Internal Revenue Service

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Department of the Treasury
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Person To Contact:
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Telephone Number:

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Date:
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Legend

Taxpayer	=
Year 1	=
Shareholders	=
Royalty Corporation	
Subsidiary 1	=
Subsidiary 2	=
Mineral	=
Process 1	=
Process 2	=
Product 1	=
Product 2	=
Country A	=
Year 2	=
Year 3	=
N	=

Dear :

This responds to a letter submitted on July 29, 2011, on behalf of Taxpayer by your authorized representative requesting a ruling regarding the application of section 871(l)(1)(A)(iii).

FACTS

Taxpayer was organized in Year 1 as a corporation under the laws of Delaware. Shareholders, all foreign corporations, own the stock of Taxpayer.

Since formation, all business activities of Taxpayer have been conducted in Country A. Taxpayer extracts and processes Mineral. Taxpayer processes the Mineral it extracts into Product 1 through Process 1. Product 1 is either sold to customers or is subject to Process 2. Process 2 converts Product 1 into Product 2, which is sold to customers. Taxpayer's extraction operations, Process 1, and Process 2 are referred to as "Production Activities."

Taxpayer also directly owns all the outstanding stock of Subsidiary 1 and Subsidiary 2. All the activities of Subsidiary 1 and Subsidiary 2 are conducted in Country A. Subsidiary 1, a corporation organized under the laws of Country A, operates a railway used to transport Product 1, Product 2, passengers, finished goods, and other products. Subsidiary 1 also performs various port activities, including the storage, handling, and ship loading of Product 1 and Product 2. Subsidiary 2, a corporation organized under the laws of Country A, provides the power supply to the port where Subsidiary 1 operates. Taxpayer's Production Activities, its railway and shipping operations conducted through Subsidiary 1, and its power activities conducted through Subsidiary 2, are collectively referred to as "Mineral Business."

Subsidiary 1 and Subsidiary 2 have elected, pursuant to section 1504(d), to be treated as domestic corporations for U.S. federal income tax purposes and are members of Taxpayer's consolidated group.

In Year 3, in anticipation of long-term growth in the demand for Mineral, Taxpayer decided to increase its Production Activities by incurring approximately N in capital expenditures to upgrade and expand its equipment and facilities. The additional equipment and facilities are similar, and in some cases identical, to the existing equipment and facilities used in Taxpayer's Production Activities. This increase in Production Activities by Taxpayer, along with an anticipated increase in production of Mineral and other products by third parties, is expected to result in an increase in demand for Subsidiary 1's railway and port services, and Subsidiary 2's power supply. To accommodate this expected demand, Subsidiary 1 and Subsidiary 2 intend to incur additional capital expenditures to upgrade their capacity.

The expansion of Taxpayer's Mineral Business is expected to be funded with operational cash flow, third party borrowing, and equity contributions from Shareholders.

The expansion of Taxpayer's Mineral Business will not result in a change of products or services offered or sold to Taxpayer's customers. Taxpayer will continue to provide the same or similar products and services to the same class of customers through the same Production Activities, railway activities, and port activities.

Taxpayer has requested a ruling that the proposed expansion of its Mineral Business will not constitute "an addition of a substantial line of business" within the meaning of section 871(l)(1)(A)(iii).

REPRESENTATIONS

Taxpayer has made the following representations:

a) Taxpayer satisfies the requirements described in section 871(l)(1)(A)(i) and (ii).

b) Taxpayer's business activities resulting from the proposed expansion are closely related to Taxpayer's pre-existing Mineral Business and not the addition by Taxpayer of a new line of business under the principles of Treas. Reg. section 1.7704-2(d).

c) The acquisition of foreign operating assets is not for the purpose of increasing Taxpayer's active foreign business percentage (within the meaning of section 871(l)(2)).

LAW AND ANALYSIS

Except as provided in section 871(h), section 871(a)(1) imposes for each taxable year a tax of 30 percent of the amount received from sources within the United States by a nonresident alien individual as interest (other than original issue discount) and dividends. Section 881(a) provides a similar rule with respect to interest and dividends received by foreign corporations.

Prior to the enactment of the *Education, Jobs and Medicaid Assistance Act* (EJMAA), P.L. 111-226 (2010), special rules applied to interest and dividends received from domestic corporations that met the 80 percent foreign business requirements of section 861(c)(1) (so-called "80/20 companies"). See former sections 861(a)(1)(A), 861(c)(1), 871(i)(2)(B) and 881(d). EJMAA repealed these special rules, subject to a "grandfather" rule provided in current section 871(i)(2)(B). This grandfather rule provides that tax is not imposed under section 871(a) on the active foreign business percentage (as defined in section 871(l)(2)) of (i) any dividend paid by an existing 80/20 company, and (ii) any interest paid by an existing 80/20 company. Current section 881(d) similarly provides that no tax is imposed under section 881(a) on dividends or interest described in section 871(i)(2)(B).

Section 871(l)(1)(A) defines the term "existing 80/20 company" as any corporation if:

(1) Such corporation met the 80 percent foreign business requirements of section 861(c)(1) (as in effect prior to August 10, 2010) for such corporation's last taxable year beginning before January 1, 2011;

(2) Such corporation meets the 80 percent foreign business requirements of section 871(l)(1)(B) with respect to each taxable year after the taxable year referred to in paragraph (1), above; and

(3) There has not been an addition of a substantial line of business with respect to such corporation after August 10, 2010.

Section 871(l)(3) provides that for purposes of determining whether there has not been an addition of a substantial line of business under section 871(l)(1)(A)(iii) the corporation referred to in section 871(l)(1)(A) and all of such corporation's subsidiaries shall be treated as one corporation. For this purpose, the term "subsidiary" means any corporation in which the corporation described in section 871(l)(3)(A) owns (directly or indirectly) stock meeting the requirements of section 1504(a)(2) (determined by substituting "50 percent" for "80 percent" each place it appears and without regard to section 1504(b)(3)).

The Joint Committee on Taxation's technical explanation of the revenue provisions of EJMAA states that:

> For purposes of determining whether a substantial line of business has been added, rules similar to those of section 7704(g) and the Treasury regulations thereunder (relating to certain publicly-traded partnerships treated as corporations) apply. It is anticipated that the Secretary will issue guidance providing that the acquisition of foreign operating assets or stock of a foreign corporation by the existing 80/20 company for the purpose of increasing its active foreign business percentage will be treated as the addition of a substantial line of business.

Staff of the Joint Committee on Taxation*, Technical Explanation of the Revenue Provisions of the Senate Amendment to the House Amendment to the Senate Amendment to H.R. 1586,* Scheduled for Consideration by the House of Representatives on August 10, 2010, at 34 and 35 (August 10, 2010).

In its discussion of the termination of the 80/20 company rules pursuant to EJMAA, the Joint Committee on Taxation's General Explanation of Tax Legislation Enacted in the 111th Congress similarly provides:

> For purposes of determining whether a substantial line of business has been added, rules similar to those of section 7704(g) and the Treasury regulations thereunder (relating to certain publicly-traded partnerships treated as corporations and including specifically Treas. Reg. section 1.7704-2(c) to (e)) apply.

Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 111th Congress (JCS-2-11), at 454, March 2011.

Section 7704(a) provides that, except as provided in section 7704(c), a publicly traded partnership shall be treated as a corporation.

Section 7704(g)(1) provides that section 7704(a) shall not apply to an electing 1987 partnership. Section 7704(g)(2) provides that an electing 1987 partnership ceases to be treated as an electing 1987 partnership as of the first day after December 31, 1997, on which there has been an addition of a substantial new line of business with respect to such partnership.

Treasury Reg. section 1.7704-2(c)(1) provides that a new line of business is substantial as of the earlier of (i) the taxable year in which the partnership derives more than 15 percent of its gross income from that line of business, or (ii) the taxable year in which the partnership directly uses in that line of business more than 15 percent (by value) of its total assets.

Treasury Reg. section 1.7704-2(d)(1) provides that a new line of business is any business activity of the partnership not closely related to a pre-existing business of the partnership to the extent that the activity generates income other than "qualifying income" within the meaning of section 7704 and the regulations thereunder.

Treasury Reg. section 1.7704-2(d)(2) provides, in relevant part, that a business activity is a pre-existing business of the partnership if the partnership was actively engaged in the activity on or before December 17, 1987.

Treasury Reg. section 1.7704-2(d)(3) provides that all of the facts and circumstances will determine whether a new business activity is closely related to a pre-existing business of the partnership.

CONCLUSION

Based solely on the facts and representations submitted, we conclude that the proposed expansion of Taxpayer's Mineral Business, as described above, will not constitute "an addition of a substantial line of business" within the meaning of section 871(l)(1)(A)(iii).

Except as specifically set forth above, no opinion is expressed or implied as to the federal income tax consequences of the facts of this case under any other provision of the Code.

Pursuant to a power of attorney on file with this office, a copy of this ruling is being sent to your authorized representative.

Sincerely,

John J. Merrick
Special Counsel
(International)