

IRS Addresses Lending by an Offshore Entity in the U.S.

By **Kenneth E. Werner**

In a memorandum issued by the Office of Chief Counsel directed to the Director of Field Operations, Manhattan, Financial Services, dated September 22, 2009, the IRS has set forth its legal analysis with respect to “certain lending activities undertaken by foreign corporations.” The facts described in the memorandum involve a foreign corporation that makes loans to United States borrowers. While the foreign corporation has no office or employees in the United States, it has a service contract with a United States company which negotiates the terms of the loans, performs credit analyses, and undertakes all other activities related to the origination of the loans, other than final approval and signing of the loans, which occurs outside the United States. The activities of the United States company are conducted, “on a considerable, continuous, and regular basis.” Not surprisingly, the memorandum concludes that the foreign corporation’s interest income from the loans constitutes income effectively connected with a United States trade or business.

There is nothing in the legal analysis in the memorandum that most tax advisors would disagree with. In fact, the memorandum addresses a pretty clear case, and doesn’t grapple with any of the more nuanced issues that foreign entities tend to consult their tax advisors about in this area. What is most significant about the memorandum is that it was issued at all, since the IRS has not provided any written guidance with respect to possible lending activities in the United States by foreign entities for some time. Of perhaps particular significance is the last paragraph of the memorandum, which indicates possible future activity by the IRS in this area:

We understand that foreign corporations and non-resident aliens may have used other strategies to

originate loans in the United States giving rise to effectively connected income. We encourage you to develop these cases, and we stand ready to assist you in the legal analysis.

Please let us know if you would like a copy of the memorandum, or if we can provide any assistance in considering issues involving activities of foreign entities which could give rise to effectively connected income.

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If you have any questions regarding the matters discussed in this memorandum, please call your usual contact at Richards Kibbe & Orbe LLP or the person listed below.

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Memorandum

September 23, 2009

“...[T]he memorandum addresses a pretty clear case, and doesn’t grapple with any of the more nuanced issues that foreign entities tend to consult their tax advisors about in this area.”

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