Internal Revenue Service
DEPARTMENT OF THE TREASURY

LB&I International Practice Service Transaction Unit

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Volume	4	Repatriation	**Level 1 UIL**	9414
Part	4.1	§956 - Investment in U.S. Property	**Level 2 UIL**	9414.01
Chapter	4.1.1	Identification of Investments in U.S. Property	**Level 3 UIL**	9414.01-01
Sub-Chapter	4.1.1.1	Obligations of a U.S. Person - CFC Loans to U.S. Person	–	–

Unit Name	Short Term Loan Exclusion from United States Property

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Issue and Transaction Overview

Short Term Loan Exclusion from United States Property

Some U.S. companies have significant earnings offshore in their Controlled Foreign Corporations (CFCs) that have not been distributed as dividends. To avoid taxable dividend distributions of the Earnings and Profits (E&P) back to the U.S. Parent (USP), some companies may attempt to use short term loans from the CFCs to related U.S. group companies to achieve economic repatriation of the foreign earnings. This Practice Unit examines the short term loan exclusion from the definition of U.S. Property, and whether such loans may trigger an income inclusion under IRC Section 951. It looks both at the issue of whether the relatively "mechanical" rules for the short term loan exception are met as well as at the more complex issue of whether a series of short term loans is being used in an attempt to circumvent IRC Section 951.

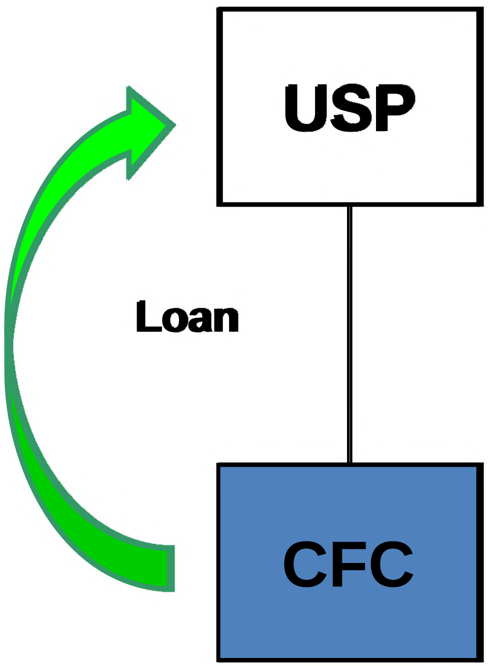
The examiner should determine early on in the audit process the total amount of un-repatriated offshore E&P, whether the taxpayer made loans back to related U.S. group companies and whether there are foreign tax credit offsets to any potential IRC Section 956 income inclusion. This will assist the examiner in determining any potential tax adjustment net of any offsetting foreign tax credit.

In general, under IRC Section 951 and IRC Section 956, a U.S. shareholder of a CFC includes in gross income its pro-rata share of the U.S. property held by the CFC. The amount of U.S. property held by the CFC is based on the average amount of U.S. property held by the CFC on each quarter end of the CFC's tax year. Thus, the Code takes a "snapshot" approach to determining the amount of U.S. property held by a CFC. Obligations of a U.S. person are generally considered an investment in U.S. property under IRC Section 956(c). Among the exceptions to that general rule, however, are short term loans. The "short term loan exception" exclude certain loans held by a CFC at a quarter end from the definition of United States property. The exception is based on the number of days the loan to the related U.S. person was outstanding and the number of days all loans from that CFC to all related U.S persons were outstanding during the CFC's taxable year. Provided the form of the loan is respected, the exception applies on a CFC by CFC basis.

Transaction and Fact Pattern

Short Term Loan Exclusion from United States Property

Diagram of Transaction



Facts

- CFC provides loans to USP periodically over several tax years.
- A loan is outstanding at the end of at least one quarter of the CFC's tax year.
- The definition of U.S. property for purposes of IRC Section 956 includes "an obligation of a United States person", provided the U.S. person is related to the CFC, see IRC Section 956(c)(1)(C), IRC Section 956(c)(2)(F), IRC Section 956(c)(2)(L).
- The average of the quarter-end balance of the loan constitutes the amount of U.S. property held by the CFC under IRC Section 956.
- Subject to the limitation in IRC Section 956(a), USP's pro-rata share of the U.S. property (including the loan) held by CFC is included in USP's gross income under IRC Section 951(a)(1)(B).

