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**Subject:** Fwd: Tax Alert: Major Tax Case on US Lending Activities of Offshore Funds  
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**From:** Sadis & Goldberg Tax Group <[REDACTED]>  
**Date:** Wed, Jul 15, 2015 at 1:06 PM  
**Subject:** Tax Alert: Major Tax Case on US Lending Activities of Offshore Funds  
**To:** [REDACTED]



TAX ALERT

July 15, 2015

## Major Tax Case on US Lending Activities of Offshore Funds Heads to the US Tax Court

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Please feel free to discuss any aspect of this *Alert* with your regular Sadis & Goldberg contact or with any of the partners whose names and contact information can be found at the end of the *Alert*.

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In January of this year, we circulated a Client Alert about an ongoing Internal Revenue Service audit of the US lending and stock distribution (underwriting) activities of an offshore hedge fund in which the IRS had determined that the offshore fund in question was engaged in a US trade or business both with respect to the lending and the underwriting activities, and that neither activity was shielded from US federal income tax by the well known "trading in stocks or securities" safe harbor rules in the Internal Revenue Code. Click on the link to read the alert: <http://www.sglawyers.com/admin/PDFs/347.PDF>

## Recent Developments

It was recently reported that the IRS issued a deficiency notice to the Cayman Islands hedge fund that was the subject of our prior Client Alert for over \$102 million in US income tax. Last month, such hedge fund filed a petition with the US Tax Court, claiming that such deficiency was incorrect because the IRS incorrectly determined that the fund was engaged in a US trade or business by reason of its direct lending and also its underwriting activities. Consequently, if this case is not settled, it is expected that there will be a major Tax Court decision interpreting the scope of the securities trading safe harbor rules, and possibly additional judicial guidance on exactly when lending by offshore funds constitutes a US trade or business.

## The Takeaway

Hedge fund lending and the scope of the securities trading safe harbor rules have been a topic of much discussion among tax practitioners, but such issues have rarely been considered in reported tax cases or published guidance from the IRS. As a result, tax counsel have developed their own standards for how to avoid US trade or business exposure, but such strategies (such as "season and sell") have never been tested in courts. The last major Tax Court decision on the securities trading safe harbor rules (*InverWorld Inc. v. Commissioner*) was issued in 1996, and the Tax Court's rather strict interpretation of the Code at that time caused many offshore hedge funds to reconsider how to carry on their US activities to avoid US income taxation.

The Tax Department of Sadis & Goldberg LLP will continue to monitor developments relating to this matter. If you have any questions about this *Alert*, please contact Tax partners Steven Etkind at [REDACTED] or Alex Gelinias at [REDACTED]

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