



299 Park Avenue, 17th Floor
New York, N.Y. 10171
Direct: (646) 213-1147
Facsimile: (212) 421-1119
Main: (212) 421-1611
www.iib.org

June 11, 2024

By Electronic Mail

Internal Revenue Service
CC:PA:01:PR (REG-115710-22), Room 5203,
P.O. Box 7604,
Ben Franklin Station, Washington, D.C., 20044

Re: Comments on Proposed Regulations Under Section 4501 (REG-115710-22)

Ladies and Gentlemen:

The Institute of International Bankers (“**IIB**”) appreciates this opportunity to provide comments on the proposed regulations under Section 4501 of the Internal Revenue Code of 1986, as amended (the “**Code**”),¹ that were published in the Federal Register in the Notice of Proposed Rulemaking regarding Excise Tax on Repurchase of Corporate Stock (REG-115710-22) on April 12, 2024 (the “**Proposed Regulations**”).

On March 17, 2023, the IIB provided comments (the “**2023 Comment Letter**”) to Notice 2023-2, entitled “Initial Guidance Regarding the Application of the Excise Tax on Repurchases of Corporate Stock under Section 4501 of the Internal Revenue Code” (the “**Notice**”). The 2023 Comment Letter is attached hereto as Appendix A.

The IIB represents internationally headquartered financial institutions from over 35 countries around the world 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 (referred to herein as “**FBO Groups**”).² The U.S. operations of FBOs are an important source of credit and financial intermediation for U.S. customers and enhance the depth and liquidity of U.S. financial markets. FBOs contribute greatly to the U.S. economy through the direct employment of U.S. citizens and permanent residents, as well as through lending and other operating and capital expenditures.

Our comments are limited to the rule contained in Proposed Treasury Regulations Section 58.4501-7(e)(1), which relates to the application of Section 4501(d)(1) and treats certain U.S. affiliates of a foreign publicly-traded parent as subject to the Section 4501(d)(1) stock repurchase excise tax if they are treated as funding a repurchase of parent stock by the parent or another foreign affiliate (the “**Principal Purpose Rule**”).

¹ Unless otherwise stated, all section references are to the Code or the Treasury Regulations thereunder.

² We refer to the publicly-traded parent entity of an FBO group as the “**FBO Parent**” and to the FBO Parent and all of its subsidiaries together as the “**FBO Group**.”

In summary, we believe that the Principal Purpose Rule goes beyond the statute, is contrary to sound policy and will impose substantial administrative burden on both FBO Groups and the Internal Revenue Service (the “IRS”). We therefore recommend eliminating the Principal Purpose Rule in the final regulations under Section 4501.

I. Background Regarding the Principal Purpose Rule

Section 4501(a) applies a 1% excise tax (the “Excise Tax”) to a U.S. corporation that has outstanding publicly-traded shares and repurchases its stock. Subsection (d)(1) of Section 4501 sets out an additional rule that applies when a foreign corporation has outstanding publicly-traded shares; this rule would impose the Excise Tax on a U.S. subsidiary of such a foreign parent corporation if the U.S. subsidiary purchases the foreign parent corporation’s shares from an unrelated party.³

The Notice, which was released in 2022, provided two rules in connection with Section 4501(d)(1) that were aimed at situations where a U.S. subsidiary funds a foreign parent’s buyback of its own shares and the funding is undertaken with a principal purpose of avoiding the statute. Specifically, Section 3.05(2)(a)(ii) of the Notice proposed two rules that read as follows:

“(A) General rule. For purposes of applying § 4501(d)(1), an applicable specified affiliate is treated as acquiring stock of an applicable foreign corporation if the applicable specified affiliate funds by any means (including through distributions, debt, or capital contributions) the acquisition or repurchase of stock of the applicable foreign corporation by the applicable foreign corporation or a specified affiliate that is not also an applicable specified affiliate, and such funding is undertaken for a principal purpose of avoiding the stock repurchase excise tax. For purposes of the preceding sentence, the fair market value of stock treated as acquired by the applicable specified affiliate is limited to the amount funded by the applicable specified affiliate.

(B) Per se rule. A principal purpose described in section 3.05(2)(a)(ii)(A) of this notice is deemed to exist if the applicable specified affiliate funds by any means, other than through distributions, the applicable foreign corporation or a specified affiliate that is not also an applicable specified affiliate, and such funded entity acquires or repurchases stock of the applicable foreign corporation within two years of the funding.”

We refer to the rule in Section 3.05(2)(a)(ii)(A) as the “**General Rule**,” the rule in Section 3.05(2)(a)(ii)(B) as the “**Per Se Rule**,” and the two together as the “**Notice Rules**.” In the 2023 Comment Letter, we recommended a reconsideration of the Notice Rules in light of the adverse, and we believe unintended, impact of these rules on FBO Groups.

³ Section 4501(d)(1) states: “In the case of an acquisition of stock of an applicable foreign corporation by a specified affiliate of such corporation (other than a foreign corporation or a foreign partnership (unless such partnership has a domestic entity as a direct or indirect partner)) from a person who is not the applicable foreign corporation or a specified affiliate of such applicable foreign corporation, for purposes of this section—(A) such specified affiliate shall be treated as a covered corporation with respect to such acquisition, (B) such acquisition shall be treated as a repurchase of stock of a covered corporation by such covered corporation, and (C) the adjustment under subsection (c)(3) shall be determined only with respect to stock issued or provided by such specified affiliate to employees of the specified affiliate.” Section 4501(c)(3) permits a domestic covered corporation to “net,” or offset, its stock repurchases with stock issuances during the taxable year for purposes of determining its Excise Tax base.

The Proposed Regulations follow the Notice Rules in that they impose the Excise Tax when a U.S. subsidiary (an “**applicable specified affiliate**”) is treated as funding a foreign parent stock repurchase. However, they modify the Notice Rules in certain respects. First, the Per Se Rule was replaced with a rule that would be limited to circumstances in which an applicable specified affiliate funds a “downstream relevant entity” (the “**Downstream Rule**”), generally a foreign entity owned (directly or indirectly) in significant part by the applicable specified affiliate, and within two years the downstream relevant entity makes a parent stock repurchase. The IIB strongly endorses the decision to eliminate the Per Se Rule and provides no comments regarding the Downstream Rule, as it believes the Downstream Rule reaches a more appropriately targeted set of circumstances than did the Per Se Rule. Specifically, the Downstream Rule aims at situations in which a U.S. subsidiary uses its funds to acquire, indirectly through its own foreign subsidiaries, stock of its foreign parent.

