

## LB&I International Practice Service Transaction Unit

IPS Level	Number	Title	UIL Code	Number
Shelf	N/A	Business Inbound	–	–
Volume	8	Repatriation/Withholding	<b>Level 1 UIL</b>	9424
Part	8.1	FDAP Payments	<b>Level 2 UIL</b>	9424.01
Chapter	8.1.1	Financial Intermediary Payor – U.S. Withholding Agent	<b>Level 3 UIL</b>	9424.01-01
Sub-Chapter	8.1.1.1	Portfolio Debt Exemption	–	–

<b>Unit Name</b>	Portfolio Debt Exemption – Requirements and Exceptions
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# Issue and Transaction Overview

## Portfolio Debt Exemption – Requirements and Exceptions

Nonresident alien individuals and foreign corporations are subject to withholding tax on a gross basis on U.S. source income not effectively connected with the conduct of a trade or business within the United States (aka FDAP income) under §§ 871(a) and 881. This income is subject to withholding on the gross amount of the payment, without any deductions, at a rate of 30%. Examples of FDAP (fixed or determinable annual or periodical) income include interest, dividends, rents and royalties. The 30% withholding tax is due under §§ 1441 and 1442 at the time of payment. Income that is, or is deemed to be, effectively connected with the conduct of a trade or business within the United States (ECI) is not subject to withholding under § 1441 or 1442. However, see §§ 1445 and 1446 for examples of when ECI may be subject to withholding.

Certain types of U.S. source interest income of a foreign person qualify for statutory exemptions from tax and withholding:

- obligations payable 183 days or less from the date of original issue;
- bank deposit interest; and
- portfolio interest.

This Unit discusses U.S. source interest income that qualifies for the portfolio debt exemption (aka portfolio interest exemption) under §§ 871(h) and 881(c). The Unit outlines the requirements for qualification as portfolio interest. It will also discuss certain types of interest that will not qualify for the exemption (e.g., contingent interest) and certain foreign recipients ineligible for the exemption (e.g., 10% shareholders, controlled foreign corporations (CFCs) of the U.S. borrower, and banks). #

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# Issue and Transaction Overview (cont'd)

## Portfolio Debt Exemption – Requirements and Exceptions

The portfolio debt exemption can arise in various factual scenarios, not only when the U.S. Withholding Agent is a Financial Intermediary Payor (UIL 9424.01-01). Even though this Unit covers only a basic fact pattern and is listed under the UIL for Financial Intermediary Payor – U.S. Withholding Agent, IEs will often see the portfolio debt exemption claimed in cases that would fall under the other UILs listed under FDAP Payments within the Repatriation/Withholding IPN.

### **PORTFOLIO INTEREST DEFINED**

In general, portfolio interest is:

- (A) Non-effectively connected interest that would be taxable under either § 871(a) or § 881(a) but for this subsection, and
- (B) The interest is paid on an obligation (debt) that is either in bearer form or registered form.

The interest income that the foreign lender earns must not be effectively connected to the lender's U.S. trade or business

**CAUTION:** Obligations in bearer form issued after March 18, 2012, do not qualify for the portfolio interest exemption due to the repeal of § 163(f)(2)(B). Thus, for obligations issued after March 18, 2012, only debt in registered form can qualify for the portfolio debt exemption. See Notice 2012-20.

