Selected U.S. Tax Developments

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THE VIABILITY OF THE PERSONAL SERVICE CORPORATION —THE TAX COURT IS ONCE AGAIN HEARD FROM

Fred Feingold

The Tax Court's recent sanction of personal service corporations may have significant tax implications for certain Canadian residents, including artistes and athletes, who earn income from personal services in the United States.

Consider what your reaction might be if the secretary you employ were to come into your U.S. branch office and announce that, upon the advice of her accountant, she would like to terminate her employment, form a personal service company, and have that company provide her secretarial services to you for a fee equivalent to what her salary and employee benefits cost you. While this may seem somewhat far-fetched at the moment, several recent Tax Court cases make it more difficult for you to dismiss the request out of hand.

Operating a U.S. service business in corporate form may provide tax advantages over the conduct of such a business in an unincorporated form. The most frequently mentioned tax advantage relates to the more generous tax benefits available for qualified corporate employee benefit plans.[1] This is not the only tax advantage, however. Whether a nonresident alien individual is an employee or an independent contractor may affect his exemption from U.S. federal income tax with respect to his personal service income.[2] For example, Article VII(1)(a) of the existing income tax treaty between the United States and Canada provides that a resident of Canada shall be exempt from U.S. tax with respect to an unlimited amount of compensation[3] earned for personal services, provided two conditions are met: First, the Canadian resident must not be present in the United States for a period or periods exceeding 183 days during the taxable year (presumably the year in which the services are performed), and second, the Canadian resident must perform the services for which he is compensated as an officer or employee of, *inter alia*, a resident, corporation, or other entity

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[1] For a brief description of certain of these tax benefits, see the recently decided Tax Court case, *Silvano Achiro*, 77 TC no. 62, 77.62 P-H TC, at 477-78 (1981).

[2] Compare IRC §861(a)(3)(C) with IRC §864(b)(1).

[3] Compare Article VII(1)(b), U.S.-Canada treaty.

VII. (a)(1)

of Canada.[4] If the Canadian resident can meet the first condition, whether he will be subject to U.S. income tax on the entire income derived from his personal services in the United States will depend on whether he performs the relevant services as an employee of a Canadian entity.[5] On the other hand, if he performs services for U.S. persons directly rather than through the medium of a corporation, the exemption is not available if his compensation exceeds $5,000.[6]

Given the more generous tax treatment for individuals who perform services as employees of Canadian entities over those who do not, it is not surprising that many individuals, especially artistes and athletes, have sought to incorporate personal service companies in order to take advantage of these rules. The Internal Revenue Service (IRS) did not initially respond warmly to the personal service corporation. Rather, the IRS has litigated with mixed success in an effort to preclude an individual from obtaining the sought after tax benefits of being employed by his own personal service corporation.[7] The principal theories thus far advanced by the IRS in support of its position can be categorized as follows.

• *Sham*. The IRS has argued that the corporation purporting to employ the individual is a sham and, therefore, should not be given effect for tax purposes. Where corporate formalities are observed, the courts almost uniformly reject the application of the sham doctrine to corporations that have a business purpose for formation or actually conduct some business; the furnishing of services of an employee is generally a sufficient conduct of business.

[4] It should be noted that the second condition appears to add a restriction not found in similar provisions of other tax conventions to which the United States is a party. See, for example, Article IX(1)(b), U.S.-Australia treaty, affording an exemption for services that are performed "for or on behalf of" a resident of Australia. While the phrase "for or on behalf of" would literally appear to apply to independent (for example, professional) as well as dependent (or employee) services, certain language appearing in Revenue Rulings 74-331, 1974-2 CB 281, 74-330, 1974-2 CB 278, had at one time given the impression that the latter type of provision is as limited as the former. The IRS may have back-tracked from that position, however. See Letter Ruling 7852051, September 28, 1978. Of course, in the light of the language of Article VII(1)(a) of the existing U.S.-Canada treaty, the issue of whether the "for or on behalf of" phrase expresses a different requirement than that of an employer/employee relationship does not arise. Nor will the issue arise in the context of the proposed new treaty between the United States and Canada, which provides a separate independent and dependent commercial services exemption. See Articles XIV and XV; but cf. Article XVII.

[5] Income derived from the performance (as distinguished from the furnishing) of personal services is not considered industrial and commercial profits and, therefore, would not be exempt from tax under Article I of the treaty. See Treasury Regulation §519.103(d) and compare with Revenue Ruling 54-119, 1954-1 CB 156, and Revenue Ruling 67-321, 1967-2 CB 470. In certain circumstances, a partner's distributive share of the fees of a personal service partnership for services rendered may be characterized as income from the provision by the partnership of the services of employees and partners of the partnership. See, for example, *Foster v. United States*, 329 F.2d 717, 13 AFTR 2d 1118, 1121 (2d Cir. 1964); *Andrew O. Miller*, 52 TC 752 (1969), acq., 1972-2 CB 2. If so characterized, the distributive share may be treated as industrial and commercial profits.

[6] Article VII(1)(b).

[7] Apart from the cases discussed below, compare *Estate of Nathaniel Cole*, 32 TCM 313 (1973); *Charles Laughton*, 40 BTA 101 (1939), rem'd., 113 F.2d 103, 40-2 USTC ¶9561 (9th Cir. 1940); *Fontaine Fox*, 37 BTA 271 (1938), with *Borge v. Commissioner*, 405 F.2d 673, 69-1 USTC ¶9131 (2d Cir. 1969), cert. denied, 395 U.S. 933 (1969); *U.S. v. Johansson*, 62-1 USTC ¶9130 (D. Fla. 1961), aff'd. in part, rem'd. in part, 336 F.2d 809, 64-2 USTC ¶9743 (5th Cir. 1964); *Elvin V. Jones*, 64 TC 1066 (1975); *Jerome J. Roubik*, 53 TC 365 (1969); *Richard Rubin*, 51 TC 251 (1968), rev'd. and rem'd., 429 F.2d 650, 70-2 USTC ¶9494 (2d Cir.1970), on remand, 56 TC 1155 (1971), acq., 1972-2 CB 3, aff'd. *per curiam*, 460 F.2d 1216, 72-1 USTC ¶9440 (2d Cir. 1972); *Douglas H. Damm*, 36 TCM 793 (1977); *Floyd Patterson*, 25 TCM 1230 (1966), aff'd., 68-2 USTC ¶9471 (2d Cir. 1968).

