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HAS THE 30 PER CENT. TAX ON PORTFOLIO INTEREST BEEN ELIMINATED?

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BEFORE the enactment on July 18, 1984 of the Tax Reform Act of 1984 (the "Act"),[1] the Code[2] generally imposed a tax, at the rate of 30 per cent. on interest from United States sources received by a nonresident alien individual or a foreign corporation to the extent that such interest was not "effectively connected" with the conduct of a United States trade or business.[3] Section 127 of the Act provides an exception from this tax with respect to "non-effectively connected" interest that (1) qualifies as "portfolio interest" and (2) is received after July 18, 1984 on obligations issued after that date, in taxable years ending after that date. Section 127 of the Act also amended the United States federal estate tax to provide that debt obligations giving rise to portfolio interest eligible for the exemption from the 30 per cent. tax are not treated as United States situs property. As a result, foreign holders of such obligations dying after July 18, 1984 will not be subject to the United States federal estate tax with respect thereto.

Although the principal purpose of the portfolio interest exemption was to allow United States companies direct access to the Eurodollar market for the issuance of their interest-bearing obligations free of the 30 per cent. United States "withholding" tax,[4] it was not the only purpose. Thus, it came as no surprise that the statutory language used[5] in the portfolio interest exemption provision was broad enough to cover interest on obligations that were not of the type generally issued in Eurodollar financings. Notwithstanding the use of this language, the United States Treasury Department views the portfolio interest exemption to be limited essentially to interest on obligations of the type that are issued to raise funds on the Eurodollar market.

However one views its breadth, as a result of the new portfolio interest exemption, it will, in principle, no longer be necessary for

[1] The Tax Reform Act of 1984 is contained in Division A of the Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 494.

[2] Except as otherwise indicated, all statutory references are to the Int. Rev. Code of 1954, as amended by the Act.

[3] Ss.871(*a*), 881, 1441 and 1442. The 30 per cent. statutory tax rate on payments of such interest was subject to reduction or elimination by an applicable United States tax treaty. See, for example, United States-Canada, Article XI. Interest income of a foreign person which is effectively connected with the conduct of a United States trade or business is subject to tax at the regular progressive rates of tax applied to net or taxable income. See ss. 871(*b*), 882.

[4] S. Rept. No. 98-169, 98th Cong., 2d Sess. 419-21 (1984).

[5] Ss.871(*h*), 881(*c*) 1441(*c*)(9) and 2105(*b*)(3).

a United States company to interpose a special purpose international finance subsidiary, or "IFS" (usually but not always formed in the Netherlands Antilles), between itself and its ultimate foreign lenders as a means of obtaining an exemption from the 30 per cent. United States tax imposed on the receipt of the interest paid by the United States company. Moreover, under a rather extraordinary "transitional" provision applicable only to interest paid to an IFS that is a wholly-owned subsidiary of a United States company on debt issued before June 22, 1984 and only if certain conditions were met, the Internal Revenue Service ("IRS") is precluded from raising the issue of whether the IFS is the beneficial recipient of the interest paid to it by its United States parent company.[6] Where applicable, the effect of this provision is to preclude the IRS from asserting that the United States company paying the interest was required to withhold the 30 per cent. tax it arguably would have been required to withhold if the IFS were to be treated as a conduit or agent (*i.e.*, not the beneficial recipient of the interest payment). Significantly, as more fully discussed below, the IRS has recently publicly announced that it will seek to impose liability for a "withholding" tax on interest payments that do not squarely fit under this special provision, unless, of course, the interest in question qualifies for the portfolio interest exemption.[7]

BACKGROUND—TAXATION OF FOREIGN PERSONS

In order to appreciate better the significance of the changes, some background is in order. In general, nonresident alien individuals and foreign corporations (collectively referred to in this article as "foreign persons") are, apart from any tax treaty considerations, subject to United States federal income tax only on two categories of income: the first category includes all income that is or is considered to be "effectively connected" with the conduct of a United States trade or business; such income is taxable to a foreign person generally at the same progressive tax rates that apply to United States persons.[8] The second category of income includes

[6] Act s. 127(*g*)(3). See Rev. Rul. 69-501, 1969-2 CB 233; Rev. Rul. 69-377, 1969-2 CB 231; Rev. Rul. 70-645, 1970-2 CB 273; Rev. Rul. 73-110, 1973-1 CB 454. See the discussion of this provision in the text beginning *infra* at footnote 70.

[7] See the discussion of the IRS pronouncements in the text beginning *infra* at footnote 29. Significantly, ss. 871(*h*)(3) and 881(*c*)(3) provide that the portfolio interest exemption will not apply to (1) interest on debt of a corporation or partnership received by a 10 per cent. or more owner (determined, as provided in ss. 871(*h*)(3)(C) and 881(*c*)(3)(B), after application of broad ownership attribution rules), (2) interest on debt received by a "controlled foreign corporation" from a related person (within the meaning of s. 864(*d*)(4)) (s. 881(*c*)(3)(C)), or (3) in general, interest received by a bank (except in the case of interest paid on United States government securities). (section 881(*c*)(3)(A)).

[8] Ss. 871(*b*) and 882.

income from United States sources that is not effectively connected with a United States trade or business and that is of a fixed, determinable annual or periodical nature, expressly including interest (as well as dividends, royalties and compensation).[9] A foreign person is subject to the tax on this second category of income at a 30 per cent. rate applied to the gross amount of the income received.[10] The 30 per cent. tax is generally (but not always) collected by withholding at the source[11] and therefore is often referred to as a "withholding tax" even though it is an income tax that, if not collected by withholding, is due from the recipient of the income. Income of a foreign person that does not fall within one of the above categories is not subject to United States federal income tax.

In certain cases, tax treaties to which the United States is a party modify the above rules. Thus, under virtually all United States tax treaties industrial and commercial profits of a United States trade or business of an enterprise of a treaty resident are exempt from United States federal income tax provided such profits are not attributable to a United States permanent establishment.[12] Tax treaties generally also reduce or eliminate the statutory 30 per cent. rate of tax on various items of income in the second category. The reduction in rates or exemption vary from treaty to treaty. Thus, while certain treaties provide an exemption from United States federal income tax for interest income which is not attributable to a permanent establishment[13] other tax treaties merely limit the rate of United States federal income tax that may be charged on such interest.[14]

Foreign persons who invest in the United States obviously wish to take advantage of the tax treaty with the greatest available benefits. Certain foreign persons need do little to qualify for such tax treaty benefits since they are resident in a country having an appropriate treaty provision. Other foreign persons are less fortunate. Where the stakes are significant enough, rather than forego the best available treaty benefits, the less fortunate foreign

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[9] Non-effectively connected "original issue discount" of a foreign person is subject to tax under a special rule. See ss.871(*a*)(1)(C), 871(*g*), 881(*a*)(3), 1441(*b*) and 1442(*a*). For a definition of the term "original issue discount," see section 1273. However, except to the extent effectively connected with a United States trade or business, market discount realised by a foreign person is generally not subject to United States federal income tax. See ss.1276(*a*)(3) and 1278(*b*)(1); see also Treas. Reg. §1.1441–2(*a*)(3).

