The Use of Assignment Agreements for Hedging by Treasury Centers

By Paul J. Kunkel*

In a thoughtful and comprehensive article published in the April 2021 issue of this journal, Justin Weiss and Hubert Raglan discussed the tax aspects of several models of treasury risk management by multinational corporations.[1] As discussed by those authors, the models range from decentralized arrangements in which each entity attempts to manage its own risks by entering into derivatives with unrelated third parties, to centralized arrangements in which one or more "treasury centers," perhaps on a country-by-country, regional, or global basis, act as hedging counterparties for group members, with the treasury center(s) then entering into positions with third parties to manage the aggregate risks assumed from the affiliates. Each model presents its own array of legal, operational, and tax benefits and challenges.

This article will assume a centralized risk management model in which a single domestic treasury center ("Treasury Center") enters into derivatives ("ISDA transactions") under one or more ISDA Master Agreements ("ISDA Agreements," or "ISDAs") with domestic banks in order to manage risks of affiliates (domestic and/or foreign). We assume that the Treasury Center enters into the ISDAs in its own name and does not disclose the internal assignment agreement to its ISDA counterparties; moreover, the Treasury Center typically represents in the ISDAs that it acts as a principal in each transaction and also agrees that it cannot assign or delegate positions without the explicit permission of the counterparty.[2]

For federal income tax purposes, the Treasury Center and its affiliates might take one of two different positions with respect to the tax consequences of the ISDA transactions. Under the first variant, the Treasury Center takes the position that the transactions under the ISDAs are for its own account and the Treasury Center offsets these positions by executing back-to-back trades with its affiliates. Under this model the Treasury Center has tax consequences from both trades.[3]

Under the second variant—the one discussed in this article—the Treasury Center and its affiliates execute one or more internal assignment agreements under which the parties agree that any transaction done under an ISDA is done on behalf of and for the benefit of an affiliate. Consequently, under this interpretation the Treasury Center does not execute third-party transactions for its

PAUL J. KUNKEL is a Director in KPMG Washington National Tax.

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own account that are offset by back-to-back trades with its affiliates; instead, the Treasury Center takes the position based on the assignment agreements that it does not have any items of income, expense, gain or loss with respect to transactions executed under the ISDAs or the assignment agreement(s).[4]

The authorities discussed can provide support in favor of the position that an assignment agreement of the type discussed here, under which the Treasury Center acts as a conduit or a "secret" agent for its affiliates under an undisclosed internal assignment agreement, can be respected for federal income tax purposes even if the tax position taken by the Treasury Center appears to violate representations made to its counterparty with respect to the trades.

Even though the Treasury Center appears to violate the contractual restrictions in the ISDAs stated above, the Treasury Center takes the position that for federal income tax purposes the assignment agreements are valid as between the Treasury Center and its affiliates and thus cause all gain/loss from an ISDA transaction to belong to the affiliate on whose behalf the trade was conducted. In other words, the Treasury Center treats itself for tax purposes as if it were a conduit or an agent for its affiliates in entering into trades under the ISDAs. However, this arrangement is not a standard disclosed agency arrangement but instead amounts to a "secret" agency agreement that remains undisclosed to the ISDA counterparties and, as stated earlier, on its face appears to contradict representations made to these counterparties that the Treasury Center is acting as a principal.[5] This article discusses authorities in favor of the position that such an undisclosed conduit or quasi-agency agreement can be respected for federal income tax purposes.

This article is organized as follows. After setting some assumptions that will generally apply throughout the article, first we discuss the basic tax issues raised by assignment/delegation; second, we discuss authorities in support of the position that a conduit or agency relationship between two parties can be respected with respect to a transaction in which this arrangement is not disclosed to a third party; third, we discuss authorities in support of the position that an undisclosed agency arrangement be respected for federal income tax purposes even if it contradicts representations made in the contract with the third party; finally we briefly discuss whether substance over form authorities could invalidate an undisclosed conduit or agency arrangement.

Unless otherwise stated, the discussion in this article is based on the following assumptions (in addition to any other assumptions stated above):

- The bank counterparty to an ISDA is a domestic branch of a domestic bank.
- The foreign affiliates on whose behalf the Treasury Center enters into ISDA transactions are treated as corporations for U.S. federal income tax purposes that are not engaged in the conduct of a trade or business in the United States.
- Any ISDA transactions treated by the Treasury Center as beneficially owned by a foreign affiliate under an assignment agreement generate non-U.S. source income for the affiliate under the applicable sourcing rules. In particular, no ISDA transaction generates "dividend equivalent payments" subject to Code Sec. 871(m), and no ISDA transaction is a notional principal contract ("NPC") with a nonperiodic payment treated as a deemed loan.[6]
- The bank counterparty is not aware of, and does not have any reason to be aware of, an assignment agreement between the Treasury Center and a foreign affiliate. In particular, no bank counterparty is asked to make payments to, or receive payments from, an account held in the name of a foreign affiliate.[7]

Does the "Assignment of Income" Doctrine Apply?

As an initial matter there is a question of whether under the "assignment of income" doctrine the Treasury Center should be treated as earning any income on the assigned ISDA transactions. Assuming that an assignment agreement has been executed prior to the time of entering into an ISDA transaction, it is uncertain whether the bank

counterparty will be required to make a future payment in settlement of the contract or what the amount of any such payment would be. As a result, the "all events test" of Reg. §1.451-1(a) for the accrual of income will not be satisfied at the time the contract is entered into. In addition, because the only material act necessary to earn a future payment by the bank counterparty is to be the holder or owner of the contract at the time the liability accrues, and the Treasury Center will assign the contract before any such counterparty payment liability accrues, Treasury Center will not perform any act necessary to earn income with respect to the assigned ISDA transaction. Under case law regarding assignment of income earned in respect of performing services, the Treasury Center should not be required to accrue income on the assigned ISDA transactions if it performs no acts necessary to earn such income.[8]

In addition to the above authorities regarding the assignment of income in respect of the future performance of services, there are other authorities supporting the position that the right to future income that has not yet accrued on a financial asset can be sold or assigned for tax purposes.[9] Given that the question is whether the Treasury Center can assign future income from holding a financial contract rather than from performing services, these cases arguably provide even stronger support for the position that the assignment of income doctrine does not apply to the ISDA transactions assigned to the Treasury Center's affiliates.

With regard to delegation of liabilities under the ISDA transactions (*i.e.*, the duty to pay a bank counterparty under an ISDA transaction if it expires in-the-money for the counterparty), an assignment agreement in this context typically states that the assignees assume, "to the extent permitted by applicable law, all liabilities in relation to [the assigned contracts] …." If the Treasury Center were treated as having accrued the liability for a settlement payment prior to the time of delegation, the assignee's payment of this amount to the bank counterparty would be income to Treasury Center.[10] However, the existence and amount of any such future liability is contingent at the time an ISDA transaction is entered into and assigned; hence, it seems likely that under the economic performance rules the Treasury Center would not be treated as having accrued the liability.[11] In addition, the assignees' assumption of the duty to perform should cause the assignees, as between the Treasury Center and the assignees, to become primarily liable under state law to perform, while the Treasury Center remains secondarily liable to the ISDA counterparties as a surety.[12] As a result, it appears that the assignees would properly accrue any payment liability under the assigned ISDA transactions.

"Claim of Right" Authorities Also Support the Position That an Undisclosed Assignment Could Be Respected

In addition to the cases cited and discussed above, "claim of right" authorities also support the position that the Treasury Center should not realize any income or expense with respect to ISDA transactions that are subject to an assignment agreement. These authorities suggest that the Treasury Center has no "claim of right" to any income that will be paid by the banks on the transactions assigned to the affiliates.

For example,[13] in Rev. Rul. 55-234 an employee of a domestic corporation conducted business in his own name as a sole proprietor in Country X but in fact was operating as an undisclosed agent for his employer. The Service held that all income and expense with respect to the transactions negotiated by the sole proprietor was for the tax account of the corporation. Rev. Rul. 55-234 and similar authorities support the position that a taxpayer can act as a conduit or undisclosed agent under an arrangement with another person and not realize income (or expense) with respect to transactions conducted under that arrangement.[14]

Does Restrictive Language in an ISDA Agreement Invalidate the Assignment?

Now we consider what effect, if any, the terms in an ISDA mentioned earlier have on the foregoing analysis at a time when the Treasury Center enters into an ISDA transaction and the contract is subject to an assignment agreement. In particular, can the Treasury Center treat the assignees as having entered into the ISDA transactions directly with the banks when the ISDA states that (1) the Treasury Center is acting as a principal, not an agent, and (2) any attempted transfer of "an interest or obligation" without the written permission of the bank counterparty—which permission has not been obtained—is "void"?

The author is not aware of any tax authorities that specifically address the federal income tax consequences of such contractual restrictions on assignment and delegation.[15] In the absence of any such authority, a taxpayer

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could apply the general principle that local law determines rights and obligations, and then federal tax law determines the tax consequences of such rights and obligations.[16] Consequently, in order to determine the tax consequences of the restrictive ISDA terms, we examine case law in which courts have analyzed the effect under state law of contractual restrictions on transfer of rights or delegation of obligations.

