Internal Revenue Service

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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:CORP:B03
PLR-134442-14

Date:
March 13, 2015

Foreign Parent =

Parent =

Holdco 1 =

Holdco 2 =

Subsidiary =

Sub 1 =

Sub 2 =

Sub 3 =

DE 1 =

DE 2 =

DE 3 =

Fmr Sub A =

Fmr Sub B =

Country A =

Country B =

Business =

Year 1 =

Year 2 =

Year 3 =

Date =

a =

b =

c =

d =

Intercompany Transaction 1 =

Dear :

This letter responds to your request, dated September 12, 2014, submitted by your authorized representatives on behalf of Parent, for a ruling on certain federal income tax consequences of a transaction (the "Transaction"). The information submitted in that request and in later correspondence is summarized below.

SUMMARY OF FACTS

Foreign Parent is a Country B corporation that owns all of the stock of Parent. Parent, a Country A corporation, is the common parent of an affiliated group of corporations that join in the filing of a consolidated income tax return ("Parent Group"). Parent owns all of the stock of Holdco 1. Holdco 1 owns all of the stock of Holdco 2. Holdco 2 owns all of the stock of Subsidiary, which owns all of the stock of Sub 1. Sub 1 directly owns all of the stock of Sub 2 and Sub 3 as well as all of the ownership interest of DE 1. Sub 3 owns all of the ownership interest of DE 2, and DE 1 owns all of the ownership interest of DE 3. DE 1, DE 2, and DE 3 are each classified as entities that are disregarded as separate from their owners for Federal income tax purposes. Holdco 2, Subsidiary, Sub 1, Sub 2, Sub 3, DE 1, DE 2, and DE 3 (collectively, the "Holdco 2 Group") operated Business and, together with Holdco 1, joined Parent in the filing of Parent Group's consolidated tax return.

Holdco 1 acquired the stock of Holdco 2 (and thus Holdco 2 Group) in Year 1 for approximately $a. In connection with Holdco 1's acquisition of Holdco 2, Subsidiary sold certain intellectual property to foreign affiliates of Foreign Parent (the "Subsidiary IP Sale"). The Subsidiary IP Sale consisted generally of copyrights, know-how and trade secrets, trademarks, and patents used or held for use by or in connection with Business.

Holdco 2 Group disposed of its assets to a third party in exchange for $b (the "Asset Sale") on Date. Holdco 2 Group retained some liabilities and assets subsequent

to the Asset Sale, but it used all of the retained assets to partially pay off a portion of the retained liabilities. Parent states that by Year 3, Holdco 2 Group was insolvent, and there was no expected recovery of potential value by Holdco 1 with respect to its investment in Holdco 2.

Up to Date, Holdco 2 received a small amount of interest income and income from Intercompany Transaction 1 of $c from Subsidiary. Subsidiary's receipts consisted of gain from the Subsidiary IP Sale, interest income, and a $d dividend from Sub 1. Additionally, in Year 2, Fmr Sub A and Fmr Sub B, both former subsidiaries of Sub 1, merged into Subsidiary. Fmr Sub A had gross receipts as follows: interest income, Third Party Franchise Fees, Foreign Affiliate Franchise Fees, and royalty income from other members within Holdco 2 Group. Fmr Sub B's only gross receipts came from intragroup royalty income that it received from Fmr Sub A.

DISCUSSION

Section 165(g)(3) provides taxpayers that are domestic corporations with an ordinary loss on the worthlessness of stock in an affiliated subsidiary. Section 165(g)(3) sets forth two requirements a subsidiary must satisfy in order to be considered affiliated with the taxpayer. Paragraph (A) requires that stock meeting the requirements of section 1504(a)(2) be owned directly by the taxpayer. Paragraph (B) requires that more than 90 percent of the aggregate of the subsidiary's gross receipts for all taxable years be from sources other than the listed "passive sources" which are royalties, certain rents, dividends, interest (except interest received on deferred purchase price of operating assets sold), annuities, and gains from sales or exchanges of stocks and securities.

Rev. Rul. 88-65, 1988-2 C.B. 32, concludes that the rents received from short term vehicle leases are not rents for purposes of section 165(g)(3)(B) due to the significant services provided by the lessor. The ruling reasons that guidance interpreting similar statutory language in section 1244, regarding "section 1244 stock," and section 1362, regarding the passive income limitation of S corporations with C corporation earnings and profits, is relevant in construing section 165(g)(3)(B). Section 1.1362-2(c)(5)(ii)(A)(2) provides that royalties does not include royalties derived in the ordinary course of a trade or business of franchising or licensing property. Royalties received by a corporation are derived in the ordinary course of a trade or business of franchising or licensing property only if, based on all the facts and circumstances, the corporation -- (i) created the property; or (ii) performed significant services or incurred substantial costs with respect to the development or marketing of the property.