# Transaction and Fact Pattern

## Portfolio Debt Exemption – Requirements and Exceptions

Diagram of Transaction	Facts
<div data-bbox="99 422 747 696" style="border: 1px solid black; background-color: #4F81BD; color: white; padding: 5px;"> <p><b><u>FC</u></b></p> <ul style="list-style-type: none"> <li>• [Note] Holder</li> <li>• Creditor</li> <li>• Earns interest income</li> <li>• Receives [interest] payment</li> </ul> </div> <div data-bbox="209 729 899 929" style="text-align: center; margin: 20px 0;"> <pre> graph LR     FC[FC] -- LOAN --&gt; USC[USC]     USC -- INTEREST --&gt; FC             </pre> </div> <div data-bbox="99 979 1009 1329" style="border: 1px solid black; padding: 5px;"> <p><b><u>USC</u></b></p> <ul style="list-style-type: none"> <li>• Issuer</li> <li>• Debtor</li> <li>• Receives proceeds</li> <li>• Incurs interest expense</li> <li>• Makes payment of interest</li> <li>• Repays proceeds</li> </ul> </div>	<ul style="list-style-type: none"> <li>▪ USC, a U.S. Person, is a domestic corporation.</li> <li>▪ Foreign Person (FC) is a foreign corporation.</li> <li>▪ USC issues debt [instrument] to FC (FC loans money to USC).</li> <li>▪ USC pays interest on the debt to FC.</li> <li>▪ USC, as a U.S. withholding agent, requests a W-8BEN from the lender, send interest to FC with \$0 withholding, reports the interest on Form 1042-S and Form 1042.</li> <li>▪ FC claims that the interest paid qualifies for the portfolio debt exemption; i.e., the interest is neither subject to tax nor withholding.</li> <li>▪ Initially, the parties' relationship to each other cannot be determined.</li> </ul>

# Summary of Potential Issues

## Portfolio Debt Exemption – Requirements and Exceptions

<a href="#">Issue 1</a>	Whether the debt is in either bearer form or registered form. If the debt is not in either bearer form or registered form, the interest does not qualify for the portfolio interest exemption but may still qualify for a reduced withholding rate under another statutory exemption or under an income tax treaty. Additionally, certain foreign targeted debt in bearer form issued before March 18, 2012 may also qualify for the portfolio interest exemption if it meets requirements outlined on page 8. See §§ 871(h)(2) and 881(c)(2).
<a href="#">Issue 2</a>	Whether interest is received by a 10% [owner /shareholder] of the U.S. issuer. If the interest paid is paid to a 10% shareholder, the interest does not qualify for the portfolio interest exemption but may still qualify for a reduced withholding rate under another statutory exemption or under an income tax treaty. See §§ 871(h)(3) and 881(c)(3)(B).
<a href="#">Issue 3</a>	Whether interest is received by a CFC from a related U.S. person. If the interest paid is received by a CFC from a related U.S. person, the interest does not qualify for the portfolio interest exemption. Interest received by a CFC from an unrelated U.S. person may qualify as portfolio interest. In such case, the unrelated CFC is not allowed to apply certain provisions under § 954. The interest may be eligible for a reduced withholding rate under another statutory exemption or under an income tax treaty. See §§ 881(c)(3)(C) and (5).
<a href="#">Issue 4</a>	Whether the interest paid is contingent interest. If all or a portion of the interest payments consist of contingent interest, the interest does not qualify for the portfolio interest exemption but may still qualify for a reduced withholding rate under another statutory exemption or under an income tax treaty. See §§ 871(h)(4) and 881(c)(4).
<a href="#">Issue 5</a>	Whether interest is received by a bank on an extension of credit made pursuant to a loan arrangement the bank entered into in the ordinary course of its business. If the interest is received by a bank on an extension of credit made pursuant to a loan arrangement the bank entered into in the ordinary course of its business, the interest does not qualify for the portfolio interest exemption but may still qualify for a reduced withholding rate under another statutory exemption or under an income tax treaty. See § 881(c)(3)(A).

# All Issues, Step 1: Initial Factual Development

## Portfolio Debt Exemption – Requirements and Exceptions

A foreign person may invest in debt issued by a U.S. person that qualifies for the portfolio interest exemption and to avoid the withholding tax for the interest paid on the debt. The foreign person provides the U.S. person (withholding agent) a Form W-8BEN or Form W-8BEN-E to certify that it is a foreign person. The parties to the debt can be individuals, corporations, partnerships, trusts, or estates

