

## A Note From the Editor-in-Chief

### **Notice 2008-91 Expands Code Sec. 956 Exception for Short-Term Obligations**

A loan made by a controlled foreign corporation (CFC) to a related U.S. person generally is considered as an “investment in U.S. property.”<sup>1</sup> Under subpart F, such investment triggers a deemed dividend to the CFC’s U.S. shareholders.<sup>2</sup>

The amount of a CFC’s investment in U.S. property for the year is determined by taking an average of the amounts of U.S. property held by the CFC at the close of each quarter of the CFC’s tax year. For example, if a calendar-year CFC holds a \$100 obligation of its U.S. parent on March 31 and June 30, and it is repaid on September 15, the CFC will have a \$50 investment in U.S. property  $[(\$100 + \$100) \div 4]$ .

Because the calculation is made by taking four snapshots on the last day of each quarter, loans to related U.S. persons are not considered as investments in U.S. property if they are not outstanding at the close of any quarter of the CFC’s tax year. As discussed below, however, under certain circumstances, the IRS might assert that successive loans should be treated as one continuous loan outstanding at the end of a quarter.

Certain short-term loans are excluded from the definition of U.S. property even though outstanding over the end of a quarter. Notice 88-108<sup>3</sup> provides an exception for obligations that are collected within 30 days, as long as the CFC does not have loans to related U.S. persons outstanding during the year for 60 or more days (“30/60 day exception”).<sup>4</sup> In light of current liquidity needs in the United States, Notice 2008-91<sup>5</sup> expanded this exception, excluding from the definition of U.S. property obligations that are collected within 60 days, as long as the CFC does not have loans outstanding to related U.S. persons during the year for 180 or more days (“60/180 day exception”).<sup>6</sup> Notice 2008-91 applies to the first two tax years of a foreign corporation ending after October 3, 2008, but beginning before January 1, 2010.<sup>7</sup>

Notice 88-108 was intended to provide U.S. multinationals with the ability to use quarter-end CFC loans to reduce U.S. third-party debt for financial statement purposes. For example, a CFC may loan funds to its U.S. parent for 10 days over each quarter-end, and the funds could be used to repay third-party obligations, and thus improve the U.S. multinational’s debt-to-equity ratios for the quarterly and annual financial statements. Nevertheless, this rule is mechanical, in that the exception applies regardless of the use of the loan proceeds.



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On the other hand, the 60/180 day exception was designed to provide U.S. companies greater access to cash of their foreign subsidiaries to fund U.S. needs. This is facilitated by permitting a CFC to loan funds to U.S. related persons for as long as 179 days during the year. The Notice does not address, however, whether a series of loans outstanding for less than 180 days in total may be made in immediate succession.

Under certain circumstances, the IRS has asserted that successive loans should be treated as one continuous loan. In *Jacobs Engineering Group, Inc.*,<sup>8</sup> over a two-and-a-half-year period a CFC made 12 successive loans to its U.S. parent to provide it with working capital. Each loan was repaid within a few months with interest. A new loan was made within a few days of the repayment of the prior loan. The court held that the series of 12 short-term loans should be viewed as one single continuous loan by the CFC to the U.S. parent and constituted an investment in U.S. property.

The IRS in Rev. Rul. 89-73<sup>9</sup> stated that two loans will be considered as one continuous loan if the disinvestment period is “brief.” For example, a CFC purchased its U.S. parent’s debt obligations which were repaid in 284 days, and then 60 days later in the following tax year the CFC purchased additional debt obligations of its U.S. parent. The ruling treated the two loans as one continuous loan outstanding at year-end.<sup>10</sup> On the other hand, a loan outstanding for 150 days with a disinvestment period of 198 days (1:1.32) was not stepped together with the subsequent loan. Unfortunately, there is a sizable gap between the two examples, and the ruling provides little guid-

ance on how to apply the step-transaction analysis beyond the examples.

To take full advantage of Notice 2008-91—*i.e.*, loans of 60, 60 and 59 days, respectively—the maximum disinvestment period during a tax year could be only 62 days (1:1.033), which ratio is less than in the favorable example in Rev. Rul. 89-73. Nevertheless, at a minimum, such disinvestment period should not cause the three loans to be stepped together. A contrary result would frustrate the purpose of the Notice. In addition, since the fundamental purpose of the Notice is to permit a CFC to loan funds to U.S. affiliates for up to 179 days during a tax year to provide liquidity, and cash needs are highly unpredictable in the current economic environment, it would seem entirely appropriate to permit shorter disinvestment periods,<sup>11</sup> particularly when under the circumstances another loan is important to help with an immediate liquidity problem of the U.S. company.<sup>12</sup>

The 30/60 and 60/180 day exceptions are determined separately for each CFC owned by a U.S. multinational. The Notices refer to the particular CFC that holds the obligation at the end of the quarter, and the “choice” to apply Notice 2008-91 is stated as being made by a particular CFC. This is consistent with the CFC-by-CFC approach of Code Sec. 956 and the regulations.<sup>13</sup>

Notice 2008-91 is welcome relief in a liquidity strained economy. Nevertheless, to ensure that the purpose of the Notice to provide access to foreign cash is fully carried out, it would be helpful for the IRS to provide additional guidance concerning the application of the Notice, particularly to provide maximum flexibility to taxpayers.<sup>14</sup>

## ENDNOTES

<sup>1</sup> Code Sec. 956(c)(1)(C).

<sup>2</sup> Code Secs. 951(a)(1)(B), 956. The amount of the investment included in income is limited to the earnings and profits of the CFC that have not been previously subject to taxation.

<sup>3</sup> Notice 88-108, 1988-2 CB 445.

<sup>4</sup> While Notice 88-108 literally applies to year-end obligations, GLAM 2007-0016, *reprinted in* 2007 TNT 195-39, confirmed that the 30/60 day exception applies to obligations outstanding at the end of a quarter. See Yoder, *IRS Applies Section 956 Thirty-Day Exception to Quarters*, 36 TAX MGMT. INT’L J. 664 (Dec. 14, 2007).

<sup>5</sup> Notice 2008-91, IRB 2008-43, 1001 (filed Oct. 3, 2008).

<sup>6</sup> Exceptions also are provided for certain receivables arising from the sale of inventory and the provision of services. See Code Sec. 956(c)(2)(C); Reg. §§1.956-2(b)(1)(v), -2T(d)

(2)(i)(B). Loans qualifying for these exceptions should not be taken into account when applying the 30/60 and 60/180 day requirements.

<sup>7</sup> Taxpayers must carefully monitor the CFC’s loans, since even a small loan that causes the 180-day rule to be failed appears to cause the Notice to be inapplicable.

<sup>8</sup> *Jacobs Engineering Group, Inc.*, DC-Calif., 79 AFTR 2d 97-1673 (1997), *aff’d*, CA-9, 168 F3d 499 (1999).

<sup>9</sup> Rev. Rul. 89-73, 1989-1 CB 258.

<sup>10</sup> Code Sec. 956 applied a year-end, as opposed to a quarter-end, measuring convention at that time.

<sup>11</sup> Moreover, since the ruling is intended to apply for the “first two taxable years ending after October 3, 2008,” the date the Notice was issued, for calendar year taxpayers to meaningfully apply the ruling to their first tax year the government should permit a disinvestment period of only a few days

between loans made in 2008.

<sup>12</sup> The press quotes Michael DiFronzo, IRS Deputy Associate Chief Counsel (International), as saying that the IRS will take a facts-and-circumstances approach, and that there may be circumstances in which a taxpayer could have shorter periods between the loans without running afoul of Code Sec. 956. 236 DTR G-2 (Dec. 9, 2008).

<sup>13</sup> See also FSA 200216022 (Jan. 8, 2002) (IRS applied CFC-by-CFC approach to multiple CFC guarantees of the same U.S. related person obligation even though this approach led to an odd result under Code Sec. 956). *Cf.*, Reg. §1.956-1T(b)(4)(i) (the IRS may seek to invoke an anti-abuse rule to cause Code Sec. 956 to apply to a CFC that funds another CFC’s investment in U.S. property).

<sup>14</sup> See “Letter to Eric Solomon and Donald Korb from Tax Executives Institute,” *reprinted in* 2008 WTD 205-17 (Oct. 17, 2008).