

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:

PLR-146165-07

Date:
December 19, 2007

In Re:

LEGEND

Corporation A	=
Corporation B	=
Business X	=
Buyer	=
Sale proceeds	=
Date 1	=
Year 1	=
Year 2	=

Dear :

This is in response to a letter dated October 10, 2007, submitted on behalf of Corporation A by its authorized representative, requesting rulings as to the federal income tax consequences of a disposition of stock. The rulings contained in this letter are based upon information and representations submitted by Corporation A, 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 this request for ruling, such material is subject to verification upon

examination. The information submitted in the October 10, 2007 letter and subsequent correspondence is substantially as set forth below.

FACTS

Through a series of wholly and non-wholly owned subsidiaries, Corporation A, a foreign corporation, held a greater than 25 percent interest in the value of Corporation B, a foreign corporation engaged in Business X. On Date 1, the stock of a wholly owned indirect subsidiary of Corporation A, which held the majority of Corporation A's indirectly held shares of Corporation B, was sold (the Sale) to Buyer, along with certain loan amounts due, for an amount equaling the Sales Proceeds. Corporation A intends to invest a portion of the Sales Proceeds in assets that can be used in Business X.

Corporation A has a substantial U.S. shareholder base. Applying the look-through rule of section 1297(c) of the Internal Revenue Code (Code), Corporation A is treated as if it received directly the income from the Sale and is treated as if it holds the Sales Proceeds. Due to the Sales Proceeds, if tested quarterly pursuant to the provisions of Notice 88-22, 1988-1 C.B. 489, Corporation A may hold 50 percent or more passive assets in either Year 1 or Year 2, but is unlikely to hold 50 percent or more passive assets in both years. In the absence of an exception, Corporation A may therefore qualify as a passive foreign investment company (PFIC) in Year 1 or Year 2 with respect to its U.S. shareholders under the asset test provided in Code section 1297(a)(2). Corporation A wants to provide guidance to its U.S. shareholders regarding the anticipated U.S. federal income tax consequences of the Sale, its ownership of the Sales Proceeds, and a dividend paid out of the Sales Proceeds.

Corporation A makes the following representations:

1. Corporation A was not a PFIC in any prior taxable year.
2. During the period of Corporation A's ownership of Corporation B, Corporation B was engaged in an active trade or business.
3. Based on current projections, substantially all of Corporation A's passive income for Year 1 and for Year 2 will be attributable to proceeds from the disposition of the Corporation B stock.
4. If Corporation A would qualify as a PFIC under Code section 1297(a)(2) in either Year 1 or Year 2, Corporation A does not expect to be a PFIC in either of the first two taxable years following that year.
5. In applying the income test of Code section 1297(a)(1), Corporation A will determine its gain on the disposition of the Corporation B stock by using a reasonable method to back-out income it has previously taken into account for purposes of Code section 1297(a)(1) in the current or prior taxable years.
6. In applying the income test of Code section 1297(a)(1) and the change of business exception of Code section 1298(b)(3), Corporation A will use a reasonable method to allocate income generated by the disposition of the Corporation B stock as active or passive.
7. In determining whether substantially all of the passive income for the taxable year is attributable to proceeds from the disposition of one or more active trades or businesses for purposes of applying the change of business exception of Code section 1298(b)(3), Corporation A will use a reasonable method to determine the

amount of passive income properly attributable to that portion of the Sales Proceeds that is attributable to the disposition of one or more active trades or businesses.

RULINGS REQUESTED

1. Under Code section 1297(c), the disposition of Corporation B stock will be treated, for purposes of Code section 1297(a), as a disposition of Corporation's A's proportionate share of the assets of Corporation B attributable to that stock.
2. For purposes of Code section 1298(b)(3), the disposition of Corporation B stock will be treated as a disposition of an active trade or business by Corporation A.
3. Code section 1298(b)(3) may be applied to except Corporation A from PFIC status in either Year 1 or Year 2, but not both years.

LAW

Code section 1297(a) defines a PFIC as any foreign corporation if either (1) 75 percent or more of the gross income of such corporation for the taxable year is passive income (income test), or (2) the average percentage of assets held by such corporation during the taxable year which produce passive income or which are held for the production of passive income is at least 50 percent (asset test).

Code section 1297(b)(1) defines passive income as any income which is of a kind which would be foreign personal holding company income as defined in Code section 954(c). Code section 954(c)(1)(B)(i) and Treas. Reg. § 1.954-2(e)(1)(i)(A) provide that gain from the sale of stock is foreign personal holding company income.

Code section 1297(c) provides that if a foreign corporation owns at least 25 percent of the value of the stock of another corporation, for purposes of Code section 1297(a), the foreign corporation will be treated as holding its proportionate share of the assets and receiving directly its proportionate share of the income of the 25-percent owned subsidiary (the look-through subsidiary).

Code section 1298(b)(3) provides that a corporation will not be treated as a PFIC for any taxable year if (A) neither such corporation (nor any predecessor) was a PFIC for any prior taxable year, (B) it is established to the satisfaction of the Secretary that substantially all of the passive income of the corporation for the taxable year is attributable to the proceeds from the disposition of one or more active businesses, and that such corporation will not be a PFIC for either of the first 2 taxable years following such taxable year, and (C) such corporation is not a PFIC for either of such 2 taxable years.

ANALYSIS

The PFIC provisions were enacted as part of the Tax Reform Act of 1986 (The Act), P.L. 99-514, to eliminate the deferral advantage achieved by U.S. investors making passive investments through foreign corporations. In enacting the PFIC provisions, Congress did not intend to affect foreign corporations operating active businesses. To achieve these goals, Congress enacted

Code section 1297(a) which defines a PFIC as any foreign corporation with 75 percent or more passive income or 50 percent or more passive assets. To further distinguish active from passive foreign corporations, Code sections 1297(c) and 1298(b)(3) were enacted to address holding company structures and change of business years.

