

IRS Chief Counsel advises that none of a taxpayer's CFC loans satisfy Notice 88-108 unless all do

May 7, 2015

In brief

The IRS Chief Counsel's Office issued CCA 201516064 (the CCA) on April 17, 2015, addressing the application of Notice 88-108 (the Notice) where a controlled foreign corporation (CFC) made loans back to its US parent over two quarter-ends, both of which were repaid within 30 days, but also made a third loan which caused the CFC to be a creditor of the US Parent for more than 59 days during the year. The CCA highlights that the test under the Notice is an 'all-or-nothing' test. Short-term quarter-end loans that would qualify for the exception on their own can be disqualified if the CFC holds a single dollar of debt from a US affiliate on more than 59 days during the taxable year. Taxpayers who may wish to rely on Notice 88-108 should consider whether they have controls in place adequate to assure that the CFC lender holds absolutely no debt of US affiliates (which would not otherwise qualify for an exception from the Section 956 definition of US property) for more than 59 days during the year.

In detail

Fact scenario

CCA 201516064 sets forth the following scenario:

US Parent, a US corporation, wholly owns CFC A, and both corporations have tax years ending Day 1. During post-1988 Year 1, CFC A made several loans to US Parent under a line of credit. On Date 1, CFC A loaned Amount 1 to US Parent, which was still outstanding on the last day of the quarter including Date 1. On Date 2, less than 30 days after Date 1, US Parent repaid Amount 2, which was Amount 1 less Amount 3. Amount 3 remained outstanding after Date 2. On

Date 3, CFC A loaned Amount 4 to US Parent. Both Amounts 3 and 4 were outstanding on the last day of the quarter including Date 3. On Date 4, less than 30 days after Date 3, US Parent repaid Amount 4. As a result of these advances and repayments, Amount 3 was outstanding for more than 60 calendar days during Year 1, although Amounts 2 and 4 were each outstanding for fewer than 30 calendar days during Year 1 and were cumulatively outstanding for fewer than 60 calendar days during Year 1.

Analysis

A CFC's Section 956 investments in US property

(including loans or other debt obligations owed by US shareholders to the CFC) can result in a Section 951 subpart F inclusion for those US shareholders. Specifically, the inclusion is the lesser of (i) any excess of (A) the shareholder's pro rata share of the average of the adjusted basis in US property the CFC held (directly or indirectly) as of the close of each quarter of the tax year, over (B) the earnings and profits (E&P) attributed to such shareholder, or (ii) the shareholder's pro rata share of the CFC's applicable E&P.

Notice 88-108 announced that final Section 956 regulations would include an exclusion for short-term obligations. Specifically, it excludes (from the definition of ‘obligation’) any obligation that is collected within 30 days from the time it is incurred. This exclusion would not apply if the CFC holds for 60 or more days during the tax year obligations that, without regard to the 30-day rule, would constitute a Section 956 investment if held at the end of the CFC’s tax year. In 1988, the amount of a CFC’s investment in US property was measured as of year-end, but a 1993 Section 956 amendment changed that to measuring by the average of US property amounts the CFC holds at the close of each quarter of its tax year. The legislative history indicated that the amendment was not intended to override the Notice 88-108 exception, which still applies on a quarter-end basis. The CCA notes that this legislative history describes the 60-day aggregate holding period rule as applying, “without regard to whether any such obligations are held on the [quarterly] date of measurement.”

CCA 201516064 explains that Notice 88-108 is intended to apply in fact patterns in which CFC earnings are available for use in the United States only for a small portion of the year. The CCA cites to AM 2007-016 for the example of a CFC lending to its US parent approximately five days before each quarter end to enable the US parent to make payments on a revolving line of credit with an outside lender, where the CFC loans are repaid within approximately 10 days.

Other than the quarterly 10-day loans, the US parent owes no debts to the CFC during the year. The CCA distinguishes that situation from one in which a CFC holds US obligations for a significant number of days during the year, referring to the Section 956 rationale of treating long-term CFC investments in US property as repatriation equivalents.

The CCA notes that the loans CFC A made to US Parent in Year 1 would constitute US property for Section 956 purposes unless an exception applies. The Amount 2 and Amount 4 loans were each outstanding for fewer than 30 days, and the cumulative time they were outstanding during Year 1 was fewer than 60 days. Accordingly, US Parent argued that both of those loans qualified for the Notice 88-108 exclusion, and only the Amount 3 loan needed to be taken into account in determining the average amount of US property held by CFC A in Year 1.

However, the CCA highlights the fact that when the Amount 2, Amount 3, and Amount 4 loans are viewed together, CFC A was a creditor of US Parent for more than 60 days during Year 1. The CCA declares that Notice 88-108 provides an exception for obligations that meet the 30-day test if, and only if, *all obligations* held by a CFC, *tested in the aggregate*, do not violate the 60-day test. “Contrary to US Parent’s position, Notice 88-108 does not provide a blanket exception for specific obligations that meet the 30-day and 60-day tests.” Because CFC A held obligations of US Parent for 60 or more days during the tax year, Notice 88-108 does not exclude

any obligations of US Parent from the definition of obligation for Section 956 purposes.

Observation: Because the Section 956 exception in Notice 88-108 is available only if the CFC in question is not a creditor of any US affiliates on more than 59 days during a taxable year, it is essential for a taxpayer relying on the Notice to have controls in place to assure that this requirement is satisfied. Although short-term trade payables described in Treas. Reg. sec. 1.956-2(b)(1)(v) and Temp. Treas. Reg. sec. 1.956-2T(b)(2)(i)(B) owed to a CFC by US affiliates are excluded from the day count, trade payables can disqualify a taxpayer’s quarter-end planning under Notice 88-108, if they are not timely paid or exceed reasonable amounts and thereby become Section 956 investments. For example, say a CFC holds a receivable of \$100 from a US affiliate that remains outstanding for many months (or even years) because it is too small to catch anyone’s attention, then the CFC makes a \$10 million loan to the US affiliate intended to qualify under Notice 88-108’s 30/60 rules. Even if the larger loan meets all the criteria of Notice 88-108, the outstanding receivable will disqualify it from the Notice 88-108 exception.

The takeaway

Satisfying the requirements of Notice 88-108 can be operationally challenging. Taxpayers will need to monitor their accounts very carefully to ensure that they do not inadvertently disqualify loans intended to meet those requirements.

Let's talk

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