Internal Revenue Service

Department of the Treasury

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Person to Contact:
Bethany A. Ingwalson (ID #: 50-16038)
Telephone Number:
(202) 622-3850
Refer Reply To:
CC:INTL:Br3-PLR-112511-00
Date:
April 3, 2001

Legend:

Corp A =

Corp B =

Corp C =

Corp D =

Corp E =

Corp F =

Corp G =

Corp H =

Corp I =

Corp J =

Corp K =

Country X =

Country Y =

Country Z =

Business J =

$Y =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Year 5 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Date 8 =

Date 9 =

Dear :

This is in response to your letter dated June 21, 2000, as supplemented by your letters dated November 3, 2000, December 18, 2000, December 28, 2000, and February 1, 2001, requesting a ruling that the Corp A consolidated group be permitted to take into account under section 905(c) the payment of additional Country X income taxes in respect of Corp B that are expected to be assessed after Corp B has been liquidated.

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 the appropriate party. While this office has not verified any of the material submitted in support of the request for a ruling, all of the information submitted is subject to verification on examination.

Immediately prior to the transactions described herein, Corp A was the common parent

of an affiliated group of corporations filing consolidated federal income tax returns. Corp C was a wholly owned domestic subsidiary of Corp A and a member of the Corp A consolidated group. Corp D was a wholly owned domestic subsidiary of Corp C and a member of the Corp A consolidated group. Corp E was a wholly owned domestic subsidiary of Corp D and a member of the Corp A consolidated group. Corp D and Corp E collectively owned 100 percent of Corp H, a Country X entity that was treated as a corporation for U.S. income tax purposes. Corp D held a portion of its Corp H stock directly and a portion of its Corp H stock indirectly through its wholly owned subsidiary, Corp F. Corp F is a Country Y entity treated as a corporation for U.S. income tax purposes. Corp E held all of its Corp H stock indirectly through its wholly owned subsidiary, Corp G. Corp G is a Country Z entity treated as a corporation for U.S. income tax purposes. Corp H owned 100 percent of Corp B, a Country X entity that was treated as a corporation for U.S. income tax purposes. Corp H also owned 100 percent of Corp I, a Country X entity that was treated as a corporation for U.S. income tax purposes. The Corp A consolidated group and each of the foreign entities used the calendar year as their taxable year.

Corp B was a controlled foreign corporation engaged in Business J and had been wholly owned by Corp H since Year 1. All of the taxable income accrued by Corp B for Years 2, 3, 4 and 5 had been taken into account by the Corp A consolidated group under section 951(a), and all Country X income taxes accrued by Corp B for those years had been deemed paid by the Corp A consolidated group under section 960.

Corp A wished to restructure its operations in order to reduce costs and make it possible for Corp A to achieve a more efficient use of available capital. As part of the restructuring, the following transactions occurred or will occur:

(1) An election was made pursuant to Treas. Reg. § 301.7701-3(c) to treat Corp I as a disregarded entity for U.S. income tax purposes, effective Date 1.

(2) On Date 2, the Board of Directors of Corp H adopted a plan of complete liquidation.

(3) An election was made pursuant to Treas. Reg. § 301.7701-3(c) to treat Corp H as a partnership for U.S. income tax purposes, effective Date 3.

(4) On Date 4, Corp F and Corp G sold all of their stock in Corp H, and Corp D sold a portion of its stock in Corp H, to a Country X branch of Corp C.

(5) On Date 4, Corp H transferred Corp I to Corp D in exchange for Corp D’s remaining stock in Corp H, which was then canceled.

(6) On Date 6, Corp B merged into Corp H, effective for Country X tax and

commercial law purposes on Date 5 and for Country X civil law purposes upon registration by appropriate judicial process. The merger is intended to be treated as a liquidation into Corp C for U.S. income tax purposes.

(7) On Date 6, Corp H sold all or substantially all of its assets, including the assets received from Corp B, to the Country X branch of Corp C for cash and the assumption of some or all of the liabilities of Corp H, including the liabilities of Corp B.

(8) On Date 7, Corp H made a distribution to the Country X branch of Corp C. Corp H will make at least one additional distribution to the Country X branch of Corp C, including a final liquidating distribution.

On Date 8, Corp A merged with and into Corp J. It is anticipated that Corp C will soon merge with and into Corp K, with Corp K succeeding to all of the assets and liabilities of Corp C. Corp J and Corp K are domestic corporations.

It is expected that upon the completion of Country X tax audits of the Country X income tax returns filed by Corp B for Years 2, 3, 4 and 5, additional Country X income taxes will be assessed in respect of Corp B in an amount that may exceed $Y. It is expected that the assessments will not occur until after Date 9.

Section 901(a) permits a taxpayer to elect to credit income taxes paid or accrued to a foreign country against the taxpayer's U.S. income tax.

Section 902 allows a domestic corporation that owns at least ten percent of the voting stock of a foreign corporation to credit under section 901(a) foreign income taxes of the foreign corporation that the domestic corporation is deemed to pay. The amount of foreign income taxes that a domestic corporation is deemed to pay during any given taxable year is determined by multiplying the foreign corporation's pool of post-1986 foreign income taxes by the ratio of the dividends received by the domestic corporation from the foreign corporation during the taxable year to the foreign corporation's pool of post-1986 undistributed earnings. In chart form, the deemed-paid tax calculation is as follows:

$$\text{Deemed-Paid Taxes} = \text{Post-1986 Foreign Income Taxes} \times \frac{\text{Dividends Received}}{\text{Post-1986 Undistributed Earnings}}$$

Section 960 allows a parallel deemed-paid credit for a domestic corporation that is a shareholder of a controlled foreign corporation when the domestic corporation is required to include in income under section 951(a) undistributed earnings of the controlled foreign corporation. The amount of the credit is determined by the same formula as above, except that the numerator of the ratio is the amount of the section

951(a) inclusion for the taxable year rather than the amount of dividends received during the taxable year. Section 960(a)(1); Treas. Reg. § 1.960-1(i)(1).

Section 905(c) governs the treatment of adjustments in foreign income tax liability. The Taxpayer Relief Act of 1997, Pub. L. No. 105-34, section 1102(a)(2), 111 Stat. 964-65, amended section 905(c). The amendment is effective for foreign income taxes relating to taxable years beginning after December 31, 1997. Except where otherwise indicated, all references to section 905(c) are to the amended version of section 905(c).

As in effect prior to the Taxpayer Relief Act of 1997, section 905(c) provided that if accrued taxes when paid differ from the amounts claimed as credits by the taxpayer, or if any tax paid is refunded in whole or in part, the taxpayer must redetermine its U.S. income tax liability for the year or years affected.

As amended, section 905(c)(1) generally requires a taxpayer to redetermine its U.S. income tax liability for the year or years affected if accrued taxes when paid differ from the amounts claimed as credits by the taxpayer, any tax paid is refunded in whole or in part, or accrued taxes are not paid before the date that is two years after the close of the taxable year to which the taxes relate. Section 905(c)(1) authorizes the Secretary to prescribe adjustments to the pools of post-1986 foreign income taxes and the pools of post-1986 undistributed earnings under sections 902 and 960 in lieu of such a redetermination.

Section 905(c)(2)(A) provides that, except as provided in section 905(c)(2)(B), no credit is allowed for foreign taxes that are not paid within two years of the close of the tax year to which they relate. Section 905(c)(2)(B)(i) provides that if any such unpaid taxes are subsequently paid, they must be taken into account, in the case of taxes deemed paid under section 902 or section 960, for the taxable year in which paid (and no redetermination shall be made by reason of such payment) and, in any other case, for the taxable year to which such taxes relate. Section 905(c)(2)(B)(i)(I) and (II).

Section 989(c)(4) authorizes the Secretary of the Treasury to prescribe regulations providing for alternative adjustments to the application of section 905(c).

