



Pat Smith Quoted in Tax Notes on Third Circuit Opinion in *SIH Partners*, Rejecting Challenge to Regulations on Loan Guarantees Under Section 956.

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IPB attorney Pat Smith was quoted in an article in *Tax Notes* on the Third Circuit's opinion in *SIH Partners*, rejecting the taxpayer's challenge, under the Administrative Procedure Act's arbitrary and capricious standard, to the validity of a regulation under section 956 that treats all guarantees by CFCs of loans to their U.S. shareholders as investments in U.S. property giving rise to income inclusions for the U.S. shareholders under section 956. *Hindsight Won't Save SIH's Attempt to Annul Guarantee Regs.*

Patrick J. Smith of Ivins, Phillips & Barker Chtd. was not surprised by the taxpayer's loss in *SIH*. He was, however, somewhat taken aback that the court relied so heavily on the hindsight rationale, especially since the argument was not raised by the IRS.

Although the taxpayer's argument that multiple guarantors could result in an inclusion greater than the loan itself is a strong one, it does not apply to the taxpayer's facts, Smith said. He said he expected the opinion to rely on this differentiating factor instead.

Smith added that while a standard principle of administrative law is a reg can only be challenged on grounds brought to the attention of the agency during promulgation, arguably "the double counting flaw should have been so obvious that the agency should have thought of it on its own." He said that the arbitrary and capricious standard laid out in *Motor Vehicle Mfrs. Assn. of United States Inc. v. State Farm Mut. Automobile Ins.*

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Co., 463 U.S. 29 (1983), could be applied under such circumstances.

"The fact that this regulation was so old and nobody had ever challenged it before that clearly was a factor here," Smith said. "I expected the taxpayer to lose, but I would have liked to have seen a more nuanced opinion."