• *Assignment of income.* The IRS has argued that the individual performing the services is the earner of the fee paid to his personal service company for those services and is taxable on that fee. The IRS's contention is that the corporation did nothing to earn the income generated by the services of the purported employee; rather, the employee did and assigned the income to the company. Were this theory to be sustained, the result would in many cases be identical to the result were the company treated as a sham. Thus far, this theory has met with only limited success and only in special circumstances[8] where corporate formalities either were not or could not be observed. Nevertheless, the U.S. Tax Court has sought to apply the doctrine to personal service companies. Two Appellate Courts, however, have reversed the Tax Court and remanded for dispositon under IRC section 482,[9] which authorizes the IRS to reallocate gross income between taxpayers in common control in order to reflect the proper amount of income that each would have earned had they acted at arm's length.

• *The corporation is not an employer, but rather an agent.* The IRS's published rulings (see Revenue Rulings 74-330 and 74-331[10]) take the position in the context of issues arising under provisions of tax treaties similar to Article VII, that the purported corporate employer is no more than a "booking agent" where there is no possibility of an entrepreneurial profit to the purported employer and where the employee actually guarantees due performance of the obligation of the employer to provide his services. Except in an analagous area,[11] this theory has thus far not been advanced in the Tax Court.

• *Section 482.* The IRS has contended in cases where the employee is in control of the employer that all or a substantial part of the company's income is to be reallocated to the employee pursuant to IRC section 482. In the past, the section 482 theory has been the IRS's most successful weapon in combatting the deflection of income from a high-earning U.S. individual to his lower taxed U.S. employer corporation.[12] Such reallocation does not, however, appear to affect the character of the income as employment income of the employee.[13] Thus a reallocation for U.S. tax purposes of additional compensation to a Canadian employee of his wholly owned Canadian company would not appear to be meaningful if the Canadian employee would be exempt under Article VII(1)(a) on any amount of income so allocated.

Furthermore, section 482 has no application where the employee is paid an arm's-length consideration. Thus an individual who obtains an arm's-length consideration from his employer corporation is immune from the application of section 482. Because the Service can obtain only limited benefits under section 482, it has vigorously argued for the disregard of the employer company under one or more of the theories noted above.

• *Identity of employer.* In Revenue Rulings 74-330 and 74-331 (sometimes referred to as the "lend-a-star" rulings), the IRS had raised the contention that an employee was a common-law employee of a person other than his purported corporate employer

[8] See supra, *U.S. v. Johansson; Elvin V. Jones; Floyd Patterson;* and *Jerome J. Roubik.*

[9] See *Rubin v. Commissioner*, 429 F.2d 650, 70-2 USTC ¶9494 (2d Cir. 1970), and *Foglesong v. Commissioner*, 621 F.2d 865, 80-1 USTC ¶9399 (7th Cir. 1980).

[10] Supra, footnote 4.

[11] Cf. *Aiken Industries, Inc.*, 56 TC 925 (1971), acq., 1972-2 CB 1.

[12] See *Rubin* and *Borge*, supra, footnote 7.

[13] See the dissenting opinion in *Daniel F. Keller*, 77 TC no. 70 (1981).

(that is, the company that "borrowed" his services) because, in fact, if not in law, that person actually directed the rendition of the services.[14] This issue has been raised by the Tax Court in connection with qualified employee benefit plans. In *Edward L. Burnetta*,[15] the individuals who purported to be employed by a service corporation were found to be employed by the companies for whom they performed the services rather than their service corporation.[16] Additionally, in the light of the reference to the issue in *Achiro* (discussed below), it may well be that such an argument will be made in other appropriate circumstances.

It is in the context of the above discussion that the recently decided Tax Court cases of *Silvano Achiro*,[17] *Daniel F. Keller*,[18] and *Frederick H. Foglesong*[19] are of interest. They appear to hold that except for unusual situations, the personal service corporation may not be disregarded either under the sham or assignment of income doctrines and that section 482 is the exclusive remedy of the IRS.

In *Achiro*, the principals of Company A and B, which had a number of employees, terminated their employment with A and B and formed a personal service company, Company C. The principals then entered into exclusive employment agreements with C. C, in turn, entered into management agreements with A and B under which C was required, practically if not legally, to provide the services of the principals to A and B. Under that agreement, A and B paid management fees to C, and C paid salaries under its employment agreement.

The Tax Court found that (1) the change in form did not alter the manner in which the principals rendered their services for the benefit of A and B, and (2) the principal, if not the sole purpose, of the formation of C was to take advantage of the more generous tax benefits accorded qualified corporate employee benefit plans without conferring those benefits on the other employees of A and B.[20]

The IRS contended that C was either a sham or, if a viable company, was not the true earner of the fees paid by A and B. An alternative and not well-developed argument was made under section 482. In addition, the Service argued that the tax benefits sought were precluded by section 269, which allows the IRS to bar tax benefits resulting from the acquisition of control of a corporation where the acquisition was for the principal purpose of securing those benefits.

The Tax Court rejected each of the contentions raised by the government, holding that the government's position represented a frontal attack on a taxpayer's use of a personal service corporation to obtain the more favourable tax benefits available to qualified corporate employee benefit plans—an attack it would not sanction. However, the Tax Court gratuitously footnoted that because the issue was not raised by the government, it would not pass on whether, notwith-

[14] Cf. Rev. Rul. 68-107, 1968-1 CB 427.

[15] 68 TC 387 (1977), acq., 1978-2 CB 1.

[16] But cf. *Ronald C. Packard*, 63 TC 621 (1975).

[17] 77 TC no. 62 (1981).

[18] 77 TC no. 70 (1981).

[19] 77 TC no. 74 (1981), on remand from *Foglesong v. Commissioner*, 621 F.2d 865, 80-1 USTC ¶9399 (7th Cir. 1980), reversing 35 TCM 1309 (1976).

[20] Because this could result in prohibited discrimination of employees of commonly controlled employers, a nominal 52 per cent shareholder was introduced. The plan did not work because the Tax Court refused to recognize the existence of the 52 per cent shareholder under the controlled group rules for qualified employee benefit plans. Cf. IRC §414(m).

standing the form employed, the principals remained the common-law employees of A and B.[21]

Keller involved a medical partnership in which one of the partners incorporated, replacing himself as the partner with his professional corporation in order to obtain pension and medical reimbursement benefits. The IRS attempted to allocate 100 per cent of the professional corporation's income to the individual doctor either under section 482 or assignment of income or sham. The majority opinion of the Tax Court dismissed entirely the possibility of assignment of income or sham because the corporation actually performed the relevant services. The court held[22] that section 482 would be applicable, but then went on to hold that in determining whether fair compensation was paid, the test is whether the compensation package, inclusive of salary, pension, and other corporate benefits, approximated what could have been received absent the interposition of the corporation. Using that test, the compensation package in *Keller* paid by the corporation to its stockholder amounted to virtually everything the corporation received. Thus the IRS could not allocate more income to the employee.[23]

The taxpayer in *Foglesong* had for a number of years been a highly successful sales representative for two unrelated manufacturers, performing his services pursuant to sales representative agreements. Eventually the taxpayer incorporated his business. At the request of the taxpayer, the manufacturers agreed to substitute the taxpayer's company for him under the sales representative agreements, to pay all further commissions to the company, and to release the taxpayer from further obligations under the agreements. While the taxpayer did not execute a formal employment agreement with the employer company, he in fact worked exclusively for that company. The Tax Court initially held[24] that the taxpayer was taxable on virtually all the amounts paid to the company under assignment of income principles because the most significant purpose in the formation of the company was tax avoidance. The Seventh Circuit Court of Appeals reversed and remanded the case to the Tax Court for further consideration under section 482.[25] On remand,[26] the Tax Court reached the identical result it had reached previously, but this time on the basis of section 482.[27]

In summary, while *Achiro*, *Keller*, and *Foglesong* appear to once again sanction the use of personal service corporations at least for the purpose of allowing an individual to obtain corporate pension benefits, provided corporate formalities are observed,

[21] *Achiro*, supra, footnote 17. Had it been determined that the principals remained employees of A and B, their plan would not have worked whether or not the 52 per cent shareholder of C was recognized. See *Burnetta*, supra, footnote 15.

[22] Six judges dissented in *Keller*, supra, footnote 13. The dissenting opinion would draw a distinction between the incorporation of an ongoing professional practice, which apparently it would allow, and the incorporation of "a piece of a piece" of such a practice and interposing the corporation as a partner in the practice. In the latter case, the dissent would invoke assignment of income principles.

[23] Implicit in *Keller* is that a service corporation need not earn any substantial profit. This is particularly interesting because one of the concerns in incorporating a service business is the issue of unreasonably high compensation. *Keller* seems to reach the {logical?} conclusion that an individual whose services generated a fee to his employer corporation is entitled by way of compensation to virtually all of that fee.

[24] 35 TCM 1309 (1976).

[25] 621 F.2d 865, 80-1 USTC ¶9399 (7th Cir. 1980).

[26] 77 TC no. 74 (1981).

[27] This is essentially what happened in *Rubin*, supra, footnote 9.

one cannot leap to the conclusion that these cases are to be construed as allowing every individual who would otherwise be an employee of the person for whom the services are rendered to be treated otherwise simply by separately incorporating his or her own personal service company.

Thus, while the law is not yet sufficiently developed on the point for you to safely treat your secretary as anything other than a common-law employee regardless of the form used, such a response may not be sufficient to deter other individuals who are less likely than your secretary to be regarded as a common-law employee once another corporation is interposed. The cases noted above seem to suggest that certain individuals can safely incorporate, at least to obtain corporate pension benefits. The remaining issue—eagerly awaited—is whether the conclusions reached by the Tax Court in this area will be applied to issues arising under the provisions of a treaty.

INVESTMENT IN FLORIDA REAL PROPERTY: NEW REQUIREMENTS FOR ALIEN CORPORATIONS

David M. Richardson and E. Scott Golden

A recent Florida statute proposes new filing and other procedural obligations on Canadian and other "alien" corporations owning or planning to acquire real estate in the State of Florida.

Florida recently amended its organized crime act (the Racketeer Influenced and Corrupt Organization Act or "RICO Act") to require each alien corporation (that is, any corporation not incorporated under the laws of the United States or of any state of the United States) that owns or desires to acquire real property in Florida to maintain a registered office in the state, to have a registered agent in the state, and to file an annual report with the Florida Department of State.[28] All such alien corporations are within the ambit of the amendment.

Under the new statute, the registered agent must be an individual or a corporation authorized to transact business in the state, and the registered agent's business office must be the same as the registered office of the alien corporation.[29] The registered agent must file a written statement with the Department of State accepting the appointment.[30]

The alien corporation that owns, acquires, or sells Florida real property is required to file a form with the Department of State between January 1 and July 1 of each year.[31] The form must be executed by the corporation's president, vice-president, secretary, assistant secretary, or treasurer.[32] According to a Florida Attorney General Opinion, any corporation that has none of the foregoing officers may substitute another officer who performs similar executive functions.[33] For instance, the

[28] Fla. Laws 1981, ch. 81-141, §5 (creating Fla. Stat. §943.468).

[29] Fla. Stat. §943.468(1)(b).

[30] Ibid., §(2); Op. Atty. Gen. 081-87 (November 3, 1981).

[31] Fla. Stat. §943.468(3); Op.Atty.Gen., supra.

[32] Fla. Stat. §943.468(3)(e).

[33] Op.Atty.Gen., supra, footnote 30.

managing director of a corporation formed in the Netherlands Antilles would be permitted to sign the form.

The officer executing the report must attest to its accuracy "as of the day immediately preceding" its filing.[34] To meet this somewhat unusual requirement, the report should be filed on the day of, or on the day after, execution. If the report were filed several days after it was executed, the officer signing it would not have attested to its accuracy "as of the day immediately preceding" its filing. The Attorney General has explained to the Department of State that a report that was not executed by the officer of the alien corporation on the day immediately preceding receipt should nevertheless be filed, but that the Department of State should record the status of the alien corporation as not having timely complied with the statute.[35] Therefore, to the extent possible, corporations should consider using a method of delivery that will insure receipt of the form by the Department of State within one day after the form is executed.

The penalties prescribed for failure to file the report are severe. An alien corporation failing to file will be prevented from owning, purchasing, or selling any real property in the state, and from suing or defending in the state, until the requirements are met.[36] Although the statute is not entirely clear, it appears that tardy compliance by a corporation will cure an earlier failure to file or failure to maintain a registered office or agent. The corporation's earlier failure, however, will be noted on records maintained by the Department of State.[37]

The new filing requirement is already affecting acquisitions and sales. In the case of an alien corporation that acquires property without previously filing, at least one major title guaranty company has instructed its agents to require a new deed from the grantor to the alien corporation, dated after the alien corporation has filed, before it will insure a deed or mortgage of a grantee of the alien corporation.[38] Thus the duty of alien corporations to file before acquiring or selling real property has practical, as well as legal, implications.

