Internal Revenue Service

Department of the Treasury

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TY:

Legend

Taxpayer	=
X Corp	=
Y Corp	=
Z Corp	=
XY Group	=
Country A	=
Country B	=
Country C	=
City D	=
City E	=
Country A Treaty	=
Country B Treaty	=
Country C Treaty	=
Stock Exchange 1	=
Stock Exchange 2	=

Dear :

This responds to your letter dated May 30, 2000, requesting a ruling concerning two factors under paragraph 7 of the revised Memorandum of Understanding accompanying the Income Tax Convention between the United States and Country C (the "Country C Treaty"), and under Article 22 (Limitation on Benefits) of the Country C Treaty.

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.

STATEMENT OF FACTS

X Corp is incorporated under the laws of Country A, and Y Corp is incorporated under the laws of Country B. Both Country A and Country B are member states of the European Union. X Corp and Y Corp collectively hold stock, directly and indirectly, in companies throughout the world (the "XY Group"). The principle office of X Corp is in City D, Country A, and the principle office of Y Corp is in City E, Country B. The X Corp shares are listed and traded on Stock Exchange 1, and the Y Corp shares are listed and traded on Stock Exchange 2.

At the time the ruling was submitted, X Corp and Y Corp planned to incorporate Z Corp. Z Corp will be owned indirectly by X Corp and Y Corp. Z Corp will be a resident of Country C and will be subject to Country C tax on its world-wide taxable income.

Taxpayer is a wholly owned U.S. subsidiary within the XY Group. As part of its treasury function, Z Corp will lend funds to Taxpayer. In return, Taxpayer will pay interest to Z Corp and must determine whether the interest paid to Z Corp will be exempt from U.S. withholding tax pursuant to the terms of the Country C Treaty.

Taxpayer represents that X Corp and Y Corp are eligible for benefits under Country A Treaty and Country B Treaty, respectively. Taxpayer also represents that X Corp and Y Corp are publicly traded corporations and qualify for all of the benefits of Country A Treaty and Country B Treaty, respectively, without regard to the residence of their owners. Taxpayer further represents that X Corp and Y Corp are entitled to exemption from U.S. tax on payments of interest arising in the United States pursuant to Country A Treaty and Country B Treaty, respectively. Finally, the Taxpayer represents that Z corp will satisfy, subject to the rulings requested, all the requirements for exemption under Article 11, Article 22(6), and paragraph 7 of the revised Memorandum of Understanding of the Country C Treaty. In particular, X Corp and Y Corp would be described in paragraph 1(e)(i) of Article 22 of the Country C Treaty if, instead of being residents of Country A and Country B, respectively, they were residents of Country C.

RULINGS REQUESTED

1. That X Corp and Y Corp will be considered to be the "ultimate beneficial owners" of Z Corp under paragraph 7 of the revised Memorandum of Understanding.

2. That X Corp and Y Corp will be considered qualified residents of countries that have a "comprehensive income tax convention" for purposes of applying paragraph 7 of the revised Memorandum of Understanding.

STATEMENT OF 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 in the United States. Section 1442 of the Code requires that a tax of 30% of any interest paid to a foreign corporation from sources within the United States be deducted and withheld at the source.

Section 894(a) of the Code maintains that the provisions of the Code shall be applied to any taxpayer with due regard to any treaty obligation of the United States which applies to such taxpayer. Moreover, section 1.1441-6(a) of the Treasury Regulations provides that the 30-percent rate of withholding shall be reduced as may be provided by a treaty with any country.

Article 11 (Interest) of the Country C Treaty provides that interest derived and beneficially owned by a resident of Country C is taxable only in Country C. Thus, an exemption from U.S. tax will be granted on interest derived and beneficially owned by a resident of Country C that meets the requirements of Article 22 of the Country C Treaty. Generally, benefits of the Country C Treaty will be extended to a resident of Country C only if the resident meets the specific criteria listed in paragraphs 1 through 3 of Article 22. Because Z Corp will be wholly-owned by non-Country C companies, it will fail to meet the specific criteria of paragraphs 1, 2 and 3 of Article 22.

Paragraph 6 of Article 22 of the Country C Treaty provides that a person not entitled to benefits of the Country C Treaty pursuant to paragraphs 1 through 3 of Article 22 may, nevertheless, be granted benefits if the competent authority of the state in which the income arises so determines after consultation with the competent authority of the other Contracting State.

Paragraph 7 of the revised Memorandum of Understanding (the “revised MOU”) to the Country C Treaty provides an additional method for qualifying for benefits pursuant to paragraph 6 of Article 22. In pertinent part, paragraph 7 provides that:

> [I]t is understood that a company resident in one of the Contracting States will be granted the benefits of the Convention under paragraph 6 of Article 22 with respect to the income it derives from the other Contracting State if the <u>ultimate beneficial owners</u> of 95 percent or more of the aggregate vote and value of all of its shares are seven or fewer persons that are residents of a member state of the European Union or the European Economic Area or a party to the North American Free Trade Agreement that meet the requirements of subparagraph 3(b) of Article 22....[Emphasis added.]

