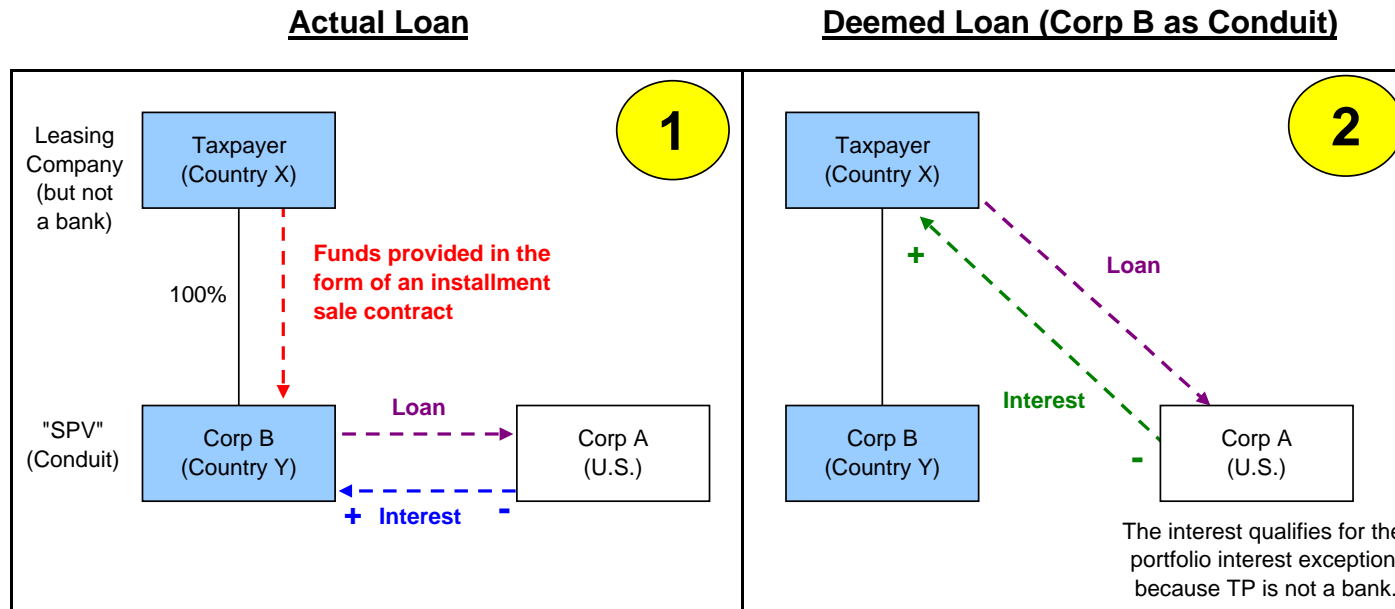


**Leasing Company Not A Bank
for Portfolio Interest Exception**



As part of an overall program to refinance existing debt, under a loan agreement dated Date A, Corporation A borrowed from Corporation B. The loan was arranged by Corporation D, a commercial bank. Corporation B was a Country Y subsidiary of Taxpayer. Taxpayer was a leasing company in Country X and was engaged in a variety of financial activities, including making commercial loans, equipment and real property leasing, installment financing, and other forms of financing and credit support, trading activities, and financial services. Consistent with this activity, commercial loans and installment obligations made up a significant part of Taxpayer's assets.

The Corporation B loan was a registered obligation within the meaning of Reg. §5f.103-1. The correspondence between Corporation A and Taxpayer, in addition to the notice given by Corporation A to senior creditors, suggested that all parties intended and understood that the loan was between Corporation A and Taxpayer. In Country X, only authorized foreign exchange banks and authorized money exchangers can make loans to nonresidents. To avoid this restriction, Corporation B, which is a "special purpose vehicle" was used in a transaction known as "square trip financing."

Section 881(a) generally imposes a 30 percent tax on certain types of income, including interest, received by a foreign corporation from sources within the United States. The tax is collected by way of withholding under section 1442. An exception from the tax is provided under section 881(c)(3) for portfolio interest. Portfolio interest includes any interest on a registered obligation, as defined in §5.103-1, if the person who must deduct and withhold tax from the interest under section 1442(a) receives a statement that meets the requirements of section 871(h)(5). Section 881(c)(3)(B). Providing a Form W-8 satisfies the statement requirement. Section 35a.9999-5(b) Q&A9.

Under section 881(c)(3)(A), portfolio interest does not include interest received by a bank on an extension of credit made pursuant to a loan agreement entered into in the ordinary course of its trade or business. No regulations have been issued under section 881(c)(3)(A) that define a bank or a loan entered into in the ordinary course of a bank's trade or business. It is this exception to the portfolio interest exemption that is at issue in this case.

The bank exception to the portfolio interest exemption has two separate requirements: (i) the recipient must be a bank, and (ii) the recipient must receive interest on a loan made in the ordinary course of its trade or business. The Blue Book provides that: “[w]hether a foreign bank will be considered to have extended credit pursuant to a loan agreement entered into in the ordinary course of its banking business will be determined, with respect to a particular obligation, under regulations prescribed by the Secretary.” Such regulations have not been issued. In writing regulations under section 881(c)(3)(A), the Secretary would be free to specify the extent to which the term “bank” should be construed to include a variety of types of foreign financial institutions engaged in lending activities in the ordinary course of business. In the absence of such regulations, however, the term “bank” must be construed narrowly and must be given a meaning that distinguishes it from all other entities that make commercial loans. The ruling concluded that the term should be defined by reference to section 581.

The section 581 definition of the term “bank” includes an operational test requiring that both accepting deposits and making loans must constitute a substantial part of the “bank’s” business. It also requires that the entity be regulated, supervised, and examined as a bank. This definition has been consistently applied in the Code, the regulations, and court decisions. When Congress uses the term “bank” alone, as opposed to “banking, financing, or other similar business,” it frequently includes a cross-reference to section 581. See, e.g., sections 165(1)(3)(A), 246A(c)(3)(B)(i), 271(a), 279(c)(5), 408(n)(1), 542(c)(2), 585(a)(2), 593(d)(1)(B)(ii), 1281(b)(1)(C), 6032, 6332(c), 6695(f), 7512(b), and 7609(a)(3)(A). Thus, using the section 581 definition of the term bank for purposes of section 881(c)(3)(A) is consistent with these other sections of the Code.

In the absence of regulations defining the term “bank” for purposes of section 881(c)(3)(A), the term should be defined with reference to section 581. Since an essential characteristic of a bank under section 581 is that it receives deposits, and since Taxpayer did not receive deposits, Taxpayer was not a bank under section 881(c). Thus, interest paid to Taxpayer, on the loan deemed to be from Taxpayer via Corporation B may qualify for portfolio interest under section 881(c), if all the other requirements of that section are met.

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