Code section 1297(c) addresses holding company structures, providing that for purposes of determining PFIC status, instead of being treated as owning stock (a passive asset), a foreign corporation is instead treated as owning its proportionate share of the assets, and receiving directly its proportionate share of the income, of any subsidiary in which it owns at least 25 percent (by value).

The policy intent behind Code section 1297(c) is stated in the Conference Report to the Act:

The conferees do not intend that foreign corporations owning the stock of subsidiaries engaged in active businesses be classified as PFICs. To this end, the agreement attributes a proportionate part of assets and income of a 25-percent owned corporation to the corporate shareholder in determining whether the corporate shareholder is a PFIC under either the asset test or income test.

H.R. Conf. Rep. No. 99-841, Vol. II, at 644 (1986).

Although Code section 1297(c) treats a foreign corporation as holding the assets of a look-through subsidiary instead of the stock of the look-through subsidiary, it is silent on whether a foreign corporation is considered to dispose of the stock or assets of a look-through subsidiary. In PLR 200604020 (January 27, 2006) the Service addressed the application of the income and asset tests of Code section 1297(a) to the disposition of look-through stock, ruling that it is considered a disposition of the foreign corporation's proportionate share of the assets of the look-through subsidiary and of those subsidiaries with respect to which the foreign corporation owns (by value) at least 25 percent. Based on the intent of Congress in crafting the special rule applicable to look-through subsidiaries, the Service continues to believe that this is the correct approach. Thus, in applying Code section 1297(a) to Corporation A, the character (active vs. passive) of the gain attributable to the disposition of the Corporation B stock should be determined by reference to the percentage of active and passive assets in Corporation B at the time of the Sale.

Code section 1298(b)(3) addresses change of business years by providing a special rule for foreign corporations in transition from one active business to another active business. Code section 1298(b)(3) provides that such a transitioning corporation will not be treated as a PFIC if (1) the corporation (or a predecessor) was not a PFIC in any prior taxable year; (2) it is established to the satisfaction of the Secretary that (a) substantially all of the passive income of the corporation in the taxable year is attributable to the disposition of an active business and (b) the corporation will not be a PFIC in either of the first two taxable years following the taxable year; and (3) the corporation is not a PFIC for either of the two taxable years following the taxable year. The policy intent behind Code section 1298(b)(3) is also stated in the Conference Report to the Act:

The conference agreement follows the Senate amendment by excluding . . . corporations in a start-up phase of an active business. The agreement expands this . . .

exception by excluding from PFIC classification corporations in transition from one active business to another active business.

Id., at 644 (1986).

Code section 1298(b)(3) does not specify the manner in which an active trade or business is to be disposed of in order to qualify for the change of business exception. Specifically, Code section 1298(b)(3) does not address whether a foreign corporation's disposition of stock of a look-through subsidiary that is engaged in an active trade or business should be considered to be a disposition of an active trade or business by the foreign corporation. The Service, however, has addressed this question, ruling in PLR 200015028 (April 14, 2000) that Code section 1298(b)(3) was applicable to a disposition of stock of a wholly-owned subsidiary that was conducting an active trade or business. The Service believes the ruling in PLR 200015028 is consistent with Congressional intent that corporations engaged in active business, either directly or through a subsidiary, be eligible to avoid PFIC classification. Thus, it is appropriate that the disposition of stock of Corporation B, a look-through subsidiary engaged in an active trade or business, constitute the disposition of an active trade or business by Corporation A for purposes of applying the change of business exception provided by Code section 1298(b)(3).

In addition to its silence with respect to the manner of disposition, Code section 1298(b)(3) is also ambiguous as to the taxable year to which the exception can be applied. One reading would limit the exception's applicability to the taxable year in which the disposition occurs. However, such a reading favors early year dispositions over late year ones. For example, a calendar year corporation that made a disposition on January 1 would have more time to reinvest and take advantage of the exception than a corporation that made a disposition on November 1. There is no indication in the legislative history that Congress intended preferential treatment towards early year dispositions. Accordingly, it is the Service's position that, while Code section 1298(b)(3) can only exclude a single year from PFIC status, that year may be the year of disposition or alternatively, the year subsequent to disposition.

Therefore, if Corporation A would be treated as a PFIC in Year 1, under either the income or asset test of Code section 1297(a), the exception to PFIC status provided in Code section 1298(b)(3) will apply (subject to Corporation A meeting all the conditions set forth in that section). Alternatively, if due to the date of the disposition of the Corporation B stock, Corporation A would not be treated as a PFIC in Year 1 under either the income or asset test of Code section 1297(a), but due to a failure to timely re-invest the Sales Proceeds in Year 2, would be treated as a PFIC in Year 2, the exception to PFIC status provided by Code section 1298(b)(3) will apply in that year (again, subject to Corporation A meeting all the conditions set forth in that section).

RULINGS

Based on the information submitted and the representations made, we rule as follows:

1. Under Code section 1297(c), the disposition of Corporation B stock will be treated, for purposes of Code section 1297(a), as a disposition of Corporation's A's proportionate share of the assets of Corporation B attributable to that stock.

2. For purposes of Code section 1298(b)(3), the disposition of Corporation B stock will be treated as a disposition of an active trade or business by Corporation A.
3. Code section 1298(b)(3) may be applied to except Corporation A from PFIC status in either Year 1 or Year 2, but not both years.

This private letter ruling is directed only to Corporation A, who requested it. Code section 6110(k)(3) provides that it may not be used or cited as precedent.

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

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

Sincerely,

Ethan A. Atticks
Senior Technical Reviewer, Branch 2
Associate Chief Counsel (International)

cc: