Before the
INTERNAL REVENUE SERVICE
Washington, D.C. 20224

In the Matter of	)	26 CFR Part 1
	)	
The Treatment of Certain Interests	)	IRS REG-108060-15
	)	
In Corporations as Stock or Indebtedness	)	RIN 1545-BN40
	)	
	)	

COMMENTS OF THE INFORMATION TECHNOLOGY INDUSTRY COUNCIL

The Information Technology Industry Council (ITI) hereby submits its comments in response to the Notice of Proposed Rulemaking in the above-captioned proceeding.

ITI represents 60 of the leading information and communications technology companies headquartered or significantly invested in the United States.[1] ITI is the voice of the high-tech community, advocating for policies that advance U.S. leadership in technology, promote innovation, open access to new and emerging markets, protect and enhance consumer choice, and foster increased global competition. ITI's member companies include wireless and wireline network equipment providers, computer hardware and software companies, Internet and digital service providers, mobile computing and communications device manufacturers, consumer electronics, and network security providers.

The technology sector consists of innovative industries that transform our daily lives and propel economic growth both at home and abroad. The innovations that emerge from our sector launch new global industries and underpin the solutions to many of the largest challenges faced by international society today. At the same time, the decisions made by governments about how to treat technology firms have a significant impact on economic growth and job creation.

The proposed regulations under section 385 of the Internal Revenue Code stand to have a large impact across our membership. In trying to capture perceived abusive uses of debt instruments

[1] For more information on ITI, including a list of its member companies, please visit: http://www.itic.org/about/member-companies.

and limit the tax benefits derived by these arrangements, the regulations as proposed dramatically alter the use of interparty debt and disrupt the basic Treasury functions of ITI members. This unexpected departure from the long-established rules governing debt and equity characterization will impact investment decisions and provide competitors with another advantage in an already difficult environment. For our foreign headquartered members, the proposed regulations stand to impact future investment in the United States.

There is evidence all around us that the United States tax system is underperforming. The United States stands alone in how we treat business profits. While our competitors have greatly lowered their corporate tax rates and moved to global rules of taxation, we still maintain a tax model where on paper we tax profits anywhere they are earned – while in reality – we keep the benefits of more and more activity that could grow our economy trapped offshore.

At ITI, we have long asserted that tax reform is a necessary and critical step to our members' continued ability to innovate and thrive. We believe we need to modernize our tax code to include a lower, competitive rate, a sensible territorial system in line with our competitors, and strong incentives to spur innovation-related economic activity. We view these pieces as essential to America's future strength in the global economy.

The proposed regulations stand to intensify the headwinds we face. Beyond increasing costs and complexity for American firms, the proposed regulations will make it even harder to efficiently redeploy foreign earnings and compete globally. The proposed rules also operate at odds with Treasury's recent work through the Organisation for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) project, which was intended to limit unilateral action by countries and curtail the use of complex, hybrid tax arrangements by the business community. In proposing such rules, Treasury has acted alone and driven companies to confront additional hurdles in the international context. Beyond BEPS, ITI members have also raised questions about how these proposed rules could affect terms agreed upon through our tax treaties. Put together, we question if the benefits of this approach outweigh the many looming downsides.

Since the proposed rule was issued in April, ITI members have worked diligently to understand its various impacts. While numerous issues have been identified, we will focus on those we view as most significant to our industry. To that end, we implore Treasury to focus on the following issues: the sweeping nature of the Per Se Rule, the parameters of the ordinary course exception to the Funding Rule, the overly narrow E&P exception, the issues surrounding the continued use of cash pools under the proposed rule, the broad scope and narrow timeline of the documentation requirements and the merits of exempting foreign-to-foreign transactions. In addition, ITI asks that should Treasury move forward with such policy changes that it put in place sensible transition rules, which we discuss below.

The Per Se Rule Operates at Odds with Our Product Cycles

The use of a proscribed time period to define problematic behavior is particularly impactful on the technology sector. We understand that the Funding Rule is intended to operate as a backstop to the General Rule to curtail the use of complex transactions to get around the intent of the rule. As drafted it does significantly more and has a particular impact on ITI members. As you know, the Per Se Rule establishes an irrebuttable presumption that a debt instrument has run afoul of the rules if it is issued within 36 months before or after a questionable transaction. Broadly we question the use of timing as the single determinant under this test.

Technology companies operate on an 18-month product cycle in most cases. Asking our members to predict the future for the purposes of avoiding recharacterization is unrealistic. Our member companies assert that this timing-based analysis will significantly change certain investment decisions and further limit their ability to compete. Further, our members would like the opportunity to appeal these decisions. In several regards, the proposed rule attempts to draw lines and penalize those who fail to meet the standard in an attempt to protect the limited resources of the agency. However, the specific facts and circumstances of many of the implicated transactions require the ability to contest an unintended reclassification. We therefore ask Treasury to shorten the timeline and include relief from potential overreach of the rule, including perhaps a rebuttable presumption.

The Ordinary Course Exception Omits Key Business Transactions

Aware that companies regularly issue loans to finance standard business functions, the proposed Funding Rule includes an ordinary course exception. As drafted, the exception only covers a narrow list of payments for inventory and services intended to fund the ongoing business needs of the issuer. This approach fails to take into account many other ordinary course transactions covering capitalized amounts, licenses or rentals or lease of property, cost sharing and royalty payments and intercompany trade receivables. Therefore, ITI asks that the exception be expanded to include such transactions intended to fund transactions conducted in the ordinary course of an issuer's trade or business.

