

Loans Aren't Securities

On May 22, in *Kirschner v. JPMorgan Chase Bank, N.A.*, the SDNY applied the “family resemblance test” articulated by the Supreme Court in *Reves v. Ernst & Young* to conclude that syndicated loans were not securities for securities law purposes. (For a detailed discussion, see our [Clients & Friends memo](#).) This decision helps shed light on the tax law applicable to foreigners that invest in primary market debt.

The IRS asserts that regularly making loans to the public (either directly or through an agent or partnership) is a U.S. trade or business that can subject a foreigner to U.S. tax. By contrast, the tax code provides that purchasing and selling “securities” on the secondary market is not a U.S. trade or business (the securities trading safe harbor), and the tax regulations define securities to include any “evidence of indebtedness.”

At first blush, it is hard to square the IRS’ position on loans with the broad definition of security. However, the tax definition of securities for this purpose is substantially similar to the corresponding definition under the Securities Act of 1933. Notes evidencing loans by commercial banks for current operations are not securities under the 1933 Act, because the Act was designed to protect investors that invest in securities, and not to protect banks and other institutional investors that make loans. Since the 1933 Act and the securities trading safe harbor use similar language to define securities, and the 1933 Act definition excludes loans, it would be reasonable to assume that securities within the meaning of the 1933 Act are also securities within the meaning of the securities trading safe harbor.

On the basis of this analysis, a number of arrangers have structured investments to look more like securities than loans under the *Reves* family resemblance test, so that foreign funds and other foreign investors could conclude that the investments did not give rise to a U.S. trade or business for them. By reaffirming that syndicated loans are not securities, *Kirschner* preserves the viability of using the securities law definition of securities to make sense of the IRS’ position on U.S. trade or business.