The Proposed Regulations, however, retain a rule that is superficially similar to the General Rule, now called the “**Principal Purpose Rule**.” The Principal Purpose Rule reads as follows (emphasis added):

*“Principal purpose rule. An applicable specified affiliate of an applicable foreign corporation is treated as acquiring stock of the applicable foreign corporation to the extent the applicable specified affiliate funds by any means (including through distributions, debt, or capital contributions), directly or indirectly, a covered purchase with a principal purpose of avoiding the section 4501(d) excise tax (a covered funding). **If a principal purpose of the covered funding is to fund, directly or indirectly, a covered purchase, then there is a principal purpose of avoiding the section 4501(d) excise tax.** Whether a covered funding is described in this paragraph (e)(1) is determined based on all the facts and circumstances. A covered funding may be described in this paragraph (e)(1) regardless of whether the funding occurs before or after a covered purchase....”*⁴

Importantly, the Principal Purpose Rule contains a new sentence, shown in bold above, that in our view dramatically broadens the rule. Whereas the General Rule in the Notice applied only if a tax avoidance motive existed, the Principal Purpose Rule applies to transactions that have no actual tax avoidance motivation; rather, its application depends on the expected purpose for which funds will be used. As a result, in contrast to the General Rule, the Principal Purpose Rule has the potential to apply to a broad swath of intercompany transactions that have no tax avoidance purpose. Consequently, it will be extremely difficult to administer and comply with because it seeks to ascertain the motivation behind transactions being conducted for reasons unrelated to tax.

Accordingly, while the elimination of the Per Se Rule is an important step forward, the retention – and expansion – of the General Rule in the form of the Principal Purpose Rule results in a regulation whose application remains overly broad. We understand from public statements by the U.S. Treasury Department (“**Treasury**”) that it intended the modified rule to be a targeted anti-abuse rule that does not capture ordinary course intercompany funding transactions.⁵ However, given the broad reach of the

⁴ Treasury Regulations Section 58.4501-7(e)(1). In this comment letter, we refer to the terms “funds by any means” and “funding” as used in the Principal Purpose Rule as a “**Funding**.”

⁵ See “U.S. Department of the Treasury and IRS Release Proposed Guidance on Stock Buyback Excise Tax to Ensure Large Corporations Pay More of Their Fair Share in Taxes” (available at <https://home.treasury.gov/news/press-releases/jy2244>, last visited June 10, 2024) (“The proposed regulations also provide a targeted anti-abuse rule to [*sic*] foreign-parented multinational corporations pay their fair share of the stock buyback excise tax, without ordinary course intercompany funding transactions among their corporate affiliates being inadvertently captured.”)

Principal Purpose Rule and the lack of clarity as to how it will be applied in practice, substantial further changes are necessary in order to provide clarity and certainty to taxpayers.

II. Application of the Principal Purpose Rule to FBO Groups

This section provides background on the operation and regulation of FBO Groups and describes the expected impact of the Principal Purpose Rule on FBO Groups. As we explain below, the massive quantity of intercompany payments undertaken in the ordinary course by FBO Groups means that the Principal Purpose Rule will disproportionately affect them. At the same time, the regulatory framework in which they operate means that applying an anti-abuse rule, such as the Principal Purpose Rule, to them is unnecessary as a policy matter.

The core business of a banking group is financial intermediation. As financial intermediaries, FBOs seek to use funds from one source, such as customers' cash deposits, to provide loans to other customers. The sources and demands for this liquidity may be in different parts of the world. Similarly, broker-dealers and/or banks within the group provide securities and derivatives to their customers in one location and may need to obtain those securities from customers in a different location, and similarly hedge those derivatives in another location where the relevant risk is centrally hedged. These business needs, as well as available funds, shift frequently to reflect changes in global markets. As a result, intercompany movements of cash, derivatives and securities occur regularly and at high volume within an FBO Group. FBOs need the flexibility to move cash and financial assets efficiently around their groups to accommodate customer needs as well as liquidity, capital and risk management imperatives of group members around the world. These transactions will necessarily involve a movement of cash or financial assets that has the potential, given the breadth of the Principal Purpose Rule, to be treated as a Funding subject to the Excise Tax.

As we explained in the 2023 Comment Letter, FBO Groups are subject to strict rules governing how they are structured and operate. FBO Groups must continuously evaluate the intragroup movement of money in light of highly detailed, restrictive, and intensive capital and liquidity regulations, activities restrictions, and myriad other requirements. Generally, rules are imposed in every jurisdiction in which FBO Groups operate. U.S. regulators are focused on protecting the group's U.S. entities and their customers, and they do this by prescribing certain minimum levels of capital, limiting withdrawals of capital from the U.S., restricting or hindering certain types of credit exposure, and closely monitoring compliance with these rules, particularly in relation to interaction with affiliated entities overseas. In some cases, an FBO Group's noncompliance with these rules and expectations could have seriously detrimental economic outcomes in the form of negative effects on the FBO Group's satisfaction of minimum capital requirements, as well as other undesirable consequences such as supervisory fines, consent orders, restrictions on business activities and penalties.

In addition to the regulatory limits that apply to intercompany financings and other payments, distributions from the U.S. group are often subject to significant limits or oversight designed to ensure that adequate capital remains in the U.S. group. Withdrawals that do occur, in the form of distributions from the U.S. group, are generally clearly identified and delineated and subject to regulatory scrutiny. Distributions that are permitted may also be driven by the FBO Parent's need to increase the amount of capital it has invested in subsidiaries in other jurisdictions or that it must otherwise retain in the home jurisdiction.

When it comes to the intragroup movement of money, FBO Groups typically dedicate enormous time and resources to comply with existing regulatory requirements in each country in which they operate. Ordinary course business needs, combined with extensive regulatory requirements, not stock buybacks, are the primary drivers of these transactions. Accordingly, these cash movements should

neither be subject to the Excise Tax as a substantive matter nor should they give rise to a highly burdensome new documentation requirement in order to demonstrate their exemption from the tax.

A. *Ordinary Course Intercompany Payments*

On a daily basis, an FBO Group engages in a large number of intercompany transactions that result in cross-border cash movements. As noted above, these transactions are necessary in order to move securities, currencies and derivative exposures into locations where they may be needed in order to carry out or hedge customer-facing transactions. They may also be necessary to allow an FBO Group to balance supply and demand for capital and liquidity in group locations around the world. The IIB provided additional detail regarding these transactions in the 2023 Comment Letter. These transactions include:

- Securities loans in which one broker-dealer obtains a security needed in its business, secured by cash collateral.
- Derivatives entered into between affiliated dealers to hedge customer derivatives or structured products issued by one affiliate where the risk is hedged in a different location within the group.
- Short-term loans to, or intercompany deposits with, affiliates in order to meet those affiliates' ordinary course liquidity needs, manage interest rate risk to which the affiliate is exposed, and move currencies into their appropriate location around the world, e.g., where they can be deposited with the central bank responsible for that currency.

In addition to occurring on a daily basis in high volumes, these transactions are often short-term (including overnight) and may occur in both directions (i.e., into and from the U.S.). As a result, even under the most expansive view of the Principal Purpose Rule's intended scope, these transactions are simply not appropriate candidates to be treated as Fundings subject to the rule.

While such ordinary course transactions should clearly not be within the scope of the Principal Purpose Rule given their business-driven nature, the IIB remains concerned that the Principal Purpose Rule will, as a practical matter, impose a significant burden on FBO Groups to demonstrate that these transactions are exempt from the rule. Currently, FBO Groups do not track these routine and frequent financial movements in any way that would allow them to present information about them to the IRS in an audit of Section 4501(d) compliance. Any requirement to provide detailed data about the large volume of such transactions that could, at least theoretically, be in scope would require a significant and costly investment in tracking systems.

