

INTERNAL REVENUE SERVICE

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APR 26 2000

Legend:

Taxpayer =

State A =

District B =

City C =

City D =

a =

b =

c =

d =

Dear :

This letter responds to your letter dated December 16, 1999, submitted on behalf of the Taxpayer, requesting a private letter ruling on the highest rate of tax specified in section 11 applicable to Taxpayer's nonqualified withdrawal from its capital construction fund under § 7518(g)(6)(A)(ii) of the Internal Revenue Code.

FACTS:

Taxpayer is a corporation, organized under the laws of State A. The Taxpayer is an accrual basis taxpayer, and, with certain of its subsidiaries, files a consolidated income tax return on a calendar year basis. District B possesses audit jurisdiction over the Taxpayer's returns which are filed with the Service Center in City C. In addition, the

Taxpayer's tax returns for the years a through b are currently under audit by the City D District Director for unrelated issues.

The Taxpayer specializes in marine and transportation services, with a primary focus in the business of owning and operating ocean-going vessels. The Taxpayer's vessels are available for charter on a voyage (transport of specific goods between specific points), time (vessel placed at charterer's disposal for specified period of time with operating costs borne by the owner of the vessel), or bareboat (charterer takes possession of the vessel and pays all expenses) basis. The Taxpayer also provides management services for vessels owned and operated by third parties, including the U.S. Government.

In year c, the Taxpayer withdrew d from the ordinary income account of its CCF. For purposes of section 7518, the withdrawal was nonqualified. On its filed c tax return, the Taxpayer used a 35 percent tax rate for purposes of calculating the additional tax required by section 7518 on nonqualified withdrawals.

LAW AND ANALYSIS:

Section 607 of the Merchant Marine Act provides, in part, that any citizen of the United States owning or leasing one or more eligible vessels may enter into an agreement with the Secretary of Transportation under section 607 to establish a capital construction fund with respect to any or all of such vessels.

Section 7518(c)(1)(A) of the Code provides that taxable income (determined without regard to this section and section 607 of the Merchant Marine Act of 1936) for the taxable year shall be reduced by an amount equal to the amount deposited into a capital construction fund out of amounts referred to in section 7518(a)(1)(A).

Section 7518(a)(1)(A) of the Code, provides, in part, that the amount deposited in a CCF shall not exceed the sum of certain specified amounts, including that portion of the taxable income of the owner or lessee for the year (computed as provided in chapter 1 but without regard to the carryback of any net operating loss or net capital loss and without regard to section 7518) which is attributable to the operation of the agreement vessels in the foreign or domestic commerce of the United States or in the fisheries of the United States.

Section 7518(e)(1) of the Code generally defines a qualified withdrawal from a capital construction fund as one made in accordance with the terms of the agreement for the acquisition, construction, or reconstruction of a qualified vessel, a barge or container that is part of the complement of a qualified vessel, or the payment of the principal on indebtedness incurred in connection with the acquisition, construction, or reconstruction of a qualified vessel, barge, or container.

Section 7518(f)(1) of the Code provides that any qualified withdrawal from a fund

shall be treated first as made out of the capital account, second made out of the capital gain account, and third as made out of the ordinary income account.

Section 7518(g)(1) of the Code, provides, in general, except as provided in section 7518(h), that any withdrawal from a capital construction fund that is not a qualified withdrawal is treated as a nonqualified withdrawal.

Section 7518(g)(2) of the Code provides that any nonqualified withdrawal from a capital construction fund shall be treated-- (A) first as made out of the ordinary income account, (B) second as made out of the capital gain account, and (C) third as made out of the capital account.

Section 7518(g)(6)(A) of the Code, provides that in the case of any taxable year for which there is a nonqualified withdrawal, the tax imposed by chapter 1 shall be determined--(i) by excluding such withdrawal from gross income, and (ii) by increasing the tax imposed by chapter 1 by the product of the amount of such withdrawal and the highest rate of tax specified in section 1 (section 11 in the case of a corporation). With respect to the portion of any nonqualified withdrawal made out of the capital gain account during a taxable year to which section 1(h) or 1201(a) applies, the rate of tax taken into account under the preceding sentence shall not exceed 20 percent (34 percent in the case of a corporation).

Section 11(a) of the Code provides that a tax is imposed for each taxable year on the taxable income of every corporation.

Section 11(b) of the Code provides that the amount of tax imposed by section 11(a) shall be the sum of--

(A) 15 percent of so much of the taxable income as does not exceed \$50,000,

(B) 25 percent of so much of the taxable income as exceeds \$50,000 but does not exceed \$75,000,

(C) 34 percent of so much of the taxable income as exceeds \$75,000 but does not exceed \$10,000,000, and

(D) 35 percent of so much of the taxable income as exceeds \$10,000,000.

The flush language to section 11(b)(1) provides that in the case of a corporation which has taxable income in excess of \$100,000 for any taxable year, the amount of tax determined under the preceding sentence for such taxable year shall be increased by the lesser of (i) 5 percent of such excess, or (ii) \$11,750. In the case of a corporation which has taxable income in excess of \$15,000,000, the amount of the tax determined under the foregoing provisions of this paragraph shall be increased by an additional amount equal to the lesser of (i) 3 percent of such excess, or (ii) \$100,000.

The flush language to section 11(b)(1) phases out the benefits of the graduated tax rates for corporations. The flush language does not, however, modify the marginal rates of tax. Accordingly, in the case of a corporation, the highest rate of tax specified in section 11 for purposes of section 7518(g)(6)(A)(ii), applicable to a nonqualified withdrawal, is 35 percent.

No opinion is expressed or implied regarding the application of any other provision of the Code or regulations. In accordance with the power of attorney, we are sending a copy of this letter to the Taxpayer.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,
Walter H. Woo
Senior Technician Reviewer
Branch 5
Office of the Assistant Chief Counsel
(Passthroughs and Special Industries)

Enclosure: 6110 copy