

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:
(202) 622-3840
Refer Reply To:
CC:INTL:Br2-PLR-111767-00
Date:
October 17, 2001

Legend

Parent	=
Subsidiary 1	=
Subsidiary 2	=
Subsidiary 3	=
Foreign Country	=
Trust A	=

Dear :

This replies to your letter on behalf of Subsidiary 1, dated June 5, 2000, and supplemented by a letter dated April 10, 2001, in which you requested a ruling that certain interest received by Subsidiary 3 would not be considered received by a controlled foreign corporation from a related person within the meaning of section 881(c)(3)(C).

You also requested a ruling that the interest will constitute portfolio interest under sections 871(h) and 881(c) of the Internal Revenue Code. We must decline to rule on this second requested ruling pursuant to section 7.01 of Rev. Proc. 2001-1, 2001-1 I.R.B. 1.

The ruling contained in this letter is 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.

Parent, a U.S. corporation, owns all of the stock of Subsidiary 1, a U.S. corporation, which owns all of the stock of Subsidiary 2, a U.S. corporation. Subsidiary 2 is engaged in the financing business.

In connection with its financing business, Subsidiary 1 holds a substantial amount of

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loans secured by liens on consumer durable goods. Subsidiary 1 proposes to enter into the following transaction. Pursuant to a trust agreement, Subsidiary 1 will establish a trust in the United States, Trust A, and transfer a portion of the loans to Trust A in exchange for all of the certificates of beneficial interest in Trust A.

Subsidiary 2 will form Subsidiary 3 in Foreign Country and will fund it with a contribution of cash. Subsidiary 3 will be a controlled foreign corporation within the meaning of section 957(a) of the Code. Subsidiary 3 will purchase all or a portion of the certificates of beneficial interest in Trust A from Subsidiary 1 at fair market value.

A servicer (who may be Subsidiary 1) will collect the payments on the underlying loans and deposit them into a collections account on behalf of Trust A. The trustee will then distribute the proceeds to the holders of the certificates of beneficial interest in Trust A, including Subsidiary 3.

Subsidiary 1 has made the following representations in connection with the proposed transaction:

(1) Trust A will be described in Subpart E of Subchapter J of the Code and will be treated as a trust of which the grantor is the owner. The certificates representing the ownership interest in Trust A will qualify as pass-through certificates within the meaning of section 1.871-14(d) of the regulations.

(2) The loans to be transferred to Trust A are not foreign targeted bearer obligations nor are they issued in registered form.

(3) The certificates representing ownership interests in Trust A will be issued in registered form within the meaning of section 881(c)(7).

(4) Subsidiary 3 will be a controlled foreign corporation within the meaning of section 957(a) of the Code. Subsidiary 3 will not be engaged in a trade or business within the United States.

Section 881(a)(1) and (3) imposes a tax of 30 percent of the amount received from sources within the United States by a foreign corporation as interest or original issue discount. Section 881(c) provides that no tax shall be imposed under paragraph (a)(1) or (3) in the case of any portfolio interest received by a foreign corporation from sources within the United States.

Section 881(c)(2) defines the term "portfolio interest" to mean any interest (including original issue discount) that would be subject to tax under section 881(a), which is paid on an obligation in bearer form and is described in section 871(h)(2)(A), or is paid on an obligation in registered form and the person who would otherwise be required to deduct and withhold tax under section 1442(a) receives a statement that the beneficial owner of the obligation is not a United States person.

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Section 1.871-14(d)(1) provides that interest received on a pass-through certificate in registered form qualifies as portfolio interest under section 881(c)(2) if the interest satisfies the conditions in sections 1.871-14(b)(1), (c)(1) or (e) without regard to whether any obligation held by the fund or trust to which the pass-through certificate relates is described in that section. This provision applies only to payments made to the holder of a pass-through certificate from the trustee and does not apply to payments made to the trustee.

Under section 1.163-5T(d) of the regulations, a pass-through certificate is a certificate evidencing an interest in a pool of mortgage loans which, under Subpart E of Subchapter J of the Code, is treated as a trust of which the grantor is the owner (or similar evidence of interest in a similar pooled fund or trust treated as a grantor trust). A pass-through certificate is considered to be in registered form if the pass-through certificate is in registered form without regard to whether any obligation held by the fund or trust to which the pass-through certificate relates is in registered form.

Section 881(c)(3)(C) provides further that the term “portfolio interest” does not include any portfolio interest which is received by a controlled foreign corporation from a related person (within the meaning of section 864(d)(4)).

Section 864(d)(4) defines the term “related person” as any person who is a related person under section 267(b) or any U.S. shareholder, as defined in section 951(b), and any person who is a related person to such U.S. shareholder under section 267(b). One of the relationships described in section 267(b) is a fiduciary of a trust and a beneficiary of that trust.

By its terms, section 1.871-14(d) only addresses the section 881(c)(2) provisions (or the section 871(b)(2) provisions not in issue here). It does not address the provisions of section 881(c)(3)(C) in relation to interest received on a pass-through certificate. It is clear that the application of these two sets of provisions are not the same. Section 1.871-14(d) provides a means by which interest may qualify as portfolio interest even if none of the obligations on which it is paid would separately satisfy the requirements of section 881(c)(2). To achieve this end, section 1.881-14(d) must apply only to payments made to the holder of a pass-through certificate from the trustee of the pass-through trust. Section 1.881-14(d) does not address the relationship between the obligor of the underlying obligation and the owner of the obligation, which is the subject matter of section 881(c)(3)(C). This section should be applied by examining the relationship between the underlying obligor and a CFC that is the beneficial owner of the obligation.

Based on the facts and representations made by the taxpayer, we conclude that section 881(c)(3)(C) will not exclude from portfolio interest the interest received by Subsidiary 3 on the pass-through certificates representing ownership in Trust A, if the interest otherwise qualifies as portfolio interest under section 881(c)(2) of the Code and section 1.871-14(d) of the regulations, except to the extent that the obligor of the

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underlying obligation on which the interest is paid is a related person with respect to Subsidiary 3, within the meaning of section 864(d)(4). In the case of any portfolio interest received by Subsidiary 3, the special rules applicable to controlled foreign corporations contained in section 881(c)(5) apply.

No opinion is expressed regarding the application of any other provisions of the Code or regulations, i.e.: (i) whether any payment of interest on the obligations will qualify as portfolio interest for purposes of sections 871, 881, 881(c)(3)(A) and (B), 1441 and 1442 of the Code, (ii) whether the transfers from Subsidiary 1 to Subsidiary 3 are bona fide sales or whether Subsidiary 3 is the creditor of the underlying loans, (iii) whether Subsidiary 3 is engaged in a trade or business within the United States and whether the interest is effectively connected with the conduct of that trade or business, (iv) whether the beneficial owner of the obligation is a U.S. person, or (v) whether the statement requirements of section 871(h)(5) are satisfied.

This ruling is directed only to the taxpayer(s) 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.

Sincerely,
Valerie Mark
Senior Technical Reviewer, Branch 2
Office of the Associate Chief Counsel
(International)