TAX ISSUES RAISED BY LNG PROJECTS

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ABSTRACT

This paper discusses tax issues that may be encountered by a company investing in an LNG project. 1. Income Taxes A seller's income from a sale of LNG pursuant to an SPA may be subject to income tax. Income may be attributed to the receiving jurisdiction because of the passage of title or risk of loss with respect to the LNG in that jurisdiction. The seller's LNG sales income may be attributed to a jurisdiction by reason of its having a permanent establishment in that jurisdiction. The applicability of income tax in the jurisdiction where an LNG liquefaction or regasification facility is located might depend on how the contractual arrangements with customers are structured. Different income tax consequences might result depending upon whether the operations are structured as tolling services, purchase and sale of LNG/natural gas, or sale of plant capacity, and whether the investment is characterized as equity or debt. The seller of the LNG may be subject to tax on transportation income when the seller is obligated to deliver the LNG to the buyer subsequent to the passage of title. 2. Non-Income Taxes. These might include ad valorem taxes imposed on the LNG or LNG tankers and transfer taxes imposed on the purchase and sale of the LNG. 3. LNG SPA Tax Clauses. The tax clause in an LNG SPA will need to provide for the allocation between the purchaser and the seller of tax liabilities related to the sale of the LNG and the LNG itself.

I. INTRODUCTION

One of the objectives of any company that makes an investment in an LNG project will be to minimize the amount of taxes that are imposed in connection with the project. This paper discusses certain tax issues that may be encountered by a sponsor of an LNG project. This paper is organized as follows:

- Section II provides an overview of the principal types of taxes that are generally relevant to an LNG project and describes the circumstances that could give rise to those taxes.
- Section III provides an overview of certain U.S. federal income tax principles that are relevant to projects for the import or export of LNG to or from the United States and discusses some common techniques to minimize the U.S. taxation of income from the LNG project.

II. APPLICABLE TAXES IN AN LNG PROJECT

The sponsor of an LNG project will need to identify the types of taxes that will or could apply to the project. The extent to which certain taxes are applicable will depend on the contractual arrangements between the parties to the project and the tax laws of the jurisdictions in which activities relating to the LNG project are performed.

a. Income or Profit Taxes

A sponsor could be subject to income or profit taxes in one or more jurisdictions as a result of (a) sales of LNG, (b) the performance of liquefaction, regasification, LNG storage, or gas storage, (c) the transportation of LNG, or (d) the receipt of distributions on the sponsor's equity investment or payments of interest on loans to the project entity. Income taxes may not represent a substantial additional cost to a foreign sponsor if the sponsor's home country income tax law provides that double taxation of a taxpayer's foreign source income is avoided through a foreign tax credit regime (which permits the taxpayer to claim a credit for foreign taxes paid on foreign source income against home country taxes imposed on such income) rather than a regime that exempts foreign source income from home country taxation. However, even if the sponsor's home country has a foreign tax credit regime, a foreign sponsor may not have the practical ability to benefit from a foreign tax credit. For example, a foreign tax credit is not as valuable to a sponsor that (a) is a tax resident of
a jurisdiction where tax rates are generally lower than the rates applied to the LNG project, (b) has a large
tax loss carryforward in its home country, (c) does not plan to distribute currently the earnings from the
project back to its home country, or (d) is a foreign governmental entity that does not pay taxes in its home
country.

i. Taxation of Income from LNG Sales

A seller's income from sales of LNG pursuant to a Sale and Purchase Agreement ("SPA") may be subject to
income or profits tax in the country in which the receiving terminal is located. The applicability of such taxes
will depend on both the domestic laws of the receiving jurisdiction and the ability of the seller to utilize any
tax treaties to which the receiving jurisdiction is a party.

The tax laws of the receiving jurisdiction may provide that income from an LNG sale is attributable to, and
thus potentially subject to tax in, the receiving jurisdiction because of the passage of title or risk of loss with
respect to the LNG in that jurisdiction (including its territorial waters). In this regard, it may be difficult to
determine from the terms of the SPA precisely where the risk of loss with respect to an LNG cargo passes
from the seller to the purchaser.