Temp. Treas. Reg. § 1.905-3T(d)(2)(i) provides that a redetermination of United States tax liability generally is not required to account for the effect of a redetermination of foreign tax paid or accrued by a foreign corporation on foreign taxes deemed paid by a United States corporation under section 902 or section 960. Instead, adjustments must be made as required by Temp. Treas. Reg. § 1.905-3T(d)(2) and (3). Id.

Temp. Treas. Reg. § 1.905-3T(d)(2)(ii)(B) provides, in general, that appropriate upward or downward adjustments must be made at the time of the foreign tax redetermination to the pool of post-1986 foreign income taxes and the pool of post-1986 undistributed earnings of the foreign corporation to reflect the effect of the foreign tax redetermination

in calculating the amount of foreign taxes deemed paid with respect to distributions and inclusions that are includible in taxable years subsequent to the year affected by the foreign tax redetermination.

For purposes of the foreign tax credit, a foreign income tax is considered to accrue in the taxable year to which such foreign income tax relates, even though the tax does not actually accrue, and is not paid, until a later year. Rev. Rul. 84-125, 1984-2 C.B. 125; Rev. Rul. 58-55, 1958-1 C.B. 266.

(1) Assessments of Country X Income Tax Relating to Taxable Years Beginning on or before December 31, 1997

After the payment of the additional Country X income taxes in respect of Corp B for Years 2 through 4, the amount of accrued foreign income taxes used to calculate the Corp A consolidated group's deemed-paid credits under section 960 will differ from the amount of accrued foreign income taxes ultimately paid. Accordingly, payment of the anticipated assessments of Country X income tax for such taxable years will result in redeterminations of foreign income tax to which the pre-1998 version of section 905(c) will apply.

Under the pre-1998 version of section 905(c), a taxpayer is generally required to redetermine its U.S. income tax liability for the taxable year to which a foreign income tax redetermination relates. Temp. Treas. Reg. § 1.905-3T(d)(2) provides an exception to this rule when the foreign income tax redetermination involves a change in the foreign income tax liability of a foreign corporation that may affect the amount of foreign income taxes deemed paid by a taxpayer under section 902 or section 960. Under the exception, the foreign corporation's pools of post-1986 foreign income taxes and undistributed earnings are adjusted at the time the foreign income tax redetermination occurs, and the redetermination is taken into account in calculating the amount of foreign income taxes deemed paid by the taxpayer with respect to subsequent distributions and inclusions. Temp. Treas. Reg. § 1.905-3T(d)(2)(ii)(B).

The exception contained in the Temporary Treasury regulations does not contemplate cases, like the instant one, where the applicable foreign corporation liquidates into its domestic parent before the redetermination of foreign income tax occurs. In such cases, the redetermination cannot be taken into account through a pooling adjustment at the time of the redetermination. First, the pools of the foreign corporation cannot be adjusted at the time of the redetermination since the pools will not exist at such time. Second, the effect of the redetermination cannot be reflected in calculating the amount of deemed-paid credits with respect to subsequent distributions and inclusions since no such distributions or inclusions will occur. Accordingly, when an assessment of additional foreign income tax with respect to a foreign corporation is paid after the foreign corporation has been liquidated into its domestic parent, the additional foreign income taxes must be taken into account under the general rule contained in the pre-

1998 version of section 905(c) by adjusting the foreign corporation's earnings and taxes pools for the year to which the foreign income taxes relate, and redetermining the U.S. shareholder's deemed-paid taxes and U.S. tax liability for such year and any intervening year affected by the adjustment.

Therefore, if, for U.S. income tax purposes, Corp B is considered to liquidate into Corp C (or Corp K) before the expected assessments of additional Country X income tax are paid, the additional Country X income taxes for Years 2, 3 and 4 must be taken into account by making appropriate adjustments to Corp B's pools of post-1986 foreign income taxes and undistributed earnings for those taxable years. Subject to applicable limitations, the Corp A consolidated group will be eligible to claim deemed-paid credits to the extent allowed under section 902 or section 960 for the additional Country X income taxes in Year 2 and subsequent years.

(2) Assessments of Country X Income Tax Relating to Taxable Years Beginning After December 31, 1997

After the payment of the additional Country X income taxes in respect of Corp B for Year 5, the amount of accrued foreign income taxes used to calculate the Corp A consolidated group's deemed-paid credits under section 960 will differ from the amount of accrued foreign income taxes ultimately paid. Accordingly, payment of the anticipated assessment of Country X income tax for Year 5 will result in a redetermination of foreign income tax under section 905(c)(1). Section 905(c)(1)(A).

It is our understanding that the additional Country X income taxes for Year 5 will be paid more than two years after the close of such year. Section 905(c)(2) governs the treatment of foreign income taxes that are paid more than two years after the close of the taxable year to which the foreign income taxes relate. Section 905(c)(2)(A). Accordingly, we assume that section 905(c)(2) will apply to any additional Country X income taxes that are paid with respect to Year 5.

Section 905(c)(2)(B)(i)(I) applies to payments of foreign income taxes in respect of a foreign corporation that are taken into account under section 902 or section 960. It requires that such foreign income taxes be taken into account in the taxable year in which they are paid (i.e., it requires an adjustment to the foreign corporation's pools of post-1986 undistributed earnings and foreign income taxes for the taxable year in which the foreign income taxes are paid). Section 905(c)(2)(B)(i)(II) applies to payments of foreign income taxes to which section 905(c)(2)(B)(i)(I) does not apply. Section 905(c)(2)(B)(i)(II) requires that the foreign income taxes be taken into account in the taxable year to which the taxes relate.

Foreign income taxes of a foreign corporation that are paid after the foreign corporation has been liquidated into its domestic parent are not eligible to be taken into account under section 902 or 960 in the taxable year in which paid. The foreign corporation's

pools cannot be adjusted for the year in which the foreign income taxes are paid since such pools will not exist at that time. Accordingly, section 905(c)(2)(B)(i)(I) does not apply when foreign income taxes are assessed against a foreign corporation that liquidates into its domestic parent prior to the time the assessment is paid. Because section 905(c)(2)(B)(i)(I) does not apply in such cases, such cases are governed by section 905(c)(2)(B)(i)(II). Under section 905(c)(2)(B)(i)(II), the foreign income taxes must be taken into account in the taxable year to which the taxes relate.

Therefore, if, for U.S. income tax purposes, Corp B is considered to liquidate into Corp C (or Corp K) before the expected assessment of Country X income tax for Year 5 is paid, appropriate adjustments must be made to Corp B's pools of post-1986 foreign income taxes and undistributed earnings for Year 5 to reflect the additional Country X income taxes paid with respect to such year. Subject to applicable limitations, the Corp A consolidated group will be eligible to claim deemed-paid credits to the extent allowed under section 902 or section 960 for the additional Country X income taxes in Year 5 and subsequent years.

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 with respect to the following:

No opinion is expressed with respect to the effective date of the merger of Corp B into Corp H for U.S. income tax purposes or with respect to the U.S. income tax consequences of the merger. See section 332; Treas. Reg. § 1.367(b)-3.

No opinion is expressed with respect to the U.S. income tax consequences of the election pursuant to Treas. Reg. § 301.7701-3(c) to treat Corp I as a disregarded entity, effective Date 1. See section 332; Treas. Reg. §§ 301.7701-3(g) and 7.367(b)-5(c).

No opinion is expressed with respect to the U.S. income tax consequences of the election pursuant to Treas. Reg. § 301.7701-3(c) to treat Corp H as a partnership, effective Date 3. See sections 331, 336 and 954(c); Treas. Reg. § 301.7701-3(g).

No opinion is expressed with respect to the U.S. income tax consequences of the sale of stock in Corp H by Corp F and G to the Country X branch of Corp C. See sections 954(c) and 951(a).

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

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 your authorized representative.

Sincerely,

Barbara A. Felker
Branch Chief, Branch 3
Office of the Associate Chief
Counsel (International)