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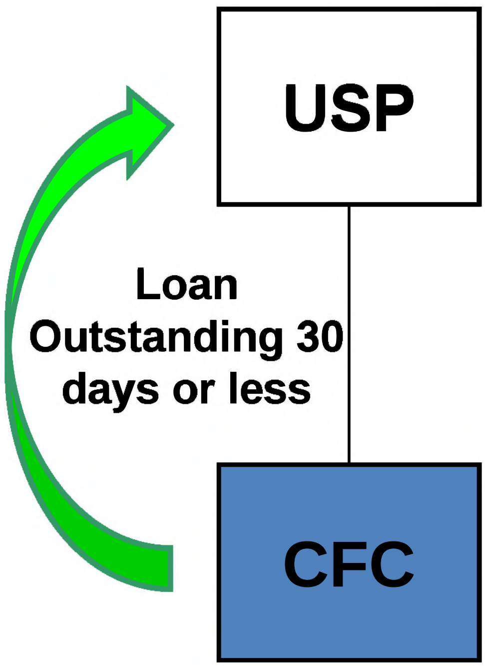
Transaction and Fact Pattern (cont’d)

Short Term Loan Exclusion from United States Property

Diagram of Transaction	Facts
	▪ For CFC tax years ending before 10/04/2008 and beginning on or after 01/01/2011, the “30/60” day short term loan exception applies: i. the CFC loan must be collected within 30 days from when it is incurred; and ii. all loans from the CFC to related U.S. persons during the CFC’s tax year must be outstanding for fewer than 60 days. ▪ USP is a multi-national company. CFC loans funds to USP. The loan is outstanding for 30 days or less. The loan is outstanding at the end of a quarter of CFC’s tax year. ▪ CFC has loans outstanding to all related U.S persons (including USP) for fewer than 60 days during CFC’s tax year

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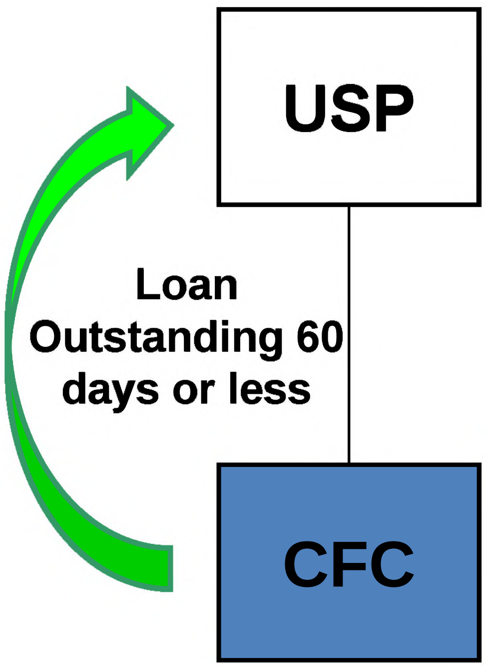
Transaction and Fact Pattern (cont’d)

Short Term Loan Exclusion from United States Property

Diagram of Transaction



Facts

- For CFC tax years ending after 10/03/2008 and beginning before 01/01/2011, the “60/180” day short term exception applies:
    - i. the loan must be collected within 60 days from when it is incurred; and
    - ii. all loans from the CFC to related U.S. persons during the CFC’s tax year must be outstanding for fewer than 180 days.
- USP is a multi-national company. CFC loans funds to USP. The loan is outstanding for 60 days or less. The loan is outstanding at the end of a quarter of CFC’s tax year.
- CFC has loans outstanding to related U.S. persons (including USP) for less than 180 days during USP’s taxable year.

