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December 10, 2018

Attn: Mabel Echols
Office of Information and Regulatory Affairs
Office of Management and Budget
725 17th Street NW
Washington, DC 20503

Re: Review of Section 965 Proposed Regulations Under Executive Order 12866, RIN 1545-BO51

Dear Ms. Echols:

We are writing on behalf of a client to bring certain issues to the attention of the Office of Information and Regulatory Affairs ("**OIRA**") regarding the regulations recently proposed by the Department of the Treasury under Section 965 of the Internal Revenue Code, as amended by Congress in P.L. 115-97, which were published in the Federal Register on August 9, 2018, at 83 Fed. Reg. 39,514 (the "**Proposed Regulations**"). A proposed final form of the Proposed Regulations was submitted to OIRA on December 6, 2018 for review pursuant to Executive Order 12866 ("**Submitted Regulations**"). Executive Order 12866 grants OIRA the authority to "reconsider the scope and implementation" of certain Treasury regulations if the regulations may "create a serious inconsistency or otherwise interfere with an action taken or planned by another agency," "raise novel legal or policy issues" or "have an annual non-revenue effect on the economy of $100 million or more, measured against a no-action baseline." Given the novel legal and policy issues raised by the Proposed Regulations and in particular the fact that certain elements of the Proposed Regulations are in conflict with the text and purpose of Section 965, as further discussed below, we believe OIRA's review is warranted.[1] Indeed, the scope of the Proposed Regulations is broader than necessary to address the concerns identified by Treasury in promulgating them.

Background

On September 21, 2018, in response to the request for comments on the Proposed Regulations, we submitted a letter to Treasury regarding the proposed requirement that cash and cash equivalents held by certain former foreign corporations no longer in existence on

[1] Because the Submitted Regulations have not been publicly released, we assume for purposes of this letter, unless otherwise indicated, that the Submitted Regulations are identical to the Proposed Regulations in all relevant respects.

November 2, 2017 or December 31, 2017 be included in the "aggregate foreign cash position" of a United States shareholder (such requirement, the "**Proposed Rule**"). As we described in that letter, a copy of which is attached hereto as Exhibit A, we view the Proposed Rule to be an impermissible reading of Section 965 that is inconsistent with the text and purpose of Section 965

On October 31, 2018, we met with Deputy Assistant Secretary of the Department of the Treasury Lafayette "Chip" G. Harter III, and other Treasury officials to discuss our September 21, 2018 submission. At that meeting, Treasury explained that the Proposed Rule was intended to address certain concerns with potentially abusive transactions that taxpayers may have undertaken so as to reduce their "aggregate foreign cash position," and thus the amount of tax required to be paid under Section 965. Although these limited situations could reasonably be addressed by the regulations, we believe that the Proposed Rule is overly broad in scope in that it would capture transactions that are not abusive. On November 2, 2018, we sent Treasury a letter proposing a narrow exception to the Proposed Rule, a copy of which is attached as Exhibit B. This narrow exception would provide appropriate relief to taxpayers in specific circumstances outside the scope of Treasury's concerns and, in our view, would significantly mitigate the Proposed Rule's overbreadth and inconsistency with Section 965. If the Submitted Regulations require revisions to address the concerns raised in our September 21 letter and further described below, we encourage OIRA to consider this narrowly tailored proposal.

Section 965 requires a deemed repatriation of accumulated, untaxed foreign earnings and profits ("**E&P**") of "deferred foreign income corporations" (i.e., certain foreign corporations in existence on either November 2, 2017 or December 31, 2017 with deferred foreign earnings) and provides that offshore E&P invested in cash or cash equivalents are taxed at an effective rate of 15.5% and earnings in excess of the cash position—reinvested earnings—are taxed at an effective rate of 8%. The statute accomplishes this result by providing the United States shareholders that are required to include such E&P in income with a deduction calculated as a function of such E&P and the excess of such E&P over their "aggregate foreign cash position."

Assuming the Proposed Rule is unchanged, our disagreement with Treasury is based on our reading of the definition of "aggregate foreign cash position" in Section 965(c)(3)(A) as requiring that the relevant foreign corporations ("**specified foreign corporations**" or "**SFCs**") be in existence on November 2, 2017 or December 31, 2017 in order for their cash positions to be included in the "aggregate foreign cash position" of a United States shareholder. By contrast, the Proposed Regulations provide that an SFC's cash position is included in a United States shareholder's "aggregate foreign cash position" even when the SFC did not exist on November 2 or December 31, 2017.[2] Treasury's reading is incompatible with the text of the statute as well as the underlying policy rationale, and is

[2] Prop. Treas. Reg. § 1.965-1(f)(30)(iii), § 1.965-1(g) Ex. 7 (United States shareholder required to include in its aggregate foreign cash position the cash held by an entity in existence on November 2, 2015 but not on November 2, 2017 or after).

precluded by Supreme Court precedent mandating that the law be no more retroactive in effect than explicitly provided by Congress.

Text of Section 965 and Conflicting Proposed Rule

Under Section 965(c)(3)(A), a taxpayer's aggregate foreign cash position is defined as:

> (3) *Aggregate foreign cash position.* For purposes of this subsection—
>
> (A) *In general.* The term "aggregate foreign cash position" means, with respect to any United States shareholder, the greater of—
>
> (i) the aggregate of such United States shareholder's pro rata share of the cash position of <u>each specified foreign corporation</u> of such United States shareholder determined as of the close of the last taxable year of <u>such specified foreign corporation</u> which begins before January 1, 2018, or
>
> (ii) one half of the sum of—
>
> (I) the aggregate described in clause (i) determined as of the close of the last taxable year of <u>each such specified foreign corporation</u> which ends before November 2, 2017, plus
>
> (II) the aggregate described in clause (i) determined as of the close of the taxable year of <u>each such specified foreign corporation</u> which precedes the taxable year referred to in subclause (I)

In this statutory language, the word "such" in the phrase "each such specified foreign corporation" refers back to the phrase "each specified foreign corporation" used earlier in the sentence. Thus, for purposes of Section 965(c)(3)(A)(i), the United States shareholder takes into account its pro rata share of the cash position of a set of SFCs as of the close of the last taxable year of each such SFC that begins before January 1, 2018. Sections 965(c)(3)(A)(ii)(I) and (II) both use the phrase "each such specified foreign corporation" without any intervening use of the term "specified foreign corporation." The use of the word "such" before a noun refers the reader back to a specific noun. Because there is no intervening use of the term "specified foreign corporation," the use of the word "such" in Sections 965(c)(3)(A)(ii)(I) and (II) necessarily refers to each of the SFCs described in Section 965(c)(3)(A)(i). It follows ineluctably under the structure and text of the statute that the SFCs tested on the second cash measurement date (in Section 965(c)(3)(A)(ii)(I)) and first cash measurement date (in Section 965(c)(3)(A)(ii)(II)) must be SFCs in existence and owned by the United States shareholder on the final cash measurement date (in Section 965(c)(3)(A)(i)).

Under the Proposed Rule, an SFC's cash position may be measured even if it was not in existence on the final measurement date:

(i) the final cash measurement date of a specified foreign corporation (the "**Final Cash Measurement Date**") is the close of the last taxable year of the specified foreign corporation that begins before January 1, 2018, and ends on or after November 2, 2017, if any;[3]

(ii) the second cash measurement date of a specified foreign corporation (the "**Second Cash Measurement Date**") is the close of the last taxable year of the specified foreign corporation that ends after November 1, 2016, and before November 2, 2017, if any;[4]

(iii) and the first cash measurement date of a specified foreign corporation (the "**First Cash Measurement Date**,") is the close of the last taxable year of the specified foreign corporation that ends after November 1, 2015, and before November 2, 2016, if any.[5]

The Proposed Rule breaks the statutory link between SFCs measured on the final measurement dates and those measured on the earlier dates without explanation. The preamble to the Proposed Regulations does not address the conflict between the Proposed Rule and the statute regarding testing specified foreign corporations on the First and Second Cash Measurement Dates that are not tested on the Final Cash Measurement Date. Instead, the preamble misquotes the statute by deleting the word "such" preceding "specified foreign corporation" each time that term appears in the language relating to the two earlier measurement dates. Here, in relevant part, is a comparison of the preamble's statement of the rule to the text of the statute itself:

aggregate foreign cash position means, with respect to any United States shareholder, the greater of

(i) the aggregate of the United States shareholder's pro rata share of the cash position of each specified foreign corporation of the United States shareholder determined as of the close of the last taxable year of ~~such~~ **the** specified foreign corporation that begins before January 1, 2018, or

(ii) one half of the sum of (A) the aggregate described in clause (i) determined as of the close of the last taxable year of each ~~such~~ specified foreign corporation that ends before November 2, 2017, plus (B) the aggregate described in clause (i) determined as of the close of the taxable year of each ~~such~~ specified foreign corporation which precedes the taxable year referred to in subclause (A).

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[3] Prop. Treas. Reg. § 1.965-1(f)(24).

[4] Prop. Treas. Reg. § 1.965-1(f)(31).

[5] Prop. Treas. Reg. § 1.965-1(f)(25).

By misquoting the statute, Treasury avoids confronting the conflict between its Proposed Rule and the statute. Moreover, the Proposed Rule extends the retroactive reach of the statute intended by Congress, which, as discussed in our September 21 letter, is in conflict with clear Supreme Court precedent applying a "traditional presumption" against retroactivity. The legislative history to Section 965, as described in our September 21 letter, also confirms that Congress intended that the aggregate foreign cash position of a United States shareholder be determined by reference to specified foreign corporations with a final cash measurement date—that is, those in existence on November 2 or December 31, 2017.

Treasury's Concerns Underlying the Proposed Rule

In our October 31, 2018 meeting with Treasury officials, Treasury identified a particular scenario that the Proposed Rule was intended to address. In the simplest form of that hypothetical scenario, a United States shareholder in 2017 was in control of two foreign corporations, Corporations A and B. On November 1, 2017, the United States shareholder causes Corporation A to merge with and into Corporation B, with Corporation B surviving. Corporation A had a modest amount of cash at the time of the merger and significantly more cash at the time of each of the earlier measurement dates. While the cash held by Corporation A would be taken into account with Corporation B's cash for Corporation B's final cash measurement date, Treasury's concern as communicated to us was that the cash held by Corporation A at the time of the earlier measurement dates would not be taken into account. The Proposed Rule, however, is far broader than necessary to address such a scenario. For example, the Proposed Rule would also require that, if the United States shareholder of Corporation A had instead liquidated Corporation A and taken its E&P into income (taxed at a 35% rate), Corporation A's cash at the earlier measurement dates would still be included for purposes of determining the rate of tax on any E&P of Corporation B included in income under Section 965. That could have the economic effect of taxing Corporation A at a 42.5% rate on its earnings, a result incompatible with Congress' intent to provide taxpayers with a preferential rate of tax on repatriated E&P. The Proposed Rule is therefore not tailored to the scope of Treasury's concerns and produces inappropriate results in common situations, clearly in tension with the intent of Congress.

A Narrowly Tailored Rule Addresses Treasury's Concerns

In contrast to the Proposed Rule, a rule narrowly tailored to address Treasury's concern would avoid any conflict with the statute and would not result in a retroactive application broader than Congress intended. Indeed, Congress long ago passed legislation addressing the concept of corporate successors in a manner which provides Treasury the authority to address its concerns in a tailored fashion. In the first chapter of the first title of the United States Code, which includes general rules of construction applicable to "any Act of Congress," Congress provided, at section 5, that the use of the word "company" or "association," "when used in reference to a corporation, shall be deemed to embrace the words 'successors and assigns of such company or association,' in like manner as if these last-name words, or words of similar import, were expressed." If corporations are deemed under the Code to refer to their successors, then logic suggests that a corporation's predecessors may also be captured when Congress uses the word corporation. A revision to

the Proposed Rule that would require that an SFC have a final cash measurement date (i.e., be in existence on either November 2 or December 31, 2017) in order for its cash position to be measured on prior dates, but which would include for the purpose of prior measurement dates the cash positions of its predecessor corporations, would therefore be consistent with the scope of the statute and alleviate Treasury's concerns.

The proposal included in our November 2 letter would also, at least in significant part, address the statutory conflict and overly broad retroactive effect of the Proposed Rule. That proposal would exclude, for purposes of the definition of aggregate foreign cash position with respect to a United States shareholder, a foreign corporation the assets of which were, prior to November 2, 2017, acquired by such United States shareholder in a transaction described in Treasury Regulation section 1.367(b)-3(a). This proposal would therefore provide relief for certain taxpayers that repatriated their foreign cash and earnings prior to November 2. Although questions may still arise in other scenarios as to the overall rule's consistency with the statute, the narrowed scope of the rule under our proposal would eliminate many potential disputes and provide necessary relief to the taxpayers most unfairly affected by the Proposed Rule.

Respectfully submitted,

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Exhibit A

Comment letter dated September 21, 2018

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September 21, 2018

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Courier's Desk
Internal Revenue Service
1111 Constitution Avenue NW
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Re: Comments Requested in Notice of Proposed Rulemaking under Section 965 and Other Provisions—Cash Measurement Dates

Dear Mses. Perkins and Cate:

We are writing on behalf of a client to comment on the regulations recently proposed under Section 965 as amended by Congress in P.L. 115-97 (the "**2017 Tax Act**"), which were published in the Federal Register on August 9, 2018, at 83 Fed. Reg. 39,514 (the "**Proposed Regulations**"). Under Section 965, a United States shareholder's "pro rata share" of the accumulated untaxed earnings of its "deferred foreign income corporations" is taxed at a higher effective rate to the extent the earnings are attributable to cash or cash equivalents. Our comments address the requirement in the Proposed Regulations that cash or cash equivalents be determined by taking into account cash and cash equivalents held by foreign corporations not in existence on November 2, 2017 or December 31, 2017, i.e., foreign corporations that are not deferred income corporations as to the United States shareholder and in which the United States shareholder has no share of the earnings for purposes of Section 965 (such requirement, the "**Proposed Rule**").[1] In our view, the Proposed Rule is an impermissible reading of the statute that is inconsistent with its text, structure and history. Rather, Section 965 permits the cash positions of only those foreign corporations held by the United States shareholder on at least one of the two measurement dates for earnings, November 2, 2017 and December 31, 2017, to be taken into account.

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[1] *See* Prop. Treas. Reg. § 1.965-1(c) (allowing a deduction equal to the "section 965(c) deduction amount"), (f)(3) (defining "15.5 percent rate amount"), (f)(8) (defining "aggregate foreign cash position"), (f)(24) (defining "final cash measurement date"), (f)(25) (defining "first cash measurement date"), (f)(30) (defining "pro rata share"), (f)(31) (defining "second cash measurement date") and (f)(42) (defining "section 965(c) deduction amount").

I. Section 965 and Proposed Regulations

Section 965 requires a deemed repatriation of accumulated, untaxed foreign earnings of certain "specified foreign corporations" and provides a partial dividends-received deduction so that offshore earnings and profits ("**E&P**") invested in cash or cash equivalents are taxed at an effective rate of 15.5% and earnings in excess of the cash position—reinvested earnings—are taxed at an effective rate of 8%. The amount of a United States shareholder's deemed repatriation under the statute is its pro rata share of the "accumulated post-1986 deferred foreign income" of each "deferred foreign income corporation," determined as of either November 2, 2017 or December 31, 2017, depending on which date results in a greater inclusion.[2] November 2, 2017 is the date the first version of the 2017 Tax Act was introduced in the House of Representatives and was chosen by Congress as a measurement date "to establish a floor for determining the post-1986 deferred foreign earnings and profits"—that is, to limit the extent to which tax planning after November 2, 2017 could undermine congressional intent.[3]

A deferred foreign income corporation is any "specified foreign corporation" that has accumulated post-1986 deferred income as of either November 2, 2017 or December 31, 2017.[4] (If a foreign corporation was not in existence on November 2, 2017, it is not a deferred foreign income corporation and its historical E&P is not captured by Section 965.) A specified foreign corporation ("**SFC**") is "any controlled foreign corporation" or "any foreign corporation with respect to which one or more domestic corporations is a United States shareholder," other than "any corporation which is a passive foreign investment company . . . with respect to the shareholder and which is not a controlled foreign corporation."[5]

The "aggregate foreign cash position" used to determine the amount of E&P subject to tax at the 15.5% rate is defined in Section 965(c)(3)(A) as the greater of (i) the United States shareholder's aggregate pro rata share of the cash position[6] of each of its SFCs on its final cash measurement date and (ii) one half of the sum of (I) the aggregate of its pro rata share of the cash position of these SFCs on its second (earlier) cash measurement date and (II) the aggregate of its pro rata share of the cash position of these SFCs on its first (earlier still) cash measurement date. The statutory text reads (emphasis added):

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[2] § 965(a).

[3] *See* H.R. REP. NO. 115-466, at 478-79 (2017) (Conf. Rep.). In the Senate's first version of the 2017 Tax Act, the first measurement date was November 9, 2017, the date the Senate bill was introduced. Id. at 485. The 2017 Tax Act was enacted by Congress on December 20, 2017, and was signed into law by the President on December 22, 2017. Congress did not include a general effective date provision in Section 14103 of the 2017 Tax Act, which amended Section 965. *See* P.L. 115-97, § 14103.

[4] § 965(d)(1). Accumulated post-1986 deferred foreign income is defined as the post-1986 E&P except to the extent such E&P is attributable to income that is effectively connected with a U.S. trade or business or previously taxed under subpart F of the Internal Revenue Code. § 965(d)(2).

[5] § 965(e)(1), (3)

[6] Cash position (a "**cash position**") is in relevant part the sum of (i) cash, (ii) the net accounts receivable of such foreign corporation and (iii) the fair market value of actively traded personal property, commercial paper and government securities, foreign currencies, short-term obligations and other assets identified by the Secretary which are economically equivalent to those listed. § 965(c)(3)(B).

(3) *Aggregate foreign cash position.* For purposes of this subsection—

(A) *In general.* The term "aggregate foreign cash position" means, with respect to any United States shareholder, the greater of—

(i) the aggregate of such United States shareholder's pro rata share of the cash position of each specified foreign corporation of such United States shareholder determined as of the close of the last taxable year of such specified foreign corporation which begins before January 1, 2018, or

(ii) one half of the sum of—

(I) the aggregate described in clause (i) determined as of the close of the last taxable year of each such specified foreign corporation which ends before November 2, 2017, plus

(II) the aggregate described in clause (i) determined as of the close of the taxable year of each such specified foreign corporation which precedes the taxable year referred to in subclause (I)

In this statutory language, the word "such" in the phrase "each such specified foreign corporation" refers back to the phrase "each specified foreign corporation" used earlier in the sentence. Thus, for purposes of Section 965(c)(3)(A)(i), the United States shareholder takes into account its pro rata share of the cash position of a set of SFCs as of the close of the last taxable year of each such SFC that begins before January 1, 2018. Sections 965(c)(3)(A)(ii)(I) and (II) both use the phrase "each such specified foreign corporation" without any intervening use of the term "specified foreign corporation." The use of the word "such" before a noun refers the reader back to a specific noun. Because there is no intervening use of the term "specified foreign corporation," the use of the word "such" in Sections 965(c)(3)(A)(ii)(I) and (II) necessarily refers to each of the SFCs described in Section 965(c)(3)(A)(i). It follows ineluctably under the structure and text of the statute that the SFCs tested on the second cash measurement date (in Section 965(c)(3)(A)(ii)(I)) and first cash measurement date (in Section 965(c)(3)(A)(ii)(II)) must be SFCs in existence and owned by the United States shareholder on the final cash measurement date (in Section 965(c)(3)(A)(i)). The language of the statute thus limits the universe of measured entities to those measured on the final measurement date contemplated in Section 965(c)(3)(A)(i), and an entity not in existence on that date may not be taken into account under Section 965(c)(3)(A)(ii).

The Proposed Rule, on the other hand, provides that an SFC's cash position may be measured on the earlier dates even if it is not in existence on the final measurement date:[7]

(i) the final cash measurement date of a specified foreign corporation (the "**Final Cash Measurement Date**") is the close of the last

[7] Prop. Treas. Reg. § 1.965-1(f)(8).

taxable year of the specified foreign corporation that begins before January 1, 2018, and ends on or after November 2, 2017, if any;[8]

(ii) the second cash measurement date of a specified foreign corporation (the "**Second Cash Measurement Date**") is the close of the last taxable year of the specified foreign corporation that ends after November 1, 2016, and before November 2, 2017, if any;[9]

(iii) and the first cash measurement date of a specified foreign corporation (the "**First Cash Measurement Date**,") is the close of the last taxable year of the specified foreign corporation that ends after November 1, 2015, and before November 2, 2016, if any.[10]

Under the Proposed Rule, a United States shareholder would take into account its pro rata share of an SFC's cash position as of any cash measurement date "without regard to whether the 958(a) U.S. shareholder is a section 958(a) U.S. shareholder of the specified foreign corporation as of any other cash measurement date of the specified foreign corporation, including the final cash measurement date of the specified foreign corporation."[11] A United States shareholder would therefore potentially be taxed at a higher rate as a result of the prior cash position of any foreign corporation it owned between November 1, 2015 and November 2, 2017, regardless of whether the foreign corporation continued to exist on November 2, 2017. Illustrating this point, examples in the Proposed Regulations make clear that any foreign corporation previously in existence is treated as an SFC and that a United States shareholder is required to pay a greater amount of tax under Section 965 if an SFC it previously owned held cash or cash-equivalent assets and was in existence on November 2, 2015.[12]

II. The Proposed Rule Is Inconsistent with the Statute

The Proposed Rule breaks the statutory link between the SFCs measured on the final measurement dates and those measured on the earlier dates without explanation. The preamble to the Proposed Regulations does not address the conflict between the Proposed Rule and the statute regarding testing SFCs on the First and Second Cash Measurement Dates that are not tested on the Final Cash Measurement Date. Instead, the preamble misquotes the statute by deleting the word "such" preceding "specified foreign corporation" each time that term appears in the language relating to the two earlier measurement dates. Here, in relevant part, is a comparison of the preamble's statement of the rule to the text of the statute itself:

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[8] Prop. Treas. Reg. § 1.965-1(f)(24).

[9] Prop. Treas. Reg. § 1.965-1(f)(31).

[10] Prop. Treas. Reg. § 1.965-1(f)(25).

[11] Prop. Treas. Reg. § 1.965-1(f)(30)(iii).

[12] *See* Prop. Treas. Reg. § 1.965-1(g) Ex. 7 (providing that a corporation that dissolved on December 30, 2010 is a specified foreign corporation with respect to which no cash measurement date is applicable).

> aggregate foreign cash position means, with respect to any United States shareholder, the greater of
>
> (i) the aggregate of the United States shareholder's pro rata share of the cash position of each specified foreign corporation of the United States shareholder determined as of the close of the last taxable year of ~~such~~ the specified foreign corporation that begins before January 1, 2018, or
>
> (ii) one half of the sum of (A) the aggregate described in clause (i) determined as of the close of the last taxable year of each ~~such~~ specified foreign corporation that ends before November 2, 2017, plus (B) the aggregate described in clause (i) determined as of the close of the taxable year of each ~~such~~ specified foreign corporation which precedes the taxable year referred to in subclause (A).

By misquoting the statute, Treasury avoids confronting the conflict between its Proposed Rule and the statute.

Furthermore, the Proposed Rule's departure from the statutory text causes the statute to have a broader retroactive effect than Congress intended, violating "the presumption against retroactive legislation [which] is deeply rooted in our jurisprudence, and embodies a legal doctrine centuries older than our Republic."[13] A retroactive rule is one that "takes away or impairs vested rights acquired under existing laws, or creates a new obligation, imposes a new duty, or attaches a new disability."[14] Considerations of "fair notice, reasonable reliance, and settled expectations" offer sound guidance as to whether a statute has a retroactive effect.[15] The inquiry "demands a commonsense, functional judgment" about whether the statute changes the consequences of events completed before its enactment.[16] This commonsense test has been the same since Justice Story, then a circuit judge, first articulated it in 1814, when he wrote "every statute, which takes away or impairs vested rights acquired under existing laws, or creates a new obligation, imposes a new duty, or attaches a new disability, in respect to transactions or considerations already past, must be deemed [to have an impermissible retroactive effect]."[17] If a court finds that "the new provision attaches new legal consequences to events completed before its enactment," then the provision is considered to apply retroactively.[18]

Congress clearly provided in the text of Section 965 that if an SFC described by Section 965(c)(3)(A)(i) held a greater amount of cash or cash equivalent assets in certain prior taxable years then the effective tax rate applicable to the E&P inclusion of its United

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[13] Landgraf v. USI Film Prods., Inc., 511 U.S. 244, 265 (1994).

[14] Sturges v. Carter, 114 U.S. 511, 519 (1885).

[15] Martin v. Hadix, 527 U.S. 343, 357–58, (1999) (citing Landgraf at 270).

[16] Id.

[17] *See* Landgraf at 268-69 (quoting Soc'y for the Propagation of the Gospel v. Wheeler, 22 F. Cas. 756, 767 (C.C.N.H. 1814) (No. 13,156) (Story, J.)), Enter. Mortg. Acceptance Co., LLC, Sec. Litig. v. Enter. Mortg. Acceptance Co., 391 F.3d 401, 409–10 (2d Cir. 2004), as amended (Jan. 7, 2005) (same).

[18] Landgraf at 270.

States shareholders would be increased. In the words of Justice Story, this has the effect of "create[ing] a new obligation . . . in respect to transactions . . . already past." That is, the prior act of a United States shareholder of owning a foreign corporation holding cash is imbued with new consequences relating to the cash position of that corporation at that time—namely the requirement to pay a greater amount of tax under Section 965.

The Proposed Rule, however, takes a more expansive retroactive approach than that required by the statute by providing that an SFC may have a First Cash Measurement Date or Second Cash Measurement Date even though it does not have a Final Cash Measurement Date. Although the statute arguably contains an ambiguity as to the scope of SFCs included on the final cash measurement date ("the close of the last taxable year of such specified foreign corporation that begins before January 1, 2018"), the only reading of this language that is consistent with both the purpose of the statute and the presumption against retroactivity limits the SFCs to be measured on the final cash measurement date to those in existence on November 2, 2017. Indeed, Treasury and IRS adopted this reading in defining the Final Cash Measurement Date, despite recognizing that the statutory reference to the "close of the last taxable year of such specified foreign corporation which begins before January 1, 2018" could be read literally to refer to the close of the final taxable year of a specified foreign corporation that ceased to exist before November 2, 2017.[19] If Section 965(c)(3)(A) were so read, the scope of prior acts that would cause a United States shareholder to pay more tax under Section 965 could be dramatically broadened to include cash positions of entities not in existence for decades. Not only is a reading of Section 965(c)(3)(A)(i) that is limited to SFCs in existence on November 2, 2017 most consistent with the purpose and structure of Section 965(c)(3)(A), it avoids a broader retroactive effect of the statute, which cannot be supported by arguable ambiguity. As the Supreme Court has stated, "congressional enactments and administrative rules will not be construed to have retroactive effect unless their language requires this result."[20]

To overcome the presumption against retroactivity, a statute must be "so clear that it could sustain only one interpretation."[21] Under the Supreme Court's jurisprudence in this area, a court first asks "whether Congress has expressly prescribed the statute's proper reach," and if there is no "congressional directive on the temporal reach of a statute," the court determines "whether the application of the statute to the conduct at issue would result in a retroactive effect."[22] If it does, the statute is presumed to not so apply, in keeping with the "traditional presumption" against retroactivity.[23] Indeed, there is no case where the Supreme Court has "read a statute substantially increasing the monetary liability of a private party to apply to conduct occurring before the statute's enactment" unless Congress has "clearly

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[19] Notice 2018-26 p. 18 ("The Treasury Department and the IRS understand that section 965(c)(3)(A)(i) could be interpreted to treat the close of the final taxable year of a specified foreign corporation that ceased to exist before November 2, 2017, as the final cash measurement date of such specified foreign corporation.").

[20] Bowen v. Georgetown Univ. Hosp., 488 U.S. 204, 208 (1988) (emphasis added) (holding that the Secretary of Health and Human Services has no authority to promulgate a rule requiring private hospitals to refund Medicare payments for services rendered before promulgation of the rule because the statute does not expressly authorize retroactive rulemaking).

[21] INS v. St. Cyr, 533 U.S. 289, 317 (2001).

[22] Hadix, at 352 (citing Landgraf at 280).

[23] Id.

spoken."[24] Only when Congress has provided an "unambiguous directive" will statutes apply retroactively.[25] And Congress is well versed in drafting retroactive tax provisions.[26]

The Proposed Rule clearly has a retroactive effect broader than that intended by Congress and set forth in the statute. And as discussed above, that Proposed Rule is hardly the "only" interpretation of Section 965(c)(3)(A)(i) that is available, which forecloses its retroactive reading. The Proposed Rule's retroactive effect in the absence of a direct congressional directive requiring retroactive application is therefore another reason—in addition to the Proposed Rule's conflict with the statutory language—to conclude that it is an impermissible interpretation of Section 965.

III. Legislative History and Policy of Section 965

The legislative history provides additional bases to conclude that Congress intended Section 965(c)(3)(A) to apply only to SFCs in existence on November 2, 2017. Like the final statutory language, the House bill's version of Section 965 expressly linked the SFCs measured on the earlier dates to those measured on the final date (emphasis added):

> The term "aggregate foreign cash position" means, with respect to any United States shareholder, one-third of the sum of—
>
> (i) the aggregate of such United States shareholder's pro rata share of the cash position of each specified foreign corporation of such United States shareholder determined as of November 2, 2017,
>
> (ii) the aggregate described in clause (i) determined as of the close of the last taxable year of each such specified foreign corporation which ends before November 2, 2017, and
>
> (iii) the aggregate described in clause (i) determined as of the close of the taxable year of each such specified foreign corporation which precedes the taxable year referred to in clause (ii).
>
> In the case of any foreign corporation which did not exist as of the determination date described in clause (ii) or (iii), this subparagraph shall be applied separately to such foreign corporation by not taking into account such clause and by substituting "one-half (100 percent in the case that both clauses (ii) and (iii) are disregarded)" for "one-third."[27]

Like the enacted version of Section 965, the House bill included three measurement dates for cash: the final measurement date and two earlier measurement dates. Also like the enacted version, the universe of SFCs taken into account on the second two measurement dates was

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[24] Landgraf at 284-85.

[25] Landgraf at 263.

[26] *See, e.g.*, U.S. v. Carlton, 512 U.S. 26, 29 (1994) (analyzing December 1987 amendment to the Code which Congress provided would take effect as if included in the amendments made by the Tax Reform Act of 1986).

[27] H .R. 1, 115th Cong. § 4004(a) (2017) (as passed by H.R., Nov. 16, 2017).

limited to the specified foreign corporations for which the cash position was determined on the final measurement date. If an SFC did not exist on the final date, it was outside the scope of the provision and the two earlier testing dates had no application. If an SFC existed on the final date but not on one or two of the earlier testing dates, the flush language made adjustments to avoid distortion of the average cash position. Notably, this language did not address an SFC that did not exist on the final measurement date but did exist on one of the earlier dates, because such an SFC was outside of the scope of the provision. The Proposed Rule is inconsistent with this history when it counts cash positions of entities that did not exist on November 2, 2017.

Nothing in the legislative history of the enacted statute suggests that the cash position of entities that did not exist on November 2, 2017 should be taken into account based on their cash position on any date. Importantly, the language of the first cash measurement date and second cash measurement date in the final version is precisely the same as the House bill (other than cross-references). It is this language in the House bill—with its references to "each such specified foreign corporation" tested on the final cash measurement date—that requires that entities tested on the earlier dates be the same entities tested on the final date.

One change from the House bill to the final version was to replace November 2, 2017 as the final cash measurement date with a date based upon the end of the specified corporation's taxable year. By defining this date by reference to the last year beginning before January 1, 2018, the statute intended to address tax years that include that date, not tax years of foreign corporations no longer in existence on November 2, 2017, the date the House bill was introduced. Similar language was used in the effective date of the repeal of Section 958(b)(4), which applies to "the last taxable year of foreign corporations beginning before January 1, 2018 . . . ." There is no suggestion that this effective date was intended to apply to foreign corporations liquidated before November 2, 2017. If retroactive treatment were intended, taxpayers would need to evaluate whether foreign corporations that were previously liquidated and had not been treated as controlled corporations due to Section 958(b)(4) would need to be treated as controlled corporations for the year of liquidation. The enacted statute contains no procedures for applying Section 958(b)(4) in such a retroactive manner, and there has been no suggestion that retroactive treatment was intended. The same logic applies to the substantively identical language in Section 965(c)(3)(A), in respect of which Congress expressed no intent for retroactive application. Moreover, as discussed above, a mere arguable ambiguity in the statute is not sufficient to support a retroactive reading. Section 965(c)(3)(A) can therefore apply only to straddle years that begin before January 1, 2018 and end on or after November 2, 2017.

Another change from the House bill was to replace the average of the cash position on the three measurement dates with a "greater of" formulation, such that the cash position would be the greater of that on the final measurement date and the average of the cash position on the two earlier dates. In both the House bill and the final version, the earlier cash measurement dates serve to mute the effect of changes in the cash position of an SFC over time. This is especially important in the enacted statute because the final cash measurement date is after November 2, 2017, the day the House bill was introduced. The substitution of the "greater of" approach for the three-year averaging approach protects against tax planning to reduce cash between November 2, 2017 and the relevant close of the taxable year of the SFC. This is the same reason identified by Congress for including two measurement dates for

determining the post-1986 deferred foreign income required to be taken into income by a United States shareholder.[28] In the case of an SFC that has a taxable year ending on November 30, a common circumstance, the United States shareholder has until November 30, 2018 to manage the final cash position, more than a year after the introduction of the House bill. By comparing inclusion year cash to prior years' cash, an SFC would not be able to reduce its post-November 2, 2017 cash position below a certain threshold (the prior years' measurements). In the case of an SFC that is a deferred foreign income corporation and that has a November 30 taxable year-end, the relevant date under Section 965(c)(3)(A)(i) is November 30, 2018, and the dates under Section 965(c)(3)(A)(ii) are the taxable year ending on November 30, 2016 (i.e., the close of the last taxable year of the SFC which ends before November 2, 2017) and on November 30, 2015 (i.e., the close of the preceding taxable year).[29] This construct therefore requires that an SFC's attributes be measured under both tests. The text of the look-back rule is consistent with this policy: it limits the universe of entities being tested to those tested in the inclusion year.

While satisfying the goal of providing a mechanism that curtails the ability of a taxpayer to reduce its cash position below an appropriate value, the Proposed Rule's overly expansive approach in this regard is inconsistent with the other purposes of Section 965. The House Ways and Means Committee Report, which contains the only discussion in the legislative history of the reason for taxing E&P held in the form of cash at a higher rate, is clear that the purpose underlying the cash measurement is to tax foreign earnings attributable to un-repatriated cash at a rate higher than such earnings attributable to less liquid assets, and the enacted statute uses precisely the same language as the House bill with respect to the relevant provisions. In its "Reasons for Change" discussion on Section 965, the House Committee report stated: "The Committee believes that many domestic companies were reluctant to reinvest foreign earnings in the United States, when doing so would subject those earnings to high rates of corporate income tax rates. Accordingly, the Committee is aware that such companies have accumulated significant untaxed and undistributed foreign earnings as a result."[30] The Committee also stated that it "believes that the tax rate should take into account the liquidity of the accumulated earnings."[31] This language contemplates a determination of the liquidity of the accumulated earnings that are being taxed under Section 965, not the liquidity of non-existing SFCs the earnings of which are not being taxed under Section 965.