A statutory fee of $15.00 must accompany the form when it is filed each year.[39] Any report not timely filed must be accompanied by a fee of $35.00 when it is filed.[40]

Finally, the legislature addressed the concern of many investors that filing the report would be construed to indicate that the corporation is doing business in the state. The statute provides that the filing of a report "shall be solely for the purposes of this act" and "shall not be used as a determination of whether the corporation is actually doing business in this state."[41]

Under this new statute, Canadians who have acquired or are planning to acquire an interest in Florida real property through a corporation that is not incorporated under the laws of a state of the United States should be aware of the need to appoint a registered agent, to maintain a registered office, and to file a report with the Florida Department of State.

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[34] Fla. Stat. §943.468(3)(e).

[35] Ibid., §(5); Op.Atty.Gen., supra, footnote 30.

[36] Fla. Stat. §943.468(6).

[37] Ibid., §(5).

[38] See Lawyers' Title Guaranty Fund, "Compliance with Florida RICO (Racketeer Influenced and Corrupt Organization) Act" (1981), 13 *Fund Concept* 47.

[39] Fla. Stat. §943.468(4).

[40] Ibid.

[41] Ibid., §(7).

LIABILITY OF CANADIANS TO RESPOND TO U.S. SUMMONS FOR INFORMATION

Laurence Goldfein

A recent U.S. decision demonstrates the long reach of the United States in obtaining information from foreign persons in pursuance of U.S. interests. While the case discussed below involved a Canadian bank, the rule is equally applicable to any Canadian corporation or individual doing business in the United States.

A recent U.S. Federal District Court decision, *United States v. Quigg*,[42] provides another instance where the location of records outside the United States (and in this case located in a jurisdiction with secrecy laws) may not provide protection from their production in a U.S. court if a basis is found to secure jurisdiction over the custodian of the records. The particular question at issue was: may a U.S. court secure jurisdiction over the records of a Canadian bank by virtue of its branch in the United States even if such records are located in an office or subsidiary of the bank located outside both the United States and Canada?

The case involved the criminal prosecution of a U.S. individual on charges of income tax evasion. A subpoena was issued ordering the Canadian Imperial Bank of Commerce to produce the bank's records of any account maintained by the U.S. defendant and was served on an officer at the bank's agency located in New York City. The specific records sought were located in the bank's branch in Nassau in the Bahamas. The bank moved to quash the subpoena on two grounds: first, that it could not be compelled to produce bank records if production would subject it to criminal liability under the laws of the Bahamas; and second, that the records were beyond the control of the New York agency of the Bank of Commerce and therefore the U.S. court did not have jurisdiction over the bank's branch in the Bahamas.

CRIMINAL LIABILITY FOR VIOLATION OF BAHAMIAN SECRECY LAWS

The U.S. government met the bank's first contention by a court order compelling the defendant to execute a consent permitting the disclosure of bank records concerning his accounts at the Bahamian branch of the Bank of Commerce. In defence, the defendant argued that his rights under the U.S. Constitution would be violated if he were required to execute the consent form, and in particular, that such compulsion to co-operate violated his personal privilege under the Fifth Amendment of the U.S. Constitution—that is, that he may not be compelled to give testimony that might tend to incriminate him.

The District Court struck down this defence: Since the records were of a third party bank and not private in nature, they were outside the protection of the privilege against self-incrimination. The court noted that there are a number of exceptions to the general proposition that a defendant is not obliged to co-operate with the government in his own prosecution; that is, he may be compelled to submit to a blood test, to participate in an identification line-up, to produce a handwriting exemplar, or to produce papers and other evidence in his possession that may be damaging at trial but that are not private or testimonial in nature.

Furthermore, the execution of the consent form was held not itself an act privileged under the Fifth Amendment of the

[42] 81-2 USTC ¶9732, 48 AFTR 2d 81-5953 (D. Vt. 1981).

Constitution; the defendant, in consenting to disclosure, would neither admit ownership of an account in the Bahamas nor vouch for the accuracy of any records produced by the bank. The consent would merely permit the Bank of Commerce to release any records it may find. Accordingly, the court ordered the defendant to consent to the disclosure.

WORLD-WIDE REACH OF SUMMONS

The second argument raised by the bank was whether its headquarters in Canada and all 1,700 of its world-wide branches were subject to the subpoena power of the court. The threshold factual issue was whether the Bank of Commerce was to be considered "in" the United States for the purpose of the service of process provision of Rule 17(e)(1) of the U.S. Rules of Criminal Procedure.[43] This test was equated with the notion of "doing business." From the affidavits of the bank's own representatives, the court found that the Canadian headquarters of the bank, through its agency in New York, had sufficient activities in the United States to meet this test.

As to the scope of the subpoena, the court states that the subpoena power over a foreign corporation doing business in the United States extends beyond inquiries related to the corporation's operations in the United States. While recognizing that foreign corporations may not be required to open all their files to American courts, in this case the subpoena was limited to bank records concerning a U.S. citizen under indictment for violation of U.S. tax laws. The subpoena therefore represented no great intrusion into the foreign affairs and operations of the Bank of Commerce and its foreign customers. In the court's view, the Bank of Commerce, having chosen to enter the United States to conduct business, became obliged to respond to reasonable requests for information concerning its transactions with Americans both in the United States and abroad.

FURTHER IMPLICATIONS OF QUIGG

This case presents yet another instance where the conduct of business within the United States may subject a non-U.S. person or entity to a U.S. court order to perform certain acts outside the United States. In *Public Admin. v. Royal Bank of Canada,*[44] the highest court in the State of New York determined that service of process in a civil case on the New York branch of the Royal Bank of Canada sufficed to give New York courts jurisdiction over an "incorporated" branch of the same bank located in France. Jurisdiction over the French subsidiary was obtained on the grounds that the subsidiary's existence and operations were indistinguishable from that of the Canadian parent despite its separate incorporation. In effect, the court pierced the corporate veil of the French subsidiary and found it to be a mere department of the Royal Bank of Canada over whom the court had obtained jurisdiction through the New York branch.

Once jurisdiction over a foreign individual or entity is obtained, a U.S. court may order such person to repatriate assets located outside the United States in satisfaction of U.S. tax liabilities, or be held in contempt of court. In *United States v. Ross,*[45] the court ordered Ross, a resident of the Bahamas, to turn over certain stock located in the Bahamas to a U.S. receiver appointed to protect the IRS in its tax claims against him. Since personal jurisdiction had been obtained by personal service

[43] Rule 17(e)(1) provides that the service of a subpoena requiring the attendance of a witness at a hearing or trial may be served at any place within the United States.

[44] 19 N.Y. 2d 127 (New York Court of Appeals, 1976).

[45] 302 F. 2d 831 (2nd Cir. 1962).

of a summons on Ross's authorized agent in the United States, the court found it had the power to order Ross to transfer property outside the limits of its territorial jurisdiction.[46]

A taxpayer's assets may also be ordered frozen in a foreign bank account. In *United States v. First National City Bank*,[47] the U.S. Supreme Court affirmed an injunction against the transfer of property located in a Uruguayan branch of a U.S. bank pending the acquisition of jurisdiction over the Uruguayan taxpayer. The court's language in the *First National City Bank* case suggests that jurisdiction over the foreign branch was obtained because the U.S. parent exercised actual, practical control over its branches. This element of control over the branch is not incompatible with the reasoning of *Quigg* since jurisdiction over the Bank of Commerce headquarters in effect gave the court jurisdiction over the entire enterprise, including foreign branches under the control of the Canadian home office. Therefore, if *Quigg* is construed as a proper extension of *First National City Bank*, a Canadian corporation with a branch or subsidiary in the United States could be ordered by a U.S. court, in the context of either a criminal or civil proceeding, to not only disclose records but also to freeze or transfer to the United States assets located in Canada, as well as in a foreign branch or foreign incorporated branch outside both the United States and Canada, in satisfaction of a U.S. tax liability.

IMPUTED INTEREST ON SALES OF PROPERTY

Michael Hirschfeld

The proposal to tax imputed interest on sales of property set forth in the November 1981 budget to Parliament invites examination of the U.S. treatment of imputed interest.

Present Canadian legislation provides that Canadian corporations lending funds to nonresident persons for one year or longer and not including in income a reasonable rate of interest on such loans are required to pay tax on imputed interest.[48] Resolution 14(a) of the November 1981 budget to Parliament proposed to amend the foregoing legislation so as "to extend the interest imputation requirement to any form of indebtedness regardless of its term."[49] It has been suggested that "[t]herefore, indebtedness not traditionally regarded as a loan, such as the unpaid purchase price on

[46]See also *United States v. McNulty*, 446 F. Supp. 90 (N.D. Cal. 1978), where, to satisfy U.S. tax assessments, McNulty was ordered to repatriate cash won in the Irish Sweepstakes and deposited in a secret bank account on the Island of Jersey.

[47]379 U.S. 378 (1965).

[48]Income Tax Act, subsection 17(1), reprinted in 1 CCH *Canadian Tax Reporter* ¶4730.

[49]Resolution 14(a), Notice of Ways and Means Motion to Amend the Income Tax Act (1), November 12, 1981, reprinted in CCH *Canadian Tax Reports, Tax Topics*, no. 505 Extra, Part I, ¶70, at 41 (November 12, 1981). The proposal was to be effective as of January 1, 1982. In a document tabled on December 18, 1981, however, the Minister of Finance proposed that the measure "not apply to require the imputation of interest for any period before January 1, 1983 except with respect to a loan made to a non-resident after November 12, 1981 by a corporation, partnership or trust. It will not apply to any such loan on which interest is payable at a reasonable rate." The Honourable Allan J. MacEachen, "Notes on Transitional Arrangements and Adjustments Relating to Tax Measures Announced November 12, 1981," reprinted in CCH *Canadian Tax Reports, Tax Topics*, no. 510 Extra (December 18, 1981), at 13.

a sale of property, which does not carry a reasonable rate of interest will result in interest at a prescribed rate being imputed to the creditor."[50]

In view of the foregoing, the following analysis of various situations illustrating the breadth and scope of U.S. taxation of imputed interest on sales of property may be of interest to Canadian tax practitioners.

- *Situation 1.* A Canadian resident owning a vacation home situated in Florida decides to sell the home to a U.S. resident individual with payment of the purchase price being deferred, in part, past one year.

- *Situation 2.* A Canadian manufacturer sells inventory to a U.S. corporation in exchange for a noninterest bearing note.

- *Situation 3.* A Canadian corporation exchanges its stock in a subsidiary for stock in a U.S. corporation. A portion of the stock of the U.S. corporation will not be transferred to the Canadian corporation unless certain contingencies occur within a stated period of time, which may exceed one year.

What do each of the foregoing Canadian parties have in common? Each must consider whether the payments being made to them are treated, in part, as interest subject to U.S. withholding tax.

Section 483 of the U.S. Internal Revenue Code (the "Code") provides that if any part of the sales price of property is payable more than one year after the date of the sale or exchange, and if the deferred purchase price does not bear interest at a rate equal to or greater than a prescribed test rate, then an interest rate will be imputed with the result that part of the purchase price will be treated as "interest" for "all purposes of the Code" rather than as proceeds of the sale.[51] The test rate for determining whether section 483 will be operative was recently increased to 9 per cent per annum simple interest for sales or exchanges occurring after June 30, 1981.[52] If the stated interest rate is less than the test rate, it becomes necessary to apply the imputed interest rate to the purchase price. The imputed rate is 10 per cent per annum compounded semiannually for sales or exchanges occurring after June 30, 1981.[53] In computing the portion of the purchase price that is considered interest under section 483, an appropriate offset for stated interest is taken into account.

Operation of section 483 can thus convert a portion of otherwise exempt capital gains into interest subject to U.S. withholding tax.[54] In Situation 1, for example, if

[50] Editorial Comment to Resolution 14, supra.

[51] Treas. Reg. §1.483-2(a)(1)(i).

[52] Treas. Reg. §1.483-1(d)(1)(ii)(C). The rate before amendment was 6 per cent per annum simple interest; this rate will still apply to sales or exchanges occurring after June 30, 1981 if made pursuant to a binding contract entered into before September 29, 1980. Treas. Reg. §1.483-1(d)(1)(ii)(B). It should be noted that it is only necessary that the effective interest rate be 9 per cent per annum simple. Thus, for example, a note bearing interest computed at variable rates over its term must be analysed to determine whether its overall effective rate is at least 9 per cent per annum simple interest. The regulations provide present value tables to make that determination.

[53] Treas. Reg. §1.483-1(c)(2)(ii)(C). The rate before amendment was 7 per cent compounded semiannually; this rate will still apply to sales or exchanges made after June 30, 1981 if made pursuant to a binding contract entered into before September 29, 1980. Treas. Reg. §1.483-1(c)(2)(ii)(B). In the case of such a sale or exchange occurring after June 30, 1981 that would be subject to the 6 and 7 per cent rates, if there is a substantial change in the terms of such contract occurring after September 28, 1980, the recently enacted 9 and 10 per cent rates will become applicable to payments made after the occurrence of such change. Treas. Reg. §1.483-1(c)(5). "Substantial change" is defined to some extent in section 1.483-1(b)(4) of the regulations.

[54] Treas. Reg. §§1.483-2(a)(2), 1.861-2(a)(4). See generally, S. I. Roberts and W. C. Warren, *U.S. Income Taxation of Foreign Corporations and Nonresident Aliens* (N.Y.: Practising Law Institute) (looseleaf service), ¶VI/5A(2)(1971).

the agreement does not provide for at least 9 per cent per annum simple interest, a portion of the total payments made under the agreement (other than payments due within six months or less, as discussed below) equal to 10 per cent per annum compounded semiannually (after an appropriate offset for interest actually charged) is considered imputed interest, subject to withholding of tax at the rate of 15 per cent under the current Canada-U.S. tax treaty.[55]

Section 483 does not apply to all sales of property.[56] It does not, for example, apply where all the payments under the contract are due in one year or less after the date of sale.[57] Thus if the individual selling the vacation home in Situation 1 received all payments within one year, section 483 would be inapplicable. If any payment is received more than one year after the date of sale, however, section 483 applies to all payments due more than six months after the sale or exchange.

Section 483 is inapplicable to a sale of property that is neither a capital asset nor "property used in the trade or business" of the taxpayer as described in Code section 1231(b); for example, it does not apply to inventory or certain copyrights and literary, musical, or artistic compositions.[58] Thus in Situation 2, section 483 will not be applicable to the Canadian manufacturer selling inventory to a U.S. corporation, although other principles of U.S. tax law, as discussed below, may result in imputed interest. Section 483 also is inapplicable to any payment on account of a sale or exchange if the sales price is not greater than $3,000.[59] A sale or exchange of a patent in certain circumstances also is not subject to section 483.[60]

Section 483 applies to payments pursuant to a contract, whether written or oral, a note, or the receipt of any other property in an exchange. Even in the situation where there is a tax-free reorganization pursuant to U.S. tax law, such as may exist in the stock-for-stock exchange in Situation 3, section 483 overrides the tax-free "rollover" provisions of U.S. law to classify a portion of the stock received as payment of interest.[61] Additionally, if the liability for, or the amount or due date of, any portion of a payment cannot be determined at the time of the sale or exchange, section 483 will nonetheless still be applicable, with its provisions separately applied to the payment when such payment is actually received.[62]

If section 483 is inapplicable to a sale (for example, where there is a sale of inventory as in Situation 2), there will generally

[55] It is assumed that under the current treaty, the gain itself is exempt under Article VIII.

[56] A transaction cast in a form other than a sale of property may be recharacterized as a sale of property for purposes of section 483. For example, a sale of stock to an employee for cash concomitantly with a loan of funds on a noninterest basis will be treated as a sale of property under section 483. Treas. Reg. §1.483-1(b)(6), Ex. 6.

[57] IRC §483(c)(1); Treas. Reg. §1.483-1(b)(1).

[58] IRC §483(f)(3); Treas. Reg. §1.483-2(b)(3)(i). However, section 483 is still applicable to the purchaser who will have imputed interest deductible under section 483 unless the section is otherwise inapplicable.

[59] IRC §483(f)(1); Treas. Reg. §1.483-2(b)(1).

[60] IRC §483(f)(4); Treas. Reg. §1.483-2(b)(4).

[61] Treas. Reg. §§1.483-1(b)(6), Ex. 7, 1.483-1(e)(3), Ex. 2, 1.483-2(a)(2), 1.483-2(b)(3). See also, *Kingsley v. Commissioner*, 81-2 USTC ¶9785 (9th Cir. 1981); *John Cocker III*, 68 TC 544 (1977); *Alfred H. Catterall, Sr.*, 68 TC 413 (1977); *Sidney R. Solomon*, 67 TC 379 (1976); Rev. Rul. 72-32, 1972-1 CB 48; Rev. Rul. 70-300, 1970-1 CB 125, clarified in Rev. Rul. 72-35, 1972-1 CB 139. However, section 483 does not apply to a transaction in which some shares received in the exchange are placed in escrow subject to a condition subsequent that may require the return of some or all of the shares. Treas. Reg. §1.483-1(b)(6), Ex. 8.

[62] IRC §483(d); Treas. Reg. §1.483-1(e)(2).

be no other provision of the Code that will seek to classify a buried interest component on a sale of property as interest.[63] Furthermore, U.S. judicial decisions preceding enactment of section 483 illustrate that the courts have generally been unwilling to impute interest to the seller (or to permit the buyer to deduct such interest) if the contract does not provide for interest unless the surrounding circumstances supply a reason for disregarding the terms of the agreement—for example, that interest was bargained for and then buried in the deferred payment schedule.[64]

Once it has been determined that section 483 is applicable, it must be determined what effect the Canada-U.S. tax treaty has on the receipt of such income. Under the current treaty, say, in Situation 1, is section 483 imputed interest considered as interest for purposes of the treaty and subject to a 15 per cent withholding tax under Article XI, as exempt capital gains under Article VIII, or as some other type of income?

While the current treaty, unlike Article XI(4) of the pending treaty, does not expressly provide that internal U.S. law determines what constitutes interest,[65] it is clear that the U.S. tax authorities would look to internal U.S. law and determine that section 483 imputed interest should be treated as interest under the treaty.[66] This approach appears to differ from the approach of *Associates Corporation of North America v. The Queen*,[67] where it was held that guarantee fees were not interest for purposes of

[63] Section 1232 of the Code deals with original issue discount on corporate bonds, which is considered as interest for U.S. tax purposes. However, the section is generally inapplicable to sales of property (unless either the property transferred or the corporate obligations received are stocks or securities that are traded on an established securities market). Treas. Reg. §§1.1232-3(b)(2)(iii)(a), (b). Section 482, which deals with allocation of income and deductions among taxpayers, is limited to "two or more organizations, trades, or businesses. . .owned or controlled directly or indirectly by the same interests. . . ."

