ConocoPhillips

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Department of Treasury
Internal Revenue Service

Via Federal e-Rulemaking Portal

Re: IRS REG-108060-15 (Section 385 Proposed Regulations)

Ladies and Gentlemen:

I. Introduction

We respectfully submit this letter in response to certain aspects of the proposed section 385 regulations (the "Proposed Regulations"),[1] released by the Department of Treasury on April 4, 2016. While we recognize the stated objectives of the Proposed Regulations are to target corporate inversions and earnings stripping transactions which erode the U.S. tax base (base erosion), we share common concerns with many companies—concerns which have been addressed in other industry and association comment letters—that the adoption of the rules would have far-reaching impacts beyond the scope of the stated objectives and significant adverse effects on intercompany lending activities and routine group treasury functions without regard to whether they represent or support inversion transactions or base erosion. This letter addresses specific concerns of ConocoPhillips as a U.S. multinational taxpayer that regularly repatriates billions of foreign earnings to the U.S. for reinvestment and distribution to shareholders.

Headquartered in the U.S., ConocoPhillips is the world's largest independent exploration and production company based on proved reserves and production of liquids and natural gas. We explore for, produce, transport and market crude oil, bitumen, natural gas, natural gas liquids and liquefied natural gas on a worldwide basis. As of December 31, 2015, we had operations and activities in 21 countries. During 2015 we produced 1,589 thousand barrels of oil equivalent per day and had proved reserves of 8.2 billion barrels of oil equivalent. ConocoPhillips employs approximately 15,600 employees worldwide, of which approximately 7,800 are U.S. based employees.

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[1] All citations herein are to the Internal Revenue Code of 1986 or the Treasury regulations thereunder.

II. Summary of Recommendations

As discussed more fully in the sections below, our recommendations are summarized as follows.

- The Proposed Regulations should exclude section 301(c)(1) dividend distributions within the meaning of "distributions" under Prop. Reg. § 1.385-3.
- The Proposed Regulations should exclude loans from foreign affiliates to U.S. affiliates (so-called section 956 loans, discussed below) to the extent of the lender's earning and profits (including previously taxed earnings and profits).
- The ordinary course exception in Prop. Reg. § 1.385-3 should apply broadly to cover any expenses (whether deductible or capitalizable) incurred in the ordinary course of the taxpayer's trade or business.

III. No U.S. Tax Base Erosion on Intercompany Lending Activities that Effectively Achieve Repatriation

As discussed below, as a U.S. multinational company in the oil and natural gas industry, our intercompany lending activities would not result in U.S. tax base erosion.

A. ConocoPhillips Repatriates Billions

ConocoPhillips repatriates billions to the U.S. to support U.S. investments, pay shareholder dividends, and for general cash management. Approximately 70 percent of our earnings are generated outside the U.S., while approximately 50 percent of our capital expenditures are invested domestically. In short, repatriation, rather than lock-out of foreign cash, is generally standard practice for ConocoPhillips.

B. Distributions of Foreign Cash Restricted Due to Timing Mismatches Arising from Foreign Country Requirements; Proposed Regulations Hinder Efforts to Effectively Repatriate Restricted Foreign Cash by Way of Taxable Loans to the U.S.

Certain foreign countries in which ConocoPhillips has historically operated restrict our foreign subsidiaries' ability to repatriate excess cash to the U.S. Such foreign countries restrict a foreign subsidiary's distributions to the amount of its cumulative earnings as determined under the laws of the foreign country (foreign statutory earnings) or require certain amounts to be maintained for capital reserve requirements.[2] As a result, an entity may have excess foreign cash

[2] Oftentimes, timing mismatches between excess cash and foreign statutory earnings arise. For example, a foreign country may permit accelerated cost recovery of capital expenditures or require accruals of certain future expenses, including an oil and natural gas company's significant abandonment and restoration obligations (AROs), which may not be paid until many years in the future. However, we will generally have sufficient earnings and profits from a U.S. tax perspective because deductions are based on U.S. tax principles, and AROs and other similar expenses are not deducted until paid under U.S. tax principles.

but may be unable to repatriate such cash to the U.S. via a corporate distribution, despite having sufficient earnings and profits from a U.S. tax perspective, due to insufficient foreign statutory earnings or capital reserve requirements.

To repatriate excess cash to the U.S. despite these foreign statutory restrictions, we cause our foreign affiliate with restricted excess cash to loan such funds back to the U.S. Alternatively, the foreign affiliate may loan the funds to another foreign affiliate to finance capital expenditures, and that foreign affiliate may have paid taxable dividends in the prior or following 36 months. In both of these examples, the loans and related transactions at issue are fully taxable or have been fully taxed in the U.S. These examples are more fully described below. Because ConocoPhillips is a U.S. multinational taxpayer, these loans and related transactions do not result in U.S. tax base erosion.

Notwithstanding, as more fully described below, because we repatriate restricted excess cash via loans to the U.S. and engage in routine capital contribution and third-party disposition activities, the Proposed Regulations would result in affiliated foreign subsidiaries owning stock in their U.S. parent—a result that we, as a U.S. multinational taxpayer, will avoid to minimize adverse U.S. tax consequences. Consequently, the Proposed Regulations would hinder our efforts to repatriate funds and encourage foreign investment, relative to domestic investment, as these impediments implicitly increase the cost of funding U.S. capital programs. U.S. capital programs would need to be funded with third party borrowings rather than excess foreign cash.

C. Technical Examples on Alternative Means to Effectively Repatriate Earnings

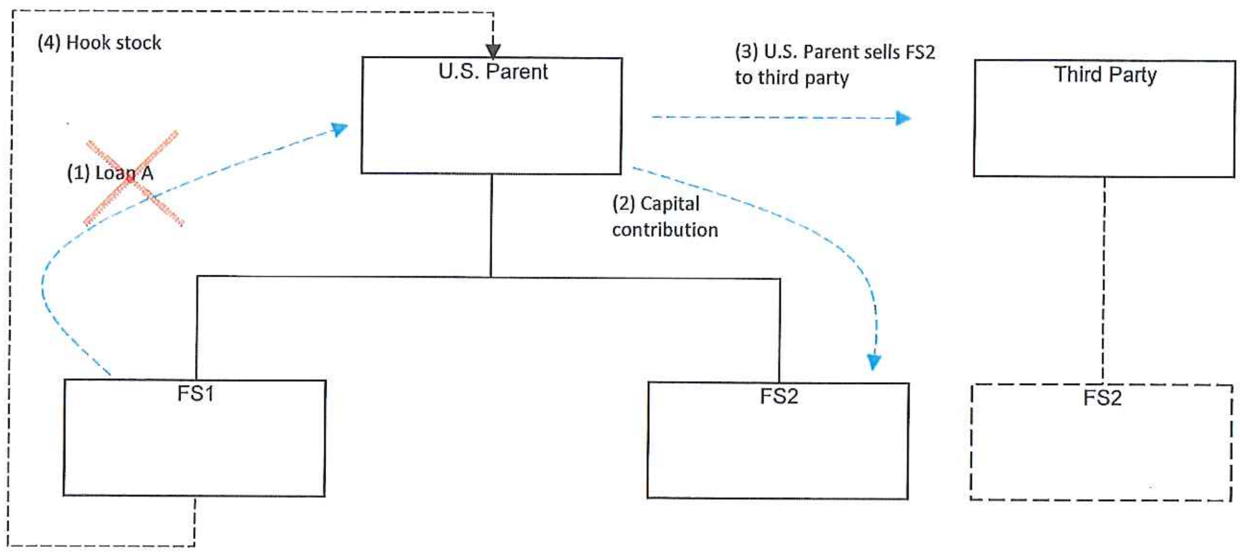
While we regularly repatriate foreign earnings to the U.S., our affiliated foreign subsidiaries may be unable to distribute funds due to local country requirements. To redeploy these funds to the U.S., in one scenario we may cause our foreign subsidiary ("FS1") to loan funds to the U.S. consolidated group to the extent of FS1's earnings and profits and previously taxed earnings and profits, and include the amount of such loan as if such loan were a section 301(c)(1) dividend distribution[3] subject to U.S. taxation under section 956 (a "section 956 loan").[4] This transaction is not used for U.S. tax avoidance because we are fully taxed on the distributed amounts.