Fact Element	Resources	6103 Protected Resources
<p>Preliminary inquiries:</p> <ul style="list-style-type: none"> <li>▪ Is the debt issued by USC bona fide debt?</li> <li>▪ When did USC issue the debt?</li> <li>▪ Are there multiple debt obligations between USC and FC?</li> <li>▪ Is FC the true holder of the debt?</li> <li>▪ Are there multiple holders?</li> <li>▪ Are multiple parties claiming the portfolio debt exemption?</li> </ul>	<ul style="list-style-type: none"> <li>▪ Global Tax Organizational charts</li> <li>▪ Taxpayer financial statements</li> <li>▪ 10-K, 10-Q, and 8-K filings (debt structure, credit facilities, debt issuance and retirement)</li> <li>▪ External credit rating reports</li> <li>▪ Loan agreements or other instruments of indebtedness</li> <li>▪ Wire transfers and accounting entries evidencing repayment</li> <li>▪ Bank statements detailing cash transfers associated with the subject loans</li> </ul>	

# Issue 1, Step 2: Review Potential Issues

## Portfolio Debt Exemption – Requirements and Exceptions

### Issue 1

Whether the debt is in either bearer form or registered form.

Fact Element	Resources	6103 Protected Resources
<p>The general rule is that to qualify for the portfolio debt exemption, the debt must be in registered form, however certain foreign targeted debt in bearer form issued before March 19, 2012 may also qualify for the portfolio interest exemption if it meets the following requirements.</p> <p>The requirements for foreign targeted debt in bearer form to qualify for the portfolio interest exemption are:</p> <p>1) there are arrangements reasonably designed to ensure that such obligation will be sold (or resold in connection with the original issue) only to a person who is not a U.S. person,</p>	<ul style="list-style-type: none"> <li>▪ § 163(f)(2)(B) – pre 03/19/2012</li> <li>▪ § 871(h)(2)</li> <li>▪ § 881(c)(2)</li> <li>▪ Treas. Reg. § 1.871-14</li> <li>▪ Notice 2012-20</li> </ul>	



# Issue 1, Step 2: Review Potential Issues (cont'd)

## Portfolio Debt Exemption – Requirements and Exceptions

### Issue 1

Whether the debt is in either bearer form or registered form.

Fact Element	Resources	6103 Protected Resources
<p>2) interest on such obligation is payable only outside the U.S. and its possessions, and</p> <p>3) on the face of such obligation there is a statement that any U.S. person who holds such obligation will be subject to limitations under the United States income tax laws.</p> <p><b>CAUTION:</b> Obligations in bearer form issued after March 18, 2012 do not qualify for the portfolio interest exemption due to the repeal of § 163(f)(2)(B).</p>	<ul style="list-style-type: none"> <li>▪ § 163(f)(2)(B) – pre 03/19/2012</li> <li>▪ § 871(h)(2)</li> <li>▪ § 881(c)(2)</li> <li>▪ Treas. Reg. § 1.871-14</li> <li>▪ Notice 2012-20</li> </ul>	

# Issue 1, Step 2: Review Potential Issues (cont'd)

## Portfolio Debt Exemption – Requirements and Exceptions

### Issue 1

Whether the debt is in either bearer form or registered form.

Fact Element	Resources	6103 Protected Resources
<p>In order to qualify for the portfolio debt exemption, debt must be in registered form.</p> <p>The requirements for an obligation to be in <u>registered form</u>:</p> <p>1) It is “registered as to both principal and any stated interest” with the issuer or its agent, and transfer may be effected only by surrender of the old instrument by the old holder and reissuance (or issuance of a new instrument) by the issuer to the new holder; or</p> <p>2) The right to the principal and stated interest may be transferred only through a book entry system maintained by the issuer or its agent.</p> <p><u>Statement Requirement:</u></p> <p>The withholding agent must receive a statement (usually on Form W-8) indicating that the beneficial owner of the obligation is not a U.S. person. See §§ 871(h)(5) and 881(c)(5).</p>	<ul style="list-style-type: none"> <li>▪ Form W-8BEN</li> <li>▪ § 149(a)(3)</li> <li>▪ § 871(h)(2)</li> <li>▪ § 881(c)(2)</li> <li>▪ § 871(h)(5)</li> <li>▪ § 881(c)(5)</li> <li>▪ Treas. Reg. § 1.871-14</li> <li>▪ Notice 2012-20</li> </ul>	

# Issue 1, Step 3: Additional Factual Development

## Portfolio Debt Exemption – Requirements and Exceptions

### Issue 1

Whether the debt is in either bearer form or registered form.