The seller's income from LNG sales may also be attributed to the receiving jurisdiction by reason of the seller
having a taxable presence in the receiving jurisdiction under the domestic tax law of that jurisdiction or, if a
tax treaty applies, maintaining a permanent establishment ("PE") in the receiving jurisdiction within the
meaning of such tax treaty. In this regard, potential causes of a PE include the following:

- maintaining an office or other fixed place of business within the receiving jurisdiction through
  which business activities are carried on;
- negotiating the terms of an SPA at one or more locations within the receiving jurisdiction;
- the presence in the receiving jurisdiction of employees who perform marketing functions with
  respect to the LNG; and
- arranging for shipping or scheduling or performing other significant services in the receiving
  jurisdiction that are necessary for the consummation of LNG sales.

These activities may give rise to a PE in the receiving jurisdiction if performed directly by the seller or the
seller's employees\(^1\) or by a dependent agent of the seller that has, and habitually exercises, in that
jurisdiction the authority to conclude contracts in the name of the seller. For this purpose, the "authority to
conclude contracts" is not the mere physical act of signing a contract but rather is the act of authorizing the
terms of contracts that are binding on the seller. The activities of an independent agent acting in the ordinary
course of its business generally do not give rise to a PE under most tax treaties, although they may cause
the seller to have a taxable presence in the receiving jurisdiction if there is no applicable tax treaty.

ii. Taxation of Income from Liquefaction or Regasification Operations

The applicability of income taxes in the jurisdiction in which the liquefaction or regasification facility is located
could vary depending on how the contractual arrangements between the sponsors and gas producers and/or
offtakers are structured. Different jurisdictions may characterize income from the liquefaction or regasification
operations differently, and accordingly different income tax consequences may apply, depending on whether
the operations are structured as (a) the provision of tolling services, (b) purchases and sales of natural gas
or LNG, or (c) sales of plant capacity. Different income tax consequences may also apply to a return of the
sponsor’s investment depending on whether such investment is characterized as debt or equity under local
tax law.

\(^1\) References in this paper to activities performed by a sponsor of an LNG project or a seller of LNG
also include activities performed by the employees of the sponsor or seller.
iii. Taxation of Income from Transportation of LNG

A seller of LNG may be subject to tax on income attributable to the transportation of LNG in a situation where the seller is obligated to deliver the LNG to the purchaser subsequent to the passage of title. Such a situation would arise, for example, in a delivery at place sale of LNG where the SPA provides that title passes to the purchaser on the high seas. However, exemptions from taxes on transportation income may be available under the domestic tax law of the receiving jurisdiction, a tax treaty, or another international agreement such as a bilateral shipping agreement.

iv. Withholding Taxes

The payment of interest to a foreign lender pursuant to a financing agreement to fund the construction of a liquefaction or regasification facility may be subject to withholding tax in the jurisdiction in which the facility is located. In addition, bareboat or time charter hire received by a seller of LNG may be subject to withholding taxes, depending on the terms of the charter agreements. However, exemptions from, or reductions in the rate of, these withholding taxes may be available under an applicable tax treaty.

b. VAT

Value added tax ("VAT") will be imposed in many jurisdictions as a percentage of the price paid for certain goods and services and a percentage of the value of imported goods and services. VAT may represent a significant cost in the start-up phase of a project because it may be imposed on amounts payable to the engineering, procurement, and construction contractor and the cost of materials used in the construction of the project.

In many jurisdictions, the cost of "input" VAT paid by the recipient or importer of the goods or services may be recoverable out of "output" VAT, which is collected by the recipient or importer from persons to which it sells LNG or natural gas from the project. Many countries provide that unrecovered VAT will be refunded to the taxpayer after some period of time. However, many developing countries will not refund VAT (or will take a long time to pay refunds and will usually do so without interest).

The tax law in some jurisdictions provides that certain sales of production are "exempt" from output VAT. This exemption is generally disadvantageous to sellers of LNG or natural gas because it does not include a mechanism for the seller to recover input VAT that it has already paid. However, the tax laws in many countries provide for a VAT "exemption with credit" for export sales, meaning that VAT will not be charged to the sponsors by their subcontractors and suppliers. If the host country does not provide for a VAT exemption with credit, then the sponsors will want to negotiate for an exemption with credit for the LNG project.

