Internal Revenue Service

Number: **201103022**
Release Date: 1/21/2011

Index Number: 954.02-07

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
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Refer Reply To:
CC:INTL:B02
PLR-124054-10

Date:
September 14, 2010

In Re:

LEGEND:

Taxpayer =
Year 1 =

Dear :

This is in response to a letter dated June 8, 2010, submitted on behalf of Taxpayer by its authorized representative, requesting a ruling granting Taxpayer permission to revoke an election made under Treas. Reg. § 1.954-2(g)(4) with respect to certain of its controlled foreign corporations (CFCs). The ruling contained in this letter is based upon information and representations submitted by 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 this request for ruling, such material is subject to verification upon examination. The information submitted in the request is substantially as set forth below.

FACTS

Taxpayer is a large corporation headquartered in the United States. It operates outside the United States in various foreign countries and through multiple legal entities, including a number of wholly-owned CFCs. Taxpayer has a significant amount of foreign sales, and it employs a hedging strategy whereby certain of its CFCs and foreign disregarded entities enter into short-term foreign currency forward contracts and options to offset some of its foreign currency exchange risk. In Year 1, Taxpayer made an election under Treas. Reg. § 1.954-2(g)(4) on behalf of its CFCs in the interest of administrative convenience to offset net currency losses from section 988 transactions against other categories of foreign personal holding company income attributable to those CFCs. As a result, net foreign currency losses of Taxpayer's CFCs are taken into account to determine its FPHCI, but net foreign currency gains cannot qualify for the business needs exception and are therefore FPHCI.

Because of significant changes of circumstances that have occurred since the Year 1 election, Taxpayer now wants to revoke the election. These changes of circumstances reflect changes in Taxpayer's foreign business operations. Taxpayer believes that the business needs exception available under Treas. Reg. § 1.954-2(g)(2) would likely allow it to exclude a significant portion of its CFCs' section 988 foreign currency gains and losses from the calculation of FPHCI.

Since the election, Taxpayer's international sales have increased dramatically, both in terms of total sales and in terms of the percentage of overall sales. This increase in sales volume as well as the increase in the percentage of sales outside of the U.S., including in new markets, exposes a larger amount of Taxpayer's revenue to foreign currency risk, magnifying the size of Taxpayer's potential hedging gains or losses.

Taxpayer claims that volatility in the foreign currency makes it more complicated for Taxpayer to hedge its foreign currency exposure, increasing the costs associated with Taxpayer's hedging operations and affecting decisions about the amounts hedged, the timing of placing hedges, and the types of hedges to use. This higher volatility results in increased gains and losses generated from both Taxpayer's underlying currency exposures and from Taxpayer's hedging activity.

In response to these changes, Taxpayer has expanded its hedging program and represents that it now has better methods of tracking data associated with hedging operations than it did in Year 1, including the ability to track currency gains and losses for purposes of the business needs exception and the bona fide hedging exception under Treas. Reg. § 1.954-2(g)(2).

RULINGS REQUESTED

Taxpayer requests permission to revoke the election under Treas. Reg. § 1.954-2(g)(4) that it made with respect to its CFCs.

LAW

Code section 951(a) requires a United States shareholder of a CFC to include in gross income its pro rata share of the CFC's subpart F income for the taxable year.

Code section 952(a) defines subpart F income to include, among other things, foreign base company income. Code section 954(a) defines foreign base company income to include FPHCI.

Code section 954(c)(1)(D) provides that FPHCI includes the excess of foreign currency gains over foreign currency losses (as defined in section 988(b)) attributable to any section 988 transactions unless the transaction is directly related to the business needs of the CFC.

Code section 988(a)(1) provides generally that any foreign currency gain or loss attributable to a section 988 transaction shall be computed separately and treated as ordinary income or loss.

Code section 988(b)(1) defines foreign currency gain as any gain from a section 988 transaction

to the extent such gain does not exceed gain realized by reason of changes in exchange rates on or after the booking date and before the payment date.

Code section 988(b)(2) defines foreign currency loss as any loss from a section 988 transaction to the extent such loss does not exceed the loss realized by reason of changes in exchange rates on or after the booking date and before the payment date.

Treas. Reg. § 1.954-1(c)(1)(ii) provides generally that a net loss in any category of FPHCI may not reduce income in any other category of FPHCI.

Treas. Reg. § 1.954-2(g)(2)(ii)(A) provides that foreign currency gain or loss directly related to the business needs of the CFC is excluded from FPHCI. Foreign currency gain or loss is directly related to the business needs of a CFC if it generally falls within one of three categories of foreign currency transactions: (1) certain transactions or property related to the business activities of the CFC; (2) certain gains and losses from bona fide hedging transactions; or (3) transactions in dealer property. Foreign currency gains or losses that fall within the general definition of FPHCI under section 954(c)(1)(D) will be excluded from FPHCI if one of the business needs exceptions is met.

Treas. Reg. § 1.954-2(g)(4)(i) provides that a U.S. shareholder can elect to include in its computation of FPHCI the excess of foreign currency gains over losses or the excess of foreign currency losses over gains attributable to any section 988 transaction (except gains or losses treated as capital gain or loss under section 988(a)(i)(B)). Thus, the general rule of Treas. Reg. § 1.954-1(c)(1)(ii) that net foreign currency losses may not reduce income in any other category of FPHCI would not apply if the CFC has made this election because the regulations specifically provide that the excess of foreign currency losses over foreign currency gains may reduce other categories of FPHCI.

Treas. Reg. § 1.954-2(g)(4)(iii) provides that an election under Treas. Reg. § 1.954-2(g)(4)(i) is effective for the taxable year of the CFC for which it is made and all subsequent years of such CFC unless revoked by or with the consent of the Commissioner.

ANALYSIS

As a U.S. shareholder of its CFCs, Taxpayer must include in gross income its pro rata share of their subpart F income for the taxable year, including their FPHCI. Since Taxpayer made an election on behalf of its CFCs under Treas. Reg. § 1.954-2(g)(4), they are subject to the terms of that election for purposes of calculating their FPHCI. Therefore, in the absence of consent being granted to revoke the Treas. Reg. § 1.954-2(g)(4) election made by Taxpayer, its CFCs must include their net foreign currency gains as FPHCI, without application of any of the exceptions to inclusion of the gains as FPHCI that might otherwise apply.

RULING

Based upon the facts submitted, permission is granted for Taxpayer to revoke the election under Treas. Reg. § 1.954-2(g)(4). The revocation is effective for the taxable year of Taxpayer in which this letter ruling is dated. Additionally, Taxpayer is prohibited from making a new election under Treas. Reg. § 1.954-2(g)(4) until the sixth taxable year following the taxable year for which the revocation is first effective.

No opinion is expressed about whether the business needs exception or the bona fide hedging exception is satisfied in this case.

This private letter ruling is directed only to the taxpayer 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, copies of this letter are being sent to Taxpayer's representatives.

Sincerely,

Jeffery G. Mitchell
Chief, Branch 2
(International)