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## IRS Memorandum Finds Loans to U.S. Borrowers by Foreign Lender with U.S. Agent Are Subject to U.S. Taxation

The Associate Chief Counsel (International) of the IRS has issued a memorandum in which it concludes that a foreign corporation (“LoanCo”) is engaged in a U.S. trade or business and subject to U.S. taxation on its net income from loans made by LoanCo to U.S. borrowers under the following circumstances:

LoanCo, which has no office or employees in the U.S., engages “Y,” a U.S. corporation (which, in the memorandum, appears to be an independent third party), to perform loan origination activities in the United States on behalf of LoanCo. The activities include soliciting U.S. borrowers, negotiating the terms of the loans, performing credit analyses, and all related activities involved in the origination of loans other than final approval and signing of the loan documents. LoanCo then reviews the documentation and executes it outside the United States. The memorandum expressly states that LoanCo’s service contract with Y provides for an arm’s length fee and explicitly provides that Y is not authorized to conclude any loans on behalf of LoanCo.

The memorandum concludes that LoanCo’s lending activity is sufficient to be a trade or business and the actions of its agent make it a U.S. business. Because LoanCo is acting as a lender, its activities do not come within the safe harbor provided for trading in securities. With respect to the tax law requirement that interest income earned by LoanCo cannot be treated as effectively connected with a U.S. trade or business unless a “U.S. office” actively and materially participates in the lending activity, the memorandum concludes that it is sufficient for these purposes that Y is itself providing loan origination services to LoanCo in the United States. In other words, the IRS’s position in the memorandum is that it is irrelevant whether the origination services are provided by an independent contractor, or whether the person providing the services lacks authority to conclude loans on behalf of the foreign lender.

The memorandum concludes with the following cautionary statement, suggesting that we should expect further IRS activity on this front:

“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 [IRS field agents] to develop these cases, and we stand ready to assist [them] in the legal analysis.”

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