Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person to Contact:

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Legend

Taxpayer	=
Corporation A	=
Subsidiary B	=
Subsidiary C	=

Dear :

This is in response to a letter, dated November 9, 2001, from your authorized representative requesting rulings under sections 901 and 305 of the Internal Revenue Code (Code). The information submitted for consideration is substantially as set forth below.

Taxpayer, a domestic corporation, wholly owns Corporation A, a German corporation, for which an election has been filed to treat it as a disregarded entity for U.S. federal tax purposes. Corporation A owns all of the outstanding stock of two German subsidiaries, Subsidiary B and Subsidiary C (the Subsidiaries). Corporation A is a holding company for its two subsidiaries; its income is composed primarily of distributions from Subsidiary B. For U.S. federal tax purposes, both of the Subsidiaries are treated as corporations.

The three German corporations have elected to aggregate their taxable income for German income tax purposes in what is commonly referred to as an "Organschaft." An Organschaft is similar in concept to, but not exactly the same as, a U.S. consolidated group. For German tax purposes, corporations are statutorily required to enter into a profit and loss transfer agreement as a condition for filing as an Organschaft. Under this agreement, the German Subsidiaries are required to transfer their pre-tax profits and losses to the parent, Corporation A. This transfer cannot be waived because Corporation A has a legal right to the pre-tax profits of the Subsidiaries. Since each subsidiary is obligated to transfer all of its pre-tax profits to Corporation A, Corporation A receives from each subsidiary the means to satisfy the related tax liability. Corporation A is obligated to compensate the Subsidiaries for any losses they incur, even when Corporation A itself has generated a loss. Each member of the Organschaft calculates its losses independently for both tax and commercial purposes in the same manner as if no Organschaft existed. A net operating loss of one subsidiary can be used against the net operating profit of Corporation A and the other subsidiary.

Each member of an Organschaft files a separate company tax return and computes its separate company taxable income. The parent of the Organschaft includes the separate company taxable income of its subsidiaries in the computation of its taxable income. The German statutory language technically requires the income of the subsidiaries to be “attributed” to the parent. It is the parent company on which any German income tax liability is assessed for technical purposes, and the parent is liable for remitting any tax due on its subsidiaries’ profits.

The mutual rights and obligations arising from the required profit and loss transfer agreement must be disclosed in the commercial balance sheet either as an account receivable or as an account payable between the parent and the subsidiaries. The obligations under the profit and loss transfer agreement must be satisfied within a reasonable period of time. In general, a “reasonable period of time” is a period of 3 months following the adoption of the annual accounts of the subsidiaries. These obligations need not be satisfied in the form of a cash payment. For example, the obligations can be converted into a loan. In addition, it is permissible under German law for the parent to be obligated to return profits to the subsidiary in the form of a contribution to capital.

Under the required profit and loss transfer agreement, the parent of the Organschaft has no specific claim against its subsidiaries for the income taxes associated with their income. Instead, as noted above, the parent has a right to all of its subsidiary’s pre-tax profits, an amount which includes both the amount of the tax and the after-tax profits. A subsidiary must transfer its pre-tax profits even if the Organschaft’s total tax liability is reduced by losses incurred by other subsidiaries. If a subsidiary must remit part or all of the income tax liability of the Organschaft as a result of a parent’s default, such subsidiary has a cause of action against the parent to recover such amount.

With respect to Taxpayer, all members of the Organschaft have entered into a binding tax allocation agreement that, in general, allocates corporate income taxes among the members based on relative profits. Pursuant to a corporate resolution, any payment by Subsidiary B or C to Corporation A in satisfaction of its payable under the Organschaft’s profit and loss transfer agreement will be contributed to such corporation’s capital to the extent such payment exceeds its allocable share of the Organschaft’s tax liability determined in accordance with the tax allocation agreement. Pursuant to the resolution, the Subsidiaries are not required to issue additional shares of capital stock to Corporation A.

The Taxpayer’s German counsel has opined that, were Corporation A unable to pay part or all of the income tax, it is likely that the German tax authorities would be able to successfully collect the group’s entire tax liability from Subsidiary B or Subsidiary C, rather than merely collect each subsidiary’s portion of the Organschaft’s tax liability.

Taxpayer's German counsel has stated that the tax authorities' legal obligation to enforce the collection of the full tax claim might take precedence over any equitable principles that would otherwise limit the authorities' ability to collect from the Subsidiaries.

FOREIGN TAX CREDIT ANALYSIS

Section 901(a) of the Code generally permits a taxpayer to elect to credit income taxes paid or accrued to a foreign country against the taxpayer's U.S. income tax. The section 901 credit includes a credit for income taxes paid directly by a U.S. corporate taxpayer as well as income taxes deemed to have been paid indirectly by such a taxpayer under section 902. Section 902 generally provides that a U.S. corporation owning 10 percent or more of the voting stock of a foreign corporation from which it receives dividends in any taxable year shall be deemed to have paid the same proportion of such foreign corporation's post-1986 foreign income taxes as the amount of such dividends (determined without regard to section 78) bears to such foreign corporation's post-1986 undistributed earnings.

Treas. Reg. §1.901-2(f)(3) provides:

> If foreign income tax is imposed on the combined income of two or more related persons (for example, a husband and wife or a corporation and one or more of its subsidiaries) and they are jointly and severally liable for the income tax under foreign law, foreign law is considered to impose legal liability on each such person for the amount of the foreign income tax that is attributable to its portion of the base of the tax, regardless of which person actually pays the tax.

As stated above, the Taxpayer's German counsel has opined that the German tax authorities would likely assess liability on and collect the entire tax from the Subsidiaries if the parent, Corporation A, failed to remit the tax. Thus, the liability of the members of the Corporation A Organschaft is substantially equivalent in practice to joint and several liability. Legal liability for the German taxes therefore is to be determined under Treas. Reg. §1.901-2(f)(3) and the German tax liability is to be divided on a pro rata basis among the members of the Organschaft.

CORPORATE ANALYSIS

In Beneficial Corp. v. Commissioner, 18 T.C. 396, aff'd per curiam, 202 F.2d 150 (3rd Cir. 1953), subsidiaries of a consolidated group made payments to their parent equal to the amount of tax that would have been due had the subsidiaries filed separate returns. The court noted that the payment by a subsidiary of its allocable portion of the group's tax liability would not constitute a dividend. The court held, however, that amounts in excess of the allocable portion of the actual liability constituted dividends. Accord Dynamics Corp. of America v. United States, 392 F.2d 241 (Ct. Cl. 1968).

Rev. Rul. 73-605, 1973-2 C.B. 109, relied on Beneficial Corp. and Dynamics Corp. to characterize payments between subsidiaries that were members of an affiliated group filing consolidated returns. In the ruling, each subsidiary whose hypothetical tax computed on a separate basis exceeded its share of the consolidated tax liability paid the excess amount to the common parent along with its share of the consolidated tax liability. The excess amounts were then paid by the common parent to another subsidiary whose losses resulted in the reduced tax liabilities of the profitable subsidiaries. The ruling concluded that the payments by the subsidiaries in excess of their actual tax liabilities are in substance dividends to their parent corporation followed by contributions to the capital of the loss subsidiary.

Section 305(a) of the Code provides that gross income does not include the amount of any distribution of the stock of a corporation made by such corporation to its shareholder with respect to its stock, except as otherwise provided in section 305 of the Code . Section 305(b)(1) of the Code provides that section 305(a) of the Code does not apply and that the distribution will be treated as a distribution of property to which section 301 applies, if the distribution is, at the election of any of the shareholders (whether exercised before or after the declaration thereof), payable either in stock or in property.

Rev. Rul. 80-154, 1980-1 C.B. 68, discusses the effect on the U.S. shareholders of a foreign corporation of a shareholder resolution that declared a cash dividend and provided that the distribution was to be used to increase capital investment in the corporation, where no cash or stock was actually distributed. The ruling contains the following analysis:

> A resolution declaring a cash dividend raises the presumption that a cash dividend is intended. However, this assumption is rebutted when the corporate resolution ties up the "cash" dividend so effectively that the shareholders never receive it, never exercise any control with respect to it, and the dividend is used to pay for additional stock.

Pursuant to a corporate resolution, any payment by the Subsidiaries to Corporation A in satisfaction of their payables under the Organschaft's profit and loss transfer agreement will be contributed to such corporation's capital to the extent such payment exceeds its allocable share of the Organschaft's tax liability determined in accordance with the tax allocation agreement. Under Rev. Rul. 80-154, section 305(a) will apply to the foregoing transaction and the payment/distribution will not be includible in the income of Corporation A.

RULINGS

Based on the legal authorities cited above and on the facts and representations submitted, including the fact that Corporation A owns 100 percent of the stock of Subsidiaries A and B:

1. German law is considered to impose legal liability within the meaning of Treas. Reg. §1.901-2(f)(3) on each member of the Corporation A Organschaft for the amount of German corporate income tax that is attributable to each member's portion of the base of the tax as described in ruling (2), regardless of which person actually remits the tax.

2. In determining the portion of the consolidated German tax liability for which each member of the group is considered legally liable under Treas. Reg. §1.901-2(f)(3), the consolidated German liability of the group must be apportioned among the members of the group in accordance with the ratio which that portion of the consolidated taxable income (measured under German law) attributable to each member of the group having taxable income bears to the consolidated taxable income. The consolidated taxable income attributable to each member of the group is to be determined prior to the transfer of tax loss or profits by the Subsidiaries to Corporation A. The portion of the German tax liability attributable to Corporation A's income, as determined under this ruling (2), is creditable by Taxpayer pursuant to section 901. The pro rata share of the German tax liability attributable to the income of the Subsidiaries, as determined under this ruling (2), is creditable by Taxpayer pursuant to section 902.

3. The transfer for German tax purposes of a tax loss or profits by the Subsidiaries to Corporation A through the use of accounts payable and accounts receivable will be disregarded.

4. A payment from each of the Subsidiaries to Corporation A up to the amount of such Subsidiary's share of the Organschaft's taxes will not be treated as a dividend by such Subsidiary; any payment from the Subsidiaries to Corporation A in excess of such Subsidiary's share of the Organschaft's taxes will be treated as a dividend, provided sufficient earnings and profits exist, except to the extent a corporate resolution described in ruling (5) below is in existence at the time of such payment.

5. If pursuant to a binding corporate resolution, an amount of cash that would otherwise be paid to Corporation A by the Subsidiaries is instead required to be used to increase the capital of such subsidiary, such amount will represent a distribution by the subsidiary of its common stock to its shareholder, and such distribution will not be includible in Corporation A's gross income.

These rulings have effect only to the extent that the relevant German law remains substantially unchanged. The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalties 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.

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. No opinion is expressed or implied regarding the application of any other provisions of the Code or regulations. A copy of this letter must be attached to any income tax return to which it is relevant.

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

Sincerely,
Anne O’Connell Devereaux
Senior Technical Reviewer
Office of Associate Chief Counsel
(International)