Current Year E&P Diminishes Exception

We appreciate Treasury's acknowledgement that ordinary course transactions must be considered in applying the General Rule and Funding Rule. However, we have concerns about how you attempt to achieve this goal, specifically the use of current year E&P to achieve a balance between problematic and ordinary course transactions. ITI member companies assert that current year E&P is an often impossible number to calculate in the timeline mandated by the proposed rule, which is within a given tax year. Further, the proposed rule is silent on accumulated E&P. To address these concerns, we respectfully request that Treasury expand the

E&P exception to include accumulated E&P. Beyond these concerns, we also question the treatment of previously taxed income (PTI) under the proposed regime. It seems consistent with both current policy and the intent of the proposed rules to also allow PTI to be included in the exception.

Cash Pools are Threatened as an Essential Cash Management Tool

ITI members employ a number of internal treasury practices that allow for the efficient management of cash to fund their global operations. The proposed regulations disrupt these mechanisms and stand to fundamentally change basic financing functions such as cash pooling.

As you are aware, multinational companies widely use cash pools to centrally manage resources for use by affiliates operating across diverse environments. Cash pools operate like internal banks where the balances fluctuate daily as thousands of transactions are conducted between parties. Put another way, cash pools facilitate efficient inter-party lending, to fund basic operations, acquisitions and other common business practices. The centralization of cash is undisputedly faster and cheaper for ITI member companies and other global businesses, which face myriad circumstances and challenges across a broad range of jurisdictions. For example, beyond lending, pooling allows our members to mitigate currency risk exposure as they operate across a variety of economies.

The proposed rules threaten the current use of cash pools by ITI members. Under the rules as drafted many long-established debt positions could be recharacterized as equity under the proposed rules. Once one such a transaction has been recharacterized under the General Rule or Funding Rule within a cash pool arrangement, it can cause the recharacterization of subsequent transactions and create a cascading effect.

It is clear that basic Treasury functions were not the intended target of the proposed regulations. We implore Treasury to further clarify the rules governing cash pool arrangements to allow for the continued use of legitimate cash management practices by ITI member companies. We recommend including broader safe harbor criteria to exempt routine transactions, including moving away from the flat $50 million standard proposed to take into account the size of the entity when determining a reasonable percentage.

Documentation Requirements Implicate Millions of Transactions

ITI represents some of the largest companies in the world. As proposed, these regulations sweep up millions of transactions for additional, detailed monitoring by our members. While companies continue to calculate the costs associated with the development and maintenance of new internal systems and controls, we collectively estimate compliance to cost in the hundreds of millions of dollars for our 60 member companies. This estimate is consistent with the comments

submitted by the United States Council for International Business to the Office of Management and Budget (OMB), which estimates total costs into the billions of dollars for the American business community.

Beyond the scope of information targeted for review, the timelines are also problematic. The proposed rule suggests companies report out relevant information within 30 or 120 days depending on the information. If the documentation is not received within the window, the arrangement is automatically recharacterized, which is a dramatic outcome given the number of transactions called into question and the complexity of many of the fact patterns implicated. ITI members assert that they are not currently able to comply with these requirements in the time allotted. In the best case, these requirements would necessitate massive changes to accounting systems. At worst, it will be impossible in certain cases to be compliant with the requirements.

Given the extraordinary costs and constraints, we ask Treasury to find ways to streamline the documentation requirements and shift the reporting requirements to be reportable at the timing of the filing of the tax return for the year. In addition, we ask Treasury to make any failure to document subject to normal penalty rules.

Foreign-to-Foreign Transactions Should Be Exempt

ITI asks Treasury to exempt foreign-to-foreign transactions. In cases where lending occurs between foreign subsidiaries and there is no taxable element for the US Treasury, there should be no additional burdens placed on our members. As suggested above, ITI companies making acquisitions abroad and/or funding operations compete with companies that are already more nimble in their ability to deploy resources and manage the costs associated with those activities. Requiring American companies to document activities that at face value have no bearing on the US tax base will lead to various negative economic consequences that stand to diminish our firms and therefore our economy.

Transition Time is Essential

The rules as proposed are noteworthy in their delivery, scope and timeline. While these rules state curtailing earnings stripping as the intended policy goal, in reality they are a rewrite of how our system defines debt and equity and extend far past arrangements that would be considered earnings stripping. We note that there is already a section in the code 163(j) that is intended to target the exact types of transactions policymakers view as abusive to our tax base. It seems that unable to achieve further legislative action to go after the perceived abuses, Treasury decided to use a broad and blunt instrument under Section 385 to address a much narrower problem. In doing so, ITI members will have to revisit how they conceptualize their cash management and capital deployment. In conjunction, accounting mechanisms will need to be rebuilt to ensure compliance with the final rules. Given the extreme consequences of non-compliance, we

consider transition time a critical concern in the rule-making process. ITI estimates it will take companies up to two years to create and implement the systems required to meet the requirements under the proposed rule and avoid the punitive ramifications associated with incorrect or incomplete documentation. We therefore ask Treasury to allow companies until 2019 to shift to the new rules, moving away from the April 2016 effective date.

Conclusion

ITI appreciates the opportunity to submit comments and looks forward to working with the Treasury Department and the Internal Revenue Service as you finalize the rule. As our comments suggest, the policy changes suggested by the proposed regulations are significant and impactful. We therefore ask you to please carefully weigh these considerations.

Respectfully submitted,

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