International Tax Watch

The IRS Issues New Code Sec. 956 Regulations

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I. Introduction

Code Sec. 956 applies when a controlled foreign corporation (CFC) invests its earnings in certain types of property ("U.S. property"). If Code Sec. 956 applies, the U.S. shareholders of the CFC may be required to recognize an income inclusion. The legislative history of Code Sec. 956 explains that Congress enacted the statute because it viewed having untaxed earnings of a CFC invested in the United States as substantially the equivalent of a CFC paying a dividend to the shareholder.[1] This policy is especially apparent with respect to CFC loans to U.S. parent entities, where, but for the provisions of Code Sec. 956, the U.S. parent would have relatively unfettered use of its CFC's cash earnings, without the need to distribute said earnings. In the context of CFC loans, the legislative history goes further to explain that "if the facts indicate that the controlled foreign subsidiary facilitated a loan to, or borrowing by, a U.S. shareholder, the controlled foreign corporation is considered to have made a loan to (or acquired the obligation of) the U.S. shareholder."[2] The most straightforward way for a CFC to "facilitate" a U.S. parent's borrowing is for the CFC to guarantee such borrowing. The concern described in the legislative history has implications that apply beyond the guarantee context, however. The outer boundaries of the legislative history and how Code Sec. 956 may apply to partnerships have been unanswered questions for some time. Three key questions are highlighted below.

II. Issues and Examples

A. Issue 1

When one CFC facilitates a different CFC's investment in U.S. property, may the latter's investment in U.S. property be "imputed" to the former? Historically, prior temporary regulations provided that "[A] controlled foreign corporation will be considered to hold indirectly … at the discretion of the District Director, investments in U.S. property acquired by any other foreign corporation that is controlled by the controlled foreign corporation, if one of the principal purposes for creating, organizing, or funding (through capital contributions or debt) such other foreign corporation is to avoid the application

of section 956 with respect to the controlled foreign corporation" (the "Section 956 Anti-Abuse Rule").[3] The temporary regulations applied whenever a CFC with significant amounts of earnings and profits (E&P) loaned to a CFC with no E&P with the objective of enabling the latter CFC to acquire U.S. property (*e.g.*, a loan to the CFC's U.S. parent). What was unclear was whether the rule would also apply when both CFCs had significant E&P but the latter CFC had E&P with a higher effective tax rate than the former.

Example 1. USCO is a U.S. corporation that wholly owns both CFC1, a Country X corporation, and CFC2, a Country Y corporation. Country X does not impose a corporate income tax, while Country Y imposes a 33.3-percent corporate income tax. Both CFC1 and CFC2 have E&P of $100. CFC1's foreign taxes are zero and CFC2 has $50 of foreign taxes in its Code Sec. 902 indirect foreign tax credit pool. CFC1 loans $100 to CFC2, and CFC2 loans the same amount to USCO. USCO will report a $150 deemed dividend from CFC2 ($100 under Code Sec. 951(a)(1)(A) and $50 under Code Sec. 78). Yet, the foreign tax credits resulting from the distribution under Code Sec. 902 may substantially reduce the resulting tax liability. *See* Diagram 1.

Assuming that in Example 1, CFC1's loan to CFC2 would be treated as a "funding" of CFC2, the taxpayer would still have the opportunity to argue that its purpose was not "to *avoid the application of section 956* with respect to the controlled foreign corporation." After all, there was no avoidance of Code Sec. 956. Whether CFC1 or CFC2 made the loan to USCO, USCO would have had a Code Sec. 951(a)(1)(A) inclusion of $100. Indeed, the tax benefit illustrated in Example 1 is from Code Sec. 902 tax credits, not from avoiding Code Sec. 956. On the other hand, arguably, Code Sec. 956 was avoided *with respect to CFC1* and, therefore, USCO avoided the "application of section 956 with respect to *the* controlled foreign corporation." Resolution of the issue depends on whether the anti-abuse rule is designed to prevent the avoidance of Code Sec. 956, generally, or whether it is designed to prevent avoidance of Code Sec. 956 with respect to specific CFCs that "fund" other CFCs.

