

**Internal Revenue Service**

Number: **201515006**  
Release Date: 4/10/2015  
Index Number: 1297.00-00

Department of the Treasury  
Washington, DC 20224

Third Party Communication: None  
Date of Communication: Not Applicable

Person To Contact:  
, ID No.

Telephone Number:

Refer Reply To:  
CC:INTL:BR:2  
PLR-119133-14  
Date:  
November 21, 2014

TY:

Legend

Corp X =

Country M =

a =

US Corp Y =

US Corp Z =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Year 5 =

Dear :

This is in response to a letter received in this office dated May 6, 2014, in which a ruling is requested to clarify the proper application of certain look-through rules for purposes of determining whether Corp X is a passive foreign investment company ("PFIC") within the meaning of section 1297.

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

Corp X is a publicly traded Country M corporation that was founded in Year 1. Approximately a% of its shares are currently held by United States persons. Corp X is not a controlled foreign corporation within the meaning of section 957(a). Corp X has requested a determination regarding the application of sections 1298(b)(7) and 1297(c) for purposes of determining whether Corp X is a PFIC.

Corp X directly owns all of the outstanding shares of US Corp Y, a domestic corporation that was formed in Year 2. US Corp Y formed US Corp Z, a domestic corporation, in Year 3 with a capital contribution, and has directly owned all of the outstanding shares of US Corp Z since its formation.

Corp X is engaged in a business involving the research, development, commercialization, and marketing of certain pharmaceutical treatments. US Corp Y conducts operations related to Corp X's pharmaceutical, research, and development business.

Corp X holds an obligation of US Corp Y, which requires US Corp Y to pay or accrue U.S.-source interest expense in Year 5 and subsequent taxable years.

Corp X does not currently own any PFIC stock. Taking into account only income earned and assets owned directly by Corp X and income earned and assets owned by US Corp Y other than dividends from and stock of US Corp Z, Corp X would not currently be a PFIC within the meaning of section 1297.

The treaty between the United States and Country M includes a provision that would prevent the United States from taxing (including under the accumulated earnings tax described in section 531) undistributed profits of a corporation that is a resident of Country M. However, the board of directors of Corp X has passed a resolution to formally and irrevocably waive any protection under the U.S.-Country M treaty against

the imposition of the accumulated earnings tax, effective for the tax year ending December 31 of Year 4 and all future taxable years.

## LAW

Section 1297(a) provides that a foreign corporation is a PFIC with respect to a taxable year if either (1) 75 percent or more of the gross income of the corporation for the taxable year is passive income (“income test”), or (2) the average percentage of assets held by the corporation during the taxable year which produce passive income or which are held for the production of passive income (“passive assets”) is at least 50 percent (“asset test”).

Section 1297(b)(1) provides that, for purposes of section 1297(a), the term “passive income” means any income (other than income qualifying under the exceptions set forth in section 1297(b)(2)) which is of a kind which would be foreign personal holding company income as defined in section 954(c).

Section 1297(c) contains a look-through rule that provides that if a foreign corporation owns, directly or indirectly, at least 25 percent of the value of the stock of another corporation, then the foreign corporation is treated (for purposes of section 1297(a)) as holding its proportionate share of the assets, and as receiving directly its proportionate share of the income of, the 25-percent owned subsidiary.

Section 1298(b)(7) contains a look-through rule that provides that if a foreign corporation owns 25 percent or more (by value) of the stock of a domestic corporation (“first-tier domestic corporation”), and if the foreign corporation is either subject to the accumulated earnings tax or waives any benefit under any treaty which otherwise would prevent the imposition of the accumulated earnings tax, then for purposes of determining whether the foreign corporation is a PFIC: (1) any shares of another domestic corporation, other than a regulated investment company or real estate investment trust (“second-tier domestic corporation”), that are held by the first-tier domestic corporation are not treated as a passive asset; and (2) any amount included in the gross income of the first-tier domestic corporation with respect to the shares of such second-tier domestic corporation is not treated as passive income.

