Internal Revenue Service

Number: **200522006**
Release Date: 6/3/2005
Index Number: 894.02-00

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:INTL:BR1
PLR-131778-04
Date:
March 04, 2005

In Re:

Legend

Taxpayer	=
UK Group	=
A Co	=
B Co	=
C Co	=
US Co	=
Year 1	=
Year 2	=
Date 3	=
Date 4	=
Date 5	=
Date 6	=
Country X	=

Dear

This is in response to a request dated June 10, 2004 for a private letter ruling under Article 10, Dividends, of the Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and on Capital Gains, signed at London on July 24, 2001, as amended by a Protocol signed at Washington on July 19, 2002 (the “Treaty”).

The ruling contained in this letter is 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.

FACTS

Taxpayer is a U.K. corporation and member of the UK Group, a multinational group of corporations headed by A Co. For the period from Year 1 through Year 2, Taxpayer was the 100 percent direct legal owner of B Co, a resident of Country X that made an election to be a disregarded entity on Date 3. Since Date 4, Taxpayer has also owned 100 percent of C Co, another Country X company that made an election to be a disregarded entity on Date 5.

On Date 6, a restructuring occurred and B Co was recapitalized. The B Co stock held by Taxpayer was converted to Class A stock. B Co created two additional classes of stock, Class B and Class C, which were issued to C Co in exchange for property. Thus, since Date 6, B Co has been legally owned directly by Taxpayer and C Co, a disregarded entity of which the sole legal owner is Taxpayer. C Co's ownership does not affect B Co's status as a disregarded entity because C Co is also Taxpayer's wholly owned disregarded entity.

B Co has been the 100 percent direct legal owner of US Co since at least Date 3. The UK Group has recently concluded that it would be preferable for Taxpayer to own US Co directly rather than through B Co. Accordingly, B Co transferred its interest in US Co to Taxpayer. It is contemplated that US Co will repurchase some of its stock from Taxpayer less than 12 months after Taxpayer acquires legal title to the shares of US Co. Taxpayer represents that, for U.S. tax purposes, this would be a dividend to the extent of US Co's earnings and profits. Taxpayer also represents that it would be a dividend under Article 10(10)(a) of the Treaty.

RULING REQUESTED

For purposes of the 12-month stock ownership requirement in Article 10(3)(a) of the Treaty, the Taxpayer is the direct owner of shares in US Co that are directly owned by wholly-owned, disregarded entities of the Taxpayer.

LAW AND ANALYSIS

Under the general rule of Article 10(1) of the Treaty, a Contracting State may tax its residents on dividends paid by a company that is a resident of the other Contracting State. Under Article 10(2), the State of source may also tax dividends, subject to certain limitations. Article 10(3) provides for exclusive residence-State taxation with respect to certain dividends paid by a company resident in one Contracting State to a company resident in the other Contracting State.

Under Article 10(3)(a), dividends are not taxable in the source State if the beneficial owner is a company resident in the other Contracting State that has owned shares representing 80 percent or more of the voting power of the company paying the dividends for a 12-month period ending on the date the dividend is declared and certain other requirements are satisfied. The Treasury Department Technical Explanation to Article 10(3)(a) clarifies that such shares must have been "owned directly."

Taxpayer has wholly owned US Co through disregarded entities since , but it has held legal title to the shares of US Co for less than 12 months. Accordingly, to meet the 12-month holding period required under Article 10(3)(a), Taxpayer's ownership of US Co's shares during the time that its disregarded entities held legal title to such shares must be considered to be direct ownership. Taxpayer requests a ruling on the sole issue of whether, for purposes of the 12-month stock ownership requirement contained in Article 10(3)(a), Taxpayer was considered the direct owner of the shares of US Co that were owned through its wholly-owned, disregarded entity.

While the Technical Explanation to Article 10(3)(a) clarifies that the term "owned" includes only direct ownership, it does not define what types of ownership will be considered direct ownership. Under Article 3(2), General Definitions, unless the context otherwise requires or the competent authorities agree on a common meaning, an undefined term will have the meaning that it would have under the law of the State applying the Treaty, with any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws. Thus, the term "directly owned" will have the meaning that it has under U.S. law, unless the context otherwise requires.

Treasury Regulation section 301.7701-(3)(a) allows a business entity that is not a *per se* corporation to elect its classification for federal tax purposes. An eligible entity with a single owner can elect to be disregarded as an entity separate from its owner. Under Treas. Reg. section 301.7701-2(a), if an entity is disregarded, "its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner."

