

**Office of Chief Counsel
Internal Revenue Service
Memorandum**

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to: Jack Forsberg
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from: Jeffery Mitchell
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(International)

subject: Application of Short-Term Obligation Exception in Notice 88-108

This Chief Counsel Advice responds to your request for assistance dated October 24, 2014. This advice may not be used or cited as precedent.

LEGEND

US Parent =
CFC A =
Country A =
Day 1 =
Year 1 =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Amount 1 =
Amount 2 =
Amount 3 =
Amount 4 =

ISSUE

If a controlled foreign corporation holds for 60 or more calendar days during a taxable year an obligation which, without regard to the 30-day rule described in Notice 88-108, 1988-2 C.B. 446, would constitute United States property within the meaning of section 956, can the controlled foreign corporation rely on the exclusion from the definition of the term “obligation” in Notice 88-108 with respect to obligations that meet the 30-day and 60-day tests?

CONCLUSION

No. Unless a controlled foreign corporation holds for fewer than 60 calendar days during a taxable year all obligations which, without regard to the 30-day rule described in Notice 88-108, would constitute United States property within the meaning of section 956, the exclusion from the definition of the term “obligation” in Notice 88-108 does not apply with respect to any obligation held by the controlled foreign corporation.

FACTS

US Parent, a domestic corporation, wholly owns CFC A, a controlled foreign corporation (“CFC”) within the meaning of section 957 that is organized in Country A. US Parent and CFC A both have taxable years ending Day 1. During Year 1, which is after 1988, CFC A made several loans to US Parent pursuant to a line of credit between CFC A as lender and US Parent as borrower. On Date 1, CFC A loaned Amount 1 to US Parent. Amount 1 was outstanding on the last day of CFC A’s quarter including Date 1. On Date 2, fewer than 30 calendar days after Date 1, US Parent repaid Amount 2, which is Amount 3 less than Amount 1, to CFC A. Amount 3 remained outstanding after Date 2. On Date 3, CFC A loaned Amount 4 to US Parent. Amount 4 and Amount 3 were outstanding on the last day of CFC A’s quarter including Date 3. On Date 4, fewer than 30 calendar days after Date 3, US Parent repaid Amount 4 to CFC A. As a result of these advances and repayments, Amount 3 was outstanding for more than 60 calendar days during Year 1, although Amount 2 and Amount 4 were each outstanding for fewer than 30 calendar days during Year 1 and were cumulatively outstanding for fewer than 60 calendar days during Year 1.

LAW AND ANALYSIS

I. Section 956 and the Short-Term Obligation Exception

Section 951(a)(1) provides that every person who is a United States shareholder (as defined in section 951(b)) of a CFC and who owns (within the meaning of section 958(a)) stock in such corporation on the last day, in the CFC’s taxable year, on which such corporation is a CFC shall include in his gross income for his taxable year in which or with which such taxable year of the corporation ends, in addition to his pro rata share of subpart F income of the CFC, the amount determined under section 956 with respect

to such shareholder for such year (but only to the extent not excluded from gross income under section 959(a)(2)).

Section 956(a) provides:

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.

The amount taken into account under paragraph (1) with respect to any property shall be its adjusted basis as determined for purposes of computing earnings and profits, reduced by any liability to which the property is subject.

The term "United States property" generally includes an obligation of a domestic corporation that is a United States shareholder (as defined in section 951(b)) of the CFC.¹ Subject to certain exceptions, the term "obligation" is defined in §1.956-2T(d)(2) to include "any bond, note, debenture, certificate, bill receivable, account receivable, note receivable, open account, or other indebtedness."

Former §1.956-2(d)(2)(ii) excluded from the definition of "obligation" any indebtedness which a CFC collected within one year from the time the indebtedness was incurred. This one-year rule was eliminated effective for obligations incurred on or after June 14, 1988, by the promulgation of §1.956-2T(d)(2), which does not include a one-year rule.² Notice 88-108 then announced that final regulations under section 956 would include an exclusion for short-term obligations in lieu of the one-year exception eliminated by the temporary regulations. Notice 88-108 provides:

[F]inal 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

¹ Section 956(c)(1)(C), 956(c)(2)(F), 956(c)(2)(L).

² T.D. 8209, 1988-2 C.B. 174.

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.

At the time of the promulgation of §1.956-2T(d)(2) and the issuance of Notice 88-108, the amount of a CFC's investment in United States property was measured as of the CFC's year end. However, in 1993, section 956 was amended to provide that a CFC's investment in United States property is determined using the average of the amounts of United States property held by the CFC as of the close of each quarter of its taxable year.³ The legislative history indicates that the amendment was not intended to invalidate the short-term obligation exception in Notice 88-108.⁴

Although the final regulations described in Notice 88-108 have not yet been issued, the short-term obligation exception described in Notice 88-108 continues to apply.⁵ However, given the Notice's focus on a CFC's year end, the application of Notice 88-108 must be adapted to be consistent with amended section 956, which takes into account United States property held on quarterly measuring dates. In that regard, the legislative history indicates that, "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 [sic] at least 60 days in the taxable year, without regard to whether any such obligations are held on the date of measurement."⁶ The date of measurement for purposes of post-1993 section 956 is the quarterly measuring date.