Case law distinguishes between two types of anti-assignment clauses: those in which the clause is a covenant or promise not to assign (an agreed-upon limitation on a party's general right under state law to assign contract rights), and those in which a party appears to waive its power to assign. In the latter case, the anti-assignment clause often contains language such as the statement that any purported assignment is "void" unless the explicit consent of the non-assigning party is obtained in writing.[17] A critical question is whether the "void" language in the ISDA anti-assignment clause means that the purported assignment is not effective as between the Treasury Center and the assignees as a matter of state law. It is important that the assignment be respected under state law because, as stated above, federal income tax consequences follow from the initial determination of state law rights and obligations. If the purported assignment is not effective under state law as between the Treasury Center and its assignees, the Treasury Center is likely to be treated as the tax owner of the transactions executed under the ISDAs.

At least one case suggests that an assignment done in violation of a "void" clause is not valid as between the assignor and assignee,[18] but this case appears to be an outlier; under the majority of cases, the "void" language is interpreted by courts as meaning that the non-assigning party need not recognize the purported assignment[19] (implying that the non-assigning party would have a cause of action against the assignor for nonpayment on the transaction) or that the only party who may complain about the assignment is the non-assigning party.[20] The latter interpretation is consistent with other cases in which courts have held that neither the assignor itself nor a third party can subsequently challenge the validity of an assignment done in violation of a clause limiting the assignor's power to assign.[21] These cases and others[22] support the position that an assignment agreement can be effective under state law as between the Treasury Center and the assignees despite the presence of the anti-assignment clause in the ISDAs and the fact that the bank counterparties have not waived that clause. Consequently, these cases support the position taken by the Treasury Center that for federal income tax purposes the assignment agreements transfer the rights and obligations under the ISDA transactions to the assignees.

Additional support for this position is found by noting that, while the standard anti-assignment clause in an ISDA states that transfer without the written permission of the bank is "void," this clause also states that the transfer restriction applies "to the extent permitted by applicable law," thus acknowledging that the meaning and effect of the restriction is subject to and should be interpreted under applicable state law. In the case of an ISDA governed by New York law, there is case law applying the principles regarding assignment and delegation summarized above. These cases also support the position that an undisclosed assignment agreement between the Treasury Center and its affiliates can be respected for federal income tax purposes.

In *Allhusen v. Caristo Construction Corp.*,[23] the court interpreted language stating that any assignment without written permission "shall be void" to mean that any such attempted assignment is void "as against the obligor;" *i.e.*, the assignee acquires no rights against the obligor unless the obligor consents (explicitly or implicitly) to the assignment, but the assignment is not void as between assignor and assignee under New York state law.[24] A similar conclusion was reached in the case *In re Estate of Campbell*,[25] where the court held that a third party had no right to challenge an assignment done in violation of a non-assignment clause, thus suggesting that assignment was not void as between the assignor and assignee, even if done in violation of anti-assignment clause.

Administrative rulings and case law support the position that, for tax purposes, the Treasury Center and the assignees can agree among themselves who bears the benefits and burdens of purely executory derivatives even if this arrangement is not disclosed to the ISDA counterparties and even if the arrangement is in violation of the Treasury Center's agreements with the banks. Even though the Treasury Center has represented to the ISDA counterparties that it is acting as a principal, these authorities support the position that for tax purposes the Treasury Center can act under an assignment agreement as a conduit for the assignees.

For example, in *N.B. Updike*,[26] the taxpayer was a member of the Chicago Board of Trade ("CBOT") and also the sole shareholder of a corporation engaged in the publishing business (the "Bee Corporation"). Because the Bee Corporation had sustained losses, the taxpayer decided to raise funds for the corporation by trading futures contracts on the CBOT. In order to take advantage of the reduced commissions paid by exchange members, the taxpayer conducted the trades in his own name and through his own account at the exchange. According to the court, the taxpayer:

… adopted a system of records and accounts which would entirely conceal the Bee Corporation in investigations by the Board of Trade. He used his own symbol in making trades and keeping his trading accounts. But he identified the Bee transactions by a further symbol known only within his organization.[27]

The taxpayer reported the profits from these trades on the Bee Corporation's returns, but the Service "found that the transactions were in the name of petitioner, held the profits to be his, and increased [the taxpayer's] net income" by the amount of the profits. The Board of Tax Appeals held that, on the evidence, "the profits were those of the Publishing Company, and should be excluded from the gross income of Petitioner."[28] Thus, even though the taxpayer in *Updike* conducted trades at CBOT in his own name and through his own account, thus representing to CBOT that he was acting as principal, the Board of Tax Appeals respected the fact that, for tax purposes, the income from the trading could be assigned to the taxpayer's wholly-owned corporation through an arrangement that was concealed from the counterparty to the trades (CBOT). The holding in *Updike* provides strong support for the position that, despite the Treasury Center's representation in the ISDA Agreements that it is acting as a principal, the assignment of the ISDA transactions to the assignees can be respected for tax purposes.

Similarly, in *Lashells' Estate* and *J. Shaara*[29] courts held that taxpayers who acted as conduits for kickback payments or payments of bribes or graft had no claim of right to the payments even though the agreement to make the payments was concealed from the payor and might have been unenforceable and perhaps illegal under state law. These cases also support the position that the Treasury Center has no claim of right to income from the assigned ISDA transactions even if the assignment was done in violation of an ISDA anti-assignment clause.[30]

Finally, there are cases and rulings in which courts and the Internal Revenue Service have held that an assignee who receives the economics of a partnership interest should be treated as a partner for federal income tax purposes even if the assignor continues to be recognized as a partner under the terms of the partnership agreement.[31] However, it should be noted that the strength of these cases as analogous authority might be diluted by the fact that specific partnership provisions in the Code supported the conclusion that the assignees should be recognized as partners for tax purposes, whereas there arguably are no such specific provisions in the Code supporting the same conclusion for an assignee of the economics of derivative transactions of the type considered here.

Does the Treasury Center Act Contrary to the "Form" of the ISDA Agreement?

The fact that the Treasury Center, at least between itself and its affiliates, ignores the representation made under its ISDA Agreements that it enters into trades as a principal might suggest that the Treasury Center is ignoring the "form" of its ISDA transactions and is asserting that it follows the "substance" as embodied in the assignment agreement(s). It is not the purpose of this article to present a general discussion of all the variants of the substance over form doctrine or the various standards of proof that a court would require a taxpayer to meet in order to successfully disregard the form of a transaction; these topics have been treated exhaustively by other authors. Instead, we are concerned only with how the doctrine might apply to the specific facts assumed here.

First note that if, as we assume is the case, the Treasury Center and its affiliates adopt the same tax characterization of an ISDA transaction (*e.g.*, forward, option, NPC) that is adopted by the counterparty, all of the counterparty, the assignor, and the assignee arguably are following the "form" of the transaction.[32] Even if all three parties adopt the same tax characterization of an ISDA transaction, the Treasury Center's tax treatment nevertheless could deviate from the form followed by the ISDA counterparty if the identity of the beneficial owner of the transaction for tax purposes is properly treated as part of the "form." Assuming this is the case, we then ask if there are authorities supporting the position that the Treasury Center has the ability to ignore its formal presence as party to the ISDA transactions and to treat its affiliates as the beneficial owners of the ISDA transactions under the assignment agreement.

A major purpose of the substance over form doctrine in restricting the ability of a taxpayer to disavow the form of a transaction is to prevent the possible whipsaw that the government might suffer if the taxpayer disavows the form but another party to the transaction adheres to the form for tax purposes.[33] But if the Treasury Center and its ISDA counterparties agree on the tax characterization of transactions done under the ISDAs, what kind of tax whipsaw might the government be subject to if the affiliates are treated as the beneficial owners of the ISDA transactions? One possible source of whipsaw could be inconsistent application of the Chapter 3 withholding rules in Code Sec. 1441 for "fixed or determinable annual or periodical" ("FDAP") income or the Chapter 4 ("FATCA") withholding rules in Code Secs. 1471–1474

if the bank counterparty treats the Treasury Center as the beneficial owner of an ISDA transaction but the Treasury Center treats a foreign affiliate as the beneficial owner. However, as discussed below the circumstances considered here appear to present little risk of withholding whipsaw.

Under the FDAP withholding regulations a payment on an ISDA transaction made by the counterparty to the Treasury Center generally should not be subject to withholding on FDAP payments or backup withholding if the Treasury Center provides a valid Form W-9 to the counterparty. The Form W-9 affirms the status of the Treasury Center as a domestic "payee or beneficial owner" with respect to the payment.[34] Thus, the Form W-9 is not necessarily an affirmation that the Treasury Center is the beneficial owner of any payment received on an ISDA transaction. Assuming that the Treasury Center treats itself as a payee and not as a beneficial owner, the Treasury Center itself becomes a withholding agent with respect to any portion of the receipt transferred to an affiliate that is the beneficial owner under the assignment agreement.[35] Assuming that the Treasury Center itself has valid Forms W-8BEN-E from its foreign assignees, the Treasury Center should not be required to withhold under the FDAP withholding rules on any receipts on the ISDA transactions that it forwards to foreign accounts under the assignment agreement because, under the assumptions stated earlier, the receipts are treated as non-U.S. source income to the foreign assignees. The same withholding result—*i.e.*, no Chapter 3 withholding—would result if a foreign assignee had entered into an ISDA Agreement directly with the bank counterparty and had provided a Form W-8BEN-E to the bank counterparty. Consequently, even if the ISDA counterparty does not treat the foreign affiliate as the beneficial owner because it acts according to "form" and treats the Treasury Center who provided the form as the payee of a payment, the correct withholding result should be reached even if the Treasury Center acts according to "substance" and treats itself as an agent or intermediary.[36]

Under Code Sec. 1471(a), FATCA withholding applies to "withholdable payments" made to a "foreign financial institution" that does not comply with the documentation and reporting requirements imposed by Code Sec. 1471(b). Code Sec. 1472(a) similarly imposes withholding on withholdable payments made to certain "non-financial foreign entities." The definition of withholdable payment in Code Sec. 1473(1)(A)(i) generally requires that the payment be from sources in the United States (but excludes effectively connected income); for this purpose, Reg. §1.1473-1(a)(2)(i)(B) states that the sourcing rules of Code Secs. 861 through 865 and other relevant provisions of the Code apply.[37] Like FDAP withholding, then, FATCA withholding does not apply with respect to non-U.S. source income of foreign persons. If a foreign assignee had entered into an ISDA Agreement directly with a bank counterparty, and the counterparty had received the appropriate documentation with regard to a foreign account owned by the assignee to which any payments on ISDA transactions are to be made, no FATCA withholding would be required because the payments would be non-U.S. source income and the bank counterparty could associate them with the proper account documentation. The same result—no FATCA withholding—should be reached if an ISDA transaction and the assignment of that transaction are treated as back-to-back transactions for tax purposes and the appropriate withholding documentation exists at each stage.

Based on the above, it seems that there is little risk of the government being whipsawed with respect to withholding by inconsistent tax positions taken by the ISDA counterparties and the Treasury Center if the assignment agreements with the Treasury Center's affiliates are respected for tax purposes. Arguably, then, there is no reason to subject the combination of the ISDAs and the assignment agreement(s) to scrutiny under the substance over form doctrine. However, if for the sake of argument the substance over form doctrine is applied because the Treasury Center is taking a tax position contrary to its ISDA representations, the Treasury Center appears to have a strong argument that it can invoke the "step transaction" doctrine and have the assignment agreement(s) determine the substance of the ISDA transactions for federal income tax purposes.[38]

Under the step transaction doctrine, a court will ignore one or more formal steps in a sequence of related transactions if under the facts and circumstances of the case the court determines that those steps should not be given independent significance for federal income tax purposes. Typically, the government involves the doctrine by asserting that the challenged step(s) should not be respected as having independent significance for tax purposes. However, courts have affirmed that taxpayers have the ability to assert that a formal step in the taxpayer's own transaction can be ignored for tax purposes if giving the step-independent significance would be inconsistent with the substance of the overall transaction (as determined under the particular facts and circumstances of the case).[39]

There are three general tests that a court might apply to the steps in a transaction in order to determine whether a step should be ignored for tax purposes: the "end result" test; the "mutual interdependence" test; and the "binding commitment" test.[40] The strongest version of the step transaction doctrine—the binding commitment

test—appears to be applicable in the circumstances considered here assuming that the assignment agreement is a legally binding contract between the Treasury Center and its affiliates; hence, the representations made by the Treasury Center in the ISDAs can be ignored for tax purposes and—at least as between the Treasury Center and its assignees—the derivatives thus can be treated as occurring directly between the bank and the assignees.[41] Finally note that the step transaction treatment is consistent with the W-9 representation that the Treasury Center is not a beneficial owner of a receipt from an ISDA counterparty but instead is a "payee" who becomes a withholding "agent" for purposes of transferring the receipt under an assignment agreement. Thus, the mechanics and logic of the withholding regulations are consistent with the position that the Treasury Center can follow the "substance" of the transactions as defined by the assignment agreement(s).

Conclusion

The authorities discussed can provide support in favor of the position that an assignment agreement of the type discussed here, under which the Treasury Center acts as a conduit or a "secret" agent for its affiliates under an undisclosed internal assignment agreement, can be respected for federal income tax purposes even if the tax position taken by the Treasury Center appears to violate representations made to its counterparty with respect to the trades.

ENDNOTES

* The author thanks Justin Weiss and Laurie Hatten-Boyd for their comments and criticisms. Any mistakes in this article should be attributed to the author alone. Unless stated otherwise, all references in this article to the "Code" and "Code Sec." are to the Internal Revenue Code of 1986, as amended.

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[1] The Modern Treasury Risk Management Function: An Overview of Certain Key Tax Considerations. In footnote 51 of their article Weiss and Raglan acknowledge an earlier article on similar topics; *see* Humphrey and Glenn, *Global Risk Management: Hedge Center Tax Considerations*, 1 JOTFP 24 (2000).

[2] Often such representations do not state that they are being made for tax purposes, although in some cases the counterparty may require the Treasury Center to provide a substitute W-9 in which the counterparty asks for a representation that the Treasury Center is acting as a principal for tax purposes. The reader should note that the author is not advocating that a taxpayer should act in violation of representations to third parties that it is acting as a principal, whether such a representation is made generally or is made specifically for tax purposes; the purpose of this article is merely to cite and discuss authorities that could support a taxpayer's position that an assignment agreement should be respected for federal income tax purposes if the taxpayer appears to act in violation of such a representation.

[3] Weiss and Raglan mention the risk that, under this arrangement, the Treasury Center could become a dealer in securities for purposes of Code Sec. 475 if it regularly enters into derivatives with its foreign affiliates (specific mention in Reg. §1.475(c)-1(a)(3)(i) of foreign affiliates as potential "customers" for Code Sec. 475 purposes).

[4] We leave aside question of whether the Treasury Center should earn a fee under Code Sec. 482 for the service of acting as a conduit or intermediary on behalf of its affiliates with respect to their hedging transactions.

[5] The typical disclosed agency arrangement is discussed in cases such as *J.C. Bollinger*, SCt, 88-1 USTC ¶9233, 485 US 340, 108 SCt 1173 and *Nat'l Carbide Corp.*, SCt, 49-1 USTC ¶9223, 336 US 422, 69 SCt 726.

[6] Payments on options, forwards, and futures treated as beneficially owned by the foreign affiliates under the assumptions here should be treated as non-U.S. source payments under Code Sec. 865(a)(2) and Reg. §1.1441-2(b)(2)(i) (derivatives other than NPCs); under the assumption that no NPC creates a deemed loan, receipts with respect to NPCs should be treated as non-U.S. source under Reg. §1.863-7(b)(1). With respect to any ISDA transactions that are Code Sec. 988 transactions, under Code Sec. 988(a)(3) and Regs. §§1.988-2(d), 1.988-2(e), and 1.988-4 any gain/loss on an ISDA transaction for which the gain/loss is FX gain/loss that is not effectively connected with the conduct of a U.S. trade or business is treated as sourced to the "residence" of the foreign affiliate. The special rules in Reg. §1.988-3 for allocating and apportioning FX gain or loss treated as interest are assumed to not apply to the type of transactions considered here; in addition, Reg. §1.988-4(g) states that any FX gain/loss required to be allocated in the same manner as interest under Reg. §1.861-9T does not affect the source of the payment for purposes of Code Secs. 871(a), 881, 1441, 1442 and 6049.

[7] If the bank had such knowledge, it probably would have the right under the ISDA to void the contract with the Treasury Center; alternatively, the bank might agree to novate the ISDA by accepting the assignee as the party to the ISDA but for credit reasons might require the Treasury Center to act as a guarantor. The consequences of these possibilities are not discussed in this article.

[8] *See, e.g.*, *Nat. Harrison Assoc., Inc.*, 42 TC 601, Dec. 26,858 (1964); *Iowa Bridge Co.*, CA-8, 2 USTC ¶479, 39 F2d 777 (1930); *J.A. Paxson*, CA-3, 44-2 USTC ¶9457, 144 F2d 772.

[9] *See, e.g.*, *Estate of Stranahan*, CA-6, 73-1 USTC ¶9203, 472 F2d 867; *F. Fox*, CA-8, 37 BTA 271, Dec. 9942 (1930).

[10] *Old Colony Trust*, SCt, 1 USTC ¶408, 279 US 716, 49 SCt 499 (1929).

[11] Reg. §1.461-4(j) reserves on defining economic performance for contingent liabilities. However, the case law discussed here suggests that, because income should be taxed to the party who performs the acts necessary to earn the income, a valid assignment of the right to income from the ISDA transactions should be accompanied by a valid delegation of the contingent liability to pay the bank counterparties. Separation of the income from the deductions on the assigned ISDA transactions arguably would not clearly reflect income.

[12] *See, e.g.*, *Noblett v. General Electric Capital Corporation*, CA-10, 400 F2d 442 (1968).

[13] Rev. Rul. 55-234, 1955-1 CB 217.

[14] *See also, e.g.*, *Ross Glove Co.*, 60 TC 569, Dec. 32,053 (1973); *Dixie Grain*, 5 TCM (CCH) 887, Dec. 15,443(M) (1942); *Savannah Ship Chandlery & Supply Co*, 13 BTA 958, Dec. 4456 (1928); *Illinois*

Smelting and Refining Co., 16 BTA 1410, Dec. 5341 (1929); *B. McCloskey*, CA-5, 35-1 USTC ¶9242, 76 F2d 373; and the authorities cited in LTR 201323006.

[15] *Compare Liberty Life Assurance Co. et al. v. Stone Street Capital, Inc.*, DC-MD, 93 FSupp2d 630 (2000) (discussing the possible effect of a prohibited assignment of payments from a structured settlement agreement on the status of the agreement for purposes of Code Sec. 104(a)(2) and Code Sec. 130(c)(2)(D), but not generally). A similar issue could be present in a setting where two financial instruments (*e.g.*, one instrument is a loan in form and the other some kind of equity investment) are "stapled" together with a transfer restriction stating that a transfer of one instrument without the other is "void." Such a stapled instrument was at issue in *Universal Castings Corp.*, 37 TC 107, Dec. 25,101 (1961). In this case, the court treated the two instruments as a single unit for tax purposes due to the transfer restriction created by the stapling. The court, however, does not consider how its conclusions would be affected if one of the parties had in fact attempted to transfer one portion of the investment without the other.

[16] *See, e.g., R. Aquilino*, SCt, 60-2 USTC ¶9538, 363 US 509, 512–513, 80 SCt 1277.

[17] *See, e.g., Bel-Ray Company, Inc. v. Chemrite (Pty) Ltd.*, CA-3, 181 F3d 435 (1999), and *Garden State Buildings L.P. v. First Fidelity Bank, N.A.*, 702 A2d 1315 (N.J. Super. Ct. App. Div. 1997), for a discussion of anti-assignment clauses that limit the "right" to assign and those which limit the "power" to assign.

[18] *Short v. Singer Asset Finance Company, LLC*, CA-9, 107 Fed. Appx. 738 (2004). Arguably this case carries minimal authority because it is an unpublished decision and has minimal relevance because the anti-assignment clause at issue was present for the benefit of the assignor, not the non-assigning party.

[19] *See, e.g., Bel-Ray*, *supra* note 17, at 442; *Fox-Greenwald Sheet Metal Co., Inc. v. Markowitz Bros, Inc.*, DC-DC, 28 A.F.T.R. 2d 71-5860 (1971).

[20] *See, e.g., Midwest Sheet Metal Works v. Frank Sullivan Co.*, DC-MN, 215 FSupp 607, 609–610 (1963), *aff'd*, CA-8, 335 F2d 33 (1964).

[21] *In re Kaufman*, DC-OK, 37 P3d 845 (2001) (assignor cannot challenge its own assignment); *Midwest Sheet Metal Works*, *supra* note 20 (same); *Johnson v. Structured Asset Servs., LLC*, 148 S.W.3d 711 (Tex. App., 2004) (same); *In re Campbell's Estate*, 299 N.Y.S. 442, 447 (N.Y. Sur. 1937) (creditor of assignor could not object to assignment because it was not in privity with the non-assigning party).

[22] *See, e.g.*, *Paul v. Chromalytics Corp.*, 343 A.2d 622 (Del. Super. 1975).

[23] *Allhusen v. Caristo Construction Corp.*, 103 N.E.2d 891, 303 N.Y. 446 (Ct. of App. 1952).

[24] As noted, *Short v. Singer Asset Finance Company, LLC*, cited in note 18, *supra*, holds to the contrary, but *Short* was decided under Colorado law. For this and the other reasons discussed earlier, *Short* should not be controlling (or even persuasive) in the analysis of any restrictions on transfer in an ISDA Agreement.

[25] *In re Estate of Campbell*, 299 N.Y.S. 442 (N.Y. Sur. 1937).

[26] *N.B. Updike*, 22 BTA 12, Dec. 6675, acq., 1931-2 CB 72.

[27] *Id*.

[28] *Id*. As noted, the Service later acquiesced in the decision.

[29] *Lashells' Estate*, CA-6, 54-1 USTC ¶9102, 208 F2d 430 (1953); *J. Shaara*, 40 TCM 643, Dec. 37,062(M), TC Memo. 1980-247.

[30] The assignment of positions in derivatives by the Treasury Center under its internal agreement(s) with its affiliates raises the question of whether such activity, in and of itself, could result in the Treasury Center being treated as a dealer in securities within the meaning of Code Sec. 475. We do not discuss this issue here.

[31] *See, e.g., D.L. Evans*, 54 TC 40, Dec. 29,915 (1970), *aff'd*, CA-7, 71-2 USTC ¶9597, 447 F2d 547; *E.W. Abrams*, 20 TCM 1501, Dec. 25,082(M), TC Memo. 1961-287.

[32] Assignment of FX forwards that, if held for tax purposes by the Treasury Center, would be treated as "foreign currency contracts" under Code Sec. 1256(g)(2)(A) raises the question of whether such contracts are properly treated as Code Sec. 1256 contracts if they are assigned. The legislative history to the inclusion of foreign currency contracts as Code Sec. 1256 contracts in the 1982 Technical Corrections Act states that at least one party to the contract must be a bank or other participant in the "interbank market." The author is not aware of any authority on the question of what effect, if any, an undisclosed assignment of a non-bank party's position in a foreign currency contract has on the status of the contract as a Code Sec. 1256 contract. From the perspective of the bank the contract "in form" looks like a foreign currency contract even if assigned but, from the perspective of the assignee, the contract does not appear to be a contract with the bank because, in the absence of a novation agreed to by the bank, the bank continues to treat the assignor as having all rights and obligations under the contract whereas the assignee has no rights against the bank under state law (even if the assignee is properly treated as the tax owner of the contract).

[33] *See, e.g., Comdisco*, CA-7, 85-1 USTC ¶9245, 756 F2d 569, 577–578; *Estate of Durkin*, 99 TC 561, Dec. 48,644 (1992), citing *Comdisco* at 577.

[34] Under Reg. §31.3406(h)-3 and Reg. §1.1441-7(b), the counterparties can rely on the representations made by the Treasury Center in the W-9 and in the ISDAs that the payments are being made to "a payee or beneficial owner" who is a U.S. person. Reg. §1.1441-1(b)(2)(i) defines a payee to be the person to whom a payment is made, regardless of whether such person is the beneficial owner of the amount as defined in Reg. §1.1441-1(c)(6). Reg. §1.1441-1(c)(6) defines (in a somewhat circular manner) the beneficial owner of a payment to mean the person who is the owner of the payment for tax purposes and who beneficially owns that income. A person shall be treated as the owner of the income to the extent that it is required under U.S. tax principles to include the amount paid in gross income under Code Sec. 61 (determined without regard to an exclusion or exemption from gross income under the Code). The regulation also states that a person receiving income in a capacity as a nominee, agent, or custodian for another person is not the beneficial owner of the income.

[35] Reg. §1.1441-7(a) generally defines a withholding agent for purposes of Chapter 3 of the Code and the applicable regulations to mean a person who has "control, receipt, custody, disposal or payment of an item of income of a foreign person subject to withholding …."

[36] Reg. §§1.1441-1(b)(2)(ii) and 1.1471-3(a)(3)(iii) provide that if a withholding agent makes a payment to a U.S. agent of a foreign person, it must treat the payment as made to the foreign person unless the U.S. agent is a financial institution and the withholding agent does not know or have reason to know the U.S. person will not withhold and report as required.

[37] Code Sec. 1473(1)(A)(ii) states that withholdable payments include gross proceeds from the sale or other disposition of "any property of a type which can produce interest or dividends from sources within the United States;" this provision should not apply to the ISDA transactions under consideration here.

[38] We do not address the general question of the standard of proof that a taxpayer must meet in order to challenge the form of its own transaction; as is well-known, this standard of proof varies among the federal circuits.

[39] *See, e.g., S. Bay Corp.*, CA-2, 65-1 USTC ¶9433, 345 F2d 698, 703; *McDonald's Restaurants of Ill., Inc.*, 82-2 USTC ¶9581, 688 F2d 520; *MAS One LP*, DC-OH, 271 FSupp2d 1061 (2003), *aff'd*, CA-6, 2004-2 USTC ¶50,413, 390 F3d 427.

[40] *See, e.g., J.D. True*, CA-10, 99-2 USTC ¶50,872, 190 F3d 1165, 1174–1175.

[41] In *I. Gordon*, SCt, 68-1 USTC ¶9383, 391 US 83, 88 SCt 1517, the Court affirmed the taxpayer's invocation of the step transaction doctrine when there was a binding commitment to execute the later step in the overall transaction. Arguably the Treasury Center also could apply the end result version of the step transaction doctrine to an ISDA transaction if the Treasury Center would not have entered into the ISDA transaction but for the assignment to a foreign affiliate when the affiliate requires a hedge.

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