



INSTITUTE OF INTERNATIONAL BANKERS

299 Park Avenue, 17th Floor
New York, N.Y. 10171
Telephone: (212) 421-1611
Facsimile: (212) 421-1119
www.iib.org

LAWRENCE R. UHLICK
Chief Executive Officer
E-mail: luhlick@iib.org

April 20, 2009

Internal Revenue Service
CC:PA:LPD:PR (Notice 2009-8)
Room 5203
1111 Constitution Ave, NW
Washington, DC 20224
Notice.comments@irs.counsel.treas.gov

Re: Notice 2009-8 and guidance under Section 457A of the Internal Revenue Code

Ladies and Gentlemen:

We write to express the view of our members that the guidance set out for purposes of Section 457A of the Internal Revenue Code in Notice 2009-8 needs to be changed in order to provide workable and sensible results for internationally headquartered banks. Absent the changes recommended below, the Notice may treat a deferred compensation plan of an international bank as “nonqualified” if the bank has significant branches outside of its home country. This would have serious consequences to U.S. citizens and residents who are employed by, or from time to time work in, branches outside the United States, notwithstanding that those branches are subject to local tax on their income.

The Institute represents internationally headquartered financial institutions from over 30 countries. Many of these financial institutions have networks of branches (as well as subsidiaries) around the world and employ U.S. citizens or residents in their non-U.S. branches.

Section 457A. Section 457A of the Internal Revenue Code accelerates the inclusion in income by an employee or other “service provider” of compensation that is deferred under a nonqualified deferred compensation plan of a nonqualified entity. For this purpose, a nonqualified entity is any foreign corporation unless “substantially all” of its income is either subject to a comprehensive foreign income tax or is effectively connected with the conduct of a business in the United States. Q&A-13 of Notice 2009-8 requires the determination of whether a foreign corporation is or is not a nonqualified entity to be made as of the last day of each taxable year of the employee or other service provider in which the deferred compensation is no longer subject to a substantial risk of forfeiture. Q-8 and paragraph (c)(i) of A-8 of Notice 2009-8 provide in effect that income



derived by a foreign corporation outside its country of residence that is exempt from that country's tax is not subject to a comprehensive foreign income tax, regardless of whether it is taxable in the country of the branch. If that income is in the aggregate more than 20% of the gross income of the foreign corporation in any year, "substantially all" of its income will not be subject to a comprehensive foreign income tax and it will be a nonqualified entity.¹

Guidance in Notice 2009-8. There are, broadly, two problems with the guidance provided by Notice 2009-8.

First, because the gross income test excludes income that is exempt from tax in the foreign corporation's country of residence, the guidance may exclude a foreign corporation that is a qualified resident in a country that uses an exemption rather than a foreign tax credit system to eliminate double taxation. Many countries with which the U.S. has double tax treaties exclude active nonresident sourced income from the domestic taxable base of resident corporations, including Germany, France, Switzerland, Canada, Belgium and the Netherlands. Notice 2009-8 has a special mitigation rule for dividends from nonresident subsidiaries² but no similar rule for income of branches.

Second, the guidance in Notice 2009-8 requires a calculation of worldwide gross income for U.S. federal income tax purposes, which is an obviously complex calculation and one that a foreign corporation would not otherwise have reason to make. And because the calculation must be made for the year in which the deferred compensation is no longer subject to a substantial risk of forfeiture, it requires a calculation that cannot as a practical matter be made until months after that year has closed.

The failure to correct these problems in a simple and sensible way will have serious implications for internationally headquartered banks, many of which have networks of branches around the world and employ U.S. citizens or residents in their non-U.S. branches.

Recommendation. Our first recommendation, intended to address both of these issues for most international banks, is that any foreign corporation be excluded from the definition of a nonqualified entity for purposes of Section 457A if it is a qualified resident (as defined in the relevant treaty) of a country that is party to a comprehensive income tax treaty with the United States. The existence of such a treaty should be

¹ Specifically, A-8(c)(i) says the income will be regarded as excluded if "the foreign corporation's taxable income under the laws of its country of residence excludes an item of nonresidence source income...[whether] by means of an exemption, exclusion..., deduction or [more than 50% rate reduction]".

² In A-8(c)(iv)(C), as discussed hereafter.



sufficient to establish that the income tax imposed by the foreign country is comprehensive.

There is nothing in the statutory language or its history which suggests that this cannot be done – in other words, which suggests that Section 457A(d)(2) should be limited to the extent now provided in Notice 2009-8. The Joint Committee explanation of Section 457A explicitly says that there is regulatory authority to deal with source country taxation, *i.e.*, the issue of whether “substantially all of the income of a corporation will be considered to be subject to a comprehensive income tax if the corporation derives income not only from its country of residence but also from one or more countries that may or may not have tax treaties with the United States”.³

Alternative Recommendation. In the alternative, if the Internal Revenue Service believes that the simple rule recommended above is too broad, we would recommend that guidance include a rule for branch income that parallels the rule applicable to dividends from nonresident subsidiaries.⁴ Under this recommendation, income of a foreign branch that is subject to a third country comprehensive foreign income tax (or that is eligible for the benefits of a U.S. income tax treaty) would be included in the income of a foreign corporation that is considered subject to a comprehensive foreign income tax.⁵

Of the two alternatives, the first is simpler to apply and therefore better. It would not require foreign corporations to incur the expense and effort to calculate world-wide gross income under U.S. federal income tax principles – something that would otherwise be unnecessary.

Both alternatives would recognize that many countries, including U.S. treaty partners, exempt income of foreign branches rather than eliminating double taxation

³ JCX-7508.

⁴ A-8(c)(iv)(C) which includes dividends in the income subject to a comprehensive foreign income tax, whether or not they are taxed in the country of the corporation’s residence, if the dividends are paid by a corporation substantially all of whose income is subject to such a tax in another country. Specifically, “an item of nonresidence source income is not...excluded ...[if it is] a dividend from a corporation substantially all of the income of which is subject to a comprehensive foreign income tax (determined by applying the principles of this A-8)”

⁵ Another alternative might be to provide (by analogy with the “triangular” rule in treaties such as those with France (Article 30(5)), Switzerland (Article 22(4)) and Germany (Article 28(5)) that a foreign corporation which is resident in a country with which the U.S. has a comprehensive income tax treaty is eligible unless more than 20% of its gross income is derived from branches which, under a triangular rule, would not be entitled to treaty benefits.



INSTITUTE OF INTERNATIONAL BANKERS

through the allowance of a foreign tax credit.⁶ Both would also be consistent with the rule in A-8(c)(iv)(C) that applies to dividends from subsidiaries of foreign corporations.

If our first recommendation is not accepted, and there are circumstances in which a qualified resident of a U.S. treaty partner may nonetheless be a nonqualified entity, we recommend that the rule in Q&A-13 that determines whether a corporation is or is not a nonqualified entity on the last day of the employee or other service provider's taxable year should be changed so that the determination is either made on the basis of the prior year's results or, alternatively, on the basis of a rolling average of prior years' results. The present rule is not practical, since it bases the determination of whether a corporation is or is not a nonqualified entity on a quantitative analysis which can often only be done after the time when it must be determined whether the income is or is not taxable.

We appreciate the opportunity to comment on Notice 2009-8 and would be pleased to discuss any questions that you may have with respect to our comments.

Very truly yours,

A handwritten signature in black ink that reads 'Lawrence R. Uhlick'.

Lawrence R. Uhlick
Chief Executive Officer

⁶ See, e.g., Article 24(2)(a) of the U.S.-France Treaty; Article 23(2)(a) of the U.S.-Germany treaty; and Article 23(1)(a) of the U.S.-Switzerland treaty. The OECD Model Convention (*see* Articles 23A and 23B) includes both exemption and tax credit systems as ways to avoid double taxation.