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Effective Tax Rate Overview

Short Term Loan Exclusion from United States Property

ETR of Company

- Identify the company's ETR as reported in its financial statement tax footnote, and compare the company's ETR with the ETR of other companies in the same industry.
- Determine the total amount of offshore profits that are treated as Permanently Reinvested Offshore Income (PRI) from the company's financial statement tax footnote or other sources.
- Determine the amount of PRI (if possible) and E&P for each CFC that makes loans to USP.

ETR Impact of Adjustment

- An adjustment under IRC Section 956 attributable to a CFC in a low-tax jurisdiction would generally increase financial tax expense (a permanent difference) causing ETR to increase and PRI to decline.
- An adjustment under IRC Section 956 attributable to a CFC in a high-tax jurisdiction may not increase ETR and may even cause ETR to decrease, depending on USP's foreign tax credit position (e.g., excess limitation).

Summary of Potential Issues

Short Term Loan Exclusion from United States Property	
Issue 1	Whether the requirements of Notice 88-108 or Notice 2008-91 are satisfied with respect to the obligation of the related U.S. person. If not, for IRC Section 956 purposes, the obligation will be considered to be acquired by the CFC as of the obligation's origination date, and will be U.S. property if held by the CFC on a quarter end.
Issue 2	Whether the related U.S. person executes and repays each obligation to its CFC as a separate, independent transaction. If not, multiple obligations may be collapsed into a single obligation for purposes of IRC Section 956.

All Issues, Step 1: Initial Factual Development

Short Term Loan Exclusion from United States Property

The definition of U.S. property for purposes of IRC Section 956 includes an obligation of a related U.S. person, see IRC Section 956(c)(1)(C), IRC Section 956(c)(2)(F), IRC Section 956(c)(2)(L). However, certain obligations held by a controlled foreign corporation (CFC) are excluded from the definition of "obligation". Depending on the years under examination, there are different time periods to consider when determining whether a short-term obligation may be excluded from the definition of "obligation."

Fact Element	Resources	6103 Protected Resources
▪ CFC loans funds to USP	▪ Form 1120, Schedule L, Line 18 ▪ Form 5471, Schedule F, Line 5 (may also be reported on Lines 4 or 12) ▪ Form 5471, Schedule M, columns (b) and (c), Lines 10 and 26	

All Issues, Step 1: Initial Factual Development (cont'd)

Short Term Loan Exclusion from United States Property

The definition of U.S. property for purposes of IRC Section 956 includes an obligation of a related U.S. person, see IRC Section 956(c)(1)(C), IRC Section 956(c)(2)(F), IRC Section 956(c)(2)(L). However, certain obligations held by a controlled foreign corporation (CFC) are excluded from the definition of "obligation". Depending on the years under examination, there are different time periods to consider when determining whether a short-term obligation may be excluded from the definition of "obligation."

Fact Element	Resources	6103 Protected Resources
▪ CFC loans funds to USP	Request and/or review relevant: ▪ Organizational charts ▪ Taxpayer financial statements ▪ SEC Forms 10-K, 10-Q, and 8-K regarding (debt structure, credit facilities, debt issuance and retirement) ▪ External credit rating reports ▪ Loan agreements or other instruments of indebtedness (or, if no formal agreement exists, a description of the terms of the arrangement and all payment information) ▪ Wire transfers and accounting entries evidencing repayment ▪ Bank statements detailing cash transfers associated with the subject loans	

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Issue 1, Step 2: Review Potential Issues

Short Term Loan Exclusion from United States Property
Issue 1
Whether the requirements of Notice 88-108 or Notice 2008-91 are satisfied with respect to the obligation of the related U.S. person. If not, for IRC Section 956 purposes, the obligation will be considered to be acquired by the CFC as of the obligation's origination date and will be U.S. property if held by the CFC on a quarter end.