In light of the breadth of the Principal Purpose Rule, as drafted, we are concerned that, effectively, the rule will serve as a rebuttable presumption whereby taxpayers will be required to prove a negative – to demonstrate the absence of a “bad” purpose. Without the practical ability to track these potential Fundings, let alone provide relevant detail about the purpose for which each one occurred, FBO Groups may end up being subject to the Excise Tax based on arbitrary estimates asserted on audit. Consequently, given the volume of transactions potentially in scope, these ordinary course intercompany payments within FBO Groups are likely to be disproportionately affected by the Principal Purpose Rule. Such a result cuts against any rational policy and likely Congressional intent, as the free movement of cash and securities around the world, subject to bank regulatory requirements, is central to the safe and efficient functioning of the international banking system.

B. *Distributions*

A U.S. subsidiary group within an FBO Group generally makes determinations regarding whether to distribute dividends to its home jurisdiction based on factors such as the profitability and anticipated growth of the U.S. operations, typically subject to significant regulatory oversight and/or limitations on withdrawing capital from regulated U.S. entities.

As discussed in more detail in the 2023 Comment Letter, under the rules applicable to U.S. insured depository institutions (“IDIs”) and intermediate holding companies (“IHCs”), FBO Groups with U.S. financial subsidiaries are generally limited in their ability to cause dividend distributions from the U.S. subsidiary group due to the need to maintain required minimum regulatory capital levels in the relevant U.S. subsidiaries. Moreover, home jurisdiction regulatory bodies will also exert oversight over these distributions. As a result, the determination by the U.S. group of subsidiaries within an FBO Group to make distributions will generally be based on a detailed capital plan, approved by the U.S. parent’s board of directors, that satisfies these capital requirements while allowing excess funds to be repatriated to the home country. By longstanding policy, therefore, FBO Groups will typically cause distributions from their U.S. groups to be made according to their capital planning without regard to the specific uses of those funds, including whether those distributions might fund a parent stock buyback. Furthermore, because of the regulatory constraints on these distributions, it is important for FBO Groups that their U.S. subsidiaries be able to make distributions when permitted so that the funds are then fully available to the FBO Group for its potential needs around the world.

Distributions from U.S. subsidiaries that are determined and planned in this manner should not be treated as Fundings subject to the Principal Purpose Rule because their principal purpose is to repatriate funds for general use by the group, according to a regulatorily-supervised capital plan. These distributions are typically determined according to policies and methodologies that are separate from the governance processes under which the FBO Parent conducts stock buybacks. When permitted by business performance and approved by the U.S. subsidiary’s board, under the oversight of local regulators, U.S. subsidiaries of FBO Groups may distribute excess net income annually regardless of whether a parent stock buyback is anticipated or ultimately occurs. Retaining excess capital in subsidiaries results in inefficiencies and lower returns on capital, particularly if the FBO Group has capital needs elsewhere in the world. These capital plans and their methodologies, and an FBO Group’s related distribution policies, are transparent and made available to the relevant regulators exercising oversight, and therefore serve as a reliable record of the group’s intent in making distributions.

For these reasons, distributions made by the U.S. subsidiaries of an FBO Group of the type described above should not be subject to the Principal Purpose Rule even if the FBO Parent also engages in periodic or occasional stock buybacks. The FBO Group’s policies and capital plans, which are overseen by regulators, should serve as sufficient evidence that these distributions are made independently of parent stock buyback decisions and are therefore not made with a principal purpose of funding stock buybacks (or to avoid the application of Section 4501(d)(1)). However, as with ordinary course intercompany financings, the Proposed Regulations are silent as to whether or how taxpayers will, in practice, be required to demonstrate the absence of a purpose to fund stock buybacks, and therefore the rule may nonetheless apply inappropriately to these distributions.

III. **Additional Concerns Regarding the Principal Purpose Rule**

While the discussion above focuses on the special concerns of FBO Groups, the IIB believes that there are more general concerns regarding the Principal Purpose Rule that militate in favor of eliminating it. This section focuses on those general considerations.

The Principal Purpose Rule goes far beyond the contours of Section 4501(d)(1), as the statute's fundamental aim is to apply tax where a U.S. subsidiary acquires its foreign parent's stock from unrelated parties. Upstream dividends, as well as upstream payments to make or repay a financing, have long been commonplace within foreign-parented groups, and there is no indication in the statutory language or history that Congress intended Section 4501(d)(1) to also apply to these upstream fundings.

Section 4501(d)(1) contains no language referencing "funding" or suggesting any intent to apply to stock purchases by any affiliate other than a domestic subsidiary. In fact, in relevant part, Section 4501(d)(1) applies to "an acquisition of stock of an applicable foreign corporation by a specified affiliate of such corporation (**other than a foreign corporation or a foreign partnership (unless such partnership has a domestic entity as a direct or indirect partner)**)..." (emphasis added). The highlighted statutory language indicates that the targeted purchase must be by a domestic subsidiary (or a foreign partnership with a domestic partner). A regulation that applies the Excise Tax to stock purchases by a foreign member of the group would, therefore, appear directly contrary to the language contained in Section 4501(d)(1) unless it is carefully aimed at abusive transactions.

The language in Section 4501(d)(1) contrasts clearly with that of Section 4501(d)(2), applicable to inverted entities. Section 4501(d)(2) largely parallels Section 4501(d)(1) except that it provides expressly that any repurchase of the stock of the foreign parent (a "covered surrogate foreign corporation") by the foreign parent or any other specified affiliate, whether domestic or foreign, is treated as subject to the Excise Tax. It makes sense that inverted corporations would be subject to more punitive rules than ordinary foreign groups with U.S. subsidiaries given the Code's generally harsh treatment of them, but the Principal Purpose Rule has the effect of treating a foreign-parented group that regularly distributes profits from its U.S. subsidiaries or otherwise has a large number of potential Fundings as the functional equivalent of a group headed by an inverted corporation; this result is inconsistent with the statutory framework reflected in Sections 4501(d)(1) and (2).

We appreciate Treasury's objective of preventing taxpayers from undertaking transactions designed to avoid the application of Section 4501(d)(1), and we acknowledge Treasury's regulatory authority under Section 4501(f) to promulgate regulations to carry out, and prevent avoidance of, the purposes of Section 4501(d). However, the purpose of Section 4501(d)(1) is to tax purchases of foreign parent stock by a domestic affiliate. Therefore, regulatory measures should be narrowly tailored to cases in which a U.S. subsidiary effectively acquires, not just funds the acquisition of, its parent's stock, in order to carry out the purpose of Section 4501(d)(1). While the Downstream Rule seems reasonably designed to achieve this aim given its focus on parent stock acquired indirectly through a subsidiary, the Principal Purpose Rule does not.

