MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

July 7, 2016

Via Electronic Filing:

Internal Revenue Service
CC:PA:LPD:PR (REG-108060–15)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Managed Funds Association Comments on Proposed Rules -- Treatment of Certain Interests in Corporations as Stock or Indebtedness

Dear Ladies and Gentlemen:

Managed Funds Association ("MFA")[1] appreciates the opportunity to respond to proposed regulations on the treatment of certain interests in corporations as stock or indebtedness (the "Proposed Rules"). MFA and its members are not directly concerned with, and MFA thus is not commenting on, the apparent primary policy consideration underlying the Proposed Rules, which is to make it "more difficult for foreign-parented groups to quickly load up their U.S. subsidiaries with related-party debt following an inversion or foreign takeover, by treating as stock the instruments issued to a related corporation in a dividend or a limited class of economically similar transactions."[2]

MFA does, however, share the concerns articulated recently in letters from Democratic and Republican Members of the House Ways and Means Committee and

[1] The Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and many other regions where MFA members are market participants.

[2] Treasury Fact Sheet: Treasury Issues Inversion Regulations and Proposed Earnings Stripping Regulations, available at https://www.treasury.gov/press-center/press-releases/Pages/jl0404.aspx.

Republican Members of the Senate Finance Committee,[3] that the broad scope of the Proposed Rules, if adopted, would have an adverse effect on many ordinary course business transactions involving related parties, including (as discussed below) transactions involving commingled investment funds by parties that are not otherwise related.

To address these concerns, MFA strongly recommends that any final rules adopted by the Department of the Treasury ("Treasury") and the Internal Revenue Service (the "IRS" or "Service") more narrowly focus on the types of corporate transactions, such as inversions, that Treasury has identified to be of primary policy concern. In MFA's view, such a tailored approach should (among other things) limit the scope of the final rules to transactions involving business structures where the ultimate parent entity is a corporation, or is so classified for US tax purposes. Adoption of such an approach would still capture the inversion-related transactions that appear to be the primary motivation for the Proposed Rules, while helping to avoid some of the adverse consequences of an overly broad scope such as the one contemplated by the Proposed Rules.

Set out below are additional concerns regarding the application of the expanded group and modified expanded group rules and the downward attribution rules to investment funds. Also discussed below are our views on why blocker entities used by investment funds should not be included in any final rules.

Expanded Group and Modified Expanded Group Rules for Investment Funds

We encourage Treasury and the IRS to reconsider the definition of expanded group (and "modified expanded group" as it applies to the bifurcation provisions) in the context of the business structures of investment funds and their adviser entities. For the reasons set out below, we believe that any final rule under section 385[4] should clarify that, with respect to the determination of whether an expanded group or modified expanded group exists under section 385, any vote held by an investment adviser, or a related entity to the investment adviser, should be ignored.

Private investment funds are typically structured so that the fund's investment adviser, or a related entity, owns the voting interests in the fund while investors own non-voting economic interests in the fund. Despite the adviser or related entity's ownership of

[3] June 22, 2016 letter from Democratic Members House Ways and Means Committee-- http://www.kpmg.com/US/en/IssuesAndInsights/ArticlesPublications/taxnewsflash/Documents/tnf-dem-letter-jun28-2016.pdf.

June 28, 2016 letter from Republican Members of the House Ways and Means Committee -- http://waysandmeans.house.gov/wp-content/uploads/2016/06/20160628_WM-Reps_Lew_385-Regs.pdf.

July 1, 2016 letter from Republican Members of the Senate Finance Committee -- http://www.heller.senate.gov/public/_cache/files/095552bf-854e-4731-a063-f983c18e372b/Section%20385%20letter%207_1_16.pdf.

[4] Unless otherwise indicated, any references to a "section" or "sections" are references to a "section" or sections" of the Internal Revenue Code of 1986, as amended, or the regulations issued under the Code by the Treasury and the IRS.

the voting interests, we believe that different investment funds should not be deemed to be part of an expanded group (or a "modified expanded group" as it applies to the bifurcation provisions) simply because they are managed by the same investment adviser or same related entity. Similarly, we do not believe that an investment fund should be deemed to be part of an expanded group (or a "modified expanded group" as it applies to the bifurcation provisions) with an investment adviser solely due to the investment adviser owning the voting interests in the fund.

Investment advisers owe fiduciary obligations to each investment fund they manage, which require the adviser to cause each fund to enter into transactions only if they are in the best interest of each investment fund. Further, different investment funds managed by the same adviser often have different investor bases. Because an adviser owes obligations to each fund separate and apart from its obligations to its other funds, it does not enter into transactions that shift tax obligations from one fund (and one set of investors) to another fund (and a different set of investors) because the transaction would lower the amount of taxes paid by all of its investment funds collectively. This is a clear distinction from a corporate structure in which a parent company may be incentivized to lower the overall amount of taxes paid across the entire structure. Transactions in the context of the business structures of investment funds and their adviser entities are therefore very different from the types of transactions in the context of corporate structures that Treasury has identified as being of primary concern in proposing these rules.

As proposed, however, groups of investment funds may be part of an expanded group simply because a common investment adviser, or a related entity, controls all of the voting interests in the investment funds. We believe that Treasury and the IRS should amend any final rule to avoid treating groups of investment funds as part of an expanded group, or modified expanded group under the bifurcation provisions, simply because they share a common adviser, or related entity, with voting control of the funds. Similarly, we believe that Treasury and the IRS should amend any final rule to avoid treating an investment adviser and an investment fund as part of an expanded group simply because the investment adviser owns the voting shares of the investment fund.

Accordingly, any final rule under section 385 should clarify that, with respect to the determination of whether an expanded group or modified expanded group exists under section 385, the voting interests held by an investment adviser, or a related entity to the investment adviser, should be ignored.

Downward Attribution Rules

We also are concerned about the potential application of the downward attribution rules under section 318 to fund structures.[5] Under the Proposed Rules, indirect ownership for purposes of establishing an expanded group under section 385 means applying the attribution rules of section 318, as modified by section 304(c)(3). The attribution rules

[5] We note that others also have raised this concern, including the report of the Tax Section of the New York State Bar Association (the "NYSBA Report"), submitted on June 29, 2016 (see, for example, pages 41 through 43 of the NYSBA Report).

include upward attribution (section 318(a)(2)), which attributes stock held by subsidiary entities to their owners, and downward attribution (section 318(a)(3)), which attributes stock held by owners to their subsidiary entities.

Of particular concern is that the downward attribution rules generally are more expansive in application than the upward attribution rules. Whereas the upward attribution rules attribute stock owned by a subsidiary to a parent in an amount proportionate to the parent's ownership interest in the subsidiary, the downward attribution rules can attribute 100% of the stock owned by a parent to a subsidiary. Under the downward attribution rules in section 318(a)(3), as modified by section 304(c)(3), a subsidiary corporation is treated as owning a share of stock held by the parent corporation in an amount that is proportionate to the parent's ownership interest in the subsidiary, if the parent's ownership is more than 5% but less than 50%. Under those rules, however, if the parent's ownership interest in its corporate subsidiary is 50% or more, then all of the stock held by the parent is attributed to the subsidiary. In addition, a partnership is treated as owning all of the stock owned by its partners, regardless of the ownership percentage of the partners.

We believe the application of downward attribution in the context of an expanded group under the Proposed Rules that affects transactions beyond the intended scope of the Proposed Rules.

> *Example*. P1 is a corporation that is the common parent of a consolidated group. P1 owns a small 1% interest in Fund A, a partnership for US tax purposes. Fund A owns 80% of the value of Portfolio Company A. S1, a wholly-owned affiliate of P1 engaged in a lending business, makes a loan to Portfolio Company A in the ordinary course of its lending business.

Under the downward attribution rules, Fund A is treated as owning all of the stock owned by its partners, including P1. Consequently, Fund A is treated as owning all of P1's subsidiaries, including S1. Because Fund A is treated as owning 100% of P1's subsidiaries, including S1, each of P1's subsidiaries also are treated as owning all of the stock owned by Fund A, including the stock in Portfolio Company A, thereby making Portfolio Company A and S1 members of the same expanded group. Similar concerns would arise in the context of investment fund partnerships that have multiple tiers of corporate entities used for certain types of investors or to make certain investments.

We believe that expansive scope of the downward attribution rules, particularly in the context of partnerships like investment funds, would expand the scope of the Proposed Rules to transactions and structures beyond the stated purpose of the Rules. Small partners in a partnership are not the types of related parties with enhanced incentives to engage in transactions that result in excessive indebtedness identified in the preamble to the Proposed Rules as the type of relationship intended to be addressed by the Rules.[6]

[6] See proposing release, 81 FR 20911, at 20914 (April 8, 2016).

We recommend that Treasury and the IRS amend the downward attribution rules to apply only when 80% of an entity is owned by a parent company.[7] This amendment would ensure that the downward attribution rules apply only when the subsidiary to which stock ownership is attributed is closely related to its parent.

Blocker Entities

Finally, we note that Treasury and the IRS are seeking comments on whether indebtedness used by investment funds and so-called blocker entities raise similar policy concerns as those underlying the Proposed Rules. Private investment funds, such as hedge funds, use these structures principally to avoid creating adverse tax consequences for investors that choose to invest through pooled investment funds rather than invest directly. Accordingly, the use of the levered blocker structure is intended to preserve the result that taxation on the funds' income occurs at the level of the investor rather than at or below the fund level.

Further, many private investment funds are ultimately owned by a large number of investors. Private investment funds provide investors the ability to pool capital with other investors for the purpose of having an asset manager make investment decisions. Although the private investment fund itself may own 100% of the blocker entity, on a look-through basis, each ultimate investor in the investment fund typically owns an interest in the blocker entity that is significantly less than the 50% and 80% thresholds that apply under the expanded group or modified expanded group rules.

In addition, transactions involving these blocker entities typically are already subject to "earnings-stripping" limitations under section 163(j). As such, we believe that these structures do not raise the same policy concerns as those underlying the Proposed Rules. Because blocker entities used by private investment funds, such as hedge funds, do not implicate the same types of policy concerns and transactions involving such entities are already subject to existing rules regarding earnings-stripping, we believe that they should not be included in any final rules adopted by Treasury and the IRS.

MFA appreciates the willingness of Treasury and the IRS to consider the issues discussed. If you have any questions regarding any of MFA's suggested amendments to the Proposed Rules, or if we can provide further information with respect to the issues raised in our letter, please do not hesitate to contact Benjamin Allensworth or me at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell

Executive Vice-President and Managing Director, General Counsel

[7] We note that this is similar to the recommendation made in the NYSBA Report.