Fact Element	Resources	6103 Protected Resources
<p>Is the debt that USC issues to FC in bearer or registered form? If in bearer form, was the debt issued after March 18, 2012?</p>	<ul style="list-style-type: none"> <li>▪ U.S. issuer must take steps to ensure that the debt is not issued to a U.S. person.</li> <li>▪ For debt in registered form, U.S. issuer must demonstrate either that (1) the debt is registered as to both interest and principal and transfer is restricted, or (2) the right to principal and interest can only be done through a book entry system.</li> </ul>	

# Issue 1, Step 4: Develop Arguments

## Portfolio Debt Exemption – Requirements and Exceptions

### Issue 1

Whether the debt is in either bearer form or registered form.

Fact Element	Resources	6103 Protected Resources
For obligations in registered form, the audit team must determine if the U.S. issuer has adequate controls to ensure that the debt is not issued to U.S. persons; i.e., any transfer of the debt must be controlled by the issuer or its agent. In addition, the foreign person must provide a valid Form W-8BEN.	<ul style="list-style-type: none"><li>▪ § 149(a)(3)</li><li>▪ § 163(f)(2)(B)</li><li>▪ § 871(h)(2)</li><li>▪ § 881(c)(2)</li><li>▪ Treas. Reg. § 1.871-14</li></ul>	

# Issue 2, Step 2: Review Potential Issues

## Portfolio Debt Exemption – Requirements and Exceptions

### Issue 2

Whether interest is received by a 10% shareholder of the U.S. issuer.


Fact Element	Resources	6103 Protected Resources
<p>Whether interest is received by a 10% shareholder does not qualify as portfolio interest.</p> <p><u>Definition of 10% Shareholder:</u></p> <p>(1) In the case of an obligation issued by a corporation, a 10% shareholder is any person who owns 10% or more of the total combined voting power of that corporation's stock.</p> <p>(2) In the case of an obligation issued by a partnership, a 10% shareholder is anyone who owns 10% or more of the capital or profits interest in the partnership.</p> <p>Ownership generally is determined under the attribution rules of § 318.</p>	<ul style="list-style-type: none"> <li>▪ § 871(h)(3)</li> <li>▪ § 881(c)(3)(B)</li> <li>▪ Treas. Reg. § 1.871-14(g)</li> </ul>	<p>NOPA – Section 1441 Compliance</p>

# Issue 2, Step 3: Additional Factual Development

## Portfolio Debt Exemption – Requirements and Exceptions

### Issue 2

Whether interest is received by a 10% shareholder of the U.S. issuer.


Fact Element	Resources	6103 Protected Resources
<p>Determine whether FC is a 10% shareholder of USC.</p>	<ul style="list-style-type: none"> <li>▪ U.S. issuer must provide detailed entity organizational charts so that a Revenue Agent can verify that the portfolio debt exemption is not claimed on interest being paid to a 10% shareholder. A revenue agent applies the § 318 ownership attribution rules to ensure that the creditor is not a 10% shareholder.</li> <li>▪ § 318</li> <li>▪ § 7701(o)</li> <li>▪ Treas. Reg. § 1.881-3</li> <li>▪ Treas. Reg. § 1.441-3(g)</li> <li>▪ Information Gathering IPN Inbound Financing IPN</li> </ul>	
<p> <b>CONSULTATION: Elaborate organizational structures may make it difficult to determine whether the interest is received by a 10% shareholder. #</b> [REDACTED]</p> <p>#</p>		

# Issue 2, Step 3: Additional Factual Development (cont'd)

## Portfolio Debt Exemption – Requirements and Exceptions

### Issue 2

Whether interest is received by a 10% shareholder of the U.S. issuer.


Fact Element	Resources	6103 Protected Resources
<p>Determine whether FC is a 10% shareholder of USC.</p> <p> <b>CONSULTATION (cont'd): #</b> [REDACTED]</p> <p>#</p>	<ul style="list-style-type: none"> <li>▪ § 871(h)(3)</li> <li>▪ § 881(c)(3)(B)</li> <li>▪ § 318</li> <li>▪ § 7701(o)</li> <li>▪ Treas. Reg. § 1.881-3</li> <li>▪ Information Gathering IPN</li> <li>▪ Inbound Financing IPN</li> </ul>	

# Issue 2, Step 4: Develop Arguments

## Portfolio Debt Exemption – Requirements and Exceptions

### Issue 2

Whether interest is received by a 10% shareholder of the U.S. issuer.

Fact Element	Resources	6103 Protected Resources
Applying § 318 constructive ownership rules to determine if the foreign payee is a 10% shareholder requires detailed organizational charts.	<ul style="list-style-type: none"> <li>▪ § 871(h)(3)</li> <li>▪ § 881(c)(3)(B)</li> <li>▪ § 318</li> </ul>	
 <p><b>DECISION POINT:</b> Determine whether to proceed with this issue by applying the § 318 constructive ownership rules. If the interest is received by a shareholder who owns 10% or more of the total combined voting power of all classes of stock, then the portfolio interest exception does not apply.</p>		



# Issue 3, Step 2: Review Potential Issues

## Portfolio Debt Exemption – Requirements and Exceptions

### Issue 3

Whether interest is received by a CFC from a related U.S. person.

Fact Element	Resources	6103 Protected Resources
<p><b><u>Withholding Tax Issue</u></b></p> <p>Is any portion of the interest paid to a CFC from a related person within the meaning of § 864(d)(4)?</p> <ul style="list-style-type: none"> <li>▪ Interest paid to a CFC from a related party is NOT considered portfolio interest.</li> </ul> <p><b><u>Related Issues</u></b></p> <p>Interest received by an <u>unrelated</u> CFC may qualify as portfolio interest. However, in the case of any portfolio interest received by an <u>unrelated</u> CFC, the following provisions do not apply:</p> <ul style="list-style-type: none"> <li>▪ § 954(b)(3)(A) – relating to de minimis rule where foreign base company income is less than 5% of gross income or \$1 million.</li> <li>▪ § 954(b)(4) – relating to certain income subject to high foreign taxes; i.e., where effective rate of foreign country is &gt; 90% of maximum corporation income tax rate per § 11.</li> </ul>	<ul style="list-style-type: none"> <li>▪ § 954</li> <li>▪ § 957</li> <li>▪ § 881(c)(3)</li> <li>▪ § 881(c)(5)</li> <li>▪ § 864(d)(4)</li> <li>▪ Deferral Planning IPN</li> </ul>	

# Issue 3, Step 2: Review Potential Issues (cont'd)

## Portfolio Debt Exemption – Requirements and Exceptions

### Issue 3

Whether interest is received by a CFC from a related U.S. person.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> <li>▪ § 954(c)(3)(A)(i) – relating to certain income received from related persons.</li> <li>▪ See § 881(c)(5).</li> </ul>	<ul style="list-style-type: none"> <li>▪ § 954</li> <li>▪ § 957</li> <li>▪ § 881(c)(3)</li> <li>▪ § 881(c)(5)</li> <li>▪ § 864(d)(4)</li> <li>▪ Deferral Planning IPN</li> </ul>	

# Issue 3, Step 3: Additional Factual Development

## Portfolio Debt Exemption – Requirements and Exceptions

### Issue 3

Whether interest is received by a CFC from a related U.S. person.

Fact Element	Resources	6103 Protected Resources
<p>Determine whether FC lender is a CFC of USC borrower.</p>	<ul style="list-style-type: none"> <li>▪ The Revenue Agent must determine whether the foreign person who received the interest payments is a CFC pursuant to § 957(a). # [REDACTED]</li> </ul>	

# Issue 3, Step 4: Develop Arguments

## Portfolio Debt Exemption – Requirements and Exceptions

### Issue 3

Whether interest is received by a CFC from a related U.S. person.

Fact Element	Resources	6103 Protected Resources
<p>If the U.S. issuer owns the CFC and is considered a related party pursuant to § 864(d)(4), the interest paid by the taxpayer to a CFC is not portfolio interest.</p>	<ul style="list-style-type: none"> <li>▪ § 957</li> <li>▪ § 864(d)(4)</li> <li>▪ § 881(c)(3)(C)</li> </ul>	
<p><b>DECISION POINT:</b> Determine whether to proceed with this issue. If the interest is received by a CFC from a related U.S. person, then the portfolio interest exception does not apply.</p>		



# Issue 4, Step 2: Review Potential Issues

## Portfolio Debt Exemption – Requirements and Exceptions

### Issue 4

Whether the interest paid is contingent interest.

Fact Element	Resources	6103 Protected Resources
<p>Is the interest contingent interest as defined under §§ 871(h)(4) and 881(c)(4)?</p> <p>Contingent interest is defined as any interest if the amount of such interest is determined by reference to:</p> <ul style="list-style-type: none"> <li>▪ Any receipts, sales or other cash flow of the debtor or a related person,</li> <li>▪ Any income or profits of the debtor or a related person,</li> <li>▪ Any change in value of any property of the debtor or a related person,</li> <li>▪ Any dividend, partnership distributions, or similar payments made by the debtor or a related person, or</li> </ul>	<ul style="list-style-type: none"> <li>▪ § 881(c)(4)</li> <li>▪ § 871(h)(4)</li> <li>▪ § 707(b)(1)</li> <li>▪ § 267(b)</li> <li>▪ Inbound Financing IPN</li> <li>▪ Financial Instruments IPG</li> </ul>	

# Issue 4, Step 2: Review Potential Issues (cont'd)

## Portfolio Debt Exemption – Requirements and Exceptions

### Issue 4

Whether the interest paid is contingent interest.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> <li>▪ Any other type of contingent interest that is identified by the Secretary by regulation, where a denial of the portfolio interest exemption is necessary or appropriate to prevent avoidance of Federal income tax.</li> </ul> <p>Related person means any person who is related to the debtor within the meaning of §§ 267(b) and 707(b)(1),</p>	<ul style="list-style-type: none"> <li>▪ § 881(c)(4)</li> <li>▪ § 871(h)(4)</li> <li>▪ § 707(b)(1)</li> <li>▪ § 267(b)</li> <li>▪ Inbound Financing IPN</li> <li>▪ Financial Instruments IPG</li> </ul>	

# Issue 4, Step 3: Additional Factual Development

## Portfolio Debt Exemption – Requirements and Exceptions

### Issue 4

Whether the interest paid is contingent interest.


Fact Element	Resources	6103 Protected Resources
<p>Determine whether the interest that USC pays to FC is contingent interest.</p>	<ul style="list-style-type: none"> <li>▪ Revenue Agent must determine if the interest paid is contingent interest. Contingent interest does not qualify for the portfolio debt exemption. # [REDACTED]</li> </ul>	

# Issue 4, Step 4: Develop Arguments

## Portfolio Debt Exemption – Requirements and Exceptions

### Issue 4

Whether the interest paid is contingent interest.

Fact Element	Resources	6103 Protected Resources
Revenue Agent should ask for copies of the loan agreements and related documents to determine if the amounts paid are contingent interest.	<ul style="list-style-type: none"> <li>▪ § 871(h)(4)</li> <li>▪ § 881(c)(4)</li> <li>▪ Inbound Financing IPN</li> <li>▪ Financial Instruments IPG</li> </ul>	
 <b>DECISION POINT:</b> Determine whether to proceed with this issue. If the interest is contingent interest, then the portfolio interest exception does not apply.		



# Issue 5, Step 2: Review Potential Issues

## Portfolio Debt Exemption – Requirements and Exceptions

### Issue 5

Whether interest is received by a bank on an extension of credit made pursuant to a loan arrangement the bank entered into in the ordinary course of its business.

Fact Element	Resources	6103 Protected Resources
<p>Under the bank loan exception of § 881(c)(3)(A), interest is received by a bank on an extension of credit made pursuant to a loan arrangement the bank entered into in the ordinary course of its business is ineligible for the portfolio interest exemption.</p> <p>However, an obligation issued by the United States to a foreign bank may qualify for the portfolio debt exemption.</p>	<ul style="list-style-type: none"><li>▪ § 881(c)(3)(A)</li><li>▪ § 1441(a)</li><li>▪ § 1461</li></ul>	

# Issue 5, Step 3: Additional Factual Development

## Portfolio Debt Exemption – Requirements and Exceptions

### Issue 5

Whether interest is received by a bank on an extension of credit made pursuant to a loan arrangement the bank entered into in the ordinary course of its business.


Fact Element	Resources	6103 Protected Resources
<p>Determine whether FC is a bank. If FC is a bank, determine whether FC made the loan to USC pursuant to a loan arrangement FC entered into in the ordinary course of its business.</p>	<ul style="list-style-type: none"> <li>▪ Revenue Agent should verify that FC is not a bank. This may be done by reviewing the loan agreement, FC's articles of incorporation, organization charts, and other documents deemed relevant.</li> <li>▪ # [REDACTED]</li> </ul>	

# Issue 5, Step 4: Develop Arguments

## Portfolio Debt Exemption – Requirements and Exceptions

### Issue 5

Whether interest is received by a bank on an extension of credit made pursuant to a loan arrangement the bank entered into in the ordinary course of its business.

Fact Element	Resources	6103 Protected Resources
It may be necessary to use information gathering techniques and resources to determine if the foreign payee is a bank.	<ul style="list-style-type: none"> <li>▪ § 881(c)(3)(A)</li> <li>▪ § 1441(a)</li> <li>▪ § 1461</li> </ul>	
 <p><b>DECISION POINT:</b> Determine whether to proceed with this issue. If the interest is received by a bank on an extension of credit made pursuant to a loan arrangement the bank entered into in the ordinary course of its business, then the portfolio interest exception does not apply.</p>		

# Training and Additional Resources

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## Chapter 8.1.1 Financial Intermediary Payor – U.S. Withholding Agent

Type of Resource	Description(s) and/or Instructions for Accessing	References
CENTRA sessions	<ul style="list-style-type: none"><li>▪ July, 2012 -Nonresident Alien Withholding Form 1042 Auditing Techniques</li><li>▪ International Training OJT Workshops - Withholding on Foreign Payments</li></ul>	<ul style="list-style-type: none"><li>▪ Playback on CENTRA</li><li>▪ <a href="http://lmsb.irs.gov/search/lmsbGoogleSearch.asp?site=lmsb.irs.gov&amp;query=withholding portfolio interest">http://lmsb.irs.gov/search/lmsbGoogleSearch.asp?site=lmsb.irs.gov&amp;query=withholding portfolio interest</a></li></ul>
White Papers / Guidance	Notice 2012-20 - Portfolio Interest: Registration-Required Obligations	This notice provides guidance related to the repeal of § 163(f)(2)(B).

# Glossary of Terms and Acronyms

Acronym	Definition
CFC	Controlled Foreign Corporation
ECI	Effectively Connected Income
FC	Foreign Corporation
FDAP income	Fixed or determinable annual or periodical income – broadly construed to generally include any income of a foreign person not effectively connected with a trade or business in the U.S., other than capital gains from the sale of property. See §§ 871(a); 881(a); 1441(b); 1442(a), and 1.1441-2(b).
USC	U.S. Corporation

# Index of Related Issues

Issue	Associated UIL(s)	References
§ 954(b)(3)(A) – relating to de minimis rule where foreign base company income is less than 5% of gross income or \$1 million.	9412.03-02	
§ 954(b)(4) – relating to certain income subject to high foreign taxes; i.e., where effective rate of foreign country is > 90% of maximum corporation income tax rate per § 11.	9412.05	
§ 954(c)(3)(A)(i) – relating to certain income received from related persons.	9412.06	
Bona Fide Debt Determination	9423.01-01	