

Office of Chief Counsel
Internal Revenue Service
Memorandum

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to: Nancy Johnson
Pre-filing and Technical Guidance
(Large & Mid-Size Business)

from: Steven A. Musher
Associate Chief Counsel (International)

subject: Application of Notice 88-108 to section 956(a)(1)

This memorandum responds to your request for assistance regarding the application of section 956 with respect to taxpayers with a revolving credit line from outside lenders.

ISSUE

Whether the exception from the definition of an obligation as provided in Notice 88-108, 1988-2 C.B. 445, applies to section 956(a)(1) as modified by Pub. L. 103-66, Title XIII, §13232(a) and (b) ("OBRA").

CONCLUSION

Notice 88-108 will continue to apply to section 956(a)(1) and will exclude certain obligations as determined on a quarterly basis.

FACTS

Corporation X, a domestic corporation, wholly owns Corporation Y, a controlled foreign corporation. Corporation X and Corporation Y are calendar year end corporations for tax and financial reporting purposes. Corporation X maintains a revolving line of credit with Outside Lender of \$400x. In general, the outstanding debt balance averages \$40x. Approximately five days prior to each quarter end, Corporation X borrows the outstanding balance of the revolving debt of \$40x from Corporation Y and pays off the

credit line to Outside Lender. Subsequently, approximately five days after the quarter ending, Corporation X draws down its credit line from Outside Lender by \$40x and repays Corporation Y. Corporation X has no other debt owed to Corporation Y.

LAW AND ANALYSIS

Section 956(a) provides, in pertinent part, that:

In the case of any controlled foreign corporation, the amount determined under this section with respect to any United States shareholder for any taxable year is the lesser of—

(1) the excess (if any) of--

(A) such shareholder's pro rata share of the average of the amounts of United States property held (directly or indirectly) by the controlled foreign corporation as of the close of each quarter of such taxable year, over

(B) the amount of earnings and profits described in section 959(c)(1)(A) with respect to such shareholder, or

(2) such shareholder's pro rata share of the applicable earnings of such controlled foreign corporation.

Treas. Reg. § 1.956-2T(d)(2), promulgated on June 14, 1988 in T.D. 8209, eliminated the exception from the definition of U.S. property for obligations not exceeding one year. In response to that regulation, Notice 88-108 was issued. However, at the time of issuance, an investment in U.S. property was determined based upon year-end amounts. Notice 88-108 provides, in pertinent part, that

final regulations issued under section 956 will exclude from the definition of the term 'obligation' an obligation that would constitute an investment in U.S. property if held at the end of the CFC's taxable year, so long as the obligation is collected within 30 days from the time it is incurred. This exclusion shall not apply, however, if the CFC holds for 60 or more calendar days during such taxable year (or 120 days or more during the CFC's taxable year that includes June 14, 1988) obligations which, without regard to the 30 day rule described in the preceding sentence, would constitute an investment in U.S. property if held at the end of the CFC's taxable year.

The regulations referenced in Notice 88-108 have not been issued. However, subsequent to the issuance Notice 88-108, section 956(a)(1) was modified so that the amount of investment in U.S. property is currently determined on a quarterly basis.

The House Report¹ for OBRA, provides in pertinent part, that

The bill is not intended to change the measurement of U.S. property that may apply, for example, in the case of certain short-term obligations, as provided in IRS Notice 88-108 (1988-2 C.B. 445), interpreting present law. Obligations subject to the special treatment of IRS Notice 88-108 are those that are collected within 30 days of their issuance, but the exclusion of such short-term obligations does not apply if the controlled foreign corporation holds obligations that would constitute U.S. property if held by the controlled foreign corporation on the date of measurement (determined without regard to this 30-day rule) for aggregate periods totalling at least 60 days in the taxable year, without regard to whether any such obligations are held on the date of measurement.

Accordingly, if outstanding debt held at quarter-end is collected within 30 days of issuance, and total debt obligations are not held for 60 or more calendar days during the year, then such obligations would not constitute an investment in U.S. property under section 956(a)(1). Thus, in the example, Corporation Y's holdings of the Corporation X debt as of the end of each quarter would not be obligations under section 956(a)(1) because the Corporation X debt held by Corporation Y at the end of each quarter is repaid within 30 days of issuance and the total number of days outstanding for Corporation X's debt held by Corporation Y for the taxable year is less than 60 days.

Please call John Seibert at (202) 622-0171 if you have any further questions.

¹ H.R. Rep. 103-111 at 701 (May 25, 1993).