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October 12, 2010

The Honorable Michael Mundaca
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Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable Douglas H. Shulman
Commissioner
Internal Revenue Service
111 Constitution Avenue, NW
Washington, DC 20224

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1111 Constitution Avenue, NW
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Re: Report on Section 367(d)

Dear Sirs,

The Tax Section of the New York State Bar Association hereby submits a report concerning Section 367(d) of the Internal Revenue Code of 1986, as amended. Section 367(d) requires inclusion of deemed royalties following the outbound transfer of certain intangible assets otherwise qualifying for non-recognition.

In the 26 years since Section 367(d) was enacted in its current form, the internationalization of the business of American multi-nationals and the development of business model restructurings has increased the number and complexity of transactions subject to the application of Section 367(d). We commend the initiative of the Department of Treasury and the Internal Revenue Service to revisit the 24-year old temporary regulations, to address certain ambiguities and issues which have been encountered in practice.

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The report sets forth a number of recommendations that could add clarity to the regulations and balance the interests of taxpayers with the revenue concerns of the Service. Among these are the following:

1. We recommend that the consistency and coordination between the provisions of Section 367(d) and the companion provisions of Section 482 be made more explicit. Greater parity and consistency in application of these provisions would make both provisions clearer for compliance by taxpayers and more easily administered by the Service.

2. We recommend that the definition of Section 936(h)(3)(B) intangibles, to which both Section 367(d) and 482's commensurate with income provision relate, be preserved. That is, we believe that the legislative history expresses the clear intention that goodwill and going concern value used in connection with a foreign trade or business should be eligible for non-recognition and that 367(d) should be administered to honor that intention unless and until superseding legislation has been enacted.

3. We recommend that the lump sum election of the temporary regulations (Regulation Section 1.367(d)-1T(g)(2) applicable to operating intangibles and to certain transfers to foreign joint ventures) be expanded to include all transfers to non-controlled corporations as well as to a broader group of joint ventures with an unrelated party. In the situations where the U.S. transferee does not control directly or indirectly the foreign transferor corporation, we believe that the arm's-length negotiation of the parties protects the correctness of the transfer price. Moreover, the deemed royalty provisions of 367(d) in such contexts generally are not consistent with the economic returns to the U.S. transferor.

4. Several valuation issues have arisen in the current administration of Section 367(d), two of which we believe could be addressed: aggregate valuation and valuation of foreign goodwill. In connection with aggregate valuation, because synergistic assets may have greater value in combination with each other than would be attributed to the isolated individual components, valuation methodologies should properly capture that aggregate value for purposes of administering Section 367(d). However, such aggregate valuations should not frustrate the requirement that a 936 intangible must have substantial value independent of services. In addition, aggregate values should not be utilized to subsume values more properly attributed to foreign goodwill and going concern value.

   We also note that methodologies for differentiating foreign goodwill from domestic goodwill would benefit from greater articulation. In this regard, the report suggests that segregation of foreign goodwill either by apportionment based on gross revenues (as is used for interest allocation purposes) or by a three factor formulas (e.g., salaries, property and sales) should be considered as a default rule.

5. The report also recommends that certain coordination with the cost sharing rules of Regulation §1.482-7T be clarified. Specifically, because cost sharing arrangements are prevented from utilizing stock and since Section 367(d) is made inapplicable to cost sharing, we believe the new Section 367(d) regulations could expressly state that transfers

subject to Section 367(d) are governed by its provisions alone. Following such a transfer, goodwill or intangible values, taxed or untaxed, as the case may be, may be utilized by a foreign corporation as a platform contribution in a qualified cost sharing arrangement.

6. In the case of partnerships, the report concludes that the regulatory authority granted under Section 367(d)(3) to apply similar rules to the transfers of Section 936 intangibles to partnerships does not require that the regulations override the normal non-recognition provisions provided by Section 721. However, to prevent taxpayers from manipulating the normal operation of Section 704(c) by exploiting limitations under the "ceiling-rule," it may be useful to consider making the remedial allocation method mandatory for such partnerships.

The Tax Section believes that the preservation of U.S. taxing jurisdiction in respect of U.S. created intangible assets is an area of increasing importance and one deserving clarity in a manner consistent with the legislative intent of Congress. We commend Treasury and the Service on the initiative to bring the regulations interpreting Section 367(d) current. We would be pleased to discuss with appropriate personnel the issues address in this report if that would be helpful.

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Peter H. Blessing
Chair

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