Internal Revenue Service

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Date:
January 13, 2004

Legend

Corp A =
Corp B =
Corp C =
Corp D =
Corp E =
Corp F =
Corp G =
FC 1 =
FC 2 =
FC 3 =
FC 4 =
Country A =
Country B =
Country C =
Country D =
Activity A =
$x =
$y =
Date 1 =
Date 2 =
Date 3 =

Dear :

This is in response to your representative's letter dated July 16, 2002 and supplemental information provided on February 13, 2003, November 12, 2003 and

January 5, 2004 requesting a determination that: 1) following the transfer of FC 2 to Corp G, Corp G (as FC 4's sole United States shareholder) will succeed to Corp B's share of FC 4's qualified deficit under section 952(c)(1)(B) of the Code and 2) following the transfer of FC 1 to Corp G, Corp G (as FC 1's sole United States shareholder) will also succeed to Corp F's share of FC 1's qualified deficit under section 952(c)(1)(B) of the Code.

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 this request for ruling, such material is subject to verification upon examination.

FACTS

Corp A is a domestic corporation and common parent of an affiliated group of corporations (Corp A consolidated group) that files a consolidated federal income tax return. Corp B, a domestic corporation, is a wholly owned subsidiary of A. Corp C, a domestic corporation, is a wholly owned subsidiary of Corp B. Corp D, a domestic corporation, is a wholly owned subsidiary of Corp C. Corp E, a domestic corporation, is a wholly owned subsidiary of Corp D. Corp F, a domestic corporation, is a holding company and wholly owned subsidiary of Corp E. Corp G, a domestic corporation, is a wholly owned subsidiary of Corp F. FC 1, a Country A corporation, is a wholly owned subsidiary of Corp F and a controlled foreign corporation (CFC) within the meaning of section 957(a) of the Code. FC 2, a Country B corporation, is a wholly owned subsidiary of Corp B and a CFC within the meaning of section 957(a) of the Code. FC 3, a Country C corporation, is a wholly owned subsidiary of FC 2 and a CFC within the meaning of section 957(a) of the Code. FC 4, a Country C corporation, is a wholly owned subsidiary of FC 3 and a CFC within the meaning of section 957(a) of the Code.

FC 4 is engaged primarily in Activity A. Since Date 2, and while indirectly owned by Corp B, FC 4 has accumulated, as of Date 3, a deficit in earnings and profits attributable to foreign base company shipping income as defined in section 952(c)(1)(B), in the approximate amount of $x. Corp A represents that this amount has not been previously taken into account and is a qualified deficit, within the meaning of section 952(c)(1)(B)(ii).

FC 1 has also engaged in Activity A. Since Date 2, and while owned by Corp F, FC 1 has accumulated, as of Date 3, a deficit in the earnings and profits attributable to foreign base company shipping income as defined in section 952(c)(1)(B), in the approximate amount of $y. Corp A represents that this amount has not been previously

taken into account and is a qualified deficit, within the meaning of section 952(c)(1)(B)(ii).

Corp A proposes to cause:

(a) Corp B will contribute FC2 to Corp C in a section 351(a) transaction, followed by Corp C contributing FC 2 in a series of section 351(a) contributions to Corp G;
(b) Corp F to contribute FC 1, in a section 351(a) contribution, to Corp G; and
(c) at a later date (approximately 2 years from the date of the transactions described above in (a)), Corp B would merge with and into Corp C or would otherwise be liquidated;

As a consequence, FC 1 and FC 4 would be held, directly or indirectly, by Corp G.

Corp A and Corp G represent that:

1. There is no plan or intention by Corp G, directly or through any subsidiary corporation, to sell, exchange, transfer by gift or otherwise dispose of any of its stock in FC 1, FC 2, FC 3 or FC 4 after Corp G's acquisition of FC 2 and FC 1, as described herein, and for a one year period following the date of this private letter ruling; and

2. There is no plan or intention to liquidate FC 1, FC 2, FC 3 or FC 4, to merge any of those corporations with any other corporation, or to sell or otherwise dispose of the assets of such corporation, except in the ordinary course of business, after Corp G's acquisition of FC 2 and FC 1, as described herein, and for a one year period following the date of this private letter ruling,

whereby, in either circumstance, such qualified deficit could be utilized to reduce the gross income attributable to any activity giving rise to foreign base company shipping income of any person other than FC 1, FC 2, FC 3 or FC 4.

RULINGS REQUESTED

Corp A, on behalf of Corp G, requests the following rulings:

(i) FC 4 to Corp G. Following the transfer of FC 2 to Corp G, Corp G (as FC 4's sole United States shareholder) succeeds to Corp B's share of FC 4's qualified deficit under section 952(c)(1)(B).

(ii) FC 1 to Corp G. Following the transfer of FC 1 to Corp G, Corp G (as FC 1's sole United States shareholder) succeeds to Corp F's share of FC 1's qualified deficit under section 952(c)(1)(B).

LAW

Section 952(c)(1)(B)(i) provides, in part, that a United States shareholder may reduce such shareholder's pro rata share of subpart F income for any taxable year which is attributable to a qualified activity by the amount of such shareholder's pro rata share of any qualified deficit.

Section 952(c)(1)(B)(ii) provides, in part, that a qualified deficit is any deficit in the earnings and profits of the CFC for any prior taxable year beginning after December 31, 1986, but only to the extent such deficit is: 1) attributable to the same qualified activity as the activity giving rise to the income being offset and, 2) has not previously been taken into account.

ANALYSIS

Section 952(c)(1)(B)(i) allows the use of qualified deficits of a CFC by its United States shareholder to reduce the shareholder's pro rata share of subpart F income but only if the United States shareholder was a United States shareholder of the CFC in the taxable year when the deficits arose. The Tax Reform Act of 1986 modified the prior accumulated deficit rule under section 952 to limit the use of a CFC's deficits by United States shareholders. Specifically, in part, Congress intended to limit the use of acquired deficits by a United States shareholder of a CFC because it was concerned with the use by a United States shareholder of deficits in earnings and profits incurred by a foreign corporation before its acquisition by the U.S. shareholder to reduce the United States shareholder's post-acquisition subpart F income ("loss trafficking"). See H.R. Rep. No 98-841 at II-622-23 (1986).

In the instant case, Corp B was the sole United States shareholder of FC 4 when FC 4's deficits arose and Corp F was the sole United States shareholder of FC 1 when FC 1's deficits arose. Currently, Corp B, Corp C and Corp F are members of the Corp A consolidated group. Prior to Date 1, Corp B was a member of an affiliated group of corporations, which included Corp C, that filed a consolidated tax return and Corp F was a member of another affiliated group of corporations that filed a consolidated tax return. Following the proposed transaction, FC 2 and FC 1 will be held directly by Corp G, also a member of the Corp A consolidated group. Although Corp B and Corp F will no longer be the United States shareholders of FC 4 and FC 1, respectively, for subpart F income inclusion purposes, Corp F and Corp B will continue to indirectly own 100 percent of FC 4 and FC 1 and to file a consolidated return with Corp A. Comparing the subpart F

inclusion amount from the application of the accumulated deficit rule to the current structure and the proposed structure, under the proposed structure the amount of subpart F income includable on the Corp A consolidated group's Federal income tax return will not change from that which would be includable under the current structure. Provided that the United States shareholders of the CFCs, when the qualified deficits arose, remain members of the consolidated group, allowing corporations within a consolidated group to rearrange their structure does not present the loss trafficking abuse Congress intended to restrict. Therefore, following the transfer of FC 2 by Corp B to Corp C to Corp G, Corp G should be able to succeed to Corp B's pro rata share of FC 4's qualified deficit and will be permitted to offset its inclusion of subpart F income of FC 4 attributable to the same qualified activity by such qualified deficit. Further, following the transfer of FC 1 by Corp F to Corp G, Corp G should be able to succeed to Corp F's pro rata share of FC 1's qualified deficit and will be permitted to offset its inclusion of subpart F income of FC 1 attributable to the same qualified activity by such qualified deficit.

HOLDING

Accordingly, based solely on the information and representations set forth above and provided that Corp B, Corp C, following the proposed merger or liquidation of Corp B into Corp C, and Corp F continue to indirectly own 100 percent of FC 1 and FC 4 and to be members of the Corp A consolidated group it is held: 1) following the transfer of FC 2 to Corp G, Corp G will succeed to Corp C's (the successor to Corp B) pro rata share of FC 4's qualified deficit and will be permitted to offset its inclusion of subpart F income of FC 4 attributable to the same qualified activity by such qualified deficit and 2) following the transfer of FC 1 to Corp G, Corp G will succeed to Corp F's pro rata share of FC 1's qualified deficit and will be permitted to offset its inclusion of subpart F income of FC 1 attributable to the same qualified activity by such qualified deficit.

Except as expressly provided herein, no opinion is expressed with respect to whether FC 1 and FC 4's deficits are qualified deficits or about this transaction under any other section of the Code.

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.

Sincerely,

Phyllis E. Marcus
Branch Chief, Branch 2
Office of Office of Associate Chief Counsel
(International)