However, assuming FS1's section 956 loan were viewed as a debt instrument within the meaning of Prop. Reg. § 1.385-3, any transaction by the U.S. consolidated group subject to the funding rule in Prop. Reg. § 1.385-3(b)(3), including routine capital contributions by the U.S. consolidated group in another foreign affiliate ("FS2"), followed by a disposition of FS2 to a third party within 36 months, would cause FS1's section 956 loan to the U.S. consolidated group

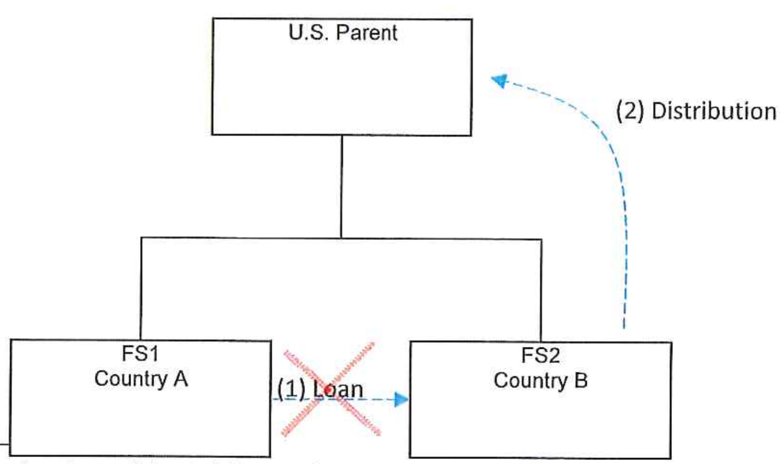
[3] A taxable dividend distribution under section 301(c)(1) may include a return of earnings and profits and previously taxed earnings and profits.

[4] While the treatment of section 956 loans under the Proposed Regulations is unclear, it appears section 956 loans may be viewed as debt instruments that generate income inclusions as opposed to distributions within the meaning of Prop. Reg. § 1.385-3.

to be treated as equity.[5] This gives rise to a "hook stock" ownership structure representing FS1's ownership of its U.S. parent corporation, resulting in adverse U.S. tax consequences. This scenario is illustrated below.



Alternatively, in another scenario we may cause FS1 to loan funds to FS2 to finance FS2's capital expenditure program. FS2 may make regular distributions to the U.S. consolidated group treated as section 301(c)(1) dividend distributions subject to U.S. taxation. FS2's dividend distributions, however, would fall within Prop. Reg. § 1.385-3 and cause FS1's loan to FS2 to be treated as an equity interest resulting in adverse U.S. tax consequences. This scenario is illustrated below.



[5] Assuming instead that FS1's Section 956 loan were viewed as a distribution within the meaning of Prop. Reg. § 1.385-3, any future related party borrowings by FS1 during the 36-month period following the distribution would cause FS1's related party borrowings to be treated as equity.

The two scenarios described above involve section 956 loans and section 301(c)(1) dividend distributions that generate amounts that are currently or have previously been subject to U.S. taxation. These scenarios do not thwart the stated objectives of the Proposed Regulations. Therefore, a recharacterization of these transactions pursuant to the Proposed Regulations would generate an unnecessary burden on a U.S. taxpayer's ability to repatriate foreign earnings.

Accordingly, we recommend the Proposed Regulations exclude section 956 loans to the extent of the lender's earnings and profits (including previously taxed earnings and profits) and loans incurred as part of or to fund section 301(c)(1) dividend distributions to U.S. affiliates as such loans and distributions do not erode the U.S. tax base. The Proposed Regulations burden our ability to repatriate foreign earnings to the U.S., and we believe the introduction of these exclusions would remove such burdens without hindering the stated objectives of the Proposed Regulations. Without these exclusions, the Proposed Regulations will limit our ability to repatriate foreign earnings to the U.S. and will increase the cost of U.S. capital investments, relative to competing foreign projects.

IV. Ordinary Course Exception Too Narrow

As an oil and natural gas company, our affiliated foreign companies may have intercompany debt from expenses that are deductible under provisions other than section 162. For example, oil and natural gas producers like ConocoPhillips incur drilling expenses that are capitalized under section 263, but are eligible to be deducted in the year spent pursuant to section 263(c).[6] We find the ordinary course exception under Prop. Reg. § 1.385-3 too narrow in its description. Rather than restrictively limiting the ordinary course exception to a few items, the exception should apply broadly to cover any expenditures (whether deductible or capitalizable) if they are incurred in the ordinary course of the taxpayer's trade or business.

If you have any questions, please feel free to request for me at (281) 293-3106.

Respectfully submitted,

Chris Delk

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[6] Our affiliated foreign companies may incur ordinary course working capital debt through their notional cash pool borrowings to fund short-term working capital needs. While not discussed in this letter, like many other companies across various industries, we are concerned the Proposed Regulations may apply to notional cash pools that are conducted entirely through interactions with an unrelated third-party bank.