

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:  
CC:INTL:Br2-PLR-167255-01  
Date:  
April 17, 2002

In Re:

TY: and later

Legend

- Parent =
- Subsidiary =
- Foreign Subsidiaries =
- Market Segment =
- Software =
- Continent =

Dear :

This replies to your letter on behalf of Parent, dated December 7, 2001, in which you requested a ruling on the definition of "United States property" under section 956(c)(1)(D) of the Internal Revenue Code as it relates to computer programs under section 1.861-18 of the Income Tax Regulations.

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

Parent, a publicly traded U.S. corporation, is a Market Segment supply, service, and technology company. Subsidiary, a U.S. corporation and a wholly-owned subsidiary of Parent, is a Market Segment information technology company. Parent is a leading wholesale distributor of various Market Segment products and supplies, and is also a leading provider of various Market Segment services. Subsidiary provides various Market Segment software solutions, as well as various services, to Market Segment organizations. Parent and Subsidiary engage in their business operations both in the

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United States and in numerous countries throughout the world.

Various wholly-owned Foreign Subsidiaries of Subsidiary own Software that is protected by copyright laws in the United States and foreign countries. Foreign Subsidiaries produce the Software in various locations in Continent. Foreign Subsidiaries sell the Software, usually on disks, to customers in the United States and in numerous foreign countries, with title to the Software passing in the country of production. Some purchasers of the Software use the Software in the United States. Foreign Subsidiaries do not own any inventory of Software in the United States and the Software master disks are stored at production facilities outside the United States.

To guard against the unauthorized use and distribution of the Software, under federal copyright law and local law, the Software sales are made under agreements that provide for a "license" of the Software. Purchasers of the Software, however, do not receive any of the following rights: (1) the right to make copies of the Software for purposes of distribution to the public by sale or other transfer of ownership, or by rental, lease or lending; (2) the right to prepare derivative computer programs based upon the Software; (3) the right to make a public performance of the Software; or (4) the right to publicly display the Software. All benefits and burdens of ownership of the Software are transferred to the purchasers of the Software.

Foreign Subsidiaries are controlled foreign corporations (CFCs), and Subsidiary is a United States shareholder thereof.

Section 951(a)(1) provides that every person who is a United States shareholder of a CFC and who owns stock in such corporation on the last day of the CFC's taxable year must include certain items in gross income. Under section 951(a)(1)(B), one of such items is the amount determined under section 956 with respect to the shareholder for the year. The section 956 amount is determined, in part, based on the U.S. shareholder's pro rata share of the average amounts of United States property held by the CFC as of the close of each quarter of the taxable year.

Section 956(c)(1) generally defines United States property as (1) tangible property located in the United States, (2) stock of a domestic corporation, (3) an obligation of a United States person, or (4) any right to the use in the United States of (i) a patent or copyright, (ii) an invention, model, or design (whether or not patented), (iii) a secret formula or process, or (iv) any other similar property right, which is acquired or developed by the controlled foreign corporation for use in the United States. The two types of United States property that may be relevant here are tangible property located in the United States, described in section 956(c)(1)(A), and the right to the use in the United States of a copyright which is acquired or developed by the controlled foreign corporation for use in the United States, described in section 956(c)(1)(D)(i).

Section 1.861-18 of the regulations provides rules for classifying transactions relating to computer programs under certain provisions of the Internal Revenue Code, including subchapter N of Chapter 1, in which section 956 is contained.

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Section 1.861-18(b)(1) generally requires that transactions relating to computer programs be treated as being solely within one of four categories: (i) a transfer of a copyright right in the computer program, (ii) a transfer of a copy of the computer program (a copyrighted article), (iii) the provision of services for the development or modification of the computer program, or (iv) the provision of know-how relating to computer programming techniques.

Under section 1.861-18(c)(1)(i), a transfer of a computer program is classified as the transfer of a copyright right if, as a result of the transaction, a person acquires any one or more of the rights described in section 1.861-18(c)(2)(i) through (iv). Those rights are: (i) the right to make copies of the computer program for purposes of distribution to the public by sale or other transfer of ownership, or by rental, lease or lending, (ii) the right to prepare derivative computer programs based upon the copyrighted computer program, (iii) the right to make a public performance of the computer program, or (iv) the right to publicly display the computer program.

Under section 1.861-18(f)(1), when a transfer is classified as a transfer of a copyright right, the transaction is further classified as either a sale or a license of such right. A transaction is a sale if, taking into account all facts and circumstances, there has been a transfer of all substantial rights in the copyright. A transaction that does not constitute a sale because not all substantial rights were transferred is classified as a license.

If a computer program is transferred, but none of the rights listed in section 1.861-18(c)(2) are acquired, and the transaction involves no more than a de minimis provision of services or know-how, the transfer of the computer program is treated solely as a transfer of a copyrighted article under section 1.861-18(c)(1)(ii). Under section 1.861-18(f)(2), when a transfer is classified as a transfer of a copyrighted article, the transaction is further classified as either a sale or a lease of the article. A transaction is a sale if, taking into account all facts and circumstances, the benefits and burdens of ownership have been transferred. A transaction that does not constitute a sale because insufficient benefits and burdens have been transferred is classified as a lease.

Under section 1.861-18(g)(1), neither the form adopted by the parties to a transaction, nor the classification of the transaction under copyright law, is determinative. Therefore, for example, a transaction that is characterized by the parties as a "license" can be treated as a sale of a copyrighted article if there is a transfer of a computer program on a single disk for a one-time payment with restrictions on transfer and reverse engineering. See section 1.861-18(h), Example 1.

The purchasers of the Software do not receive any of the rights enumerated in section 1.861-18(c)(2). Therefore, under section 1.861-18(c)(1)(ii), the transfers of Software by Foreign Subsidiaries constitute transfers of tangible property, namely, copyrighted articles and not copyright rights. In addition, Foreign Subsidiaries do not own any inventory of Software in the United States, the production of the Software takes place in Continent, title to the Software passes in Continent, and the master disks to the

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Software are physically located outside the United States.

Based on the facts presented and representations made by the taxpayer, we conclude that the Software does not constitute a right to the use in the United States of a copyright, within the meaning of section 956(c)(1)(D). We also conclude that, to the extent the transfers of the Software by the Foreign Subsidiaries are treated as sales pursuant to section 1.861-18(g)(1), the Software does not constitute tangible property located in the United States, within the meaning of section 956(c)(1)(A).

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.

A copy of this letter is to be attached to any 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 the taxpayer.

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

cc: