Silicon Valley
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VIA ELECTRONIC TRANSMISSION

Secretary Steven T. Mnuchin
U.S. Department of the Treasury
1500 Pennsylvania Avenue NW
Washington, DC 20220

Dear Secretary Mnuchin,

The Silicon Valley Tax Directors Group ("***SVTDG***") hereby submits these comments in response to Executive Order 13789. SVTDG members are listed in the Appendix of this letter.

The SVTDG would be happy to meet with you to discuss these guidance projects in more detail. Please contact me at 408-527-9087, or Michael Bernard at 425-706-6339, if you would like to discuss these items further.

Sincerely,

Robert F. Johnson

Robert F. Johnson
Co-Chair, Silicon Valley Tax Directors Group

CC: Justin G. Muzinich, Counselor to the Secretary

Brian Callanan, Acting General Counsel

Thomas West, Acting Assistant Secretary, Tax Policy

I. INTRODUCTION AND SUMMARY

a. Background on the Silicon Valley Tax Directors Group

The SVTDG represents U.S. high technology companies with a significant presence in Silicon Valley, that are dependent on R&D and worldwide sales to remain competitive. The SVTDG promotes sound, long-term tax policies that allow the U.S. high tech industry to continue to be innovative and successful in the global marketplace.

b. Executive Order 13789

On April 21, 2017, President Trump signed Executive Order 13789, Identifying and Reducing Tax Regulatory Burdens. The Executive Order identifies policy goals for the Federal tax system, including that "[t]he Federal tax system should be simple, fair, efficient, and pro-growth. The purposes of tax regulations should be to bring clarity to the already complex Internal Revenue Code (title 26, United States Code) and to provide useful guidance to taxpayers."[1]

To further these policy goals, the Executive Order instructs Secretary Mnuchin to review all significant tax regulations issued on or after January 1, 2016, and to work with the OIRA Administrator to send an interim report to the President within 60 days identifying any such regulations that (1) impose an undue financial burden on US taxpayers, (2) add undue complexity to federal tax laws, or (3) exceed the IRS's statutory authority. Within 150 days of the Executive Order, Treasury is required to submit another report to the President recommending specific actions to mitigate the burdens identified in the interim report. Treasury shall take "appropriate steps" to delay or suspend effective dates of regulations, to the extent permitted by law, or modify or rescind such regulations (including through notice-and-comment rulemaking).

c. Summary of Recommendations

The SVTDG supports the tax policy goals identified in the Executive Order. In addition, the SVTDG has identified several guidance projects that it believes are significant regulations and meet one or more criteria set forth in the Executive Order.

A more detailed explanation of the SVTDG's recommendations is set forth below.

II. SPECIFIC RECOMMENDATIONS

a. Section 385 Final and Temporary Regulations

On October 13, 2016, Treasury and IRS released final and temporary regulations under section 385, which impose burdensome documentation requirements on related-party debt and recharacterize as equity certain related-party transactions that would otherwise be treated as loans.[2]

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[1] EO 13789, Section 1.

[2] T.D. 9790.

The SVTDG appreciates that Treasury responded to some of its comments on the proposed section 385 regulations, but many of SVTDG's recommendations, and those of other commenters, were not accepted. SVTDG believes that the final regulations continue to pose challenges to taxpayers and exceed Treasury's statutory authority, and recommends that the final regulations be withdrawn.

The SVTDG believes that Treasury and the IRS exceeded their statutory authority in the section 385 regulations by automatically recharacterizing certain related-party transactions as equity. Treasury and the IRS's policy concerns are more appropriately addressed through legislative changes to section 163(j), not by issuing regulations under section 385.

At a minimum, the documentation requirements (which are effective for loans entered into on or after January 1, 2018) should be withdrawn while Treasury makes additional modifications to those requirements to lessen the burdens imposed on taxpayers. Treasury should publicly announce any plans to modify the documentation requirements quickly, because taxpayers are currently developing processes and technological changes to implement the requirements. Taxpayers are required to ensure that all affected loans are documented regardless of the amount of debt (e.g., a $1 loan could be subject to documentation requirements that could cost in excess of $50,000). Compliance with the documentation rules is also extremely costly, as an affected US loan is subject to an ability-to-pay analysis that is not required for many third party loans. These implementation efforts are time-consuming and expensive, reducing taxpayers' ability to focus on core business functions.

b. Section 7602 Final Regulations

Treasury and IRS issued final regulations, effective July 14, 2016, under section 7602 which allow individuals that the IRS contracts with for outside services (including economists, engineers, consultants, and attorneys) to (1) receive books, papers, records, or other data summoned by the IRS, and (2) participate fully in IRS interviews in the presence of IRS officers or employees.[3] The regulations finalized highly controversial temporary regulations that were issued without notice and comment in June 2014 in an attempt to provide the IRS with the legal authority to enter into a $2.2 million contract with a law firm to participate in the income tax audit of a taxpayer, including conducting witness interviews under oath. Comments submitted on the temporary regulations argued that Treasury and the IRS did not have the statutory authority to issue the regulations, and stated that questioning witnesses under oath is an inherently governmental function that cannot be delegated to outside contractors.

