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United States Senate

COMMITTEE ON FINANCE

WASHINGTON, DC 20510-6200

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August 22, 2016

The Honorable Jacob Lew
Secretary of the Treasury
U.S. Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Secretary Lew:

I am committed to overhauling our tax system to make it simpler, fairer, and more efficient. I am also committed to promoting job growth at home and improving the country's economic competitiveness abroad. I am concerned that the Treasury Department's proposed debt-equity regulations under Internal Revenue Code section 385 (the "proposed regulations")¹ would unfortunately move us in the opposite direction.

I have valued conversations with you and other Treasury officials in recent weeks, both in the July 6 Joint Committee on Taxation meeting, and in the July 7 meeting with Finance Committee members, as well as in other venues, and you know many of the concerns with the substance of these proposals. The Treasury Department has also heard from a broad array of employers, individual Americans, business groups, and tax practitioners expressing concern over the proposals' likely economic effects. You have received approximately 200 sets of unique comments on the proposed regulations. On June 22, most of the minority members of the Ways and Means Committee wrote to you out of concern over "a number of unforeseen circumstances in which the regulation could adversely affect ordinary course business transactions between parties in the absence of tax avoidance motives." On June 28, all the Ways and Means majority members sent you a detailed letter outlining their substantive policy and process concerns with the proposed regulations, including the fact that it would "undoubtedly reduce overall investment and economic activity to the detriment of the United States...." On July 1, a number of Finance Committee members detailed likely effects of the proposed regulations and asked that you make reforms before proceeding. Chairman Brady and his majority colleagues also express their concerns over the substance of the section 385 regulations. I share these concerns expressed by my fellow members of Congress, and agree they must be addressed in any regulations that are finalized.

¹ REG-108060-15, available at: <https://www.regulations.gov/docket?D=IRS-2016-0014>

Today, I write to lay out my concerns with the process of the regulations and also to suggest a path forward.

First, I am concerned that the Treasury Department is moving at an unprecedented pace and is attempting to regulate a very complex area on a very short timeline. There was no advanced notice of the proposed regulations in the Priority Guidance Plan or the Unified Agenda of Regulatory and Deregulatory Actions prior to the early April promulgation of the proposed regulations. Only the standard 90 days was given for written comments to be submitted – despite their tremendous complexity, and despite numerous calls from the business community and tax-writing members of Congress to extend the comment period. To schedule a hearing only a mere week after the close of the written comment period does not conform with the well-enshrined principle of thoughtful and careful deliberation that is at the heart of the notice and comment process, as it is hard to see how the oral comments at the public hearing could be well understood if there was not adequate time to read and reflect upon the written comments beforehand.² Given the thousands of pages of comments you have received in response to the proposed regulations, it is clear that the consideration of these comments should not be rushed. Other regulatory efforts have moved on a much more deliberate and slower pace: for example, regulatory implementation of the Foreign Account Tax Compliance Act took place over a period of four years, and other Treasury Department regulations that are newly effective this year have followed a timeline of two-to-eight years from proposal to effectiveness. Indeed, I note that the section 163(j) anti-earnings stripping regulations were proposed 25 years ago and have yet to be finalized. Moving swiftly to finalize the 385 regulations, without time to understand fully the consequences, is unwise.

Second, I am concerned that the Treasury Department is acting contrary to statutory and Executive Order requirements. Both the Congress and past presidents have established rules to promote transparency and accountability in the regulatory process. Among these are requirements that agencies consider the economic costs and benefits of any given proposal. Congress has sought to ensure consideration of costs and benefits of regulatory action through, among other statutes, the Congressional Review Act (CRA).³ The CRA generally requires that, before a regulation can take effect, the Federal agency promulgating such regulation must make available to each House of Congress “a copy of the rule ... and ... a complete copy of the cost-

² As an interesting contrast, consider the regulations under section 501(r). The section 501(r) proposed regulations were released by Treasury on June 22, 2012. Fred Stokeid, *Proposed Regs Released on Hospitals' Financial Assistance Policies*, 136 TAX NOTES 47 (July 2, 2012). They were published in the Federal Register on June 26, 2012. REG-130266-11, 77 Fed. Reg. 38148. The due date for written comments was September 24, 2012. *Id.* The public hearing on the proposed regulations was December 5, 2012. Announcement 2012-41, 2012-44 I.R.B. 532 (Oct. 29, 2012). In contrast to the present circumstances, there were 72 days from the closing date for written comments until the date of the public hearing.

Or consider, as another of many such examples, the section 423 Employee Stock Purchase Plan proposed regulations from 2008. The close of the written comment period was October 27, 2008. REG-106251-08, 73 Fed. Reg. 43875 (Jul. 29, 2008). The public hearing was January 15, 2009. Announcement 2008-121, 2008-50 I.R.B. 1296 (Dec. 15, 2008). As such, there were 80 days from the close of the comment period until the public hearing.

³ Pub. L. 104-121 (1996), 5 U.S.C. § 801-808.

benefit analysis of the rule, if any....”⁴ The purpose of this requirement is to allow Congress to consider how a regulation will affect the country before deciding whether to invoke CRA’s disapproval process. I furthermore ask you to consider whether the most reasonable interpretation of the CRA is that it requires the Office of Management and Budget’s Office of Information and Regulatory Affairs (OIRA) to determine whether the regulations would be a major or a non-major rule. *Please assure me that the section 385 regulations will be submitted to OIRA for a determination as to whether they are major within the meaning of the CRA.*

Regulatory transparency has been a goal of past presidential administrations as well, including that of President Bill Clinton, who issued Executive Order 12866. That order was issued, in part, to “restore the integrity and legitimacy of regulatory review and oversight; and to make the process more accessible and open to the public.”⁵ President Obama modified and adopted this order in his own Executive Order 13563. Following the same economic threshold as the CRA, the orders require that the regulating agency provide an analysis of the “costs anticipated from the regulatory action (such as, but not limited to, the direct cost... to businesses and others in complying with the regulation, and any adverse effects on the efficient functioning of the economy...), together with, to the extent feasible, a quantification of those costs...”⁶

Your department has long taken the position that tax regulations are exempt from these transparency requirements because of a secret agreement between the Treasury Department and OIRA. Your department only very recently responded positively to concerns about this secret agreement. Treasury officials have referenced their “special rule” for tax regulations in recent comments, hinting that the current proposed regulations will not receive a full cost-benefit analysis and will be subject to more limited transparency. Treasury’s “special rule” works against the goals of transparency and accountability.

I ask that the Treasury Department give serious consideration to these concerns over the proposed regulations, both on grounds of policy and regulatory process. You and other officials in the Treasury Department have indicated you will, which I appreciate. Nevertheless, your consideration of these concerns needs to be done in a thoughtful and deliberate manner. Moving swiftly to finalize the proposed regulations would not be consistent with such an approach. 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

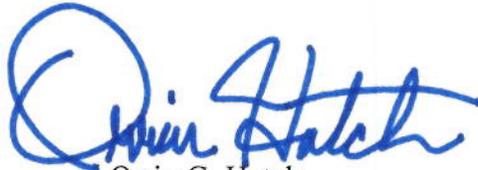
⁴ See 5 USC § 801(a)(1).

⁵ Exec. Order No. 12,866 (Oct. 4, 1993).

⁶ *Id.*

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.

Sincerely,

A handwritten signature in blue ink that reads "Orrin Hatch". The signature is written in a cursive style with a large, circular initial "O".

Orrin G. Hatch
Chairman

CC: The Honorable Mark J. Mazur, Assistant Secretary for Tax Policy, U.S. Department of the Treasury

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

Ms. Emily S. McMahon, Deputy Assistant Secretary (Tax Policy), U.S. Department of the Treasury