

Office of Chief Counsel
Internal Revenue Service
memorandum

CC:INTL:
POSTN-113713-04

Number: **200428007**
Release Date: 7/9/04

UILC: 1503.04-00; 1503.04-07

date: March 25, 2004

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subject:

Noncompliance with regulations under section 1503(d)

This memorandum is to advise you of certain matters uncovered by the National Office during the course of causing the IRS to enter into a closing agreement under §1.1503-2(g)(2)(iv)(B)(2)(i) with (" "), EIN , and (" "), EIN . Specifically, we would like to make you aware of certain rebuttal statements attached to 's and consolidated income tax returns. An abbreviated version of the facts is provided below.

Background

Prior to , was a domestic corporation and the common parent of a consolidated group (Group) that included its wholly owned subsidiary . On , acquired the stock of an unrelated entity, , a domestic corporation (" "), EIN: . Prior to the acquisition, was the common parent of an unrelated calendar-year consolidated group (" ") that included (" "), and (" "), both domestic corporations. The operations of were conducted entirely out of its (" Branch"), (" Branch"), and

branches (“ Branch”) (collectively, “ Branch”). Similarly, the operations of were conducted solely out of its branch (“ Branch”). , and were all members of the .

Each of the Branches, as well as the Branch is a foreign branch separate unit as described in Treas. Reg. §1.1503-2(c)(3)(i)(A) and a dual resident corporation under Treas. Reg. §1.1503-2(c)(2). , as the common parent of the Group, filed consolidated Federal income tax returns for the tax years ended December 31, , , , and for the short period ended . Each of the Branches generated net operating losses (“NOLs”), that are dual consolidated losses as described in Treas. Reg. §1.1503-2(c)(5), as follows:

Branch

<u>Taxable Year End</u>	<u>Amount of loss</u>
December 31,	

Branch

<u>Taxable Year End</u>	<u>Amount of loss</u>
December 31,	

Branch

<u>Taxable Year End</u>	<u>Amount of loss</u>
December 31,	

The Branch generated a NOL, computed in accordance with Treas. Reg. §1.1503-2(d)(1), that is a dual consolidated loss as described in Treas. Reg. §1.1503-2(c)(5) as follows:

<u>Taxable Year End</u>	<u>Amount of loss</u>

The used all of the NOLs of the Branches and the Branch within the meaning of Treas. Reg. §1.1503-2(c)(15)(i).

Points of interest

Although we determined that there were several areas where the taxpayer had not strictly complied with the regulations under §1503(d), it was decided that these areas should not hinder the execution of the requested closing agreement. Instead, it was decided that we would point out our concerns to the taxpayer and advise the taxpayer that a memorandum summarizing our concerns would be sent to the appropriate IRS officials. The areas we identified that are of interest are listed below. Points 2-5 each involve a disposition of a branch that occurred after the initial acquisition of on , which was the subject of the closing agreement, and these transactions have not previously been described. All of the points (1-5), in their own right, would trigger some or all of the dual consolidated losses previously used by the Group. The items are listed in chronological order.

1. The acquisition of on , caused the Group to cease to exist and , the Branches, and the Branch became part of the Group. The acquisition by , which terminated the Group, is a triggering event under Treas. Reg. §1.1503-2(g)(2)(iii)(A)(2). Because of the acquisition, the Group was required to file an agreement under Treas. Reg. §1.1503-2(g)(2)(i) with its timely filed income tax return for the taxable year. The Group failed to properly file this agreement and requested relief under Treas. Reg. §301.9100 for an extension of time to file the agreement. This relief was granted in a letter ruling issued on February 27, 2004. The letter ruling requires to file an amended return attaching the agreement within 45 days of the date the letter ruling was issued. To our knowledge, this agreement has not been filed (and was not yet due as of the date of this memorandum).

2. On , transferred the assets of its Branch to (), a company wholly owned by , in exchange for Class B shares of . This transfer constituted a triggering event under Treas. Reg. §1.1503-2(g)(2)(iii)(A)(5). represents that the recapture of all of the DCLs of was properly rebutted because it attached the statement required by Treas. Reg. §1.1503-2(g)(2)(vii)(B). We have examined this rebuttal statement and believe it is flawed. First, the rebuttal statement incorrectly lists the amount of losses to be rebutted because it references only the post-acquisition losses of the branches rather than the pre-acquisition losses. Second, the rebuttal statement attempts to rebut the recapture of the dual consolidated losses based upon income that was earned by the Group prior to the time that the dual consolidated losses were incurred. The taxpayer's position appears contrary to the language of §1.1503-1(g)(2)(vii)(B) and the examples illustrating the rule. See §1.1503-2(g)(2)(vii)(G) Examples 1 and 2.

3. On , sold the assets of its branch to for cash. This transfer would have constituted a triggering event under Treas.

Reg. §1.1503-2(g)(2)(iii)(A)(5) but for _____'s representation that the rebuttal statement required by Treas. Reg. §1.1503-2(g)(2)(iii)(B) was attached to its timely filed U.S. income tax return for the taxable year ended December 31, _____. However, we have examined the rebuttal statement and note that _____ has not attached documents demonstrating that the losses, expenses, or deductions of the dual resident corporation or separate unit could not be carried over or otherwise used under the laws of the foreign country, as required by §1.503-2(g)(2)(iii)(B).

4. On _____, _____ sold the assets of its _____ branch to _____ for cash. This transfer would have constituted a triggering event under Treas. Reg. §1.1503-2(g)(2)(iii)(A)(5) but for _____'s representation that the rebuttal statement required by Treas. Reg. §1.1503-2(g)(2)(iii)(B) was attached to its timely filed U.S. income tax return for the taxable year ended December 31, _____. However, we have examined the rebuttal statement and note that _____ has not attached documents demonstrating that the losses, expenses, or deductions of the dual resident corporation or separate unit could not be carried over or otherwise used under the laws of the foreign country, as required by §1.503-2(g)(2)(iii)(B).

5. On _____, _____ sold the assets of its _____ branch to _____ for cash. This transfer constituted a triggering event under Treas. Reg. §1.1503-2(g)(2)(iii)(A)(5). _____, as the common parent of the _____ Group, failed to attach the statement required under Treas. Reg. §1.1503-2(g)(2)(iii)(B) to its timely filed U.S. income tax return to rebut the presumption of the triggering event. _____ requested relief under Treas. Reg. §301.9100 for an extension of time to file the statement required by Treas. Reg. §1.1503-2(g)(2)(iii)(B) with its amended return for the taxable year ended December 31, _____. The Service granted additional time to timely file the proper statement in a private letter ruling issued on June 6, 2003 (PLR-12579-03), and the statement was filed with the Service as part of _____'s amended return on _____. We have examined the rebuttal statement and note that _____ has not attached documents demonstrating that the losses, expenses, or deductions of the dual resident corporation or separate unit could not be carried over or otherwise used under the laws of the foreign country, as required by §1.503-2(g)(2)(iii)(B).

Conclusion

We have identified several instances where the taxpayer's compliance with the regulations under §1503(d) is questionable. The transactions set forth in 2-5 above were not initially disclosed to the National Office in the closing agreement request, but rather, were identified after further inquiry by our office. Upon delving into the various dispositions, it appears taxpayer's compliance with the regulations is insufficient. However, the sufficiency of the documentation is appropriately within your discretion.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views. Please call (202) 622-3860 if you have any questions.

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