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YA Global Heads to Appeals Court Over Tax Court Ruling on Offshore Fund's U.S. Activities

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Last month, YA Global Investments, LP (the "Fund") filed a notice of appeal to the U.S. Court of Appeals for the Third Circuit, seeking review of the U.S. Tax Court holding in *YA Global Investments, LP v. Commissioner*.[1] In November 2023, the Tax Court held that this Cayman Islands fund was engaged in a U.S. trade or business through an agency relationship with its U.S. investment manager, Yorkville Advisors (YA), and failed to withhold tax on income that was effectively connected with its U.S. trade or business (ECI) and allocable to its non-U.S. partners. Further, the Tax Court determined that the Fund was a dealer in securities subject to the Section 475 mark-to-market rules.[2] Our prior summary of the case is available here.

This appeal reopens the discussion on agency principles, the characterization of a U.S. trade or business, and the Section 475 dealer definition. The Tax Court found YA to be the Fund's agent primarily because the investment management agreements designated YA as such. In determining that the Fund was engaged in a U.S. trade or business through YA's activities, the Tax Court emphasized that YA's fees tied to convertible debt and standby equity distribution agreement transactions from portfolio companies were compensation for services and exceeded returns on invested capital. The Tax Court also classified the Fund as a Section 475 dealer and its gains as ordinary income and ECI. It rejected the Fund's claim that it had no customers and invested for its own account. Sponsors to credit funds with non-U.S. investors and their tax advisors continue to follow the case closely, as it could has significant implications on such credit funds.

[1] 161 T.C. 11 (2023). [https://www.foley.com/wp-content/uploads/2023/11/161-tc-no-11-YA-Global.pdf]

[2] All Section references are to the U.S. Internal Revenue Code of 1986, as amended.

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