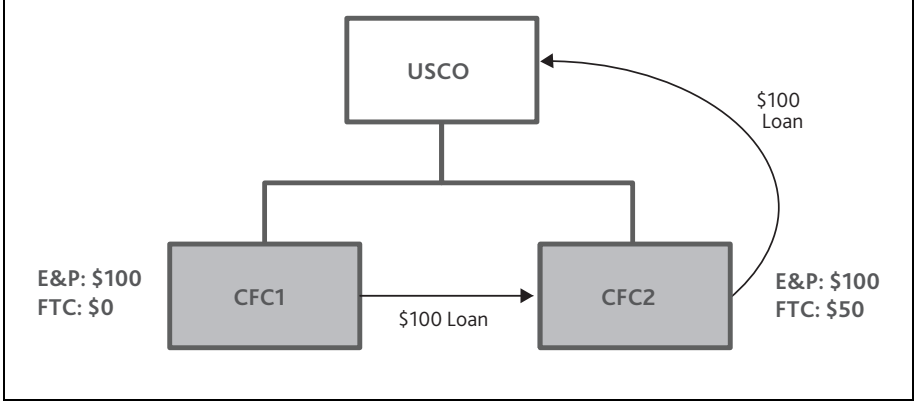
B. Issue 2

When should a CFC's indirect ownership of U.S. property through a partnership be imputed to the CFC? To an extent, this issue was addressed in Rev. Rul. 90-112.[4] The ruling discussed whether a CFC that is a partner in a partnership (whether U.S. or foreign) that owns U.S. property should be treated as owning a share of the partnership's U.S. property. The ruling discussed whether the partnership should be treated as a separate and distinct "entity" or whether the partnership is treated merely as an "aggregate" of all of the properties that it owns (the "Entity/Aggregate Question"). The ruling concluded that, in this case, the aggregate approach was most appropriate. Thus, a CFC that was a 25-percent owner in a partnership was treated as owning 25 percent of the U.S. property held by the partnership. In 2002, the Treasury finalized regulations confirming the IRS's approach in Rev. Rul. 90-112. The final regulations provide under Reg. §1.956-2(a)(3):

> For purposes of section 956, if a controlled foreign corporation is a partner in a partnership that owns property that would be United States property, within the meaning of paragraph (a)(1) of this section, if owned directly by the controlled foreign corporation, the controlled foreign corporation will be treated as holding an interest in the property equal to its interest in the partnership and such interest will be treated as an interest in United States property.

The most significant issue with the regulations was that they failed to indicate whether special allocations of partnership items (*e.g.*, income, gain and loss) with respect to a partnership's U.S.

DIAGRAM 1.



property may be a reason to deviate from the "interest in the partnership" standard. The IRS did issue a much discussed letter ruling suggesting that special allocations of partnership items derived from U.S. property are taken into account.[5] The issue is illustrated in Example 2. There were two further issues with the regulations. First, they provided no guidance with respect to the method for calculating a CFC's "interest in the partnership," as illustrated in Example 3. Second, certain arguably abusive transactions were not addressed, as illustrated in Example 4. For each of the examples, CFC is the wholly owned foreign subsidiary of USCO, a U.S. corporation, and CFC is a partner in a foreign partnership, FPP.

Example 2. FPP holds no U.S. property other than a $100 loan to USCO, and income, gain and loss with respect to the loan are specially allocated to FPP's non-CFC partners. In this circumstance, it is unclear whether (1) a portion of the loan receivable is allocable to CFC based on its interest in FPP, or (2) no portion of the loan receivable is allocable to CFC because the income, gain or loss from the loan is specially allocated away from CFC.

Example 3. Under FPP's partnership agreement, CFC is entitled to 100 percent of all partnership profits until it receives a preferred return of 10 percent on its investment of $100. Thereafter, FPP is entitled to 30 percent of the profits of FPP. CFC is also entitled to a $100 preference on liquidation. In this scenario, Reg. §1.956-2(a)(3) provides no guidance to determine CFC's "interest in the partnership."

Example 4. CFC's interest in FPP is a uniform 51 percent. CFC contributes $100 to FPP, and FPP then lends $100 to USCO. Under Reg. §1.956-2(a)(3), with respect to FPP's loan to USCO, CFC's investment in U.S. property is only $51, its proportionate interest in USCO's obligation to FPP. Nevertheless, USCO has the benefit of a $100 loan from CFC's earnings in much the same way that it would have had that benefit had CFC loaned the money directly to USCO. *See* Diagram 2.

All of the foregoing examples raise questions about how to measure CFC's ownership of the U.S. property held by the partnership. Should taxpayers be able to use special allocations to avoid any investment as in Example 2? Should they be able to effectively loan money through a partnership to their related U.S. parent through a partnership without being considered to own the entire loan, as in Example 4? What happens when the partnership has a more complex income allocation scheme, as in Example 3?

C. Issue 3

When a CFC makes a loan to a foreign partnership owned by related or unrelated U.S. persons, should the partnership's liability be treated a liability of its partners?

