Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
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Date:
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DO: TY:

Parent =
Corporation X =
Corporation Y =
Corporation Z =
Year A =
Year B =
Year C =
Year D =
Month E =
Date F =
Country G =
State H =
State I =
Family J =
Business K =

Activity L =
Activity M =

Section N =

Dear

This is in response to a letter dated July 27, 1998, which was supplemented by your letters of October 28 and December 16, 1998, in which your authorized representatives requested a ruling that distributions paid by Corporation X to Parent are entitled to a five percent reduced rate of withholding pursuant to Article VI(3) of the income tax convention that is currently in effect between the United States and Country G (the Treaty).

The ruling contained in this letter is 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.

Parent is a corporation organized under the laws of Country G. It was originally founded by Family J in Year A. Each share of Parent's stock is owned either by a member of Family J or by a Country G corporation that is wholly owned by members of Family J. Each member of Family J who directly or indirectly owns stock of Parent is a citizen and resident of Country G.

Parent is engaged in Business K. It has been represented that Parent has no permanent establishment in the United States.

Corporation X, a domestic corporation, was incorporated under the laws of State H on Date F to act as a holding company for the consolidation of U.S. operations. Corporation X is wholly owned by Parent. Corporation X has two wholly owned subsidiaries: Corporation Y and Corporation Z.

Corporation Y was incorporated in State I in Year B. It is engaged in Activity L.

Corporation Z was originally incorporated under another name in State H in Year C. Parent acquired Corporation Z in Month E to perform Activity M.

During Year D, its first year of existence, Corporation X's gross income consisted solely of dividends paid to Corporation X by Corporation Y and Corporation Z.

For Year D and the two years preceding Year D, less than 25 percent of the gross income of each of Corporation Y and Corporation Z consisted of dividends and interest. Neither Corporation Y nor Corporation Z had any subsidiary corporation from which it received dividends or interest during Year D or the two years preceding Year D.

Corporation X paid a dividend to Parent during Year D.

Section 881(a)(1) of the Internal Revenue Code generally imposes a 30 percent tax on the amount received by a foreign corporation as dividends from a domestic corporation to the extent not effectively connected with the conduct of a trade or business in the United States. Section 894(a) of the Code, however, provides that the provisions of subtitle A shall be applied to any taxpayer with due regard to any treaty obligation of the United States that applies to such taxpayer. Sections 881 and 1441 are included under subtitle A of the Code.

Section 1441 of the Code generally requires that a tax of 30 percent be deducted and

withheld at the source on any dividend paid to a foreign corporation by a domestic subsidiary. Section 1.1441-6(a) of the Income Tax Regulations provides that the statutory 30 percent withholding rate shall be reduced as may be provided by a treaty with any country.

Article VI(2) of the Treaty provides that each of the Treaty countries reserves the right to collect and retain withholding taxes with respect to dividends, but the tax shall not exceed 15 percent if the recipient of the dividends has no permanent establishment in the Treaty country from which the dividends are derived.

Article VI(3) provides that the rate of withholding tax shall not exceed 5 percent if the shareholder is a corporation controlling, directly or indirectly, at least 95 percent of the entire voting power in the corporation paying the dividend, and if not more than 25 percent of the gross income of such paying corporation is derived from interest and dividends other than interest and dividends received from its own subsidiary corporations. However, the reduced rate shall not apply if the relationship of the two corporations has been arranged or is maintained primarily with the intention of securing the reduced rate.

Paragraph (b)(1) of section N of the withholding regulations published in conjunction with the Treaty provides that, under the provisions of Article VI(3) of the Treaty, dividends paid by a domestic corporation to a Country G corporation controlling, directly or indirectly, at the time the dividend is paid, 95 percent or more of the entire voting power in such domestic corporation, are subject to tax at the rate of only 5 percent, if (i) not more than 25 percent of the gross income of such paying corporation for the three-year period immediately preceding the taxable year in which the dividend is paid consists of dividends and interest (other than dividends and interest paid to such domestic corporation by its own subsidiary corporations, if any) and (ii) the relationship between such domestic corporation and such Country G corporation has not been arranged or maintained primarily with the intention of securing such reduced rate of 5 percent.

Paragraph (b)(2) of section N of the withholding regulations provides, in part, that any domestic corporation that claims or contemplates claiming that dividends paid or to be paid by it are subject to the 5 percent rate must file certain information with the Commissioner of Internal Revenue.

Paragraph (b)(3) of section N of the withholding regulations provides that the Commissioner will determine whether the dividends concerned fall within the provisions of Article VI(3) of the Treaty. Paragraph (b)(3) further provides that in any case in which the Commissioner has notified the domestic corporation that its dividends fall within the provisions of Article VI(3), the reduced rate of 5 percent will apply to any dividends subsequently paid to the Country G corporation unless the stock ownership of the domestic corporation, or the character of its income, materially changes. If such

change or changes occur, the domestic corporation is required promptly to notify the Commissioner.

Rev. Rul. 79-65, 1979-1 C.B. 458, addresses whether the relationship between a foreign parent corporation and its subsidiary has been established to secure a reduced 5 percent withholding tax rate on dividend distributions from the subsidiary to its parent corporation. Rev. Rul. 79-65 concerns the application of Article VII(1) of the former income tax treaty between the United States and the Netherlands, as extended to the Netherlands Antilles. Rev. Rul. 89-110, 1989-2 C.B. 275, modifies and clarifies Rev. Rul. 79-65 and provides that, although Rev. Rul. 79-65 no longer applies to dividends paid to a Netherlands Antilles corporation, the principles stated in Rev. Rul. 79-65 will continue to apply to similar provisions in other tax treaties. Article VI(3) of the Treaty is similar to Article VII(1) of the former treaty with the Netherlands, as extended to the Netherlands Antilles.

Application of the principles set out in Rev. Rul. 79-65 requires a wholly owned subsidiary in the United States to demonstrate that business exigencies dictated the organization and maintenance of the foreign parent in Country G and that any dividends distributed by the foreign parent to its stockholders are paid not merely as a result of the receipt of a distribution from the U.S. subsidiary.

Based on the information submitted and the representations made, and provided that Parent does not have a permanent establishment in the United States, it is held that dividends paid by Corporation X to Parent in Year D qualify for the five percent reduced rate of withholding pursuant to Article VI(3) of the Treaty.

This ruling will remain in effect with respect to dividends subsequently paid by Corporation X to Parent unless the stock ownership of Parent or Corporation X, or the character of Corporation X's income, materially changes, or unless the Commissioner determines that the relationship between Corporation X and Parent is being maintained primarily with the intention of securing the five percent reduced rate. If any of the material facts upon which this ruling is based subsequently change, Corporation X must promptly notify the Commissioner of such change.

This letter ruling is made solely with respect to the Treaty. We make no determination regarding the tax consequences, if any, that any subsequently ratified income tax convention between the United States and Country G may have on distributions from Corporation X to Parent.

We make no determination with respect to whether Parent has a permanent establishment in the United States. Pursuant to section 4.09 of Rev. Proc. 98-7, 1998-1 I.R.B. 222, the Service will not ordinarily issue a ruling regarding whether a taxpayer has a permanent establishment in the United States for purposes of any United States income tax treaty. Such determination shall be made by the District Director upon the

subsequent examination of the federal income tax return filed for the taxable year in which any dividend is distributed.

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 ruling is directed only to the taxpayer(s) requesting it. Section 6110(j)(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 your authorized representatives.

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

Sincerely,

W. Edward Williams, Jr.
Senior Technical Reviewer, Branch 1
Office of the Associate Chief Counsel
(International)