[10] S.871(*a*)(1) and 881(*a*).

[11] Ss.1441 and 1442.

[12] See, *e.g.* United States–Germany, Article III.

[13] See, for example, United States–United Kingdom, Article 11; United States–Netherlands, Article VIII.

[14] See, for example, United States–Switzerland, Article VII (5 per cent.); United States–France, Article 10 (10 per cent.); United States–Canada, Article XI(2) (15 per cent.).

person is likely to attempt, in one manner or another, to take advantage of a more favourable tax treaty a third country has with the United States.

This generally is attempted by organising an intermediate entity in a jurisdiction that has the appropriate treaty provision. Third country residents have availed themselves of this technique, for example, in connection with the acquisition of United States real estate. The objective is to acquire United States real estate in a manner that allows for the financing of such acquisition to be made partly with "internal" debt giving rise to interest deductions available against the taxable income to be derived from the real estate and at the same time avoid United States withholding taxes on such interest. Netherlands and Netherlands Antilles companies have been used for this purpose because Article XII of the respective treaties generally permits the payment of United States source interest and dividends to a foreign person free of United States withholding tax.

In another, and in dollar terms much more significant, application of this technique, United States corporations have set up a treaty entity as an intermediary between the foreign person and the United States corporation. Virtually all "Eurodollar" financing of United States companies have in recent years been structured to take advantage of this technique. United States companies borrow on the Eurodollar market essentially because the interest rates are less there than they are in the United States. To be able to borrow at these reduced rates, however, the United States borrower must ensure that the agreed interest rate will be payable free of any United States withholding tax (and that the holder of any such obligation will not be subject to United States estate tax with respect thereto). If the United States corporation borrowed directly for the purposes of using the funds in its United States operations,[15] a United States "withholding tax" would be due on the interest paid unless a holder of a Eurodollar obligation was entitled to a treaty exemption with respect to interest income. Given the nature of the instrument (usually issued in bearer form) and that many non-treaty residents were likely to acquire the Eurodollar bonds, a device had to be created that would allow for the issuance of these bonds that would be free of United States taxes.

The device created to accomplish the objective was the IFS. Very generally, an IFS is usually but not always a wholly-owned

[15] United States borrowers deriving substantially all (that is, more than 80 per cent. of) their income from foreign sources were able to borrow directly without the interest paid on such borrowing being treated as United States source interest subject to United States withholding tax. S.861(*a*)(1)(B).

subsidiary of a United States borrower organised under the laws of a jurisdiction such as the Netherlands Antilles that has a tax treaty with the United States that exempts from United States federal income tax and withholding interest paid to corporations organised under the laws of such jurisdiction,[16] provided such corporation is the beneficial recipient of the interest income.[17] Armed with an appropriate guarantee of the United States borrower and flush with capital contributed by the United States borrower, the IFS issues its bonds to foreign persons on the Eurodollar market. The IFS loans the proceeds of the borrowing to its United States parent. The United States parent claims a deduction for the interest due to the IFS, and the IFS claims an exemption from United States withholding tax on the interest payments. The basis for the latter claim is the treaty between the United States and the country of incorporation of the IFS. The IFS has two bases for not withholding United States tax on the interest payments it makes to the ultimate foreign purchasers of the IFS obligation. First, it can claim that such interest is not United States source income under the Code because the IFS is not engaged in a United States trade or business.[18] Second, it can claim the benefit of a provision such as Article XII of the Netherlands Antilles treaty, which under stated conditions exempts from United States tax (and withholding) interest paid to a foreign person. By acquiring the obligations of the IFS, the foreign person is not acquiring United States situs property and therefore is not subject to United States estate tax.[19] Moreover, the IFS can even issue its bonds in bearer form, provided certain steps are taken.[20]

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[16] See, *e.g.* Article VIII, United States–Netherlands treaty as extended to the Netherlands Antilles. Generally, for a Netherlands Antilles company to qualify for this exemption, it cannot obtain the special rates of taxation in the Netherlands Antilles generally available to investment companies. See 1963 Protocol modifying and supplementing the extension to the Netherlands Antilles of the Convention between the United States and the Netherlands, Article I.

[17] See the discussion of *Aiken Industries, Inc.*, 56 T.C. 925 (1971), *acq.*, 1972–2 CB 1, *infra* at footnote 30 and in text beginning *infra* at footnote 57.

[18] S.861(*a*)(1)(A) and Treas. Reg. §1.861–2(*a*).

[19] See s.2104(*c*).

[20] Generally, an IFS can issue its bonds in bearer form after December 31, 1982 only if (1) steps are taken to ensure that such bonds would not be sold (or resold in connection with the original issue) to United States persons, (2) interest thereon is payable only outside the United States and its possessions and is not paid to a United States address, and (3) on the face of the bonds (and any detachable interest coupons) there is a statement that any United States person who holds the bonds will be subject to limitations under the United States income tax laws. See section 163(*f*). See also Temporary Reg. §§5f.163–1, 1.163–5(*c*)T. For a more detailed discussion of the registration requirements and this exclusion therefrom, see Richard G. Fishman, "Recent Procedural Changes to United States Tax Law." (January–February, 1983), 31 *Canadian Tax Journal* 108–26, at 114–117. As discussed therein, if there is a failure to comply with any applicable registration requirements, certain sanctions are imposed upon the issuer (for example, interest deductions are denied under s.163(*f*) and an excise tax is imposed under s.4701) and upon a holder (for example, loss deductions and capital gains treatment on sale or exchange are denied under ss.165(*g*) and 1287).

Initially, issues arose as to whether the techniques described above should be allowed as a matter of policy. For example, in connection with use of a Netherlands Antilles corporation by a resident of a third party country, the IRS considered whether the benefits of the Netherlands Antilles treaty (particularly Article XII) should be granted where the ultimate shareholders were not residents of the Netherlands Antilles and correctly concluded that the extension of the Netherlands treaty to the Netherlands Antilles contemplated that result.[21] Similarly, the IRS concluded early on (in connection with the Interest Equalisation Tax (the "IET")) that, depending on the debt-equity ratio of the IFS and certain other facts, the IFS and not the United States parent would be regarded as the obligor with respect to the obligations held by the foreign person.[22] Although the rulings issued under the IET were revoked in 1974[23] once the IET was phased out, numerous opinions of counsel, using an analysis similar to that found in these rulings, have been issued that have allowed billions of dollars of financings to be accomplished through the Netherlands Antilles IFS route.

Recently, the United States has revisited the area using two different approaches. First, the United States has announced that it will insist not only that all new treaties to which the United States is a party limit benefits thereunder generally to residents of countries with which the United States has the treaty,[24] but in addition, it will seek to renegotiate all existing treaties in order to accomplish the policy objective of limiting treaty benefits. Consistent with this general policy, the United States has sought to renegotiate its tax treaty with the Netherlands Antilles. The Netherlands Antilles, of course, had a considerable stake in the continuance of the *status quo* since a significant part of its revenue arose as a result of the ability of United States persons to use and benefit from the Netherlands Antilles IFS route. It, therefore, could not readily agree to a strict limitation of benefits provision that would negate the beneficial use of a Netherlands Antilles IFS owned entirely by a United States corporation. Notwithstanding that the Netherlands Antilles believed it could not readily agree, one might have thought that it had little with which to bargain. The Netherlands Antilles, with some justification, apparently believed

[21] Rev. Rul. 75-23, 1975-1, CB 290. See also PLR 7501171180A.

[22] See IRS rulings cited *supra* at footnote 6.

[23] Rev. Rul. 74-464, 1974-2 CB 47; Rev. Rul. 74-620, 1974-2 CB 380.

[24] See and compare 1981 United States Treasury Model Income Tax Convention, Article 16; United States Treasury Discussion Draft of Article 16 at CCH, *Tax Treaties*, ¶152A; United States-Australia, Article 16; H. David Rosenbloom, "Tax Treaty Abuse: Policies and Issues," 15 *Law and Policy in International Business* 763-831 (1983). This does not apply with respect to the recently ratified United States treaty with Canada except to the limited extent prescribed in Article XXIX(6) of that treaty.

otherwise, possibly because a termination of the Netherlands Antilles treaty could be a serious problem for large United States companies that had a considerable stake in the issue.[25] Perhaps to show they were serious, the United States gave notice of termination of a similar treaty with the British Virgin Islands.[26] The Netherlands Antilles apparently was not too impressed, and it had some justification, because very few United States companies had used the British Virgin Islands as the base for an IFS. All the while, there lurked in the background the possibility the United States would repeal the 30 per cent. tax on portfolio interest making the Netherlands Antilles IFS route superfluous. Since this had been suggested on several previous occasions,[27] perhaps it was not taken too seriously. Possibly unrelated to the first approach, a second approach developed. On audit, some IRS agents considered proposing a deficiency for the 30 per cent. withholding tax against United States borrowers who had used the Netherlands Antilles IFS route. Their proposal was based on one or more theories, including that the IFS should be disregarded for tax purposes, either because it was a sham or a mere agent of the United States borrower or because the guarantee by the United States parent obligor evidenced that it, and not the IFS, was the obligor with respect to the financing. Under any of these theories, the treaty exemption would not be available since the United States obligor would be regarded as paying United States source interest to a foreign person not entitled to the treaty exemption.[28]

Possibly as an outgrowth of the second approach and subsequent to the enactment of the portfolio interest exemption and the related extraordinary transitional provision, the IRS for the first time publicly announced, in Rev. Rul. 84–152 and Rev. Rul. 84–153 (issued on October 15, 1984),[29] its position to the effect that the 30 per cent. withholding tax was applicable on United States source interest payments made to a Netherlands Antilles finance company in circumstances where the Netherlands Antilles finance company was obligated to pay interest on its obligations to persons not entitled to treaty benefits in an amount which represented a

[25] Generally, under the terms of a Eurodollar borrowing, bonds issued through an IFS may be prepaid if there is a significant change of circumstances such as, for example, termination of the treaty exempting the interest from withholding tax. Depending on interest rates at the time of any such termination in comparison to the stated interest rate of the bonds, United States obligors could have been adversely affected.

[26] Treasury Department Release R–859, July 1, 1982.

[27] See, for example, House Ways and Means Committee Print No. 3 of Tentative Draft of Title III, Changes in Treatment of Foreign Income, of Tax Reform Bill of 1974, section 351; section 1041 of H.R. 10612, Tax Reform Bill of 1975.

[28] See, for example, s.269; *Aiken Industries, Inc.*, *supra* at footnote 17; *Perry Bass*, 50 T.C. 595 (1968); *Planatation Patterns, Inc. v. Commissioner*, 462 F.2d 712 (5th Cir. 1972), *cert. denied*, 406 United States 1076.

[29] Rev. Rul. 84–152, 84–42 IRB 8; Rev. Rul. 84–153, 84–42 IRB 9.

significant portion of the interest it received. In those circumstances, according to the IRS, interest received by the Antilles company has not been "derived" by it within the meaning of Article VIII of the United States–Netherlands treaty as applicable to the Netherlands Antilles because, in the IRS's view, the Antilles company does not exercise complete "dominion and control" over any amount it receives when it has an off-setting obligation to pay out a substantially similar sum.

Significantly, the rulings would reach the result of requiring withholding even where (1) the Antilles finance company is adequately capitalised, (2) its debt is not guaranteed by a United States person, and (3) it earns a profit on its borrowing and lending activities which is a reasonable return on the equity it has invested. To this extent, the rulings do not appear to be supportable by any authorities and certainly not the authority referred to in the rulings.[30a] Moreover, they are at odds with the IRS's previous pronouncements in this area which have formed the basis for the issuance of numerous opinions of counsel involving billions of dollars. At this writing, it is too early to tell whether the IRS position in the rulings will prevail if tested in the courts.

It is against this background that the new exemption from portfolio interest can best be appreciated. This article will analyse the new rules in the context of the issues discussed above.

The Statutory Framework

In General

The new provisions do not alter the general rules of taxation of foreign persons noted above. Thus, "portfolio interest" that is "effectively connected" with the conduct of a United States trade or business by a foreign person will continue to be subject to United States federal income tax along with all other effectively connected income.[30b] Under the new rules, United States source

[30a] *Aiken Industries, Inc.*, *supra* at footnote 17 is cited in the rulings as authority for the position taken. That case, however, appears distinguishable on a number of different bases. First, in *Aiken* the finance company had no reasonable prospect of making any profit in the transaction; in the rulings the finance company was entitled to earn a 1 per cent. spread between its interest income and expense. Second, in *Aiken*, it did not appear that the finance company had any significant capital; whereas in the rulings it was assumed that the finance company was adequately capitalised. Third, unlike *Aiken*, in the ruling the finance company initiated the loan rather than purchasing existing loans for equivalent notes. In one of the rulings the finance company dealt with the public in offering its debt rather than dealing with related parties and otherwise appeared to act in the same manner as any third party finance company might act.

[30b] There is a parallel here with the United Kingdom position on quoted Eurobonds where the provisions of Finance Act 1984 s.35 ease the withholding tax requirement while leaving the

interest that is not effectively connected and is received by a foreign person either will be subject to tax at the 30 per cent. rate, at the reduced rate allowed by treaty or, if the portfolio interest exemption is applicable, will be exempt from tax.[31] Thus, reduced rates of United States federal income tax accorded by an income tax treaty will continue to have significance to those foreign taxpayers who are receiving United States source interest income that does not qualify as portfolio interest.

The new provisions do not expressly exclude from gross income portfolio interest that is exempt from tax.[32] Thus, unless excluded for other reasons, portfolio interest exempt from tax under the new provision is, for example, included in gross income for purposes of applying, to the extent applicable, the controlled foreign corporation rules, the foreign personal holding company rules, the personal holding company tax and the accumulated earnings tax.[33]

Portfolio Interest Defined

The exemption applies only with respect to "portfolio interest." The Code defines this term[34] broadly to include, with certain exceptions, all interest and original issue discount ("OID") paid on any obligation (including United States government obligations) which satisfies either of the following conditions:

(1) With respect to interest paid on an obligation which is in "registered form,"[35] the United States person otherwise required to withhold tax on the interest must receive a statement to the effect that the beneficial owner is not a United States person. The statement may be issued by the beneficial owner of the obligation or a securities clearing organisation, bank or other financial

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interest as United Kingdom source so that the non-resident must rely on extra-statutory concession B13 for protection and that does not cover the position where the non-resident has a branch or agency in the United Kingdom, see [1984] BTR 138. Ed.

[31] Ss.871(*h*), 881(*c*) and 1441(*c*)(9).

[32] S.894 and Treas. Reg. §1.894–1(*a*).

[33] Inclusion in the income of a United States shareholder of a controlled foreign corporation or a foreign personal holding company is required in any event. See section 555(*a*) and Treas. Reg. §1.952–2(*a*).

[34] See ss.871(*h*)(2) and (3), and ss.881(*c*)(2) and (3).

[35] Ss.871(*h*)(2)(B) and 881(*c*)(2)(B). For purposes of ss.871(*h*) and 881(*c*), the term "registered form" has the same meaning given such term by section 163(*f*). Temporary Reg. §5f.163–1(*a*) provides that such term is defined in Temporary Reg. §5f.103–1(*c*). The latter regulation provides that an obligation is issued in registered form if "(i) The obligation is registered as to both principal and any stated interest and transfer of the obligation may be effected only by the surrender of the old instrument and either the reissuance by the issuer of the old instrument to the new holder or the issuance by the issuer of a new instrument to the new holder, or (ii) The right to the principal of, and stated interest on, the obligation may be transferred only through a book entry system . . ."; Temporary Reg. §5f.103–1(*c*)(1). *Cf.* ss.103(*j*)(3)(A), 163(*f*)(3) and 31 U.S.C.A. §3121(*g*)(3). Temporary Reg. §5f.103–1(*c*)(2) defines a book entry system as one in which the ownership of an interest in an obligation is required to be reflected in a book entry, whether or not physical securities are issued. This regulation also states that "[a] book entry is a record of ownership that identifies the owner of an interest in the obligation."

institution that holds securities in the ordinary course of its business.[36] If one month before the payment of interest, however, the Secretary has published a statement to the effect that any statement from such person does not qualify, interest thereon will no longer qualify as portfolio interest.[37]

(2) With respect to interest paid on an obligation which is not in registered form (for example, in bearer form),[38] the obligation must be "foreign targeted" (that is, if arrangements have been made that are reasonably designed to ensure that the obligation will be sold (or resold in connection with the original issue) only to non-United States persons),[39] interest on the obligation must be payable only outside the United States and its possessions, and except for certain obligations issued by qualifying banks, on the face of the obligation (and any detachable interest coupons) there must be a statement that any United States person who holds the obligation will be subject to limitations under the United States income tax laws.[40] Significantly, the IRS is given the discretion to require registration of any or all of these obligations without regard to whether these obligations are used frequently in avoiding United States taxes.[41]

Under a literal reading of the statutory definition of portfolio interest, interest on the following obligations would seem to qualify as portfolio interest if the obligations are in registered form or are foreign-targeted and satisfy the other requirements (stated above) with respect to obligations not in registered form: (1) an obligation issued by an individual; (2) an obligation which is not of a type offered to the public; and (3) an obligation which has a maturity (at issue) of not more than one year. With respect to the latter two types of obligations, the obligations would include those issued by any borrower including a corporation.

Nevertheless, Temporary Regulations issued in question and answer form by the IRS on August 17, 1984 expressly state,

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[36] S.871(*h*)(4).
[37] *Ibid.*
[38] Ss.871(*h*)(2)(A) and 881(*c*)(2)(A).
[39] An example of an obligation for which there are such arrangements is an obligation which, in connection with its original issuance, is offered for sale or resale only outside the United States and its possessions, is delivered only outside the United States and its possessions, and need not be registered under the Securities Act of 1933 because such obligation is intended for distribution to persons who are not United States persons. Temporary Reg. §§1.163–5(*c*)T(1)(i); 1.163–5(*c*)T(2)(i)(A).
[40] Ss.871(*h*)(2)(A) and 881(*c*)(2)(A). See also s.163(*f*)(2)(B), Temporary Reg. §1.163–5(c)T(1). Under Temporary Reg. §1.163–5(*c*)T(1)(ii)(B), a "temporary global security" is excluded from the legend requirements. A temporary global security is defined therein to mean a security in bearer form which is held for the benefit of the purchasers of the obligation of the issuer and interests in which are exchangeable for securities in definitive registered or bearer form before its stated maturity.
[41] S.163(*f*)(2)(C).

without citation of any supporting authority, that interest on the above obligations would not qualify as portfolio interest since none of the obligations are "registration-required obligations," as defined in section 163(f)(2) of the code.[42] Under these Temporary Regulations, which relate to the conditions under which interest may qualify as portfolio interest and the application of information reporting and backup withholding to foreign holders of obligations, the interest on the above obligations would not qualify as portfolio interest even if the obligations were in registered form.[43]

The Treasury Department's interpretation of the portfolio interest rules is surprising not only because it does not appear to be supported by the language of the Code or the Committee Reports but because it runs counter to the expressed statutory policy of the provisions dealing with registration-required obligations.[44] In furtherance of that policy (the prevention of tax evasion), these provisions permit the IRS to increase the class of obligations defined as registered-required obligations. Ironically, since, in the Treasury Department's view, interest qualifies as portfolio interest (and is exempt from the 30 per cent. withholding tax) only if it is paid on a registration-required obligation, any broadening of the class of obligations requiring registration also broadens the class of obligations the interest on which qualifies as portfolio interest and is exempt from the 30 per cent. withholding tax. At this time, it is not clear whether the Treasury Department's interpretation will prevail or will be modified, and close attention should be given to further developments in this area.

Although interest on United States government obligations having a maturity of more than one year could qualify as portfolio interest even if the obligations were issued in bearer form (provided they were foreign targeted), the Treasury Department in connection with its issuance of the above Temporary Regulations announced that it will not issue bearer obligations, making United States government obligations less attractive to foreign investors and

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[42] Temporary Reg. §§35a.9999–5(*a*), Q&A–1; 35a.9999–5(*b*), Q&A–8. A "registration-required obligation" is defined in section 163(*f*)(2) to mean "any obligation (including an obligation issued by a governmental entity) other than an obligation which—(i) is issued by a natural person, (ii) is not of a type offered to the public, (iii) has a maturity (at issue) of not more than one year, or (iv) . . . ." is foreign-targeted and if not in registered form, interest thereon is payable only outside the United States and its possessions and on the face of such obligation there is a statement that any United States person who holds such obligation will be subject to limitations under the United States income tax laws. Under section 163(*f*)(2)(C), the IRS has the authority to include other obligations in the category of registration-required obligations if, in the case of any obligation described in (ii) and (iii), such obligation is of a type the IRS determines by regulations to be used frequently in avoiding federal taxes, or in the case of any obligation described in (iv), such obligation is of a type specified by the IRS in regulations.

[43] Temporary Reg. §35a.9999–5(*b*), Q&A–8.

[44] See s.163(*f*)(2)(C).

therefore more expensive to the United States.[45] This is somewhat ironic since it appears that one of the reasons for enactment of the legislation was to permit the United States to benefit from lower interest rates available on the Eurodollar market. With a little bit of creativity, however, entrepreneurs were soon repackaging registered United States government obligations by issuing bearer securities backed by registered United States government obligations. Were this to be permitted, the United States would have the worst of both worlds, higher interest costs without the perceived benefits of registration. So the Treasury Department announced on September 7, 1984 that it would prohibit repackaging at least after the initial transactions then in process were completed.[46] In addition, on September 11, 1984, it acknowledged that it was unlikely that the United States would be able to enforce this prohibition if the repackagers were foreign and not controlled by United States persons (an admission of a jurisdictional limitation generally outside the character of the United States).[47]

Creativity, however, is by no means the exclusive province of entrepreneurs. The United States has created a combination bearer-registered instrument—neither fish nor fowl, although smelling more like the former than the latter. This hybrid instrument is issued abroad in registered form to a foreign financial institution (for example, a foreign bank) or to a foreign office of a United States financial institution which, subject to certain restrictions, may purchase these obligations for the accounts of foreign persons. These institutions are not required to provide the United States with the identity of their customers but are required to certify at the time of purchase and prior to each annual interest payment date that the beneficial owner of the note is not a United States citizen or resident.[48] Whether the marketplace will treat these hybrid instruments as bearer or registered or something in between still remains to be seen but the Treasury Department has indicated that it regards at least the first offering of these instruments to be a success.

Exclusions from Portfolio Interest

1. *Payments to 10 per cent. or more owners*

Portfolio interest does not include interest on an obligation issued to a 10 per cent. or more owner of the obligor.[49] For this purpose,

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[45] See T.D. 7965, 84–38 IRB 6.

[46] Treasury Department Release R-2835, September 7, 1984; Treasury Department Release R-2847, September 14, 1984.

[47] The Bureau of National Affairs, Inc., Daily Tax Report No. 177, G-5 (September 12, 1984).

[48] Treasury Department Documents on Sale of Targeted Registered Treasury Securities to Foreigners, released September 11, 1984.

[49] Ss.871(*h*)(3) and 881(*c*)(3)(B). Moreover, withholding is required where the person required to deduct and withhold the tax knows, or has reason to know, that interest is not portfolio interest by reason of the 10 per cent. or more owner rule. Ss.1441(*c*)(9) and 1442(*a*).

a 10 per cent. or more owner means, in the case of a corporate obligor, any person who owns 10 per cent. or more of the total combined voting power of all classes of stock of such corporation entitled to vote. In the case of a partnership obligor, a 10 per cent. or more owner means any person who owns 10 per cent. or more of the capital or profits interest in such partnership.

A possible concern here is that a "look-through" rule will be applied with respect to an obligation issued by a partnership (that is, an obligation may, for this purpose, be considered "issued" by the partnership as well as the partners). In such event, for purposes of the 10 per cent. or more owner rule, each partner would be regarded as an issuer of his appropriate portion of the obligation.[50] Because the Code language does not appear either to establish or to permit a look-through rule, however, this interpretation appears unlikely. It also appears unlikely because a possible rationale of the 10 per cent. rule is to permit a party related to a less than 10 per cent. partner to receive interest qualifying as portfolio interest from such partnership in order to avoid the complexities inherent in a look-through rule.[51] Since, as noted above, the Treasury Department maintains that interest on an obligation that is not a registration-required obligation does not qualify as portfolio interest, it is possible that a look-through rule will be applied for the purpose of disqualifying as portfolio interest all or a portion of the interest paid on obligations issued by partnerships in which, for example, an individual is a partner.[52]

In any event, the statute itself indicates that the concept of 10 per cent. or more owner applies only to obligors that are corporations or partnerships and not to obligors that are natural persons or estates or trusts.[53] Although broad ownership attribution rules apply for purposes of determining whether one is a 10 per cent. or more owner of a corporate or partnership obligor,[54] these rules do not convert an option to acquire an interest in property owned by a corporation or partnership to an ownership interest in the owning entity. Thus, an obligation issued, for example, by a corporate obligor that provides in one or a series of related documents that the creditor or its affiliate has an option to acquire

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[50] For this purpose, a partner's appropriate portion of an obligation could be determined by, for example, reference to the cash flow of the partnership (*i.e.* who bears the cost of servicing the debt), or by analogy to ss.465 or 752.

[51] *Cf.* ss.897(*c*)(4).

[52] See Temporary Reg. §§35a.9999–5(a), Q&A–1; 35a.9999–5(b), Q&A–8.

[53] Although it is not clear, presumably the 10 per cent. or more owner rules will apply with respect to a grantor trust if the grantor is a corporation or a partnership. See generally s.671 *et seq.*

[54] S.871(*h*)(3)(C).

property of the corporation securing the debt is not likely to be considered an ownership interest in the obligor.[55]

Since portfolio interest does not include interest paid on obligations issued to a 10 per cent. or more owner, loans made by, for example, a foreign parent company to its United States subsidiary will not be covered by the exemption. Of course, denial of the portfolio interest exemption will not affect entitlement to an exemption under an applicable treaty provision and accordingly Netherlands Antilles companies that hold United States real estate will continue to be able to pay United States source interest to related foreign persons free of United States withholding tax so long as Article XII of the Netherlands Antilles treaty continues to be in effect. For those foreign persons who cannot take advantage of a treaty exemption or do not wish to rely on its availability, it will probably be difficult, although not entirely impossible, to get around the prohibition applicable in the case of a 10 per cent. or more owner. The Conference Report states:

> The conferees understand that taxpayers may attempt to circumvent the foreign shareholder . . . rule . . . by entering into "back to back" loans, wherein a foreign affiliate of a U.S. taxpayer . . . lends money to an unrelated foreign party that relends that money at discount to the U.S. taxpayer. *The conferees intend that the Internal Revenue Service, when appropriate, use means at its disposal to determine whether back to back loans exist.*[56]

Significantly, the quoted language does not say what the effect of a back-to-back loan will be although the implication is fairly clear. The quoted language will probably be the genesis of regulations that are likely to incorporate certain of the principles of *Aiken Industries*.[57]

In *Aiken Industries*, the Tax Court held that an intermediary borrower and lender was to be viewed as a nominee or agent in the case of a back-to-back loan involving identical interest rates in which the intermediary had no economic stake. While the case has been cited by the IRS in connection with private rulings issued in

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[55] Depending on the terms of the option as well as the other terms of the transaction, a transaction will be treated as either an option (see *Estate of Charles T. Franklin* v. *Commissioner*, 64 T.C. 752 (1976), *aff'd*, 544 F.2d 1045 (9th Cir. 1976)), a loan (see *Helvering* v. *F. & R. Lazarus & Co.*, 308 United States 252 (1939); *Sun Oil Co.* v. *Commissioner*, 562 F.2d 258 (3d Cir. 1977), *cert. denied*, 98 S. Ct. 2845 (1978)), or as present ownership in the property (see, for example, *Frank Lyon Co.* v. *United States*, 435 United States 561 (1978)).

[56] H. Rept. No. 98-861, 98th Cong., 2d Sess. ("Conf. Rept.") at 937–38 (1984) (*emphasis added*).

[57] *Aiken Industries, Inc., supra* at note 17.

other areas,[58] it was, at least until the release of Rev. Rul. 84–152 and Rev. Rul. 84–153 on October 15, 1984,[59] generally distinguished on the basis that in the particular case, the intermediary is not contractually bound to give up all the income it receives. On this basis, it has been the conventional wisdom that if there is an appropriate difference between the interest received and paid by the "intermediary," and if it has significant capital of its own at risk, the transaction will not be viewed as a back-to-back arrangement within the meaning of *Aiken Industries*. Indeed, numerous opinions of counsel issued in connection with IFSs were predicated on this distinction. Thus, it was thought that if the regulations seek to apply a nominee concept merely because the intermediary has borrowed from a person related to the person to whom the funds are lent, they will be going beyond the general perception of current law. The language used in the legislative history does not appear to support such an expansive reading. To the contrary, the legislative history of the new rules relating to OID of a foreign person uses slightly different language suggesting that nothing more than the common perception of current law is contemplated.[60]

Nevertheless, possibly as an attempt to head off entrepreneurs from taking advantage of the new rules, for example, in the same manner as has been considered in connection with the repackaging of United States Treasury obligations, the IRS in Rev. Rul. 84–152 and Rev. Rul. 84–153 set forth its position on the application of the *Aiken Industries* test to this area. These rulings set forth the IRS view that merely obtaining a spread of, say, one percentage point on a loan will not by itself constitute a business or economic purpose sufficient to establish that the IFS was more than a mere conduit for the passage of the United States company's interest payments to foreign shareholders. Unfortunately, the IRS does not tell us what would be sufficient. The courts have in other contexts told us that even a minimal "cash on cash" return on the equity invested may be sufficient.[61]

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[58] See PLR 8004139, PLR 7931056 and PLR 7406280930A. The IRS applied similar principles in a number of other rulings. See, for example, PLR 8250028 and 8217104.

[59] Rev. Rul. 84–152, *supra* at note 29; Rev. Rul. 84–153, *supra* at note 29.

[60] Conf. Rept., *supra* at fn 56 939–40. ("The conferees intend that the Internal Revenue Service, when appropriate, investigate the capitalisation of foreign-owned United States corporations issuing OID debt to unrelated foreign parties to attempt to determine whether back to back loans exist.")

[61] For example, in *Frank Lyon Co.*, *supra* at footnote 55, the return on the equity investment was 6 per cent. In the case of an IFS that has a debt: equity ratio of 4:1, if funds are borrowed at 10 per cent. and relent at 11 per cent. and equity capital is invested at 11 per cent., the return on the equity investment, before taxes and before operating expenses (which if the IRS is correct cannot be substantial since in the IRS view the IFS has no substance) would be 15 per cent. Not a bad return!

Two comments are in order. First, as has always been the case, to run the *Aiken Industries* gauntlet, it appears that the intermediary must run some risk. The rulings, however, appear to increase significantly the risk the intermediary must run. Any effort to reduce this risk will put greater pressure on the nominee issue. Second, there are limits to what an intermediary will be able to do without becoming a bank. A bank generally is not entitled to the exemption from tax on portfolio interest, except in the case of interest on government obligations.[62]

2. *Special Rules for Controlled Foreign Corporations*

Portfolio interest does not include interest on an obligation received by a controlled foreign corporation (a "CFC") from a related person.[63] Virtually every IFS will fit within the related CFC category and therefore an IFS will not be able to obtain the benefit of the new exemptions with respect to new debt; old debt does not qualify in any event. A special transitional rule (described below) is provided, however, that in many cases will resolve any "audit" issues arising under Eurodollar financings that were made through an IFS.

While the new exemption applies to a CFC that is not so related to the payer, other special rules are included to ensure that United States shareholders thereof do not take advantage of the new rule. Thus, portfolio interest received by a CFC will be includible under section 951 without regard to the 10 per cent. *de minimis* rule of section 954(*b*)(3) even in the case where the CFC would have been exempt from such tax under an applicable tax treaty.[64] In addition, other exceptions to the application of section 951 will not apply.[65]

The application of the special rules for a CFC may yield surprising results. For example, consider the case of a CFC that would be exempt by virtue of a tax treaty from the 30 per cent. withholding tax on interest whether or not such interest qualifies as portfolio interest.[66] Under the special rules, the 10 per cent. *de minimis* rule will no longer be available to the United States

[62] s.881(*c*)(3)(A). The term "bank" is not defined in this provision. But see s.581. *Cf.* Treas. Reg. §§1.864-4(*c*)(5)(i) and 1.954-2(*d*)(2)(ii).

[63] s.881(*c*)(3)(C). For this purpose, a "related person" is defined in s.864(*d*)(4) to mean (1) any person who is a related person within the meaning of s.267(*b*), or (2) any United States shareholder (as defined in s.951(*b*)) and any person who is a related person (within the meaning of s.267(*b*)) to such a shareholder.

[64] s.881(*c*)(4)(A)(i). The 10 per cent. *de minimis* rule of s.954(*b*)(3) generally provides that if the foreign base company income of the CFC is less than 10 per cent. of gross income, no part of the gross income of the taxable year will be treated as foreign base company income and hence will not be includible in the gross income of the United States shareholders of the CFC.

[65] s.881(*c*)(4)(A)(ii) through (v).

[66] see, *e.g.* United States–United Kingdom, Article 11; United States–Netherlands, Article VIII.

shareholders of such a CFC with respect to its portfolio interest even though the CFC did not need the portfolio interest exemption to avoid taxation on such interest. As a result, unlike under prior law, the CFC's portfolio interest will be includible in the income of the United States shareholders whether or not the CFC satisfied the 10 per cent. *de minimis* rule. While this provision has obvious revenue raising implications, it will likely discourage CFCs from investing in obligations issued by United States borrowers. This appears to be contrary to the policy underlying the exception to the rules of section 956 (relating to investment of earnings by a CFC in stock or obligations of certain domestic corporations)[67] which is to encourage CFCs to invest in obligations issued by United States borrowers.[68]

3. *Inadequate Exchange of Information*

If the United States determines that the exchange of information between the United States and a foreign country is not sufficient to prevent evasion of United States tax by a United States person, the United States may publish a statement to that effect. In such case, the exemption from tax will not apply to interest paid after the publication to persons in that country on obligations issued after that date.[69]

Resolving Audits Relating to an IFS

Under a special "transitional" rule,[70] if an IFS was an "applicable CFC" that was in existence on or before June 22, 1984, interest paid to it by its United States parent corporation on obligations issued before June 22, 1984 will be treated as interest paid to a corporation resident in the country in which the CFC was incorporated.[71] A Senate floor statement indicates that this special rule also applies to "rollovers" of debt provided the total amount of United States relendings does not increase and the CFC does

[67] s.956(*b*)(2)(F).

[68] H. Rept. No. 94–658, 94th Cong., 1st Sess. 216 (1975); S. Rept. No. 94–938, 94th Cong., 2d Sess. 225–226 (1976).

[69] ss.871(*h*)(5) and 881(*c*)(5).

[70] Act s.127(*g*)(3).

[71] The special transition rule does not apply to obligations issued on or after June 22, 1984 even though the Act did not take effect until July 18, 1984. Issuers of, and investors in, obligations issued during the June 22, 1984 and July 18, 1984 "window period" may be adversely affected, on a retroactive basis, by Rev. Rul. 83–152, *supra* at note 29 and Rev. Rul. 83–153, *supra* at footnote 29. In recognition of this, the IRS on October 18, 1984 advised that issuers of, and investors in, obligations in process prior to June 22, 1984 who believe they have a reasonable basis for relief from the operation of the rulings for obligations issued during the window period should take advantage of existing procedures under s.7805(*b*) to request relief promptly from the IRS. The IRS will grant such requests for relief expedited consideration. IR-84-110. As previously noted, Eurodollar bonds generally contain call provisions if withholding taxes are applied to interest payments. Since interest rates have generally fallen since the window period, issuers may prefer to call the obligations than to seek this relief.

not acquire new funds.[72] Under the transitional rule, the IRS is, in effect, precluded from contesting the withholding tax issue at least so long as the treaty providing the exemption from withholding remains in effect. This rule applies only if the the IFS met the "principles" of certain rulings issued under the IET and since revoked.[73] It appears that the controlling principles relate to the debt-equity ratio (which cannot exceed 5 to 1) and the use of the capital of the IFS (which could be used to invest in short term obligations or even deposited with a bank that has lent the money to the United States parent that has been contributed to the IFS provided such deposit was not held as collateral for that loan).

An "applicable CFC" is defined[74] as a CFC the principal purpose of which consisted of (a) the issuing of obligations in a manner reasonably designed to ensure their sale or resale to non-United States persons (and with respect to obligations issued after December 31, 1982, interest thereon is payable outside the United States and its possessions and the instrument contains a legend to the effect that any United States person who hold the obligation will be subject to limitations under the United States tax laws), (b) the holding of short-term obligations, and (c) lending the proceeds of such obligations to affiliates.

Significantly, the special transitional rule will continue to be of assistance with respect to a Netherlands Antilles IFS only so long as the tax convention between the United States and the Netherlands Antilles were to remain in effect in its present form. As has been noted earlier, the United States and the Netherlands Antilles have been negotiating a new treaty for several years. However, even if the treaty benefits were to be abrogated, the special transitional rule will still resolve withholding issues arising prior to the abrogation.

Impact of Backup Withholding

At first blush, one would have thought that the repeal of the 30 per cent. withholding tax on portfolio interest eliminated any withholding tax concerns with respect to the issuance of obligations (including bearer obligations) the interest on which qualifies as portfolio interest. It turns out, however, that before the technical requirements of the backup withholding system were amended by Temporary Regulations, a payer, under certain conditions, would

[72] 130 Cong. Rec. S8417 (daily ed. June 27, 1984) (remarks of Senator Wallop).
[73] See IRS rulings cited *supra* at footnote 6.
[74] Act ss.127(*g*)(3) and 121(*b*)(2)(D).

have been required to withhold a 20 per cent. tax on certain payments of interest and principal.[75]

The backup withholding system applies only with respect to "reportable payments" made after December 31, 1983 to payees who have failed to comply with certain information reporting requirements (such as failing to furnish a correct taxpayer identification number).[76] If such a failure arises, the payer is required to withhold a 20 per cent. tax from each reportable payment.[77] A reportable payment includes payments of interest on, and the principal of, an obligation if such payments are required to be reported on an information return.[78] Generally, payments of interest on, or principal of, an obligation to a corporation is not subject to such reporting requirements and are therefore generally exempt from backup withholding.[79]

Before the Act, interest subject to the 30 per cent. withholding tax was not a reportable payment and was not subject to backup withholding.[80] However, as a result of the Act, such interest is no longer subject to the 30 per cent. withholding tax and this exception is no longer applicable to payments of portfolio interest. As a result, in order to avoid backup withholding before the IRS issued the Temporary Regulations, a foreign holder (other than, in general, a corporation) generally was required to certify (on, for example, Form W-8) that he was a foreign person. Such certification is not a problem with respect to a registered obligation since the holder is identifiable by means of the registration system. However, such certification is contrary to the characteristic of anonymity inherent in bearer obligations.

In order to avoid this apparently unintended result, the IRS issued Temporary Regulations that contain an exemption from backup withholding for certain obligations issued in bearer form

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[75] See s.3406 and Temporary Reg. §§35a.9999–3, Q&A–34; 35a.9999–5. Temporary Reg. ss.35a.9999–5(*a*), Q&A–2 and 35a.9999–5(*b*), Q&A–11 eliminate information reporting requirements under sections 6041 and 6049 (relating to reporting for payments of interest) with respect to portfolio interest. Moreover, the definition of portfolio interest is broad enough to cover interest which is effectively connected with the owner's United States trade or business as well as foreign source interest income even though both effectively connected and foreign source income would not be subject to Chap. 3 withholding without regard to the portfolio interest exemption added by the Act. There does not appear to be any requirement to file Forms 1042 and 1042S with respect to portfolio interest exempt under the Act unless the interest is paid on a non-foreign targeted obligation (which as previously discussed must be in registered form for interest thereon to qualify as portfolio interest). *See* Treas. Reg. §1.1461–2(*c*); Temporary Reg. §35a.9999–5(*b*), Q&A–9; Temporary Reg. §35a.9999–5(*d*), Q&A–19.

[76] The information reporting requirements which payees must satisfy to avoid backup withholding are contained in s.3406(*a*).

[77] s.3406(*a*).

[78] s.3406(*b*).

[79] See Treas. Reg. §§1.6041–3(*c*); 1.6045–1(*c*)(3); 5f.6045–1(*c*)(3); 1.6049–4(*c*). See also Temporary Reg. §35a.9999–3, Q&A–13.

[80] See Treas. Reg. §1.6049–5(*b*)(1)(vi)(A).

and certain foreign-targeted registered obligations. A foreign investor who owns or controls a foreign corporation may not find the changes made by the new regulations particularly significant if either (1) the investor would have no problem certifying that he is a foreign person, or (2) he makes his investments through a foreign corporation. In the latter situation, either the corporation, as a corporation, will generally be exempt from backup withholding without having to provide any documentation[81] or the foreign investor will have no problem disclosing that the foreign corporation (as opposed to its shareholders) is the owner of an obligation issued by a United States borrower. Presumably, such investors will simply acquire, or cause their foreign corporations to acquire, the obligations that represent the best investments, regardless of whether the obligations were in registered or bearer form or whether the obligations were issued on a United States market or on, say, the Eurodollar market.

The following is a brief summary of the relevant provisions of the new Temporary Regulations. However, the technical details of these complex regulations (as well as the applicable backup withholding rules) are beyond the scope of this article and should be carefully reviewed when planning transactions in this area.

Generally, these new Temporary Regulations exempt from information reporting and backup withholding interest and principal payments made by United States issuers or their agents on obligations issued in bearer form the interest on which qualifies as portfolio interest if the issuer or its agent does not have actual knowledge that a payee is a United States person and the payment is made outside the United States.[82] This exemption, however, does not extend to payments by a person acting in the capacity of a custodian, nominee or other agent of the payee with respect to an obligation if that person is otherwise required to report payments made to the payee.[83] An example of the latter given by the regulations[84] is that of a foreign branch of a United States bank holding a bearer obligation on behalf of a customer. The branch is required to backup withhold on payments of portfolio interest unless the branch has documentary evidence[85] in its files that the customer either is not a United States person or is otherwise exempt.[86]

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[81] See Temporary Reg. §35a.9999-3, Q&A-13. §35a.9999-1, Q&A-22.

[82] See Temporary Reg. §35a.9999-5(*a*), Q&A-2, 7. See also Temporary Reg. §35a.9999-5(a), Q&A-3 through 6.

[83] Temporary Reg. §35a.9999-5(*a*), Q&A-2.

[84] *Ibid.*

[85] For a discussion of the documentary evidence necessary to satisfy this requirement, see Temporary Reg. §35a.9999-3, Q&A-34.

[86] See, *e.g.* Treas. Reg. §1.6049-4(*c*).

Similar rules are applicable with respect to foreign-targeted registered obligations except that, in general, the registered owner of the obligation, if it is outside the United States and a financial institution that holds the customers' securities in the ordinary course of its trade or business, must certify, with respect to each interest payment, that the beneficial owner is not a United States person. The identity of the beneficial owner, however, need not be given.[87] Finally, these regulations confirm that with respect to foreign non-targeted registered obligations, backup withholding is generally imposed unless the foreign person certifies that he is a foreign person.[88] In any event, a foreign person who is not interested in preserving his anonymity can avoid backup withholding by certifying his foreign status to the issuer.

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[87] See Temporary Reg. §35a.9999-5(*b*), Q&A-12 through 17.
[88] See Temporary Reg. §35a.9999-5(*b*), Q&A-9 through 11.