The SVTDG believes that the Section 7602 final regulations should be withdrawn and that no further guidance should be issued on this subject. The SVTDG agrees with concerns expressed in the comments submitted on the temporary regulations and shares the concerns expressed by Senator Hatch in his May 13, 2015 letter to Commissioner Koskinen that the section 7602 regulations "appear[] to violate federal law and the express will of Congress." In addition, taxpayers have challenged—and are likely to continue to challenge—the validity of the section 7602 regulations when the IRS hires outside law firms to participate in tax audits. Even if

3 T.D. 9778.

Treasury and the IRS had the statutory authority to issue the section 7602 regulations, hiring an outside law firm to participate and take testimony in an exam to ascertain the correctness of a tax return—in lieu of using attorneys in the IRS Office of Chief Counsel or the Department of Justice, Tax Section—is a gross waste of the government's resources.

c. Section 987 Final and Temporary Regulations

On December 8, 2016, Treasury and the IRS issued final and temporary regulations for translating foreign currency gains and losses under section 987.[4] Section 987 was added to the Internal Revenue Code in 1986 and, over the past thirty years, taxpayers developed different approaches to comply with section 987's requirements because Treasury and the IRS have not issued definitive guidance. Some taxpayers relied on the approach described in proposed regulations that Treasury and IRS released in 2006, while others did not. The regulations that were finalized in 2017, which purport to finalize the 2006 proposed regulations, take a drastically different—and much more burdensome—approach than the approach taken in 2006.

The SVTDG believes that the section 987 final and temporary regulations should be withdrawn because they impose an undue burden on US taxpayers. Taxpayers are currently attempting to implement the final regulations. This has proven challenging for a number of reasons, including that the calculations required by the final regulations do not conform with US GAAP. Moreover, the final and temporary regulations may result in the unfair and unexpected inability to use certain foreign currency losses that would have been available to taxpayers in the absence of the final and temporary regulations.

If the Trump Administration wishes to repropose regulations under section 987, the SVTDG agrees with the United States Council for International Business's recommendation that Treasury should carefully consider section 987's statutory authority and legislative history, the practices that taxpayers have developed over the past 30 years in the absence of guidance from Treasury and the IRS, and the compliance costs imposed on taxpayers and the audit costs imposed on the IRS relative to the potential tax liability. As with any proposed regulations, Treasury and the IRS should carefully consider and take into account any comments provided by taxpayers.

d. Section 901(m) Temporary and Proposed Regulations

On December 7, 2016, Treasury and the IRS issued temporary and proposed regulations under section 901(m), which were immediately effective.[5] Section 901(m) denies foreign tax credits with respect to foreign income that is attributable to a Covered Asset Acquisition (CAA). Among other things, the regulations designate additional transactions as CAAs and provide rules with respect to calculating foreign tax credits.

The SVTDG recommends that Treasury withdraw the temporary regulations and reopen the comment period on the proposed regulations to allow additional comments to be submitted and considered by the Trump Administration. Any further guidance issued under section 901(m)

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4 T.D. 9794 and T.D. 9795.

5 T.D. 9800 and 81 Fed. Reg. 88563 (Dec. 7, 2016).

should be prospective only. In addition, the SVTDG recommends that Treasury and the IRS (1) consider adding a related-party exception and (2) withdraw Prop. Reg. § 1.901(m)-2(b)(6), which the SVTDG believes extends section 901(m) to transactions that do not raise the policy concerns addressed by section 901(m).

e. Section 367 Final Regulations

The SVTDG submitted comments to Treasury and the IRS's proposed regulations under section 367, which were largely ignored. The December 2016 final regulations would effectively require US taxpayers to recognize gain on the transfer of foreign goodwill and going concern to foreign corporations.[6] The final regulations retained a retroactive effective date tied to the date of the proposed regulations.

Despite comments from numerous stakeholders, the proposed regulations were finalized with minimal changes. Consistent with our comments, it is the SVTDG's view that Treasury and the IRS lacked statutory authority to issue the final regulations[7] and the regulations impose an undue financial burden on taxpayers because they will be required to pay tax on transactions otherwise not subject to US tax. For these reasons, Treasury and the IRS should withdraw the final regulations and reinstate the prior regulations.

f. Section 482 Temporary Regulations on Aggregation of Transactions

Treasury and the IRS published temporary and final regulations under section 482 at the same time it published the proposed section 367 regulations. The SVTDG submitted comments on these regulations as well. The section 482 regulations contain sweeping changes that modify the arm's length standard through: (1) a vague and unworkable "all value provided" test for pricing related part transactions; and (2) an aggregation or synergies rule for "economically interrelated" transactions.

Consistent with our comments, the SVTDG believes that the section 482 regulations are inconsistent with the arm's length standard, and Treasury and the IRS lack authority to make such changes. Similar to the section 367 regulations, Treasury annually proposed statutory changes to section 482 because it realized it needed a legislative change to reach an outcome in the temporary and final section 482 regulations.[8] The positions taken in these regulations are in conflict with case law, including *Xilinx, Inc. v. Commissioner*,[9] *VERITAS Software Corp. and*

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[6] T.D. 9803.

[7] Treasury recognized it lacked regulatory authority because it included legislative proposals to amend section 367(d) to achieve the result in the proposed and final section 367 regulations. See, e.g., *Department of the Treasury, General Explanations of the Administration's Fiscal Year 2014,* p. 51.

[8] *See Department of the Treasury, General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals* ("2010 Greenbook"), p. 32. The same or similar language is included in the *2011, 2012, 2013, 2014, 2015,* and *2016 Greenbooks*.

[9] 125 T.C. 37 (2005), *aff'd* 598 F.3d 1191 (9th Cir. 2010).

Subs. v. Commissioner,[10] and *Altera Corp. v. Commissioner*.[11] The temporary and final regulations will increase significant costs because taxpayers will be forced to either comply with or challenge an invalid regulation. As described in the SVTDG comments, these regulations add significant complexity because they are vague and lack guidance.

While these section 482 regulations were published prior to January 1, 2016, they are an integral part of the section 367 regulations that were finalized in December 2016. Treasury should consider these section 482 regulations as part of its review of the section 367 regulations, and, because the regulations exceed statutory authority, impose an undue financial burden on taxpayers, and add incredible complexity to the Code, Treasury should withdraw these section 482 regulations.

g. Section 199 Proposed Regulations

The SVTDG submitted comments on Treasury and the IRS's 2015 proposed regulations under section 199, which have not been finalized. Consistent with our previous comment letter, the SVTDG recommends that Treasury and the IRS withdraw the rule in the proposed regulations that the party actually performing a manufacturing, production, growth, or extraction activity is always treated as performing the activity. Instead, the current rules—which provide that the party with the benefits and burdens of ownership of the qualifying production property during manufacturing is treated as engaging in the manufacturing—should be retained.

In addition, we recommend that proposed regulations under § 199 be issued regarding online, or hosted, software. Much of the software developed currently by technology companies in the United States is provided to customers online for their direct use and access. Although disk/download delivery modes of software can clearly qualify for the § 199 deduction, the IRS regularly denies the deduction to companies if they host their software online. This is despite the fact that the software was developed in the United States, consistent with the primary purpose of § 199 to encourage job creation in the United States. We recommend such new proposed regulations provide that a qualifying disposition of software include (in addition to historic means, such as via disk or download) the online access and use of such software by unrelated customers. This will ensure that software developed in the United States can qualify for the § 199 deduction without regard to whether such software is accessed via disk, download, or online.

h. Notices 2016-73 and 2012-39

Although EO 13789 only refers to regulations, the SVTDG believes that Treasury should also take this opportunity to review other forms of guidance under the Executive Order. In particular, Treasury has developed a practice over the past several years of issuing notices describing transactions of which Treasury disapproves and promising future proposed regulations that will address these transactions. These notices are troubling for many reasons, not the least of which is that they have immediate effective dates and do not comply with the notice and comment

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[10] 133 T.C. 297 (2005).

[11] 145 T.C. 91 (2015).

requirements in the Administrative Procedure Act. Moreover, in many cases, Treasury and the IRS fail to issue the proposed regulations described in the notice—no doubt because the notices achieved the *in terrorem* effect that Treasury desired.

Notices 2016-73 and 2012-39 are particularly emblematic of these concerns. Notice 2016-73 announced that regulations will be issued under section 367 modifying the rules relating to cross-border triangular reorganizations and inbound non-recognition transactions and would effectively disallow certain transactions as of December 2, 2016. Notice 2012-39 announced that regulations would be issued under section 367(d) that would require certain items received by a US transferor in an outbound reorganization to be included in income and would apply to transfers of intangible property occurring on or after July 13, 2012. Proposed regulations have not been issued under either Notice, and Notice 2012-39, in particular, has been criticized by commenters as vague and confusing.

The SVTDG believes that both Notices should be withdrawn. If Treasury is interested in reissuing such guidance, it should be done in the form of proposed regulations with a prospective effective date to provide taxpayers with an opportunity to provide comments. In developing any such proposed regulations, Treasury and the IRS should take into account any comments received on the Notices. Moreover, Treasury and the IRS should reconsider the practice of issuing notices with immediate effective dates in lieu of issuing proposed regulations with prospective effective dates.

i. The 2016 U.S. Model Tax Treaty

Similar to our discussion of subregulatory guidance, Treasury should review the U.S. Model Tax Treaty published on February 17, 2016 (the 2016 Model) without an accompanying technical explanation. The 2016 Model includes several significant changes to the 2006 Model that are complicated and burdensome, which would ultimately deny legitimate treaty benefits to multinational enterprises that are not treaty shopping. Some of the most controversial changes include provisions on special regimes, subsequent changes in law, and the limitation on benefits. Several parts of the limitation-on-benefits (LOB) article are also complicated and burdensome, including the new base erosion test, the public subsidiary test, the new derivative benefits test, the new headquarters company test, and the severely limited active trade or business test.

For example, the subsequent-changes-in-law provision would partially terminate a tax treaty where a treaty jurisdiction substantially reduces its tax rate. This provision, if in effect, could affect a tax treaty if the U.S. implemented a patent box that substantially reduced the income tax rate on royalty income from intellectual property held in the U.S.

It is our understanding that the 2016 Model is currently the basis for treaty negotiations with Ireland and the Netherlands. Given the above concerns and the lack of a technical explanation, the SVTDG recommends that Treasury cease using the 2016 Model in its negotiations. Moreover, the Trump Administration should consider the voluminous comments (e.g., those filed by USCIB, the American Bar Association Tax Section, and the Organization for International Investment) and decide whether the 2016 Model Tax Treaty reflects its priorities. The SVTDG recommends that Treasury should pull the changes to the LOB article in the 2016 Model, as well as the other changes, and then Treasury should then reissue the Model Tax Treaty, taking into account concerns raised by stakeholders, and publish a technical explanation so that potential treaty partners and taxpayers understand how the changes will operate.

III. CONCLUSION

The SVTDG recommends that Treasury and the IRS review the above described regulations, notices, and the 2016 Model, and withdraw and modify the guidance as recommended. These guidance items and the 2016 Model satisfy the criteria described in Executive Order 13789. Until Treasury and the IRS withdraw and revise such guidance, the SVTDG recommends Treasury delay the effective dates. Otherwise, taxpayers will face significant uncertainty and may be forced to comply with regulations that are withdrawn later this year or early next year. Treasury should also not use the 2016 Model in negotiating treaties.

Appendix—SVTDG Membership

Accenture
Activision Blizzard
Acxiom
Adobe
Agilent
Amazon
Apple
Applied Materials
Atlassian
Autodesk
Bio-Rad Laboratories
BMC Software
Broadcom Limited
Brocade
Cadence
Chegg, Inc.
Cisco Systems Inc.
Coherus BioSciences, Inc.
Dell Inc.
Delphi
Dolby Laboratories, Inc.
Dropbox Inc.
Electronic Arts
Expedia, Inc.
Facebook
Fitbit, Inc.
Flex
Fortinet
GE Digital
Genentech
Genesys
Genomic Health
Gigamon
Gilead Sciences, Inc.
GitHub
GLOBALFOUNDRIES
GlobalLogic
Google Inc.
GoPro
Harmonic
Hewlett-Packard Enterprise
HP Inc.
Indeed.com
Informatica
Ingram Micro, Inc.
Integrated Device Technology
Intel
Intuit Inc.
Intuitive Surgical
KLA-Tencor Corporation
Lam Research
Marvell
Maxim Integrated
Mentor Graphics
Microsemi
Microsoft
NetApp, Inc.
Netflix
NVIDIA
Oracle Corporation
Palo Alto Networks
PayPal
Pivotal Software, Inc.
Plantronics
Pure Storage
Qualcomm
salesforce.com
Sanmina-SCI Corporation
Seagate Technology
ServiceNow
ShoreTel
Snapchat, Inc.
SurveyMonkey
Symantec Corporation
Synopsys, Inc.
Tesla Motors, Inc.
The Cooper Companies
The Walt Disney Company
Theravance Biopharma
TiVo Corporation
Trimble, Inc.
Twitter
Uber Technologies
Veeva Systems
Veritas
Visa
VMware
Western Digital
Xilinx, Inc.
Yahoo!
Yelp