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Tax committee chairmen write Treasury, seeking changes to section 385 proposed regulations

Republican members of the House Ways and Means Committee today reiterated in a letter to Treasury Secretary Jacob Lew their concerns about the effects of proposed regulations under section 385.

Today's **letter** [PDF 1.83 MB] is the second letter to the administration from members of the Ways and Means Committee about the regulations, and today's letter calls on administration to "completely overhaul the proposed regulations" before they are finalized.

The letter (August 22, 2016) in part states:

"…we are not confident that … modifications would be sufficient to eliminate the harm that the proposed regulations would inflict on businesses and American workers if they were to be finalized in their current form. Overall, the joint Ways and Means and Finance Committee discussion with your tax policy team reinforced our view that, at a minimum, a complete overhaul of the current proposal would be necessary in order to ensure that any rules in this area appropriately target abusive tax-planning without interfering with normal business financing arrangements. Unfortunately, the clear message from your tax policy team was a single-minded intention to finalize the regulations 'swiftly.' As we emphasized at the July 6 discussion, the American people deserve a tax system that reflects accuracy and correct policy, not rules that are rushed out without proper vetting and consideration."

Background

Republican members of the Ways and Means Committee on June 28, 2016, sent Treasury a letter expressing "grave concern" about the proposed regulations under section 385, citing the broad scope of the rules and their negative effect on the ability of companies to engage in normal business activities.

Members of both the Ways and Means and the Senate Finance committees on July 6, 2016, discussed their concerns with Treasury's policy team. At that meeting, the congressional tax writing committees members highlighted ways that they believe the proposed regulations would “prevent American businesses from conducting basic, day-to-day operations and transactions.”

Possible changes

The letter further states that, at the July 6 meeting, Treasury acknowledged that modifications to the proposed regulations were being considered in the following areas:

- Provide an exclusion for cash pooling arrangements
- Provide exceptions for broader cash management practices including currency and interest-rate hedging
- Eliminate any adverse impact on S corporation and REIT status
- Provide exceptions for equity compensation
- Extend the consolidated group exception to industries such as insurance for which consolidation is restricted
- Provide exceptions for regulated industries that are subject to capital and debt requirements

Still today’s letter suggests that other areas the members believe merit further consideration as well to avoid “negative unintended consequences for businesses” including changes concerning:

- The treatment of longer-term cash and financial management arrangements and transactions
- The implications for foreign-to-foreign transactions
- The effect on transactions involving partnerships and disregarded entities
- The compliance burden of the documentation requirements

Finance Committee letter

Separately, Senate Finance Committee Chairman Orrin Hatch (R-UT) today also wrote to the Treasury Secretary requesting that the proposed regulations under section 385 regarding debt and equity be withdrawn and re-issued. The letter is available on the Finance Committee’s **website**.

The letter notes that Treasury officials met with Finance Committee members on July 7, and the letter highlights the large number of comments received on the proposed regulations. The letter further expresses concerns with the process of the regulations and suggests a “path forward.” According to the letter:

“The only prudent way to move forward—given the complexity of the subject matter, given the many significant substantive concerns that have been pointed out, and given the procedural irregularities—is to issue the regulations in re-proposed form. Finalizing the regulations, without another round of proposed regulations, would be imprudent.

I therefore ask you to re-propose the regulations. Complying with such request would not necessarily delay the regulation beyond this Administration, as time may still exist to re-propose with a 90-day comment period, with finalization during this Administration. It is worth noting that under the current congressional calendar the 115th Congress will already have a chance to disapprove of the measure under the CRA, even if you were to finalize the regulations in August 2016, so there need not be a rush to finalize swiftly the regulations. I ask you to re-propose the regulations not because I wish for there to not be any section 385 regulations. Rather, I am seeking to ensure that, should the Treasury Department issue regulations under IRC section 385, the Department does so in a thoughtful, prudent, and legal manner.”

Direct comments, including requests for subscriptions, to Washington National Tax. For more information, contact KPMG’s Federal Tax Legislative and Regulatory Services Group at + 1 202.533.4366, 1801 K Street NW, Washington, DC 20006-1301.