Moreover, the divergence of the Principal Purpose Rule from the statutory intent can be seen in the fact that, due to the limited netting available under Section 4501(d), foreign-parented groups making stock buybacks are at risk of paying more Excise Tax than their U.S. counterparts in parallel circumstances. Under Section 4501(d)(1)(C), a U.S. subsidiary can only net its foreign parent stock repurchases against issuances of stock to its employees, as opposed to any issuances of stock by the foreign parent (to employees or otherwise). As a result, a perverse consequence of the Principal Purpose Rule is that stock buybacks by a foreign parent, if funded out of dividends or other Fundings from a U.S. subsidiary, are more likely to be subject to the Excise Tax than similar buybacks of a U.S. parent because the Section 4501 tax base of the U.S. subsidiaries of the foreign parent group would not be reduced by stock issuances by the parent. Thus, for example, U.S. subsidiaries of a foreign parent that makes zero net repurchases in a year because those repurchases are fully offset by issuances of its shares to employees outside the United States would nonetheless be subject to tax on those repurchases if funded by dividends from the U.S. group even if a comparable U.S. corporation would pay no tax on the identical repurchases. It is hard to believe that Congress intended such a result.

We understand that aspects of the Principal Purpose Rule may have been inspired by regulations interpreting Sections 304 and 956 that contain similar language. Very generally, Section 304 treats the purchase by one corporation of a related corporation's stock from another related corporation as a redemption by the acquiring corporation that is typically treated as a dividend. Section 951, by reference to Section 956, treats an investment by a controlled foreign corporation ("CFC") in "United States property," including stock of the CFC's U.S. parent, as Subpart F income. To backstop these statutory provisions, both sets of regulations contain anti-abuse rules that apply when one entity funds another entity "by any means" and the second entity acquires the property that would otherwise trigger the operation of the rule.⁶ These rules may be relevant, for example, when a corporation with earnings and profits (the putative dividend payer) funds a second corporation that acquires parent stock but may not have dividend consequences (because for example it has no earnings and profits).

Although different from each other in many respects, both Sections 304 and 956 are essentially focused on transactions that are purchases of property in form but are substantively similar to dividends in that funds originating from a subsidiary effectively benefit its parent. Accordingly, the central policy aim of those statutes is to track funds from a subsidiary that move – directly or indirectly – around the group in a way that inures to the parent's benefit. Section 4501(d)(1) is quite different. Its aim is not to police potential dividends from U.S. subsidiaries to their foreign parents, but instead to apply to a narrow circumstance in which a U.S. subsidiary acquires parent stock through a repurchase from the public. The ownership of parent stock is the central focus, rather than funds leaving the U.S. group. Therefore, reliance on Sections 304 and 956 to inform regulatory policy under Section 4501(d)(1) is misplaced.

Moreover, the regulations under both Sections 304 and 956 apply only if a principal purpose of the funding is to avoid Section 304 or 956, as applicable. By expanding the language in the Principal Purpose Rule to cover situations where a principal purpose is funding a buyback, rather than the avoidance of tax, the Principal Purpose Rule far exceeds the analogous Section 304 and 956 regulations in scope. A taxpayer operating in the ordinary course, without regard to tax considerations, can be confident that it is not subject to the Section 304 and 956 regulations because by their terms they require a purpose of avoiding tax; this will not be the case if the Principal Purpose Rule is included in the final Section 4501 regulations, because it applies to transactions with no tax motivation. As a result, the Principal Purpose Rule is much more onerous than these other regulations even though it has considerably less statutory support.

We further observe that the Principal Purpose Rule is likely to result in double taxation on a foreign parent's stock buybacks in the future. Jurisdictions other than the United States appear likely to implement stock buyback taxes similar to Section 4501. Canada's 2023 federal budget included a stock buyback tax of 2% that would apply to the net value of share repurchases made by Canadian resident

⁶ See Treasury Regulations Section 1.304-4(b)(1) ("A corporation (deemed acquiring corporation) shall be treated as acquiring for property the stock of a corporation (issuing corporation) acquired for property by another corporation (acquiring corporation) that is controlled by the deemed acquiring corporation, if a principal purpose for creating, organizing, or funding the acquiring corporation by any means (including through capital contributions or debt) is to avoid the application of section 304 to the deemed acquiring corporation..."); Treasury Regulations Section 1.956-1(b)(1) ("For purposes of section 956, United States property...includes—... (ii) United States property acquired by any other foreign corporation that is controlled by the controlled foreign corporation if a principal purpose of creating, organizing or funding by any means (including through capital contributions or debt) the other foreign corporation is to avoid the application of section 956 with respect to the controlled foreign corporation...").

companies whose shares are listed on a “designated stock exchange.”⁷ Reports have indicated that France is considering a similar tax.⁸

If excise taxes similar to Section 4501 become common around the world, with a Principal Purpose Rule similar to that of the Proposed Regulations, multinational corporate groups may find a single stock repurchase to be subject to multiple taxes. For example, a publicly-traded Canadian parent corporation may regularly receive dividends from its U.S. subsidiaries and subsidiaries in a third country (“Country A”). If Canada and Country A adopt principles similar to those of the Principal Purpose Rule, each of Canada, Country A and the United States could treat the buyback as subject to the Excise Tax. This would be in addition to any dividend withholding taxes paid to the United States and to Country A, as well as any applicable corporate income tax. It is hard to believe that such multiple taxes on a single stock repurchase were intended or represent any rational policy.

Finally, a consistent theme throughout the Preamble to the Proposed Regulations is that Treasury (i) sought administrability in crafting the regulations and (ii) closely followed the statutory language. These general aims make sense, particularly in the context of a statute with such limited legislative history. By contrast, the Principal Purpose Rule is likely to be difficult for the IRS to administer and burdensome to taxpayers, and it veers far away from the statutory text.

IV. Conclusion and Recommendations

Financial intermediation – that is, the transmission of funds between and among borrowers and lenders – is the central business of an FBO Group, and FBO Groups rely on intercompany transactions between affiliates to move money, securities and other financial exposures to the right location in the world. Moreover, transactions between affiliates, whether in the form of ordinary course financial transactions or dividend distributions, are generally supervised and/or regulated by multiple regulators. Burdening these transactions with Excise Tax or, at a minimum, a need to demonstrate a lack of principal purpose to fund buybacks, will unnecessarily create an onerous new requirement with limited to no policy benefit.

For taxpayers with large numbers of potential Fundings, such as FBOs, the Principal Purpose Rule is likely to function less as a narrow anti-abuse rule and more like a rebuttable presumption or *de facto* allocation rule. In most cases, cash movements within FBO Groups are either made in the context of ordinary course business transactions or are distributions that accomplish general goals of highly supervised capital planning and are not earmarked for specific uses such as a parent stock buyback. As such, these transactions should not be subject to the Principal Purpose Rule; however, demonstrating a lack of bad purpose – proving a negative – is likely to be a burdensome and potentially impossible exercise. Without elimination of the rule, the Principal Purpose Rule may, as applied to FBO Groups in practice, always find a Funding and thus always apply whenever the FBO Parent engages in a stock buyback. Such a result has no support in the statute, and the final regulations should be revised to prevent it from happening.

