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U.S. Department of the Treasury
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William M. Paul
Acting Chief Counsel & Deputy Chief Counsel (Technical)
Internal Revenue Service
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Re: Repeal of section 958(b)(4) and the unintended consequences for Form 1099 reporting for foreign subsidiaries of foreign banks

Dear Messrs. Kautter and Paul:

The Institute of International Bankers (the "IIB") would like to bring to your attention an unintended consequence resulting from the repeal of Internal Revenue Code section 958(b)(4) (the "Repeal") by the Tax Cuts and Jobs Act of 2017 (TCJA). As described below, absent guidance from the Internal Revenue Service (IRS) and U.S. Treasury, the Repeal imposes new U.S. tax reporting obligations on *foreign* subsidiaries of foreign banks, if the bank has a U.S. subsidiary. Congress clearly did not intend that result. We ask that guidance be issued to eliminate the new reporting obligation, in conformity with Congressional intent. In light of the 2017 effective date,[1] relief is needed quickly to prevent immediate and severe consequences for many financial institutions doing business in the United States.

The IIB represents internationally headquartered financial institutions from over 35 countries doing business in the United States. The IIB's members consist mostly of foreign banking organizations ("FBOs") that conduct banking operations in the United States through branches, agencies and bank subsidiaries, and nonbanking operations through subsidiaries such as commercial lending firms, broker-dealers, investment advisers and insurance companies. Our members' U.S. banking assets are over $3.7 trillion, and their U.S. operations fund 25% of all commercial and industrial bank loans made in the United States, contributing to the vitality of

1 The Repeal is effective for the last taxable years of foreign corporations beginning before January 1, 2018, and each subsequent taxable year. For calendar year foreign corporations, therefore, the Repeal is effective January 1, 2017.

U.S. capital markets. Additionally, our members play a key role in the distribution and market making for U.S. government securities, as foreign-owned primary dealers constitute 15 out of the 23 primary dealers in U.S. Treasury securities. Our members also provide services that are critical to connecting foreign customers to the U.S. market, and vice versa.

Executive summary

As described in more detail below, the IIB requests that the IRS issue guidance that controlled foreign corporations (CFCs) created due to the repeal of section 958(b)(4) will not be treated as "U.S. Payors" for purposes of Form 1099 reporting (chapter 61) and backup withholding (section 3406) purposes.

Such relief could be in the form of a Notice, similar to the approach taken by the IRS in Notice 2018-13, 2018-6 I.R.B. 341, for Form 5471 reporting.[2]

Background

Summary of tax reporting concern

Under pre-TCJA law (and current law), "real" CFCs – meaning, foreign subsidiaries of U.S. companies – are subject to U.S. tax information reporting obligations, for amounts reported on IRS Form 1099, and related backup withholding obligations similar to those of their U.S. affiliates, as so-called "U.S. Payors."[3] Since those CFCs are typically owned by U.S. financial institutions that are independently subject to the same rules, these rules harmonize the tax reporting rules for payments to the U.S. financial institution's customers regardless of whether the financial institution operates outside the United States in branch or subsidiary form.

By contrast, under pre-TCJA law, foreign subsidiaries of foreign financial institutions generally were subject to U.S. 1099 tax reporting and backup withholding obligations only for U.S. source income, as described below. That is, transactions by foreign financial institutions outside the United States generally were exempt from 1099 reporting and related obligations, unless the transaction involved income of a kind subject to U.S. taxing jurisdiction.

2 We note that other proposals relating to the Repeal focus more on the impact of unrelated U.S. shareholders and would not address the issues raised in this letter. *See, e.g.,* letter dated February 15, 2018, from the American Investment Council.

3 *See, e.g.,* Treasury regulation section 1.6049-5(c)(5)(i)(C) (defining a CFC as a "U.S. payor" under regulations addressing information reporting for interest); Treasury regulation section 1.6045-1(a)(1) (cross-reference to Treasury regulation section 1.6049-5(c)(5) for broker reporting). Citations to sections herein are to the Internal Revenue Code of 1986, as amended (the "Code"), or to the Treasury regulations promulgated thereunder.

