Selected International Tax Issues in the Joint Venture Context

Passthroughs & Real Estate Committee

DC Bar Section of Taxation
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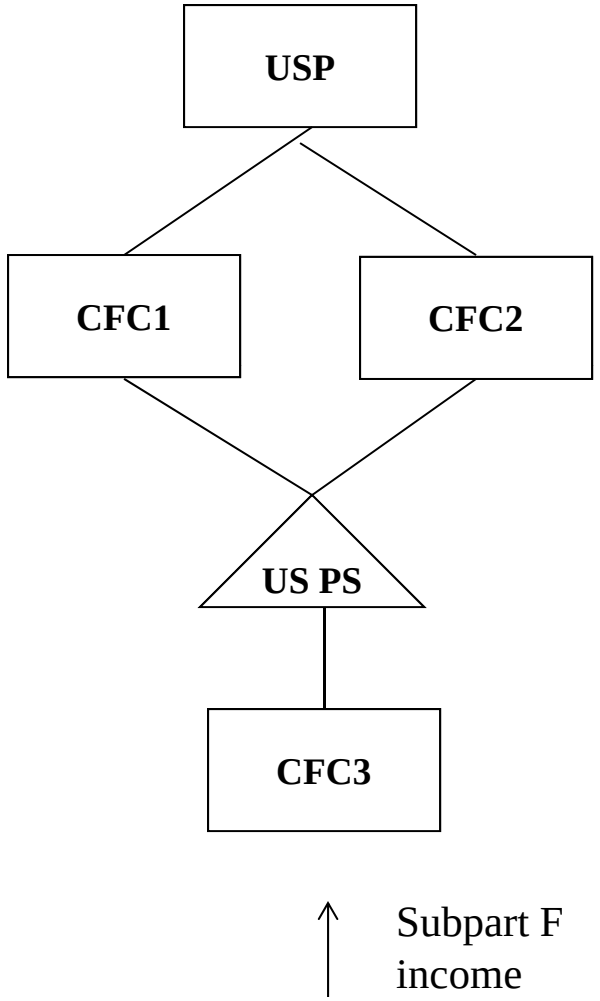
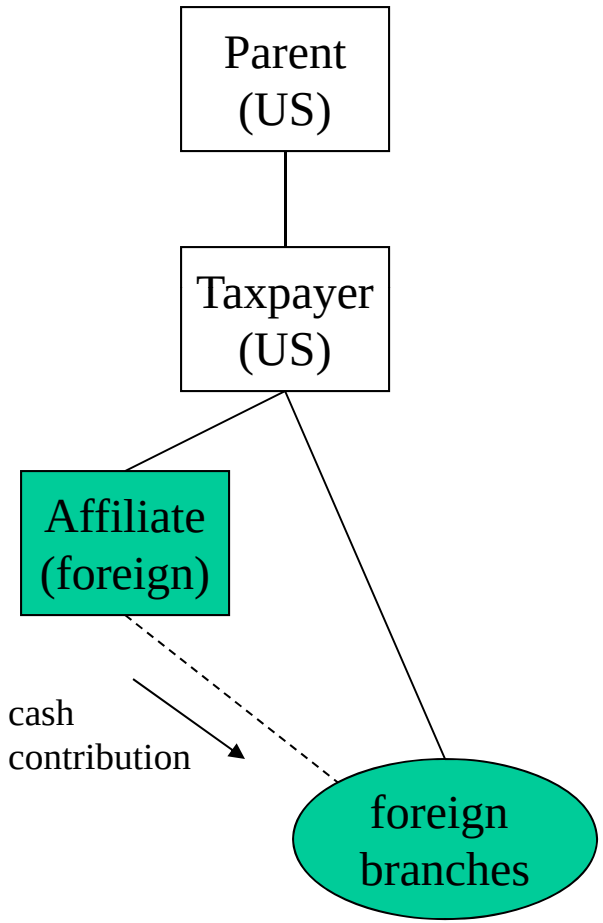
Issues in Entity Classification

Entity Classification Issues – Notice 2010-41

- Taxpayers took position that US PS was US shareholder for subpart F purposes, and USP avoids a subpart F inclusion. IRS viewed this result as inconsistent with purpose of subpart F
- US shareholders include "US persons." Section 951(b).
- Notice 2010-41 – regulations will provide that US PS is treated as a foreign partnership for purposes of identifying US shareholders of CFC3 required to include amounts under section 951(a).
  - Attribution rules effectively look through foreign business entities (e.g., foreign partnerships). Section 958(a)(2).
  - Under Notice, USP would be treated as US shareholder required to take into account subpart F inclusion



PLR 201305006 (Feb. 1, 2013)



- Taxpayer conducted foreign operations in Region in branch form.
- Taxpayer and its foreign affiliate entered into a contractual joint venture under which Affiliate contributed cash to the branches in exchange for an interest in capital and profits.
- The arrangement did not give rise to an entity under local law but was regarded as a business entity under sec. 301.7701-2.
- Taxpayer checked the box on the entity to treat it as a corporation for federal tax purposes.
- Because the contract was governed by foreign law and subject to the jurisdiction of foreign courts, it was held to be a foreign entity under sec. 301.7701-5.
- Income allocable to the foreign business activity was treated as income of the entity for federal tax purposes.

Foreign Partnership Safe-Harbor Compliance

Foreign Partnership Economic Effect Safe-Harbor Compliance

- Big Three
  - Maintain Partner Capital Accounts in Accordance with the Regulations.
  - Liquidate in Accordance with Partner Positive Capital Accounts.
  - Deficit Restoration Obligation if any Partner's Capital Account has a Deficit upon Liquidation.
- §1.704-1(b)(2)(ii)(b) safe harbor mandates that the Big Three are satisfied "if and only if, throughout the full term of the partnership, the partnership agreement provides" for the Big Three.
- Alternate Test for Economic Effect
  - Requires Liquidation in Accordance with Positive Capital Accounts.
- Economic Effect Equivalence
  - Ambiguous
- (We set aside the "substantiality" requirement for this discussion.)

Foreign Partnership Safe-Harbor Compliance

- Unlike Delaware law, even after some recent revisions to foreign statutes, it is still not entirely clear whether you can achieve the equivalent of US partnership tax law capital account liquidation under the commercial laws of many countries.
- Liquidation regime under the commercial laws of many countries may not track the Treasury regulation capital account maintenance requirements.
- If not, if may not be possible to satisfy the liquidate in accordance with partner positive capital account balances requirement.
- Non-taxable solution is to use targeted allocations and rely on PIP.

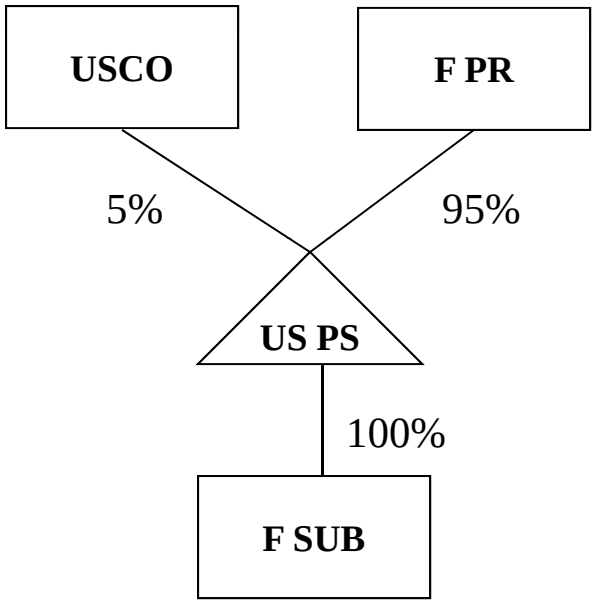
Foreign Partnership Economic Effect Safe-Harbor Compliance

- Under PIP, no assurance partnership allocations will be respected.
- Moreover, using targeted allocations and relying on PIP, under current US partnership tax law, prevents the foreign partnership from relying on certain additional safe harbors the operation of which are contingent on satisfying the safe harbor.
  - §1.704-2(e)(1)
  - Others?

Select Issues Involving CFCs and Partnerships

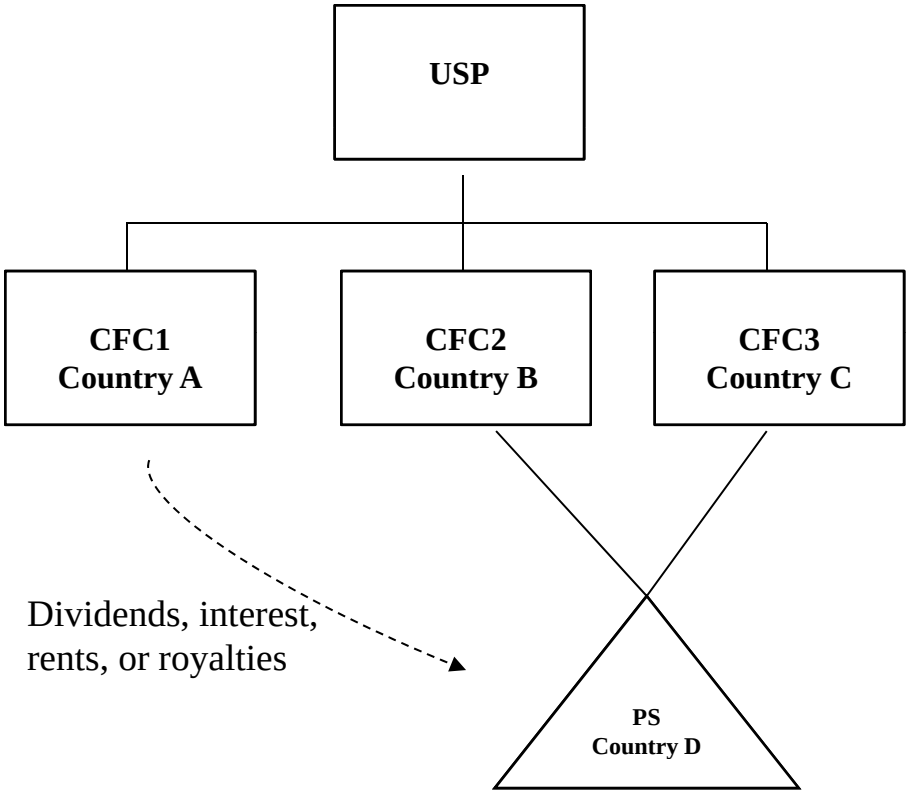
Subpart F Issues – CFC Status

- Because US PS is a domestic partnership and, therefore, a U.S. person under §7701(a)(30), it is a US shareholder for purposes of §951(b) and 957(a)
- Consequently, F Sub is a CFC despite the fact that USCo owns only 5% indirectly (*cf. Textron v. Commissioner*, 117 T.C. 67 (2001) (regarding ownership through a grantor trust)
- USCo must include its distributive share of US PS's subpart F inclusions in income



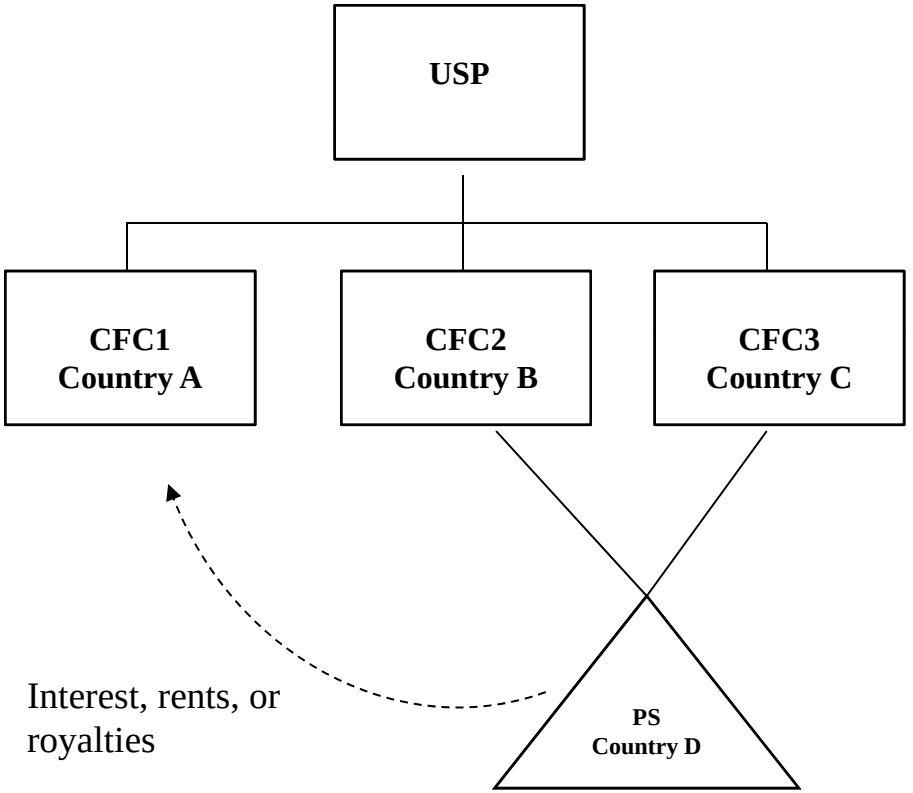
Subpart F Issues – Section 954(c)(6) Look-Through Rule

- §954(c)(6) generally excepts from FPHCI dividends, interest, rents, or royalties paid by related CFC to the extent not attributable to subpart F income or ECI. Also, rule will not apply in the case of any interest, rent, or royalty to the extent such interest, rent, or royalty creates (or increases) a deficit which under § 952(c) may reduce the subpart F income of the payor or another CFC. See Notice 2007-9 for additional details.
- Payments received by partnership treated as received by CFC partners (Notice 2007-9)
- CFC2's and CFC3's distributive shares of income exempt under §954(c)(6) to the extent payment not attributable subpart F income, ECI or deficit that may reduce subpart F of CFC1 (or related CFC).



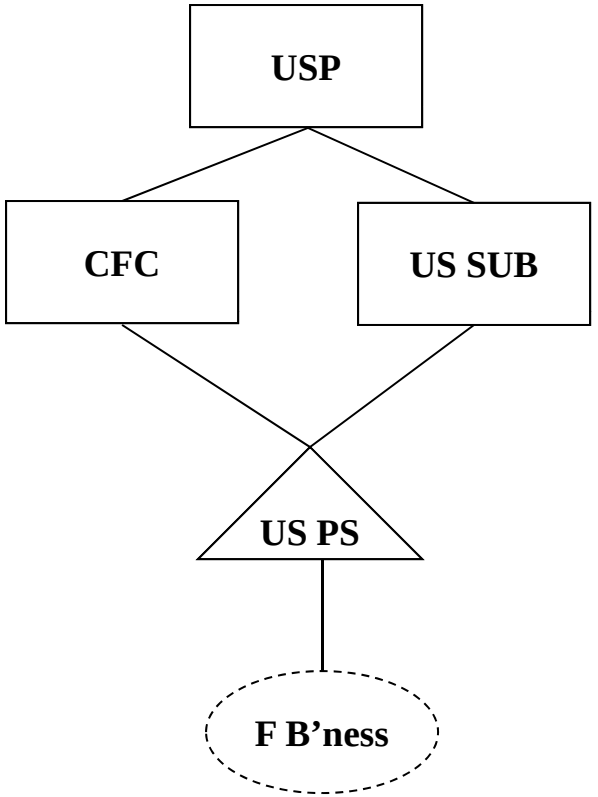
Subpart F Issues – Section 954(c)(6) Look-Through Rule

- Payments made by partnership treated as made by CFC partners (Notice 2007-9)
- Payment to CFC1 treated as made by CFC2 and CFC3
- CFC1's income exempt under §954(c)(6) to the extent payment not attributable to subpart F income, ECI, or deficit that may reduce subpart F income of CFC partners (or related CFC).
- Suppose PS makes an interest, rent, or royalty payment to CFC2 or CFC2 makes a rental payment to PS. What are the consequences to CFC2?

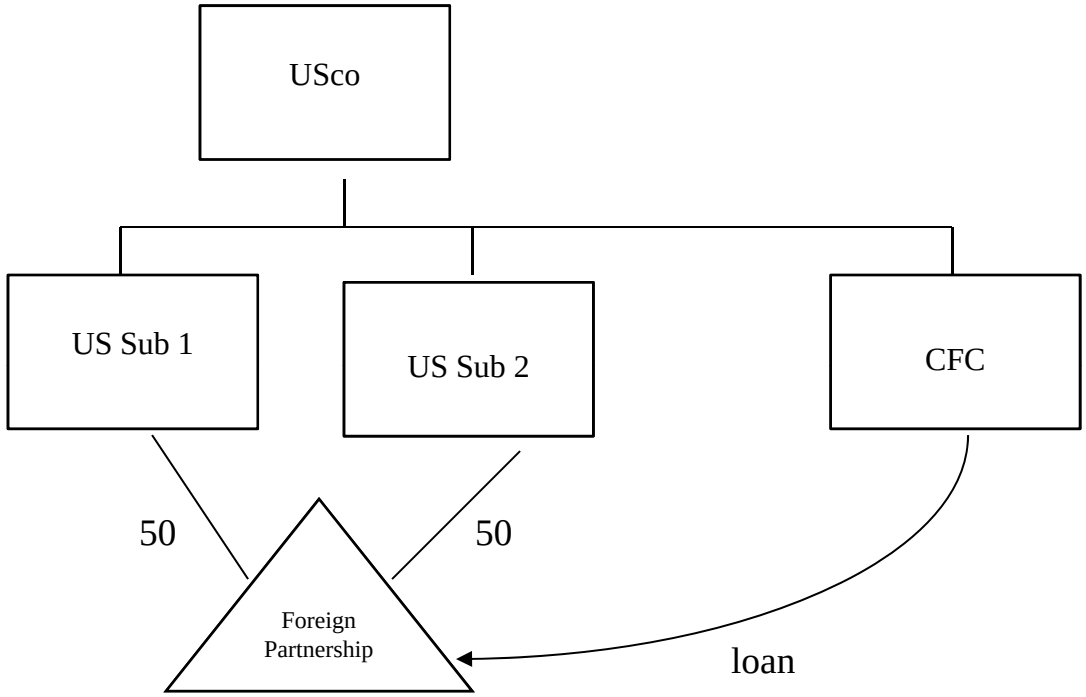


Subpart F Issues – Section 956

- Generally, section 956 causes US shareholder to have an income inclusion for share of CFC's investment in "U.S. property"
- Generally, look-through partnership interest to partnership's assets for purposes of section 956 (i.e., aggregate approach) (Reg. § 1.956-2(a)(3); Rev. Rul. 90-112)
- CFC would not be treated as holding U.S. property because US PS's assets do not consist of US property

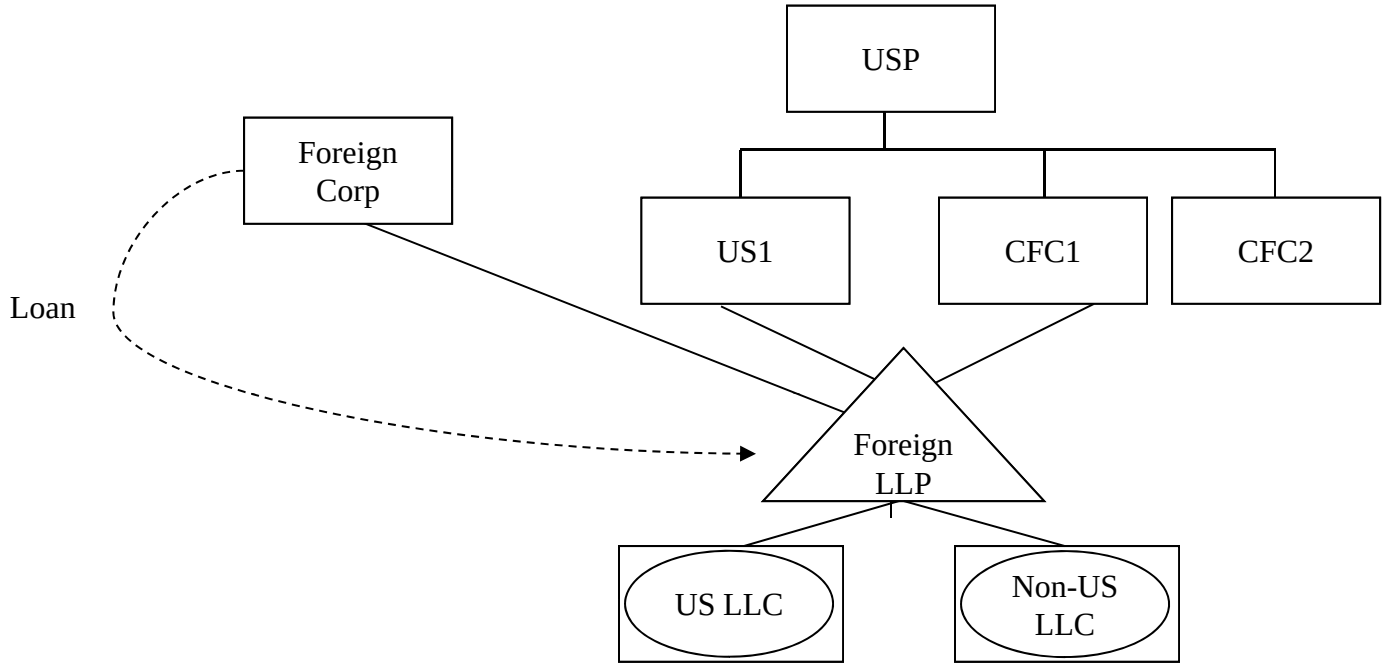


Subpart F Issues – Section 956; Loan by CFC to Partnership



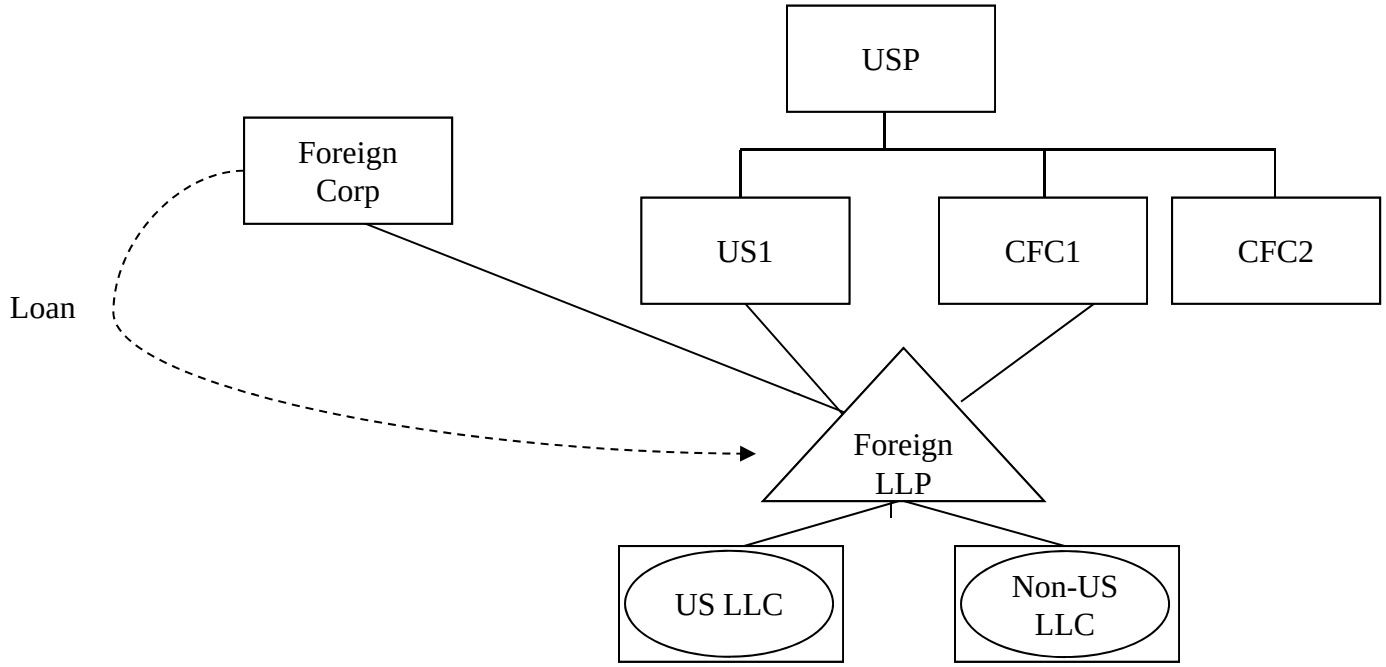
- IRS officials have indicated that IRS is working on issues raised by partnerships and §956.
- Issues include: automatic aggregate rule? Liability for debt under foreign law? Use of funds by partnership?

Subpart F Issues – Section 956 Cont'd; PLR 200832024



- US1, CFC1, and unrelated Foreign Corp contribute cash to Foreign LLP, which acquires U.S. business from USP and non-U.S. business from CFC2.
- Non-US LLC holds no U.S. property. No fund transfers between U.S. LLC and Non-U.S. LLC.
- CFC1 has no interest in any items or assets of US LLC.

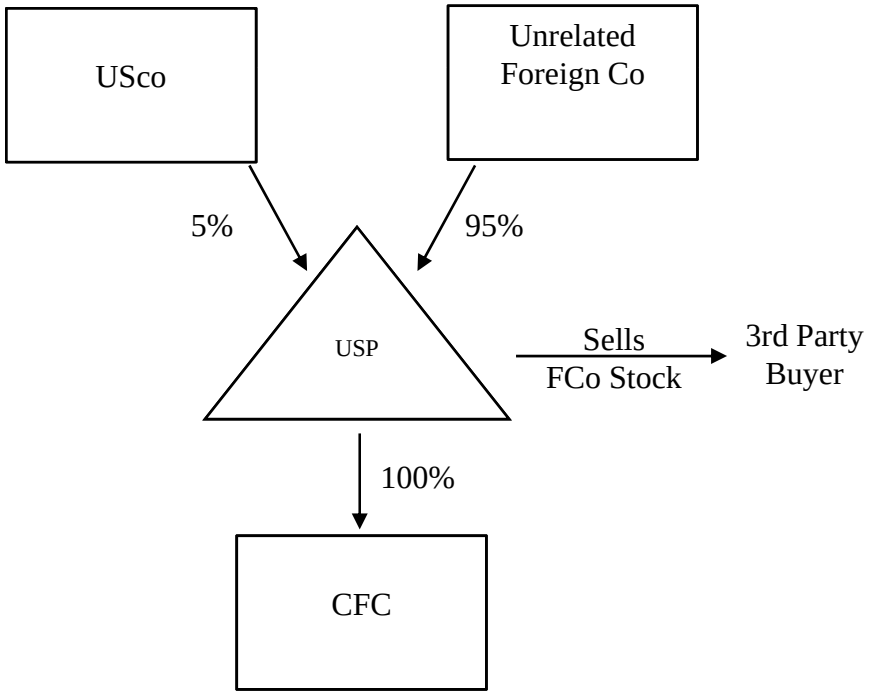
Subpart F Issues – Section 956 Cont'd; PLR 200832024



- IRS held no investment in U.S. property for CFC1. (Presumably, CFC1 should not be engaged in U.S. trade or business.)
- Numerous reps (e.g., CFC1 will have no rights to share in any income, gain, deduction, or loss of the US business and will have no right to receive any property from the US business in liquidation of Foreign LLP)

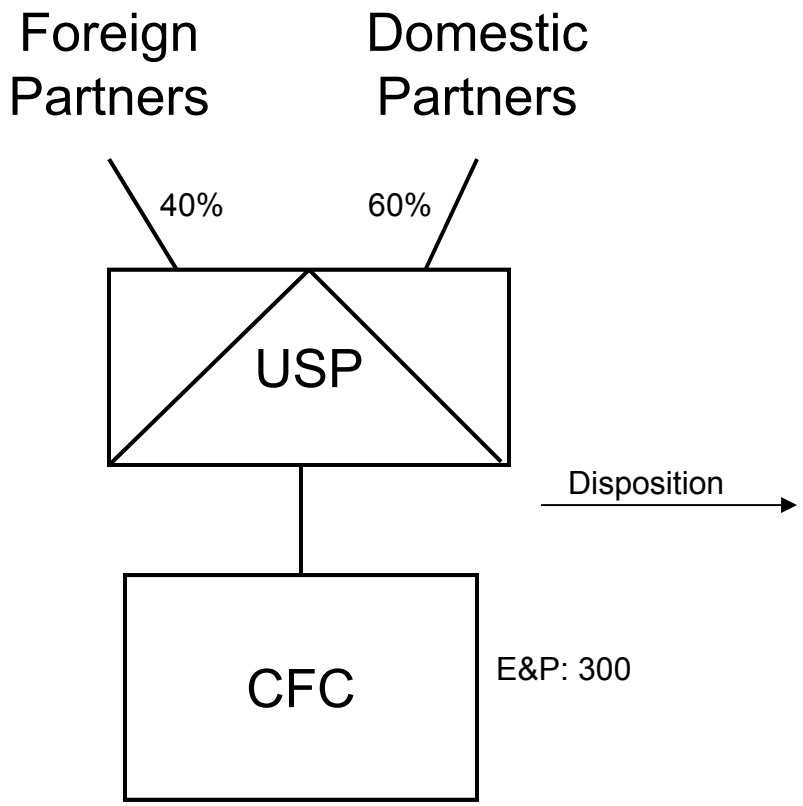
Select Section 1248 Issues Involving Partnerships

§1248 Sale by U.S. Partnership



- §1248 treats gain from sale of CFC by a US person that has a10% voting stock interest as a dividend to extent of relevant E&P of the CFC.
- If USco had held 5% of FCo stock directly, it would not qualify for §1248(a) treatment.
- However, under the partnership structure, U.S. Partnership is a U.S. person holding 100% of FCo stock, and accordingly, §1248(a) applies to the sale. §7701(a)(30)(B), §1.1248-1(a)(1); Rev. Rul. 69-124.

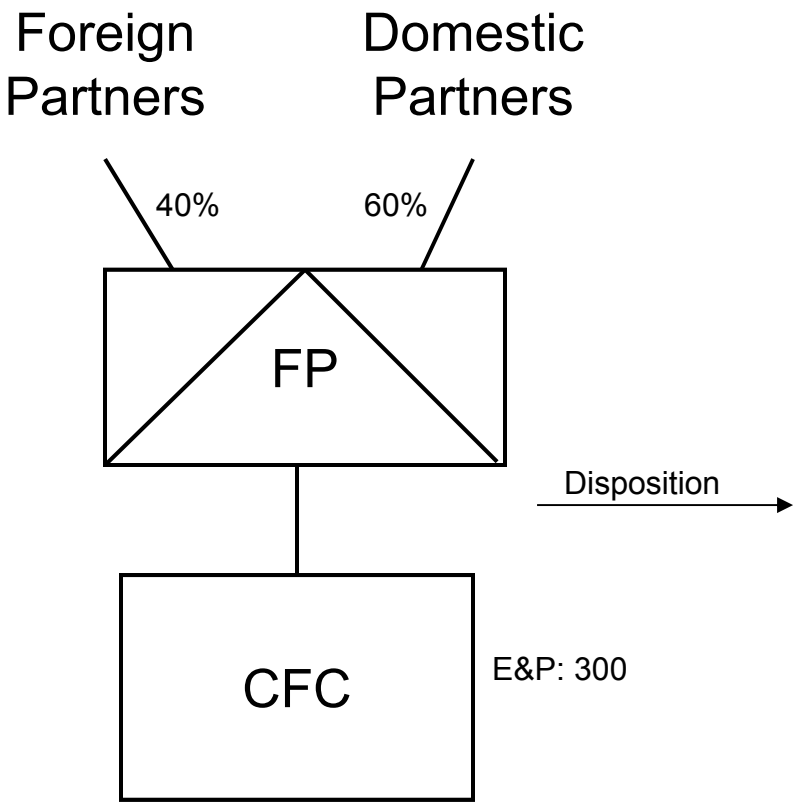
§1248 and Partnerships: Sale of CFC by Domestic Partnership



CFC FMV	600
Partnership Basis in CFC	100
Gain on Sale	500
§1248:	300
Capital Gain:	200

- Disposition treated as a sale of CFC stock by a US person to which §1248 applies.
- Each domestic partner allocated its respective share of §1248 dividend income and capital gain.
- Credits allowable to certain domestic corporate partners that own ≥10% under Rev. Rul. 71-141, §902(c)(7) and §902.
- If lower tier CFCs as well, §1248 dividend amount would reflect their E&P to extent provided in §1248(c)(2).

§1248 and Partnerships: Sale of CFC by Foreign Partnership

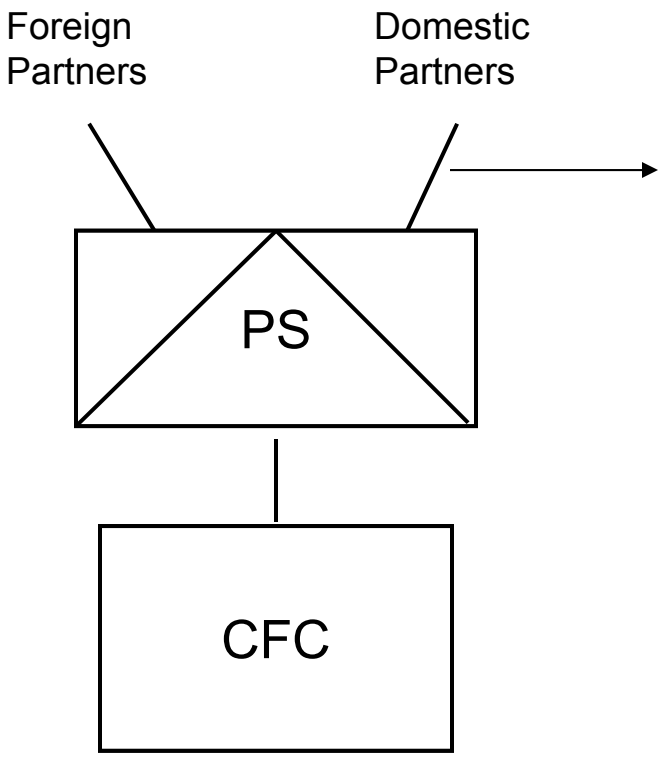


See Treas. Reg. §1.1248-1(a)(5), Ex. 4.

Partners of Foreign Partnership treated as selling or exchanging their proportionate share of the stock of CFC. Treas. Reg. §1.1248-1(a)(4).

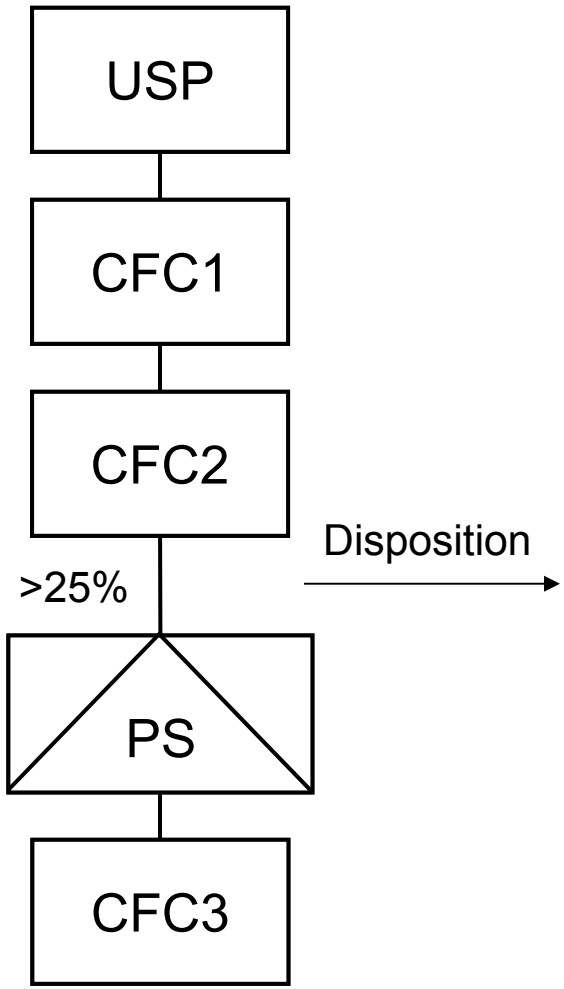
CFC FMV	600
Partnership Basis in CFC	100
Gain on Sale	500
Gain Allocable to Domestic Partners (60% x 500)	300
E&P Allocable to Domestic Partners (60% x 300)	180
§1248 Amount	180
Capital Gain `	120

§1248 and Partnerships: Sale of Interest in Partnership Holding CFC Stock



- §751(c) treats stock of a CFC held through a partnership as a zero-basis unrealized receivable in an amount equal to the potential §1248 dividend amount.
- A domestic partner of the partnership recognizes ordinary income to the extent of its share of any gain that would have been treated as a dividend under §1248 had the partnership sold the CFC stock directly. §1.751-1(c)(4)(iv).
- Section 1248 does not apply to any amount to the extent that such amount is, under another Code section, treated as ordinary income. §1248(g)(2).
- §1248 appears to yield to §751(c). See also TD 9345. FTCs appear not available.

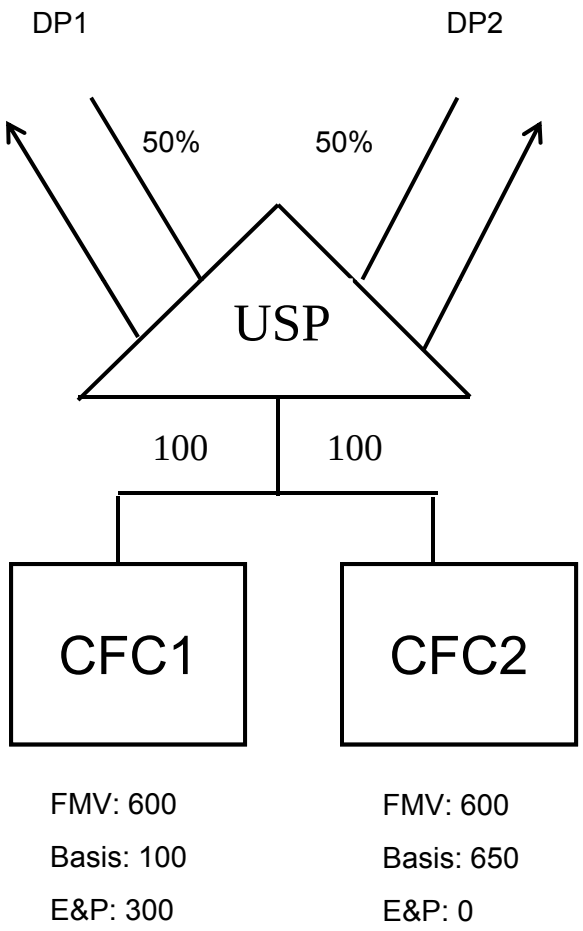
§1248 and Partnerships: Sale by CFC of Substantial Interest in Partnership Holding CFC Stock



- Subpart F: §954(c)(4) treats CFC2's sale of FP as a sale of CFC2's proportionate share of assets of FP (i.e., CFC3 stock).
- But only "for purposes of this subsection." So:
  - Does the reference to "subsection" limit the ability to apply §964(e) (which applies §1248 principles, including rules relating to deemed dividend/FTC)?
  - Also, if still viewed as a sale of a partnership interest generally, need to consider interaction of 1248(g)(2) and 751.

Partnership Liquidation Issues in the International Context

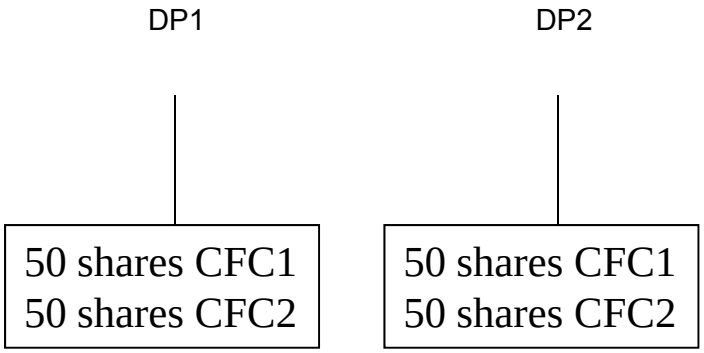
§1248 and Partnerships: Complete Liquidation of a Partnership Holding §1248 Stock



- DP1 and DP2 are U.S. citizens and are equal partners in the "straight-up" USP.
- USP owns two assets – stock of CFC1 and stock of CFC2.
- Assume no gain is recognized on the liquidating distribution under §731.
- §1248(a) generally only operates when gain is recognized. §1248(a) bottom flush language.
- When stock in a CFC is owned by a partnership, the amount of potential §1248 dividend income is treated as a zero-basis unrealized receivable under §751(c). §1.751-1(c)(4)(iv), 1.751-1(c)(5).
- If USP liquidates distributing 50 shares of CFC1 and 50 shares of CFC2 each to DP1 and DP2, then presumably each partner inherits part of the CFC1 stock with a zero basis and a $150 potential §1248 amount. *See* §751(c) (bottom flush language), §1.751-1(c)(4)(iv), §1.751-1(b)(5), and §732(c)(1)(A). (Note: the same should be true if a US partner received a tax-free liquidating distribution from a foreign partnership.)

§1248 and Partnerships: Complete Liquidation of a Partnership Holding §1248 Stock

Post Liquidation



- Issue 1: Does §1248 or §751 cause gain to be recognized to either DP1 or DP2? No.
- Issue 2: What happens to the inherent §1248 amount in the CFC1 stock upon liquidation? Does §735 apply? Yes.
  - §751(c) (bottom flush) – expanded definition of "unrealized receivable" (including §1248 stock) applies "[f]or purposes of *this section* and sections 731, 732, and 741 . . . ."
  - §735 – applies to gain or loss on the disposition by a distributee of unrealized receivables (*as defined in §751(c)*) distributed by a partnership.
- Issue 3: For purposes of §735, is the CFC1 stock received in liquidation of USP divided into two separate tranches – a §1248 tranche and a non-§1248 tranche? Presumably so. See §732(c).
  - If not, is a portion of each share of CFC1 stock treated as subject to §1248 (and another portion of each share treated as not subject to §1248)?
  - May the distributee partner specifically identify which share(s) of CFC1 stock contain the §1248 taint? See, e.g., §1.358-2, §1.1012-1(c) (allowing specific identification).
- Issue 4 (related to Issue 3): How does one track the §1248 amount into the future? Unclear.

§1248 and Partnerships: Complete Liquidation of a Partnership Holding §1248 Stock

DP1

50 shares CFC1
50 shares CFC2

50 shares CFC1 divided into tranches

§1248 Tranche:
AB = $0
FMV = $150

Non§1248 Tranche:
AB = $150
FMV = $100

DP2

50 shares CFC1
50 shares CFC2

- Post Liquidation Depreciation: What if DP1 sells the 50 shares of CFC1 stock for $100 (i.e., the price depreciated post distribution)? No gain or loss on sale. Does §1248 apply? Presumably no.
- What if DP1 sells the 50 shares of CFC1 stock for $150? $50 gain on sale. Does §1248 apply? Probably so, but it depends.
  - Is the §1248 amount a separate tranche?
  - Is each share of CFC1 partially hot and partially not?
  - Does the §1248 amount attach to some, but not all, shares of the CFC stock distributed to DP1?
    - If so, may DP1 specifically identify the shares DP1 sells?
- Post Liquidation Appreciation: What if DP1 sells 25 shares of CFC1 stock for $200 (because the price appreciated post-distribution)?
  - Does the sale trigger all of the §1248 amount?
  - If not, how much is triggered?

§1248 and Partnerships: Complete Liquidation of a Partnership Holding §1248 Stock

- Issue may also arise in nonliquidating partnership distributions.
- Issue may arise any time a partnership distributes a single asset with both a hot and a not hot component
  - 1245 recapture property
  - 1250 recapture property
  - 1253 oil, gas and geothermal property

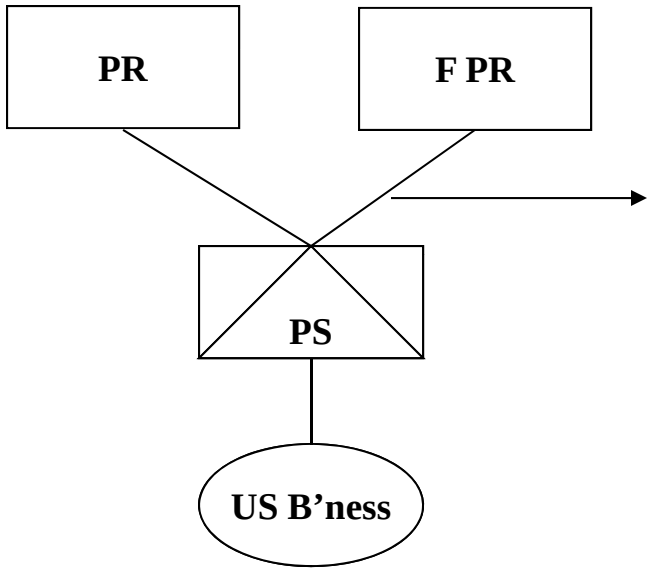
§1248 and Partnerships: Complete Liquidation of a Partnership Holding §1248 Stock

- Possible Tracing/Identification Regimes for §1248 stock distributed by a partnership:
  - 1.1248-8
  - 1.367(b)-13
  - 1.358-2
  - 1.1012-1(c)
  - 1.1248(f)-2
  - Others?

Rev. Rul. 91-32

Sale of Partnership Interest by Foreign Partner – Rev. Rul. 91-32

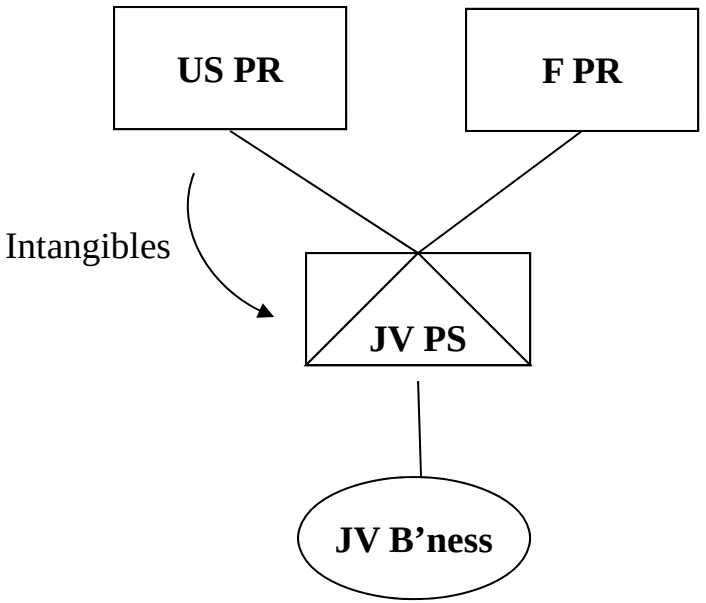
- Controversial revenue ruling (criticized by many practitioners based on the conclusions reached in ruling)
- Ruling reaches the following conclusions:
  - Gain or loss of a foreign partner that disposes of its interest in a partnership that is engaged in a trade or business through a fixed place of business in the U.S. will be U.S. source ECI gain, or will be ECI loss that is allocable to U.S. source ECI gain, to the extent that the partner's distributive share of unrealized gain or loss of the partnership would be attributable to ECI (U.S. source) property of the partnership.
  - In the case of a treaty, gain of a foreign partner that disposes of its interest in a partnership that has a U.S. permanent establishment ("PE") is gain that is attributable to a PE and is subject to U.S. tax under the applicable treaty, to the extent that the partner's potential distributive share of unrealized gain of the partnership is attributable to the partnership's permanent establishment.
- President Obama's budget proposals for the last 2 years have had a proposal to codify Rev. Rul. 91-32.
- Other considerations with this type of sale:
  - If partnership has U.S. real property interests, need to consider sections 897(g) and 1445.
  - If the foreign partner disposing of the partnership interest is a foreign corporation, need to consider section 884.



Transfer of Intangibles to Joint Ventures

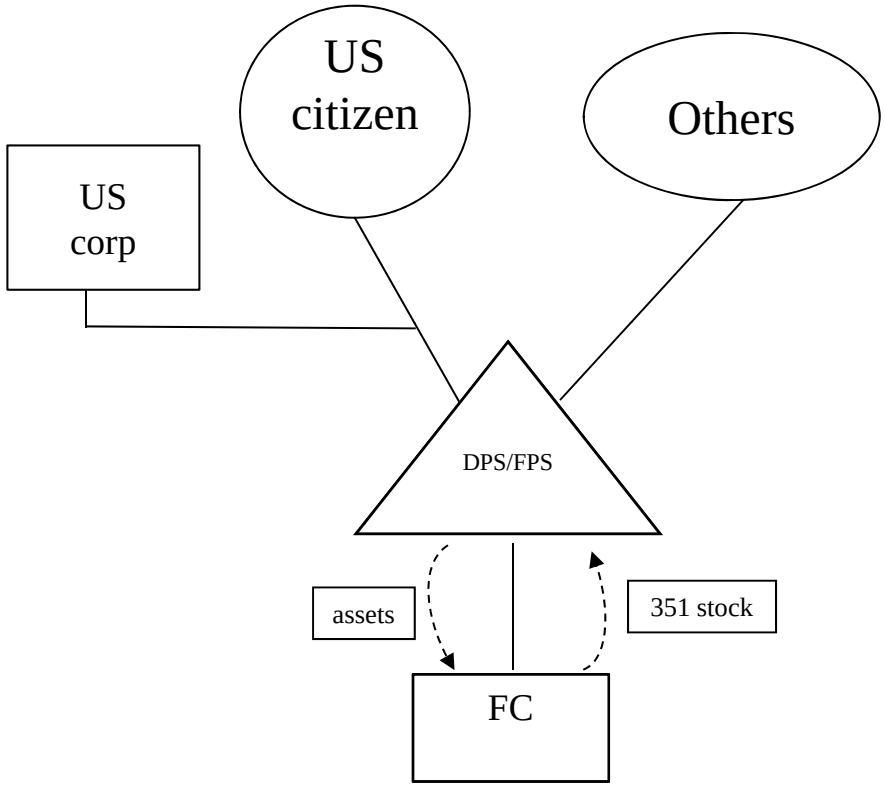
Transfer of Intangibles to Joint Ventures

- Intangibles owned by USP can be transferred to JV PS tax-free
- §367(d)(3) (no regs)
- §721(c) (no regs)
- Application of §482 commensurate with income standard?
- What if foreign JV partner is related CFC?



Section 367 and Partnership Transfers

Section 367 and Partnership Transfers



Example assumes section 7874 is not implicated

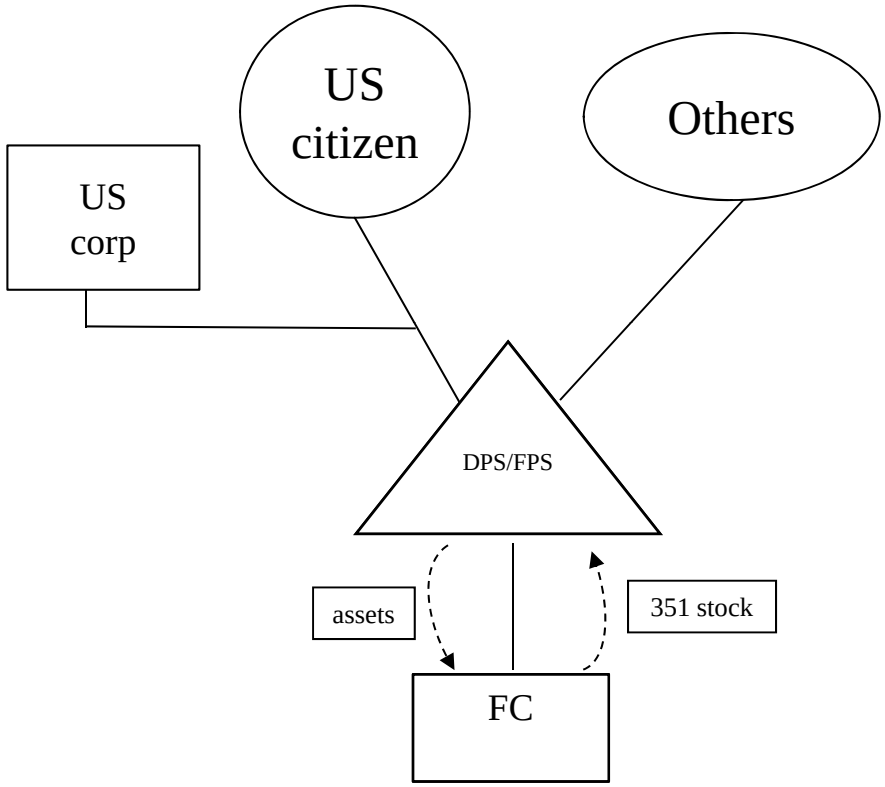
- U.S. persons that are partners in the partnership treated as having transferred a proportionate share of the property in an exchange described in section 367(a)(1).

-Aggregate approach. See Treas. Reg. 1.367(a)-1T(c)(3)(i)

- A U.S. person's proportionate share of partnership property is determined under the rules and principles of sections 701 through 761 and the regulations thereunder.

-Do you look to at partners' capital accounts or interest in partnership income (net or gross)? Do you just look to the year of transfer?

Section 367 and Partnership Transfers



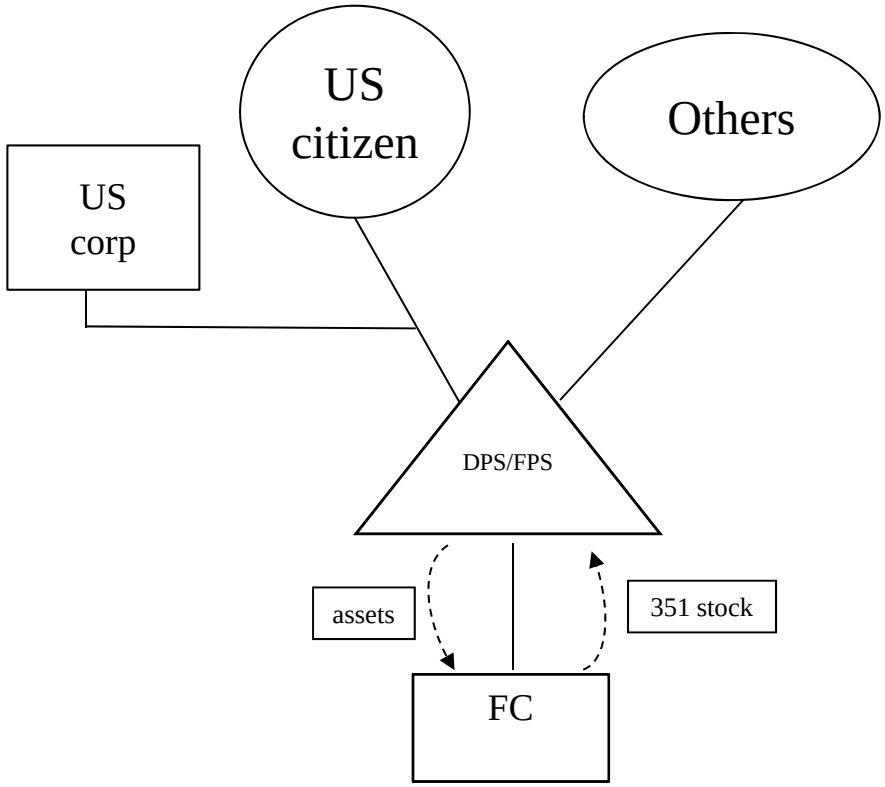
Example assumes section 7874 is not implicated

- If U.S. person is required to recognize gain upon the transfer (i.e., no exception to gain recognition under section 367(a) applies), then—

-U.S. person's basis in the partnership shall be increased by the amount of gain recognized by him;
-Solely for purposes of determining the basis of the partnership in the stock of the transferee foreign corporation, the U.S. person is treated as having newly acquired an interest in the partnership (for an amount equal to the gain recognized), permitting the partnership to make an optional adjustment to basis pursuant to sections 743 and 754; and
-Transferee foreign corporation's basis in the property acquired from the partnership is increased by the of gain recognized by U.S. persons.

- *For transfers of partnership interests, see Treas. Reg. 1.367(a)-1T(c)(3)(ii).*
- Section 367(d) provides that for purposes of determining whether a U.S. person has made a transfer of intangible property that is subject to section 367(d), the rules of Treas. Reg. 1.367(a)-1T(c) apply. See Treas. Reg. 1.367(d)-1T(a).

Section 367 and Partnership Transfers

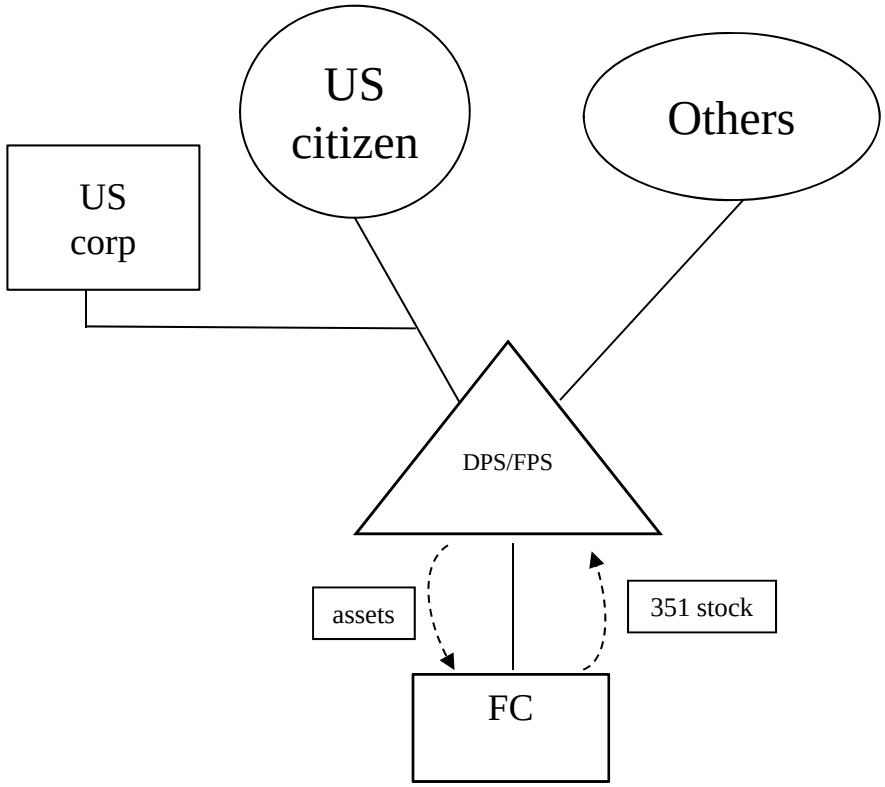


Example assumes section 7874 is not implicated

- In this example, if a domestic partnership (DPS) transfers stock of a CFC (or, in some cases, a former CFC) to FC, in applying Treas. Reg. 1.367(b)-4, DPS generally is treated as a section 1248 shareholder (entity approach).

- Treas. Reg. 1.367(b)-2(k) provides that stock of a corporation that is owned by a *foreign* partnership is considered as owned proportionately by its partners under the principles of Treas. Reg. 1.367(e)-1(b)(2). (e.g., US corp is treated as owning its proportionate share of stock owned by FPS). Aggregate approach

Section 367 and Partnership Transfers



Example assumes section 7874 is not implicated

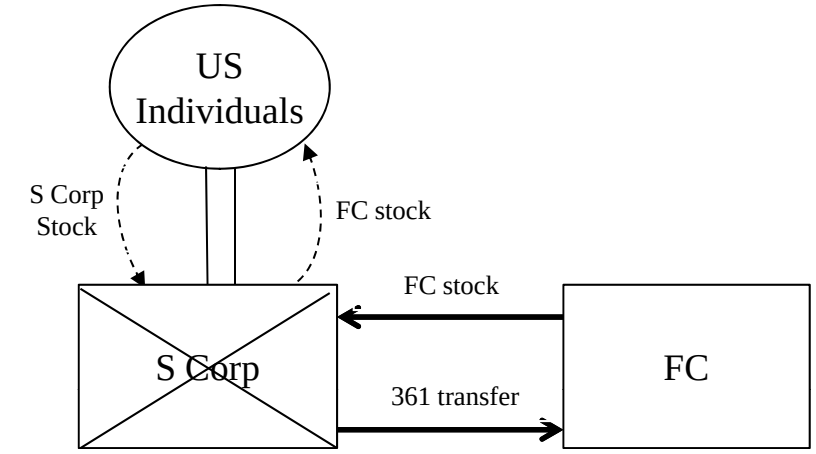
- Given the language of Treas. Reg. 1.367(b)-2(k), if one of the U.S. partners of FPS is a section 1248 shareholder of a CFC (or, in some cases, a former CFC) that is being transferred by FPS to FC, is such partner treated as engaging in a section 351 exchange for purposes of Treas. Reg. 1.367(b)-4 ?

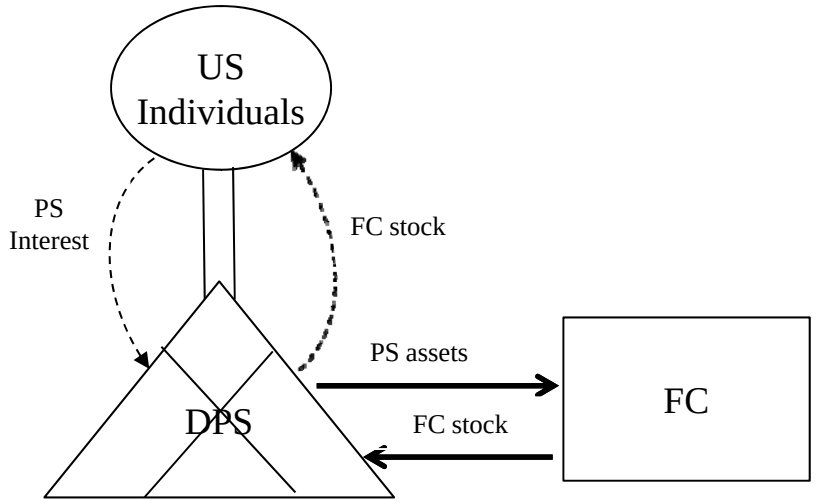
  -*Note: Treas. Reg. 1.1248-1(a)(4) provides that, for purposes of applying section 1248, if a foreign partnership sells or exchanges stock of a corporation, the partners in such foreign partnership shall be treated as exchanging their proportionate share of stock of such corporation.*

- Depending on the particular facts and circumstances, other international tax issues may need to be considered as a result of the transfer (DCL issues if domestic corporate partner, 987 issues, etc.)

Partnership v. S Corporation- Certain Outbound Transfers

Section 367(a)(5)
S Corp vs. Partnership

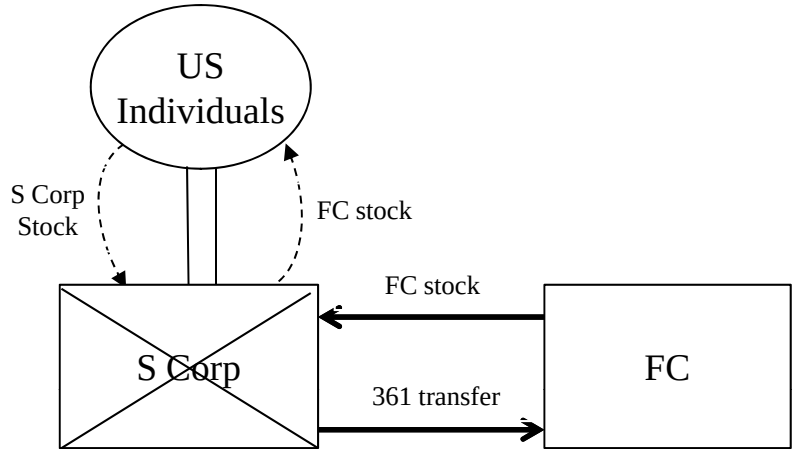


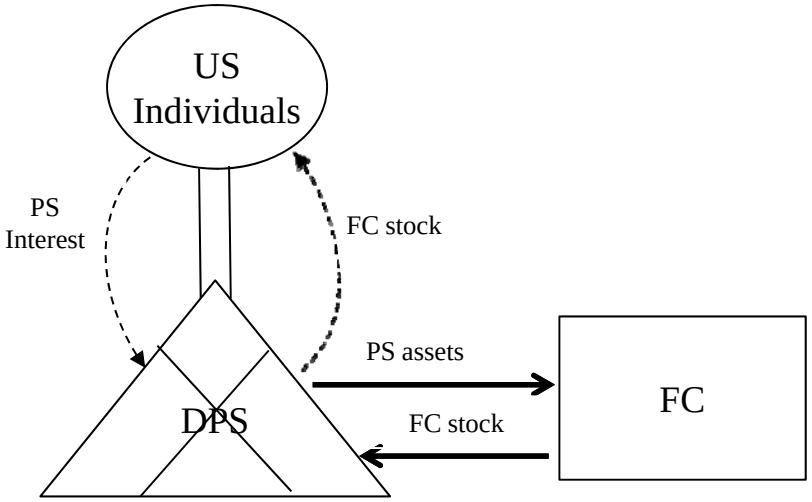


*** Assume neither transfer is subject to section 7874**

- Section 367(a)(5) provides that section 367(a)(2) and (3) [certain exceptions to the general gain recognition rule of section 367(a)(1)] shall not apply in the case of an exchange described in **section 361(a) or (b) exchange**. Subject to such basis adjustments and such other conditions as shall be provided in regulations, the preceding sentence shall not apply if the transferor corporation is controlled (within the meaning of section 368(c)), by 5 or fewer domestic corporations. For purposes of the preceding sentence, all members of the same affiliated group (within the meaning of section 1504) shall be treated as 1 corporation.
- IRS has issued final regulations under section 367(a)(5).
- IRS has broad authority under section 367(a)(6) to exempt certain transaction from section 367(a)(1) in order to carry out the purposes of section 367(a).

Section 367(a)(5)
S Corp vs. Partnership





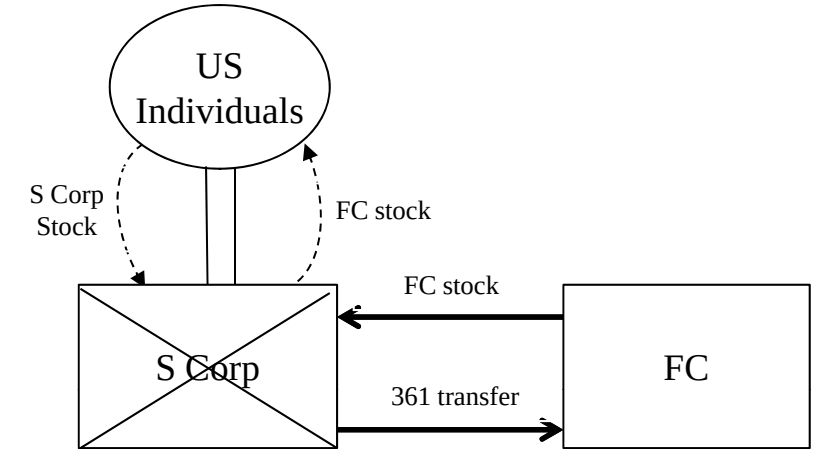
*** Assume neither transfer is subject to section 7874**

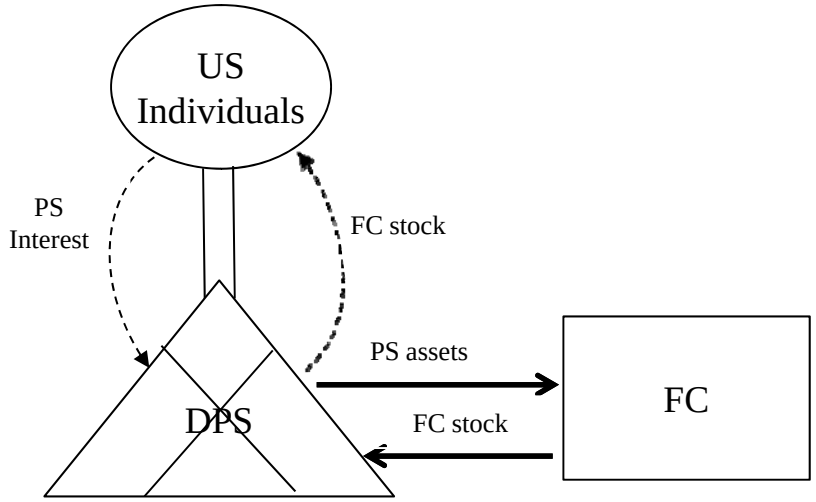
- IRS has final regulations under section 367(a)(5) providing guidance on the application of section 367(a)(5).
  - -Section 367(a)(5) applies to exchanges that are section 351/361 overlap transactions
  - -Section 367(a)(5) applies to S corporations that make section 361 transfers [An S corporation generally is treated as a domestic corporation that can make a section 361 transfer to a foreign corporation in an asset reorganization]
  - --S corporations cannot satisfy section 367(a)(5) requirements (S corporations are not controlled by 5 or fewer domestic corporations)

--Therefore, the exceptions to the section 367(a)(1) general gain recognition (e.g., the foreign active trade or business exception) are not available to S corp.

--Thus, the general gain recognition rule of section 367(a)(1) applies.

Section 367(a)(5)
S Corp vs. Partnership





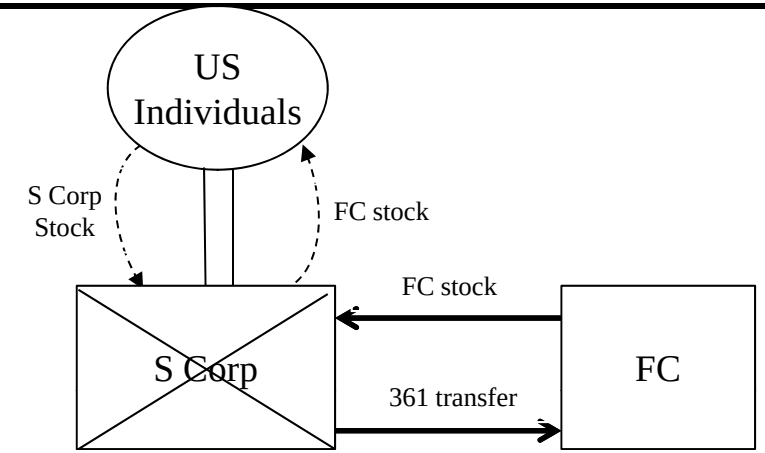
*** Assume neither transfer is subject to section 7874**

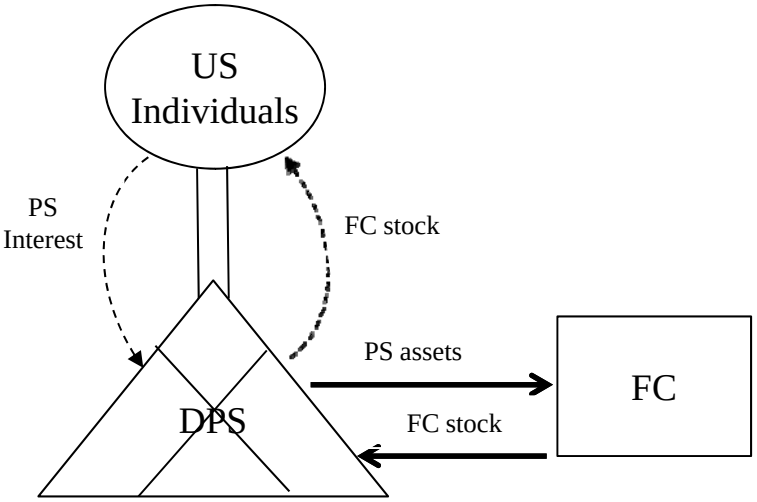
- This should be compared to the transfer by DPS in this example of its assets to FC [DPS is not a domestic corporation that can make a section 361 transfer of its assets to FC in an asset reorganization]

--Although U.S. persons (U.S individuals) that are partners in the partnership are treated as transferring their proportionate share of the assets for purposes of section 367(a), such a deemed transfer should not be a section 361 transfer (assume this exchange is a section 351 exchange).

-Thus, section 367(a)(5) N/A to this exchange and exceptions to general gain recognition rule of section 367(a)(1) available if requirements for such exceptions otherwise satisfied.

Section 367(a)(5)
S Corp vs. Partnership





*** Assume neither transfer is subject to section 7874**

- Is this different treatment of S corporations and partnerships warranted?

-Subject to certain exceptions (e.g., section 1374), S corporations generally are not subject to corporate level tax and are treated as a flow thru entity.

-**Interesting Note:**

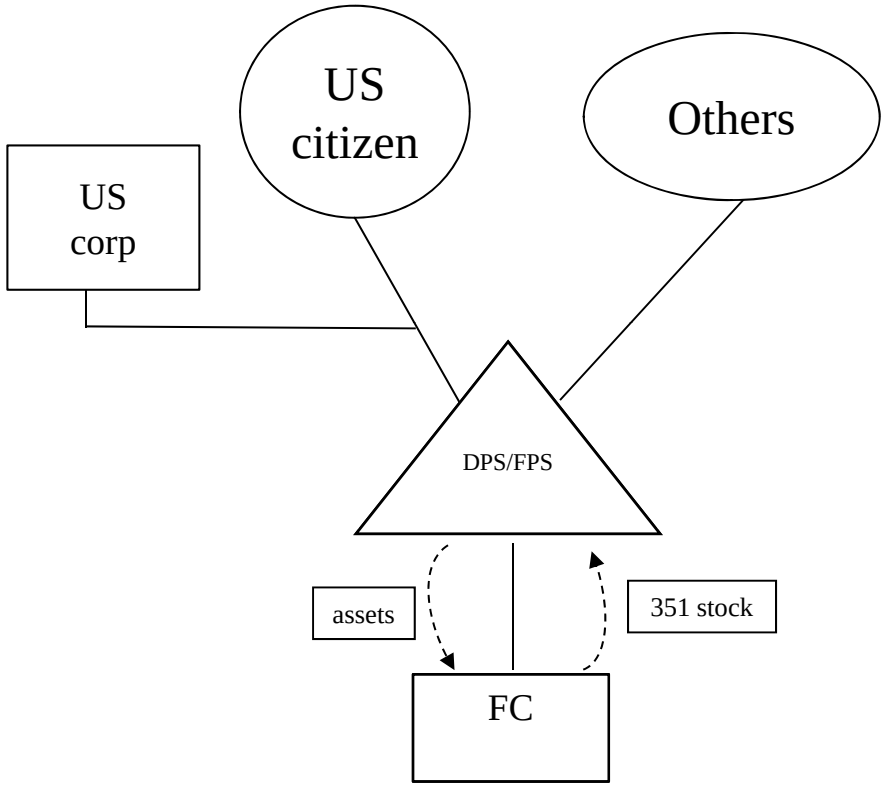
Even though S corporations are domestic corporations, the final regulations do not treat S corporations that own stock in other domestic corporations making a section 361 transfer to a foreign corporation as domestic corporations that can be members of the control group for purposes of satisfying the requirement of section 367(a)(5) that the transferor domestic corporation be controlled by 5 or fewer domestic corporations.

-Nevertheless, S corporation subject to section 367(a)(5) when it makes a section 361 transfer.

--Is this disparate treatment of S corporations in these different contexts appropriate under the final section 367(a)(5) regulations?

Section 6038B and Partnership Transfers

Section 6038B and Partnership Transfers

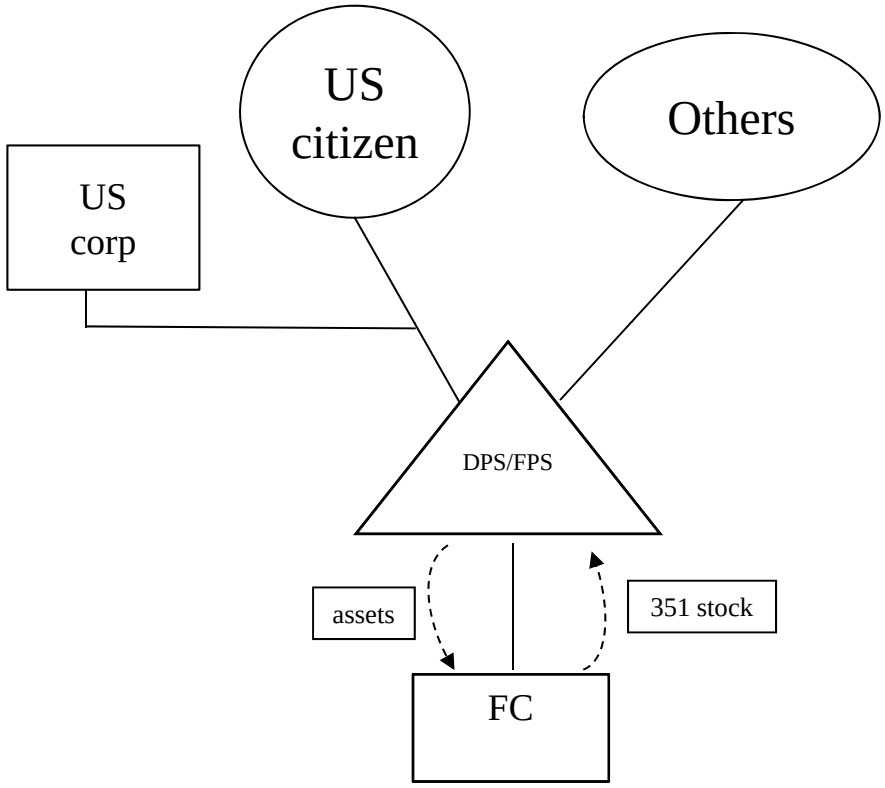


Example assumes section 7874 is not implicated

- Code Sec. 6038B(a)(1)(A) generally requires that each U.S. person who transfers property to a foreign corporation in a section 351exchange (among other exchanges) to furnish to the Secretary such information regarding the exchange as the Secretary may require in regulations

- Treas. Reg. §1.6038B-1(b) provides that Form 926 must be used for reporting certain transfers pursuant to section 6038B
  - *Special rules for transfers of cash*
  - *Certain exceptions to filing and special rules may need to be considered (see section 6038B regulations and instructions to Form 926)*

Section 6038B and Partnership Transfers



Example assumes section 7874 is not implicated

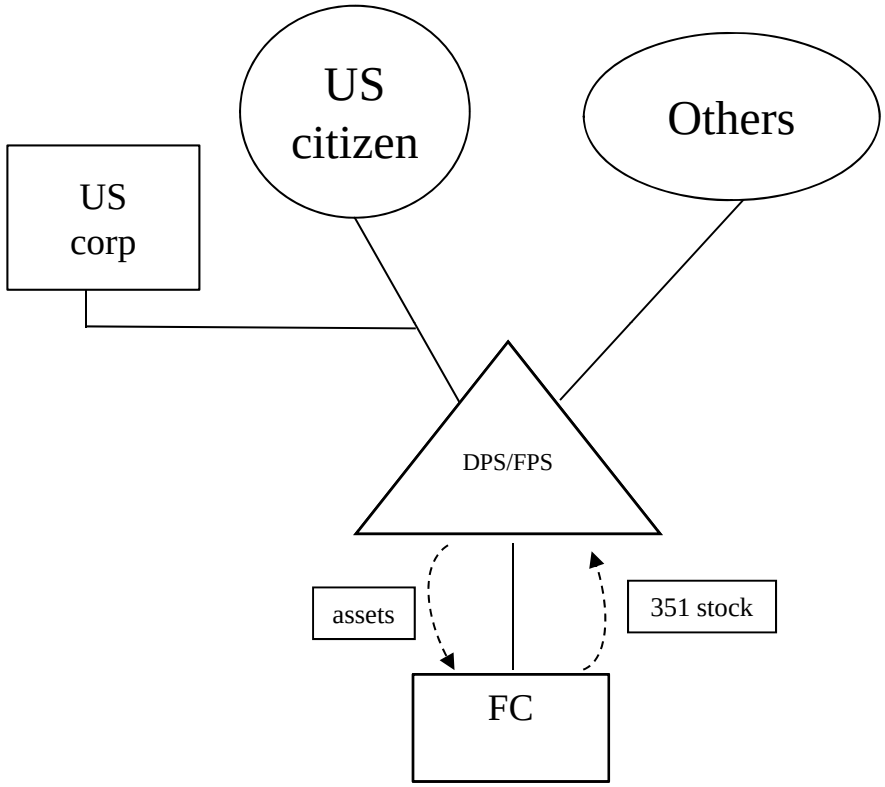
- If the transferor is a partnership (domestic or foreign), the domestic partners of the partnership, not the partnership itself, are required to comply with section 6038B and file Form 926 (Aggregate approach).

-Treas. Reg. 1.6038B-1(b) states that for purposes of determining if a U.S. transferor is subject to section 6038B, the rules of Treas. Reg. 1.367(a)-1T(c) and 1.367(a)-3(d) apply with respect to a transfer described in section 367(a) and the rules of Treas. Reg. 1.367(a)-1T(c)(3) apply with respect to a transfer described in section 367(d).

-Each domestic partner is treated as a transferor of its proportionate share of the property

-See AM 2008-006 for analysis of issue; compare treatment under section 6038B when S corporation transfers property to a foreign corporation in a section 351 transfer

Section 6038B and Partnership Transfers



Example assumes section 7874 is not implicated

- Potential consequences for failure to file Form 926 may include:

-Ineligibility for active trade or business exception under section 367(a).

-A penalty in the amount equal to 10% of the fair market value of the property at the time of the transfer.

--Penalty is limited to $100,000 unless the failure to comply was due to intentional disregard.

-Reasonable cause exception

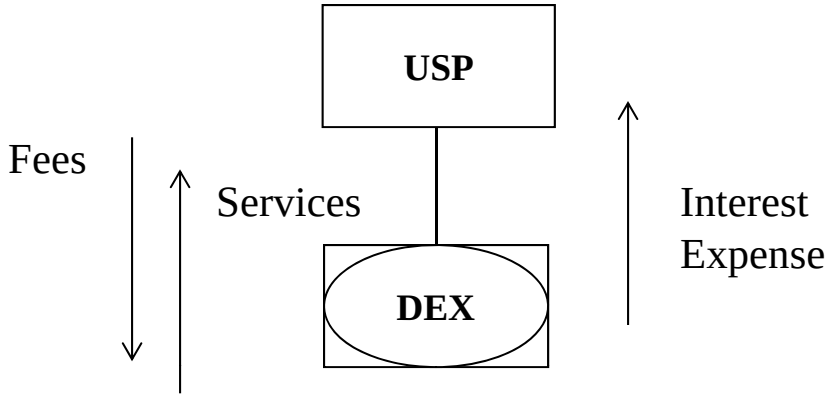
-Extension of Statute of Limitations. See section 6501(c)(8).