REPRESENTATIONS

(i) Holdco 1 will claim a worthless stock loss with respect to the stock of Holdco 2 only to the extent permitted by Treas. Reg. § 1.1502-36.

(ii) Holdco 2 and the subsidiaries in Holdco 2 Group were insolvent for Federal income tax purposes following the Asset Sale on Date.

(iii) Holdco 2 and the subsidiaries in Holdco 2 Group disposed of all of their assets pursuant to Asset Sale within the meaning of Treas. Reg. § 1.1502-19(c)(1)(iii).

(iv) Holdco 2's stock was worthless within the meaning of section 165(g)(1) and Treas. Reg. §1.1502-80(c).

(v) The taxpayer will take into account in income any excess loss account ("ELA") in its Holdco 2 stock or any ELAs in the stock of the subsidiaries of Holdco 2 Group.

(vi) Holdco 1 owns directly more than 80 percent of the voting power and the value of Holdco 2 within the meaning of section 1502(a)(2).

(vii) Business was comprised, in part, of an active trade or business of franchising that was supported by the provision of significant services.

RULINGS

Based solely on the information provided, we rule as follows:

(1) Provided that the requirements of section 165(g) (taking into account the provisions of Treas. Reg. § 1.1502-80(c)) are satisfied, Holdco 1 may claim a worthless stock deduction under section 165(g)(3), subject to the application of Treas. Reg. § 1.1502-36.

(2) For purposes of the section 165(g)(3)(B) gross receipts test, Holdco 2 will include in its aggregate gross receipts all amounts of gross receipts received in intercompany transactions that are described in Treas. Reg. § 1.1502-13 (as effective/applicable on or after July 12, 1995) ("Intercompany Transactions"), and such amounts from Intercompany Transactions will be treated as "gross receipts from passive sources" only to the extent they are attributable to the Intercompany Transactions' counterparty's "gross receipts from passive sources" ("Look-Through Approach"). See Treas. Reg. 1.1502-

13(a), (b), and (c) (as effective/applicable on or after July 12, 1995). For purposes of these rulings, "gross receipts from passive sources" is defined as royalties (other than the franchise fees described in ruling 5), certain rents, dividends(other than dividends received from affiliates), interest, annuities, and gains from sales of stock and securities as defined in section 165(g)(3) and the regulations thereunder.

(3) For purposes of computing Holdco 2's "gross receipts" under section 165(g)(3)(B), Holdco 2 (and any relevant counterparty in an Intercompany Transaction) will take into account the historic gross receipts of any transferor corporation in a transaction to which section 381(a) applied, provided, however, that Holdco 2 (and any relevant counterparty in an Intercompany Transaction) will eliminate gross receipts from Intercompany Transactions with any such transferor corporation, as appropriate, to prevent duplication.

(4) In applying the Look-Through Approach, for purposes of computing the "gross receipts from passive sources" of Holdco 2's counterparty in an Intercompany Transaction or any other counterparties in Intercompany Transactions, the counterparty will include in its aggregate gross receipts all amounts of gross receipts it received in Intercompany Transactions, and such amounts from Intercompany Transactions will be treated as "gross receipts from passive sources" to the extent they are attributable to its counterparty's "gross receipts from passive sources." In other words, Holdco 2's "gross receipts from passive sources" is determined by looking at all of Holdco 2's gross receipts from Intercompany Transactions (even if on its face the Intercompany Transaction appears not to be "gross receipts from passive sources") and sourcing the gross receipts based on Holdco 2's counterparty's "gross receipts from passive sources." Furthermore, Holdco 2's counterparty in Intercompany Transactions (and Holdco 2's counterparty's counterparty, and so on until it reaches an ultimate counterparty) will apply a similar rule.

(5) Neither the Third Party Franchise Fees and the Foreign Affiliate Franchise Fees received by Fmr Sub A nor the proceeds received by Subsidiary from the Subsidiary IP Sale constitute gross receipts from any of the passive sources listed in section 165(g)(3)(B).

CAVEATS

The rulings contained in this letter are based upon facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This office has not verified any of the material submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

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. Specifically, we express or imply no opinion whether the taxpayer otherwise meets the requirements of section 165.

PROCEDURAL STATEMENTS

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 your authorized representative.

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.

Sincerely,

Isaac W. Zimbalist
Senior Technician Reviewer, Branch 1
Office of the Associate Chief Counsel
(Corporate)

cc: