

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Date:

March 25, 2005

TY:

Legend

Taxpayer	=	TIN:
Parent Co	=	
US Finance Co	=	
Holding Co	=	
Country A	=	
Country B	=	
Country C	=	

Dear :

This responds to your letter dated April 12, 2004, requesting rulings concerning Article (Limitation on Benefits) of the United States-Country A income tax treaty (the "Treaty").

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.

FACTS

Parent Co, a Country B corporation, and its direct and indirect subsidiaries (collectively, the "Group") are a global group of companies engaged in manufacturing, production, and sales in a number of principal lines of business. Taxpayer is an indirect Country A subsidiary of Parent Co owned by Parent Co through Holding Co, a Country C corporation. Taxpayer acts as a finance company for Group companies. Taxpayer

issues medium and short term debt obligations in public debt markets. All non-Group debt obligations of Taxpayer are effectively guaranteed through an agreement under which Parent Co agrees to maintain a certain liquidity level in Taxpayer. Taxpayer is not itself directly engaged in any of the Group's principal lines of business. Taxpayer represents that it is a resident of Country A for purposes of the Treaty.

US Finance Co, a U.S. corporation, is the principal financing vehicle for the Group's U.S. operations. US Finance Co is indirectly owned by Parent Co through a chain of domestic corporations. US Finance Co borrows funds from Taxpayer and from U.S. Group companies and through the issuance of commercial paper and medium term notes in U.S. and non-U.S. capital markets. US Finance Co's non-Group borrowings are effectively guaranteed through an agreement with Parent Co to maintain a certain liquidity level in US Finance Co. US Finance Co loans funds to U.S. Group companies or to Taxpayer (which in turn on-lends the funds to non-U.S. Group companies). US Finance Co is not itself directly engaged in any of the Group's principal lines of business. All of US Finance Co's income is derived from other U.S. Group companies and from Taxpayer.

Parent Co owns the Country A components of its principal lines of business in a number of different ways: through a chain of U.S. and Country A entities; through another Country B corporation; and through a Country C corporation. The Country A Group companies that are themselves directly engaged in the Group's principal lines of business in Country A are hereinafter collectively referred to as the "Country A Operating Affiliates." Taxpayer represents that each of the Country A Operating Affiliates is a resident of Country A for purposes of the Treaty.

Parent Co owns the U.S. components of its principal lines of business through a chain of U.S. corporations and through another Country B corporation. The U.S. Group companies that are themselves directly engaged in the Group's principal lines of business in the United States are hereinafter collectively referred to as the "U.S. Operating Affiliates." Taxpayer represents that other than the income derived by US Finance Co, all of the income of the U.S. Group companies is derived from the conduct of the principal lines of business in the United States.

Taxpayer represents that the U.S. and Country A Operating Affiliates engage in parallel activities in their respective countries and that there are significant business relationships between the U.S. and Country A Operating Affiliates that are engaged in the same businesses.

In its role as a finance company for Group companies, Taxpayer receives interest payments from the U.S. Operating Affiliates and US Finance Co. These interest payments are the income of Taxpayer at issue in the present ruling.

ISSUES PRESENTED

1. For purposes of Article _____ of the Treaty, is Taxpayer considered to conduct the activities of its Country A Operating Affiliates and thus entitled to take into account such activities in determining whether it is engaged in the active conduct of a trade or business in Country A?
2. For purposes of Article _____ of the Treaty, assuming Taxpayer is engaged in the active conduct of a Country A trade or business based on the activities of the Country A Operating Affiliates, how should Taxpayer determine whether the interest it derives from US Finance Co and the U.S. Operating Affiliates is derived in connection with the active conduct of a trade or business by Taxpayer in Country A?
3. For purposes of Article _____ of the Treaty, how should Taxpayer determine whether Taxpayer's Country A trade or business is substantial in relation to the U.S. trade or business that gives rise to an item of U.S. source interest income?

RULING 1

Section 881(a) of the Internal Revenue Code (the "Code") generally imposes a 30 percent tax on the amount received by a foreign corporation as interest from sources within the United States to the extent that the interest is not effectively connected with the conduct of a trade or business within the United States.

Section 894(a) of the Code provides that the provisions of the Code shall be applied to any taxpayer with due regard to any treaty obligation of the United States that applies to such taxpayer. Treas. Reg. § 1.871-12(c) provides that, with respect to items of income the tax on which is limited by a tax convention, the tax is determined upon the gross amount of each separate item of income at the reduced rate applicable to that item under the convention.

Article _____ (Interest) of the Treaty provides that interest arising in the United States and beneficially owned by a resident of Country A shall be taxable only in Country A.

To be entitled to the exemption from U.S. withholding provided by Article _____, the recipient of interest generally must be a "qualified person" within the meaning of Article _____ (Limitation on Benefits) of the Treaty, or if not a qualified person, must meet the requirements of either Article _____ or Article _____ with respect to the interest income. As represented, Taxpayer fails to meet the specific criteria of either Article _____ or Article _____.

Article _____ of the Treaty provides that a Country A resident that is not a qualified person shall be entitled to the benefits of the Treaty with respect to an item of income derived from the United States if (1) the resident is engaged in the active conduct of a trade or business in Country A (other than the business of making or managing investments for the resident's own account, unless these activities are banking, insurance or securities activities carried on by a bank, insurance company or registered securities dealer), (2) the U.S. source income is derived in connection with that Country A trade or business, and (3) that resident satisfies any other specified conditions for the obtaining of such benefits.

Article _____ of the Treaty provides that, in determining whether a Country A resident is engaged in the active conduct of a trade or business in Country A under Article _____, activities conducted by persons connected to such person shall be deemed to be conducted by such person. A company shall be connected to another company if one possesses at least 50 percent of the aggregate voting power and value of the other company or another company possesses, directly or indirectly, shares representing at least 50 percent of the aggregate voting power and value of each company. In any case, a person shall be considered to be connected to another if, on the basis of all facts and circumstances, one has control of the other or both are under the control of the same person or persons.

Based solely on the information submitted and the representations made, we conclude that Taxpayer is considered to be engaged in the making or managing of investments for its own account and is, therefore, not engaged in the active conduct of a trade or business in Country A. However, provided that Taxpayer is connected to the Country A Operating Affiliates within the meaning of Article _____ of the Treaty, Taxpayer would be considered to conduct the activities of the Country A Operating Affiliates for purposes of determining if it is engaged in the active conduct of a trade or business in Country A and for purposes of determining the line of business in connection with which the item of U.S. source income must be derived to entitle Taxpayer to Treaty benefits with respect to such item under Article _____.

RULING 2

The TE to Article _____ of the Treaty states that income is derived in connection with a trade or business if the source State income-producing activity is a line of business that "forms part of" or is "complementary" to the trade or business conducted in the State of residence. The TE explains that where more than one trade or business is conducted in the source State and only one of the trades or businesses forms a part of or is complementary to a trade or business conducted in the State of residence, it is necessary to identify the source State trade or business to which an item of income is attributable. The TE states that interest income may be allocated to Source country activities under any reasonable method consistently applied, and that a method that conforms to U.S. principles for expense allocation will be considered a reasonable method.

Accordingly, based solely on the information submitted and the representations made, and assuming the Country A Operating affiliates are connected to Taxpayer, we conclude that whether interest received by Taxpayer from U.S. Operating Affiliates or US Finance Co is derived in connection with the trade or business of Taxpayer depends on whether the interest is attributable to income producing activities of a U.S. Operating Affiliate whose line of business forms part of or is complementary to a trade or business treated as conducted by Taxpayer through the activities of the Country A Operating Affiliates in Country A.

RULING 3

Article _____ of the Treaty provides that a Country A resident is entitled to benefits under Article _____ with respect to any item of U.S. source income only if the Country A resident's Country A trade or business is substantial in relation to the U.S. trade or business that gives rise to the item of U.S. source income. The TE to Article _____ of the Treaty states that the trade or business carried on in the State of residence must be substantial in relation to the activity in the State of source. This determination is made based upon all the facts and circumstances and takes into account the comparative sizes of the trades or businesses in each Contracting State (measured by reference to asset values, income, and payroll expenses), the nature of the activities performed in each Contracting State, and the relative contributions made to that trade or business in each Contracting State. In making each determination or comparison, due regard will be given to the relative sizes of the U.S. and Country A economies.

Accordingly, based solely on the information submitted and the representations made, and assuming that the income producing activities of the U.S. Operating Affiliate form part of a line of business or are complementary to a trade or business conducted by Taxpayer through its Country A Operating Affiliates, we conclude that whether Taxpayer's Country A trade or business is substantial in relation to the U.S. trade or business that gives rise to the interest income must be determined by comparing the size and nature of the trade or business conducted by the Country A Operating Affiliates in Country A with that trade or business conducted in the United States by the U.S. Operating Affiliate or Affiliates that gives rise to the item of income (for example, the relative asset values, income, and payroll expenses of the Country A Operating Affiliates and the U.S. Operating Affiliates, and the relative contributions made to that trade or business in Country A and the United States). In making this comparison, the assets, income, and payroll of US Finance Co and Taxpayer are not taken into account because, under Article _____, the finance companies' own activities do not constitute the active conduct of a trade or business and, accordingly, their assets, income, and payroll are not considered the assets, income, or payroll of trades or businesses conducted in Country A or the United States.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed as to:

- (1) Whether Taxpayer is connected to any of its Country A Operating Affiliates within the meaning of Article _____ of the Treaty;
- (2) Whether the Country A Operating Affiliates are engaged in the active conduct of Country A trades or businesses within the meaning of Article _____ of the Treaty;
- (3) Whether a particular item of U.S. source interest income received by Taxpayer from a U.S. Operating Affiliate or US Finance Co is attributable to income producing activities of a U.S. Operating Affiliate whose line of business forms part of or is complementary to a trade or business treated as conducted by Taxpayer in Country A;
- (4) Whether the trades or businesses of the Country A Operating Affiliates in Country A that are treated as conducted by Taxpayer are substantial in relation to that trade or business conducted in the United States by the U.S. Operating Affiliates that gives rise to the item of U.S. source income, based on all the facts and circumstances.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

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

Sincerely,

Elizabeth U. Karzon
Chief, Branch 1
Office of Office of Associate Chief Counsel
(International)