NEW YORK STATE BAR ASSOCIATION
One Elk Street, Albany, New York 12207 PH 518.463.3200 www.nysba.org

November 30, 2016

The Honorable Mark Mazur
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable John Koskinen
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

The Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: *Report No. 1360 on Notice 2016-52, on Splitter Arrangements from Foreign-Initiated Tax Adjustments*

Dear Messrs. Mazur, Koskinen and Wilkins:

I am pleased to submit the attached report of the Tax Section commenting on Notice 2016-52, which identifies a new foreign tax credit splitter arrangement under Section 909 of the Internal Revenue Code, applicable to specified long-delayed foreign-initiated tax adjustments to foreign subsidiaries of U.S.-parented groups. The Notice mentions that a target of this new splitter arrangement would be long-delayed foreign-initiated tax adjustments such as those arising under the European Union ("EU") State Aid Law, proposing foreign tax adjustments to various U.S. multi-nationals.

Under the Notice, a new "foreign initiated adjustment splitter arrangement" (a "Section 905(c) Splitter") would exist where foreign initiated adjustments reflected as per Section 905(c) in the taxable year for

which the tax is actually paid, will be treated as a splitter arrangement subject to the Section 909 mechanics. Broadly, the effect of the new splitter arrangement would be to defer any foreign tax credit to the U.S. multi-national for those foreign initiated adjustments until the related income that gave rise to the adjustment is also reflected in the U.S. income of the U.S.-parented group.

In the Tax Section's past reports on Section 909 splitters, we stated that creditable foreign taxes actually paid by foreign subsidiaries of a U.S.-parented group can be permanently disallowed under some transactional patterns and other situations where the U.S. group is unable to substantiate the required tracing of earnings. The Tax Section suggests that the future regulations embodying the new Section 905(c) Splitter might operate more effectively by using Section 905(c) authority to avoid the splitting of foreign taxes from the related income.

Specifically, we make the following recommendations for the regulations contemplated by the Notice:

1. Treasury and the IRS should consider issuing regulations under section 905(c) to address long-delayed foreign-initiated adjustments in a manner that avoids the separation of foreign income from foreign income taxes. For transactions that under the Notice would be Covered Transaction Splitter Arrangements, the Treasury and the IRS should consider an approach where the additional foreign income taxes are to be reflected in the foreign income tax pool of the person that would have been the payor in the relation-back year, and that appropriate adjustments are made if deemed payments between this person and the actual payor have to be reflected. Similarly, for distributions that under the notice would be Covered Distribution Splitter Arrangements, the Treasury and the IRS should consider making simultaneous adjustments to the foreign tax pools of the distributor and distributee (and any intermediate distributees) together with appropriate adjustments to the amounts distributed.

If the Treasury and the IRS conclude that Section 905(c) Splitter Arrangements remain necessary for the proper administration of the foreign tax credit regime because they believe that certain transactions cannot be appropriately addressed through adjustments under section 905(c) as proposed above, we further recommend the following with respect to Section 905(c) Splitter Arrangements:

2. The examples in sections 3.01 and 3.02 of the Notice do not appear to present an abusive separation of foreign income taxes from related foreign income. Rather, only cross-chain transfers (of the lower-tier technical taxpayer after a distribution of its earnings or a disregarded entity or hybrid partnership interest) or repatriations to a section 902 shareholder would allow for the separate repatriation of the foreign tax pool without also repatriating the related foreign earnings. Future examples should clarify this.

3. The Treasury and the IRS should consider using a lower, annual threshold in lieu of the $10 million threshold for adjustments, or series of related adjustments, in order to avoid the need to determine whether several adjustments over a period of years (or in relation to the same year) by the same or different taxing authorities are parts of a series of related adjustments.

4. The principal purpose requirement should not be regarded as satisfied if the taxpayer shows its absence by a preponderance of evidence, not by the higher standard of clear and convincing evidence. We are concerned that, in practice, a principal purpose presumption would operate as an irrebuttable presumption under a clear-and-convincing-evidence threshold of proof because the threshold for rebuttal would be too high for proving a negative. We believe that taxpayers should be allowed to introduce evidence under general preponderance-of-evidence criteria. We also think certain safe harbors would be justified.

We appreciate your consideration of our recommendations. If you have any questions or comments regarding this report, please feel free to contact us and we will be glad to discuss or assist in any way.

Respectfully submitted,

Stephen B. Land
Chair

cc: Emily S. McMahon
Deputy Assistant Secretary (Tax Policy)
Department of the Treasury

Robert B. Stack
Deputy Assistant Secretary (International Tax Affairs)
Department of the Treasury

Thomas C. West, Jr.
Tax Legislative Counsel
Department of the Treasury

Danielle E. Rolfes
International Tax Counsel
Department of the Treasury

William M. Paul
Deputy Chief Counsel (Technical)
Internal Revenue Service

Marjorie A. Rollinson
Associate Chief Counsel (International)
Internal Revenue Service

Jeffrey L. Parry
Attorney-Advisor, Branch 3 (International)
Internal Revenue Service