Explanation of Issue	Resources
Generally, if a CFC holds an obligation of a related U.S. person at the end of a quarter of the CFC's tax year, the CFC will be considered to hold U.S. property. However, pursuant to certain Notices issued by the IRS, short term obligations of a related U.S. person may be excluded from the definition of US property. For the short term loan exception to apply to a CFC's tax years ending before October 4, 2008 and beginning on or after January 1, 2011: – The obligation of the related U.S. person must be collected by the CFC within 30 days from the time the obligation is incurred (excluding the date of issuance, and including the date of repayment); and – The CFC must hold obligations of related U.S. persons for less than 60 days during the CFC's tax year.	▪ IRC Section 956(c)(1)(C) ▪ IRC Section 956(c)(2)(F) ▪ IRC Section 956(c)(2)(L) ▪ Treas. Reg. § 1.956-2(a)(1)(iii) ▪ Treas. Reg. § 1.956-2T(d)(2) ▪ Notice 88-108, 1988-2 C.B. 445 ▪ Chief Counsel Memorandum (IRS AM) 2007-0016 (October 5, 2007)

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

Short Term Loan Exclusion from United States Property
Issue 1
Whether the requirements of Notice 88-108 or Notice 2008-91 are satisfied with respect to the obligation of the related U.S. person. If not, for IRC Section 956 purposes, the obligation will be considered to be acquired by the CFC as of the obligation's origination date and will be U.S. property if held by the CFC on a quarter end.

Explanation of Issue	Resources
For the short term loan exception to apply to a CFC's tax years ending after October 3, 2008 and beginning before January 1, 2011: − The obligation of the related U.S. person must be collected by the CFC within 60 days from the time the obligation is incurred; and − The CFC must hold obligations of related U.S. persons for less than 180 days during the CFC's tax year. The CFC may elect to apply Notice 2008-91 or Notice 88-108, but may not apply both. The provisions of Notice 2008-91, as extended by Notice 2009-10 and Notice 2010-12, may be applied to up to three consecutive tax years of the CFC, but not to any taxable year of the CFC beginning on or after January 1, 2011.	▪ Notice 2008-91, 2008-43 I.R.B. 1001 ▪ Notice 2009-10, 2009-5 I.R.B. 419 ▪ Notice 2010-12, 2010-4 I.R.B. 326 ▪ Chief Counsel Memorandum (IRS AM) 2009-013 (October 19, 2009)

Issue 1, Step 3: Additional Factual Development

Short Term Loan Exclusion from United States Property
Issue 1
Whether the requirements of Notice 88-108 or Notice 2008-91 are satisfied with respect to the obligation of the related U.S. person. If not, for IRC Section 956 purposes, the obligation will be considered to be acquired by the CFC as of the obligation's origination date and will be U.S. property if held by the CFC on a quarter end.

Fact Element	Resources	6103 Protected Resources
▪ CFC loans funds to USP	In addition to the items requested during initial development, request copies of: ▪ Relevant schedules reflecting receivables/payable terms and payment and balance history, including details of increases/decreases in intercompany receivables ▪ Respective quarter end balances ▪ The taxpayer's IRC Section 956 calculations ▪ A description of the taxpayer's IRC Section 956 position	

Issue 1, Step 4: Develop Arguments

Short Term Loan Exclusion from United States Property
Issue 1
Whether the requirements of Notice 88-108 or Notice 2008-91 are satisfied with respect to the obligation of the related U.S. person. If not, for IRC Section 956 purposes, the obligation will be considered to be acquired by the CFC as of the obligation's origination date and will be U.S. property if held by the CFC on a quarter end.

Explanation of Adjustment	Resources
If the form of the related party loan is respected, the application of IRC Section 956 is mechanical. The determination of whether the loan satisfies the short term exception set forth in either Notice 88-108 (for the exclusion relative to a CFC's tax years ending before October 4, 2008 and beginning on or after January 1, 2011) or Notice 2008-91 (for the exclusion relative to a CFC's tax years ending after October 3, 2008 and beginning before January 1, 2011) is similarly mechanical	▪ IRC Section 956(c)(1)(C) ▪ IRC Section 956(c)(2)(F) ▪ IRC Section 956(c)(2)(L) ▪ Treas. Reg. § 1.956-2(a)(1)(iii) ▪ Treas. Reg. § 1.956-2T(d)(2) ▪ Notice 88-108, 1988-2 C.B. 445 ▪ Chief Counsel Memorandum (IRS AM) 2007-0016 (October 5, 2007)
DECISION POINT: Determine whether to proceed with this issue based on the results of the mechanical application of the rule to the facts gathered (i.e., were the loans repaid within the time limit to satisfy the exception?)	▪ Notice 2008-91, 2008-43 I.R.B. 1001 ▪ Notice 2009-10, 2009-5 I.R.B. 419 ▪ Notice 2010-12, 2010-4 I.R.B. 326 ▪ Chief Counsel Memorandum (IRS AM) 2009-013 (October 19, 2009)

Issue 2, Step 2: Review Potential Issues

Short Term Loan Exclusion from United States Property
Issue 2
Whether the related US person executes and repays each obligation to its CFC as a separate, independent transaction. If not, multiple obligations may be collapsed into a single obligation for purposes of IRC Section 956.

Explanation of Issue	Resources
Certain judicial doctrines may be relevant to the analysis of whether an obligation is excluded under the short-term loan exception. For instance, in order for the short-term loan exception to apply to an obligation, the substance of the obligation must match its form, and the obligation must not be one step in a series of related steps in a unified transaction. If it is determined that a series of obligations constitute successive roll-overs of a single obligation, then the periods of disinvestment will be ignored for purposes of testing the 30/60 day and 60/180 day rules of Notice 88-108 and Notice 2008-91, respectively.	▪ Chief Counsel Memorandum (IRS AM) 2009-013 (October 19, 2009) ▪ *Jacobs Engineering Group Inc. v. United States*, 79 AFTR 2d 97-1673 (D.C. Ca., 1997), *aff'd w/o reported opinion*, 168 F.3d 499 (9th Cir. 1999)

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

Short Term Loan Exclusion from United States Property
Issue 2
Whether the related US person executes and repays each obligation to its CFC as a separate, independent transaction. If not, multiple obligations may be collapsed into a single obligation for purposes of IRC Section 956.

Explanation of Issue	Resources
All relevant facts and circumstances must be considered to determine whether an obligation held by a CFC should be respected in accordance with its form. The relevant factors will vary depending on the facts of the case, and may include (but are not limited to): ▪ The volatility of economic conditions (both in general and in the taxpayer's specific industry) ▪ The related U.S. person's access to commercial paper markets, and a reasonable evaluation of whether this access will persist during the term of the loan ▪ The availability and terms of alternative sources of outside financing to the related U.S. person ▪ The related U.S. person's financial capacity to repay each obligation independently ▪ The CFC's period of disinvestment between holding obligations of the related U.S. person	▪ Rev. Rul. 89-73, 1989-1 C.B. 258. ▪ *Schering-Plough Corp. v. United States*, 651 F.Supp.2d 219 (D.N.J., 2009), *aff'd sub. nom. Merck & Co. v. U.S.*, 652 F.3d 475 (3rd Cir. 2011)

Issue 2, Step 3: Additional Factual Development

Short Term Loan Exclusion from United States Property
Issue 2
Whether the related US person executes and repays each obligation to its CFC as a separate, independent transaction. If not, multiple obligations may be collapsed into a single obligation for purposes of IRC Section 956.

Fact Element	Resources	6103 Protected Resources
▪ CFC loans funds to USP	In addition to the items requested during initial development, consider requesting copies of: ▪ Relevant schedules reflecting receivables/payable terms, payment and balance history, including details of increases/decreases in intercompany receivables. ▪ Tax planning documents, including slide decks for multi-step transactions, internal correspondence regarding loan program, tax research, memos, or opinions prepared by outside advisors.	

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

Short Term Loan Exclusion from United States Property
Issue 2
Whether the related US person executes and repays each obligation to its CFC as a separate, independent transaction. If not, multiple obligations may be collapsed into a single obligation for purposes of IRC Section 956.

Fact Element	Resources	6103 Protected Resources
▪ CFC loans funds to USP	▪ Relevant intercompany agreements or manuals containing internal policies or procedures relating to the taxpayer’s treasury function. ▪ Any materials (emails, documents, workpapers, etc.) that demonstrate that decisions with respect to the subject loan were driven by an intent to avoid IRC Section 956. ▪ Interview tax department and treasury personnel as needed (see IRM 4.10.3.2 Interviews: Authority and Purpose).	

Issue 2, Step 4: Develop Arguments

Short Term Loan Exclusion from United States Property
Issue 2
Whether the related US person executes and repays each obligation to its CFC as a separate, independent transaction. If not, multiple obligations may be collapsed into a single obligation for purposes of IRC Section 956.

Explanation of Adjustment	Resources	6103 Protected Resources
Rollover loans and collapsing multiple loans for purposes of IRC Section 956 is a fact-intensive issue. In addition to consideration of the documents identified in Step 3, the factors listed in IRS AM 2009-013 should be considered and weighed according to the facts and circumstances of the case: ▪ The volatility of economic conditions (both in general and in the taxpayer's specific industry) ▪ The related U.S. person's access to commercial paper markets, and a reasonable evaluation of whether this access will persist during the term of the loan ▪ The availability and terms of alternative sources of outside financing to the U.S. person ▪ The related U.S. person's financial capacity to repay each obligation independently; and ▪ The CFC's period of disinvestment between holding obligations of the related U.S. person	▪ Chief Counsel Memorandum (IRS AM) 2009-013 (October 19, 2009) ▪ *Jacobs Engineering Group Inc. v. United States*, 79 AFTR 2d 97-1673 (D.C. Ca., 1997), *aff'd w/o reported opinion*, 168 F.3d 499 (9th Cir. 1999) ▪ Rev. Rul. 89-73, 1989-1 C.B. 258. ▪ *Schering-Plough Corp. v. United States*, 651 F.Supp.2d 219 (D.N.J., 2009), *aff'd sub. nom. Merck & Co. v. U.S.*, 652 F.3d ▪ Treas. Reg. § 1.956-1T(b)(4)	

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Issue 2, Step 4: Develop Arguments (cont’d)

Short Term Loan Exclusion from United States Property
Issue 2
Whether the related US person executes and repays each obligation to its CFC as a separate, independent transaction. If not, multiple obligations may be collapsed into a single obligation for purposes of IRC Section 956.

Explanation of Adjustment	Resources	6103 Protected Resources
CONSULTATION: Local counsel should be consulted as necessary, when attempting to use judicial doctrines (*e.g.*, step transaction or substance over form) to collapse multiple loans for purposes of IRC Section 956.		

Training and Additional Resources

Chapter 4.1.1 Identification of Investments in U.S. Property		
Type of Resource	**Description(s) and/or Instructions for Accessing**	**References**
CENTRA sessions	June 2010 Centra: Intl Current Topics in Subpart F (PTP769724)	Intl Current Topics in Subpart F
CENTRA sessions	April 2013 Centra: IBC IRC Section 956 and Other Repatriation Strategies (VKH785440)	IBC IRC Section 956 and Other Repatriation Strategies
Podcasts / Videos	IBC 2011 CPE : Repatriation	IBC 2011 CPE : Repatriation
Other Training Materials	2011-2013 IE Phase III Classroom Presentation: IRC §956	International Examiner Phase III Training

Glossary of Terms and Acronyms

Term/Acronym	Definition
AM	Advice Memorandum
CFC	Controlled Foreign Corporation
ETR	Effective Tax Rate
PRI	Permanently Reinvested Offshore Income
USP	United States Parent

Index of Related Issues

Issue	Associated UIL(s)	References
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FTC management	9413	To Be Developed
Substance over Form and IRC Section 956	9414.01	To Be Developed
Identification of investments in U.S. property	9414.01-01	To Be Developed
Transactions in a foreign currency – Section 988	9470.02	To Be Developed