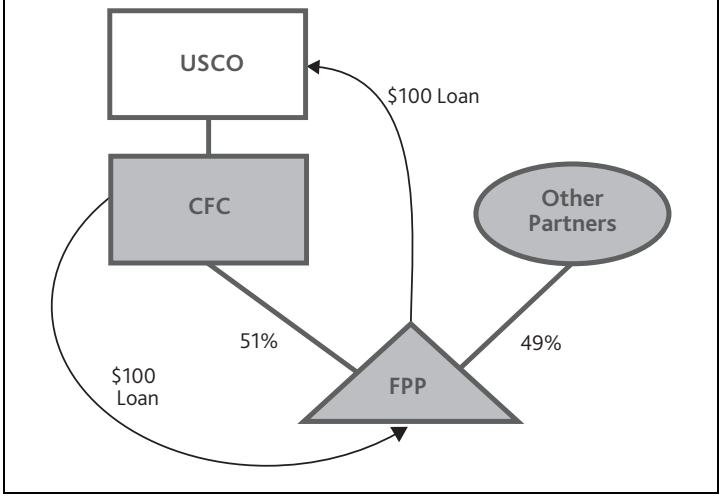
Example 5. USCO wholly owns CFC. USCO is also a partner in a foreign partnership, FPP. CFC loans $100 to FPP, and FPP distributes the proceeds to USCO. *See* Diagram 3.

Here, it is important that FPP is a foreign partnership. If FPP were a domestic partnership, the result would be clear. Domestic partnerships are "U.S. persons"[6]; therefore, CFC's loan to FPP would itself have been an investment in U.S. property. In Example 5, because FPP is a foreign partnership, CFC would only be treated as having made an investment in U.S. property to the extent that we look through FPP and treat CFC's loan to FPP as a loan to USCO.

In the instant circumstance, the question is whether a partnership is viewed as the debtor for its liabilities or whether the partnership is an aggregate of, generally, nonrecourse liabilities owed by its partners. Under an aggregate theory, in Example 5, a portion of CFC's loan to FPP should be treated as a loan to USCO and, thus, an investment in U.S. property.

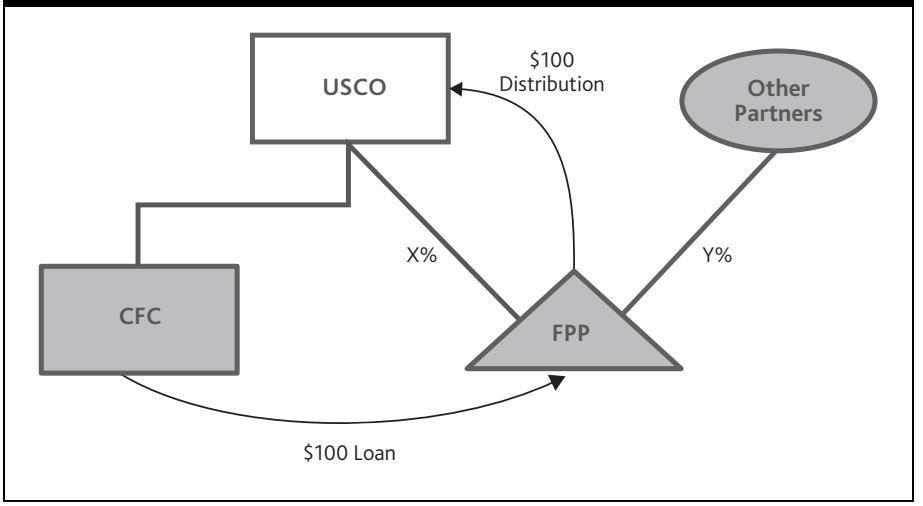
The issues described above are the subjects of new temporary and proposed regulations.

DIAGRAM 2.



III. New Temporary and Proposed Regulations

DIAGRAM 3.



On September 2, 2015, the Treasury and the IRS released new temporary and new proposed regulations for Code Sec. 956 (separately, the "Temporary Regulations" and the "Proposed Regulations" and together, the "Regulations").[7] The Temporary Regulations modify the existing text of the Section 956 Anti-Abuse Rule, and they add a similar rule that applies when a CFC creates, organizes or funds a partnership to acquire U.S. property. The Temporary Regulations also provide a separate anti-abuse rule that applies when a CFC makes a loan to a partnership and that loan enables the partnership to make a distribution to the CFC's U.S. parent. The Temporary Regulations' modification to the Section 956 Anti-Abuse Rule and their two new anti-abuse rules relating to partnerships were effective September 2, 2015. Thus, taxpayers with foreign partnerships in their structure should review these rules now to ensure they do not have any arrangements that would run afoul of the modified anti-abuse rule.

The Proposed Regulations provide two partnership rules that both generally apply the aggregate concept for partnerships in the Code Sec. 956 context. One rule provides the method for attributing the U.S. property of a partnership to a CFC partner, and a second rule provides the method for attributing the liabilities of a foreign partnership to its U.S. partners. The Proposed Regulations will not come into effect until they are finalized.[8]

IV. Modifications to the Anti-Abuse Rule

The Temporary Regulations modify the existing language of the Section 956 Anti-Abuse Rule. First, the Temporary Regulations remove the requirement that the District Director exercise her authority to execute the rule.[9] The preamble to the Temporary Regulations indicates that this requirement was removed because the rule "should apply without requiring the IRS to exercise its discretion."[10] A possible alternative explanation may be that by act of Congress, the IRS has not had district directors in nearly 15 years, and regulations granting authority to defunct IRS offices have been troublesome to the IRS in the recent past.[11]

The Temporary Regulations also include language to indicate that "funding" means funding "by any means."[12] No explanation is provided in the preamble. This unexplained expansion of the term "funding" could raise concerns over whether the rule now captures dividend distributions. Most practitioners would likely agree that dividends are not considered a "funding" because the term "funding" had been included in the Section 956 Anti-Abuse Rule to target transactions that separate assets from the E&P arising in connection with those assets.[13] In a dividend distribution, by definition, assets representing E&P are moved with E&P. Moreover, there was always a strong argument that although the CFC receiving the dividend did not directly possess the assets it received in the distribution, it indirectly owned the assets. Put another way, the dividend merely converted indirect ownership into direct ownership and did not provide the CFC with assets that the CFC was not entitled to. In our view, the term "funding" should still not be read to include dividends.

The more important change in the Temporary Regulations is the addition of an Example,[14] which clarifies that even if a funding results in a Code Sec. 956 inclusion, the funding still can be treated as having been executed for the principal purpose of avoiding Code Sec. 956.

In our Example 1, above, CFC1 had E&P of $100 and no foreign taxes. CFC2 had $100 of E&P and $50 of foreign taxes. CFC1 loaned $100 to CFC2, and CFC2 on-loaned the funds to USCO. The new Example in the Temporary Regulations now indicates that in such a transaction, there is a principal purpose to avoid the application of Code Sec. 956 to CFC1 even though the funding did not have the effect of reducing the Code Sec. 956 inclusion.

It is notable to mention that in our Example 1, if instead of lending the money to USCO, CFC2 distributed the money to USCO, there is no question that Code Sec. 956 would *not* apply. *See* Diagram 4. Granted, the option to make an actual distribution is not always available. Furthermore, in certain instances, a Code Sec. 956 inclusion would be preferable to an actual distribution (for example, a Code Sec. 956 inclusion does not give rise to source-country dividend withholding tax).

Lastly, the Temporary Regulations address certain partnership-related issues. Example 4 involved a CFC contributing funds to a partnership that loaned them to the CFC's related U.S. parent. Example 5 illustrates how U.S. taxpayers could cause their wholly owned CFCs to loan money to partnerships owned, at least in part, by them. Those partnerships could then make a distribution to the taxpayer, effectively repatriating cash to the U.S. partner.

The Proposed Regulations, discussed below, address these issues holistically by providing rules for determining what portion of the partnership's assets should be imputed to a CFC and what portion of a partnership's liabilities owing to a CFC should be considered attributable to U.S. partners related to the CFC. As a stop-gap measure, while the Proposed Regulations are being vetted and commented on, however, the Temporary Regulations amend the anti-abuse rule effective September 2, 2015, to address the fact patterns in Example 4 and Example 5. We address the Temporary Regulations and the Proposed Regulations below.

V. Guidance on Property Held by a CFC Through a Partnership

The Temporary Regulations also add a new rule to the Section 956 Anti-Abuse Rule that applies when a CFC forms, organizes or funds a partnership to avoid the application of Code Sec. 956 to the partnership's investment in U.S. property. In this case, the partnership's *entire* investment in U.S. property is attributed to the CFC. The Proposed Regulations provide a broader rule that applies even if there is no abuse present. The Proposed Regulations provide rules for determining what *portion* of a partnership's U.S. property should be attributed to a CFC owner under Reg. §1.956-2(a)(3).

A. The Temporary Regulations' Anti-Abuse Rule

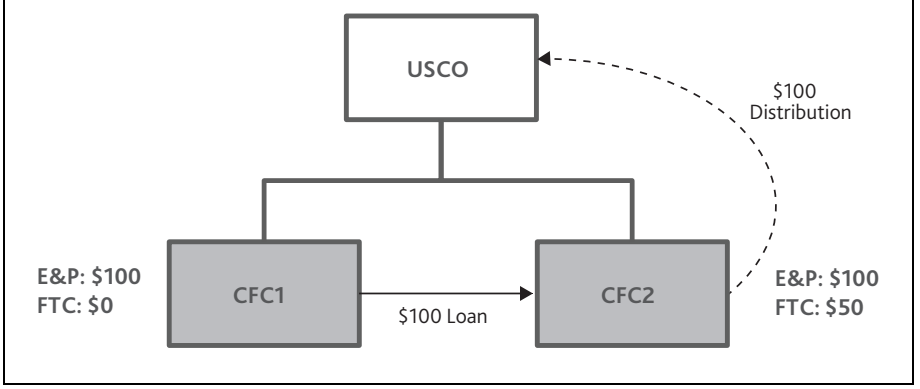
The Temporary Regulations provide that[15]:

> Property acquired by a partnership that is controlled by the controlled foreign corporation if the property would be United States property if held directly by the controlled foreign corporation, and a principal purpose of creating, organizing, or funding by any means (including through capital contributions or debt) the partnership is to avoid the application of section 956 with respect to the controlled foreign corporation.
>
> …
>
> [A] controlled foreign corporation controls a … partnership if the controlled foreign corporation and the … partnership are related within the meaning of section 267(b) or section 707(b).

One of the issues identified in Issue 2 was that a CFC partner could make indirect loans to its U.S. parent by funding loans through its controlled partnership. Under Reg. §1.956-2(a)(3), by itself, the CFC's Code Sec. 956 inclusion would be limited by the CFC's interest in the partnership even though the U.S. parent received a benefit in the full amount of the loan. The Temporary Regulations alter this result.

In Example 3, CFC, a 51-percent partner in FPP, contributed $100 to FPP so that FPP would on-loan the $100 to USCO. Under the Temporary Regulations, CFC would be treated as being in control of FPP and, therefore, CFC's funding of the loan to USCO would cause CFC to be treated as the owner of the entire loan receivable, resulting in a $100 investment in U.S. property for CFC.

DIAGRAM 4.



This rule only applies when the partnership is "controlled" by the CFC within the meaning of Code Sec. 707(b). Code Sec. 707(b) determines control of a partnership based on the capital or profits interests of the partners. For example, if CFC held all of the voting interests of FPP and 50 percent or less of the economic interests in FPP, the Temporary Regulations would not apply. It is unclear why the IRS did not choose a standard focused more on voting control, considering that voting control over FPP will determine whether or not it accepts a loan from CFC and whether or not it on-lends the proceeds to USCO.

B. Proposed Regulations Provide General Rule for Imputing U.S. Property Held by a Partnership to a CFC Partner Even When There Is No Abuse

The Proposed Regulations provide new rules governing the method for allocating a partnership's U.S. property to its CFC partners, when the anti-abuse rule does not apply.[16] The Proposed Regulations establish a "General Rule" and a "Special Allocation Rule." Under the General Rule, a CFC partner in a partnership is treated as holding its attributable share of any property held by the partnership. A partner's attributable share of the partnership's property is determined in accordance with the partner's "liquidation value percentage" (LVP). A partner's LVP is determined by hypothesizing a constructive liquidation. Such constructive liquidation is deemed to occur immediately after the partnership's most recent "revaluation event" (*e.g.*, a non-*de minimis* contribution, a partial/complete liquidation of a partner's interest and other specified events that impact the relative interest of the partners).[17] If there has been no revaluation event, the constructive liquidation is deemed to occur immediately after the formation of the partnership.

In the constructive liquidation, the partnership is treated as:

1. selling all of its assets for cash equal to their fair market values of such assets;
2. satisfying all of its liabilities (*i.e.,* those described in Reg. §1.752-1) in a fully taxable transaction;
3. paying an unrelated third party to assume all of its nonliability obligations (*i.e.,* its Reg. §1.752-7 obligations); and then
4. liquidating.

A partner's LVP is the ratio (expressed as a percentage) of the liquidation value of the partner's interest in the partnership divided by the aggregate liquidation value of all of the partners' interests in the partnership.

The Special Allocation Rule modifies the General Rule to accommodate for the existence of special allocations:

> … if a partnership agreement provides for the allocation of income (or, where appropriate, gain) from partnership property to a partner that differs from the partner's liquidation value percentage in a particular taxable year (a special allocation), then the partner's attributable share of that property is determined solely by reference to the partner's special allocation with respect to the property, provided the special allocation does not have a principal purpose of avoiding the purposes of section 956.

The Special Allocation Rule states that it applies to special allocations of gain "where appropriate," without providing an explanation. The Proposed Regulations provide an Example that sheds some light, illustrating that the "where appropriate" determination is made based on the type of return that is expected to be generated from the property subject to the special allocation.[18] In the Example, the partnership's "property is anticipated to appreciate in value but generate relatively little income"; therefore, "the partners' attributable shares of the [partnership's] property are determined in accordance with the special allocation of gain."

In Example 2, FPP held a $100 loan receivable owing from USCO, but income, gain and loss with respect to the loan were specially allocated to FPP's non-CFC partners. Reg. §1.956-2(a)(3) left open the possibility that FPP's CFC partner could still be treated as owning a share of the loan receivable. The Special Allocation Rule would clarify that CFC would not be considered to own the loan receivable, unless the special allocations with respect to the loan had a principal purpose of avoiding the purposes of Code Sec. 956. This is generally consistent with the IRS's conclusion in LTR 200832024.

One significant omission is the failure of the regulations to address precisely how the Special Allocation Rule and the General Rule would apply at the same time to the same partnership. In Example 2, it is possible that a reviewing court would simply conclude that the loan, and income or gain associated with the loan, would be excluded from the partnership altogether and only the remaining assets of the partnership would be dealt with under the General Rule.

But more complex fact patterns raise more challenging issues. Recall that in Example 3, CFC was entitled to (1) 100 percent of FPP's profits until it received a preferred return of 10 percent on its investment of $100; (2) 30 percent of the profits thereafter; and (3) a liquidation preference of $100 on its equity. Let us further assume that FPP had no liabilities and no nonliability obligations and

that the combined equity of all partners in FPP was $200 ($100 provided by CFC and $100 by the other partners).

If the assets of FPP had a fair market value of $300, in a constructive liquidation, CFC would receive $137 resulting in a 45.67 percent LVP based on the following procedure. Specifically, FPP would have sold its assets for $300. Because FPP had no liabilities or nonliability obligations, all $300 would be distributed to FPP's partners. CFC would receive $100 for its liquidation preference and the remaining $100 of equity would go to FPP's other partners, totaling $200 distributed on equity. There would be $100 of profit remaining, with $10 paid to CFC's for its preferred return (10 percent of $100) and $27 (30 percent of $90) paid to CFC from the residual profits. The distribution to CFC, $137, would then be divided by the distributions to all partners, $300, to arrive at a 45.67 percent LVP for CFC.

This LVP is different from the 30-percent allocation of profits. The question is whether the Special Allocation Rule should apply. The Special Allocation Rule would presumably not apply so long as the 30-percent allocation was not with respect to unique items of partnership property. This is not entirely clear from the regulations, but one could assume based on the examples that the Special Allocation Rule is intended to apply only when there are allocations of income or gain from specific items of partnership property.

If Example 3 were changed, and the 30-percent allocation was directly related to a specific item of property, the Special Allocation Rule would presumably apply. Yet, the regulations do not tell us what we then do with that asset and how we apply the General Rule to the remaining partnership assets. The examples dodge the issue by assuming that the special allocation relates to the U.S. property owned by the partnership. Given that the only reason the taxpayer needs to embark on this analysis is to figure out the CFC's share of that property, there is no need to go further. Yet, this need not be the case. The special allocation could relate to one item of U.S. property and not another. It could also apply to property that is not U.S. property. Either way, a determination has to be made how the General Rule applies to the remaining property that is not subject to the Special Allocation Rule.

VI. Guidance on Loans to a Foreign Partnership Owned by U.S. Persons

The Temporary and Proposed Regulations discussed above apply the aggregate theory to partnerships to treat the assets of the partnership as though they were owned by the partnership's CFC owner. The Temporary and Proposed Regulations also provide rules further applying the aggregate theory to treat the liabilities of foreign partnerships as the liabilities of their owners, causing CFC loans to foreign partnership to be treated as loans to the partnership's U.S. partners.

A. The Temporary Regulations' Anti-Abuse Rule

The Temporary Regulations provide that an obligation of a foreign partnership held by (or treated as held by) a CFC is treated as an obligation of a partner, when[19]:

1. the partnership makes a distribution to the partner;
2. the distribution to the partner would not have been made but for the CFC's funding the obligation (a "Funded Distribution"); and
3. the partner is "related" to the CFC (under Code Sec. 954(d)(3)).

The amount of the obligation treated as a direct obligation of such partner is equal to the lesser of:

1. the amount of the Funded Distribution; and
2. the amount of the obligation.

In Example 4, CFC made a loan to FPP, FPP made a distribution to USCO and USCO was related to CFC. Therefore, if CFC's loan was the "but-for" cause of the distribution to USCO, the Temporary Regulations will treat CFC as having lent $100 directly to USCO.

Here, the Temporary Regulations require taxpayers to determine what constitutes a "but-for" cause of the distribution. For example, add to the facts of Example 4 that FPP has made annual $100 distributions to USCO every year since FPP was formed. In the current year, FPP has sufficient operating profits to make a $100 distribution to USCO, but FPP would like to reinvest its operating profits in its business. For this reason, FPP borrows $100 from CFC so that it can invest an amount equal to its total profits in its business while at the same time making its annual $100 distribution to USCO. Is the loan the "but-for" cause of the distribution? In other words, if FPP can establish that it would have distributed its operating profits and not reinvested them had CFC not made the $100 loan to FPP, would that be a necessary or even a sufficient condition to show that the loan was not the "but-for" cause of the distribution?

B. General Rule for Imputing a Foreign Partnership's Liabilities to Its Partners

The Proposed Regulations address the same issue more holistically and treat some of FPP's liabilities as liabilities

of USCO regardless of whether the partnership distributes any cash to its U.S. partners or not. The Proposed Regulations provide that generally[20]:

> [A]n obligation of a foreign partnership is treated as a separate obligation of each of the partners in the partnership to the extent of each partner's share of the obligation. A partner's share of the partnership's obligation is determined in accordance with the partner's interest in partnership profits. The partner's interest in partnership profits is determined by taking into account all facts and circumstances relating to the economic arrangement of the partners.

An exception applies, however, when the partner is not a CFC nor a person related to a CFC (under Code Sec. 954(d)(3)) to which Code Sec. 956 would have applied by virtue of such attribution.[21] In such case, the obligations of a foreign partnership are not attributed to a partner.

In Example 5, USCO is a partner in FPP. If USCO holds more than 50 percent of the beneficial interest in FPP, by value, a share of FPP's obligations will be treated as obligations of USCO. Otherwise, the Partnership Liability General Rule will not apply. So, for example, if USCO owns 51 percent of FPP, $51 of CFC's loan to FPP will be treated as a liability of USCO, resulting in a $51 investment in U.S. property.

It is not clear how to apply the Proposed Regulations when partners share different partnership items differently. These regulations do not incorporate the LVP calculation of the Proposed Regulations discussed above.[22] Instead, these rules use an amount that tracks with the method applied for allocating partnership excess nonrecourse liabilities under Code Sec. 752, as indicated in the preamble to the Proposed Regulations.[23] Determining a "partner's share of the partnership's profits" under Code Sec. 752 has been a point of confusion for the IRS and for taxpayers in the recent past, when the IRS released proposed regulations under Code Sec. 752.[24] Confusing the issue further, the recently proposed Code Sec. 752 regulations use a calculation that is materially the same as the LVP method to determine a "partner's share of the partnership's profits."[25] If the IRS's view is that "partner's share of the partnership's profits" and LVP are the same in the context of Code Sec. 752, it is curious why the IRS explicitly distinguishes the two in the context of Code Sec. 956. To an extent, the IRS appears to recognize the lack of clarity, soliciting comments "on whether the liquidation value percentage method or another method would be a more appropriate basis for determining a partner's share of a foreign partnership's obligation."[26]

VII. Conclusion

In the new Regulations, the Treasury and the IRS attempt to address difficult and complex issues that have been pervasive since Congress enacted Code Sec. 956. The IRS should be commended for attempting to make headway in a difficult area. We envision that the determination of a CFC's interest in a partnership's assets and the allocation of a partnership's liabilities to its U.S. partners will provide very difficult in real-world fact patterns, however.