Notice 88-108 is intended to apply in fact patterns in which CFC earnings are available for use in the United States for a small portion of the year. Consider, for example, a CFC that makes loans to its US parent approximately five days before each quarter end in order to enable the US parent to make payments on a revolving line of credit with an

³ Omnibus Budget Reconciliation Act of 1993, Pub. L. No. 103-66, §13232, 1993-3 C.B. 3, 89. Prior to its amendment, section 956(a)(1) read, in relevant part: "The amount of earnings of a controlled foreign corporation invested in United States property at the close of any taxable year is the aggregate amount of such property held, directly or indirectly, by the controlled foreign corporation at the close of the taxable year . . ."

⁴ H.R. Rep. No. 103-111 at 701 (1993) ("The bill is not intended to change the measurement of certain U.S. property that may apply, for example, in the case of short-term obligations, as provided in IRS Notice 88-108.")

⁵ Notice 88-108 does not apply to obligations treated as United States property pursuant to section 3.01(b) of Notice 2014-52, 2014-42 I.R.B. 712, as provided therein.

⁶ H.R. Rep. No. 103-111 at 701 (1993).

outside lender; the CFC loans are repaid within approximately 10 days. Other than the quarterly 10-day loans, the US parent owes no debts to the CFC during the year.⁷ This situation is clearly distinguishable from one in which a CFC holds obligations of its United States shareholders, or other United States persons whose obligations would be United States property, for a significant number of days during the year. Notice 88-108 reflects an understanding that short-term obligations outstanding for a small portion of the year may not constitute a repatriation of the type that section 956 was intended to address. However, the purposes of section 956 require that, if CFC earnings are available for use by a related United States person for a significant portion of the year, the amounts be taxed similarly to the way that earnings distributed to a United States shareholder of the CFC would be taxed.⁸ Accordingly, Notice 88-108 provides that its short-term obligation exception does not apply if a CFC holds for 60 days or more during the taxable year any obligations that would (without regard to the short-term obligation exception) be United States property.

II. Application of the Short-Term Obligation Exception to the US Parent Obligations

US Parent is a United States shareholder (within the meaning of section 951(b)) of CFC A. Accordingly, the loans made to it by CFC A in Year 1 are obligations that constitute United States property unless an exception, such as the short-term obligation exception described in Notice 88-108, applies.

As discussed in the Facts section of this memorandum, CFC A made a loan in the amount of Amount 1 to US Parent, which comprised an obligation in the amount of Amount 2 that was repaid on Date 2 (the "Amount 2 Obligation") and an obligation in the amount of Amount 3 that was still outstanding after Date 4 (the "Amount 3 Obligation"). It also made a loan in the amount of Amount 4 (the "Amount 4 Obligation"). The Amount 2 Obligation and the Amount 4 Obligation were each outstanding for fewer than 30 calendar days. Furthermore, the cumulative time that the Amount 2 Obligation and Amount 4 Obligation were outstanding during Year 1 is fewer than 60 calendar days. On that basis, US Parent argues that the Amount 2 Obligation and Amount 4 Obligation each qualify for the exclusion from the definition of obligation for short-term obligations provided in Notice 88-108. Accordingly, US Parent argues, only the Amount 3 Obligation is United States property that must be taken into account in determining the average amount of United States property held by CFC A in Year 1.

However, as indicated in the Facts section of this memorandum, the Amount 3 Obligation was outstanding for a period in excess of 60 calendar days during Year 1.

⁷ Compare AM 2007-016, which indicates that Notice 88-108 excludes the 10-day obligations from the definition of obligation for purposes of section 956.

⁸ Cf. H.R. Rep. No. 94-658 at 216 (1976); S. Rep. No. 94-938 at 225 (1976) ("The reason why this provision was adopted was the belief that the use of untaxed earnings of a controlled foreign corporation to invest in U.S. property was 'substantially the equivalent of a dividend' being paid to the U.S. shareholders.").

Contrary to US Parent's position, Notice 88-108 does not provide a blanket exception for specific obligations that meet the 30-day and 60-day tests. Instead, it provides an exception for obligations that meet the 30-day test if, and only if, all obligations held by a CFC meet the 60-day test. Because CFC A held an obligation of US Parent—the Amount 3 Obligation—for 60 or more calendar days during the taxable year, Notice 88-108 does not exclude any obligations of US Parent from the definition of obligation for purposes of section 956.

Please call (202) 317-6934 if you have any further questions.