Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: **202203013**
Release Date: 1/21/2022

CC:INTL:B02:JMOben
POSTU-123407-16

UILC: 956.00-00

date: October 19, 2021

to: Lisa M. Rodriguez
Senior Counsel
(Large Business & International)

from: Megan J. Hickman
Special Counsel
Associate Chief Counsel
(International)

---

subject: Application of anti-abuse rule in Treas. Reg. §1.956-1(b)(1)(ii)

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

USP =

Company =

CFC1 =

CFC2 =

CFC3 =

CFC4 =

CFC5=

CFC6 =

CFC7 =

DRE1 =

DRE2 =

DRE3 =

DRE4 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

Date 10 =

Amount 1 =

Amount 2 =

Amount 3 =

Amount 4 =

Amount 5 =

Amount 6 =

Amount 7 =

Amount 8 =

Amount 9 =

Amount 10 =

CFC2 E&P =

CFC5 E&P =

CFC7 E&P =

CFC3 Distribution Amount =

CFC2 Foreign Taxes =

CFC2 Subpart F Income =

CFC2 Distribution =

CFC2 Dividend Distribution =

CFC2 Dividend Inclusion =

CFC2 956 Inclusion =

CFC2 ETR =

CFC5 ETR =

CFC7 ETR =

x percent =

y percent =

z percent =

Tax Year =

State A =

State B =

ISSUE

Whether, under Treas. Reg. § 1.956-1(b)(1)(ii) (the "**Anti-Abuse Rule**"), CFC5 and CFC7 indirectly held in Tax Year certain Taxpayer loans held by CFC2 that were issued on or after September 1, 2015.

CONCLUSION

Yes. CFC5 and CFC7 indirectly held in Tax Year the Taxpayer loans held by CFC2 because CFC2, a foreign corporation that is controlled by CFC5 and CFC7, was funded with a principal purpose of avoiding the application of section 956 with respect to CFC5 and CFC7.

FACTS

A. Relevant Corporate Structure

USP is a State A corporation and the common parent of an affiliated group of corporations that file a consolidated U.S. federal income tax return ("**Taxpayer**"). Taxpayer has a taxable year ending .

Taxpayer wholly owns CFC1, a controlled foreign corporation (within the meaning of section 957) ("**CFC**"). CFC1 wholly owns CFC2. CFC2 wholly owns DRE1, a foreign entity that is disregarded as an entity separate from its owner for U.S. federal tax purposes (a "**disregarded entity**"). DRE1 wholly owns DRE2, a disregarded entity. DRE1 and DRE2 own x percent and y percent, respectively, of CFC3, a CFC.[1] CFC3 wholly owns CFC4, a CFC, and DRE3, a disregarded entity. DRE3 wholly owns CFC5, a CFC. CFC5 wholly owns DRE4, a disregarded entity.

USP wholly owns Company, a State B corporation that USP acquired on Date 4. Company wholly owns CFC6, a CFC. CFC6 wholly owns CFC7, a CFC.

USP is a United States shareholder ("**U.S. shareholder**") (within the meaning of section 951(b)) of CFC1, CFC2, CFC3, CFC4, CFC5, CFC6 and CFC7.

As of the end of Tax Year, CFC2 had earnings and profits ("**E&P**") in the amount of CFC2 E&P, which included E&P from a cash distribution from CFC3 of CFC3 Distribution Amount. Also as of the end of Tax Year, CFC2 had foreign taxes in the amount of CFC2 Foreign Taxes. CFC5 and CFC7 had E&P in the amount of CFC5 E&P and CFC7 E&P, respectively. CFC2's E&P was effectively taxed at a rate of CFC2 ETR, which is approximately twice the effective tax rate of the CFC5 E&P and CFC7 E&P, which were taxed at CFC5 ETR and CFC7 ETR, respectively. CFC5 and CFC7 control CFC2 within the meaning of Treas. Reg. § 1.956-1(b)(2).

CFC4 acts as Taxpayer's primary in-house financing and cash pooling entity by receiving deposits and loans from, and making loans to, Taxpayer's non-U.S. affiliates under deposit and loan arrangements and a cash pooling arrangement. Taxpayer's stated purpose of each of these arrangements is to centralize available cash through intra-group cash pooling to provide liquidity through intra-group loans.

[1] The Form 5471 for CFC3 indicates that it is a holding company with minimal income statement activity.

CFC4's deposit and loan arrangements are bilateral contracts between CFC4 and each of its depositors and lenders. Each deposit and loan arrangement has uniform terms, except for the loan limits and interest rates. Each deposit and loan arrangement designates CFC4 as the "Funding Coordinator," and the participating depositor/borrower as the "Participant." The Funding Coordinator accepts cash from Participants and lends funds to Participants, to the extent a Participant requires funding, up to the applicable credit limit, and invests any remaining cash with appropriate financial institutions outside Taxpayer. DRE4 and CFC7 executed deposit and loan arrangements with CFC4 on Date 1 and Date 5, respectively.

B. Background on Taxpayer's Acquisition of Company and Financing Transactions

Taxpayer acquired Company and executed several financing transactions before September 1, 2015.[2] Exam has not proposed adjustments under section 956 with respect to the financing transactions described in this section B.

On Date 2, Taxpayer entered into an Agreement and Plan of Merger to acquire Company for Taxpayer stock and cash. Taxpayer would obtain the cash from external borrowings and from cash held by Taxpayer and its foreign subsidiaries.

On Date 3, Taxpayer repatriated approximately Amount 3 in cash by executing a series of transactions. First, CFC4 loaned Amount 3 to CFC3. Second, CFC3 distributed cash equal to Amount 3 and two newly issued notes ("**CFC3 Note 1**" and "**CFC3 Note 2**", collectively, the "**CFC3 Notes**"), with an aggregate principal amount of approximately Amount 4, to CFC2, through DRE1 and DRE2.[3] Lastly, CFC2 loaned Amount 3 to Taxpayer.

The CFC3 Notes had a stated interest rate of z percent, a 10-year term, and allowed CFC3 to prepay the notes, in whole or in part, without penalty at any time by giving a minimum five-day notice.

Taxpayer asserts that these financing transactions resulted in less third-party lending, lower interest expense, and higher accretion to earnings per share than other options for financing the acquisition.

. Finally, Taxpayer noted that it anticipated that, by using the offshore cash to lower the amount of external financing, it would improve its credit rating.

---

[2] Treas. Reg. § 1.956-1(b) applies to taxable years of CFCs ending on or after September 1, 2015, and to taxable years of U.S. shareholders in which or with which such taxable years end, with respect to property acquired on or after September 1, 2015. Treas. Reg. § 1.956-1(g)(2). See paragraph (b)(4) of § 1.956–1T, as contained in 26 CFR part 1 revised as of April 1, 2015, for the rules applicable to taxable years of CFCs ending before September 1, 2015 and property acquired before September 1, 2015.

[3] CFC3 distributed CFC3 Note 1 to DRE2 and CFC3 Note 2 to DRE1. Then, DRE2 assigned CFC3 Note 1 to DRE1, and DRE1 assigned the CFC3 Notes to CFC2. Because DRE1 and DRE2 were disregarded entities, this series of transactions was treated for U.S. federal income tax purposes as though CFC3 distributed the CFC3 Notes directly to CFC2.

Following these transactions, Taxpayer borrowed Amount 5 from third parties and, on Date 4, acquired Company in exchange for Taxpayer stock and cash.

After the Company acquisition closed, the relevant Taxpayer affiliates engaged in another series of transactions that allowed Taxpayer to access additional cash held by its foreign subsidiaries, including CFC5 and CFC7, to pay down the acquisition debt. On Date 5, CFC7 withdrew Amount 6 that it had deposited with CFC6 and placed the funds on deposit with CFC4. Through a series of loans and a partial repayment of the CFC3 Notes, Taxpayer repatriated Amount 7 on Date 6 and Amount 8 on Date 7.

C. Transactions at Issue: Taxpayer's Transactions to Access Offshore Cash

Between Date 8 and Date 10, DRE4 and CFC7 deposited Amount 9 and Amount 10, respectively, with CFC4 (the "**Deposits**"). DRE4's deposits were treated for U.S. federal income tax purposes as if made by CFC5 to CFC4 because DRE4 was a disregarded entity.

On Date 9, CFC4 loaned Amount 1 to CFC3 ("**CFC4 Loan 1**"). Then, CFC3 transferred Amount 1 to CFC2 in partial satisfaction of the outstanding principal amount and accrued interest on the CFC3 Notes ("**Repayment 1**"). CFC2 then loaned Amount 1 to Taxpayer ("**CFC2 Loan 1**"). Two months later, on Date 10, CFC4 loaned Amount 2 to CFC3 ("**CFC4 Loan 2**," together with CFC4 Loan 1, the "**CFC4 Loans**"). Then, CFC3 transferred Amount 2 to CFC2 in satisfaction of the outstanding principal amount and accrued interest on the CFC3 Notes ("**Repayment 2**," together with Repayment 1, the "**Repayments**"). CFC2 then loaned Amount 2 to Taxpayer ("**CFC2 Loan 2**," together with CFC2 Loan 1 the "**CFC2 Loans**"). On both Date 9 and Date 10, CFC4 deposited Amount 1 and Amount 2, respectively, of cash with Taxpayer's bank.[4]

D. Taxpayer's Income Inclusions with Respect to CFC2

For Tax Year, Taxpayer included in gross income its pro rata share of CFC2's subpart F income in the amount of CFC2 Subpart F Income. Taxpayer also included in gross income under section 956 an amount equal to CFC2 956 Inclusion.[5]

LAW

Section 951(a) generally requires that every person who is a U.S. shareholder of a CFC and owns (within the meaning of section 958(a)) stock of such CFC on the last day of the CFC's taxable year include in gross income the amount determined under section

[4] Taxpayer indicated that neither CFC1 nor CFC3 has a bank account and that this allowed Taxpayer to avoid the time and costs required to transfer cash to each intermediate entity in each series of financing transactions.

[5] In addition, CFC2 distributed an amount equal to CFC2 Distribution to CFC1, of which an amount equal to CFC2 Dividend Distribution was treated as a dividend and CFC2 Dividend Inclusion was included in Taxpayer's gross income.

956 for the relevant tax year (but only to the extent not excluded from gross income under section 959(a)(2)).[6] A CFC is a foreign corporation in which more than 50 percent of the total combined voting power of all classes of stock of the corporation entitled to vote or more than 50 percent of the total value of the stock of the corporation is owned, directly, indirectly, or constructively, by U.S. shareholders on any day during the taxable year of the foreign corporation.[7] A U.S. shareholder is a "United States person" ("**U.S. person**") who owns, directly, indirectly, or constructively, 10 percent or more of the total combined voting power of all classes of stock entitled to vote of the foreign corporation or 10 percent or more of the total value of shares of all classes of stock of such foreign corporation.[8] For this purpose, a U.S. person includes a domestic corporation.[9]

The amount determined under section 956 with respect to a U.S. shareholder for any taxable year is generally the lesser of (i) the excess of the shareholder's pro rata share of the average of the amounts of United States property ("**U.S. property**") held (directly or indirectly) by the CFC as of the close of each quarter of the taxable year over the amount of E&P described in section 959(c)(1)(A) with respect to the shareholder, or (ii) the shareholder's pro rata share of the applicable earnings of the CFC.[10] The amount of the section 956 income inclusion is computed after giving effect to subpart F income inclusions and distributions during the year.[11]

Subject to certain exceptions not applicable to the facts of this case, U.S. property includes an obligation of a U.S. person.[12] For these purposes, an obligation generally includes a note, account receivable, note receivable, or other indebtedness.[13] The amount taken into account with respect to an obligation of a U.S. person is determined by reference to the CFC's adjusted basis in the obligation.[14]

The Anti-Abuse Rule treats a CFC as indirectly holding U.S. property in certain circumstances. The Anti-Abuse Rule provides that a CFC is considered to hold indirectly

> United States property acquired by any other foreign corporation that is controlled by the [CFC] if a principal purpose of creating, organizing, or

[6] Section 951(a)(1)(B).
[7] Section 957(a) and section 958(a) and (b).
[8] Section 951(b) and section 958(a) and (b). For the year at issue, section 951(b) defined U.S. shareholder only by reference to voting power. P.L. 115-97, §14214(a), 131 Stat. 2054, 2218 (2017), amended I.R.C. § 951(b) to also include the "value test" for taxable years of foreign corporations beginning after December 31, 2017, and to taxable years of U.S. shareholders with or within which such taxable years of foreign corporations end.
[9] Sections 957(c) and 7701(a)(30).
[10] Section 956(a).
[11] Section 956(b)(1)(A). Under sections 951(a)(1)(B), 959(a)(2), and 959(f), only section 956(a) amounts in excess of section 959(c)(2) previously taxed E&P (attributable to subpart F income and measured at the end of the year taking into account current-year activity) give rise to a section 956 inclusion for U.S. shareholders.
[12] Section 956(c).
[13] Treas. Reg. § 1.956-2(d)(2).
[14] Section 956(a) and Treas. Reg. § 1.951-1(e)(1).