Pursuant to subparagraph b) of paragraph 3 of Article 22 of the Country C Treaty, shares held by shareholders that are residents of member states of the European Union or the European Economic Area or a party to the North American Free Trade Agreement will count toward qualification only if the resident meets three tests. First, the person must be entitled to benefits of a <u>comprehensive income tax convention</u> between its state of residence and the Contracting State from which benefits are claimed. Second, the person must be described in the subparagraph 1 of Article 22, applied as if the person were a resident of the Contracting State in which the company claiming benefits is resident. Finally, the person must be entitled, under the income tax convention between its state of residence and the Contracting State from which the treaty benefits are claimed, to a rate of tax equal to or less than the rate provided under the Country C Treaty with respect to income derived from that Contracting State.

Taxpayer represents that X Corp and Y Corp are residents of Country A and Country B, respectively; that the shares of X Corp and Y Corp are traded on Stock Exchange 1 and Stock Exchange 2, respectively; and that X Corp and Y Corp are the indirect owners of the shares of Z Corp. Taxpayer further represents that Z Corp's ownership requirements under paragraph 7 of the revised MOU will be met if X and Y Corp are considered the "ultimate beneficial owners" of Z Corp under the derivative benefits test, and the Country A and B Treaties are considered "comprehensive income tax conventions" under Article 22(3)(b) of the Country C Treaty.

<u>Ruling One</u>

The Country C Treaty does not specifically define the term "ultimate beneficial owner." However, the term is also used in subparagraph 1(e)(ii) of Article 22. The Technical Explanation to Article 22(1)(e)(ii) provides that

> Under this test, a company will qualify for benefits if one or more companies described in paragraph 1(e)(i) [publicly traded companies] are the <u>ultimate beneficial owners</u> of a predominant interest in the company. The predominant interest test will be interpreted consistently with the predominant interest test that applies for purposes of subparagraph 1(f) and which generally requires a direct, <u>or indirect</u>, interest of more than 50 percent. [Emphasis added.].

A similar term**,** "ultimately owned," appears in Article 24 (Limitation on Benefits) of the United States - Luxembourg Income Tax Convention (the "Luxembourg Treaty). According to the Technical Explanation to subparagraph 2(c) of Article 24 of the Luxembourg Treaty provides as follows:

> Subparagraph 2(c)(i) refers to persons who "ultimately" own the company's principle class of shares. In general, this test <u>requires that any intermediate owners of the company be disregarded</u> and that ownership

> be traced to a person that is a qualified resident without reference to its owners (such as a publicly-traded company under subparagraph 2(d)). [Emphasis added.]

Based on the use of the term “ultimate beneficial owner” in the Country C Treaty, and comparable usage in other United States income tax treaties, it is concluded that X Corp and Y Corp are the ultimate beneficial owners of Z Corp.

Ruling Two

In order to satisfy the first clause of Article 22(3)(b), the person must be entitled to all the benefits of a “comprehensive income tax convention” between its state of residence and the Contracting State from which benefits are being claimed. The term “comprehensive income tax convention” is not defined in the Country C Treaty.

Subparagraph 8(h) of Article 26 (Limitation on Benefits) of the United States - Netherlands Income Tax Convention (the “Netherlands Treaty”) also uses the term in a similar context. The explanation of the Joint Committee on Taxation with respect to Article 26(8) of the Netherlands Treaty provides that

> [t]o be considered an EC member country for this or any other purpose of the limitation of benefits article of the proposed treaty, the country generally must be either the Netherlands or a member of the EC with which both the United States and the Netherlands have in effect a comprehensive income tax treaty. Of the 12 current members of the EC, currently all but Portugal meet these criteria.

The Technical Explanation to subparagraph (8)(h) of Article 26 of the Netherlands Treaty explains that

> [a]s of the date of this Explanation, the Netherlands has in effect a comprehensive income tax convention with all the members of the European Communities, and the United States has such Conventions in effect will all members except Portugal. Therefore, for purposes of this definition, all members of the European Communities are included except for Portugal. This definition is ambulatory; if both States and Portugal conclude a comprehensive income tax convention, Portugal would be included within the definition.

Based on the use of the term “comprehensive income tax convention” in the Country C Treaty and comparable usage in the Netherlands treaty, it is held that both Country A Treaty and Country B Treaty will be considered “comprehensive income tax conventions” for purposes of paragraph 3(b) of Article 22 of the Country C Treaty.

This ruling is directed only to the taxpayer(s) 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 your authorized representative.

Sincerely,

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

cc: