



Number I =  
Amount J =  
Number K =  
Amount L =  
Number M =  
Amount N =  
Number O =  
Amount P =  
Date 1 =  
Date 2 =  
Year 1 =  
Year 2 =  
Year 3 =  
Year 4 =

Dear :

This responds to your letter dated October 7, 2005, requesting rulings concerning Article (Limitation on Benefits) of the United States-Country A income tax treaty (the "Treaty").<sup>1</sup>

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

### A. Taxpayer

Taxpayer is a corporation organized in Country A. Taxpayer represents that it is a resident of Country A for purposes of Country A income tax law. Taxpayer is a wholly owned subsidiary of Parent Co, a publicly traded Country B corporation that is engaged in Business X, a service business, and other business activities related thereto through its direct and indirect subsidiaries. Taxpayer represents that Parent Co is entitled to the benefits of the United States-Country B income tax treaty. Taxpayer is not itself directly engaged in the active conduct of a trade or business within the meaning of Article of the Treaty. Taxpayer's principal business purpose is to finance the activities of

---

<sup>1</sup>

Parent Co and its worldwide affiliates, including U.S. Co and U.S. Co's U.S. subsidiaries.<sup>2</sup>

Taxpayer currently has loans outstanding to the Country A Group of approximately Amount C. Taxpayer was also indirectly involved in providing funds for the acquisition of Country A Co. Taxpayer currently has loans outstanding to the U.S. Group of approximately Amount D, which represents less than 15 percent of Taxpayer's total assets. The members of the U.S. Group have utilized the loan proceeds for capital expenditures and business operations.

Taxpayer has raised funding by issuing notes to the public in U.S. and international capital markets and by the issuance of medium-term notes. Taxpayer has also borrowed relatively small amounts from banks. As of Date 1, Taxpayer had notes outstanding with an aggregate principal amount of approximately Amount E. Approximately Amount F of the notes were issued in bearer form as Eurobonds and medium-term notes. Since at least Year 1, Taxpayer issued bearer notes under procedures that complied with the rules of section 163(f)(2)(B) and other requirements of the U.S. portfolio interest exemption under sections 871(h) and 881(c). The remaining approximately Amount G of the notes were issued under the shelf registration statement that Taxpayer filed with the Securities and Exchange Commission.

Taxpayer receives interest payments from the members of the U.S. Group. These interest payments are the income of Taxpayer at issue in the present ruling.

#### B. Country A Co

Country A Co is a corporation organized in Country A. Taxpayer represents that Country A Co is a resident of Country A for purposes of Country A income tax law. Country A Co is a wholly owned indirect subsidiary of Parent Co. Parent Co acquired a significant interest in Country A Co in Year 1. Also in Year 1, Parent Co entered into a Contract to acquire certain Country A Co shares. In Year 2 Parent Co entered into another Contract to acquire the balance of the Country A Co shares. Parent Co completed its purchase of 100 percent of Country A Co in Year 3. The acquisition of Country A Co was accomplished by purchasing shares of Country A Holding Co, a Country A corporation that wholly owns Country A Co. Country A Co and Taxpayer are wholly owned by Parent Co, directly in the case of Taxpayer and indirectly<sup>3</sup> in the case of Country A Co.

---

<sup>2</sup> U.S. Co is the common parent of an affiliated group of corporations making a consolidated return for U.S. federal income tax purposes. This group is hereinafter referred to as the "U.S. Group."

<sup>3</sup> Taxpayer represents that, in the tax year at issue, Country A Co was indirectly wholly owned by Parent Co through a series of wholly owned Country B entities: Parent Co wholly owned Country B Entity 1, which wholly owned Country B Entity 2 and Country B Entity 3. Country B Entity 2 and Country B Entity 3 wholly owned Country B Entity 4, which wholly owned Country A Holding Co.

Country A Co has Number H wholly owned Country A subsidiaries that support its activities in Country A. Country A Co and its Number H Country A subsidiaries collectively form the “Country A Group.” The Country A Group’s activities in Country A consist solely of Business X and activities related to Business X.

The Country A Group ranks as the third largest participant in Business X in Country A, with approximately Number I customers and approximately Amount J in revenues in Year 4. The Country A Group had about Number K employees on Date 2, and its gross assets on Date 2 were approximately Amount L.

Taxpayer represents that the officers and employees of the companies comprising the Country A Group exercise substantial managerial and operational control over Business X activities of the Country A Group.

### C. U.S. Co

U.S. Co is a domestic corporation incorporated in State. U.S. Co is a wholly owned indirect subsidiary of Parent Co and the common parent of the U.S. Group.

The U.S. Group operates Business X in the United States. The U.S. Group’s activities in the United States consist solely of Business X and activities related to Business X.

The U.S. Group ranks as the fourth largest participant in Business X in the United States, with approximately Number M customers and approximately Amount N of revenues in Year 4. The U.S. Group had about Number O employees on Date 2, and its gross assets, as set forth in the U.S. Group’s consolidated financial statements as of Date 2, were approximately Amount P.

Taxpayer represents that the officers and employees of the companies comprising the U.S. Group exercise substantial managerial control over Business X activities of the U.S. Group.

## ISSUES PRESENTED

- (1) Can a Country B corporation be the indirect common owner for purposes of determining whether Taxpayer and the members of the Country A Group are connected for purposes of Article \_\_\_\_\_ of the Treaty?
- (2) Assuming (i) that Taxpayer is a resident of Country A for purposes of the Treaty and (ii) that Taxpayer is not itself directly engaged in the active conduct of a trade or business in Country A within the meaning of Article \_\_\_\_\_ of the Treaty, will Taxpayer be viewed as engaged in the active conduct of the trade or business of connected Country A resident corporations (within the meaning of Article \_\_\_\_\_ of the Treaty)?

of the Treaty) to the extent such Country A resident connected corporations are engaged in the active conduct of a trade or business in Country A?

- (3) For purposes of Article \_\_\_\_\_ of the Treaty, assuming Taxpayer is engaged in the active conduct of a Country A trade or business based on the activities of connected Country A resident corporations, how should Taxpayer determine whether the interest it derives from the U.S. Group is derived in connection with the active conduct of a Country A trade or business?
- (4) For purposes of Article \_\_\_\_\_ of the Treaty, how should Taxpayer determine whether Taxpayer's Country A trade or business is substantial in relation to the U.S. trade or business that gives rise to an item of U.S. source interest income?

### LAW AND ANALYSIS

Section 881(a) of the Internal Revenue Code (the "Code") generally imposes a 30-percent tax on the amount received by a foreign corporation as interest from sources within the United States to the extent that the interest is not effectively connected with the conduct of a trade or business within the United States.

Section 894 of the Code provides that the provisions of the Code shall be applied to any taxpayer with due regard to any treaty obligation of the United States that applies to such taxpayer. Treas. Reg. § 1.871-12(c) provides that, with respect to items of income the tax on which is limited by a tax convention, the tax is determined upon the gross amount of each separate item of income at the reduced rate applicable to that item under the convention.

Article \_\_\_\_\_ (Interest) of the Treaty provides that interest arising in the United States and beneficially owned by a resident of Country A shall be taxable only in Country A.

To be entitled to the exemption from U.S. withholding provided by Article \_\_\_\_\_, the recipient of interest generally must be a "qualified person" within the meaning of Article \_\_\_\_\_ (Limitation on Benefits) of the Treaty, or if not a qualified person, must meet the requirements of either Article \_\_\_\_\_, Article \_\_\_\_\_, or Article \_\_\_\_\_ with respect to the interest income. Based on Taxpayer's representations, Taxpayer is not an Article \_\_\_\_\_ qualified person and fails to meet the specific criteria of Article \_\_\_\_\_ or Article \_\_\_\_\_.

Article \_\_\_\_\_ of the Treaty sets forth a test under which a resident of a Contracting State that is not an Article \_\_\_\_\_ qualified person may receive Treaty benefits with respect to certain items of income that are connected to an active trade or business. Article \_\_\_\_\_ provides that a resident of a Contracting State shall be entitled to Treaty benefits with respect to an item of income derived from the other Contracting State if:

- (1) The resident is engaged in the active conduct of a trade or business in its state of residence (other than the activities of making or managing investments for the resident's own account, unless these activities are banking, insurance or securities dealing carried on by a bank, insurance company or registered securities dealer);
- (2) The income derived from the other state is derived in connection with, or is incidental to, that trade or business; and
- (3) The resident satisfies any other specified conditions to obtain such benefits.

#### RULING 1

Article \_\_\_\_\_ of the Treaty provides that a resident of a Contracting State must be engaged in the active conduct of a trade or business in its State of residence (other than the activities of making or managing investments for the resident's own account, unless these activities are banking, insurance or securities dealing carried on by a bank, insurance company or registered securities dealer) to be entitled to Treaty benefits with respect to an item of income derived from the other Contracting State.

For purposes of Article \_\_\_\_\_, Article \_\_\_\_\_ provides that, in determining whether a resident of a Contracting State is engaged in the active conduct of a trade or business in that Contracting State, activities conducted by a partnership in which that person is a partner and activities conducted by persons "connected to" that person shall be deemed to be conducted by such person.

As represented, Taxpayer is not itself directly engaged in the active conduct of a trade or business within the meaning of Article \_\_\_\_\_ of the Treaty. Taxpayer would accordingly rely on Article \_\_\_\_\_ to satisfy the active conduct of a trade or business requirement in Article \_\_\_\_\_. Article \_\_\_\_\_ provides that, for purposes of Article \_\_\_\_\_, a resident of a Contracting State will be considered to conduct activities conducted by persons connected to that resident. Article \_\_\_\_\_ further provides that sister corporations will be connected for purposes of that sub-paragraph if another person possesses, directly or indirectly, shares representing at least 50 percent of the aggregate voting power and value of each corporation or of the beneficial equity interest in each corporation.