> funding by any means (including through capital contributions or debt) the other foreign corporation is to avoid the application of section 956 with respect to the [CFC].[15]

For this purpose, a CFC controls a foreign corporation if the CFC and the other foreign corporation are related within the meaning of section 267(b) or 707(b), with a specified attribution rule.[16]

For taxable years of CFCs ending on or after September 1, 2015, and taxable years of U.S. shareholders in which or with which such taxable years end, with respect to property acquired on or after September 1, 2015, the Treasury Department and the IRS expanded the Anti-Abuse Rule by adding the phrase "by any means" so that the Anti-Abuse Rule "appl[ies] to all fundings, regardless of the form of the funding."[17] The Treasury Department and the IRS explained that this was necessary because "[t]he policy concerns addressed by the anti-avoidance rule are not limited to fundings by debt or equity."[18]

The broad definition of the term "funding" generally extends to common business transactions, but these are subject to the Anti-Abuse Rule only if undertaken with a principal purpose of avoiding section 956.[19] When the Anti-Abuse Rule was expanded to apply to all fundings, the preamble acknowledged that "[w]hether a transaction is a 'funding' does not alone determine whether the transaction is subject to the anti-abuse rule because the rule applies only when a principal purpose of the funding is to avoid section 956 with respect to the funding CFC."[20] The preamble reiterated that the "by any means" language broadened the funding standard, but "the 'avoidance' requirement ensures that ordinary course transactions are not subject to the [Anti-Abuse Rule]."[21] Whether the avoidance requirement is met is based on objective facts.

In response to a comment requesting clarification of the scope of the term funding with examples, the final regulations added "new examples that address common transactions highlighted by the comment to further illustrate the distinction between funding transactions that are subject to the [Anti-Abuse Rule] and common business transactions to which the [Anti-Abuse Rule] does not apply." [22]

---

[15] Treas. Reg. § 1.956-1(b)(1)(ii). See T.D. 9792, 2016-48 I.R.B. 751, at 752. See also T.D. 8209, 1988-2 C.B. 174, 176 (preamble to an earlier version of the Anti-Abuse Rule from 1988 stating that "[t]he regulations under section 956 prevent the avoidance of section 956 by a CFC by providing that an investment in U.S. property made by a foreign corporation that is created or availed of by the CFC principally for the purpose of holding the U.S. property shall be considered to be an investment held by the CFC.").
[16] See Treas. Reg. § 1.956-1(b)(2).
[17] T.D. 9792, 2016-48 I.R.B. 751, at 752.
[18] Id.
[19] T.D. 9792, 2016-48 I.R.B. 751, at 753.
[20] Id.
[21] Id.
[22] T.D. 9792, 2016-48 I.R.B. 751, at 752-53.

The example in Treas. Reg. §1.956-1(b)(4)(vi) ("**Example 6**") illustrates the application of the Anti-Abuse Rule to a fact pattern involving a loan repayment. Specifically, Example 6 illustrates that in certain circumstances a loan repayment is not subject to the Anti-Abuse Rule, but it does not provide a blanket exception to the Anti-Abuse Rule for all loan repayment transactions. In the example, P is a United States citizen that wholly owns two CFCs, FS1 and FS2. Example 6 provides:

> (A) Facts. In Year 1, FS2 loans $100x to FS1 to finance FS1's trade or business. The terms of the loan are consistent with those that would be observed among parties dealing at arm's length. In Year 2, FS1 repays the loan in accordance with the terms of the loan. Immediately after the repayment by FS1, FS2 loans $100x to P. FS2 has no earnings and profits, and FS1 has substantial accumulated earnings and profits.
>
> (B) Result. FS1 will not be considered to indirectly hold United States property under [Treas. Reg. §1.951-1(b)] because a repayment of a loan that has terms that are consistent with those that would be observed among parties dealing at arm's length and that is repaid consistent with those terms does not constitute a funding.

As noted above, Example 6 does not create a blanket exception applicable to all loan repayments; it applies only where the facts are consistent with those in the example. Where the facts are not consistent with the example, a loan repayment may still fall within the scope of the Anti-Abuse Rule if the taxpayer enters into the arrangement with a principal purpose of avoiding section 956. Reading Example 6 as an exception to the Anti-Abuse Rule for all loan repayment arrangements would be inconsistent with the stated intent to not adopt a "narrow definition" of "funding" that "could allow taxpayers to engage in planning that would inappropriately avoid the application of section 956."[23]

Further, the examples in Treas. Reg. §1.956-1(b)(4)(i) (**"Example 1**") and Treas. Reg. §1.956-1(b)(4)(ii) ("**Example 2**") highlight that a change in facts can transform an arrangement that would not be subject to the Anti-Abuse Rule into one that is. Both Example 1 and Example 2 deal with the sale of inventory from one CFC (FS1) to another CFC (FS2) in exchange for trade receivables due within 60 days. In each case, FS2 makes a loan to P, a U.S. citizen who wholly owns FS1 and FS2. In Example 1, the parties do not enter into the arrangement with a principal purpose of avoiding section 956 and FS2 pays the trade receivables according to their terms. That example concludes that the Anti-Abuse Rule does not apply. Conversely, in Example 2, the parties have a principal purpose of avoiding section 956, FS1 and FS2 agree to defer FS2's payment obligation, and FS2 does not timely pay. In that case, the Anti-Abuse Rule does apply.

The example in Treas. Reg. §1.956-1(b)(4)(iii) ("**Example 3**") illustrates the application of the Anti-Abuse Rule where a funding results in an artificial increase in the foreign

[23] T.D. 9792, 2016-48 I.R.B. 751, at 752-53.

taxes that are deemed paid by the U.S. shareholder and the related increase in foreign tax credits. Specifically, Example 3 shows that the Anti-Abuse Rule applies to a funding by loan from FS2, a CFC with a significant amount of cash and E&P but no foreign income taxes, to FS1, a CFC without cash but with significant amounts of E&P and foreign income taxes, which in turn makes a loan to its U.S. shareholder with a principal purpose of avoiding the application of section 956 with respect to FS2. In this example, a single loan is deemed made directly to the U.S. shareholder by FS2 rather than the superfluous step of an intermediate loan to FS1 from FS2 followed by a second loan to the U.S. shareholder from FS1.

ANALYSIS

A. Funding Transactions

1. The Deposits and the CFC4 Loans

Under the plain language of the Anti-Abuse Rule, loans are fundings. The rule specifically refers to "funding by any means (including through capital contributions or debt) . . . ."[24] Both the Deposits and the CFC4 Loans are debt. In the case of the Deposits, CFC5 and CFC7 each deposited funds with CFC4, creating a debt obligation.[25] In the case of the CFC4 Loans, CFC4 loaned cash to CFC3. Therefore, both the Deposits and the CFC4 Loans are fundings within the meaning of the Anti-Abuse Rule.

CFC5 and CFC7 deposited portions of the cash before the current version of the Anti-Abuse Rule was applicable. Nonetheless, a deposit is a loan and thus creates a debt that is a funding both under the current and prior versions[26] of the Anti-Abuse Rule. Therefore, the deposits of CFC5 and CFC7 are properly treated as fundings.

2. The Repayments

a. In General

A loan repayment is also a funding for purposes of the Anti-Abuse Rule. The term "funding" is interpreted broadly in the context of section 956 and the section 956 regulations.[27] This approach is consistent with the addition of the technical language "by any means" in the regulations, which was included "so that the rule can also apply when a foreign corporation controlled by a CFC is funded other than through capital contributions or debt."[28] As noted above, the preamble reiterates that the funding standard was expanded so that it would apply to all fundings, regardless of the form of

[24] Treas. Reg. §1.956-1(b)(1)(ii).
[25] See Thompson v. Riggs, 72 U.S. 663, at 678 (1866) ("the law is well settled that the depositor parts with the title to his money, and loans it to the bank").
[26] Treas. Reg. §1.956-1T(b)(4)(i)(B), as in effect prior to September 1, 2015.
[27] See T.D. 9792, 2016-48 I.R.B. 751, at 752.
[28] T.D. 9733, 2015-41 I.R.B. 494, at 494. See also T.D. 9792, 2016-48 I.R.B. 751, at 752.

the funding,[29] with the "avoidance" requirement filtering any transactions that are not subject to the rule.[30] Because the term "funding" is not specifically defined in section 956, the section 956 regulations, or in any relevant case law, the term should be afforded its customary and ordinary meaning, which is "[t]he action or practice of providing money for a particular cause or purpose."[31] Here, pursuant to the Repayments CFC3 provided money (Amount 1 and Amount 2) to CFC2 for a particular cause or purpose (to finance the loans of Amount 1 and Amount 2 that CFC2 made to Taxpayer). Therefore, the Repayments are fundings under the Anti-Abuse Rule, unless they fall within the ambit of Example 6, which they do not.

b. Example 6

Taxpayer incorrectly argues that Example 6 precludes the application of the Anti-Abuse Rule to its facts. As an initial matter, "examples incorporated into Treasury Regulations are generally considered illustrative only and are not to be considered as dispositive"[32] and do not create any rule or principle. Therefore, Example 6 must be read within the broader context of the Anti-Abuse Rule, not as providing a separate rule. Neither section 956 nor the section 956 regulations (including the preambles) suggests that the repayment of a loan is not a funding; indeed, as discussed above, the regulatory text, the relevant preambles, and the general definition of the term "funding" suggest that a loan repayment is a funding. Read in this context, the premise of Example 6 is that repayments that are not described by the example and that satisfy the "avoidance" requirement would be a funding.

When analyzing the application of Example 6, it is necessary to compare the facts of the example to the facts of the matter at hand. One cannot simply apply the conclusion of the example to any fact pattern.[33] There are four important facts that are set forth in Example 6. First, one CFC transfers cash to another CFC in exchange for a note. Second, the cash is used by the CFC to fund its trade or business. Third, the terms of the note are arm's length. Finally, the note is repaid in accordance with its terms.

Here, CFC2 did not transfer any cash (or make any other economic outlay) to CFC3 in exchange for the CFC3 Notes. CFC3 also did not obtain from CFC2 any funds that it could use to finance a trade or business. Instead, CFC3 issued the CFC3 Notes to CFC2 as a distribution; in other words, the CFC3 Notes were essentially a promise that CFC3 would provide funds to CFC2 at a later date. Second, the CFC3 Notes were issued as a step in a series of transactions, including the Repayments, designed for the express purpose of repatriating cash to Taxpayer. Third, it appears that CFC3 is merely

[29] See T.D. 9792, 2016-48 I.R.B. 751, at 752.
[30] Id., at 753.
[31] *Funding*, Oxford English Dictionary (3d ed. 2017); see also Black's Law Dictionary (11th ed. 2019) ("The provision of financial resources to finance a particular activity or project, such as a research study.").
[32] Tennessee Baptist Children's Homes, Inc. v. United States, 790 F.2d 534, 538–39 (6th Cir. 1986) (citing Nico v. C.I.R., 565 F.2d 1234, 1238 (2d Cir.1977) and other cases).
[33] See, e.g., Est. of Schwartz v. Comm'r of Internal Revenue, 83 T.C. 943, 955 (1984) (noting that results called for in examples do not follow where actual facts differ from those in the examples).

a holding company that does not have a trade or business. Fourth, a right of prepayment of a long-term note in its first year for no penalty and on 5 days' notice is not an arm's length term. Fifth, this case involves a prepayment of a loan with a 10-year term to facilitate the repatriation. None of these facts are present in Example 6. Rather, unlike the loan in Example 6, the CFC3 Notes served no purpose other than to facilitate the future transfer of cash once it was available. As such, the creation of the CFC3 Notes and the subsequent Repayments were merely steps in an overall transaction designed to repatriate cash from CFC5 and CFC7 to Taxpayer without direct loans from those entities to Taxpayer that would give rise to an inclusion under section 956 (with minimal resulting deemed paid foreign tax credits to offset the inclusion).

