Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:INTL:BR6 – PLR-108166-99
Date:
April 12, 2000

DO:
TY:
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LEGEND

A =
B =

Product =

Brand =

Date A =
Date B =

Year A =
Year B =
Year C =
Year D =

$a =
$b =
$c =
$d =
$e =
$f =

Dear :

This responds to your request dated April 28, 1999, and letters submitted subsequently on April 29, 1999, October 22, 1999, November 18, 1999, February 2, 2000 and March 9, 2000 on behalf of the above-referenced taxpayer for a private letter ruling consenting to a change of its election under section 936(h)(5)(F) of the Internal Revenue Code of 1986, as amended (hereinafer "I.R.C."), from the cost sharing method under I.R.C. section 936(h)(5)(C)(i) to the profit split method under I.R.C. section 936(h)(5)(C)(ii).

The rulings contained in this letter are based upon information and representations submitted by Taxpayer and accompanied by statements executed by an appropriate party under penalty of perjury. 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/REPRESENTATIONS

Taxpayer makes the following representations:

A, an I.R.C. section 936 corporation, is a wholly-owned subsidiary of B, a domestic corporation. A's business consists primarily of the manufacture of Product that is distributed by B under the Brand name. B manufactures and distributes Product through its Brand division.

B acquired the Brand business in Year A for $a.

A has been engaged in the direct manufacture of Product in since Year B. Pursuant to I.R.C. sections 936(e) and 936(h)(5), A made elections to be treated as a possessions corporation utilizing the cost sharing method described in I.R.C. section 936(h)(5)(C)(i) effective for the tax year beginning Date A, Year B.

In Year B, Brand sales consisted only of Product that was manufactured by A and B's Brand division exclusively.

Total sales of Product in Year B were $b. In Year B, $c of Brand advertising (1.7% of sales) was undertaken.

In Year B, the manufacturing intangibles accounted for 90% of the value associated with sales of Product, whereas only 10% of that value derived from marketing intangibles.

Subsequent to Year B, as a part of a change in corporate strategy to exploit the value of the Brand name, B entered into a number of licensing agreements permitting unrelated third parties to use the Brand name with respect to specific products. Some of these products are sold by B with the Brand name and logo, and other products are

sold by the licensee with the Brand name. B's Brand division also began earning royalty income in Year C, which it had not through Year B. By Year D, a majority of the items bearing the Brand name were not manufactured by A or B's Brand division.

Total sales of B's Brand division sales increased 278% by Year D to $d. In Year D, a total of $e (4.9% of sales) (a 8 fold increase of the $c total dollars spent in Year B) of Brand advertising was undertaken by B and the unrelated third party licensees of the Brand name.

As a result of the changes in corporate strategy, the licensing agreements and the name recognition that developed from the sales of Product, the value of Brand's marketing intangibles increased substantially. In Year C, an unrelated party offered B $f to purchase the Brand division (including A), which is a 38 fold increase from the original purchase price of $a in Year A. This increase is attributable to the marketing intangibles following the changed corporate strategies, product diversification and the licensing of the Brand name subsequent to Year B.

As a result of these changes, by Year D, the marketing intangibles accounted for 90% of the value associated with sales of Product, whereas only 10% of that value now derived from manufacturing intangibles. These changes were not reasonably anticipated when A made its election to use the cost sharing method described in I.R.C. section 936(h)(5)(C)(i).

RULING REQUESTED

A requests a ruling granting permission to change its election under I.R.C. section 936(h)(5)(F) of the Code from the cost sharing method under I.R.C. section 936(h)(5)(C)(i) to the profit split method described in section 936(h)(5)(C)(ii), effective for the tax year ending Date B, Year D and all years subsequent. A represents that, if permission to change is granted, it will make all adjustments required under section 5 of Revenue Procedure 94-70, 1994-2 C.B. 806, 808-09.

LAW AND ANALYSIS

I.R.C. section 936(a) of the Code generally allows a credit against federal income tax to a domestic corporation in an amount equal to the portion of the tax attributable to the sum of taxable income from sources without the United States from the active conduct of a trade or business within a possession of the United States. The credit is available only if the domestic corporation elects the application of I.R.C. section 936 pursuant to I.R.C. section 936(e), 80% or more of its gross income for the preceding three year period was derived from sources within a possession of the United States within the meaning of I.R.C. section 936(a)(2)(A), and 75% or more of its gross income for such period was derived from the active conduct of a trade or business within a possession of the United States within the meaning of I.R.C. section

936(a)(2)(B).

I.R.C. section 936(h)(1)(A) generally requires that the intangible property income of the electing corporation be included on a pro rata basis in the gross income of its shareholders as income from sources within the United States. I.R.C. section 936(h)(5)(A) provides that the rules under I.R.C. section 936(h)(1)-(3) regarding the general treatment of intangible property income will not apply to a possessions corporation that has a significant business presence in a possession within the meaning of I.R.C. section 936(h)(5)(B) and that has made an election with respect to each product area pursuant to I.R.C. section 936(h)(5)(F) to compute its taxable income using either the cost sharing method of I.R.C. section 936(h)(5)(C)(i) or the profit split method of I.R.C. section 936(h)(5)(C)(ii).

I.R.C. section 936(h)(5)(F) contains guidelines addressing the manner in which a taxpayer shall elect to use either the cost sharing method or the profit split method under I.R.C. section 936(h)(5)(A), as well as guidelines for revoking and changing such an election once made. I.R.C. sections 936(h)(5)(F)(i) and (iii)(I) generally provide that a taxpayer may revoke or change to another election under I.R.C. section 936(h)(5)(A) only with the consent of the Secretary and Treasury Regulation section 1.936-7(a) Q&A 6, provides that a taxpayer generally may only revoke its method and change to another method under section 936(h)(5) with the consent of the Commissioner.

Based on taxpayer’s representations, when A initially elected to utilize the cost sharing method under section 936(h)(5)(C)(i) in Year A, the income from the sale of Product was attributable principally to its manufacturing intangibles. Taxpayer represented that in Year A the manufacturing intangibles accounted for 90% of the value associated with sale of Product, whereas only 10% of that value derived from marketing intangibles.

Pursuant to B's changes in A’s corporate strategy and other business developments of the Brand division, taxpayer further represents that A’s marketing intangibles now account for 90% of the value associated with the sales of Product in Year D, whereas only 10% of that value is now derived from the manufacturing intangibles.

These representations, in conjunction with the other represented changes and factors in the Brand division business from Year A to Year D, demonstrate that taxpayer’s business has undergone a substantial changes since Year A. These changes were not reasonably anticipated when A made its election to use the cost sharing method described in I.R.C. section 936(h)(5)(C)(i).

RULING

Based on the facts submitted and the representations made, we conclude that

consent should be given to A to revoke its existing election and to make a subsequent election of another method under I.R.C. section 936(h)(5)(C) for computing its taxable income. Therefore, permission is granted for A to change its election under section 936(h)(5)(F) from the cost sharing method under section 936(h)(5)(C)(i) to the profit split method under section 936(h)(5)(C)(ii), effective for the tax year ending Date B, Year D and all years subsequent.

Permission to change method is conditioned on A's making all appropriate adjustments required in changing from the cost sharing method to the profit split method as provided under section 5 of Revenue Procedure 94-70, 1994-2 C.B. 806 at 808-09.

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 who requested it, I.R.C. 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 and its second authorized representative.

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

Sincerely,

Steven A. Musher
Chief, Branch 6
Associate Chief Counsel (International)

cc: Assistant Commissioner (International)
International District Operations OP:IN:D
Chief, Examination Division