branches, the regulation of those branches, and those cases where they must reorganize their foreign branches into new or existing foreign subsidiaries. These branch incorporations often result from pressure or compulsion imposed by local regulators that increasingly require such financial services companies to operate as subsidiaries. Prior to the final regulations, a branch incorporation would be either an actual or deemed transfer of eligible property that, through the application of the active trade or business exception, was excluded from recognition treatment otherwise required by Section 367(a)(1). SIFMA members identified the issue for the Treasury and IRS in response to their request for comments on the proposed regulations, but the final regulations provided no exceptions.

SIFMA Position

SIFMA would urge Treasury to review the Section 367 regulations, taking into account the unique circumstances faced by U.S. financial services companies.

IV. **FATCA Regulations**

Two final regulations relating to implementation of the Foreign Account Tax Compliance Act (FATCA) were published on December 30, 2016: final and temporary regulations under Chapter 4 (T.D. 9809) and final and temporary FATCA coordinating regulations under Chapter 3 and Chapter 61 (T.D. 9808).

The Hiring Incentives to Restore Employment (HIRE) Act of 2010 added a new Chapter 4 to the Internal Revenue Code, containing the Foreign Account Taxpayer Compliance Act (FATCA). FATCA imposes a 30% gross-basis withholding tax on payments of U.S. source interest, dividends, rents, salaries, or gross proceeds from the sale of U.S. assets to foreign financial institutions (FFIs) that do not meet certain reporting requirements with respect to its accounts.

The Treasury Department issued final regulations under FATCA on January 17, 2013, although subsequent regulations continue to be finalized regarding implementation. Furthermore, several significant provisions of FATCA have yet to be finalized, such as withholding on gross proceeds and foreign passthru payments, the effective date of which has been delayed until January 1, 2019.

The chapter 3 temporary regulations issued on December 30, 2016 included a particularly problematic requirement that payments beginning in 2017 include a withholding certificate that contains a beneficial owner's foreign Taxpayer Identification Number (FTIN) and, in the case of an individual, date of birth. Although the FTIN requirement has now been delayed until 2018, withholding agents are not prepared operationally to remediate all withholding certificates that do not include an FTIN and, in the case of an individual, date of birth when the date of birth is not otherwise in the withholding agent's files. The consequence of invalidating forms and requiring withholding beginning in 2018 will create turmoil in the financial markets as it will require excessive amounts of chapter 3 or 4 withholding and backup withholding on reportable payments.[7]

SIFMA conducted a survey of its members to determine the potential impact of the FTIN requirement in the December 30th rules. Among the 21 members that participated in the survey, the members maintain nearly 4 million accounts held by foreign persons. According to our survey, the reportable payments received by these accounts holders and potentially subject to withholding due to the FTIN requirement total over $1 trillion dollars per year. This amount includes U.S. and foreign source fixed, determinable, annual, or periodic (FDAP) income and gross proceeds paid to accounts held by foreign persons.

SIFMA supports the goals of FATCA, and we recognize that the statute imposes burdens that cannot entirely be alleviated by regulations, nevertheless we believe it would be helpful to consider less burdensome regulatory pathways to meet the statute's offshore compliance objectives, particularly with respect to the new FTIN requirement. SIFMA found in 2014 that a subset of our members expected to spend over $1 billion on FATCA compliance. These firms constitute a small fraction of the financial institutions around the world that are required to comply with FATCA. Its associated compliance costs are passed on to consumers of financial services in the United States and around the world.

One illustration of the extent of these costs is the number of foreign financial institutions who have applied for and obtained FATCA Global Intermediary Identification Number (GIIN). As of April 2017, just under 300,000 foreign financial institutions have completed the complex registration process necessary to obtain a GIIN, a process which commits the applicant to significant ongoing FATCA compliance costs.

Foreign investors often have many options about where to invest, and regulatory regimes such as FATCA that impose costs or create significant uncertainty as to the outcome of a given investment can change investor behavior. Less international

[7] SIFMA expects to file recommendations with the IRS and Treasury's Office of Tax Policy to address these FTIN concerns in the near future.

demand for U.S. financial services, as a result of FATCA, has the potential to reduce the price of U.S. financial assets or reduce the liquidity of U.S. financial markets.

SIFMA Position

While SIFMA supports the objective to improve offshore tax compliance, we remain concerned that the FATCA regulations and ongoing compliance burden unnecessarily disrupts the operation of the financial markets and encumbers financial institutions and taxpayers with enormous costs and complexity. We believe a number of steps can be taken to address these concerns, including, for example, changes to the FTIN requirement discussed above.

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SIFMA would welcome an opportunity to help explore options as you complete your review of these regulations, and should you have any questions please feel free to contact me at ppeabody@sifma.org or 202-962-7000. Thank you for your consideration of SIFMA's views.

Sincerely,

Payson R Peabody

Payson Peabody
Managing Director & Tax Counsel
SIFMA

cc: Dan Kowalski, Counselor to the Secretary,
Justin Muzinich, Counselor to the Secretary,
Neomi Rao, Administrator, Office of Information and Regulatory Affairs,
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