ENDNOTES

1 H.R. Rep. No. 87-1447, 2d Sess., at 58 (1962); S. Rep. No. 94-938, at 226 (1976).
2 H.R. Rep No. 94-658, at 217 (1976); S. Rep. No. 94-938, at 227 (1976).
3 Temporary Reg. §1.956-1T(b)(4)(i)(B).
4 Rev. Rul. 90-112, 1990-2 CB 186.
5 LTR 200832024 (Dec. 11, 2007).
6 *See* Code Secs. 957(c); 7701(a)(30)(B). The new proposed regulations also confirm this conclusion stating "For purposes of section 956, an obligation of a domestic partnership is an obligation of a United States person." Proposed Reg. §1.956-4(e).
7 T.D. 9773, IRB 2015-41, 494 (Sept. 1, 2015); Notice of Proposed Rulemaking, FR Vol. 80, No. 170, p. 53058 (Sept. 2, 2015).
8 However, except for in the circumstances described below, at the time the Proposed Regulations go into effect, they will apply to any property acquired as of September 1, 2015.
9 Temporary Reg. §1.956-1T(b)(4)(i)(B).
10 T.D. 9733, IRB 2015-41, 494 (Sept. 2, 2015); *see also* T.D. 9477, IRB 2010-6, 385 (Dec. 30, 2009) (offering the same explanation for the removal of this requirement in the context of the related anti-abuse rule applicable under Code Sec. 304).
11 The Internal Revenue Service Reform and Restructuring Act of 1998 set out procedures for the reorganization of the IRS, which included the elimination of the office of district director. Since the restructuring, the IRS has litigated a number of cases where the taxpayer attempted to use the IRS's failure to update references to offices eliminated in the restructuring to challenge the IRS's authority to execute such regulations. Most notably, taxpayers have unsuccessfully argued that tax assessments should all be void because under Reg. §301.6201-1, the authority to make assessments is vested in the district director. *See S. Grunsted*, 136 TC 455, Dec. 58,621; *T.F. Zdun*, DC-OR, 2011-1 USTC ¶50,229. Nevertheless, the IRS has also lost cases owning to its failure to update rules to respond to the restructuring. *See Living Word Christian Ctr.*, DC-MN, 2009-1 USTC ¶50,199; *Glasgow Realty, LLC v. Withington*, DC-MO, 2005-1 USTC ¶50,124, 345 FSupp2d 1025.
12 Temporary Reg. §1.956-1T(b)(4)(i)(B).
13 *See* T.D. 8209 (June 14, 1988) (explaining that the term "funding" was added to the original rule to correct a flaw that allowed taxpayers to circumvent Code Sec. 956 through the, "transfer [of] assets representing earnings and profits to another CFC and [by] having the transferee invest those earnings in U.S. property"); *see also* FSA 1995-1 (July 11, 1995).
14 Temporary Reg. §1.956-1T(b)(4).
15 Temporary Reg. §1.956-1T(b)(4)(i)(C).
16 Proposed Reg. §1.956-4(b).
17 Reg. §§1.704-1(b)(2)(iv)(f)(5) and 1.704-1(b)(2)(iv)(s)(1) describe what constitutes a revaluation event.
18 Proposed Reg. §1.956-4(b)(3), Ex. 3.
19 Temporary Reg. §1.956-1T(b)(5).
20 Proposed Reg. §1.956-4(c)(1).
21 Proposed Reg. §1.956-4(c)(2).
22 *See supra*, Section V, Part B.

[23] The preamble to the New Proposed Regulations states that the "Treasury Department and the IRS have considered various methods for determining a partner's share of a partnership obligation, including the regulations under section 752 for determining a partner's share of partnership liabilities, the partner's liquidation value percentage (discussed in Part 3 of this preamble), and the partner's interest in partnership profits. Using the partner's interest in partnership profits to determine a partner's share of a partnership obligation is consistent with the observation that, to the extent the proceeds of a partnership borrowing are used by the partnership to invest in profit-generating activities, partners in the partnership (including service partners with limited or no partnership capital) will benefit from the partnership obligation to the extent of their interests in the partnership profits." In other words, the New Proposed Regulations adopt the standard for partnership excess nonrecourse liabilities. *See* Reg. §1.752-3(a)(3) ("The partner's share of the excess nonrecourse liabilities … of the partnership as determined in accordance with the partner's share of partnership profits. The partner's interest in partnership profits is determined by taking into account all facts and circumstances relating to the economic arrangement of the partners").

[24] *See* Notice of Proposed Rulemaking, FR Vol. 79, No. 20, p. 4826 (Jan. 30, 2014); Richard M. Lipton, *Proposed Regulations on Debt Allocations: Controversial, and Deservedly So*, 120 J. Tax. 156 (2014).

[25] *See* Proposed Reg. §1.752-3(a)(3).

[26] Notice of Proposed Rulemaking, 80 FR Vol. 80, No. 170, p. 53058 (Sept. 2, 2015).