[64] B. I. Bittker, *Federal Taxation of Income, Estates and Gifts*, Vol. 2 (Boston: Warren, Gorham & Lamont, 1981), ¶31.1.3, at 31-14, footnote 63 and text accompanying (citing precedent). While the cited precedent deals with pre-section 483 law, *Starker v. United States*, 602 F.2d 1341, 79-2 USTC ¶9541, at 87, 972 (9th Cir. 1979), dealt with a post-section 483 situation that appeared to be governed by section 483. Nonetheless, in finding imputed interest to be present, the court did not cite section 483 and the government did not argue applicability of section 483 (perhaps because the imputed rate for the affected year was less than the rate ultimately imposed). Rather, the court noted that a 6 per cent growth factor in a deferred payment contract was " 'compensation for the use or forbearance of money' " and was therefore "disguised interest." In effect, section 483 was not needed since the court found that there really was interest on the transaction, albeit buried interest, citing *United States v. Midland-Ross Corp.*, 381 U.S. 54 (1965).

[65] Protocol 6(b) to the treaty merely defines the term "interest" to "include income arising from interest-bearing securities, public obligations, mortgages, hypothecs, corporate bonds, loans, deposits and current accounts." There is no provision in the current treaty that incorporates the law of the respective contracting states in interpreting the treaty. Compare U.S. Treasury Department's Model Income Tax Treaty of May 17, 1977, Art. 3(2), reprinted in, 1 *CCH Tax Treaties* ¶153.

[66] Withholding Reg. §519.1(b), reprinted in, 1 *CCH Tax Treaties* ¶1289 ("As used in this subpart, any term defined in the convention shall have the meaning so assigned to it; any term not so defined shall have the meaning which such term has under the Internal Revenue Code."). See also Withholding Reg. §519.110(a), reprinted in, 1 *CCH Tax Treaties* ¶1242 (defining capital assets by reference to specific provisions of U.S. tax law); Rev. Rul. 56-446, 1956-2 CB 1065, modified on another issue, Rev. Rul. 58-247, 1958-1 CB 623 (holding that a lump-sum distribution from an employee's pension trust constituted exempt capital gain by virtue of its characterization as such by the Code).

[67] 80 DTC 6049 (FCTD), aff'd 80 DTC 6140 (FCA). The trial court added "Lest it be thought that such a result renders paragraph 214(15)(a) a nullity, I should note that the tax conventions concluded by Canada since its enactment in 1974 all contain expanded definitions of 'interest' which may well not be inconsistent with the paragraph." 80 DTC, at 6051, per Mahoney, J. The pending Canada-U.S. treaty, as currently drafted and discussed above, will fall into this category when adopted.

the treaty even though paragraph 214(15)(a) of the Income Tax Act deems such fees to be interest subject to Canadian withholding tax.

Where a term is defined by reference to U.S. internal law, the next question is whether the internal law at the time of enactment of the treaty governs. That is, does a change in the Code subsequent to enactment of the treaty apply in the construction of the treaty? This has relevance because section 483 was enacted in 1964, whereas the current treaty became effective January 1, 1941.[68] In Revenue Ruling 56-446,[69] the U.S. Internal Revenue Service implicitly assumed that the reference was to the Code as it may be amended from time to time, since the Service relied upon provisions of the Code that were enacted subsequent to the treaty. Moreover, in revenue rulings under treaties that, unlike the current Canada-U.S. treaty, expressly provide for reference to internal law, the Internal Revenue Service takes the position that such reference is to the Code as amended subsequent to the treaty.[70] Accordingly, the U.S. administrative authorities are likely to conclude that section 483 does apply to the existing Canada-U.S. treaty despite the fact that section 483 was enacted in 1964, long after the signing of the treaty.[71]

The U.S. approach appears to differ from the approach of *Melford Developments Inc. v. The Queen*,[72] where it was held in part that paragraph 214(15)(a) of the Income Tax Act, which relates to the treatment of guarantee fees as interest, could not be incorporated into the definition of "interest" for purposes of the Canada-Germany tax treaty since paragraph 214(15)(a) was enacted "some eighteen years after the agreement was entered into."[73] Article II(2) of the Canada-Germany applicable tax treaty cited therein expressly requires reference to internal law for defining terms not otherwise defined in the treaty.

Article XI(4) of the pending Canada-U.S. treaty provides that the term "interest" includes "income assimilated to income from money lent by the taxation laws of the Contracting State in which the income arises."[74] Thus in Situation 1, imputed interest under section 483 will be subject to a 15 per cent withholding tax under the terms of the pending treaty.[75] Article XI(3)(d) of the pending treaty, however, provides that interest received by a Canadian resident from "the sale on credit of any equipment, merchandise or services," such as in Situation 2, shall be exempt from U.S. tax.

To the extent that differences in the internal law of Canada and the United States result in double taxation, resort to the competent authority mechanism set forth under Article XVI of the current treaty or Article

[68] However, it should be noted that the current treaty was modified subsequent to 1964; in particular, a supplemental convention to modify the treaty was signed on October 25, 1966 and brought into force on December 20, 1967. This raises another issue—namely, whether a modification to a treaty implicitly incorporates by reference all changes in the Code made to that date. As will be seen in the above discussion, U.S. tax authorities need not confront this issue. As to whether Canadian authorities will have to confront this issue under the pending treaty is purely problematical at this time. See also *Melford Developments Inc.*, infra, footnote 72 and accompanying text.

[69] 1956-2 CB 1065 (discussed supra, footnote 66).

[70] See, for example, Rev. Rul. 80-243, 1980-2 CB 413 (under the superseded U.K.-U.S. treaty).

[71] See generally, Roberts and Warren, supra, footnote 54, ¶IX/7A(5).

[72] 80 DTC 6074 (FCTD), aff'd 81 DTC 5020 (FCA).

[73] 81 DTC, at 5024.

[74] Pending Canada-U.S. tax treaty, Art. XI(4). See also Pending Canada-U.S. tax treaty, Art. III(2).

[75] Pending Canada-U.S. tax treaty, Art. XI(2).

XXVI(3)(c) of the pending treaty may be appropriate. As a last point, the 15 per cent reduced rate will be allowed only if the recipient files IRS Form 1001 with the payor.[76] In the absence of such filing, the 30 per cent withholding rate would apply.[77]

CORPORATIONS HOLDING TITLE TO REAL PROPERTY —REVISITED SO SOON

Ronald A. Morris

A recent decision softens the U.S. resistance to utilization of a corporation to hold property as agent for its shareholders on the basis of the facts in that case; in more common cases, however, a favourable result remains unlikely.

In the July-August issue of this feature[78] we discussed the differing approaches taken by the tax authorities of Canada and the United States with respect to the common practice of holding title to real property in the name of a corporation as agent or nominee. We described the seemingly inexorable trend of U.S. cases decided in favour of taxing the corporation as if it were the owner of the property. We concluded that for purposes of U.S. taxation, it is doubtful that the goal of avoiding separate taxation of the corporation can ever be attained, surely not with the degree of certainty that tax planners like to have.

No sooner than it took for the ink to dry, the U.S. Tax Court, in what may prove to be a major reversal of policy, recognized the status of a title-holding corporation as an agent.[79] However, the facts relied upon by the majority opinion to distinguish earlier cases and a strong dissenting opinion (which suggests that an appeal may be taken by the U.S. government) leave the issue without the predictability that is available under Canadian law.

As is usual in such cases, deductions were claimed upon the contention that such amounts were the proper losses of the partnership in which the individuals were members. Although a corporation was formed to facilitate construction of an apartment complex, the partners asserted that the corporation was a bona fide agent of the partnership. As such, they claimed that the actions of the corporation for or on behalf of the partnership should be attributed to the partnership.

The Internal Revenue Service ("IRS"), as might be expected, asserted that income and losses from the apartment complex should be attributed to the corporation, a separate taxable entity whose business purpose and activities related entirely to the apartment complex. It was the legal owner of the assets that generated the taxable losses and therefore should be the party reporting the losses on its returns.

The court, citing earlier cases, acknowledged that the agency and nominee agreements so meticulously prepared, though

[76] Treas. Reg. §§1.1441-6(c)(1), 1.1442-1. Form 1001 is effective for the successive three-calendar-year period during which the income to which the form applies is paid. Treas. Reg. §1.1441-6(c)(2).

[77] IRC §§871(a)(1)(A), 881(a)(1).

[78] Ronald A. Morris, "Corporations Holding Title to Real Property" (July-August 1981), 29 *Canadian Tax Journal* 561-63.

[79] *Joseph A. Roccaforte*, 77 TC no. 22 (1981).

that no capital contributions were made to the corporation on formation and the corporation never had any employees of its own; its only asset was recorded title to the apartment complex. The cash outlays needed to acquire the land and to secure financing for the project came from the partners. From this the court concluded that the apartment complex was an asset of the partnership. Therefore, whatever income was received by the corporation was attributable to an asset of the partnership.

The fifth factor was whether the agent's relationship with the partnership was dependent on the fact that it was owned and controlled by the partners. The investors owned 100 per cent of the stock of the corporation. The corporation clearly was controlled and dominated by the identical individuals who were investors in the partnership. The corporation was not compensated for the services it performed and the relationship truly was based upon the partners' ownership and control of both entities. On this point, the court concluded that the IRS position was correct.

The final factor was whether the corporation's activities were consistent with the normal duties of an agent. The partners put forth sufficient evidence to convince the court that the acts of the corporation were consistent with the claims of agency.

The court concluded that the entire substance of the arrangement was one of an agency relationship and that even the form (outside of the corporation's primary liability on the mortgages) indicated the agency relationship that was intended.

It is, however, of more than passing interest that six judges of the Tax Court dissented. This fact, coupled with the long history of cases favouring the IRS, suggests that an appeal is likely and that the outcome at the appellate level is far from certain, even on the strong factual situation in this case.

NEW PROPOSED DEBT-EQUITY REGULATIONS ISSUED BY U.S. TREASURY

Stanley Weiss

Thirteen years after Congress authorized the Treasury to issue regulations to clarify the uncertain and unpredictable but voluminous case law on classification of corporate instruments as debt or equity, a second set of proposed regulations has been issued with an anticipated effective date of July 1, 1982, but with the rules applicable to international transactions expressly excluded and deferred "pending further study."

Another chapter now has been written in the continuing saga of the development of regulations under section 385 of the Internal Revenue Code for determining whether corporate instruments and certain other interests in corporations are to be treated as debt or equity for U.S. tax purposes. Proposed regulations first were issued on March 24, 1980 and were summarized in the July-August 1980 issue of this feature.[82] These regulations subsequently were issued in final form on December 31, 1980, and the changes made in that version were noted in the March-April 1981 feature.[83]

[82] Stanley Weiss and Philip A. McCarty, "Summary of Proposed Regulations for Distinguishing Between Corporate Debt and Equity" (July-August 1980), 28 *Canadian Tax Journal* 524-28.

[83] Stanley Weiss and Philip A. McCarty, "Summary of Final Regulations on Treatment of Certain Interests in Corporations as Stock or Debt" (March-April 1981), 29 *Canadian Tax Journal* 239-45.

The regulations as proposed in 1980 were to apply to interests created after December 31, 1980. The final regulations issued in 1980 deferred the effective date to interests created after April 30, 1981. Thereafter, on May 1, 1981 the regulations were amended to postpone the effective date to interests created after December 31, 1981. On December 9, 1981, an Internal Revenue News Release[84] announced a further deferment of the effective date to July 1, 1982. On January 5, 1982 new proposed regulations were issued, stating an "anticipated" effective date of July 1, 1982.

The recent proposed regulations make a number of additional changes of which the most important is a liberalization of the safe harbour rules so that a straight debt instrument (that is, one without any equity features) generally will be treated as indebtedness if the corporation's debt-equity ratio does not exceed 3:1, the instrument has a fixed maturity and bears interest at a rate falling within a range of acceptable rates, and all principal and interest are paid when due.

More significantly for readers of this journal, the new proposed regulations expressly do *not* apply to international transactions—that is, to an instrument or loan issued or made by or to a foreign person or a U.S. corporation deriving the bulk of its income from foreign sources. The preamble to these proposed regulations emphasizes, however, that this exception is only an interim measure pending further study and that the issuance of regulations relating to interests created in international transactions is contemplated. There is no indication as to when those regulations might be issued, but it may take some time. Accordingly, for such international transactions, taxpayers and their advisers are left to rely upon the current law, which the preamble elsewhere describes as "the voluminous and uncertain case law."

There undoubtedly are a few chapters left before the saga of the debt-equity rules is completed.

[84] IR-81-134, December 9, 1981.