Domestic law clearly contemplates that the sole owner of a disregarded entity is considered to own the assets of the disregarded entity for federal tax purposes. Under Treas. Reg. section 1.367(e)-1(b)(1)(B)(2), ". . . stock owned by or for an entity that is disregarded as an entity separate from its owner (disregarded entity) under § 301.7701-3 of this chapter *are owned directly by the owner of such disregarded entity*." [Emphasis added.] Accordingly, for purposes of the 12-month stock ownership requirement in Article 10(3)(a) of the Treaty, Taxpayer will be considered to directly own the shares of US Co that are owned by its wholly-owned, disregarded entities unless the context otherwise requires.

As noted above, Article 3(2), General Definitions, provides that an undefined term will have the meaning that it would have under the law of the State applying the Treaty, unless the context otherwise requires. The Technical Explanation to Article 3 explains that:

> The reference in both paragraphs 1 and 2 to the "context otherwise requir[ing]" a definition different from the treaty definition, in paragraph 1, or from the internal law definition of the Contracting State whose tax is being imposed, under paragraph 2, *refers to a circumstance where the result intended by the Contracting States is different from the result that would obtain under either the paragraph 1 definition or the statutory definition*. Thus, flexibility in defining terms is necessary and permitted. [Emphasis added.]

Therefore, to determine whether the "context" requires a definition of direct ownership that is different from that which is found in domestic law, it is necessary to determine whether the result that the Contracting States intended would be obtained under the provisions of Article 10(3).

The Joint Committee on Taxation Explanation of the Treaty discusses the rationale for the zero rate of withholding with respect to dividends, stating:

> If the dividend-paying corporation is at least 80-percent owned by the dividends-receiving corporation, it is arguably appropriate to regard the dividend-receiving corporation as a direct investor (and taxpayer) in the source country in this respect, rather than regarding the dividend receiving corporation as having a remote investor-type interest warranting the imposition of second-level source-country tax.

Thus, the purpose of Article 10(3)(a) was to eliminate the withholding tax on certain direct investment. As noted above, the threshold for being considered a direct investor under Article 10(3)(a) is direct ownership of at least 80-percent of the payor's voting shares for the 12-month period ending on the date the dividend is declared. Eligibility for the zero rate of withholding tax provided by subparagraph (a) is also subject to additional restrictions. One such restriction states that companies qualifying for treaty benefits by virtue of the active trade or business or ownership-base erosion test must have acquired shares representing 80 percent or more of the voting stock of the company paying the dividends prior to October 1, 1998. According to the Technical Explanation,

> [t]his restriction supplements those imposed under Article 23 (Limitation on Benefits), and is necessary because of the increased pressure on the Limitation on Benefits tests resulting from the fact that the Convention is one of the first U.S. tax treaties to provide for a zero rate of withholding on inter-company dividends. The test is intended to prevent companies from re-organizing in order to become eligible for the zero rate of withholding tax in circumstances where the Limitation on Benefits provision does not provide sufficient protection against treaty-shopping.

The Technical Explanation continues to explain that,

> [i]n order to prevent this type of treaty-shopping, the Convention imposes an *additional holding requirement* on companies that qualify for benefits only under the "active conduct of a trade or business" test (paragraph 4 of Article 23) or under the "ownership-base erosion" test (paragraph 2(f) of Article 23). For those companies, the zero rate of withholding tax is available only with respect to dividends received from companies that the recipient company owned, directly or indirectly, prior to October 1, 1998.

The 12-month holding period requirement contained in paragraph 3(a) is, therefore, not necessary to prevent companies from re-organizing in order to become eligible for the zero rate of withholding tax in circumstances where the Limitation on Benefits provision does not provide sufficient protection against treaty-shopping; rather the threshold is necessary to prevent the short-term shifting of ownership of a subsidiary to obtain the benefit of the zero rate.

In the case at hand, defining the term “direct ownership” to include stock directly owned by Taxpayer’s disregarded entity is not contrary to the purpose of Article 10(3)(a)—the elimination of the withholding tax on direct investment—and does not cause a result that was not intended by the Contracting Parties. Accordingly, on the facts presented, the context does not require “direct ownership” to be defined in a manner that differs from domestic law.

Based solely on the information submitted and the representations made by the taxpayer, we conclude that for purposes of the 12-month stock ownership requirement in Article 10(3)(a) of the Treaty, Taxpayer is the direct owner of shares in US Co that are directly owned by wholly-owned, disregarded entities of the Taxpayer.

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. No opinion is expressed as to whether Taxpayer has derived dividends within the meaning of the regulations under Code section 894(c) or Article 1(8) of the Treaty. No opinion is expressed as to whether Taxpayer qualifies for benefits under Article 23 of the Treaty.

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.

Sincerely,

/s/Karen Rennie
Senior Technical Reviewer
Office of Associate Chief Counsel (INTL)

cc: