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to:
Senior Counsel
(Large Business & International)

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

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subject: Trade or business within the United States for purposes of sections 864(b) and 882

This Chief Counsel Advice responds to your request for assistance. This memorandum discusses whether certain lending and stock distribution activities constituted a trade or business within the United States for purposes of sections 864(b) and 882 of the Internal Revenue Code of 1986, as amended (the "Code"). This advice may not be used or cited as precedent.

LEGEND

Foreign Feeder = .
Fund =
Fund Manager =
Year 1 =
Year 2 =
Date A =
State A =
Country X =
Amount 1 =
Amount 2 =
Amount 3 =
Amount 4 = $

Amount 5 = $
Amount 6 =
Amount 7 =
Distribution Agreement =

ISSUES

1. During Year 1 and Year 2, did Fund engage in a trade or business within the United States (before considering the possible application of the safe harbors described in section 864(b)(2)(A) (the "Trading Safe Harbors"))?

2. Were Fund's lending and stock distribution activities during Year 1 and Year 2 "trading in stocks or securities" within the meaning of the Trading Safe Harbors?

3. If Fund's lending and stock distribution activities were treated as "trading in stocks or securities" for purposes of the Trading Safe Harbors, would Fund be eligible for the Trading Safe Harbors during Year 1 and Year 2?

CONCLUSIONS

1. During Year 1 and Year 2, Fund engaged in a trade or business within the United States.

2. Fund's lending and stock distribution activities during Year 1 and Year 2 did not constitute "trading in stocks or securities" within the meaning of the Trading Safe Harbors.

3. Even if Fund's lending and stock distribution activities were treated as "trading in stocks or securities" for purposes of the Trading Safe Harbors, Fund would have been ineligible for the Trading Safe Harbors during Year 1 and Year 2.

FACTS

I. Organization

Fund, a State A limited partnership, was formed on Date A. In Year 2, Fund converted from a State A limited partnership to a Country X exempted limited partnership. During Year 1 and Year 2, Fund was treated as a partnership for federal tax purposes. During Year 1 and Year 2, Foreign Feeder, a Country X entity taxable as a corporation for federal tax purposes, was a limited partner in Fund. Country X does not have a bilateral

income tax treaty with the United States. During the years at issue, Fund's taxable year was the calendar year.

II. Management of Fund

During Year 1 and Year 2, Fund had no employees. The management of Fund was vested exclusively in Fund Manager. Fund and Fund Manager entered into a management agreement pursuant to which Fund appointed Fund Manager as Fund's agent and irrevocable attorney-in-fact with full power to buy, sell, and otherwise deal in securities and related contracts for Fund's account. Fund further granted Fund Manager the full power and authority to do and perform every act necessary and proper to be done as fully as Fund might or could do personally. Pursuant to that grant of authority, Fund Manager conducted an extensive lending and stock distribution business on behalf of Fund. Fund Manager conducted these business activities and otherwise managed Fund primarily through an office in the United States. Fund Manager provided similar services for other investment entities, and no employees of Fund Manager worked exclusively for Fund.

Fund Manager held Fund out to the markets as a lender and underwriter, generating business for Fund in a variety of ways. Fund Manager had over Amount 1 investment professionals who used their extensive business and personal relationships to generate lending and stock distribution deals for Fund. As a result of the efforts of these investment professionals, accounting firms, securities attorneys, and third-party investment bankers referred potential borrowers and stock issuers to Fund. In marketing materials, Fund touted its "

." Fund Manager also sponsored and attended industry conferences relating to deal origination to generate lending and stock distribution opportunities for Fund.

III. Fund's Lending

Fund Manager, acting on Fund's behalf pursuant to the management agreement, committed extensive time and resources to Fund's lending activities. Over the course of Year 1 and Year 2, Fund held at least Amount 2 convertible debt instruments and Amount 3 promissory notes. Fund made many of the loans associated with those convertible debt instruments and promissory notes during Year 1 and Year 2. In Year 1, Fund determined that the value of its loan portfolio was over Amount 4. In Year 2, the value of Fund's loan portfolio exceeded Amount 5.

On behalf of Fund, Fund Manager negotiated directly with borrowers concerning all key terms of the loans. Before agreeing to make a loan, Fund conducted extensive due diligence on a potential borrower. Often, Fund lent borrowers money in return for debt instruments that were convertible into the borrowers' stock at a future date. Typically, the conversion prices were discounted from the trading prices of the borrowers' stock, determined at the time of conversion. After converting a debt instrument into stock at a

discount, Fund sought to earn a spread by quickly disposing of the stock. Fund often received other property in connection with its lending agreements, including warrants to purchase additional shares of borrowers' stock. Borrowers also paid Fund various fees. Aside from Fund Manager, no other entity participated in Fund's lending activities.

IV. Fund's Stock Distribution Activity

Fund Manager, acting on Fund's behalf pursuant to the management agreement, also committed extensive time and resources to conducting Fund's stock distribution, or underwriting, activities.[1] Fund entered into Amount 6 Distribution Agreements with unrelated issuers in Year 1 and Amount 7 Distribution Agreements with unrelated issuers in Year 2. On behalf of Fund, Fund Manager negotiated the terms of each Distribution Agreement directly with the issuers.

A typical Distribution Agreement entitled an issuer to periodically issue and sell to Fund shares of stock in an amount equal to a total specified purchase price (often referred to as Fund's commitment amount). However, an issuer could typically only request a portion of the commitment amount (referred to as an advance) at any given time. The issuer was prohibited from requesting an advance until the issuer had filed with the Securities and Exchange Commission a registration statement registering the issuer's stock for resale by the Fund, and the registration statement had become effective. An issuer requested an advance by providing Fund with a written notice. After the issuer provided notice, Fund was irrevocably bound to purchase stock from the issuer after a specified number of business days (the " Period"). During the Period, Fund endeavored to pre-sell an amount of the issuer's stock that would generate enough cash to fund the advance requested by the issuer. Typically, Fund succeeded. Fund's sales of stock included sales to U.S. purchasers.

At the end of the Period, the issuer sold stock to Fund at a discounted price (generally percent below the stock's lowest daily trading price during the Period). Because Fund sold the stock at the current market price, but received stock from the issuer at a discount, Fund earned a spread on each share sold. Usually, an issuer also paid fees to Fund, including commitment, structuring, and due diligence fees.

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[1] Section 2(a)(11) of the Securities Act of 1933 defines an ''underwriter'' as "any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking." In its Distribution Agreements, Fund agreed to act as a statutory underwriter for its counterparty. In some cases, Fund's counterparties were required to disclose in securities filings that

. Although Fund's Distribution Agreements included terms that differed from conventional underwriting arrangements, Fund still possessed the defining characteristics of an underwriter; specifically, Fund purchased stock from issuers with a view to distributing that stock.

LAW

I. Taxation of Foreign Corporations Engaged in a Trade or Business within the United States

A foreign corporation that engages in a trade or business within the United States is taxable on a net basis on its taxable income that is effectively connected with the conduct of a trade or business within the United States. § 882(a)(1).[2] A foreign corporation is considered to be engaged in a trade or business within the United States if that foreign corporation is a member of a partnership that is engaged in a trade or business within the United States. § 875(1).

II. Determining Whether Activities Constitute a "Trade or Business within the United States"

A. Statutory Definition

The Code does not include a comprehensive definition of the term "trade or business within the United States." Instead, the Code provides only that "the term 'trade or business within the United States' includes the performance of personal services within the United States at any time within the taxable year, but does not include" certain de minimis personal service activity, and also does not include, under certain circumstances, "trading in stocks or securities" or trading in commodities. § 864(b)(2)(A).[3] There is no other statutory definition of the term.

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[2] Except as noted, all section references are to the Code.

[3] I.R.C. § 864(b):

> **(b) Trade or business within the United States.**--For purposes of this part, part II, and chapter 3, the term "trade or business within the United States" includes the performance of personal services within the United States at any time within the taxable year, but does not include—
>
> **(1) Performance of personal services for foreign employer.—**The performance of personal services--
>
> (A) for a nonresident alien individual, foreign partnership, or foreign corporation, not engaged in trade or business within the United States, or
>
> (B) for an office or place of business maintained in a foreign country or in a possession of the United States by an individual who is a citizen or resident of the United States or by a domestic partnership or a domestic corporation,
>
> by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding a total of 90 days during the taxable year and whose compensation for such services does not exceed in the aggregate $3,000.

B. Judicial and Administrative Interpretation

1. Facts and Circumstances Test

The courts and the Internal Revenue Service have adopted a facts and circumstances test to evaluate whether the activities of a foreign person cause that person to be engaged in a trade or business within the United States. See, e.g., Lewenhaupt v. Comm'r, 20 T.C. 151, 162 (1953) aff'd, 221 F.2d 227 (9th Cir. 1955); Treas. Reg. § 1.864-2(e). For a foreign corporation to be engaged in a trade or business within the United States, the foreign corporation's profit-oriented activities in the United States must be considerable, continuous, and regular. See De Amodio v. Comm'r, 34 T.C. 894, 906 (1960) aff'd, 299 F.2d 623 (3rd Cir. 1962); Lewenhaupt, 20 T.C. at 163 (1953); Pinchot v. Comm'r, 113 F.2d 718, 719 (2d Cir. 1940). The conduct of activities in the United States that are ministerial and ancillary to a business conducted outside the United States are not sufficient to give rise to a trade or business in the United States. Scottish American Investment Co. v. Comm'r, 12 T.C. 49, 59 (1949).

Mere managerial attention to investments is also insufficient to cause a foreign person to be engaged in a trade or business within the United States. Higgins v. Comm'r, 312 U.S. 212 (1941); Wilson v. United States, 376 F.2d 280, 293 (Ct. Cl. 1967) ("managing one's own investments in securities is not the carrying on of a trade or business"). An investor is "primarily interested in the long term growth potential of [the investor's] stocks." Estate of Yaeger v. Comm'r, 889 F.2d 29, 33 (2d Cir. 1989). By contrast, a foreign bank was "engaged in business" when the bank engaged in multiple financial transactions through U.S. brokers, including the purchase and sale of securities, taking deposits, participating in underwriting syndicates, and other monetary transactions.

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(2) Trading in securities or commodities.—

(A) Stocks and securities.—

(i) In general.--Trading in stocks or securities through a resident broker, commission agent, custodian, or other independent agent.

(ii) Trading for taxpayer's own account.--Trading in stocks or securities for the taxpayer's own account, whether by the taxpayer or his employees or through a resident broker, commission agent, custodian, or other agent, and whether or not any such employee or agent has discretionary authority to make decisions in effecting the transactions. This clause shall not apply in the case of a dealer in stocks or securities.

(B) Commodities.--[….]

(C) Limitation.--Subparagraphs (A)(i) and (B)(i) shall apply only if, at no time during the taxable year, the taxpayer has an office or other fixed place of business in the United States through which or by the direction of which the transactions in stocks or securities, or in commodities, as the case may be, are effected.

Berliner Handels-Gesellschaft v. United States, 30 F. Supp. 490 (Ct. Cl. 1939), cert. denied, 309 U. S. 670 (1940).

Whether an income-producing activity rises to the level of a trade or business within the United States is based on the nature and the extent of the activity required to conduct that activity. For example, in Pinchot, the Second Circuit held that a nonresident alien's management of real estate constituted a trade or business within the United States rather than "investment and re-investment of funds in real estate" based on the nature and degree of activity necessary to manage real estate. Pinchot, 113 F.2d at 719. The Second Circuit noted that the taxpayer's management activity "required regular and continuous activity of the kind which is commonly concerned with the employment of labor; the purchase of materials; the making of contracts; and many other things which come within the definition of business … and within the commonly accepted meaning of that word." Id. at 719 (citations omitted); cf. Snell v. Comm'r, 97 F.2d 891, 892-93 (5th Cir. 1938) ("[t]he word [business], notwithstanding disguise in spelling and pronunciation, means busyness; it implies that one is kept more or less busy, that the activity is an occupation."). Isolated or occasional activities, on the other hand, generally do not give rise to a trade or business. Pasquel v. Comm'r, 12 T.C.M. 1431 (1953) (holding that a nonresident alien was not engaged in a trade or business within the United States on account of the nonresident alien's limited involvement in a single, isolated loan transaction); Linen Thread Co. v. Comm'r, 14 T.C. 725 (1950) (holding that two small, isolated transactions did not give rise to a trade or business within the United States).

Cases addressing when lending activity gives rise to a trade or business for purposes of other Code provisions are also informative. For example, courts have frequently addressed whether lending constitutes a "business" for purposes of the bad debt deduction permitted by section 166. In those cases, courts have considered a number of factors, including the total number of loans made, the amount of time and effort expended, whether the taxpayer made loans to unrelated borrowers, and whether the taxpayer actively sought out lending business and solicited borrowers. E.g., Fuller v. Comm'r, 21 T.C. 407, 412–413 (1953); McCrackin v. Comm'r, 48 T.C.M. 248 (1984); Ruppel v. Comm'r, T.C.M. 1987-248.

2. Activities of Agents on Behalf of the Taxpayer

In determining whether a foreign person is engaged in a trade or business within the United States, activities undertaken on behalf of the foreign person by an agent are considered to be performed by the foreign person, regardless of the degree of control the foreign person exercises over the agent. See Adda v. Comm'r, 10 T.C. 273, 277-78 (1948), aff'd, 171 F.2d 457 (4th Cir. 1948) (concluding that a nonresident alien engaged in a trade or business within the United States when the nonresident alien granted a U.S.-resident agent authority to use his discretion in trading commodity futures for the nonresident alien's account); Lewenhaupt, 20 T.C. at 163 (concluding that a nonresident alien engaged in trade or business in the United States when the

nonresident alien managed real property through an agent with "a broad power of attorney which included the power to buy, sell, lease, and mortgage real estate" on the nonresident alien's behalf); Rev. Rul. 55-617, 1955-2 C.B. 774 (holding that a foreign corporation was engaged in trade or business within the United States when it marketed goods in the United States through an independent "commission agent"). For example, in De Amodio, the Tax Court held that a nonresident alien was engaged in a trade or business in the United States when the nonresident alien acquired real property through a real estate agent and managed the properties through other local real estate agents. 34 T.C. at 909. The Tax Court concluded that the nonresident alien's conduct of considerable, continuous, and regular activities "through his agents in the United States" caused the nonresident alien to be engaged in trade or business in the United States. De Amodio, 34 T.C. at 905-06. The court did not consider any specifics of the nonresident alien's relationship with his agents, such as whether the nonresident had entered into written agreements with the agents. Nor did the Tax Court describe as relevant, for purposes of determining whether the nonresident alien had a trade or business within the United States, the degree of control that the nonresident alien exercised over his agents, whether the agents had the power to bind the nonresident alien, or whether the agents were "independent."[4]

III. Statutory Safe Harbors for Certain Trading Activities

A. The Trading Safe Harbors

The Trading Safe Harbors are two statutory safe harbors pursuant to which certain trading activities conducted by or for a foreign person that might otherwise constitute a trade or business within the United States are treated as not being a trade or business within the United States. One requires that the foreign person not conduct those activities through an agent who has been granted discretionary authority or through a U.S. office of the foreign person. The other permits trading through an agent with discretionary authority or through the foreign person's U.S. office but requires that the foreign person not be a dealer.

1. The First Trading Safe Harbor

The first Trading Safe Harbor (the "(A)(i) Safe Harbor") provides that the term "trade or business within the United States" does not include "[t]rading in stocks or securities through a resident broker, commission agent, custodian, or other independent agent." § 864(b)(2)(A)(i). Any foreign person, including a foreign dealer in stocks or securities, may use the (A)(i) Safe Harbor. See Treas. Reg. § 1.864-2(c)(1). The (A)(i) Safe Harbor does not apply if the foreign person has an office or other fixed place of business in the United States at any time during the taxable year through which the transactions in stocks or securities are effected. § 864(b)(2)(C).

[4] The Tax Court held that the nonresident alien's agents were independent agents for purposes of the U.S.-Switzerland income tax treaty, such that the nonresident alien was not treated as having a U.S. permanent establishment in the United States. De Amodio, 34 T.C. at 909.

2. The Second Trading Safe Harbor

The second Trading Safe Harbor (the "(A)(ii) Safe Harbor") provides that the term "trade or business within the United States" does not include "[t]rading in stocks or securities for the taxpayer's own account, whether by the taxpayer or his employees or through a resident broker, commission agent, custodian, or other agent, and whether or not any such employee or agent has discretionary authority to make decisions in effecting the transactions." § 864(b)(2)(A)(ii). A dealer in stocks or securities may not use the (A)(ii) Safe Harbor. Id. On the other hand, the (A)(ii) Safe Harbor may apply to a foreign person who has an office or other fixed place of business in the United States. See Taxpayer Relief Act of 1997, P.L. 105-34, § 1162(a) (eliminating a statutory restriction on the applicability of the (A)(ii) Safe Harbor to certain corporations if their principal offices were in the United States).

B. The Meaning of "Trading in Stocks or Securities" for Purposes of the Trading Safe Harbors

Both Trading Safe Harbors apply to "trading in stocks or securities." The regulations under section 864 interpret that term to mean "the effecting of transactions in stocks or securities," which includes "buying, selling (whether or not by entering into short sales), or trading in stocks, securities, or contracts or options to buy or sell stocks or securities, on margin or otherwise[.]" See Treas. Reg. § 1.864-2(c)(2)(i) and (ii).[5] The volume of stock or security transactions effected during a taxable year is not taken into account in determining whether a taxpayer's activities qualify for the Trading Safe Harbors. See Treas. Reg. § 1.864-2(c)(1) & (2). For these purposes, the term "securities" means any note, bond, debenture, or other evidence of indebtedness, or any evidence of an

[5] Treas. Reg. § 1.864-2(c):

> **(c) Trading in stocks or securities.** For purposes of paragraph (a) of this section--
>
> **(1) In general.** The term "engaged in trade or business within the United States" does not include the effecting of transactions in the United States in stocks or securities through a resident broker, commission agent, custodian, or other independent agent. [….]
>
> **(2) Trading for taxpayer's own account--(i) In general.** The term "engaged in trade or business within the United States" does not include the effecting of transactions in the United States in stocks or securities for the taxpayer's own account, [….]
>
> For purposes of this paragraph, […] the effecting of transactions in stocks or securities includes buying, selling (whether or not by entering into short sales), or trading in stocks, securities, or contracts or options to buy or sell stocks or securities, on margin or otherwise, for the account and risk of the taxpayer, and any other activity closely related thereto (such as obtaining credit for the purpose of effectuating such buying, selling, or trading). The volume of stock or security transactions effected during the taxable year shall not be taken into account in determining under this subparagraph whether the taxpayer is engaged in trade or business within the United States.

interest in or right to subscribe to or purchase any of the foregoing. Treas. Reg. § 1.864-2(c)(2).

C. The Meaning of "Dealer in Stocks or Securities" For Purposes of the (A)(ii) Safe Harbor

The regulations under section 864 define a "dealer in stocks or securities" as "a merchant of stocks or securities, with an established place of business, regularly engaged as a merchant in purchasing stocks or securities and selling them to customers with a view to the gains and profits that may be derived therefrom." Treas. Reg. § 1.864-2(c)(2)(iv)(*a*).[6] A person that buys and sells, or holds, stocks or securities solely for investment or speculation is not a dealer. Id. A person's transactions in stocks or securities effected both in and outside the United States are taken into account to determine whether the person is a dealer in stocks or securities. Id.

The regulations provide two exceptions to the definition of the term "dealer in stocks or securities." A foreign person that otherwise may be considered a "dealer in stocks or securities" is not considered a dealer:

> *(1)* Solely because he acts as an underwriter, or as a selling group member, for the purpose of making a distribution of stocks or securities of a domestic issuer to foreign purchasers of such stocks or securities, irrespective of whether other members of the selling group distribute the stocks or securities of the domestic issuer to domestic purchasers, or
>
> *(2)* Solely because of transactions effected in the United States in stocks or securities pursuant to his grant of discretionary authority to make decisions in effecting those transactions, if he can demonstrate to the satisfaction of the Commissioner that the broker, commission agent, custodian, or other agent through whom the transactions were effected acted pursuant to his written representation that the funds in respect of

[6] Treas. Reg. § 1.864-2(c)(2)(iv)(a):

> **(iv) Definition of dealer in stocks or securities--**(a) In general. For purposes of this subparagraph, a dealer in stocks or securities is a merchant of stocks or securities, with an established place of business, regularly engaged as a merchant in purchasing stocks or securities and selling them to customers with a view to the gains and profits that may be derived therefrom. Persons who buy and sell, or hold, stocks or securities for investment or speculation, irrespective of whether such buying or selling constitutes the carrying on of a trade or business, and officers of corporations, members of partnerships, or fiduciaries, who in their individual capacities buy and sell, or hold, stocks or securities for investment or speculation are not dealers in stocks or securities within the meaning of this subparagraph solely by reason of that activity. In determining under this subdivision whether a person is a dealer in stocks or securities such person's transactions in stocks or securities effected both in and outside the United States shall be taken into account.