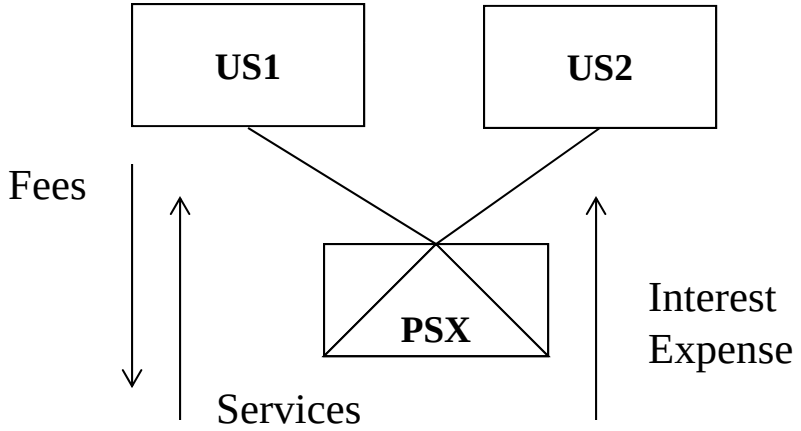
-See also Offshore Voluntary Disclosure Initiative and IRS FAQ 18 relating to missed Forms 926

Dual Consolidated Loss Issues Involving Partnerships

Dual Consolidated Loss Issues Involving Partnerships – Disregarded Payments

- Whether a separate unit incurs a DCL generally is determined by taking into account "only those existing items of income, gain, deduction, and loss of the separate unit's … domestic owner (or owners, in the case of certain combined separate units), as determined for US tax purposes." Reg. § 1.1503(d)-5(c)(1)(ii).
- Potentially different treatment of DEX's and PSX's items for purposes of determining whether separate units incur DCLs. PSX is viewed as separate entity for US tax purposes, so transactions and related items not disregarded.



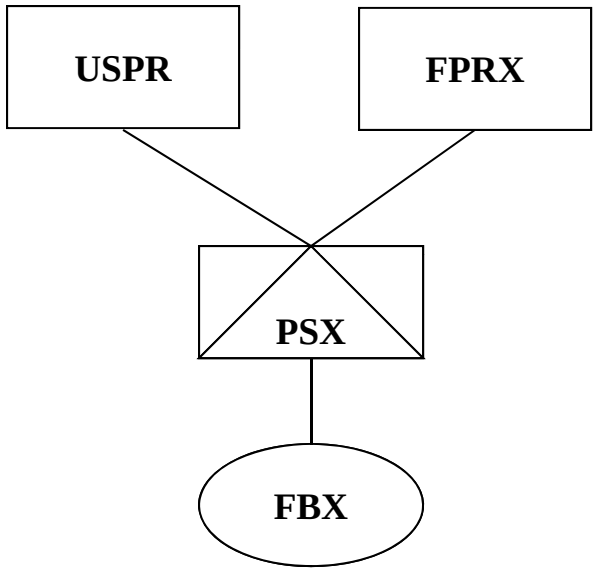


Dual Consolidated Loss Issues Involving Partnerships – Domestic Use Election and Triggering Events

- General rule is that unless taxpayer can show no possibility of "foreign use," "domestic use limitation" rules apply. Reg. § 1.1503(d)-4(b).
- Domestic use limitation rules limit amount of DCL that can be taken into account in US to amount of income generated by separate unit taken into account in US, determined on cumulative basis. Reg. § 1.1503(d)-4.
- Exception if taxpayer makes "domestic use election" (DUE). Reg. § 1.1503(d)-6(d). Under DUE, if "triggering event" occurs within 5-year certification period, taxpayer generally must recapture DCL.
- Triggering events include foreign use of DCL, which occurs if *any portion* of deduction or loss composing DCL is *made available* directly or indirectly under foreign tax law to offset income of foreign corporation or direct or indirect owner of interest in hybrid entity that is not a HESU. Reg. § 1.1503(d)-3(a)(1).
- Triggering events also include transfer of 50% or more of separate unit's assets (outside the ordinary course of business) within 12-month period or transfer of 50% or more of taxpayer's interest in separate unit within 12-month period. Reg. § 1.1503(d)-6(e)(1)(iv) and (v). *But see* Reg. § 1.1503(d)-6(e)(2)(ii) (rebuttal of asset transfer triggering event if taxpayer can show that asset transfer did not result in carryover of deductions or losses under foreign law).
- Thus, triggering event can result from either sale of partnership interest or sale of partnership assets.

Dual Consolidated Loss Issues Involving Partnerships – Exceptions to Foreign Use

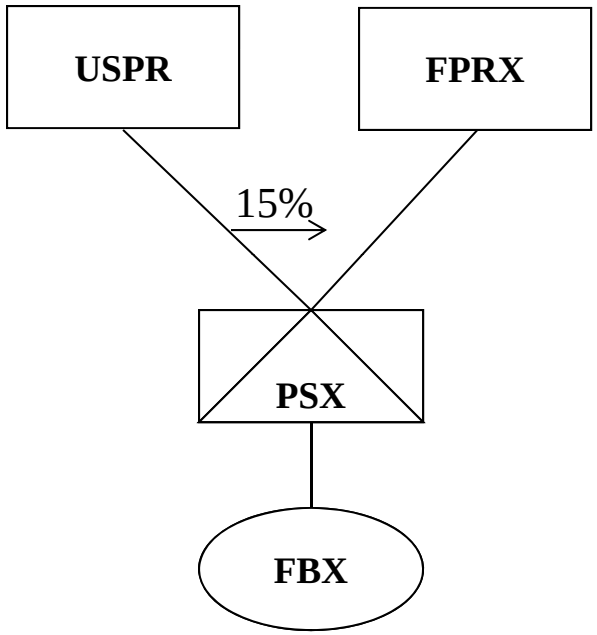
- Assume that an item of deduction or loss composing the Year 1 DCL is made available to offset income of FPRX in Year 1 under Country X tax law.
- Alternatively, assume an item of deduction or loss composing the Year 1 DCL is made available to offset income of FPRX in Year 2 under Country X tax law because PSX incurs a Year 1 NOL and the NOL can be carried forward.
- Generally, exception to foreign use if "solely the result of another person's ownership of an interest in the partnership … and the allocation or carry forward of an item of deduction or loss composing such dual consolidated loss as a result of such ownership." Reg. § 1.1503(d)-3(c)(4)(i).



Assume USPR's Country X separate unit incurs Year 1 DCL of ($100) because of losses incurred by PSX through activities of FBX

Dual Consolidated Loss Issues Involving Partnerships – Exceptions to Foreign Use

- Assume an item of deduction or loss composing the Year 1 DCL is made available to offset income of FPRX in Year 2 under Country X tax law because PSX incurs a Year 1 NOL and the NOL can be carried forward. Also assume that in Year 2, USPR sells 15% of its interest in PSX to FPRX.
- Foreign use occurs because -3(c)(4) exception does not apply if partner's interest is reduced by either (i) 10% or more during any 12-month period or (ii) 30% or more at any time as compared to end of year DCL was incurred. Reg. § 1.1503(d)-3(c)(5)(ii); -7(c) Ex. 13.
- How is USPR's interest in PSX measured? Similarly to partner's interest in partnership for section 704(b) purposes? What if partnership agreement calls for special allocations and income and loss allocations fluctuate from year to year?
- Foreign use can result from transactions not involving USPR (e.g., dilution from contribution by FPRX to PSX).
- No foreign use if FPRX were instead a US corporation.

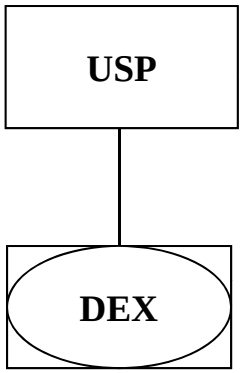


Assume USPR's Country X separate unit incurs Year 1 DCL of ($100) because of losses incurred by PSX through activities of FBX

Dual Consolidated Loss Issues Involving Partnerships – DRE to PP (Rev. Rul. 99-5) Transactions

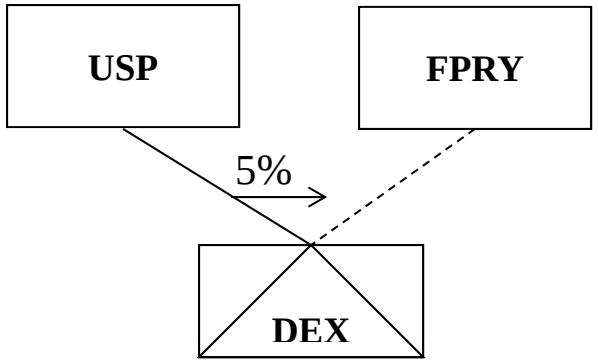
- In Year 1, USP owns DEX, which incurs a DCL of ($100). Assume that DEX incurs a Year 1 NOL for Country X tax purposes that is carried forward under Country X tax law.
- In Year 3, USP sells 5% of its interest in DEX to FPRX, a Country Y foreign corporation.
  - But for *de minimis* exception (Reg. § 1.1503(d)-3(c)(5)), foreign use would occur because DCL carries over under Country X tax law to offset income that is viewed under US tax principles as an item of an owner (FPRY) of an interest in a hybrid entity (DEX) that does not constitute a HESU (in FPRY's hands). *See* Reg. § 1.1503(d)-7(c), Ex. 5(iv).
  - De minimis exception not available if domestic owner's interest is reduced by either (i) 10% or more during any 12-month period or (ii) 30% or more at any time as compared to end of year DCL was incurred. Reg. § 1.1503(d)-3(c)(5)(ii).
- Under Rev. Rul. 99-5, sale treated as (i) asset sale, followed by (ii) contribution to newly formed partnership. Deemed contribution by USP would constitute asset transfer triggering event but for exceptions in Reg. §§ 1.1503(d)-6(f)(1) and (3).
- If, instead, USP sold 15% of interests, would result in foreign use and asset transfer triggering events because *de minimis* exception unavailable.

Year 1



DCL of ($100)

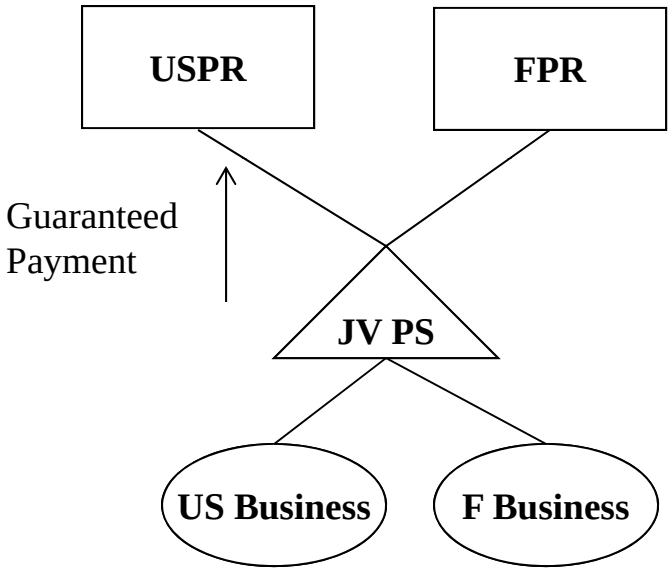
Year 3



Source of Section 707(c) Guaranteed Payment

Source of Guaranteed Payments – Guaranteed Payments, Generally

- Section 707(c) guaranteed payment is a payment to a partner in its capacity as a partner for services or for use of capital, where payment is not dependent on the income of the partnership.
- If no applicable sourcing rule, income sourced by analogy to other type or types of income for which there are explicit rules.
- Services income generally sourced by location where services are performed. Section 861(a)(3); section 862(a)(3).
- Interest income received from partnership generally sourced by partnership's place of residence. A partnership, whether foreign or domestic, generally considered a US resident for these purposes if engaged in US trade or business at any time during year. Reg. § 1.1861-2(a)(2). Exception provided, however, for interest paid by foreign partnership if (i) partnership predominantly engaged in foreign trade or business, (ii) interest not paid by US trade or business of partnership, and (iii) interest not allocable to ECI. Section 861(a)(1)(B).
- Under aggregate approach, guaranteed payment sourced as distributive share of partnership income. Under entity approach, likely sourced by analogy to service income or interest income, as appropriate.
- Camp Proposal Option 1 – Repeal of rules relating to guaranteed payments. Proposal states that payments made by a partnership to a partner are treated as either a payment to a partner not acting in its capacity as a partner under section 707(a), or as a distribution of partnership income or capital under section 731.



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