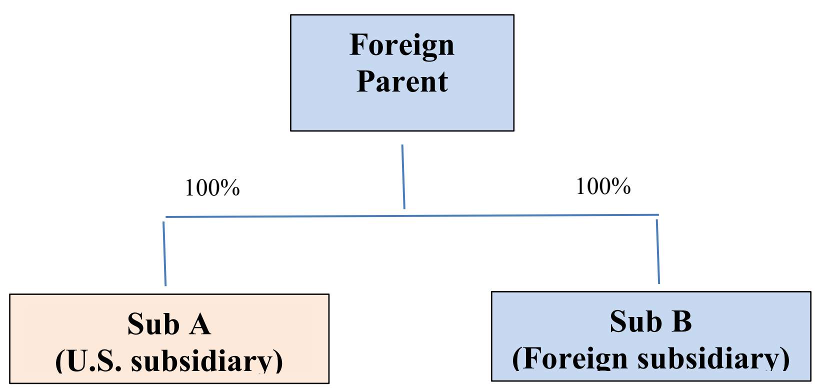
The Repeal has created legions of new controlled foreign corporations (New CFCs), the implications of which are still not fully understood. New CFCs include non-U.S. subsidiaries of foreign banks, if the bank group also has a U.S. subsidiary. As a result, New CFCs are now also treated as "U.S. Payors," and therefore are subject to expanded Form 1099 reporting and backup withholding requirements.[4] These requirements can result in significant legal and operational challenges for affected institutions.

Based on the legislative history, however, the repeal of section 958(b)(4) was not intended to create more U.S. Payors. The Repeal was intended to ensure that CFC status could not be avoided by U.S. shareholders by entering into so-called "de-control" transactions by transferring stock in a foreign subsidiary to a foreign related person. Prior to repeal by the TCJA, section 958(b)(4) prevented "downward attribution" of such shares to the U.S. shareholder, thus providing an avenue to avoid subpart F income. To address this concern, the TCJA simply repealed section 958(b)(4), resulting in a downward attribution requirement.

Therefore, as mentioned above, the Repeal will create many new CFCs. The simple examples below further illustrate this result:

Pre-TCJA law -- common inbound structure

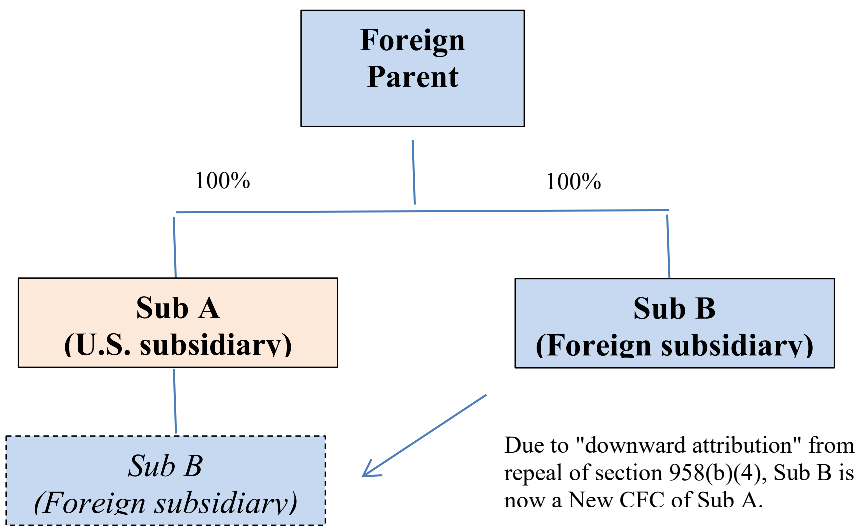
Prior to the TCJA, Sub A was not treated as owning shares of Sub B since section 958(b)(4) prevented such downward attribution. As a result, Sub B was not a CFC.



4 The Repeal also expanded the number of foreign entities that are ineligible to claim the portfolio interest exemption on interest received from U.S. affiliates because the foreign entities are now treated as CFCs for purposes of section 881(c)(3)(C). This change is less significant, however, since the foreign entities typically would have been treated as "10 percent shareholders" within the meaning of sections 871(h)(3) and 881(c)(3)(B) in any event, and would have been ineligible for the portfolio interest exemption under those provisions.

Post TCJA – Sub B now treated as CFC

After the TCJA, however, the repeal of section 958(b)(4) now requires downward attribution, resulting in Sub B becoming a CFC to Sub A.



<u>Unintended consequences of CFC status – Form 1099 reporting / backup withholding</u>

Scope of Form 1099 reporting / backup withholding for U.S. Payors vs. non-U.S. Payors

Sub B's New CFC status comes with significant additional compliance requirements: as a CFC, Sub B is a U.S. Payor with significantly expanded Form 1099 reporting and backup withholding requirements. The Form 1099 reporting regulations carefully delineate the circumstances under which persons acting outside the United States are required to comply with reporting obligations. For non-U.S. Payors, Form 1099 reporting is generally limited to payments of U.S. source income,[5] and even then such reporting may be reduced or even eliminated by reporting performed under the Foreign Account Tax Compliance Act (FATCA).[6]

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5 *See, e.g.,* Treasury regulation section 1.6049-5(b)(6) (non-U.S. source interest paid by a "non-U.S. payor" is excluded from reporting if certain conditions are met).

6 *See, e.g.,* Treasury regulation section 1.6049-4(c)(4)(i) (no reporting required under section 6049 for interest paid by a participating FFI or registered deemed-compliant FFI that is a non-U.S. payor, under specified conditions). A participating FFI or registered deemed-compliant FFI often also will be a "qualified intermediary" that has chosen to take on withholding and reporting obligations under other

In contrast, U.S. Payors must file Forms 1099 for all U.S. *and non-U.S.* source payments that are reportable transactions, including interest and dividends, among other payments, subject to various exceptions. Consequently, foreign subsidiaries like Sub B face a dramatically broader scope of payments subject to Form 1099 reporting, for transactions and income that have no connection to the United States. Sales transactions effected outside the U.S. by U.S. Payors are also subject to Form 1099-B reporting, including cost basis information. Non-U.S. Payors are generally exempt from reporting such transactions.[7]

In addition, payments reportable on Form 1099 may be subject to backup withholding under section 3406 if, for example, the payee's U.S. TIN is not provided in the manner required (*e.g.,* on Form W-9).[8] With the increase in CFCs and the corresponding increase in Form 1099 transactions, backup withholding requirements will likely also rise.

Legal and operational challenges due to U.S. Payor status

Due to the Repeal, New CFCs face numerous legal and operational challenges as U.S. Payors:

- Form 1099 reporting from CFCs directly to the IRS may violate local confidentiality laws. Backup withholding, whenever applied, also may also violate local law.

- Such reporting would frustrate and conflict with the extensive network of Intergovernmental Agreements (IGAs) entered into between the IRS and over 100 foreign countries. IGAs were intended to "address … legal impediments to compliance, simplify practical implementation, and reduce FFI [Foreign Financial Institution] costs."[9]

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provisions of the Code. Our understanding is that most qualified intermediaries have not elected to take on obligations related to information reporting on IRS Form 1099 and related backup withholding.

7 *See, e.g.,* Treasury regulation section 1.6045-1(a)(1) (brokers are not required to report sales effected at a non-U.S. office unless they are U.S. payors or U.S. middlemen).

8 Treasury regulation section 31.3406(g)-1(e) provides an exception to backup withholding for certain reportable payments that are paid and received outside the United States. However, the scope of that exception is narrower as applied to controlled foreign corporations than it is for payors that do not have a similar connection to the United States. *See* Treasury regulation section 1.6049-4(f)(16), which defines "paid and received outside the United States" for this purpose.

9 *See* Joint Statement from the United States, France, Germany, Italy, Spain and the United Kingdom Regarding an Intergovernmental Approach to Improving International Tax Compliance and Implementing FATCA, Feb. 7, 2012, *available at* https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/FATCA-Joint-Statement-US-Fr-Ger-It-Sp-UK-02-07-2012.pdf .

Form 1099 reporting by CFCs, however, would undermine this purpose by imposing new requirements that may violate local laws. For example:

- Model 1 IGAs require Reporting Financial Institutions to report U.S. account holder information directly to the local tax authority, thus incorporating U.S. tax reporting as a matter of local law.[10] Reporting directly to the IRS on Form 1099, however, could violate confidentiality laws in these countries.

- Model 2 IGAs also require Reporting Financial Institutions to report U.S. account holder information, but reporting is made directly to the IRS on Form 8966 and pursuant to the terms of an FFI Agreement with the IRS. Under the TCJA, however, additional reporting on Form 1099 is also required, even in the case of "non-consenting" account holders for which specific reporting is not allowed without a "group request" from the United States.[11]

- Entities that were CFCs prior to the Repeal have faced Form 1099 reporting requirements for over 30 years.[12] Historic CFCs have had ample opportunity to implement the processes and procedures for Form 1099 reporting and backup withholding. In contrast, New CFCs created by the Repeal have had no time to comply with the new requirements, resulting in exposure to IRS penalties and withholding liabilities.

- New CFCs will not be able to simply take the same information reported under FATCA and put it on a Form 1099 for the IRS. In many cases, FATCA information will need significant enhancements before it is reported on Form 1099, such as basis information in the case of sales reported on Form 1099-B.

Clearly, these significant – and completely unexpected – legal hazards and administrative burdens imposed on New CFCs violate the stated intent of the IGAs, and undermine the policy

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10 See Model 1 IGA, Art. 2. The Model IGAs are available at https://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx .

11 See Model 2 IGA, Art. 2; although some non-consenting accounts will be exempt from Form 1099 reporting under the coordination provisions of Reg. §1.6049-4(c)(4)(ii), not all U.S. accounts will qualify for the relief (such as accounts held by payees who the FFI knows are U.S. persons).

12 *See* Temporary Treasury regulation section 35a.9999-4T, Q&A 2 (broker reporting under 6045 by CFCs) and Q&A 5 (interest and OID reporting under 6049 by CFCs); T.D. 7966 (8/22/84), as amended by T.D. 7972 (8/29/84); removed, effective Jan. 1, 2001, by T.D. 8734.

judgments that were made by the drafters of the Form 1099 reporting regulations in delineating the appropriate scope of reporting obligations for persons acting outside the United States.

The IRS and Treasury have authority to limit the scope of 1099 reporting and backup withholding by New CFCs

The information reporting rules grant discretion to the IRS and Treasury to determine which persons are obligated to provide information reporting and therefore to backup withhold, and on what payments.[13] That discretion has been exercised in the past to distinguish between U.S. Payors and non-U.S. payors. Nothing in the Repeal or other provisions of the TCJA affects the authority that the IRS and Treasury have under these rules. Accordingly, the IRS and Treasury have authority to treat only "real"/historic CFCs as U.S. Payors.

Requested relief

To prevent unintended compliance risks and restructuring costs for financial institutions, we recommend the IRS issue, as soon as possible, a Notice that new CFCs created solely on account of the Repeal will not be treated as U.S. Payors.

We note that the IRS has already recognized expanded Form 5471 filing requirements as another unintended consequence from the Repeal. In Notice 2018-13, the IRS announced its intention to revise the Form 5471 instructions to exempt certain U.S. shareholders from filing this form if such shareholders would be required to file due to the new "downward attribution" rule resulting from the Repeal. We urge the IRS to again issue a Notice that prevents other unintended consequences.

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We appreciate your consideration of our comments. Please contact me, if I can provide any additional information.

Sincerely,

Briget Polichene

Briget Polichene
Chief Executive Officer

13 *See, e.g.,* Section 6049(a) (reporting required pursuant to "the forms or regulations prescribed by the Secretary"), section 6049(b)(2)(C) (non-U.S. source income not treated as interest subject to reporting "except to the extent otherwise provided in regulations"); section 6045(a) (brokers shall "when required by the Secretary" make a return "in accordance with such regulations at the Secretary may prescribe").

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