> which such discretion was granted were the funds of a customer who is neither a dealer in stocks or securities, a partnership described in subdivision (ii)*(b)* of this subparagraph, or a foreign corporation described in subdivision (iii)*(b)* of this subparagraph.

Treas. Reg. § 1.864-2(c)(2)(iv)*(b)*. The regulations include two examples illustrating the foregoing exceptions:

> **Example 1.** Foreign corporation X is a member of an underwriting syndicate organized to distribute stock issued by domestic corporation Y. Foreign corporation X distributes the stock of domestic corporation Y to foreign purchasers only. Domestic corporation M is syndicate manager of the underwriting syndicate and, pursuant to the terms of the underwriting agreement, reserves the right to sell certain quantities of the underwritten stock on behalf of all the members of the syndicate so as to engage in stabilizing transactions and to take certain other actions which may result in the realization of profit by all members of the underwriting syndicate. Foreign corporation X is not engaged in trade or business within the United States solely by reason of its participation as a member of such underwriting syndicate for the purpose of distributing the stock of domestic corporation Y to foreign purchasers or by reason of the exercise by M corporation of its discretionary authority as manager of such syndicate.
>
> **Example 2.** Foreign corporation Y, a calendar year taxpayer, is a bank which trades in stocks or securities both for its own account and for the account of others. During 1967 foreign corporation Y authorizes domestic corporation M, a broker, to exercise its discretion in effecting transactions in the United States in stocks or securities for the account of B, a nonresident alien individual who has a trading account with foreign corporation Y. Foreign corporation Y furnishes a written representation to domestic corporation M to the effect that the funds in respect of which foreign corporation Y has authorized domestic corporation M to use its discretion in trading in the United States in stocks or securities are not funds in respect of which foreign corporation Y is trading for its own account but are the funds of one of its customers who is neither a dealer in stocks or securities, a partnership described in subdivision (ii)*(b)* of this subparagraph, or a foreign corporation described in subdivision (iii)*(b)* of this subparagraph. Pursuant to the discretionary authority so granted, domestic corporation M effects transactions in the United States during 1967 in stocks or securities for the account of the customer of foreign corporation Y. At no time during 1967 does foreign corporation Y have an office or other fixed place of business in the United States through which, or by the direction of which, such transactions in stocks or securities are effected by domestic corporation M. During 1967 foreign corporation Y is not engaged in trade or business within the United States solely by reason

> of such trading in stocks or securities during such year by domestic corporation M for the account of the customer of foreign corporation Y. Copies of the written representations furnished to domestic corporation M should be retained by foreign corporation Y for inspection by the Commissioner, if inspection is requested.[7]

ANALYSIS

Fund's position is that Fund's lending and stock distribution activities in Year 1 and Year 2 constituted mere investment activity, and thus do not constitute a trade or business within the United States. Alternatively, Fund argues that its lending and stock distribution activities constituted "trading in stocks or securities," and that Fund qualifies for the Trading Safe Harbors.

We conclude that during Year 1 and Year 2: (1) the nature and extent of Fund's lending and underwriting, which were conducted by Fund Manager acting as Fund's agent, caused Fund to be engaged in a trade or business within the United States; (2) Fund's lending and underwriting did not constitute "trading in stocks or securities" for purposes of the Trading Safe Harbors; and (3) even if Fund's lending and underwriting had constituted "trading in stocks or securities" for purposes of the Trading Safe Harbors, Fund would not have qualified for the Trading Safe Harbors.

I. During Year 1 and Year 2, Fund's Lending and Stock Distribution Activities Caused Fund to Be Engaged in a Trade or Business within the United States.

Fund's lending and underwriting activities were profit-oriented activities that Fund conducted on a considerable, continuous, and regular basis in the United States during Year 1 and Year 2. Based on the facts and circumstances, Fund's lending and underwriting activities rose to the level of a trade or business within the United States.[8]

Fund Manager, acting as Fund's agent, conducted all aspects of Fund's business. Those activities were performed by Fund Manager on behalf of Fund, and were attributable to Fund for purposes of sections 864(b) and 882. See, e.g., De Amodio v. Commissioner, 34 T.C. 894 (1960).

Unlike a passive investor, Fund conducted an active business in the United States. Contrast Higgins v. Comm'r, 312 U.S. 212 (1941); Estate of Yaeger v. Comm'r, 889

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[7] The Taxpayer Relief Act of 1997, P.L. 105-34, § 1162(a), which eliminated a statutory restriction on the applicability of the (A)(ii) Safe Harbor to certain corporations if their principal offices were in the United States, obsoleted certain regulations under Treas. Reg. § 1.864-2(c)(2)(iv). However, the quoted exceptions and examples continue to be effective.

[8] Because Fund conducted a lending and underwriting business on a considerable, continuous, and regular basis, it is unnecessary to address, and this memorandum does not address, whether certain of the Fund's activities may constitute engaging in a U.S. trade or business without regard to the extent of those activities. See § 864(b).

F.2d 29 (2d Cir. 1989). Nor were Fund's activities sporadic and occasional. Contrast Pasquel v. Comm'r, 12 T.C.M. 1431 (1953); Linen Thread Co. v. Comm'r, 14 T.C. 725 (1950). During the years at issue, Fund made numerous loans to borrowers and entered into dozens of Distribution Agreements with issuers. Fund dedicated significant time, resources, and effort to these activities. Fund negotiated with its counterparties and conducted extensive due diligence on potential borrowers and issuers. Fund actively solicited potential borrowers and issuers. Acting as an agent of Fund, Fund Manager dedicated over Amount 1 of its investment banking personnel and other professionals to the process of sourcing and originating potential deals.

The nature and extent of Fund's lending and underwriting activities demonstrate that Fund engaged in a lending and underwriting business on a considerable, continuous, and regular basis. As a result, Fund was engaged in a trade or business within the United States during the years at issue.

II. Fund's Lending and Stock Distribution Activities during Year 1 and Year 2 Did Not Constitute "Trading in Stocks or Securities" within the Meaning of the Trading Safe Harbors.

Fund's lending and underwriting activities also did not constitute "trading in stocks or securities" for purposes of the Trading Safe Harbors. The regulations under section 864, as well as relevant authorities in other contexts, establish that lending and underwriting are distinctive activities that go beyond the "effecting of transactions in stocks and securities" and are therefore not treated as trading for purposes of the Trading Safe Harbors.

A. Active Conduct of a Banking, Financing, or Similar Business

With respect to lending, Treas. Reg. § 1.864-4(c)(5) stipulates that a foreign person is considered engaged in the active conduct of a banking, financing, or similar business within the United States when the person "[m]ak[es] personal, mortgage, industrial, or other loans to the public" in the United States. Although this regulation provides rules for determining whether income is effectively connected to a banking, financing, or similar business, these regulations demonstrate that the conduct of that type of business in the United States does not qualify as "trading in stocks or securities" for purposes of the Trading Safe Harbors. The Tax Court has also looked to these regulations as a "useful framework" for analyzing whether a person is engaged in trade or business within the United States. Inverworld, Inc. v. Comm'r, 71 T.C.M. 3231 at 24 (1996). In Year 1 and Year 2, Fund actively solicited unrelated borrowers in the United States and made multiple loans to those borrowers. Because Fund made "personal, mortgage, industrial, or other loans to the public" in the United States, Fund was engaged in the active conduct of a banking, financing, or similar business within the United States. Fund's lending activities, therefore, did not constitute trading in stocks or securities. Treas. Reg. § 1.864-4(c)(5).

B. Limited Underwriting Exception

Similarly, the section 864 regulations establish that underwriting generally does not constitute trading for purposes of the Trading Safe Harbors. Those regulations describe a narrow set of circumstances under which a foreign underwriter may qualify for the Trading Safe Harbors. Specifically, a foreign underwriter will not be treated as a dealer, and will not be engaged in a trade or business within the United States, if the foreign person acts as an underwriter, or as a selling group member, for the purpose of making a distribution of stocks or securities of a domestic issuer only to foreign purchasers of such stocks or securities. Treas. Reg. §§ 1.864-2(c)(2)(iv)(*b*)(*1*) & 1.864-2(c)(2)(iv)(*c*), Example (1). The limited nature of the exception demonstrates that distributing stocks or securities to U.S. customers exceeds the level of underwriting activity permitted to qualify as "trading in stocks or securities." Through Distribution Agreements, Fund purchased shares from U.S. issuers and sold those shares to purchasers in the United States and abroad. Fund's underwriting activities in the United States were more extensive than the limited underwriting activities permitted under the Trading Safe Harbors. See Treas. Reg. § 1.864-2(c)(2)(iv)(*b*)(*1*).

C. Trading for Section 1221(a)(1) Purposes

This interpretation of what constitutes "trading" for purposes of the Trading Safe Harbors is consistent with judicial determinations of the scope of trading activity in other contexts. For example, for purposes of section 1221(a)(1), courts have described "trading" as purchasing and selling in secondary markets in order to generate profit based on changes in value of the traded assets.[9] See, e.g., United States v. Wood, 943 F.2d 1048, 1051-52 (9th Cir. 1991) ("[t]raders … are sellers of securities or commodities who 'depend upon such circumstances as a rise in value or an advantageous purchase to enable them to sell at a price in excess of cost …. A trader performs no merchandising functions nor any other service which warrants compensation by a price mark-up of the securities he or she sells.") (quoting Kemon v. Comm'r, 16 T.C. 1026, 1033 (1951)); Bielfeldt v. Commissioner, 231 F.3d 1035, 1037 (7th Cir. 2000) ("the trader's income is based not on any service he provides but rather on, precisely, fluctuations in the market value of the securities or other assets that he transacts in."). Fund profited from its lending and underwriting activities by earning fees, a spread, and interest payments. Fund did not seek to profit from a change in value of the securities it received from issuers and borrowers. As a result, Fund's lending and underwriting did not constitute trading.

[9] Section 1221(a)(1) excludes from capital asset status "stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer … or property held by the taxpayer primarily for sale to customers and property held for sale to customers in the ordinary course of his trade or business." Courts have held that section 1221(a)(1) describes securities held by dealers, but not traders. See, e.g., Marrin v. Comm'r, 147 F.3d 147, 151 (2d Cir. 1998).

D. Conclusion

Based on the regulations under section 864 and case law defining the term "trader" for purposes of section 1221(a)(1), Fund's lending and underwriting activities did not constitute trading in stocks or securities. These regulations and judicial decisions establish that certain activities may entail the "effecting of transactions in stocks and securities," but nonetheless exceed the scope of the trading activities protected by the Trading Safe Harbors. These characteristics may include the conduct of one or more activities typical of a banking, financing, or similar business: interaction with customers; the attempt to generate profit from merchandising rather than market appreciation; or the extent of an underwriter's involvement in the U.S. markets. Fund's lending and underwriting activities demonstrate these characteristics. When Fund engaged in lending and underwriting, it did not profit from taking on risk or identifying advantageous purchases. Rather, in exchange for performing lending and underwriting activities, Fund received compensation in the form of fees, discounted property, and spreads. Both the activities performed and the compensation received by the Fund demonstrate that Fund's activities are not properly characterized as trading in stocks or securities.

III. Even if Fund's Lending and Stock Distribution Activities Were Treated as "Trading in Stocks or Securities" for Purposes of the Trading Safe Harbors, Fund Would Have Been Ineligible for the Trading Safe Harbors during Year 1 and Year 2.

The conclusion that Fund's lending and underwriting activities were not "trading in stocks or securities" is sufficient to exclude these activities from the Trading Safe Harbors. However, even if Fund's lending and underwriting activities had constituted trading in stocks or securities, Fund was ineligible for the (A)(i) Safe Harbor because Fund granted discretionary authority to Fund Manager. Further, Fund did not qualify for the (A)(ii) Safe Harbor because Fund acted as a dealer during Year 1 and Year 2.

A. The (A)(i) Safe Harbor

Fund was ineligible for the (A)(i) Safe Harbor because Fund delegated discretionary authority to a U.S.-resident agent to conduct Fund's lending and underwriting. Neither section 864(b) nor the regulations interpreting that section specifically define the term "independent agent" for purposes of the (A)(i) Safe Harbor. However, the statutory language of section 864(b), the legislative history, and the regulations under section 864 demonstrate that a taxpayer may not qualify for the (A)(i) Safe Harbor if the taxpayer delegates discretionary authority to a U.S.-resident agent.

1. The Trading Safe Harbors after FITA

Congress enacted section 864(b)(2) in 1966 partly in response to judicial and administrative interpretations of the trading safe harbor provided in the Internal Revenue Code of 1939 (the "1939 Code"). The term "independent agent" in section

864(b)(2)(A)(i) must be construed in light of that context, which demonstrates that Congress intended that transactions conducted through an agent vested with discretionary authority could not qualify for the (A)(i) Safe Harbor.

The 1939 Code provided that a "nonresident alien individual engaged in trade or business in the United States or having an office or place of business therein" was subject to U.S. tax on a net basis. See § 211(b) of the 1939 Code. The 1939 Code also included a safe harbor that was similar to the current (A)(i) Safe Harbor. Specifically, section 211(b) of the 1939 Code provided that the phrase "engaged in trade or business within the United States" did not include "the effecting of transactions in the United States in stocks, securities, or commodities through a resident broker, commission agent, or custodian." Id. In 1966, Congress amended that safe harbor by adding "or other independent agent" so that it permitted trading through "a resident broker, commission agent, custodian, or other independent agent."

The amendment was prompted by a 1948 Tax Court decision interpreting the 1939 Code's trading safe harbor. In Adda, the Tax Court concluded that the section 211(b) safe harbor in the 1939 Code was inapplicable to a nonresident alien who granted discretionary authority to a U.S.-resident agent (the taxpayer's brother) to deal in commodity futures for the nonresident alien's account. 10 T.C. at 277-78. The Tax Court reasoned:

> Had the petitioner come to the United States and effected these transactions while here for a sufficient period he would be taxed upon the profits of these transactions, for he would lose the status of nonresident alien and section 211 would not be applicable. He seeks to accomplish in this case, through his brother as his agent, what he could not accomplish directly by himself, that is, to effect transactions by decisions made in the United States by one who is not a resident broker, commission agent, or custodian, and not be taxed upon the gains. In effect he is engaging, by his agent, in trade or business in the United States.

Id. at 277.

Soon afterwards, the Internal Revenue Service reached a similar conclusion, ruling that a Canadian investment company was engaged in trade or business in the United States when the company had an agent in the United States with discretionary power to purchase and sell securities. See Rev. Rul. 55-282, 1955-1 C.B. 634.

Congress enacted section 864(b)(2) as part of the Foreign Investors Tax Act of 1966 (P.L. 89-809) ("FITA"). FITA amended the 1939 Code's statutory trading safe harbor in two relevant ways. First, whereas the 1939 Code permitted trading in the United States "through a resident broker, commission agent, or custodian," Congress amended that safe harbor to permit trading through a resident broker, commission agent, custodian, "or other independent agent." Second, in the newly-enacted (A)(ii) Safe Harbor,

Congress expressly permitted foreign persons that are not dealers in stocks or securities to trade in stocks, securities, and commodities in the United States through resident agents vested with discretionary authority.

The term "independent agent" is not explicitly defined for purposes of section 864(b). However, the term should be understood in the context of FITA's overhaul of the pre-1966 statutory trading safe harbor. Congress expressly permitted taxpayers invoking the (A)(ii) Safe Harbor to grant discretionary authority to U.S.-resident agents, but did not extend the same right to taxpayers invoking the (A)(i) Safe Harbor. Concurrently, Congress limited the scope of trading permitted under the (A)(i) Safe Harbor to trading "through a resident broker, commission agent, custodian, or other independent agent." By specifically permitting trading through resident agents granted discretionary authority solely in the (A)(ii) Safe Harbor, while simultaneously limiting the scope of the (A)(i) Safe Harbor to trading "through a resident broker, commission agent, custodian, or other independent agent," Congress implicitly defined an "independent agent" as an agent lacking discretionary authority.

Permitting dealers to trade in the United States through resident agents vested with discretionary authority would have undermined Congress's decision to exclude dealers from the (A)(ii) Safe Harbor. Unlike the (A)(i) Safe Harbor, the (A)(ii) Safe Harbor permits trading through employees or an office located in the United States.[10] By preventing dealers from qualifying for the Trading Safe Harbors when trading through an employee or office in the United States, Congress sought to block foreign dealers from actively competing with U.S. dealers while also qualifying for the Trading Safe Harbors. See CC:LR-1185, 1987 WL 1363873 at p.7-8 ("A second question arose with respect to the exclusion of dealers from section 864(b)(2)(A)(ii) (trading for taxpayer's own account). The reason for this is that dealers are in the business of trading in stocks or securities for their own account. If they were artificially to be considered not engaged in trade or business in the United States by virtue of their United States trading they would have a distinct competitive advantage vis-à-vis their United States counterparts."). If the (A)(i) Safe Harbor permitted trading through resident agents vested with discretionary authority, then dealers could use that safe harbor to do exactly what Congress was trying to prevent: that is, those dealers could trade through U.S.-resident agents granted discretionary authority and exempt their trading gains from U.S. taxation while their domestic competitors were subject to full U.S. taxation on their trading gains. This would eviscerate Congress's purpose in banning dealers from the (A)(ii) Safe Harbor.

Furthermore, the legislative history to FITA demonstrates that Congress sought to overturn the result in Adda for non-dealers (by enacting the (A)(ii) Safe Harbor) while

[10] Prior to the Taxpayer Relief Act of 1997, P.L. 105-34, § 1162(a), a foreign corporation generally could qualify for the (A)(ii) Safe Harbor unless the foreign corporation's principal business was trading in stocks or securities and the corporation's principal office was in the United States. The Taxpayer Relief Act eliminated that restriction.

preserving the Adda result for dealers (by clarifying that if an agent were granted discretionary authority, then the (A)(i) Safe Harbor would not apply):

> Under present law, the granting of this discretionary authority may prevent a nonresident alien or foreign corporation from qualifying for [the pre-1966 statutory trading safe harbor…. Y]our committee has amended present law to specifically provide that, except in the case of a dealer, the trading in stocks, securities, or commodities in the United States, for one's own account, whether by a foreign person physically present in the United States, through an employee located here, or through a resident broker, commission agent, custodian, or other agent – whether or not that agent has discretionary authority – does not constitute a trade or business in the United States….
>
> Although, under [section 864(b)], a dealer is specifically excluded from those who may grant discretionary authority and not be deemed to be conducting a business in the United States, he may trade in securities or commodities, for his own account, through a U.S. agent without being considered to be conducting a business in the United States.

H.R. Rep. No. 1450, 89th Cong., 2d Sess., 1966-2 C.B. 965, 975-76.

