



722 12<sup>th</sup> Street, N.W.

Fourth Floor

Washington, D.C.

20005

T: (202)785-0266

F: (202)785-0261

[www.atr.org](http://www.atr.org)

July 6, 2016

Re: REG-108060-15: Treatment of Certain Interests in Corporations as Stock or Indebtedness (IRC sec. 385)

Dear Sir or Madam:

**I write to express strong opposition to the “Debt-Equity” regulations proposed under section 385 of the tax code.** The proposed regulations give unelected bureaucrats power over internal business decisions through the authority to collect detailed, sensitive tax information in order to unilaterally reclassify debt as equity.

Debt and equity have been treated differently under the tax code for decades and businesses have structured themselves based on these rules. Altering these rules without adequate expert input as this administration proposes will immediately impact a wide range of common, internal business transactions such as the ability to redistribute cash among subsidiaries to make new investments.

In turn, this will result in extensive compliance and regulatory burdens affecting businesses across all industries. These regulations may result in less money invested in the U.S. economy, slow our already stagnant economic growth, and further encumber job growth. Additionally, the information disclosure requirements created to enforce this rule empower the already dysfunctional IRS to collect an excessive level of new information.

#### **Does Not Address Business Inversions**

When this regulation was unveiled, Treasury stated it was to “reduce the benefits of and limit the number of corporate tax inversions, including by addressing earnings stripping.”<sup>1</sup> This is clearly not the case as the regulations affect businesses regardless of whether they are inverting.

If the goal is stopping inversions, then the appropriate solution is passing tax reform that removes the need to invert altogether. This fact has been acknowledged both by Congress<sup>2</sup> and this administration.<sup>3</sup>

American businesses are laboring under a tax code that is one of the world’s most complex and burdensome. They face the highest marginal tax rates in the developed world and are struggling to compete against foreign competitors. Our competitors

---

<sup>1</sup> U.S. Department of Treasury, Press Center. (2016, April 04). Treasury Announces Additional Action to Curb Inversions, Address Earnings Stripping [Press release]. Retrieved July 5, 2016, from <https://www.treasury.gov/press-center/press-releases/Pages/jl0405.aspx>

<sup>2</sup> U.S. House of Representatives, Committee on Ways and Means. (2015, November 19). Chairman Brady Calls for Tax Reform to Tackle Inversions [Press release]. Retrieved July 5, 2016, from <http://waysandmeans.house.gov/chairman-brady-calls-for-tax-reform-to-tackle-inversions/>

<sup>3</sup> U.S. Department of the Treasury. (2016, February 11, 2016) (testimony of Jacob J. Lew before the Committee on Ways and Means), from <http://waysandmeans.house.gov/wp-content/uploads/2016/02/20160211-Testimony-Lew.pdf>

understand the importance of tax competition, and in recent years have aggressively lowered their tax rates and implemented simpler, more pro-growth systems in a bid to steal American jobs and businesses.

Our failure to reform our code has meant there have been close to 50 inversions in the last decade.<sup>4</sup> This competitiveness deficit also explains why foreign competitors have acquired American businesses and assets in ever increasing numbers. According to a report by Ernst & Young, our inability to implement a competitive tax rate has resulted in a loss of \$769 billion through mergers and acquisitions over the past decade.<sup>5</sup>

Instead of reforming the code, section 385 regulations make it harder for our already disadvantaged businesses to compete. They may temporarily halt pending inversions as businesses figure out how to comply, but in the long-term will speed up the rate of inversions as America becomes an even more uncompetitive place to do business.

### **Reduces American Investment**

As they are so broad, the proposed regulations will force a complete rework of internal business strategies and operational models that could leave businesses in limbo for years as they adjust.

Businesses already spend close to \$150 billion and 3 billion hours complying with onerous income tax regulations,<sup>6</sup> and section 385 regulations will only increase these costs.

These regulations are also backdated to April 4, meaning that ongoing or pending transactions have – and will – be stalled by regulatory uncertainty because businesses have no way of knowing how these pending regulations may affect a transaction.

This regulation even applies to the overseas operations of U.S. businesses. Companies will have to comply with any regulations in the country they are operating in AND comply with the tax and administrative burdens resulting from 385 regulations. The proposed regulations may also reduce repatriation of funds, resulting in less income flowing back into the U.S. to be reinvested in new jobs and higher wages.

---

<sup>4</sup> Kyle Pomerleau (2014, August 04). Everything You Need to Know About Corporate Inversions [Web log post]. Retrieved July 5, 2016, from <http://taxfoundation.org/blog/everything-you-need-know-about-corporate-inversions>

<sup>5</sup> Buying and Selling: Cross-border mergers and acquisitions and the US corporate income tax (Rep.). (2015, March). Retrieved July 5, 2016, Ernst & Young: [http://businessroundtable.org/sites/default/files/reports/EY\\_BRT\\_Cross-border\\_MA\\_report\\_2015\\_03\\_10.pdf](http://businessroundtable.org/sites/default/files/reports/EY_BRT_Cross-border_MA_report_2015_03_10.pdf)

<sup>6</sup> Scott Hodge (2016, June 15). The Compliance Costs of IRS Regulations [Web log post]. Retrieved July 5, 2016, from <http://taxfoundation.org/article/compliance-costs-irs-regulations>

### **Extensive Data Disclosure Requirements**

In order to comply with these regulations, businesses will be forced to provide the IRS with an extensive list of information to justify routine transactions. This includes documentation proving that there is a “binding obligation to pay,” documentation proving that creditor rights are enforced, documentation of reasonable repayment, and documentation proving a genuine debtor-creditor relationship – all for transactions between two subsidiaries of the same business.

After they provide this documentation, businesses will then be required to continuously provide information on transactions to ensure they meet government-defined parameters.

These excessive requirements are not proportional to the value of a transaction with the same level of documentation requirements existing for every transaction regardless of size and complexity. Complying with these regulations could increase compliance costs by \$50,000 per transaction, according to one estimate.

Not only are they excessive, the regulations empower the IRS at a time when the agency has proven unable or unwilling to perform basic duties.

Under this administration, the IRS has a history of using its authority to discriminate against taxpayers based on educational, political, or religious views.<sup>7</sup> Watchdog reports have also raised concerns that the IRS has repeatedly failed to safeguard taxpayer data that the agency does not have the competency to collect and safeguard taxpayer information.<sup>8</sup>

Given these well documented failures, the IRS should not be given more responsibilities, especially to enforce unnecessary data disclosure requirements forcing businesses to provide detailed information over internal practices.

### **Will Impact Entire U.S. Economy**

While these regulations directly impact businesses organized as corporations, they will also negatively impact the U.S. economy as a whole. It must be remembered that large American businesses are not competing with businesses on Main Street – they are competing with businesses in Europe, Asia, and the rest of the world. The success of small businesses and workers are tied to the success of corporations and vice versa.

The 2,243 U.S. parent companies that will be directly affected by section 385 regulations are responsible for 76.7 million direct and indirect American jobs, according to the Bureau of Economic Analysis. These companies, and their 26,919

---

<sup>7</sup> IRS RETURN SELECTION: Certain Internal Controls for Audits in the Small Business and Self-Employed Division Should Be Strengthened (Rep. No. GAO-16-103). (2015, December 16). Retrieved July 5, 2016, from U.S. Government Accountability Office website: <http://www.gao.gov/products/GAO-16-103>

<sup>8</sup> INFORMATION SECURITY: IRS Needs to Further Improve Controls over Financial and Taxpayer Data (Rep. No. GAO-16-398). (2016, March). Retrieved July 5, 2016, from U.S. Government Accountability Office website: <http://www.gao.gov/assets/680/676097.pdf>

subsidiaries are responsible for exporting \$788 billion worth of American goods each year.<sup>9</sup>

Any changes to the tax code should be made with the goals of reducing government interference and tax complexity toward the ultimate goal of taxing income once – at the point of consumption. This regulation goes in the opposite direction by drastically increasing the complexity of the code, increasing compliance costs, and granting the government authority to reclassify tax treatment of transactions.

### **Conclusion**

As written, section 385 regulations are an indiscriminate weapon that the federal government can use to restrict and undermine the legitimate business transactions of American companies operating at home and abroad, and foreign companies operating in the U.S.

**Implementing these regulations as a way to halt business inversions is misguided and destructive.** Business inversions are only one symptom of the underlying problem – the complex and overly burdensome tax code that leaves American businesses struggling to compete with the rest of the world.

**These regulations will only make the American competitiveness problem worse.**

They are unnecessary, will make it harder for our businesses to compete with foreign competitors, will reduce investment in the U.S., and will open the door for the IRS to further abuse its powers.

Onward,



Grover G. Norquist  
President, Americans for Tax Reform

---

<sup>9</sup>BRT Letter to the Office of Management and Budget on Debt/Equity Regulations [Letter written June 07, 2016 to Department of Treasury]. (2016, June 08). In Business Roundtable. Retrieved July 5, 2016, from <http://businessroundtable.org/resources/brt-letter-the-office-management-and-budget-debtequity-regulations>