We accordingly recommend that, in the final Section 4501 regulations, Treasury eliminate the Principal Purpose Rule entirely. For the reasons discussed in this letter, the Principal Purpose Rule expands

⁷ See, e.g., Government of Canada, “What’s New for Corporations,” available at https://www.canada.ca/en/revenue-agency/services/tax/businesses/topics/corporations/whats-new-corporations.html#fdrl_2023 (last visited June 10, 2024).

⁸ See, e.g., Baldassari, Valentine, “France Wants Share Buyback Tax in 2025 Budget Bill, Figaro Says,” *Bloomberg*, Apr. 25, 2024, available at <https://news.bloombergtax.com/daily-tax-report-international/france-wants-share-buyback-tax-in-2025-budget-bill-figaro-says> (last visited June 10, 2024).

the scope of the Excise Tax well beyond what appears to have been intended in the context of foreign groups, generally, and FBO Groups, specifically.

We observe that a significantly narrower version of the Principal Purpose Rule could avoid some or many of the adverse consequences to FBO Groups described in this letter.⁹ Should Treasury decide to retain a version of the Principal Purpose Rule, we would be happy to engage further with you in order to discuss potential ways to mitigate the adverse impact of the rule on FBO Groups. However, we reiterate our firm belief that, based on the lack of statutory support for Principal Purpose Rule as well as the myriad problems it is likely to cause, the Principal Purpose Rule should be removed in its entirety from the final Section 4501 regulations as opposed to being retained in a revised form.

* * *

We appreciate your consideration of our comments on the Proposed Regulations. If we can answer any questions or provide any further information, please contact me (646-213-1147, bzorc@iib.org).

Very truly yours,



Beth Zorc
Chief Executive Officer
Institute of International Bankers
bzorc@iib.org

⁹ For example, the final regulations would be improved by (i) removal of the sentence that expands the Principal Purpose Rule to situations where the purpose of a Funding is to fund a stock buyback and (ii) clarification that “avoiding the section 4501(d) excise tax” means entering into a transaction designed to achieve a situation in which the U.S. subsidiary effectively acquires, not just funds, foreign parent stock. This would better align the rule with the fundamental aim of Section 4501(d)(1): a repurchase of parent stock by the U.S. subsidiary.

Appendix A

Comments on Notice 2023-2 “Initial Guidance Regarding the Application of the Excise Tax on Repurchases of Corporate Stock Under Section 4501 of the Internal Revenue Code”



INSTITUTE OF INTERNATIONAL BANKERS

299 Park Avenue, 17th Floor
New York, N.Y. 10171
Direct: (646) 213-1147
Facsimile: (212) 421-1119
Main: (212) 421-1611
www.iib.org

March 17, 2023

By Electronic Mail

Internal Revenue Service
CC:PA:LPD:PR (Notice 2023-2), Room 5203,
P.O. Box 7604,
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Ladies and Gentlemen:

The Institute of International Bankers (“**IIB**”) appreciates this opportunity to provide comments on Notice 2023-2, entitled “Initial Guidance Regarding the Application of the Excise Tax on Repurchases of Corporate Stock under Section 4501 of the Internal Revenue Code” (the “**Notice**”). Our comments are limited to the two rules set out in Section 3.05(2)(a)(ii) of the Notice, which rules relate to the application of Section 4501(d)(1) of the Internal Revenue Code of 1986, as amended (the “**Code**”).

The IIB represents internationally headquartered financial institutions from over 35 countries around the world 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. The U.S. operations of FBOs are an important source of credit and financial intermediation for U.S. customers and enhance the depth and liquidity of U.S. financial markets. FBOs contribute greatly to the U.S. economy through the direct employment of U.S. citizens and permanent residents, as well as through lending and other operating and capital expenditures.

I. Introduction

Section 4501(a) provides a rule which applies when a U.S. corporation has outstanding publicly-traded shares. Subsection (d)(1) of Section 4501 sets out an additional rule which applies when a non-U.S. corporation has outstanding publicly-traded shares; this rule would impose the Section 4501 excise tax if a U.S. subsidiary of that non-U.S. parent corporation purchases that parent corporation’s shares from an unrelated party.

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In connection with Section 4501(d)(1), Section 3.05(2)(a)(ii) of the Notice proposes two rules which read as follows:

“(A) General rule. For purposes of applying § 4501(d)(1), an applicable specified affiliate is treated as acquiring stock of an applicable foreign corporation if the applicable specified affiliate funds by any means (including through distributions, debt, or capital contributions) the acquisition or repurchase of stock of the applicable foreign corporation by the applicable foreign corporation or a specified affiliate that is not also an applicable specified affiliate, and such funding is undertaken for a principal purpose of avoiding the stock repurchase excise tax. For purposes of the preceding sentence, the fair market value of stock treated as acquired by the applicable specified affiliate is limited to the amount funded by the applicable specified affiliate.

(B) Per se rule. A principal purpose described in section 3.05(2)(a)(ii)(A) of this notice is deemed to exist if the applicable specified affiliate funds by any means, other than through distributions, the applicable foreign corporation or a specified affiliate that is not also an applicable specified affiliate, and such funded entity acquires or repurchases stock of the applicable foreign corporation within two years of the funding.”

We refer to the rule in Section 3.05(2)(a)(ii)(A) as the “**General Rule**”, the rule in Section 3.05(2)(a)(ii)(B) as the “**Per Se Rule**”, and the two together as the “**Rules**”; we refer to the terms “funds by any means” and “funding” as used in the Rules as a “**Funding**”.

These Rules do not implement the statutory provision Congress enacted. Instead, the actual effect of the Rules¹ is to impose a new tax on any stock buyback by an FBO merely for conducting its business within the United States in the ordinary course. This result is not only contrary to Sections 4501(a) and (d)(1), but (as discussed further below) is also inconsistent with Section 4501(d)(2).

Banks operate by moving money and assets to locations where customers are requesting financial transactions, so an FBO Group’s² ordinary course of business involves cross-border lendings, purchases and sales, and financial transactions of all types (such as hedges). Because this is how FBOs operate, the Rules as drafted will easily find transfers of cash and liquid assets that could be viewed as “Fundings” when, in fact, the transfers have no connection to any stock buyback. In the case of FBOs, any anti-avoidance impact of the Rules is dwarfed by the collateral damage – *i.e.*, the Rules will always find a Funding and thus always apply whenever the foreign parent engages in a stock buyback.

The Rules therefore do not implement the statutory provision Congress enacted; instead, the Rules create a new tax imposed on *any* stock buyback by an FBO *so long as* the FBO has a U.S. subsidiary from which the tax can be collected.

Against this background of the Rules’ overbreadth and collateral damage as applied to FBOs, FBO Groups are subject to extensive regulation and supervision in the United States and elsewhere which makes it unlikely that FBO Groups will engage in any disguised financings to avoid the Section

¹ This is clearly the effect of the Per Se Rule. The General Rule is equally concerning because of the apparent intended breadth of the clause “funds by any means (including through distributions, debt, or capital contributions)” (and the interpretation of similar language in certain existing Treasury Regulations), and the ambiguity of the remainder of the text of the rule leading to uncertainty as to how that text could potentially be interpreted by the IRS.

