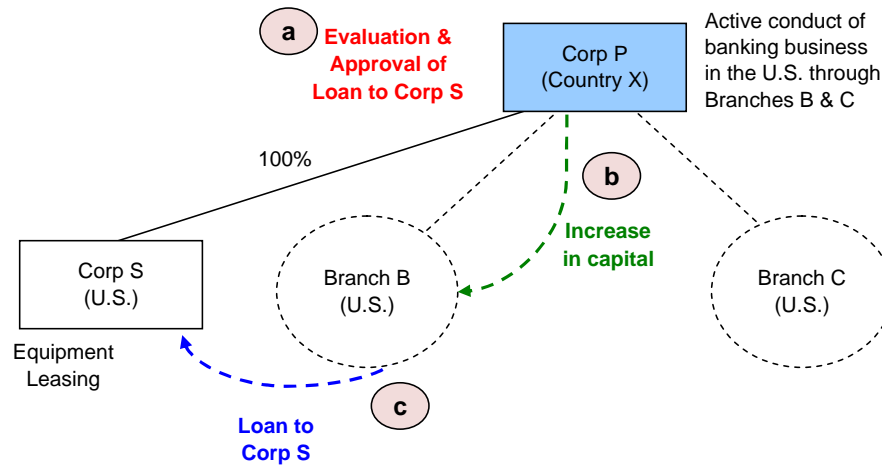


**Revenue Ruling 86-154,  
Situation 2**

**Banking: Loan Not Attributable to U.S.  
Office Where Foreign Home Office  
Evaluates & Approves Related Party Loan**

Copyright © 2012 Andrew Mitchel LLC  
International Tax Services  
[www.andrewmitchel.com](http://www.andrewmitchel.com)



P, a foreign corporation whose home office is located in foreign country X, is actively engaged in the conduct of the banking business within the United States within the meaning of Reg. 1.864-4(c)(5)(i) through B and C, P's United States branch offices. B has in its possession and has recorded on its books interest-bearing securities of related and unrelated United States corporations evidencing funds advanced by B to these borrowers. Typically, the branch offices' participation in the loan acquisition process varies.

P has a wholly-owned United States subsidiary, S, which is actively engaged in equipment leasing and related services. S is in need of additional funding for expansion of its operations. The home office of P reviews S's expansion plans, evaluates the customer orders and the credit worthiness of the customers' future receivables, and approves the loan. P funds the loan through B, by increasing B's capital and having B loan the funds to S. B actually disperses the funds to S. As evidence of the loan, S executes a promissory note in favor of B. B services the loan throughout its term.

B did not actively and materially participate in the acquisition of the loan merely because it funded the loan. All essential functions in connection with the loan were performed by P's home office. Therefore, the interest income received with respect to the security evidencing the related party loan to S is not effectively connected with the active conduct of the banking, financing, or similar business within the United States.

The ruling states that the I.R.S. will closely scrutinize loans made to related parties to determine whether a United States branch office actively and materially participates in arranging the acquisition of the securities. Absent facts clearly indicating active and material participation by a United States branch office including contemporaneous written evidence documenting such participation it will be presumed that the office did not actively and materially participate.