As represented, Taxpayer is a wholly owned subsidiary of Parent Co. Parent Co indirectly wholly owns Country A Co (and Country A Co's wholly owned Country A subsidiaries) through a chain of wholly owned Country B entities. There is nothing in the Treaty that requires the Article \_\_\_\_\_ common owner to be a resident of Country A.

Accordingly, based solely on the information submitted and the representations made, a Country B corporation can be the indirect common owner for purposes of determining

whether Taxpayer and the members of the Country A Group are connected for purposes of Article .

## RULING 2

Article of the Treaty provides that, in determining whether a person is engaged in the active conduct of a trade or business in a Contracting State, activities conducted by persons “connected to” that person will be deemed to be conducted by such person.

Based solely on the information submitted and the representations made, and assuming that

- (i) Taxpayer is a resident of Country A for purposes of the Treaty and
- (ii) Taxpayer is not itself directly engaged in the active conduct of a trade or business in Country A within the meaning of Article of the Treaty,

Taxpayer would be deemed to conduct the activities conducted by connected Country A corporations and, to the extent the activities of the connected Country A corporations constitute the active conduct of a trade or business in Country A, Taxpayer would be considered engaged in the active conduct of a trade or business in Country A for purposes of Article of the Treaty.

## RULING 3

To qualify for treaty benefits with respect to an item of income under Article of the Treaty, Article requires that an item of income be derived in connection with, or incidental to, an active trade or business conducted by the taxpayer in its State of residence.

Paragraph of the MOU<sup>4</sup> provides that an item of income is to be considered as derived in connection with an active trade or business in the residence State if the source State activity generating the income is a line of business that “forms a part of” or is “complementary to” the trade or business conducted in the residence State. The Technical Explanation to Article states that a residence-State business activity generally will be considered to form part of a source-State business activity if the two activities involve the design, manufacture, or sale of the same products or type of products, or the provision of similar services.

To determine whether an item of interest income is considered to be derived in connection with an active trade or business in the residence State, it is necessary to identify the source State trade or business to which the interest income is attributable.

---

4

Accordingly, based solely on the information submitted and the representations made, and assuming the members of the Country A Group are connected to Taxpayer, whether interest received by Taxpayer from members of the U.S. Group is derived in connection with the trade or business of Taxpayer depends on whether such interest is attributable to income producing activities of a member of the U.S. Group whose line of business forms part of or is complementary to a trade or business treated as conducted by Taxpayer through the activities of the members of the Country A Group in Country A.

#### RULING 4

Article \_\_\_\_\_ of the Treaty provides that a Country A resident is entitled to treaty benefits under Article \_\_\_\_\_ with respect to any item of U.S. source income only if the Country A resident's Country A trade or business is substantial in relation to the U.S. trade or business that gives rise to the item of U.S. source income.

Paragraph \_\_\_\_\_ of the MOU states that the substantiality requirement is intended to prevent a narrow case of treaty-shopping abuses in which a company attempts to qualify for the benefits of the Treaty by engaging in de minimis connected business activities that have little economic cost or effect with respect to the company's business. The MOU provides that the determination whether a trade or business is substantial for purposes of Article \_\_\_\_\_ will be based on all the facts and circumstances. The MOU states that this determination will take into account the comparative sizes of the trades or businesses in each Contracting State (measured by reference to asset values, income, and payroll expenses), the nature of the activities performed in each Contracting State, and the relative contributions made to that trade or business in each Contracting State. In making each determination or comparison, due regard will be given to the relative sizes of the U.S. and Country A economies.

Accordingly, based solely on the information submitted and the representations made, and assuming that the income producing activities of the members of the U.S. Group form a part of or are complementary to a trade or business considered to be conducted by Taxpayer based on the activities of the members of the Country A Group, we conclude that whether Taxpayer's Country A trade or business is substantial in relation to the U.S. trade or business that gives rise to the interest income must be determined by comparing the size and nature of the trade or business conducted by the members of the Country A Group in Country A with the trade or business conducted in the United States by the member or members of the U.S. Group that gives rise to the item of income (for example, the relative asset values, income, and payroll expenses of the members of the Country A Group and the members of the U.S. Group, and the relative contributions made to those trades or businesses in Country A and the United States). In making this comparison, the asset values, income, and payroll expenses of Taxpayer are not taken into account because under Article \_\_\_\_\_ Taxpayer's own activities do not constitute the active conduct of a trade or business.

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. In particular, no opinion is expressed as to whether members of the Country A Group are engaged in the active conduct of a Country A trade or business, whether Taxpayer's U.S. source interest income is derived in connection with a Country A trade or business, or whether a Country A trade or business conducted by the members of the Country A Group is substantial in relation to a U.S. trade or business conducted by a member or members of the U.S. Group. No opinion is expressed as to whether any of the assumptions set forth in the rulings are correct. In addition, no opinion is expressed as to whether the information or representations submitted by taxpayer are correct.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely,

Elizabeth U. Karzon  
Chief, Branch 1  
Office of Associate Chief Counsel (International)

cc: