

Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: **AM2009-015**
Release Date: 11/6/2009

CC:INTL:BR5
PRENO-136400-09

UILC: 882.07-00

date: November 04, 2009

to: Lori L. Nichols
Director, International Compliance Strategy and Policy

from: Steven A. Musher
Associate Chief Counsel (International)

subject: Treas. Reg. §1.882-5 - Guidance on Interest Rate for Excess U.S.-Connected Liabilities

This memorandum provides guidance on the interest rate to be used under Treas. Reg. §1.882-5(d)(5)(ii) when a foreign corporation taxpayer does not have U.S.-dollar denominated liabilities on the books of the offices or branches of the foreign corporation outside the United States. This advice may not be used or cited as precedent.

ISSUE

What is the appropriate interest rate to use under Treas. Reg. §1.882-5(d)(5)(ii) when a foreign corporation has excess U.S.-connected liabilities under the adjusted U.S. booked liabilities (AUSBL) method but does not have U.S.-dollar denominated liabilities shown on the books of the offices or branches of the foreign corporation outside the United States for the taxable year?

CONCLUSION

The foreign corporation should use an interest rate that is reasonable under the facts and circumstances.

FACTS

A foreign corporation has income that is effectively connected with the conduct of a trade or business within the United States. The foreign corporation determines its interest expense deduction under the AUSBL method in Treas. Reg. §1.882-5. Under the three-step calculation provided in Treas. Reg. §1.882-5, the foreign corporation determines it has U.S.-connected liabilities in excess of U.S.-booked liabilities. However, the foreign corporation does not have any U.S.-dollar denominated liabilities on the books of the foreign corporation's offices or branches located outside of the United States. The foreign corporation is not a bank within the meaning of section 585(a)(2)(B) (without regard to the second sentence thereof or whether any such activities are effectively connected with a trade or business within the United States).

LAW AND ANALYSIS

Under Treas. Reg. §1.882-5(d)(5)(ii), if a foreign corporation has U.S.-connected liabilities, as determined under Treas. Reg. §1.882-5(c)(1), in excess of U.S.-booked liabilities, as determined under Treas. Reg. §1.882-5(d)(2), the applicable interest rate is determined by:

dividing the total interest expense paid or accrued for the taxable year on U.S.-dollar liabilities that are not U.S.-booked liabilities and that are shown on the books of the offices or branches of the foreign corporation outside the United States by the average U.S.-dollar denominated liabilities (whether interest-bearing or not) that are not U.S.-booked liabilities and that are shown on the books of the offices or branches of the foreign corporation outside the United States for the taxable year.

However, when the foreign corporation does not have U.S.-dollar denominated liabilities shown on the books of the offices or branches of the foreign corporation outside the United States the regulation is indeterminate in the interest rate to be used. In such instances, the foreign corporation should use an interest rate that is reasonable under the facts and circumstances. One reasonable approach in determining such interest rate would include using an interest rate that (i) approximates the foreign corporation's actual average U.S.-dollar borrowing rate with respect to interest-bearing U.S.-dollar denominated liabilities and (ii) is consistently applied by the foreign corporation from year to year. Examples of interest rates that would generally be considered reasonable include the actual average interest rate on interest-bearing U.S.-dollar denominated liabilities that are U.S.-booked liabilities or an average arm's length rate of interest that would be charged to the foreign corporation on its interest-bearing U.S.-dollar denominated liabilities.¹ A U.S.-dollar borrowing rate of zero would generally not be considered reasonable.

¹ Taxpayers following the guidance provided in this memorandum to determine the interest rate to be used on excess U.S.-connected liabilities should continue to fill out lines 10a through 10c on Form 1120-F (Schedule I). However, on Line 10e, the taxpayer may enter an appropriate interest rate consistent with this memorandum and attach a statement to its timely filed return explaining how that interest rate was derived.

Since a bank has the option to elect to use the 30-day London Interbank Offering Rate under Treas. Reg. §1.882-5(d)(5)(ii)(B) to compute its interest on excess U.S.-connected liabilities, it is not eligible to use the method provided in this memorandum for purposes of making a reasonable approximation of its U.S.-dollar borrowing interest rate.

Please call Anthony J. Marra of the Office of the Associate Chief Counsel (International) at (202) 622-3870 (not a toll-free number) if you have any further questions.