Countries that do not impose a VAT, such as the United States, typically impose sales tax as a percentage of the price paid for certain goods and services. Unlike VAT, which must be collected by each person in the chain of production that adds value to the product, sales tax is generally collected only by the seller from the purchaser at the point of sale.

c. Customs Duties

Customs duties may be imposed by the jurisdiction in which the liquefaction or regasification facility is located on the import of equipment, materials, or supplies used in the construction of the project. The amount of such duties is generally a percentage of the value of the imported goods. Like VAT, customs duties may represent a substantial cost in the start-up phase of a project. Customs duties are not recoverable, but some jurisdictions provide an exemption for goods that are only temporarily located in the jurisdiction (e.g., equipment that is imported solely for the purpose of constructing the liquefaction or regasification facility). Customs duties may also be imposed on the export of LNG, based on a percentage of the value of the LNG.
d. Property Taxes

Property taxes may be imposed by particular jurisdictions as a percentage of the value of any real or personal property situated within the jurisdiction on a certain testing date (e.g., December 31 of each year). Because property taxes are applied in a mechanical way, there may be opportunities to minimize the amount of property taxes that are imposed on a project, particularly in the case of a mobile asset such as LNG and LNG tankers.

e. Taxes on Subcontractors and Employees

Subcontractors may be subject to all or some of the above mentioned taxes in connection with their involvement with a project. In addition, employees of the sponsors and subcontractors may be subject to income tax and social security or social insurance contributions in the country in which they perform services. However, exemptions from these latter taxes may be available under domestic tax law, a tax treaty, or another international agreement such as a bilateral social security agreement.

f. Port Charges

Port charges may be imposed when a vessel uses a port for purposes of loading or unloading cargoes. These charges typically apply based on the quantity of LNG that is loaded or unloaded at the port.

III. U.S. TAX STRUCTURING CONSIDERATIONS

Many LNG projects are structured for the purpose of importing or (more recently due to the increase in U.S. shale gas production) exporting LNG to or from the United States. As a consequence, it is important for sponsors of such projects to consider (a) the U.S. federal income tax principles that are relevant to such projects and (b) techniques for minimizing the amount of U.S. taxes that are imposed on the project.

a. Structuring Considerations for a U.S. Sponsor of a Foreign Joint Venture

i. Project Entity

The structure of the sponsors' ownership of the liquefaction or regasification facility can have an impact on their tax liabilities, both in the jurisdiction in which the facility is located and in their home countries. Many jurisdictions will require the sponsors to form a separate entity to own the facility, which entity will be the taxpayer under local law. Some jurisdictions require the project entity to be organized under local law, whereas other jurisdictions permit the entity to be organized under foreign law. If the sponsors are not required to form a separate entity, then they may choose to own the facility through an unincorporated joint venture, in which case each of the sponsors may be viewed as taxpayers under local law.

Generally, a U.S. resident sponsor of a joint venture to develop an LNG project outside the United States will want the project entity to be treated as a "flow-through" entity (namely, a partnership) for U.S. federal income tax purposes. In this regard, any non-U.S. entity that is not on the U.S. "per se corporation" list may make a "check-the-box" election with the U.S. Internal Revenue Service (the "IRS") to be treated as a partnership for U.S. federal income tax purposes. An unincorporated joint venture will generally be treated as a partnership for U.S. federal income tax purposes. The benefit of using a flow-through entity is that it preserves the U.S. investor's ability to utilize a "deferral structure" for its investment in the project. Under a deferral structure, the U.S. sponsor would hold its investment in the project entity (or unincorporated joint venture) through a non-U.S. holding company that is treated as a controlled foreign corporation ("CFC") for U.S. tax purposes. Provided that the holding company can reinvest the profits of the project outside the United States, it may be possible to defer U.S. federal income tax on such profits until they are distributed to the U.S. sponsor, subject to the application of the U.S. anti-deferral rules, discussed below.
ii. Intermediate Holding Company

A sponsor may be able to reduce taxes in the jurisdiction in which the liquefaction or regasification facility is located by interposing a holding company between the sponsor and the facility. If the holding company is formed in a jurisdiction that has entered into a tax treaty with the local country, then it may be possible to utilize the treaty to reduce local country dividend withholding taxes on distributed profits. Another potential benefit of a holding company is the ability to utilize "earnings stripping" techniques, which generally involve deductible payments (e.g., interest) being made by the project entity to a holding company organized in a jurisdiction where it is subject to tax on such payments at a lower rate.