Because the Repayments were designed to facilitate the repatriation of offshore cash held by CFC5 and CFC7 without giving rise to section 956 inclusions from those entities, the Repayments fall squarely within the text and policy of the Anti-Abuse Rule. Moreover, the facts regarding the Repayments are materially different than those in Example 6 (and that would be the case even if one or more factors described above were not present);[34] and so Example 6 is not inconsistent with this conclusion. Giving Example 6 an expansionary reading in order to claim coverage of transactions such as the Repayments would be inconsistent with the overall policy of the Anti-Abuse Rule because it would "allow taxpayers to engage in planning that would inappropriately avoid the application of section 956."[35] If a repayment of a loan were per se excluded from the Anti-Abuse Rule, taxpayers could easily plan out of section 956 by including a repayment step, as in the matter at hand, even if a principal purpose of the overall transaction is the avoidance of section 956. This result would be contrary to the Anti-Abuse Rule and the preamble's stated objective of preventing the avoidance of the purposes of section 956.[36]

3. Overall Funding Arrangements Including the Deposits, the CFC4 Loans, and the Repayments

An arrangement that includes the Deposits, the CFC4 Loans, and the Repayments is a funding resulting in CFC5 and CFC7 indirectly holding the CFC2 Loans, because each of these transactions individually is a funding. The Anti-Abuse Rule generally provides that U.S. property held indirectly by a CFC includes U.S. property acquired by any other foreign corporation that is controlled by the CFC if a principal purpose of funding by any means the other foreign corporation is to avoid the application of section 956 with respect to the CFC. The control test is met by each relevant corporation.[37] The Anti-Abuse Rule does not require that the CFC directly fund the foreign corporation that acquired the U.S. property or that the arrangement not involve multiple funding steps. To the contrary, the "by any means" phrase in the Anti-Abuse Rule confirms that the rule may apply to a transaction with multiple funding steps. A result of the broadly worded rule is to prevent a taxpayer from circumventing the application of the Anti-

[34] For example, even if the terms of the CFC3 Notes were arm's length in all respects.
[35] T.D. 9792, 2016-48 I.R.B. 751, at 752-53.
[36] Id., at 752.
[37] See Treas. Reg. § 1.956-1(b)(2).

Abuse Rule by simply adding one or more intermediate steps between the funding CFC and the entity that acquires and holds the U.S. property for purposes of determining the section 956 amount. Because the Deposits, the CFC4 Loans, and the Repayments are each fundings, these transactions taken together are also treated as a funding of the CFC2 Loans by CFC5 and CFC7.

B. Taxpayer had a Principal Purpose of Avoiding the Purposes of Section 956

Taxpayer incorrectly argues that the Anti-Abuse Rule cannot apply because the Deposits were made in the ordinary course of business pursuant to its longstanding overall cash management function.[38]

The Anti-Abuse Rule applies to a funding only if a principal purpose of the funding is to avoid section 956 with respect to the funding CFC.[39] A principal purpose "needn't be the only purpose, it need only have been one of the factors that weighed heavily in the [taxpayer's] thinking."[40] This formulation is consistent with the preamble to the regulations that makes clear that there may be more than one principal purpose for a transaction.[41] Therefore, the Anti-Abuse Rule applies if a principal purpose of a funding transaction is to avoid the application of section 956, even if there also were one or more other principal purposes for the transaction.[42]

The facts demonstrate that Taxpayer had a principal purpose of avoiding section 956 when it structured the repatriation of funds from CFC5 and CFC7 through CFC2, CFC3, and CFC4. Even if Taxpayer had considered other reasons when it decided how to repatriate its foreign cash as Taxpayer asserts, such as maintaining a certain credit rating,[43] and regardless of whether the transactions might be argued to be consistent with its historical cash management functions, the Anti-Abuse Rule applies to its

---

[38] Taxpayer also argues that Exam conceded that the financing transactions that occurred before September 1, 2015, were not subject to the Anti-Abuse Rule and therefore the Repayments could not have had a principal purpose of avoiding section 956. Although Exam did not propose adjustments under section 956 with respect to these earlier transactions, Exam in no way conceded that those financing transactions were undertaken without a principal purpose of avoiding section 956.

[39] Treas. Reg. § 1.956-1(b)(1)(ii).

[40] Santa Fe Pac. Corp. v. Cent. States Se. and Sw. Areas Pension Funds, 22 F.3d 725, 727 (7th Cir. 1994). See also The Limited, Inc. v. Comm'r, 113 T.C. 169 (1999), rev'd on other grounds, 286 F.3d 324 (6th Cir. 2002) (Tax Court upheld the IRS's reliance on earlier version of the Anti-Abuse Rule (former Treas. Reg. § 1.956-1T(b)(4)) to attribute to an upper-tier CFC with considerable E&P certificates of deposit issued by a U.S. affiliate acquired by a lower-tier CFC with negligible E&P. The taxpayer had a valid business purpose but was also found to have had a second principal purpose of avoiding section 956).

[41] T.D. 9733, 2015-41 I.R.B. 495 ("[Treas. Reg. §] 1.956-1T(b)(4) applies if 'one of the principal purposes' for the transaction is to avoid the application of section 956 with respect to the CFC. These temporary regulations apply when 'a principal purpose' for the transaction is to avoid the application of section 956 with respect to the CFC. The Treasury Department and the IRS do not view this modification as a substantive change, since **both formulations appropriately reflect that there may be more than one principal purpose for a transaction**.") (Emphasis added.)

[42] Id.

[43] For example, a taxpayer may not use the fact that avoiding federal income tax obligations would result in greater cash flow or a more favorable balance sheet as a justification to avoid such obligations.

transaction if a principal purpose of the funding transactions was to avoid the application of section 956.

Several factors indicate that a principal purpose of the arrangement involving the Deposits, the CFC4 Loans, and the Repayments was to avoid the application of section 956 with respect to CFC5 and CFC7. First, the pattern created by the financing transactions undertaken prior to Tax Year shows an intent to move cash from CFC5 and CFC7 to Taxpayer in a way that avoids the application of section 956. When Taxpayer designed these earlier transactions, its advisors clearly believed that the insertion of loan repayments into the chain of financing transactions would defeat the application of the prior version of the Anti-Abuse Rule.[44] The Deposits, the CFC4 Loans, the Repayments, and the CFC2 Loans are merely the completion of that overall design to repatriate cash while avoiding the application of section 956, as demonstrated by the fact that the Repayments extinguished the CFC3 Notes.[45] Further, CFC4 would not have had sufficient cash available to make the CFC4 Loans without the Deposits.

Second, absent the application of the Anti-Abuse Rule, Taxpayer would have reduced its section 956 amount and increased the related foreign tax credits by transferring cash from CFC5 and CFC7 to Taxpayer through CFC4, CFC3, and CFC2. By routing the funding through CFC2, Taxpayer artificially increased the amount of foreign taxes that Taxpayer was deemed to pay with respect to the section 956 income inclusion because CFC2's E&P were effectively taxed at approximately twice the rate of tax at which CFC5's or CFC7's E&P were effectively taxed. As highlighted in Example 3 (discussed above), an increase in deemed paid taxes and related foreign tax credits is indicative of a principal purpose of avoiding the application of section 956 with respect to earnings of a low-taxed CFC.[46] If CFC5 and CFC7 had loaned the cash directly to Taxpayer, Taxpayer would have had a significantly greater inclusion with foreign taxes deemed paid at a lower effective tax rate.

Third, the Deposits, the CFC4 Loans, the Repayments, and the CFC2 Loans occurred within very close proximity in time. The Deposits occurred in the months leading up to Date 9 (on which CFC4 Loan 1, Repayment 1, and CFC2 Loan 1 occurred) and Date 10 (on which CFC4 Loan 2, Repayment 2, and CFC2 Loan 2 occurred). Further, the total Deposits were similar to the amounts repatriated on Date 9 and Date 10. In the end, Taxpayer could have accomplished the same economic result if CFC5 and CFC7 had loaned the cash directly to Taxpayer, but with less favorable tax consequences; this is the exact type of structure that the Anti-Abuse Rule is intended to prevent.

---

[44] In support of its argument that the Repayments cannot be fundings, Taxpayer refers to a comment letter on the proposed regulations that argues that a repayment of a loan should not be a funding.
[45] The prepayment notices related to the CFC3 Notes are labeled as "Step 16," further indicating that the Repayments were part of an overall plan.
[46] Treas. Reg. §1.956-1(b)(4)(iii).

C. CFC5 and CFC7 Indirectly Held the Taxpayer Notes

Under the Anti-Abuse Rule, CFC5 and CFC7 indirectly held in Tax Year the CFC2 Loans because CFC2 was funded with a principal purpose of avoiding the application of section 956 with respect to CFC5 and CFC7. Accordingly, for purposes of section 951(a)(1)(B) and 956, CFC5 and CFC7 are treated as indirectly holding the CFC2 Notes in Tax Year proportionately based on CFC5's deposits of Amount 9 and CFC7's deposits of Amount 10.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 317-3800 if you have any further questions.