

Internal Revenue Service

Department of the Treasury

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December 8, 1999

DO:

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A	=	
B	=	
C	=	
D	=	
E	=	
F	=	
G	=	
H	=	
Date 1	=	
Date 2	=	
Date 3	=	
Date 4	=	
Date 5	=	
Date 6	=	(a date 90 days after Date 5)
Date 7	=	
Year 1	=	
Year 2	=	

Dear :

This is in response to your letter, dated April 12, 1999, and letters submitted subsequently on July 21, 1999 and October 15, 1999, requesting a ruling as to the federal income tax consequences of certain transactions on behalf of D.

Based upon the same facts represented herein, a similar letter ruling is being issued to E simultaneous to this letter ruling.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury

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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.

Taxpayer represents the following facts:

A, a domestic corporation, is the parent of a corporate group which offers a variety of products and services worldwide. A created B, a domestic corporation, and contributed certain assets to B. A then distributed the stock of B to its shareholders in Date 1, Year 1 (the "B spin-off"). The purpose of the B spin-off was to make the F, G and H businesses an independent corporation from A.

C, a domestic section 936 corporation and a wholly-owned subsidiary of A, actively conducted several trades or businesses in Puerto Rico as of October 13, 1995. C had an election in place for the Puerto Rico and possession tax credit under section 936(e) and the reduced percentage limitation under section 936(a)(4)(B). C conducted the F, G and H businesses in Puerto Rico on behalf of A. Following the B spin-off, A created two new, wholly-owned subsidiaries, D and E in Date 2, Year 1. C transferred all of its assets relating to F, G and H to D and E in Date 3, Year 1. After the transfer, in Date 4 of Year 1, A distributed the stock of D and E (the "D and E spin-off") to B.

D owns all of the assets related to the operation of F in Puerto Rico and E owns all of the assets related to the operation of G and H in Puerto Rico.

Rulings Requested

1. That D may be allowed the benefits of the Puerto Rico economic activity credit described in section 30A.
2. That D's adoption of the economic activity limitation under sections 936(a)(4)(A) and 30A for its taxable year ending Date 7, Year 1, and subsequent taxable years, is not prohibited by the consistency requirement under section 936(a)(4)(B)(iii)(III).

Representations

1. C has an election in effect under Code section 936(a)(4)(B) to use the reduced percentage limitation method of calculating the credit allowed pursuant to section 936(a)(1)(A).
2. As of October 13, 1995, C had qualifying actively conducted trades or businesses with regard to F, G and H within the meaning of section 936(j)(9) and Temporary Treasury Regulation section 1.936-11T.
3. D is not a member of the A group following the D and E spin-off to B.

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4. D is not making an election under section 936(h)(5) and is subject to the general rules provided in sections 936(h)(1)-(4) regarding intangible property income.

Electing the Puerto Rico economic activity credit

The Small Business and Job Protection Act of 1996 enacted certain provisions that phase out section 936 of the Code over 10 years, eliminating it entirely for taxable years beginning after December 31, 2005. Section 936(j)(1) states that, except as otherwise provided in section 936(j), the section 936 credit does not apply to any taxable year beginning after December 31, 1995. Section 936(j)(2) then provides that an existing credit claimant may continue to elect the credit provided for in sections 936(a)(1)(A) or 30A(a)(1)(A), subject to the limitations of the phase out provisions. For those taxpayers who have not elected the percentage limitation under section 936(a)(4)(B), the rules of section 30A apply for taxable years beginning after December 31, 1995.

The rules of section 936 are to be used in applying section 30A. Section 30A(e)(1) provides that the provisions of section 936, including any applicable election thereunder, apply as if the credit under section 30A were a credit under section 936(a)(1)(A) for any domestic corporation to which section 936(a)(4)(A) applies. Section 30A(e)(2) provides that the credit under section 30A is treated in the same manner as the credit under section 936. Section 30A(e)(3) provides that a corporation to which section 30A applies shall be treated as if it were a corporation electing section 936. Finally, section 30A(f) provides that any term used in section 30A that is also used in section 936 shall have the meaning given such term by section 936.

Taxpayer requests a ruling that for the tax year ending Date 7, Year 1, D may elect to apply section 30A, subject to the transition rules under sections 936(j) and 30A.

D may elect to be treated as a section 936 corporation and subject to the Puerto Rico economic activity credit under section 30A, for the tax year ending Date 7, Year 1, if it is a qualified domestic corporation as defined in section 30A(a)(2), and if it satisfies the conditions of section 30A(b)(1) and (2).

A qualifying domestic corporation must satisfy two conditions. It must be an existing credit claimant with respect to Puerto Rico, and it must be a corporation to which section 936(a)(4)(B) does not apply for the taxable year.

A corporation qualifies as an existing credit claimant by satisfying the requirements of either section 936(j)(9)(A)(i) or (ii). An existing credit claimant is defined in section 936(j)(9)(A)(i) as a corporation that was actively conducting a trade or business in a possession on October 13, 1995, and that had an election under section 936 in effect for the corporation's taxable year that includes October 13, 1995. Section

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936(j)(9)(A)(ii) provides that an existing credit claimant also includes a corporation, which acquired all the assets of a trade or business of a corporation that satisfies the requirements of section 936(j)(9)(A)(i). A corporation otherwise qualifying as an existing credit claimant will cease to qualify if it adds a substantial new line of business. Section 936(j)(9)(B).