b. U.S. Taxation of a Non-U.S. Seller of LNG

Generally, a foreign person will be subject to U.S. tax at the rates that apply to U.S. persons (which, in the case of a foreign corporation, is generally 35%) on such person's net sales income only if each of three requirements is satisfied: (a) the foreign person is engaged in a U.S. trade or business; (b) the sales income is U.S. source; and (c) the sales income is effectively connected with the U.S. trade or business ("ECI"). In addition, a foreign person that is treated as a corporation for U.S. tax purposes is subject to the "branch-profits" tax at a rate of 30% (or a lower rate under an applicable tax treaty) on its after-tax earnings that are considered to be withdrawn from investment in the United States. Thus, a foreign corporation could be subject to U.S. federal income tax at an effective rate of up to 54.5% (35% + (30% X (1 - 35%)) on its profits from an LNG project.

i. U.S. Trade or Business

Whether a foreign person is engaged in a U.S. trade or business depends on an analysis of all facts and circumstances. Generally, a foreign person will be engaged in a U.S. trade or business if it regularly performs, either directly or through a dependent or independent agent, important business activities in the United States. This is a somewhat low threshold, particularly where the foreign person or its agents perform any amount of activities in the United States. In addition, if a foreign person is a partner in a partnership (including a co-venturer in an unincorporated joint venture that is treated as a partnership) that is engaged in a U.S. trade or business, then the foreign person will be deemed to be engaged in such U.S. trade or business. However, if a foreign person is a shareholder of a corporation that is engaged in a U.S. trade or business, then the foreign person will not be deemed to be engaged in such U.S. trade or business merely by being a shareholder, unless the corporation is performing activities in the United States as an agent for the foreign shareholder.

If the foreign person is eligible for the benefits of a tax treaty to which the United States is a party, then the foreign person will be subject to U.S. tax only if the foreign person has a PE in the United States. Generally, a PE is defined more narrowly than a U.S. trade or business. For example, the activities of independent agents are typically disregarded when determining whether a foreign person maintains a PE in the United States.

A foreign person that is engaged in a U.S. trade or business at any time during a taxable year is required to file a U.S. tax return with the IRS for such year, whether or not the person has any income that is ECI and whether or not the person has a PE in the United States.

ii. U.S. Source Income

1. Seller Purchased LNG

Generally, all income from a sale of LNG will be U.S. source if (a) the seller purchased the LNG and (b) title or risk of loss passes to the LNG purchaser in the United States. Thus, a foreign seller of LNG will want to ensure that title and risk of loss to the LNG pass to the purchaser outside of U.S. territorial waters. In this regard, the SPA should (a) specify that risk of loss passes outside the United States and (b) include terms which ensure that risk of loss actually passes outside the United States. Note, however, that this may subject the seller to U.S. tax on transportation income, discussed below.
Even if title and risk of loss pass to the purchaser outside the United States, sales income would nevertheless be U.S. source if the LNG sale is attributable to a U.S. office or other fixed place of business of the seller, which is generally defined as any place through which the seller engages in a U.S. trade or business. An LNG sale is considered to be attributable to a U.S. office of the seller if employees who are based in such office actively participate in marketing, contract negotiations, or performing other significant services for the purchaser necessary for the consummation of the sale (e.g., arranging for shipping or scheduling), provided that the office regularly carries on activities relating to sales of LNG. For this purpose, a U.S. office of the seller includes the U.S. office of a dependent agent of the seller that (a) has the authority to conclude contracts in the name of the seller and regularly exercises that authority or (b) has a stock of merchandise belonging to the seller from which orders are regularly filled on behalf of the seller.

In the case of an export sale (but not an import sale) of LNG, the participation of a U.S. office in the sale will not cause sales income to be U.S. source if a foreign office of the seller materially participates in the sale. Material participation does not require the foreign office to have final approval rights over the sale or to participate in the sale to the same extent as the U.S. office, but it does require employees based in the foreign office to be actively involved in marketing, contract negotiations, or performing other significant services for the purchaser necessary for the consummation of the sale.

Thus, for import sales of LNG, a foreign seller will want to ensure that no U.S.-based marketing personnel are involved in soliciting sales orders. Moreover, the foreign seller will want to avoid having SPA negotiations in the United States, particularly in the case of long-term SPAs. If it is not possible to avoid having SPA negotiations in the United States, then the foreign seller will at least want to avoid having multiple negotiations at the same location in the United States and will not want to have any negotiations at the U.S. office of an affiliate. For export sales of LNG, a foreign seller will also want to ensure that foreign-based employees are actively involved in a substantial aspect of the SPA negotiations.

2. Seller Produced Natural Gas

Different sourcing rules apply in the case of LNG sales where the seller produced, rather than purchased, the natural gas. In such cases, a portion of the sales income (namely, the fair market value of the LNG at the export terminal in the country where the natural gas was produced) will be sourced to the location where natural gas production occurred. For this purpose, liquefaction is not considered to be a "production" activity, and thus, no portion of the sales income is considered to be attributable to liquefaction. This rule is beneficial in the case of an LNG export project because no portion of the sales income will be U.S. source merely because of liquefaction in the United States. However, this rule is detrimental in the case of an LNG import project because no portion of the sales income will be foreign source merely because of liquefaction outside the United States. The portion of the sales income that is not sourced to the location of natural gas production will be sourced according to the title passage rules described above.

iii. ECI

If a foreign seller is engaged in a U.S. trade or business, then U.S. source sales income derived in connection with an LNG project will be ECI and thus subject to U.S. tax. The foreign seller will also be subject to U.S. tax on any other U.S. source income (whether or not related to the activities that gave rise to the U.S. trade or business) from certain sales of property, which income is deemed to be ECI under the "force of attraction" rule. Thus, for example, if the seller is engaged in a U.S. trade or business solely as a result of activities performed in connection with the LNG project, then the seller will be subject to U.S. tax on (a) any U.S. source income from sales of LNG and (b) any U.S. source income from certain sales of property that are unrelated to the LNG project. The seller would be subject to U.S. tax on the same types of income if the seller were engaged in a U.S. trade or business solely as a result of activities that are unrelated to the LNG project.

If the foreign seller is eligible for the benefits of a tax treaty to which the United States is a party, then the seller will be subject to U.S. tax only on sales income that is attributable to a PE in the United States. The
"attributable to" standard is generally the same as the standard for attributing sales income to a U.S. office, as discussed above, except that tax treaties generally override the force of attraction rule described in the preceding paragraph. However, many foreign sponsors are organized in countries (e.g., Algeria, Nigeria, Peru, and most countries in the Middle East) that have not entered into a tax treaty with the United States. These sponsors will accordingly be subject to the force of attraction rule unless they invest through a subsidiary that is able to utilize a tax treaty to which the United States is a party (which would generally be possible only if the subsidiary is a tax resident, and actively conducts a business, in a treaty country).

c. U.S. Taxation of a Non-U.S. Investor in Liquefaction or Regasification Facility

   i. Income from Tolling Services

A foreign investor's income from the performance of tolling services will be sourced to the location of the liquefaction or regasification facility. A foreign investor's foreign source services income is exempt from U.S. taxation. However, U.S. source services income will be ECI, and thus the foreign investor will be subject to U.S. tax on the net amount of such income, plus branch profits tax if the investor is a foreign corporation. For this reason, a foreign investor will generally want to form a U.S. corporate subsidiary to hold its investment in a liquefaction or regasification facility located in the United States.

   ii. Payments of Interest to a Lender

Generally, a foreign lender's interest income on a loan to a U.S. project entity will be subject to 30% U.S. withholding tax. However, the interest would not be subject to U.S. withholding tax if the lender were eligible for the "portfolio interest exemption," which requires, among other things, that (a) the lender not be a 10% owner of the project entity and (b) the interest not be "contingent" interest that is determined by reference to the income or profits of the project entity or any distributions made by the project entity. If the lender is not eligible for the portfolio interest exemption (e.g., because the lender is a 10% owner of the project entity), then the lender may nevertheless be eligible for a reduction in or elimination of U.S. withholding tax under a tax treaty, although many treaties do not provide a rate reduction with respect to contingent interest.

d. U.S. Taxation of a Non-U.S. Transporter of LNG

   i. Tax on Transportation Income

Generally, a foreign transporter of LNG is subject to a 4% U.S. tax on the transporter's U.S. source gross transportation income, which is defined as 50% of the amount of gross income derived from, or in connection with, the use (or hiring or leasing for use) of a vessel or the performance of services directly related to the use of a vessel, where the vessel's voyage (a) begins in the United States and ends outside the United States or (b) begins outside the United States and ends in the United States. Thus, the foreign transporter is in effect subject to a 2% gross basis tax on charter hire (and other types of incidental income) with respect to voyages that begin or end in the United States (but do not begin and end in the United States).

U.S. source gross transportation income generally arises where, pursuant to the SPA, title and risk of loss to the LNG pass to the purchaser on the high seas. In such cases, the transporter will be considered to transport LNG owned by the purchaser from the title transfer point outside the United States to the purchaser's receiving terminal in the United States.

However, the foreign transporter will be exempt from the 4% U.S. tax on U.S. source gross transportation income if it is considered to be a "qualified foreign corporation," which requires the transporter to (a) be organized in a qualified foreign country and (b) satisfy a stock ownership test. A "qualified foreign country" is a foreign country that exempts U.S. corporations from taxation on the types of income from the operation of vessels that is derived by the foreign transporter. Such an exemption may be granted (a) by a provision of the country's domestic tax law, (b) through an exchange of diplomatic notes with the United States, (c) under an income tax treaty or bilateral shipping agreement, or (d) by reason of the country being a zero-tax jurisdiction (e.g., the Cayman Islands). A foreign corporation may satisfy the stock ownership test by meeting the requirements of one of the following three tests:
• The foreign corporation is "publicly traded," meaning that one or more classes of stock representing, in the aggregate, more than 50% of the vote or value of the corporation's stock is primarily and regularly traded on one or more established securities markets in the United States or any qualified foreign country. For this purpose, a class of stock will not meet the public trading requirement if it is considered to be "closely held," which is generally the case where one or more persons that individually own at least 5% of the vote or value of such class of stock own, in the aggregate, 50% or more of the vote or value of such class of stock.

• The foreign corporation is a CFC (generally, a foreign corporation more than 50% of the vote or value of which is owned by U.S. persons that individually own at least 10% of the vote of such corporation), and one or more U.S. persons that owns more than 50% of the value of all outstanding stock of such corporation provides the corporation with certain ownership certifications.

• More than 50% of the value of the outstanding shares of the foreign corporation is owned for at least half the number of days in the foreign corporation's taxable year by one or more "qualified shareholders," which generally means a shareholder that (a) is an individual resident of a qualified foreign country, the government of a qualified foreign country, or a publicly traded corporation organized in a qualified foreign country and (b) provides the corporation with certain ownership certifications.

A foreign corporation should be aware that the second and third bullets are separate tests. As a result, a foreign corporation that cannot satisfy the test in the first bullet must satisfy all the requirements of either the second or third bullet, but it may not combine elements of the two tests.

ii. ECI

A foreign transporter of LNG will not be subject to the 4% U.S. tax on U.S. source gross transportation income to the extent that such income constitutes ECI. However, as discussed above, the foreign transporter would be subject to U.S. tax on a net basis with respect to such income, plus branch profits tax if the transporter is a foreign corporation. A foreign transporter's U.S. source gross transportation income will be treated as ECI if (a) the transporter has a U.S. office or other fixed place of business that is involved in the earning of such income and (b) substantially all of the transporter's U.S. source gross transportation income is attributable to regularly scheduled voyages (or, in the case of income from leasing an LNG vessel, is attributable to a U.S. office or other fixed place of business).

iii. Tax Return Filing Obligation

A foreign transporter that derives U.S. source gross transportation income for a particular year will be required to file a U.S. tax return with the IRS for such year, even if the transporter qualifies for an exemption from tax.

e. Application of U.S. Anti-Deferral Rules to a CFC's Income

A U.S. resident sponsor of a foreign project will generally want to utilize a foreign subsidiary that is treated as a CFC for U.S. tax purposes to hold its investment in the project in order to defer U.S. taxes on the profits of the project until they are distributed to the U.S. sponsor. As discussed above, the benefits of a deferral structure will be reduced if the CFC earns income that is treated as ECI. The benefits of a deferral structure will also be reduced if the CFC (a) earns any income that is treated as "Subpart F income" or (b) holds an interest in "United States property."
i. Subpart F Income

If the CFC investor in an LNG project derives Subpart F income, then the U.S. sponsor is generally required to recognize currently, as a deemed dividend, the amount of such Subpart F income, whether or not the CFC makes a distribution of such amount to the U.S. sponsor.

1. Income from LNG and Natural Gas Sales

A CFC's income from sales of LNG or natural gas would generally be treated as Subpart F "foreign personal holding company income" unless (a) the CFC holds substantially all of its LNG or natural gas as inventory, (b) the CFC holds legal title to the LNG or natural gas, and (c) employees of the CFC are involved to a significant extent in such activities as preparing the CFC's contracts and invoices, arranging credit on behalf of the CFC, arranging insurance, arranging shipping documents, arranging storage with respect to the CFC's LNG or natural gas, and dealing with off-spec claims relating to the LNG or natural gas.

Alternatively, a CFC's income from sales of LNG or natural gas may be treated as Subpart F "foreign base company sales income" if the CFC (a) purchases the LNG or natural gas from (or on behalf of) a related person or (b) sells the LNG or natural gas to (or on behalf of) a related person. However, the CFC can avoid foreign base company sales income if it satisfies one of the following exceptions:

- The CFC qualifies for the "manufacturing exception" from foreign base company sales income, which generally requires the CFC to (a) extract the natural gas, (b) perform liquefaction or regasification activities, or (c) make a substantial contribution to the production of the LNG or natural gas (which can include oversight of the extraction, liquefaction, or regasification process) through the activities of its own employees (even if a significant portion of such activities are undertaken by a contract manufacturer). Notably, liquefaction or regasification activities will constitute "manufacturing" for foreign base company sales income purposes even though such activities do not constitute "production" for purposes of the source of income rules. This can be advantageous in the case of an LNG export project, where the CFC may be able to avoid both Subpart F income and ECI by performing U.S. liquefaction.

- The LNG or natural gas that is purchased by the CFC (or, in the case of LNG or natural gas that is sold on behalf of a related person, the property that is sold) is produced or extracted in the country under the laws of which the CFC is created or organized.

- The LNG or natural gas that is sold by the CFC is sold for use, consumption, or disposition in the country under the laws of which the CFC is created or organized (or, in the case of LNG or natural gas that is purchased on behalf of a related person, the property that is purchased is purchased for use, consumption, or disposition in such country).

The CFC's income could alternatively be treated as Subpart F "foreign base company oil-related income" unless either (a) such income is U.S. source, (b) such income is sourced to the country in which the LNG was produced, (c) such income is sourced to the country in which the LNG will be used or consumed, or (d) the CFC is not a "large oil producer," meaning that the average daily production of foreign crude oil and natural gas of the CFC and its affiliates is less than 1,000 barrels (or, in the case of natural gas, the cubic feet equivalent).

2. Income from Tolling Services

A CFC's income from tolling services may be treated as Subpart F "foreign base company services income" if the CFC performs such services for or on behalf of a related person, which includes (a) the performance of services that a related person is or has been obligated to perform, (b) the performance of services with respect to property sold by a related person where such performance constitutes a condition or material term of such sale, and (c) the performance of services where a related person has provided "substantial assistance" contributing to such performance. For purposes of the substantial assistance rules, a related
person will be considered to provide "assistance" to the CFC if it provides direction, supervision, services, know-how, financial assistance (other than capital contributions), equipment, material, or supplies. Whether such assistance is "substantial" is determined based on the facts and circumstances and depending on the type of assistance that is provided.

The CFC can avoid foreign base company services income as long as it performs any related party services in the country under the laws of which the CFC is created or organized.

3. Income from Transportation of LNG

A CFC's income from the transportation of LNG may be treated as Subpart F "foreign base company oil-related income" unless one of the exceptions described above applies.

ii. Investment in United States Property

If the CFC investor acquires an interest in United States property, then the U.S. sponsor is generally required to include in income currently, as a deemed dividend, the average amount of such property (determined by reference to the CFC's tax basis in such property) held directly or indirectly by the CFC at the close of each calendar quarter, to the extent that the U.S. sponsor has not included such amounts in income in prior years. Thus, the U.S. sponsor in effect includes in income for a particular year the amount of any increase in the CFC's average investment in U.S. property for such year. A CFC's investment in "United States property" includes, among other things (a) tangible property located in the United States (including office space and inventory), (b) stock or obligations of a U.S. affiliate, and (c) the right to use intellectual property in the United States. In addition, an obligation of a U.S. affiliate with respect to which the CFC is a pledgor or guarantor will be deemed to be United States property of the CFC in certain cases.