AICPA

March 13, 2018

The Honorable David J. Kautter
Assistant Secretary for Tax Policy
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Mr. William M. Paul
Acting Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Request for Regulatory Relief from Unintended Consequences Created by the Repeal of Section 958(b)(4)

Dear Messrs. Kautter and Paul:

The American Institute of CPAs (AICPA) appreciates the efforts of the United States Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) to quickly address the need for guidance related to the changes enacted by Pub. L. No. 115-97, commonly referred to as the Tax Cuts and Jobs Act (TCJA). One change, which requires immediate targeted relief due to the significant impact and unintended consequences it imparts on certain taxpayers, is the repeal of section 958(b)(4).[1]

Background

The repeal of section 958(b)(4) creates "downward attribution" under section 318(a)(3) from a foreign person to a United States (U.S.) person. Due to the downward attribution, certain foreign corporations are treated as Controlled Foreign Corporations (CFC). Accordingly, a non-corporate U.S. shareholder could unexpectedly own an interest in a Specified Foreign Corporation (SFC) as defined in section 965, which will result in an income inclusion to the U.S. shareholder of a portion of the corporation's accumulated post-1986 deferred foreign income. The repeal of section 958(b)(4) applies retroactively to a foreign corporation's last taxable year beginning before January 1, 2018 and each subsequent taxable year, which will cause an income inclusion on the U.S. shareholder's 2017 tax return. It also applies to taxable years of U.S. shareholders in which or with which the taxable years of those foreign corporations' end.

Recommendation

We recommend that Treasury and the IRS exercise their authority under section 965(o) to provide relief from the income inclusion to certain affected taxpayers. Specifically, we recommend providing guidance excluding a foreign corporation, which is considered a CFC solely as a result

[1] Unless otherwise indicated, hereinafter, all section references are to the Internal Revenue Code of 1986, as amended, or to Treasury Regulations promulgated thereunder.

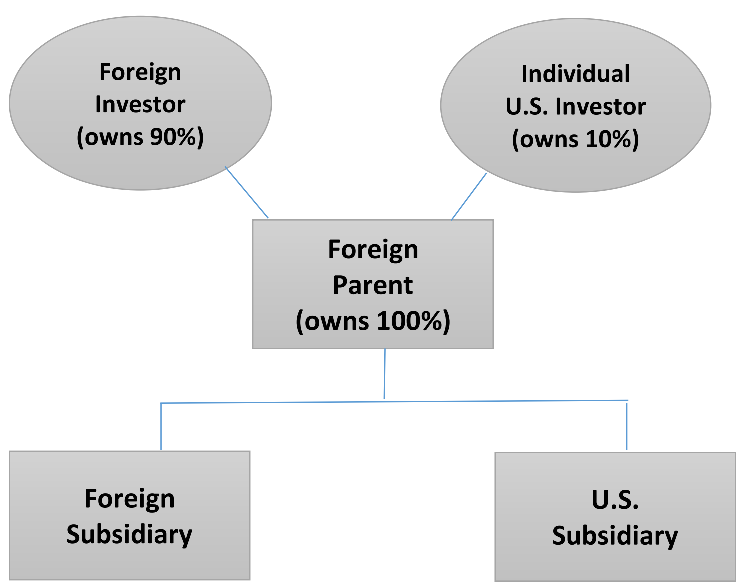
of the "downward attribution" rules of section 318(a)(3), from the definition of an SFC for any U.S. shareholder not considered a related party (within the meaning of section 954(d)(3)) with respect to the domestic corporation to which ownership was attributed.

Analysis

The AICPA believes that the income inclusion to the U.S. shareholder is inconsistent with the intent of section 965 and the repeal of section 958(b)(4). According to page 633 of the Joint Explanatory Statement of the Committee of the Conference (Conference Report) for the TCJA relating to the repeal of section 958(b)(4), "*the Senate Finance Committee explanation states that the provision is not intended to cause a foreign corporation to be treated as a controlled foreign corporation with respect to a U.S. shareholder as a result of attribution of ownership under section 318(a)(3) to a U.S. person that is not a related person (within the meaning of section 954(d)(3)) to such U.S. shareholder as a result of the repeal of section 958(b)(4).*" The Report further states that the "*conference agreement follows the Senate amendment.*"

The Conference Report also provides that "*in adopting this provision, the conferees intend to render ineffective certain transactions that are used to as a means of avoiding the subpart F provisions. One such transaction involves effectuating "de-control" of a foreign subsidiary, by taking advantage of the section 958(b)(4) rule that effectively turns off the constructive stock ownership rules of 318(a)(3) when to do otherwise would result in a U.S. person being treated as owning stock owned by a foreign person. Such a transaction converts former CFCs to non-CFCs, despite continuous ownership by U.S. shareholders.*"

The application of our recommendation is illustrated by the following example and diagram:



As a result of the changes enacted as part of the TCJA, U.S. Subsidiary is treated as owning 100% of the stock in Foreign Subsidiary, converting Foreign Subsidiary from a non-CFC, under prior law, into a CFC. Unless the related party exclusion described by the Conference Report is applied, Foreign Subsidiary would, as a new "constructive" CFC, become an SFC by reason of section 965(e)(1)(A), which would create a section 965 income inclusion to the Individual U.S. Investor. Absent the repeal of section 958(b)(4), no section 965 inclusion by the Individual U.S. Investor would have occurred (Individual U.S. Investor is not a domestic corporation and Foreign subsidiary was not considered a SFC under prior law).

Interpreting the plain language of the relevant code sections does not provide the intended result of the TCJA, resulting in an increasing number of taxpayers falling under the definition of a U.S. shareholder of a CFC than anticipated by Congress. As a result, Individual U.S. Investor in our example is also subject to all of the other provisions applicable to U.S. Shareholders of a CFC (including subpart F inclusions and GILTI, as well as increased disclosure compliance) on an ongoing basis beginning in 2018.

In order to address this issue, a technical fix to the statutory language is likely required since the IRS does not appear to have sufficient regulatory authority to apply a broad solution. However, the AICPA believes that the grant of authority in section 965(o), which provides that the "*Secretary shall prescribe such regulations or other guidance as may be necessary or* ***appropriate*** *to carry out the provisions of this section*" (emphasis added), is sufficient to allow the IRS to implement our recommended targeted relief regarding the section 965 income inclusion. While insufficient to fully address the unintended consequences of the statutory language, this relief would provide an immediate and significant degree of relief to affected taxpayers.

* * * * *

The AICPA is the world's largest member association representing the accounting profession, with more than 418,000 members in 143 countries and a history of serving the public interest since 1887. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

We appreciate your consideration of these comments and welcome the opportunity to discuss these issues further. Please feel free to contact me at (408) 924-3508 or Annette.Nellen@sjsu.edu; Philip Pasmanik, Chair, AICPA International Taxation Technical Resource Panel, at (212) 686-7160, ext. 122 or Philip.Pasmanik@hertzherson.com; or Jonathan Horn, Senior Manager – AICPA Tax Policy & Advocacy, at (202) 434-9204 or Jonathan.Horn@aicpa-cima.com.

Respectfully submitted,

Annette Nellen, CPA, CGMA, Esq.
Chair, AICPA Tax Executive Committee

cc: The Honorable David J. Kautter, Acting Commissioner, Internal Revenue Service
The Honorable Lafayette "Chip" G. Harter III, Deputy Assistant Secretary (International Tax Affairs), Department of the Treasury
Mr. Douglas L. Poms, International Tax Counsel, Department of the Treasury
Ms. Marjorie A. Rollinson, Associate Chief Counsel (International), Internal Revenue Service