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Third Circuit: Loan guarantees by CFCs includible in taxpayer's gross income

The U.S. Court of Appeals for the Third Circuit today affirmed U.S. Tax Court's conclusions that for the years at issue (2007 and 2008) a U.S. shareholder of two controlled foreign corporations (CFCs) that in turn had guaranteed loans made to a U.S. person must include in its gross income the CFCs' applicable earnings and that the amount included in gross income is subject to tax as ordinary income.

The case is: *SIH Partners LLLP v. Commissioner*, No. 18-1863 (3d Cir. May 7, 2019). Read the Third Circuit's [decision](#) [PDF 141 KB]

Summary

The taxpayer (a passthrough entity) was the U.S. shareholder of two CFCs (one established in Ireland and the other in the Cayman Islands).

- These two CFCs guaranteed loans made to a U.S. person.
- The IRS issued a final partnership administrative adjustment (FPAA) determining that the U.S. shareholder must include in its gross income, for 2007 and 2008 (the tax years at issue), the CFCs' applicable earnings under sections 951(a)(1)(B) and 956(d)—and specifically under regulations promulgated under section 956.
- The IRS also determined that the amount included in the U.S. shareholder's gross income was taxable as ordinary income.

The taxpayer contended that the regulations were invalid. Alternatively, the taxpayer asserted that the amounts included in income under sections 951(a)(1)(B) and 956(d) were to be taxed as qualified dividend income.

The Tax Court granted summary judgment for the government finding that:

- The regulations were valid.

- The IRS had correctly determined that the taxpayer must include in gross income the CFCs' applicable earnings for the tax years in issue.
- The amounts were not qualified dividend income.

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The Third Circuit today affirmed the Tax Court's "decision and order in its entirety."

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