



## Federal Tax ADVISORY ■

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### Guarantees, Debts, and Equity

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An oil services company recently lost a deduction for an investment in a Russian subsidiary because the court found it to be an equity investment and neither a loan nor an ordinary and necessary business expense for performing a guarantee of the subsidiary's contract. *Baker Hughes Inc. v. United States*, No. 4:15-cv-02675 (S.D. Tex. 2018). The takeaway is that parent guarantees are common, but if they are "performed" before the subsidiary goes into default, they are likely to result in a capital contribution, which may ultimately be deductible, but not currently as a business expense or bad debt.

The Russian subsidiary's contract with Russian customers was guaranteed by the U.S. parent. The Russian government required the subsidiary to maintain a certain level of asset value. When that dropped, the parent had to supply \$52 million, which it did in 2008. The parent claimed a current loss of the cash, either as a bad debt or for its performance of the guarantee.

The court found there was no debt because, among other facts, the parent signed a document that "confirms hereby that its financial assistance is free and that it does not expect the company to return the funds to the shareholder."

Then the parent turned to a line of cases that sometimes allows a guarantor to deduct payments to protect its reputation. The court refused to apply those cases mostly because the subsidiary was not in default; no obligation to perform on the guarantee had accrued.

Parent guarantees are common, particularly when the subsidiary is operating in a foreign country. Obtaining deductions for payments related to such a guarantee is hard. Be careful of the agreements you sign, and the timing of the payments, and the identity of the payee if a deduction is desired.

For more information, please contact [Jack Cummings](#) at 919.862.2302.

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