Numerous commentators have concurred with the conclusion that the (A)(i) Safe Harbor is inapplicable when a foreign person grants discretionary authority to a U.S.-resident agent. See, e.g., Sidney I. Roberts, U.S. Taxation of Foreign Taxpayers' Stock or Security Transactions: An Analysis, Tax'n of Int'l Trade 66, 72 (August 1970) ("a dealer can qualify for exclusion only under the general rule of Section 864(b)(2)(A)(i) …[t]hus, a foreign dealer in stocks or securities who regularly effects transactions in the United States, is within the statutory exclusion only if he effects such transactions through an independent nondiscretionary agent."); Leslie B. Samuels & Patricia A. Brown, Observations on the Taxation of Global Securities Trading, 45 Tax L. Rev. 527, 547-48 (1990) (arguing that the (A)(i) Safe Harbor does not apply to a foreign person who grants discretionary authority to a U.S.-resident agent); Yaron Z. Reich, Taxing Foreign Investors' Portfolio Investments: Developments and Discontinuities, 16 Tax Notes Int'l (TA) 1975, 1980 n.22 (Jun. 22, 1998) (noting that the (A)(i) Safe Harbor, "which is available to dealers … is intended to facilitate the execution of transactions through U.S. brokers that do not exercise discretionary authority on behalf of the taxpayer."); David R. Sicular & Emma O. Sobol, Selected Current Effectively Connected Income issues for Investment Funds, 56 Tax Law. 719, 762 (Summer 2003) (noting that pre-FITA case law suggests that an independent agent cannot, for section 864 purposes, be granted discretionary investment authority); New York City Bar, Report Offering Proposed Guidance Regarding U.S. Federal Income Tax Treatment of Certain Lending Activities Conducted Within the U.S., at 4 (May 3, 2007) (noting that legislative history to FITA suggests that an agent with discretionary authority may not be considered "independent" for purposes of the (A)(i) Safe Harbor).

This conclusion is unaffected by the fact that, in other contexts, an independent agent may exercise discretionary authority on behalf of its principal. See, e.g., Taisei Fire and Marine Insurance Co. Ltd., 104 T.C. 535, 552 (May 2, 1995) (reasoning that "[i]t is freedom in the manner by which the agent performs [specified] duties that distinguishes him as independent" in determining whether a Japanese resident would be deemed to have a U.S. permanent establishment under article 9 of the Convention Between the United States of America and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Mar. 9, 1971, 23 U.S.T. (Part 1) 969).[11]

2. Regulatory Definition of "Dealer"

The regulatory definition of the term "dealer" under the (A)(ii) Safe Harbor also confirms that a foreign person who grants discretionary authority to U.S.-resident agents is ineligible for the (A)(i) Safe Harbor (and is limited to trading through the (A)(ii) Safe Harbor). The Treasury regulations provide that a foreign person who otherwise may be considered a dealer in stocks or securities shall not be considered a dealer for purposes of the (A)(ii) Safe Harbor "[s]olely because of transactions effected in the United States in stocks or securities pursuant to his grant of discretionary authority to make decisions in effecting those transactions, if he can demonstrate … [that] the transactions were effected … [on behalf] of a customer who is [not] a dealer in stocks or securities." § 1.864-2(c)(2)(iv)(*b*)(*2*); see also Treas. Reg. § 1.864-2(c)(2)(iv)(*c*), Example 2 (providing that a foreign bank "is not engaged in trade or business in the United States" when the foreign bank authorizes a U.S. broker to exercise discretion in trading stocks for the foreign bank's customer); David S. Miller, The U.S. Federal Income Tax Consequences of Origination Activity by Foreign Investment Vehicles, 2006 ABATAX-CLE 0505014 n.3 (May 5, 2006).

This narrow exception to the dealer definition allows a foreign dealer to qualify for the (A)(ii) Safe Harbor when the foreign dealer effects transactions of a customer through an agent with discretionary authority. If a dealer could grant discretionary authority to a U.S.-resident agent to transact on the dealer's behalf and still qualify for the (A)(i) Safe Harbor, then there would be no need to provide (or illustrate) this exception to the dealer definition. Hence, the regulations demonstrate that foreign persons that grant discretionary authority to U.S.-resident agents to transact on the foreign person's behalf can only use the (A)(ii) Safe Harbor. See also CC:LR-1185, 1987 WL 1363873 at p.4

[11] Commentators have noted evolving uses of the term "independent agent" in the treaty context. See generally John F. Avery Jones & David A. Ward, Agents as Permanent Establishments under the OECD Model Tax Convention, 33 Eur. Tax'n 154 (1993); Sidney I. Roberts, The Agency Element of Permanent Establishment: The OECD Commentaries From the Civil Law View (Parts 1 &2), 9 Intertax 396 & 488 (1993); Richard Crawford Pugh, Policy Issues Relating to the U.S. Taxation of Foreign Persons Engaged in Business in the United States through Agents: Some Proposals for Reform, 1 San Diego Int'l Law L. J. 1 (2000).

(indicating, in the transmittal letter for the final section 1.864-2 regulations, that an example in section 1.864-2(c)(2)(i) was intended to demonstrate that Adda had been reversed for non-dealers by the addition of section 864(b)(2)(A)(ii) (the (A)(ii) Safe Harbor) to the Code).

3. Conclusion

During the years at issue, Fund had no employees of its own. Instead, Fund conducted its business entirely through Fund Manager, which had been granted

Fund granted discretionary authority to Fund Manager to conduct a lending and underwriting business in the United States on behalf of Fund. Therefore, Fund Manager was not a resident broker, commission agent, custodian, or other independent agent for purposes of the (A)(i) Safe Harbor during the years at issue.

B. The (A)(ii) Safe Harbor

Fund was ineligible for the (A)(ii) Safe Harbor because its underwriting activities made it a "dealer in stocks or securities." A "dealer in stocks or securities" is "a merchant of stocks or securities, with an established place of business, regularly engaged as a merchant in purchasing stocks or securities and selling them to customers with a view to the gains and profits that may be derived therefrom." Treas. Reg. § 1.864-2(c)(2)(iv)(*a*). By contrast, investing or speculating in stocks or securities does not cause a person to be treated as a dealer. Id. Through its underwriting activity, Fund was regularly engaged in purchasing stocks and selling them to customers with an intention of earning gains and profits from those purchases and sales, and it had an established place of business. In addition, regulatory exceptions available to certain dealers are inapplicable to Fund.

Fund acted as a merchant of stocks by purchasing stocks from issuers with a view to distributing or selling that stock to the public. See Seeley v. Helvering, 77 F.2d 323, 324 (2d Cir. 1935) ("a merchant, ordinarily at least, does not resell to the same class of persons from whom he buys; he is a middleman in distributing the goods."). Fund held itself out to the public as providing issuers with access to public markets through Distribution Agreements. Pursuant to the Distribution Agreements, Fund was irrevocably bound to purchase stock from the issuers. During the Period, Fund typically sold an issuer's stock in an amount that would generate enough cash to fund the advance requested by the issuer. The terms of the Distribution Agreements and the Fund's conduct show that it purchased and sold issuers' stock in the course of its underwriting business. Moreover, the number of transactions that occurred over the course of several years shows that Fund regularly engaged in this underwriting activity. Fund entered into Amount 6 Distribution Agreements with unrelated issuers in Year 1 and Amount 7 Distribution Agreements with unrelated issuers in Year 2.

Treas. Reg. § 1.864-2(c)(2)(iv)(*a*) establishes that dealers seek to derive "gains and profits" specifically from the activity of acting as merchants and buying stocks and securities and selling them to customers, meaning that dealers are distinguished from investors or traders by charging a mark-up as middlemen rather than seeking to derive profits solely from market appreciation. Whereas a dealer is one who acquires securities to hold for resale to customers, charging a mark-up on such securities for providing a service, a trader buys and sells securities with a view to profiting from changes in value in the securities. See Bielfeldt v. Commissioner, 231 F.3d 1035, 1037 (7th Cir. 2000) (explaining that "the dealer's income is based on the service he provides in the chain of distribution of the goods he buys and resells, rather than on fluctuations in the market value of those goods, while the trader's income is based not on any service he provides but rather on, precisely, fluctuations in the market value of the securities or other assets that he transacts in.").

In light of this distinction between the profits earned by a dealer and a trader, Fund earned profits as a dealer. Fund did not profit by speculating in an issuer's stock; instead, Fund acquired the issuer's stock at a discount and sold the stock at market price. Fund, as an underwriter, distributed stock or securities in exchange for fees, discounted securities, and other property. That compensation constitutes "income … based on the service [an underwriter] provides in the chain of distribution of the goods he buys and resells," rather than profits derived from market fluctuations. Id. These gains and profits are consistent with the gains and profits earned by a "dealer in stocks and securities" for purposes of Treas. Reg. § 1.864-2(c)(2)(iv)(*a*) and for other purposes of the Code.

As a result of its underwriting activity, Fund purchased stocks and sold them to customers within the meaning of Treas. Reg. § 1.864-2(c)(2)(iv)(*a*). The reference to "purchasing stocks or securities and selling them to customers" does not establish a conjunctive test pursuant to which a dealer must both (*x*) purchase stocks or securities

from a specified class of persons identifiable as "customers" and (*y*) sell those stocks or securities to a class of persons also identifiable as "customers." Rather, the regulation articulates a standard pursuant to which a dealer is a person that acts as a middleman or market-maker with respect to stocks or securities. Further, the regulations do not require that the middleman establish any particular prescribed or pre-existing relationship with a given purchaser in order for that purchaser to qualify as a "customer" for purposes of the dealer definition. Rather, a middleman's vendees are customers per se whenever the middleman is seeking to earn a profit by reselling to such vendees. Cf. Kemon v. Comm'r, 16 T.C. 1026 (1951) ("[t]hose who sell 'to customers' are comparable to a merchant in that they purchase their stock in trade, in this case securities, with the expectation of reselling at a profit, not because of a rise in value during the interval of time between purchase and resale, but merely because they have or hope to find a market of buyers who will purchase from them at a price in excess of their cost. This excess or mark-up represents remuneration for their labors as a middleman bringing together buyer and seller, and performing the usual services of retailer or wholesaler of goods. Such sellers are known as 'dealers.'"). This is true even when a middleman's vendees are, for example, other dealers, provided that the middleman is seeking to earn a mark-up through the transaction. Therefore, when Fund sold the stock acquired pursuant to the Distribution Agreements, Fund's vendees were "customers" simply by virtue of the fact that Fund was providing market access to issuers.

In addition, Fund performed its underwriting activities through the Fund Manager's office, which served as an "established place of business" within the meaning of Treas. Reg. § 1.864-2(c)(2)(iv)(*a*). Fund and Fund Manager entered into a management agreement pursuant to which Fund appointed Fund Manager as Fund's agent and irrevocable attorney-in-fact with full power to buy, sell, and otherwise deal in securities and related contracts for Fund's account. Pursuant to that grant of authority, Fund Manager conducted a stock distribution business on behalf of Fund through Fund Manager's office.

Although Treasury regulations permit a foreign person to engage in limited underwriting activities without being treated as a dealer, these exceptions are not available to Fund. Specifically, a foreign person is not considered a dealer solely because the foreign person acts as an underwriter, or as a selling group member, for the purpose of making a distribution of stocks or securities of a domestic issuer to foreign purchasers of such stocks or securities. Treas. Reg. § 1.864-2(c)(2)(iv)(*b*)(*1*) & (c)(2)(iv)(*c*), Example (1). However, Fund's activities were not within the scope of the exception because Fund's distribution of stock was not limited to foreign purchasers. Further, the narrow scope of this exception establishes that a foreign person purchasing stocks or securities from U.S. issuers with a view to distributing those stocks or securities to U.S. purchasers will typically be treated as a dealer for purposes of the (A)(ii) Safe Harbor.

Accordingly, Fund was a dealer in stocks or securities within the meaning of section 1.864-2(c)(iv)(*a*). As a dealer in stocks or securities within the meaning of section 1.864-2(c)(iv)(*a*), Fund was ineligible for the (A)(ii) Safe Harbor.[12]

SUMMARY

Based on all the facts and circumstances described above, Fund, through Fund Manager, engaged in lending and stock distribution activities within the United States on a considerable, continuous, and regular basis. Those activities were neither investment activities, nor "trading in stock and securities" as that term is used in the Trading Safe Harbors. Rather, Fund's extensive lending and underwriting activities caused Fund to be engaged in a trade or business within the United States during Year 1 and Year 2. As a partner in Fund, Foreign Feeder was engaged in a trade or business within the United States.

OTHER CASES

Determinations regarding whether nonresident individuals or foreign corporations are engaged in a trade or business within the United States for purposes of sections 864(b), 871(b), and 882 are highly factual. Depending on the facts and circumstances, we will support adjustments asserting that offshore investment vehicles that engage in a lending or underwriting business or in other activities that are not protected by the Trading Safe Harbors are engaged in a trade or business within the United States. Other fact patterns may also cause foreign investment entities to be engaged in the active conduct of a trade or business within the United States. We encourage you to contact this office to discuss the factual development and legal analysis in these cases.

This memorandum is limited to an analysis of whether Fund and Foreign Feeder were engaged in a trade or business within the United States. [redacted]

[12] Fund purchased convertible debt instruments that were typically converted to discounted stock within a year. Fund sought to distribute that stock to the public market immediately following conversion. Notwithstanding the fact that Fund (i) sold stock rather than the notes that it acquired from borrowers and (ii) held its borrowers' notes for a brief period before converting the notes to stock and selling the stock to the public, the distribution activity associated with Fund's convertible loans constituted dealing in stocks or securities for the same reasons that Fund's activities related to its Distribution Agreements constituted dealing in stocks or securities.

Moreover, in other contexts, making loans to the public may be sufficient to cause a person to be treated as a dealer even when the lender holds the loans instead of selling them. See, e.g., Treas. Reg. § 1.475(c)-1(c)(i) (providing an exception from dealer status for a "taxpayer that regularly purchases securities from customers in the ordinary course of a trade or business (including regularly making loans to customers in the ordinary course of a trade or business of making loans)" that engages in no more than negligible sales of the securities is not a dealer, unless the taxpayer elects otherwise). (Emphasis added.) This memorandum expresses no opinion as to whether other types of lending activity (for example, lending but not selling the loans) would be sufficient to cause a foreign person to be treated as a dealer for purposes of the (A)(ii) Safe Harbor.

[redacted]

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call Mark Erwin, Peter Merkel, or Raymond Stahl at (202) 317-6938 if you have any further questions.