

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Telephone Number:

Refer Reply To:

CC:INTL:6-PLR-106452-99

Date:

October 15, 1999

DO:

TY:

LEGEND:

Corp A =
Corp B =

Country A =

Material A =
Material B =

Process A =
Process B =

Product A =

Product Line A =

Taxable Year 1 =

Taxable Year 2 =

x =

y =

Dear

This responds to your request dated March 18, 1999, and supplemented by

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letters dated August 25, 1999, and August 31, 1999, on behalf of the above-referenced taxpayer, for a private letter ruling concerning the proper North American Industry Classification System (NAICS) and Standard Industrial Classification (SIC) codes for certain business activities for purposes of the Puerto Rico and possession tax credit under section 936 of the Internal Revenue Code (the Code).

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

FACTS:

You have represented the following facts on behalf of the taxpayer:

Corp A, a domestic corporation that manufactures Product Line A, has elected to be treated as a possessions corporation under section 936 of the Code. Such election has been in effect for the taxable year that included October 13, 1995, and all subsequent taxable years. Corp A is a wholly-owned subsidiary of Corp B, also a domestic corporation.

Product A is one of the products in Product Line A. Corp A is, and was on October 13, 1995, primarily engaged in the manufacture of Product A from Material A with equipment specializing in Process A at its facilities in Puerto Rico. As an intermediate step in the manufacturing process, Material A is transformed into Material B. Corp A then sells Product A to Corp B. Process B, a finishing process with respect to Product A, is then outsourced by Corp B to a related party operating in Country A. Corp B sells the finished Product A to unrelated customers. In its Federal income tax returns for taxable years prior to Taxable Year 1, Corp A used the four-digit SIC code x to identify its activities with respect to Product A. In its return for Taxable Year 1, Corp A will use six-digit NAICS code y to identify its activities with respect to Product A.

During Taxable Year 2, Corp B proposes to form Newco, a new possessions corporation under section 936 of the Code, to acquire Corp A's production facilities for the manufacture of Product A. In addition to performing all processes currently performed by Corp A, Newco will perform in Puerto Rico some of Process B. Newco will outsource the remainder of Process B to its related party in Country A. Upon completion of Process B, Product A will be shipped back to Newco for inspection in Puerto Rico and then shipped to Corp B for sale to unrelated customers. Corp B requests a ruling that the activities of Corp A and Newco with respect to Product A are appropriately classified in SIC code x and NAICS code y.

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LAW AND ANALYSIS:

Section 936(a) of the Code generally grants to certain electing corporations a tax credit with respect to income attributable to the active conduct of a trade or business within a possession of the United States. Section 936(d)(1) defines the term possession of the United States to include Puerto Rico. For taxable years beginning after December 31, 1995, section 936(j) generally limits the availability of the credit to existing credit claimants.

Section 936(j)(9)(A) provides that an existing credit claimant is a corporation that had a section 936 election in effect for the taxable year that included October 13, 1995, and was actively conducting a trade or business in a possession on October 13, 1995, or a corporation that acquires all of the assets of such a corporation.

Section 936(j)(9)(B) provides that an existing credit claimant that adds a substantial new line of business (other than by acquisition from an existing credit claimant) after October 13, 1995, will cease to be treated as an existing credit claimant as of the close of the taxable year ending before the date of such addition.

Section 1.936-11T(b)(1) of the Temporary Treasury Regulations provides that a new line of business is any business activity of the possessions corporation that is not closely related to a pre-existing business of the possessions corporation.

Section 1.936-11T(b)(2)(ii)(A) sets forth a safe harbor providing that an activity is closely related to a pre-existing business and thus is not a new line of business if the activity is within the same six-digit NAICS code or four-digit SIC code. For purposes of determining whether an activity is closely related to a pre-existing business, section 1.936-11T(b)(2)(i)(H) provides that NAICS and SIC codes are determined in accordance with the NAICS and SIC manuals published by the Executive Office of the President, Office of Management and Budget, that are in effect for the taxable year during which a new activity is added. As of the date of this ruling, the most current NAICS manual is the 1997 edition ("NAICS Manual"), and the most current SIC manual is the 1987 edition ("SIC Manual").

The NAICS Manual indicates that NAICS code y comprises establishments primarily engaged in any of the following activities with respect to Product Line A: (1) Process A; (2) production of Material B from Material A using Process A and manufacturing Product Line A; or (3) Process A, manufacturing and finishing Product Line A. The activities conducted by Corp A on October 13, 1995, and through the present time, are described by the first two parts of this NAICS code definition because Corp A uses Process A to produce Material B from Material A and to manufacture Product A, a product within Product Line A. NAICS code y also describes the proposed activities of Newco because Newco will be engaged in Process A, manufacturing, and finishing using Process B with respect to Product A, a product within Product Line A.

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The SIC Manual indicates that SIC code x comprises establishments primarily engaged in: (1) Process A with respect to Product Line A using Material A; or (2) manufacturing Product Line A from Material B produced with Process A in the same establishment. The activities conducted by Corp A on October 13, 1995, and through the present time, are described by this SIC code definition because Corp A manufactures Product A (a product within Product Line A) from Material B, which Corp A produces in the same establishment from Material A using Process A. SIC code x also describes the proposed activities of Newco because Newco will be engaged in Process A, manufacturing, and finishing using Process B with respect to Product A.

The table at Appendix B of the NAICS Manual correlates equivalent SIC and NAICS codes. This table indicates that NAICS code y corresponds to SIC code x.

CONCLUSION:

Based on the facts submitted and the representations made, we rule that for purposes of section 936(j)(9) of the Code, the activities of Corp A and the proposed activities of Newco with respect to Product A are properly classified in NAICS code y and SIC code x under the respective NAICS and SIC Manuals presently in effect.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item. In particular, no opinion is expressed or implied concerning whether Newco will qualify as an existing credit claimant within the meaning of section 936(j)(9)(A).

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 income tax return to which it is relevant.

Sincerely,
Elizabeth G. Beck
Senior Technical Reviewer, Branch 6
Office of Associate Chief Counsel (International)

Enclosures:

Copy of this letter
Copy for section 6110 purposes
cc: District Director,
Attn: Chief, Examination Division