

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **201330006**
Release Date: 7/26/2013
Index Number: 954.02-06

Third Party Communication: None
Date of Communication: Not Applicable

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, ID No.

Telephone Number:

Refer Reply To:
CC:INTL:B02
PLR-131527-12

Date:
May 28, 2013

LEGEND

Taxpayer =

US Sub =

CFC =

Country A =

Partnership =

Foreign Corporation =

DE =

Product =

x =

y =

Dear :

This is in response to a letter received in this office on July 20, 2012, in which a ruling is requested to clarify that a controlled foreign corporation’s income from a business of producing and selling Product under a long term outputs contract is not includible in foreign base company income under section 954.

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 rulings, it is subject to verification on examination.

FACTS

Taxpayer is the -percent owner of US Sub, which indirectly owns percent of CFC, a corporation for U.S. federal income tax purposes that is incorporated in Country A and is a controlled foreign corporation within the meaning of section 957. CFC owns percent of the shares of Partnership, a Country A entity that is classified as a partnership for U.S. federal income tax purposes. Foreign Corporation, an unrelated Country A corporation, owns the remaining percent of Partnership. Partnership owns all of the outstanding equity of DE, a Country A entity that is classified as a disregarded entity for U.S. federal income tax purposes.

DE is constructing a plant in Country A to produce Product. DE is and will be involved in the development, design, construction, commissioning, ownership, and operation of the plant. All of DE's assets and operations are in Country A. Partnership's business consists of the evaluation, acquisition, development, construction, operation, leasing, and other management of the Product production business conducted by it through DE.

As is typical of plants producing Product, the ongoing operation of the plant after its development and construction by DE will require a relatively low level of activity and expense, in terms of both personnel and raw materials, as compared to plants for other types of y.

The operations of the plant will be managed by a general manager, who is a full-time employee of DE. The general manager's role is to ensure that the plant is built on schedule, within budget, and to specifications, and, once the plant is operational, that the plant operates in accordance with good industry practice to maximize its output. The general manager will supervise the service providers' performance, oversee compliance under the plant's outputs contract with the customer, supervise actual performance of the plant, develop budget and business plans, maintain governmental approvals required for the project, and supervise other employees of DE, among other functions. The general manager will report to the board of Partnership.

DE will hire a service provider to provide specialized services in the maintenance and operation of the plant. In particular, the service provider will provide DE with certain continuous system monitoring, performance engineering, emergency response, maintenance, and similar functions. The persons performing these duties will be hired and paid by the service provider. DE will supervise the service provider's performance but will have no direct relationship with the service provider's employees, except that

DE will retain the right to direct the service provider to remove any employee that falls below certain standards.

During the first x years of operation, all of the Product produced at the plant will be sold under an outputs contract to an unrelated Country A corporation that is wholly owned by a subdivision of the Country A government. Partnership does not purchase any personal property from CFC or any person related to CFC. Product will be sold at a fixed price subject to adjustment based on a local consumer price index. Thus, during the period subject to this long term contract, DE bears no meaningful economic exposure to variations in the price of Product and cannot engage in speculative behavior with regard to the Product it produces because all of Product will be immediately provided to the purchaser at a pre-determined price.

Taxpayer represents that substantially all of CFC's and Partnership's commodities are property described in section 1221(a)(1), (2), or (8).

RULING REQUESTED

CFC's distributive share of income from Partnership's business of producing and selling Product is not includible in foreign base company income under section 954.

LAW

A U.S. shareholder of a controlled foreign corporation (CFC) is generally required to include in income on a current basis its pro rata share of the CFC's subpart F income. Section 951(a). Subpart F income includes foreign base company income, which consists of several categories of income, including foreign base company sales income (FBC Sales Income), foreign base company services income (FBC Services Income), and foreign personal holding company income (FPHCI). Sections 952 and 954.

Section 954(d)(1) defines FBC Sales Income to mean income (whether in the form of profits, commissions, fees, or otherwise) derived in connection with: the purchase of personal property from a related person and its sale to any person, the sale of personal property to any person on behalf of a related person, the purchase of personal property from any person and its sale to a related person, or the purchase of personal property from any person on behalf of a related person where (A) the property which is purchased (or in the case of property sold on behalf of a related person, the property which is sold) is manufactured, produced, grown, or extracted outside the country under the laws of which the CFC is created or organized, and (B) the property is sold for use, consumption, or disposition outside such foreign country, or, in the case of property purchased on behalf of a related person, is purchased for use, consumption, or disposition outside such foreign country.

Section 954(d)(2) provides that when the carrying on of activities by a CFC through a branch (or similar establishment) outside the country of incorporation of the CFC has substantially the same effect as if such branch were a wholly owned subsidiary corporation deriving such income, the income attributable to the carrying on of such activities of such branch shall constitute FBC Sales Income.

Section 954(e)(1) defines FBC Services Income to mean income derived in connection with the performance of technical, managerial, engineering, architectural, scientific, skilled, industrial, commercial, or like services which (A) are performed for or on behalf of any related person and (B) are performed outside the country under the laws of which the controlled foreign corporation is created or organized.

Section 954(c)(1) defines FPHCI to include interest, dividends, rents, and royalties, as well as the excess of gains over losses from transactions (including futures, forward, and similar transactions) in any commodities. However, net gains from transactions in commodities do not constitute FPHCI if one of three statutory exceptions applies. One of these statutory exceptions applies to certain active business gains or losses from the sale of commodities. Specifically, section 954(c)(1)(C)(ii) provides that FPHCI does not include net gains from transactions in commodities if the gains are active business gains or losses from the sale of commodities and substantially all of the CFC's commodities are property described in section 1221(a)(1), (2), or (8).

Treas. Reg. § 1.952-1(g)(1) states that a CFC's distributive share of any item of partnership income is income that falls within a category of subpart F income described in section 952(a) to the extent the item of income would have been income in such category if received by the CFC directly.

Treas. Reg. § 1.954-1(g)(1) provides that, to determine the extent to which a CFC's distributive share of any item of gross income of a partnership would have been subpart F income if received by it directly, if a provision of subpart F requires a determination of whether an entity is a related person within the meaning of section 954(d)(3), or whether an activity occurred within or outside the country under the laws of which the CFC is created or organized, this determination shall be made by reference to the CFC and not by reference to the partnership.

Treas. Reg. § 1.954-2(a)(5) provides special rules for calculating FPHCI applicable to distributive shares of partnership income. Treas. Reg. § 1.954-2(a)(5)(ii)(A) provides that the exclusion provided by Treas. Reg. § 1.954-2(e)(3)(iv) shall apply only if such exception would have applied to exclude the income from FPHCI if the CFC had earned the income directly, determined by taking into account only the activities of, and property owned by, the partnership and not the separate activities or property of the CFC or any other person.

Treas. Reg. § 1.954-4(b)(2)(iii) provides that a CFC's distributive share of a partnership's services income will be deemed to be derived from services performed for or on behalf of a related person, within the meaning of section 954(e)(1)(A), if the partnership is a related person with respect to the CFC under section 954(d)(3), and, in connection with the services performed by the partnership, the CFC (or a person that is a related person with respect to the CFC) provided assistance that would have constituted substantial assistance contributing to the performance of such services if furnished to the CFC by a related person.

RULING

Accordingly, based solely on the information and representations set forth above, it is held that CFC's distributive share of income from Partnership's business of producing and selling Product is not includible in foreign base company income under section 954.

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.

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 must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

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
Office of the Associate Chief Counsel
(International)