IRS' Implicit Parental Support Guidance "Formalizes" Past Controversy Positions

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The Internal Revenue Service (IRS) recently issued a nonbinding Generic Legal Advice Memorandum (GLAM) that provides advice on Code Sec. 482 and so-called implicit parental support. Consistent with prior IRS positions advanced in the examination phase, at the IRS Independent Office of Appeals, and in an ongoing litigation, the GLAM concludes that the IRS may consider group membership in determining the arm's length rate of interest chargeable for intragroup loans.

Because the guidance[1] was issued in nonbinding form and is consistent with the IRS' recent position in prior matters, this guidance will likely have little effect on taxpayers facing this issue. The IRS may have issued this guidance simply so that all Examination teams apply what has become their already standard position uniformly.

Below we examine the GLAM and provide our views on potential areas to which taxpayers should pay particular attention.

Background

Code Sec. 482 seeks to ensure that "taxpayers clearly reflect income attributable to controlled transactions" by determining the "true taxable income" of controlled taxpayers. The Treasury Regulations under Code Sec. 482 provide guidance for determining arm's length charges on intragroup lending arrangements. The Code Sec. 482 transfer pricing regulations currently do not expressly address whether implicit parent support must be considered in pricing intercompany debt. The regulations provide:

> Where one member of a group of controlled entities makes a loan or advance directly or indirectly to, or otherwise becomes a creditor of, another member of such group and either charges no interest, or charges interest at a rate which is not equal to an arm's length rate of interest (as defined in paragraph (a)(2) of this section) with respect to such loan or advance, the district director may

make appropriate allocations to reflect an arm's length rate of interest for the use of such loan or advance.

The regulations under Code Sec. 482 define an arm's length rate of interest as a "rate of interest which was charged, or would have been charged, at the time the indebtedness arose, in independent transactions with or between unrelated parties under similar circumstances." The regulations explain that "[a]ll relevant factors shall be considered, including the principal amount and duration of the loan, the security involved, the **credit standing of the borrower**, and the interest rate prevailing at the situs of the lender or creditor for comparable loans between unrelated parties."[2]

Taxpayers and the IRS have long contested whether the "credit standing of the borrower" includes the borrower's standing and position within a multinational group. This concept of considering a borrower's position within a group of related entities is known as implicit parental support (IPS). According to the IRS, taxpayers must evaluate whether IPS applies to its intracompany lending under Code Sec. 482. This **implicit** support generally reflects the expectation that a parent or affiliate company will step in to support a subsidiary in the event of the subsidiary's financial difficulty and help the subsidiary meet its debt obligations.

In other words, "implicit support" is the assumption that a corporate parent or affiliate would perform the same role as an explicit guarantor despite the fact that no explicit, legally binding guarantee exists. Because interest rates are generally tied to the riskiness of any lending, if IPS applies to a particular loan, that loan may be considered less risky based on these facts and circumstances, and the lending entity may be entitled to a lower interest rate.

History Behind Implicit Support

The IRS is not the first taxing authority to grapple with IPS—or related concepts—in the transfer-pricing context. In *General Electric Capital Canada Inc. v. The Queen*, the Tax Court of Canada in 2010 rejected the Canada Revenue Agency's argument that an explicit guarantee from a U.S. parent to its Canadian subsidiary should be disregarded and the Canadian subsidiary was not entitled to any deduction for the associated guaranty fee. In doing so, the Tax Court of Canada agreed with the taxpayer that IPS was not equivalent to an explicit guarantee—and hence the explicit guarantee should still command a separate fee—but did find it appears for the first time in a public case that IPS and the parent–sub relationship between the entities **can** be a relevant factor in deciding upon an arm's length transfer price.[3]

Several years later, in *Chevron Australia Holdings Pty. Ltd.*, Australia's Full Federal Court agreed with Australia's Commissioner of Taxation that the interest rate charged by a U.S. subsidiary on an unsecured, unguaranteed loan to its Australian parent was not arm's length. One rationale was that an unsecured, unguaranteed loan would not have been made at arm's length, especially viewing the borrowing parent as part of a multinational group with secure credit ratings.[4]

Commentators have recognized that recent Organisation for Economic Co-operation and Development (OECD) guidelines incorporate or address aspects of *General Electric* and *Chevron*.[5] However, it was not until 2021 that the IRS included in its Priority Guidance Plan a regulatory project to "clarify[] the effects of group membership (*e.g.*, passive association) in determining arm's length pricing, including specifically with respect to financial transactions." In recent webinars, the IRS previewed that it planned to issue advice on this issue in subregulatory guidance before being able to propose or finalize any regulations on the topic.[6] On December 29, 2023, the IRS issued the promised subregulatory guidance.[7]

GLAM AM 2023-008

GLAM AM 2023-008 addresses whether group membership could be considered in determining the arm's length rate of interest chargeable for intragroup loans. Under the fact pattern, a foreign parent directly owned 100% of the equity of a U.S. subsidiary, which owned "operating assets and operates businesses essential to the group's financial performance." Because of the essential nature of the subsidiary, the IRS explained that the foreign parent would be likely to provide financial support—by either contributing capital to the subsidiary or forgiving debt owed to it by the subsidiary—if the subsidiary's financial condition deteriorated.[8]

Under the fact pattern, the IRS treats the loan as *bona fide* debt. An independent rating agency has rated the foreign parent with a credit rating of A, the subsidiary with a standalone credit rating of B, and, when IPS is considered, rated the subsidiary with "a one-notch lower credit rating of BBB [from its parent], reflecting both its standalone credit profile and the group's group credit profile."

These credit ratings reflect the following potential commercial market interest rates, which are generally determined based on a suitable analysis depending on the date of issuance and debt terms:[9]

- A: 7%
- BBB: 8%
- B: 10%

The foreign parent lends to its subsidiary at an interest rate of 10%. Under the IRS' analysis, the subsidiary's "credit rating of BBB reflects a two-notch increase over the rating it would have if it were an independent entity, which increase is based on the implicit financial support" of the group. As such, under these facts and circumstances, the IRS concluded that it could adjust the interest rate of the foreign parent's loan to its subsidiary to 8% based on a rating of BBB.[10]

Initial Thoughts

"Formalizing" the IRS' Position

Based on our experience with Examination and Appeals, the IRS is merely "formalizing" its litigation position with respect to implicit parental support that it is applying retroactively to related-party loans made in prior years. The IRS has made clear in each forum that IPS should be considered and that, however, no compensation is due to the group for providing that support based on the principles of passive association. This is similar to positions explained by the IRS during public webinars[11] and therefore does not trod much new ground.

Nevertheless, while taxpayers continue to wait on Treasury Regulations to address this issue,[12] it is important to recall that the GLAM is merely "non-binding subregulatory guidance." This means that, generally, the IRS will **not** rely on a GLAM to seek deference for this position.[13]

Its import in litigation thus is modest at best, and in ongoing exams and litigation[14] this "formalization" should not be seen as an additional arrow in the IRS' quiver. Instead, because this guidance is from James Kelly, Chief Counsel for Controversy and Litigation, it is almost certainly the position of the IRS National Office and thus provides insights into the IRS' current analysis of this issue.

Arguments Against IPS

As many commentators have long noted, taxpayers possess any number of counterarguments against the IRS' unilaterally determined application of IPS under Reg. §1.482-2, including that treating the foreign parent as related to the U.S. subsidiary and potentially providing support is contrary to the arm's length standard that treats the parties as unrelated. Some of those counterarguments are highlighted here.

Text Does Not Require IPS

As some have rightly pointed out, an initial argument is that the text of the Treasury Regulations simply does not support IPS and in fact undercuts it.[15] Reg. §1.482-2(a)(2)(i) mandates that "an arm's length rate of interest shall be a rate of interest which was charged, or would have been charged, at the time the indebtedness arose, in independent transactions with or between unrelated parties under similar circumstances." This is generally consistent with the Treasury Regulations' overarching principles regarding the arm's length standard:

> In determining the true taxable income of a controlled taxpayer, the standard to be applied in every case is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer. A controlled transaction meets the arm's length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances (arm's length result).[16]

And while the IRS' Priority Guidance Plan describes the ongoing regulatory project as "clarifying" the Treasury Regulations on this front, the need for additional regulations at least suggests that the Treasury Regulations as currently drafted do not sufficiently address IPS.

IPS Should Require Compensation

The GLAM concludes that similar to controlled services transactions—where no compensation is owed for any benefit arising solely from passive association—in the intragroup lending context, absent a guarantee or legally binding credit support, the borrower is not required to compensate any affiliate.[17]

In total, the two-sentence explanation does not provide adequate support for this proposition given longstanding, compelling arguments from taxpayers that providing implicit support utilizes a parent's finite credit profile, which is an economic detriment to the parent and thus compensable, distinguishing it from passive association.[18] Ignoring IPS in the intragroup lending context eliminates this "free rider" problem and produces essentially the correct economic result, as the standalone credit rating would compensate the parent lender for any potential IPS through a higher interest rate.

Consistent with Debt/Equity Determinations

Finally, commentators have also noted that requiring the consideration of IPS in the transfer pricing regulations creates tension with the framework for debt/equity determinations.[19] This is because debt/equity determinations are made on a standalone basis by asking the question of whether the borrower had the ability to borrow on its own account. The IRS appeared to agree with this standalone framework when it released its regulations under Code Sec. 385 that set forth the minimum standards on documentation needed to substantiate the treatment of certain related-party instruments as indebtedness.[20]

Realistic Alternatives Principle

The GLAM attempts to support its position by reference to the "realistic alternatives" principle contained at Reg. §1.482-1(f)(2)(ii)(A), which the GLAM calls "a corollary of the regulations' arm's length standard." Reg. §1.482-1(f)(2)(ii)(A) states that:

> The Commissioner will evaluate the results of a transaction as actually structured by the taxpayer unless its structure lacks economic substance. However, the Commissioner may consider the alternatives available to the taxpayer in determining whether the terms of the controlled transaction would be acceptable to an uncontrolled taxpayer faced with the same alternatives and operating under comparable circumstances.

Rather than provide a useful interpretive touchstone, the GLAM's citation of realistic alternatives arguably muddies the waters. First, if the realistic alternatives principle is indeed a "corollary" of the arm's length standard, then it would make little sense to interpret it as supporting intercompany loan pricing that would not occur if the borrower and lender were in fact uncontrolled parties operating at arm's length. Second, despite its presence in Reg. §1.482-1 (which sets forth "general principles and guidelines to be followed under Code Sec. 482"), it is far from clear that this provision should affect the interpretation of the Treasury Regulations regarding intercompany financing. Reg. §1.482-1(f)(2)(ii)(A) expressly omits any cross-reference to Reg. §1.482-2, but expressly includes cross-references to Reg. §§1.482-1(d)(3) (general comparability factors), 1.482-3(e) (unspecified methods for pricing transfers of tangible property), 1.482-4(d) (unspecified methods for pricing transfers of intangible property), and 1.482-9(h) (unspecified methods for pricing transfers of services).

Furthermore, the GLAM does not address that Reg. §1.482-1(f)(2)(ii)(A)—like the arm's length standard—itself adopts the hypothetical "uncontrolled taxpayer" construct which, as noted above, arguably supports that IPS should not be considered in the first instance. In other words, if an uncontrolled borrower were borrowing from an uncontrolled lender, it would not be an alternative (much less realistic) for the borrower to receive a lower interest rate by virtue of the lender's IPS. Nor does the GLAM discuss that companies, driven by business realities, are not always able to borrow at the lowest interest rate based on their broader group's rating.

Finally, even under the IRS' framework, it would again require the parent to provide this IPS support without compensation. Thus, the realistic alternative argument does nothing to address or answer the question of whether the parent would require compensation for providing IPS by allowing its subsidiary to "use" its balance sheet.

Commercial Lenders' Consideration of Credit Profiles

The IRS contends that credit rating agencies would consider IPS when determining a borrower's credit rating. The IRS, however, only lists two items that credit rating agencies may take into account in determining both standalone and group credit profiles: (1) the relationship of the entity's businesses and assets to the overall group; and (2) the likelihood that another group member would provide financial support if the entity were in financial distress.

First of all, neither of these considerations is relevant to the standalone credit profile of a subsidiary. Typically, regardless of whether IPS could apply, the credit rating agency will determine the standalone credit profile of the borrowing entity.[21] This assessment will reflect the borrower's business risk profiles, their financial risk profiles, and other factors.[22] The business risk profiles may include an evaluation of the risk and return potential for the borrower "in the markets in which it participates, the competitive climate, … the country risk within those markets, and the competitive advantages and disadvantages the company has."[23] This assessment is critical because it will determine a borrower's capacity to "generate cash flows in order to service its obligations."[24] The financial risk profile typically includes an analysis of the borrower's balance sheet and how it seeks to fund itself, including "its business risk profile, to the company's financial obligations."[25] At the bottom, an important step in analyzing a borrower's credit profile is "gauging the resources available to it for fulfilling its commitments relative to the size and timing of those commitments."[26]

Instead, both items listed by the IRS relate to considerations with respect to the effect and magnitude, if any, of IPS based on the parent's willingness to provide support. While these are two items that credit rating agencies, such as S&P's and Moody's, may take into account when deriving a credit rating, there are many **other** items that may be relevant. The likelihood that another group member would provide financial support if the borrower were in financial distress may also include operational integration, shared ownership and control, management involvement, support track record, and name and brand association (reputation).[27] Moreover, a parent may make a strategic decision **not** to provide support at all if the additional incremental investment in the subsidiary did not justify the parent's support going forward.

S&P's and Moody's criteria generally require an assessment of the strategic importance of the subsidiary to evaluate the parent's economic incentives (**willingness**) to provide support, but it also requires an evaluation of the parent's **ability** to actually provide that support. The criteria expressly listed in the GLAM focuses more on the parent's economic incentive to provide support, but **not** on the parent's ability to provide such support. Ability to support may be based on the parent's own credit profile, "the correlation between the parent's and subsidiary's financial condition, and the relative magnitude and timing of all such expected investments."[28] If the parent lacks the financial wherewithal to provide support in the event of a subsidiary's default, the strategic importance of the subsidiary is more or less irrelevant. The parent's other commitments and obligations may severely limit its ability to provide any support (whether explicit or implicit). Therefore, while a parent's willingness to provide support may be relevant, it is not the only criterion that must be considered.

If the IRS is attempting to analyze what commercial lenders would do when determining the risk involved in extending credit, the two items listed in the GLAM are woefully limited and are far from an exhaustive list for group support. In the end, the IRS' analysis is devoid of any helpful guidance in first determining a standalone credit profile or rating.

"Essential" Subsidiary and Notching

Under the facts of the GLAM, the U.S. subsidiary owns operating assets and operates businesses **essential** to the group's financial performance. Such a factual finding can be important in determining the strategic importance of the subsidiary and evaluating the parent's economic incentives to provide support. In such a scenario, a parent and group may have a strong incentive to provide support (if possible) to the distressed subsidiary. Based on this factual finding, the IRS contends that the subsidiary's standalone rating of B should be increased by "two notches" to BBB so that it is "one notch lower" than its foreign parent's rating.

The "essential" designation does not directly map to either S&P's or Moody's guidance, however. But an estimate can be deduced based on the notches. For example, the primary S&P guidance on group support that was effective during many years under Examination by the IRS was released in 2013.

Under that guidance, S&P defines five categories of group status from "nonstrategic" to "core." These categories indicate S&P's views of the likelihood that an entity will receive support from the group.

Based on the IRS' view that the subsidiary is "essential" and is notched to a level one below its parent, we can surmise that the IRS views this type of subsidiary as "highly strategic" based on S&P's categories—"Almost integral to the group's current identity and future strategy. The rest of the group is likely to support these subsidiaries under almost all foreseeable circumstances." As a consequence, S&P's guidance provides that this subsidiary may be one notch below the group credit profile. On the other end of the spectrum, a "nonstrategic" subsidiary will generally retain its standalone credit rating despite being part of a larger group.

Finally, based on our past experience in this area and prior IRS positions during Examination and Appeals, the notching regime used in the GLAM is inconsistent with published S&P's and Moody's guidance. As noted previously, the IRS contends that, based on an independent credit rating agency's analysis, the subsidiary's standalone rating is a B, the subsidiary's rating taking IPS into account is BBB, and the parent's credit rating is an A. Under the IRS' regime, the increase from a B to a BBB is "two notches," and the notch from BBB to A is only a single notch. This approach is inconsistent with our experience with the notching in fact used by commercial lenders applying S&P's and Moody's guidance and is also inconsistent with how the **IRS** and their experts have applied the notching regime in prior cases.

For S&P's and Fitch, each credit rating includes a "+" and a "–" for each letter.[29] For example, a credit rating of B would also include a credit rating of B+ and B–, with each rating qualifying as a single notch. In the GLAM, the IRS disregards these additional ratings for simplification. However, in prior cases, the IRS has treated an increase from a B to BBB as six notches instead of two.[30] Such a difference in credit ratings (six notches up instead of two) may have a material effect on the corresponding interest rates applicable to the intragroup debt.

The IRS attempts to justify its notching approach in a footnote by explaining without citation or justification that "[u]nder these facts, the one-notch difference disregards that certain ratings may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories." However, this simplification is potentially (if unintentionally) misleading, and taxpayers will need to gird themselves for the reality of the IRS' notching application as compared to its hypothetical application.

"Shadow Ratings" Are Almost Always Necessary

The facts in the GLAM note that the foreign parent and the USSub were rated by an independent rating agency. It appears that under this analysis the IRS did not believe that there was any need to modify (or even re-evaluate) the independent rating agency's ratings based on the issuance of the debt at issue because the "Market Interest Rates" were determined using the ratings **as issued** by the independent rating agency. However, the GLAM does note that where ratings are not obtained by an independent rating agency for the borrower, the taxpayer and Exam may conduct "shadow ratings." Under the IRS' proposed framework, these shadow ratings could require the taxpayer to "conduct analyses similar to those performed by a rating agency," which could take into account some of the factors discussed above.

However, even when either or both a parent and subsidiary have ratings from an independent rating agency, a taxpayer should still consider how the debt from the controlled transaction may affect the rating from the independent rating agency.[31] This is because credit ratings are in part tied to the borrower's ability to repay the debt and the issuance of additional debt can affect a prior assigned rating. For example, if the subsidiary was rated **before** the intragroup debt was issued, the taxpayer should evaluate whether the new debt would change the prior assigned rating by modifying the subsidiary's financial risk profile, which would not have taken that debt into account. In another example, assume a subsidiary borrows intragroup and is **later** rated by an independent rating agency; even in that situation, the taxpayer should evaluate how the rating agency treated the debt at issue to make sure it was consistent with the IRS' central hypothesis of debt between unrelated parties. The taxpayer should consider conducting a similar exercise for the parent's credit rating as well if appropriate.

The IRS' Position Contains Internal Inconsistencies

Similar to prior cases that we have dealt with, the IRS' position contains internal inconsistencies—the IRS contends that the hypothetical pricing structure involves a loan from an unrelated lender but, at the same time, suggests that the loan at issue would—or could—be forgiven by the group if faced with future financial duress.

On the one hand, the IRS rejects the hypothetical scenario that the foreign parent should be treated as the creditor for purposes of pricing under Code Sec. 482. In the IRS' view, "that the controlled lender is the borrower's parent, is assumed away, as the central hypothesis of the arm's length standard is—'uncontrolled taxpayers … engaged in the same transaction under the same circumstances.'" Thus, the debt from the controlled transaction must be treated as coming from an unrelated lender.

On the other hand, the IRS contends that when determining the riskiness of the loan, the group may provide assistance to a distressed subsidiary by forgiving debt, potentially including the debt from the controlled transaction. The guidance provides that the foreign parent "might contribute capital to USSub or forgive debt owed to it by USSub." On its face, it is unclear whether "debt forgiveness" could—or should—include the debt from the controlled transaction.[32]

Following the IRS' central hypothesis that the creditor in this hypothetical is an uncontrolled party, then it should be without controversy that an unrelated lender would not consider itself forgiving the debt at issue when determining the likelihood of a group member providing financial support.

While such a position may seem obvious based on the IRS' Code Sec. 482 construct, the IRS has argued in prior cases that **both** the debt is from an unrelated lender **and** that the parent would forgive the debt at issue in times of distress. These two contrary positions are analytically irreconcilable.

Arguments Not Raised by the GLAM

While the GLAM lays out the IRS' position on a number of issues related to IPS, it does not explicitly address other arguments that the IRS has raised during the Exam and Appeals phases and that, ultimately, taxpayers will need to contend with. Here are two such issues.

IRS' Affirmative Use of Safe Haven Interest Rates

Under Reg. §1.482-2(a)(2)(iii)(B)(1), a "safe haven" interest rate is established for loans and advances that are between the "lower limit" (not less than 100% of the applicable Federal rate) and the "upper limit" (not greater than 130% of the applicable Federal rate).

Reg. §1.482-2(a)(2)(iii)(B)(3) continues and provides that "[i]f the rate of interest charged is greater than the upper limit, then an arm's length rate of interest shall be equal to the upper limit, compounded semiannually, unless the taxpayer establishes a more appropriate compound rate of interest under paragraph (a)(2)(i) of this section."

On multiple occasions, Exam's original adjustment invoked this "Cliff Rule" on the ground that the **taxpayer** in its "shadow ratings" and corresponding interest rates had failed to show that its interest rates were "more appropriate" under the arm's length standard than the applicable Federal rate. In these cases, the Exam team had engaged their own experts to establish "shadow ratings" and corresponding interest rates that were above (and sometimes well above) the applicable Federal rate, although below the rates established by the taxpayer.

Using the GLAM's fact pattern with one additional fact will illustrate the point. In the GLAM, the taxpayer argued that USSub should borrow at a rate of 10% based, in part, on its credit rating of B. The IRS contended that IPS should be considered and that, therefore, the credit rating of USSub should be notched up to a credit rating of BBB, with a corresponding interest rate of 8%. Assume for purposes of this example that the loan at issue would have an applicable Federal rate of 4%.[33] If the IRS were to apply the Cliff Rule, as in prior Exams, the IRS would argue that the taxpayer failed to show that its interest rates were "more appropriate" based on its contention that USSub should have a credit rating of BBB (8%) and not a credit rating of B (10%). Instead of asserting an adjustment based on the 8% interest rate, though, the IRS would propose an adjustment based on the loan having an interest rate of 4% (or the applicable Federal rate). As is clear from this example, the 4% interest rate is much lower than the 8% interest rate based on the application of IPS, and even lower than the interest rate that the parent could have obtained based on its credit rating of 7%.

In each instance, however, Exam dropped this argument in its "Rebuttal" to Appeals and had proposed revised (and lower) adjustments based on the interest rates established by its experts. Because the GLAM concludes that "[t]he Service may adjust the interest rate of foreign parent's loan to USSub to the 8% arm's length interest rate USSub would pay to an unrelated lender based on its BBB rating," it implicitly concludes that the application of the Cliff Rule is inappropriate and not arm's length. But taxpayers should continue to watch out for Exam teams that raise such arguments.

Inconsistent Treatment of Prior Year's Debt

Exam has also attempted to "disregard" pre-existing loans that the borrower was obligated to service in the IRS' determination of a borrower's credit rating. Disregarding these loans improved the financial risk profile of the borrower and thus made the loan appear to be less risky—improving the borrower's credit rating and corresponding interest rates.

This typically occurs when there are multiple years under audit and loans at issue from multiple years. For example, assume that based on the GLAM's underlying fact pattern, USSub borrows from foreign parent, but this time, in two consecutive years. Assume that in year 1, USSub borrows $200 million from a foreign parent and, based on its independent credit rating, has a standalone rating of B and a credit rating of BBB if IPS is taken into account. We assume that the independent credit rating takes into account the $200 million intercompany loan.[34]

Assume that in year 2, USSub again borrows from the foreign parent, but this time for a loan amount of $100 million. Under these additional facts, USSub now has outstanding loans from a single lender (foreign parent) of approximately $300 million (disregarding for purposes of this example any principal repayment on loan 1 in year 2). The taxpayer would likely argue that under the IRS' proposed framework, a single, unrelated lender would consider both loans in determining USSub's financial risk profile and ultimate credit rating. Thus, a larger loan balance may increase the riskiness of USSub being able to pay back loan 2 and potentially could decrease USSub's credit rating in year 2.

The IRS has argued in the past that instead of treating the loan from year 1 as debt between USSub and an unrelated lender (*i.e.*, how it treated the debt for purposes of determining USSub's credit rating in year 1), the IRS may disregard the debt from year 1 in determining USSub's credit rating in year 2. This is despite the IRS' proposed framework as treating the loans as from unrelated parties. An unrelated lender, however, would not consolidate prior debt in determining a borrower's riskiness in later years. Therefore, based on the IRS' framework, all loans should be taken into account when analyzing the borrower's credit ratings, because that is what a third-party creditor must do each time a new debt obligation is being priced.

Conclusion

Because the IRS proposed this guidance in nonbinding form and it is generally consistent with prior positions, it is unclear what immediate impact it will have. For the IRS, hopefully it will receive and implement feedback from taxpayers in any future regulations on this topic. As for taxpayers, they should continue to track this issue moving forward, consider this guidance when issuing new intracompany debt, and provide any additional feedback to the regulation writers if and when proposed regulations are issued.

ENDNOTES

1. AM 2023-008 (Dec. 29, 2023).
2. The IRS contends that its position is generally consistent with the OECD Transfer Pricing Guidelines. *See* OECD, Transfer Pricing Guidance on Financial Transactions (February 2020). Brad McCormack of the IRS Office of Associate Chief Counsel (International) explained that the reference in the GLAM to the OECD Guidelines does not contradict the IRS' 2007 GLAM (AM 2007-007) that outside of the competent authority process, the IRS is bound to enforce the Treasury Regulations without reference to the OECD Guidelines. *See* Peter Alexander, *Implicit Support Memo Consistent With OECD, IRS Official Says*, TAX NOTES (Jan. 31, 2024).
3. *Her Majesty the Queen v. General Electric Capital Canada, Inc.*, 2010 FCA 344.
4. *Chevron Australia Holdings Pty. Ltd.*, 2017 FCAFC 62 (Apr. 21, 2017).
5. *See, e.g.*, Lee A. Sheppard, *Transfer Pricing of U.S. Outbound Interest*, 177 TAX NOTES 487, 489490 (Oct. 24, 2022). Another pending case in the UK implicates similar issues. There, the UK's Upper Tribunal held in favor of the HMRC and ruled that a taxpayer was not entitled to a deduction for financing charges associated with an intercompany loan from a foreign affiliate. The case is currently pending before the UK Court of Appeal. BlackRock Holdco 5 LLC v HMRC, [2022] UKUT 00199 (TCC) 19/07/2022. *See* Bloomberg Tax, BlackRock Tax Case to Provide Clarity on Intra-Party Loan Pacts (Mar. 22, 2024).
6. Transfer Pricing Developments and Planning, Practicing Law Institute Webinar (Sep. 13, 2023); APAs/MAPs and BEPS 2.0, Public Country-by-Country Reporting and Implicit Parental Support ... Hot Transfer Pricing Topics Examined!, American Bar Association Webinar (Oct. 16, 2023).
7. Tax authorities' focus on IPS has continued after the IRS issued the GLAM—and indeed after this article first went to press. On April 11, 2024, the United Kingdom's Court of Appeal (Civil Division)—in *Blackrock Holdco 5, LLC v. HM's Revenue and Customs*—denied a U.K. company a deduction for interest on an intragroup loan, albeit not on grounds that the intragroup loan violated OECD and U.K. transfer pricing principles. [2024] EWCA Civ 330. The lower court denied interest deductions because it found the intragroup loan did not contain third-party covenants and assurances and "the transfer pricing provisions do not permit the existence of third-party covenants to be hypothesised where those covenants are not present in the actual transaction." The Court of Appeal disagreed with this conclusion and found that the intragroup loan, which lacked such "unnecessary" covenants, was comparable to third-party loans that would have included such covenants. However, the Court of Appeal denied the interest deduction on the basis that the intercompany financing violated domestic legislation that precluded loans with tax avoidance purposes.
8. The IRS concludes that the same analysis would apply to lending between corporations in a brothersister relationship.
9. Generally, both the IRS and taxpayers apply a CUT-like approach to price intracompany debt by locating comparable debt. This comparable debt will result in a range of interest rates for the same credit rating because different lenders apply different subjective factors to the same ratings in determining their required interest rates. Arm's length behavior therefore leads to a range, not a point; as such, a range of interest rates could satisfy the arm's length standard.
10. While, as noted above, the GLAM notes that its approach is "consistent with the current OECD Transfer Pricing Guidelines," it neither elaborates on that claim nor references *General Electric* or *Chevron*.
11. *See supra* n.3.
12. *See, e.g.*, David Stewart, *Officials Engage Practitioners on Pricing of Guarantee Fees*, TAX NOTES TODAY (May 10, 2010); 2021-2022 Priority Guidance Plan (Sep. 9, 2021).
13. Policy Statement on the Tax Regulatory Process (Mar. 5, 2019).
14. *See Eaton Corp. & Subsidiaries*, Docket No. 2608-23.
15. *See, e.g.*, American Bar Association, Comments and Recommendations for Guidance to the Transfer Pricing of Related Party Guarantees at 56 (Sep. 13, 2012).
16. Reg. §1.482-1(b)(1).
17. The final 2009 service regulations, which include the passive association provisions, explained that "financial transactions" were excluded from coverage. *See* 74 FR 38830-01, 38835-36.
18. American Bar Association, Comments and Recommendations for Guidance to the Transfer Pricing of Related Party Guarantees at 56 (Sep. 13, 2012).
19. American Bar Association, Comments and Recommendations for Guidance to the Transfer Pricing of Related Party Guarantees at 57 (Sep. 13, 2012).
20. *See* 81 FR 72858-01 (Oct. 21, 2016) (focusing on the "issuer's" ability to repay). These regulations were eventually withdrawn.
21. *See, e.g.*, S&P Global Ratings, Corporate Methodology (Nov. 19, 2013); Moody's Analytics, Parent / Group Support Framework (2014). In a recent PLI presentation, which included an IRS speaker, some of the criteria for determining a credit rating of the borrower were discussed. *See* PLI's Application of the Arm's-Length Standard to Related Party Debt, slide 9 (Jan. 8, 2024).
22. Other factors that may be considered include "diversification/portfolio effect, capital structure, financial policy, liquidity, and management and governance." *See, e.g.*, S&P Global Ratings, Corporate Methodology (Nov. 19, 2013). *See also* S&P Global Ratings, How We Rate Nonfinancial Corporate Entities (Feb. 19, 2021).
23. *See, e.g.*, S&P Global Ratings, Corporate Methodology (Nov. 19, 2013).
24. *Id.*
25. *Id.*
26. *See, e.g.*, S&P General Criteria: Principles of Credit Ratings (Feb. 16, 2011) (under heading "Creditworthiness Before External Support"). Even after determining the standalone credit profile of the borrower, the credit rating can be notched up or down based on an analysis of the specific loan at issue, for example, because of subordination or other unique aspects of the debt.
27. *See, e.g.*, Moody's Analytics, Parent / Group Support Framework (2014); S&P Rating Services, General Criteria: Group Rating Methodology (Nov. 19, 2013).
28. Moody's Investor Service, Rating Non-Guaranteed Subsidiaries: Credit Considerations In Assigning Subsidiary Ratings In The Absence of Legally Binding Parent Support (Dec. 2003).
29. Moody's has a different designation but includes the same number of ratings as S&P's and Fitch's.
30. This would include going from B to (1) B+, (2) BB–, (3) BB, (4) BB+, (5) BBB–, and finally (6) BBB.
31. The credit profile evaluation for both the standalone and group rating may require the testimony of an expert witness to evaluate the facts and circumstances surrounding a given loan.
32. For example, the IRS states that the "controlled lender is expected to enforce repayment of the debt according to its terms as in an arm's length *bona fide* lending." This suggests that the IRS does not believe the group may forgive the debt at issue.
33. The applicable Federal rate is not tied to the credit rating of a borrow but is instead tied to "outstanding marketable obligations of the United States." *See* Reg. §§1.482-2(a)(2)(iii)(C), 1.1274-4(b). The proposed regulations implementing the change to the applicable Federal rate safe harbor rate in 1986 explained that the "upper limit of 130% of the AFR approximates the interest yield on bonds with a Moody's rating of BAA." 51 FR at 12028. However, since around 2008, 130% of the AFR has been substantially below its historic linkage with Moody's BAA rating. For example, during the 2010s, it was not uncommon for the upper limit of the applicable Federal rate to be around 24%.
34. As noted above, if the independent credit rating agency did not take the intercompany loan into account for whatever reason, the taxpayer should consider re-evaluating that rating for purposes of pricing its intercompany loans.