Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

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Date:

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Legend

Corp X =

Corp Y =

Corp Z =

Corp R =

Country A =

Product a =

Year 1 =

Year 2 =

Date 1 =

This is in response to a letter dated May 6, 1998, requesting a ruling regarding the application of the same country exception under section 954(c)(3)(A) of the Internal Revenue Code.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Corp X is a publicly held domestic corporation. Corp X and its affiliates are accrual basis taxpayers that use a fiscal year ending on Date 1. Corp X and its affiliates manufacture and market Product a.

Corp X owns all of the stock of Corp Y, a domestic corporation. Prior to Date 1 of Year 1, Corp X also owned all of the stock of Corp Z, a corporation organized under the laws of Country A. Corp Y owns all of the stock of Corp R, a corporation organized under the laws of Country A. Both Corp Z and Corp R are controlled foreign corporations (CFCs), as defined in section 957 of the Code. The taxpayer represents that Corp Z has a substantial part of its assets used in its business located in Country A, within the meaning of section 954(c)(3)(A)(i) and §1.954-2(b)(4)(iv) of the regulations.

The taxpayer represents that, for valid business reasons, it restructured as follows. First, Corp X contributed the stock of Corp Z to Corp Y as a capital contribution on Date 1 of Year 1. On the same date, Corp Y contributed the stock of Corp Z to Corp R as a capital contribution. These capital contributions were intended to qualify under section 351 of the Code. The taxpayer represents that Corp Y will execute a valid gain recognition agreement for the transfers.

Corp Z has positive earnings accumulated during a period before the restructuring. In the year following the restructuring, Year 2, Corp Z is expected to have positive earnings and profits. In the last month of fiscal Year 2, Corp Z plans to make a distribution to Corp R that will be treated as a dividend under section 316 of the Code.

The taxpayer seeks a ruling that the distribution to Corp R in Year 2 will be deemed to come first from Year 2 earnings and profits, to the extent thereof.

Section 952(a)(2) of the Code provides that subpart F income includes foreign base company income. Section 954(a)(1) provides that foreign base company income includes foreign personal holding company income.

Section 954(c)(1)(A) of the Code provides that foreign personal holding company income includes dividends.

Section 954(c)(3)(A)(i) of the Code and §1.954-2(b)(4)(i)(A) of the Income Tax regulations provide that foreign personal holding company income does not include dividends and interest if the payor (1) is a corporation that is a related person with respect to the CFC, within the meaning of section 954(d)(3); (2) is organized under the laws of the same foreign country as the recipient CFC ; and (3) uses a substantial part of its assets in its trade or business located in such foreign country.

Section 954(d)(3) of the Code provides, in part, that a person is a related person with respect to a CFC if such person is a corporation that controls or is controlled by the CFC, or that is controlled by the same person or persons that control the CFC. Control is defined as the ownership, directly or indirectly, of stock possessing more than 50 percent of the total voting power or value of the stock of the corporation.

Section 954(c)(3)(C) of the Code and §1.954-2(b)(4)(ii) of the regulations provide that dividends will be excluded from foreign personal holding company income under the exception contained in section 954(c)(3)(A)(i) and §1.954-2(b)(4)(i)(A) only to the extent that they are paid out of earnings and profits earned or accumulated during a period in which the stock on which the dividends are paid was owned by the recipient CFC directly, or indirectly through a chain of one or more subsidiaries each of which meets the requirements of section 954(c)(3)(A)(i) and §1.954-2(b)(4)(i)(A). Section 1.954-2(b)(4)(ii) of the regulations also requires that such earnings and profits must have been accumulated during a period in which each of the requirements of §1.954-2(b)(4)(i)(A) is satisfied by the recipient CFC.

Before the restructuring, Corp Z was not owned directly or indirectly by Corp R. After the restructuring it is owned directly by Corp R. Thus, dividends paid out of earnings and profits accumulated before the date of the restructuring will not qualify for the exclusion under section 954(c)(3) of the Code.

Section 316(a) provides that, except as otherwise provided under the Code, every distribution is made out of earnings and profits to the extent thereof, and from the most recently accumulated earnings and profits. See also §1.316-2(a) of the regulations.

Based on the facts and representations made, it is held that, for purposes of

determining whether the distribution from Corp Z to Corp R is paid out of earnings and profits earned or accumulated during a period during which the requirements of section 954(c)(3)(A)(i) and (C) are satisfied, the distribution is treated as made from the most recently accumulated earnings and profits.

No opinion is expressed about whether the dividend to be paid by Corp Z to Corp R will be paid out of earnings and profits earned or accumulated during a period during which the requirements of section 954(c)(3)(A)(i) and (C) of the Code are satisfied. Further, no opinion is expressed about whether any other requirements of section 954(c)(3)(A)(i) will be satisfied at the time the dividend is paid.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely,

Phyllis E. Marcus

Phyllis E. Marcus
Chief, Branch 2
Office of the Associate Chief Counsel
(International)