Unless an income tax treaty provides otherwise, a foreign corporation (other than a PFIC) that has any shareholder who is a U.S. citizen or resident is subject to the accumulated earnings tax with respect to the corporation’s U.S.-source income (including U.S.-source dividend and interest income that is not effectively connected with a trade or business conducted within the United States by the foreign corporation). See section 532; Treas. Reg. §§ 1.532-1(c) and 1.535-1(b).

An article of the U.S.-Country M treaty provides that a Country M corporation may be subject to the accumulated earnings tax for a particular taxable year only if 50% or more

in value of the outstanding voting shares of the corporation is owned, directly or indirectly, throughout the last half of the taxable year by citizens or residents of the United States (other than certain citizens of Country M) or by residents of a country other than the U.S. or Country M. For purposes of satisfying the requirement in section 1298(b)(7)(A)(i), a corporation may waive any benefit under a treaty that otherwise would prevent the imposition of the accumulated earnings tax.

The legislative history of section 1298(b)(7) states:

The bill further treats stock of certain U.S. corporations owned by another U.S. corporation which is at least 25-percent owned by a foreign corporation as a non-passive asset. Under this rule, in determining whether a foreign corporation is a PFIC, stock of a regular domestic C corporation owned by a 25-percent owned domestic corporation is treated as an asset which does not produce passive income (and is not held for the production of passive income), and income derived from that stock is treated as income which is not passive income. Thus, a foreign corporation, in applying the look-through rule available to 25-percent owned corporations, will be treated as owning non-passive assets in these cases. This rule does not apply, however, if, under a treaty obligation of the United States, the foreign corporation is not subject to the accumulated earnings tax, unless the corporation agrees to waive the benefit under the treaty. This rule is designed to mitigate the potential disparate tax treatment between U.S. individual shareholders who hold U.S. stock investments through a U.S. holding company and those who hold those investments through a foreign holding company. If a foreign investment company attempts to use this rule to avoid the PFIC provisions, it will be subject to the accumulated earnings tax and, thus, the shareholders of that company will be subject to tax treatment essentially equivalent to that of the shareholders of PFICs.

H.R. Rep. No. 795, 100th Cong., 2d Sess., 273 (1988); S. Rep. No. 445, 100th Cong., 2d Sess., 286-87 (1988); Joint Committee on Taxation, Description of the Technical Corrections Act of 1988 (H.R. 4333 and S. 2238), 294 (JCS-10-88 March 31, 1988).

## RULINGS

For purposes of determining whether Corp X is a PFIC:

- (1) Pursuant to sections 1298(b)(7) and 1297(c), shares of US Corp Z are treated as an asset held directly by Corp X that does not produce passive income (and is not held for the production of passive income) for purposes of applying the asset test to Corp X.

- (2) Pursuant to sections 1298(b)(7) and 1297(c), dividends paid by US Corp Z to US Corp Y are treated as received directly by Corp X and are not treated as passive income for purposes of applying the income test to Corp X.
- (3) Pursuant to section 1297(c), the stock of US Corp Y and dividends paid by US Corp Y to Corp X and otherwise includible in Corp X's income are disregarded for purposes of applying the asset test and the income test, respectively, to Corp X.
- (4) Pursuant to section 1297(c), the loan from Corp X to US Corp Y and interest paid or accrued pursuant to that loan are disregarded for purposes of applying the asset test and income test, respectively, to Corp X.

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. No opinion is expressed or implied concerning the interaction of sections 1297(c) and 1298(b)(7) if Corp X would be a PFIC under section 1297 as a result of income earned and assets owned directly by Corp X and income earned and assets owned by US Corp Y other than dividends from, or stock of, US Corp Z.

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 Corp X's representatives.

Sincerely,

Jeffery G. Mitchell  
Chief, Branch 2  
Office of the Associate Chief Counsel  
(International)