Unlike the proposed House rule and the enacted statute, the Proposed Rule, by providing that cash of entities that are no longer in existence on November 2, 2017 is to be

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[28] *See* 83 Fed. Reg. at 39,514 at 39,528 ("The choice of a November 2, 2017, measurement date reflects an intent to impose a transition tax on a snapshot of earnings as of a date that coincides with the introduction of the Act in Congress, and reflects a general policy of disregarding taxpayer actions occurring after November 2, 2017, that reduce the taxpayer's liability imposed by reason of section 965, even if such future actions are otherwise respected under the Code.").

[29] The structure has the same effect and serves the same purpose in the case of SFCs with calendar year-ends, insofar as the taxpayer had notice of the rule on November 2, 2017 and could have taken measures between then and December 31, 2017. For those SFCs, the relevant date in Section 965(c)(3)(A)(i) is December 31, 2017, two months after the House of Representatives introduced the legislation, and thus the relevant dates in Section 965(c)(3)(A)(ii)(I) and (II) are December 31, 2016 and December 31, 2015, respectively.

[30] H.R. REP. NO. 115-409, at 375 (2017).

[31] Id.

included as part of the aggregate cash amount based on the average of the First Cash Measurement Date and Second Cash Measurement Date, transforms the look-back rule from a backstop into an operative rule and thereby creates a disconnect between entities that are taken into account for the purposes of E&P inclusion under Section 965 and those entities for which a cash position requires a portion of that E&P amount to be taxed at a higher rate. Turning the look-back rule into an operative rule leads to absurd results. This is most obviously demonstrated by the situation in which a first-tier CFC is liquidated into its United States shareholder prior to November 2, 2017. Under the Proposed Rule, any cash held by that CFC serves to increase the United States' shareholder's tax liability on E&P from different SFCs notwithstanding that the cash was already transferred to the United States shareholder and the United States shareholder will have paid tax (at a 35% rate) on the liquidated CFC's E&P.

IV. Conclusion

For the foregoing reasons, we believe that the Proposed Rule is an impermissible implementation of Section 965. To be consistent with the statute, the Proposed Regulations must be modified such that they take into account cash positions of an SFC only if the SFC was in existence on one of the E&P measurement dates.

Respectfully submitted,

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Exhibit B

Letter dated November 2, 2018

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London
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Madrid
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November 2, 2018

Lafayette "Chip" G. Harter III
Deputy Assistant Secretary (International Tax Affairs)
Office of the International Tax Counsel
Department of the Treasury
1500 Pennsylvania Avenue, NW, Room 3058
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Re: October 31, 2018 meeting and proposals to address the issues discussed therein and in our September 21 letter

Dear Mr. Harter:

We are writing to thank you for meeting with us on Wednesday to discuss the regulations recently proposed under Section 965 as amended by Congress in P.L. 115-97, which were published in the Federal Register on August 9, 2018, at 83 Fed. Reg. 39,514 (the "**Proposed Regulations**").

To follow up on the discussions in our meeting, we are attaching on behalf of a client a proposal that seeks to provide relief for taxpayers from the approach adopted by the Proposed Regulations in a narrowly tailored fashion to address the circumstances where a foreign corporation was repatriated into a domestic corporation prior to November 2, 2017 in a transaction governed by Section 381.

We look forward to discussing further these proposals with you.

Respectfully submitted,

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Section 965 Regulations:
DPW Proposal to Limit Scope of Foreign Cash Rule

§ 1.965-1(f)

(45) *Specified foreign corporation*—

(i) *General rule*. Except as provided in ~~paragraph~~paragraphs (f)(45)(iii) or (f)(45)(iv) of this section, the term *specified foreign corporation* means—

(A) A controlled foreign corporation, or

(B) A foreign corporation of which one or more domestic corporations is a United States shareholder.

(ii) *Special attribution rule*. Solely for purposes of determining whether a foreign corporation is a specified foreign corporation within the meaning of section 965(e)(1)(B) and paragraph (f)(45)(i)(B) of this section, stock owned, directly or indirectly, by or for a partner (*tested partner*) will not be considered as being owned by a partnership under sections 958(b) and 318(a)(3)(A) and § 1.958-2(d)(1)(i) if the tested partner owns less than five percent of the interests in the partnership's capital and profits. For purposes of the preceding sentence, an interest in the partnership owned by another partner will be considered as being owned by the tested partner under the principles of sections 958(b) and 318, as modified by this paragraph (f)(45)(ii), as if the interest in the partnership were stock.

(iii) *Passive foreign investment companies*. A foreign corporation that is a passive foreign investment company (as defined in section 1297) with respect to a United States shareholder and that is not a controlled foreign corporation is not a specified foreign corporation with respect to the United States shareholder.

(iv) *Certain repatriated foreign corporations*. For purposes of determining the aggregate foreign cash position of a section 958(a) U.S. shareholder under paragraph (f)(8) of this section and the consolidated group aggregate foreign cash position (as defined in § 1.965-8(f)(4)) of the consolidated group of which such section 958(a) U.S. shareholder is a member, a foreign corporation the assets of which were, prior to November 2, 2017, acquired by such section 958(a) U.S. shareholder in a transaction described in § 1.367(b)-3(a) is not a specified foreign corporation.