Taxpayers have represented that C is an existing credit claimant under section 936(j)(9)(A)(i), because it is a corporation that was actively conducting a trade or business in a possession on October 13, 1995, and had a valid section 936 election in effect for its taxable year that includes October 13, 1995. Taxpayer has further represented that D acquired all the assets of a trade or business from C. Thus, D qualifies as an existing credit claimant under section 936(j)(9)(A)(ii).

As an existing credit claimant, D becomes a qualified domestic corporation for purposes of section 30A(a)(2) if section 936(a)(4)(B) does not apply for the taxable year. Taxpayer represents that D will not elect the percentage limitation provided for in section 936(a)(4)(B) and will choose to calculate its credit pursuant to the economic activity credit described in section 30A.

A qualified domestic corporation may elect the section 30A credit if it satisfies both conditions in sections 30A(b)(1) and (2). Section 30A(b)(1) requires that 80 percent or more of the gross income of the qualified domestic corporation for the 3 year period immediately preceding the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within a possession. Section 30A(b)(2) requires that 75 percent or more of the gross income of the qualified domestic corporation for such period, or such part thereof, was derived from the active conduct of a trade or business within a possession.

Based on Temporary Treasury Regulation section 1.936-11T(b)(3)(ii)(B), D satisfies the conditions of section 30A. Temporary Treas. Reg. section 1.936-11T(b)(3)(ii)(B) provides that if all the assets of a pre-existing business of an existing credit claimant are acquired by a corporation that is not an existing credit claimant and the acquiring corporation makes a section 936(e) election for the taxable year that the assets are acquired, then:

1. The acquiring corporation will be treated as an existing credit claimant for the year of the acquisition,
2. The activity will be considered a pre-existing business of the acquiring corporation,
3. The acquiring corporation will be deemed to satisfy the rules of section 936(a)(2) for the year of acquisition, and
4. After making an election under section 936(e), a nonaffiliated acquiring corporation will not be bound by elections under sections 936(a)(4) and (h) made by the predecessor existing credit claimant.

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This regulation applies to the credit under section 30A as well as to the section 936 credit. Under this regulation, D will be treated as satisfying the conditions imposed by section 30A(b)(1) and (2).

Consistency requirement for section 936(a)(4) credit limitation

Sections 30A(a)(1)(A) and 936(a)(1)(A) generally provide a credit allowed against U.S. income tax in an amount equal to the portion of the tax which is attributable to non-U.S. source taxable income from the active conduct of a trade or business within a possession of the United States.

Section 936(a)(4) imposes a limitation on this credit. At the election of the taxpayer, one of two limitations applies to the credit. In the absence of an election, the economic activity limitation described under sections 936(a)(4)(A) and 30A applies. However, under section 936(a)(4)(B), the taxpayer may elect to calculate the limitation as a fixed percentage of the credit otherwise allowable.

Section 936(a)(4)(B)(iii)(III) imposes a consistency requirement on the percentage credit limitation according to the rules of this election. This section provides that "[I]f, for any taxable year, an election is not in effect for any possession corporation which is a member of an affiliated group, any election under this subparagraph for any other member of such group is revoked for such taxable year and all subsequent taxable years. . . ."

Temporary Treasury Regulation section 1.936-11T(b)(3)(ii)(B) provides that where all the assets of a pre-existing business of an existing credit claimant are acquired, the acquiring corporation may make a section 936(e) election for the taxable year in which the assets are acquired. Pursuant to sections 30A(e) and 936(e) and Treasury Regulation section 1.936-1, D would make an election to be treated as a section 936 or 30A corporation on the "date on which such corporation is required, pursuant to sections 6072(b) and 6081, to file its Federal income tax return for the first taxable year for which the election is made" Treas. Reg. 1.936-1. Solely for the purposes of the consistency requirement under section 936(a)(4)(B)(iii)(III), affiliation is determined at the end of the corporation's first taxable year as a section 936 corporation. Because the end of D's first taxable year as a section 936 corporation would be subsequent to the transfer of D to the B group on Date 4, Year 1, D may elect the percentage limitation under section 936(a)(4)(B) or compute the credit limitation by the economic activity credit as provided for in section 30A. Treas. Reg. 1.936-11T(b)(3)(ii)(B).

Ruling

Accordingly, based solely upon the information submitted, it is held as follows:

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D may use the economic activity credit provided under section 30A for the taxable year ending Date 7, Year 1 and for all subsequent taxable years.

The use of the economic activity credit under section 30A by D for its taxable year ending on Date 7, Year 1 and for subsequent taxable years is not prohibited by the consistency requirement under section 936(a)(4)(B)(iii)(III). Note that the consistency requirement requires D and E to use the same method pursuant to section 936(a)(4)(B)(iii)(III).

Because the effective date for making the section 936(e) election has passed, D must also seek section 9100 relief from the Commissioner in order for this ruling to have the effect herein granted.

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, including whether the divisive spin-off described herein satisfies section 355 for nonrecognition treatment.

This ruling is directed only to the taxpayer who requested 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 and its second authorized representative.

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

Sincerely,

Anne Shelburne, Branch 6
Office of Associate Chief Counsel
(International)

cc: Assistant Commissioner (International)
International District Operations OP:IN:D
Chief, Examination Division