CCA specifies when short-term loan exception under Notice 88-108 will not apply

In Chief Counsel Advice Memorandum 201516064 (the CCA) (17 April 2015), the IRS concluded that the 30-day-rule short-term loan exception under Notice 88-108, 1988-2 C.B. 446, does not apply to any obligation owned by a CFC unless all obligations held during the tax year by the CFC are held for less than 60 days (i.e., satisfy the 60-day-rule).

Discussion

Section 951(a)(1)(B) subjects a US shareholder of a CFC to tax on its pro-rata share of the CFC’s earnings that are invested in “US property” under Section 956. Section 956(c)(1)(C) defines US property as including an “obligation of a [US] person.” Therefore, a loan by a CFC to its US shareholder generally constitutes an investment in US property, and, as such, is potentially subject to inclusion in a US shareholder’s income under Section 951. Section 956 provides that the amount of US property held by the CFC is calculated as the average of the amounts held as of the close of each quarter of the CFC’s tax year.

Under the Notice, the IRS permitted CFCs to exclude from the definition of “obligation of a [US] person” under Section 956 certain loans from a CFC to the United States that crossed the year end (now quarter end),¹ provided that: (1) the loans were collected within 30 days of the time they were incurred (the 30-day-rule) and, (2) the loans were held for fewer than 60 days in total during the year (the 60-day-rule).

It is unclear from the Notice how the short-term loan exception applies if a CFC owns a number of short-term obligations from a US shareholder during a given tax year. Specifically, the Notice does not state whether the short-term loan exception applies to each obligation separately or in an aggregated manner. The CCA takes an aggregated approach.
approach and interprets the Notice to mean that the short-term loan exception does not provide a stand-alone exception for any obligation that satisfies both the 30-day-rule and the 60-day rule. Instead, under the CCA, the Notice provides an exception for any short-term loan that satisfies the 30-day-rule only if all obligations owned by the CFC also satisfy the 60-day-rule.

Under the specific facts of the CCA, the IRS applies its aggregated approach as follows:

On Date 1, CFC1 lent Amount 1 to its US parent (USP). Amount 1 remained outstanding as of CFC1’s quarter end date. On Date 2, which was after the quarter end but within 30 days of Date 1, USP repaid a portion of Amount 1 (the portion repaid is referred to as Amount 2), which left the remaining portion of Amount 1 outstanding (referred to as Amount 3). On Date 3, CFC1 made another loan to USP (Amount 4) that remained outstanding as of another of CFC1’s quarter end dates. Following the end of the quarter, but within 30 days of its issuance, USP repaid Amount 4. “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."

Substituting actual numbers and dates to help illustrate the facts at issue in the CCA: Assume USP and CFC1 are calendar-year taxpayers and that the following transactions take place in a single tax year. On March 25, CFC1 lends 150 (Amount 1) to USP, of which 100 (Amount 2) is repaid by USP on April 5. The remaining 50 of the original advance (Amount 3) remains outstanding. On June 25, CFC lends an additional 100 (Amount 4) to USP, which is repaid by USP on July 5. To summarize, on CFC1’s March 31 and June 30 quarter end dates, CFC1 held 150 of obligations that are potentially US property. On a standalone basis, however, Amount 2 (i.e., 100) and Amount 4 (i.e., 100) satisfy both the 30-day-rule and the 60-day-rule. Only Amount 3 (i.e., 50) does not meet the 30-day-rule nor does it satisfy the 60-day-rule.

Because Amount 3 was not eligible for the short-term loan exception under the Notice, the CCA concludes that all obligations of USP held by CFC1 are ineligible for the short-term loan exception, even though Amount 2 and Amount 4 each satisfy both the 30-day-rule and the 60-day rule.

Implications

The CCA provides a view on the application of the short-term loan exception under Notice 88-108. Although the CCA is not precedential and is not binding on taxpayers, the CCA represents the view of the IRS. Taxpayers that make use of the short-term loan exception by having their CFCs make short-term loans into the United States should consider taking action to ensure that those CFCs do not hold any obligations that constitute investments in US property that may be ineligible for the short-term loan exception under Notice 88-108.

Endnote

1. In the Revenue Reconciliation Act of 1993, the testing period in Section 956 was changed from an annual test to a quarterly test. The Senate Committee Report stated that, “[t]he bill is not intended to change the measurement of U.S. property that may apply, for example, in the case of short-term obligations, as provided in IRS Notice 88-108.” (See S. Rep. on Revenue Reconciliation Act of 1993 at paragraph 10,915 of Act Secs. 13231-13233).
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