² We refer to the publicly-traded parent entity of an FBO group as “**FBO Parent**” and we refer to the FBO Parent and all of its subsidiaries together as the “**FBO Group**”.

4501(d) tax. FBO Groups are subject to highly detailed, restrictive and intensive capital and liquidity regulations, activities restrictions and myriad other requirements – all of which must be and are considered whenever money is moved around within the group. For example, a transaction that results in a transfer of net value out of the U.S. to a foreign affiliate (*e.g.*, an uncollateralized loan or other uncollateralized derivative trade) other than by way of a permitted dividend can lead to a real economic detriment to the FBO in the form of a negative impact on its regulatory capital, and noncompliance with regulatory restrictions and expectations can also entail highly undesirable consequences such as supervisory penalties. Indeed, when it comes to the intragroup movement of money, FBO Groups typically dedicate enormous time and resources to comply with existing regulatory requirements. Because the regulatory requirements make it unlikely that an FBO Group would engage in the type of disguised financings that the Rules are aimed at and the Rules have an obvious collateral damage problem as applied to FBOs, we recommend that the scope and design of the Rules be reconsidered.

II. The Rules effectively impose a new tax on ordinary-course commercial activities that banks engage in by applying without regard to whether any of the myriad of fundings occurring within the bank group have any actual relationship to funding a buyback.

FBO Groups are in the business of moving money to and from customers, often on a cross-border basis. This activity often involves intragroup transactions, which are not only necessary to conduct this business of moving money, but also are necessary to facilitate a stabilized global financial market. FBO Groups routinely engage in intragroup transactions to fulfill regulatory requirements to promote soundness and stability in this market. Common examples of intragroup transactions include the following, but there are countless others:

- Transactions in which U.S. securities dealers and their affiliated non-U.S. securities dealers enter into securities loans with each other to access specific securities or appropriate funding for their respective customers. For example, a securities dealer in the United States may loan shares of a U.S. corporation to an affiliated London dealer, whose customer needs the shares to cover a short sale of these shares. Typically, the customer, and then the London dealer, will post cash collateral back to the U.S. securities dealer for the securities loan and this collateral will be adjusted daily until the loaned shares are returned. The reverse transactions also occur and indeed there may be a multitude of such loans, going both ways, simultaneously.
- Transactions between affiliates that hedge, offset or otherwise facilitate one of the affiliates' transactions with customers who are seeking to finance their securities positions by entering into securities repos, securities loans and margin loans.
- Transactions that occur because an affiliate in one jurisdiction has access to a currency or a security that is needed by another affiliate to meet a customer need. For example, a U.S. broker-dealer has a customer that wants to purchase a stock traded on a non-U.S. exchange. The U.S. broker-dealer is prevented by the non-U.S. regulatory rules from transacting on the non-U.S. exchange directly, so the U.S. broker-dealer must purchase the stock from a local broker, and will use an affiliated local broker if there is one. The purchase will entail a transfer of cash and a transfer of shares.
- Transactions where margin collateral may be exchanged in order to manage the risk of customer derivative transactions. For example, a U.S. swap dealer may provide an over-the-counter derivative to a customer referencing the credit risk of a European company. The U.S. swap dealer's European affiliate is much more likely to be able to access appropriate hedges for such a derivative (by purchasing or shorting the European company's bonds), so the U.S. swap dealer and the European affiliate enter into a mirror back-to-back swap to manage the risk of the customer trade. If the market on the European company's credit moves such that the derivative transaction becomes

in-the-money to the U.S. swap dealer, the customer will post collateral to the U.S. swap dealer to cover the U.S. swap dealer's credit risk to the customer. Under the back-to-back swap, the U.S. swap dealer may post that same collateral to its European affiliate.

- A U.S. client of a U.S. structured products desk may request a structured note that has a number of risk elements embedded in it. The U.S. structured products desk may hedge its exposures to the various risk elements embedded in the note through several different transactions with several different U.S. and/or non-U.S. affiliates. Each of these hedges could entail transfers of cash and collateral and the charging and payment of fees.
- Transactions in which a U.S. subsidiary of an FBO Group makes a short-term loan to a non-U.S. subsidiary of an FBO Group to cover the non-U.S. entity's temporary liquidity shortage under local liquidity regulations.
- Transactions repositioning or adjusting the amount of regulatory-required capital (*e.g.*, increases and decreases to total loss absorbing capacity or "TLAC").

Given the breadth of the phrase "funding by any means" as used in the Rules, the ordinary-course of business transactions described above could be considered Fundings. Thus, every exchange, even if it is an equivalent value-for-value exchange could appear to be a "Funding". Every movement of cash to facilitate a customer transaction – or a transaction to comply with regulatory requirements – also would appear to be a Funding. Indeed, a single transaction could easily be viewed as a funding *by* the U.S. corporation that is a party to the transaction and simultaneously a funding *to* that corporation. Take the example of a U.S. corporation that loans a U.S. Treasury security in exchange for cash collateral of equivalent value. Is the U.S. corporation a funder because it loaned out a security that can easily be converted to cash, or is it being funded because it has received and is holding cash collateral?

In addition to the difficulty of identifying all of the Fundings and who is the *funder* under each, the problems with applying the Rules to FBO Groups can be further illustrated by trying to identify the *amount* of Funding that has occurred in each of the transactions described above. One example of this quantification problem is that, for most collateralized transactions, the amount of collateral is being adjusted daily – so, is that a new funding each day or one funding and, if it is one funding, when is the amount measured? Another example, which would be common, are overnight transactions that are reversed the following morning -- and potentially repeated again the next night. Is that two fundings or is it zero fundings because the cash is returned to the funder the next morning? There is also a significant ordering question: if the FBO Parent is receiving "funding" from all over the globe, which "funding" is properly matched up to the stock buyback?

III. The Rules are not only contrary to Sections 4501(a) and (d)(1), but are also inconsistent with Section 4501(d)(2).

The Rules therefore do not implement the statutory provision Congress enacted; instead, the Rules create a new tax imposed on *any* stock buyback by an FBO *so long as* the FBO has a U.S. subsidiary from which the tax can be collected. Indeed, the arbitrary and discriminatory result of the Per Se Rule in particular is simply that the Section 4501 excise tax would apply to every stock buyback by the FBO Parent *without regard* to whether there has even been any actual transfer of *net funds* from the United States. Accordingly, the effect of the Per Se Rule is that the FBO Parent would be subject to the rule that

applies to U.S. publicly-traded entities under Section 4501(a) *so long as* there is a U.S. subsidiary from which to collect the tax.³ This could not have been the intent of the statute.

The fact that this is an incorrect implementation of the statute can be seen not only in the words of Section 4501(d)(1) but also by the special rules in Section 4501(d)(2). Under Section 4501(d)(2) some publicly-traded foreign corporations are treated exactly the same as U.S. publicly-traded corporations in that every stock buyback, regardless of which entity in the group is the stock purchaser, triggers the excise tax. This rule is in sharp contrast to the rule in Section 4501(d)(1) which, by its terms, applies only when a U.S. subsidiary is the stock purchaser. This more onerous rule in Section 4501(d)(2) applies *only to* foreign corporations that have inverted (and are not treated as U.S. corporations under Section 7874). In addition, this more onerous rule will apply to an inverted foreign corporation only if the inversion occurred after the September 20, 2021, initial introduction of the Section 4501 tax proposal in Congress. Thus, Congress *reserved this onerous rule* for inverted corporations and only those who inverted after they were put on notice that this rule might become law. If the Per Se Rule is not revised, then this more onerous treatment will apply to (i) corporations that inverted after September 20, 2021, and (ii) all FBOs.

IV. FBO Groups are subject to complex, comprehensive regulatory regimes across jurisdictions and dedicate enormous time and resources to complying with existing regulatory requirements. These obligations do not leave much room or ability for financing transactions that are structured to avoid Section 4501(d).

FBO Groups are subject to strict rules governing how they are structured and how they operate. FBO Groups must continuously evaluate the intragroup movement of money in light of highly detailed, restrictive, and intensive capital and liquidity regulations, activities restrictions, and myriad other requirements. Generally, rules are imposed in every jurisdiction in which FBO Groups operate. The regulators in the United States are focused on protecting the U.S. entities and their customers (as well as the global financial system), and they do this by prescribing certain minimum levels of capital, limiting withdrawals of capital, restricting or hindering certain types of credit, and closely monitoring compliance with these rules, particularly in relation to interaction with affiliated entities overseas.

In some cases, an FBO Group's noncompliance with these rules and expectations could have seriously detrimental economic outcomes in the form of negative effects on the satisfaction of minimum capital requirements, as well as other undesirable consequences such as supervisory penalties. Intragroup transactions that do not provide equivalent value to each side of the transaction are generally discouraged and often penalized, thereby preventing withdrawals of capital from the U.S. entities through ordinary course business transactions. Withdrawals that do occur are accordingly almost always clearly identified and delineated distributions, but even distributions are limited by these regulations. Distributions that are permitted may also be driven by the FBO Parent's need to increase the amount of capital it has invested in subsidiaries in other jurisdictions. Below, we provide some brief background as to how FBO Groups are regulated in the United States and address why it is that the U.S. affiliates generally do not provide uncollateralized financings to their foreign affiliates. A financing that *is* fully collateralized will not provide any *net funding* to the foreign affiliates and thus should not be the type of transaction that an anti-avoidance rule would apply to.

³ As indicated above, the actual effect of the General Rule is unclear and particularly unclear in the case of FBO Groups.

A. Insured Depository Institutions

Many FBO Groups have U.S. banking subsidiaries (referred to as “insured depository institutions” or “**IDIs**”). IDIs are subject to IDI-specific rules and oversight, are severely limited in the activities they may undertake and are prohibited from undertaking many types of transactions with affiliates.

Ownership of Stock. IDIs are generally prohibited from owning equities, including those of affiliates,⁴ meaning that an IDI could never purchase its FBO Parent’s stock and therefore would never engage in the transaction to which Section 4501(d) applies.

Transactions with Affiliates. Furthermore, IDIs’ transactions with affiliates are heavily regulated under Sections 23A/23B of the Federal Reserve Act and the related Regulation W.⁵ If a transaction with an affiliate is considered a “Credit Transaction”⁶ under Regulation W (including all extensions of credit, guarantees, cross-affiliate netting arrangements, securities loan/borrow/repo transactions and derivatives that create credit exposure), the IDI must receive collateral having a market value of at least 100% of the amount of the transaction if the collateral is cash held in a “segregated earmarked deposit account” or obligations of the United States or its agencies, and collateral with an even higher market value if other types of permitted collateral are received.⁷ Accordingly, a loan or other extension of credit by an IDI would not provide an affiliate with any net funding that it could use to fund a stock buyback.

Dividends. It is also important to note that, for IDIs, a distribution of retained earnings, profits or capital to a non-U.S. intermediate entity and/or to the FBO Parent would be heavily regulated and monitored for its impact on the obligation to meet minimum regulatory capital levels. There are thousands of pages of regulatory capital rules for IDIs and their related financial services entities published by international policy-setting bodies⁸ and the U.S.⁹ and non-U.S. regulators, and these regulations seek to require an IDI to maintain a minimum amount of capital to be safe and sound. An IDI is subject to its own minimum regulatory capital levels, on a subsidiary legal entity basis, even if it has a U.S. parent bank holding company (“**BHC**”) or intermediate holding company (“**IHC**”) that is subject to similar capital rules, and even if its ultimate FBO Parent is subject to similar local capital rules. Furthermore, even if an IDI could undertake some of the transactions with affiliates that are the target of the Rules (which is unlikely because of the prohibitions and restrictions above), the IDI capital rules would have similar effects as those described immediately below for BHCs and IHCs.

⁴ See 12 U.S.C. §§ 24(7) (national banks) and 1831a (applying the national bank rule to state banks).

⁵ 12 U.S.C. § 371c (“**Section 23A**”); §12 U.S.C. § 371c-1 (“**Section 23B**”); 12 C.F.R. Part 223 (“**Regulation W**”). See 12 C.F.R. § 223.2 for definitions of “affiliates”, which include an FBO Parent and almost all commonly controlled entities, whether inside or outside the U.S.

⁶ 12 C.F.R §§ 223.3(i) and (o). See also 12 U.S.C. §§ 371c(b)(7)(A), (F) and (G) (provisions of the Dodd-Frank Act added certain repurchase, securities borrow/loan and derivatives transactions to the affiliate restrictions).

⁷ 12 C.F.R. § 223.14.

⁸ See the Basel consolidated capital framework at https://www.bis.org/basel_framework/index.htm.

⁹ See 12 C.F.R. Parts 3 (Office of the Comptroller of the Currency capital framework for national banks), Part 217 (FRB capital framework for state member banks, BHCs and IHCs) and Part 324 (Federal Deposit Insurance Corporation capital framework for state non-member banks).

B. Intermediate Holding Companies and Bank Holding Companies

An FBO Group that has U.S. corporate subsidiaries with over \$50 billion in assets is required to hold these subsidiaries through a U.S. IHC.¹⁰ IHCs are required to meet minimum regulatory capital requirements¹¹ established and overseen by the Board of Governors of the Federal Reserve System (the “FRB”). The IHC’s regulatory capital is calculated by taking into account all the assets and liabilities of all its U.S. subsidiaries. FBO Groups take into account a multitude of tactical considerations related to every transaction’s impact on the amount of capital that must be held in the United States under U.S. rules. This complex analysis will drive how the FBO moves funds.

Ownership of Parent Stock. While an IHC and its U.S. subsidiaries (other than an IDI) are not prohibited from purchasing and holding FBO Parent stock, doing so would have a punitive impact on the IHC’s capital computations. Specifically, the FBO Parent stock would be given a risk weight of 300% (meaning that the IHC would have to reserve capital of an amount three times that typically held against regular corporate exposures that are weighted at 100%).¹² So, while cash has a risk weight of zero, converting that cash into FBO Parent stock would cause an immediate and significant reduction in the IHC’s regulatory capital ratios (or, stated differently, an immediate and significant requirement to increase capital, which is a real economic cost to the FBO).

Uncollateralized Loans. While there is no strict requirement that any lending or other funding by an IHC or any of its subsidiaries (other than an IDI) to a non-U.S. affiliate be fully collateralized, because of the punitive impact of an uncollateralized loan on the IHC’s regulatory capital, an uncollateralized loan is unlikely.¹³ An uncollateralized loan from a U.S. subsidiary to a foreign affiliate (that is not a bank) would generally receive a risk weight typical of a corporate exposure. Even if the loan were fully collateralized, there would still be a negative impact on the IHC’s regulatory capital unless the collateral were cash or U.S. Treasuries, or other assets the risk weight of which the IHC could substitute for the corporate exposure.¹⁴ Therefore, taking cash (risk weight of zero) and employing it in an uncollateralized loan to FBO Parent or a non-U.S. affiliate would cause an immediate reduction in the IHC’s regulatory capital ratios (or an immediate requirement to increase capital).

BHCs. If the U.S. subsidiaries are not large enough to require an IHC, the FBO Group might hold some or all of its U.S. subsidiaries under a U.S. BHC. For example, a BHC would be required if the FBO had an IDI in the United States. All but the smallest BHCs are subject to the same capital rules applicable to IHCs described above.

Dividends. As with IDIs, an IHC or BHC distribution of capital to the FBO Parent would be heavily regulated and monitored for its impact on meeting minimum regulatory capital levels.

¹⁰ See 12 C.F.R. § 252.147 and § 252.153.

¹¹ See 12 C.F.R. § 252.147(e), 12 C.F.R. § 252.153(e) and 12 C.F.R. Part 217.

¹² See 12 C.F.R. § 217.52(b)(5). If the amount of FBO Parent stock held exceeded 25% of the IHC’s common equity Tier 1 capital, the punitive impact would be even more severe: the FBO Parent stock would be required to be deducted (dollar-for-dollar) from the IHC’s common equity Tier 1 capital (the most important form of capital). See 12 C.F.R. § 217.22(c)(4).

¹³ Accounts receivables arising in the ordinary course for intercompany services may remain outstanding for a period of time before being paid and these would not normally be collateralized.

¹⁴ See 12 C.F.R. § 217.37.

C. Broker-Dealers.

A U.S. subsidiary that is a broker-dealer is subject to broker-dealer specific regulation, including the extensive regulatory capital requirements imposed by Rule 15c3-1 under the Securities Exchange Act of 1934 (the “**Net Capital Rule**”). If the broker-dealer sits under an IHC or BHC, the requirements imposed by the Net Capital Rule exist in addition to the regulatory capital rules imposed on the IHC or BHC.

The Net Capital Rule requires all broker-dealers to maintain certain minimum levels of “net capital”, which is calculated starting with the broker-dealer’s “equity” on its balance sheet, then deducting from that amount based on “haircuts” applied to the broker-dealer’s assets. If an asset is subject to a 100% haircut, then the asset is treated as having no value for net capital purposes (*i.e.*, the entire value of the asset is deducted when calculating net capital).

If a broker-dealer’s net capital declines below its required minimum amount the broker-dealer must immediately cease its operations. In addition, stockholders of the broker-dealer are not allowed to make any “equity withdrawal” from the broker-dealer—including through the redemption or repurchase of shares, through the payment of dividends, or through an unsecured loan—if the withdrawal would result in a broker-dealer’s net capital being less than 120% of its minimum required amount or less than 25% of its required securities and options haircuts.

The Net Capital Rule also imposes practical restrictions on a broker-dealer’s ability to own shares of a parent company. If a broker-dealer were to purchase the common stock, preferred stock, or convertible bonds of the FBO Parent for a proprietary account, then unless the instruments are held for no more than two business days and relate to specific aspects of the broker-dealer’s business, the instruments would receive a 100% haircut. This means that the broker-dealer would have exchanged cash—included at full value in the net capital calculation—for instruments with no value in the net capital calculation.

If a broker-dealer were to make an uncollateralized loan to an affiliate, the loan would also receive a 100% haircut, meaning that, like with a stock purchase, the broker-dealer would have exchanged cash that was included at full value in the net capital calculation for a loan receivable with no value in the net capital calculation. If such a loan to an affiliate were collateralized, the broker-dealer would still suffer a charge to its net capital because the collateral would be included in the net capital calculation, but would be subject to a haircut (unlike the cash delivered in the loan) depending upon the nature of the collateral.

In addition to the stringent treatment of unsecured loans under the Net Capital Rule, such loans would be included on a broker-dealer’s FOCUS Report—a report filed by broker-dealers with the SEC every quarter (or more frequently if the broker-dealer carries customer accounts and receives or holds customer funds or securities)—which provides net capital information and related operational information. Large loans made from a broker-dealer to a member of the FBO Group would be apparent on such FOCUS Reports and would likely prompt an inquiry by FINRA or the SEC.

D. State Regulation

Many FBO Groups operate in states where the U.S. entities are supervised by the state banking or financial services regulator. These institutions may be subject to chartering, licensing, registration or filing requirements, as well as examinations by the state banking or financial services regulator. The state banking rules are in many instances designed to protect the state institutions and their customers and to preserve the stability of the financial system through closely monitoring compliance with regulatory rules, registration and filing requirements. These rules and regulations must be taken into account with respect to how an FBO moves funds between its U.S. subsidiaries and non-U.S. affiliates.

V. Recommendation

We recognize the concern behind the Rules about transactions structured to avoid the Section 4501(d)(1) tax; however, the Rules as written have obvious collateral damage problems as applied to FBOs. We recommend that the scope and design of the Rules be reconsidered.

VI. Invalidity As Applied to All Foreign Parented Groups

While our focus in this letter is on the impact of the Rules on FBOs and how they conflict with how FBO Groups operate, we do not want to omit that we also have serious concerns regarding whether the Rules are a valid implementation of the statute, as applied to *any* foreign-parented U.S. corporation.¹⁵

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We appreciate your consideration of our comments on the Notice. If we can answer any questions or provide any further information, please contact me (646-213-1147, bzorc@iib.org).

Very truly yours,



Beth Zorc
Chief Executive Officer
Institute of International Bankers
bzorc@iib.org

¹⁵ Among the grounds we see for questioning the validity of the Rules are: the statute is clear as to what triggers the Section 4501(d)(1) tax and the Rules are in direct conflict (*see Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., et al.*, 467 U.S. 837 (1984) (“step 1”)); if the statute has any ambiguity, the proposed rules are not a permissible construction, and the regulatory grant is for regulations “for the application of the rules under subsection (d)”, not for regulations that create new rules (*see Chevron* (“step 2”)); the proposed rules impose a tax on a U.S. corporation based upon activity that the U.S. corporation did not engage in, and amount to an extraterritorial tax on the foreign corporation that buys back the stock, using the U.S. affiliate’s presence in the U.S. as a method of collecting the tax; and the proposed rules impose an additional tax on transfers of funds from a U.S. subsidiary to a foreign affiliate in contravention of the existing statutory scheme for taxing such payments found in Section 881.