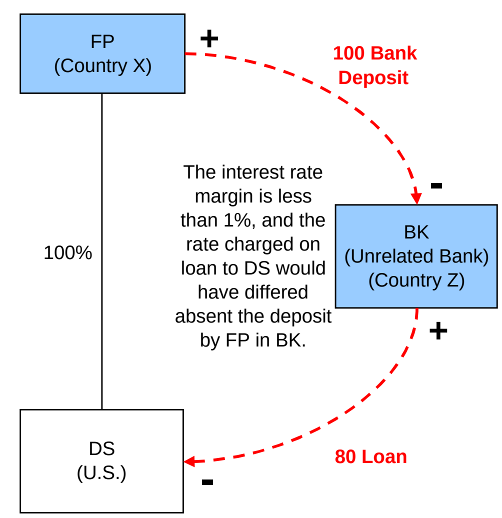
Revenue Ruling 87-89

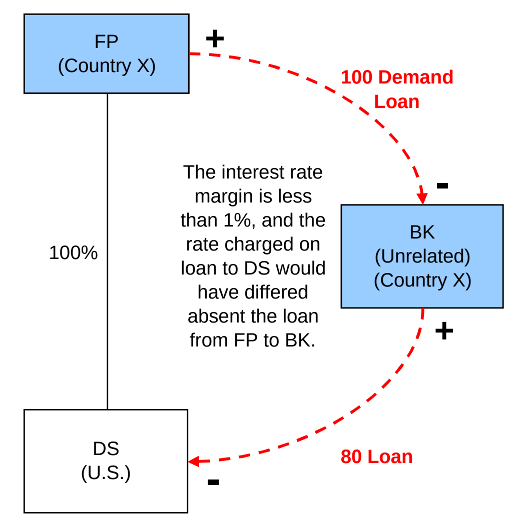
Lending Intermediary Disregarded in Cross-Border Lending Transactions

Situation 1 (Withholding Taxes)



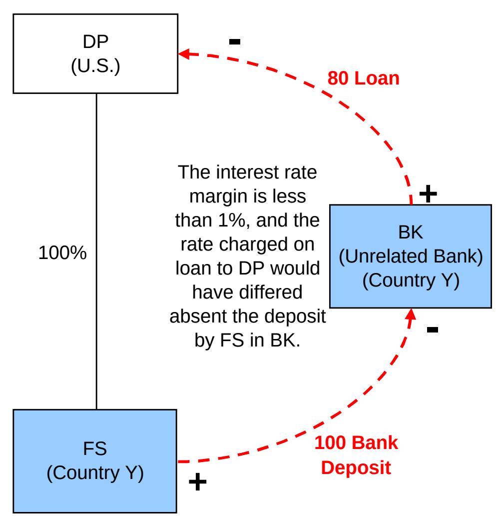
There is no Income Tax Treaty between the U.S. and Country X. However, there is an Income Tax Treaty between the U.S. and Country Z, and this treaty reduces withholding tax on interest to zero.

Situation 2 (Withholding Taxes)



There is no Income Tax Treaty between the U.S. and Country X, but the loan from BK to DS is structured so that the interest is characterized as portfolio interest.

Situation 3 (Section 956)



There is an Income Tax Treaty between the U.S. and Country Y, and this treaty reduces withholding tax on interest to zero.

Under sections 881(a) and 1442(a) of the Code, U.S. source interest income is subject to a 30% withholding tax when paid to a foreign corporation not engaged in a U.S.trade or business. Under section 894(a), such interest, to the extent required by any treaty obligation of the U.S., is exempt from the tax. Furthermore, under section 881(c), the 30% tax under section 881(a) is not imposed on portfolio interest received by a foreign corporation from sources within the U.S. However, pursuant to section 881(c)(3)(B), portfolio interest does not include interest received by a 10% shareholder of the issuer of the obligation on which the interest is paid.

Because the loan from BK to DS would not have been made on the same terms but for FP's deposit of funds in BK, the transaction will be treated as a direct loan from FP to DS and interest paid by DS on the loan will be subject to a 30% withholding tax.

The difference from Situation 1 is that BK is not a bank and BK is incorporated in Country X.

The analysis and the result are the same as in situation 1 (the loan is treated as being made directly between FP and DS, and interest to a 10% shareholder does not qualify as portfolio interest).

Under section 951(a)(1)(B), a U.S. shareholder of a CFC generally must include in gross income its pro rata share of the CFC's increase in earnings invested in U.S. property during the taxable year. Section 956(a)(1) provides that the amount of earnings of a CFC invested in U.S. property is the average of such property held, directly or indirectly, by the CFC at the close of each quarter of such taxable year, to the extent the amount would have constituted a dividend if it had been distributed.

Section 956(c)(1)(C) provides that the term "U.S. property" includes any property that is an obligation of a U.S.person. Section 956(c)(2)(F) excludes certain obligations of domestic corporations. However, the section 956(c)(2)(F) exception does not apply if the domestic corporation is the sole shareholder of the acquiring CFC.

Because the loan from BK to DP would not have been made on the same terms but for FS's deposit of funds in BK, the transaction will be treated as a direct loan from FS to DP and the loan will be considered U.S. property under section 956(c)(1)(C).