Internal Revenue Service

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Person To Contact:
, ID No.
Telephone Number:

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LEGEND

Taxpayer =

Parent =

Country 1 =

New Subs =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Percentage 1 =

Percentage 2 =

Percentage 3 =

Dear

This letter is in response to the letter submitted by Taxpayer's authorized representatives in which a ruling was requested regarding the conformity requirements of sections 472(c), 472(e)(2), and 472(g) of the Internal Revenue Code. Specifically, the ruling requested is that Parent, a foreign corporation, may issue consolidated financial statements to its shareholders and creditors reporting New Subs' operations on a non-LIFO basis without violating the LIFO conformity requirement set forth in I.R.C. §§ 472(c), (e)(2), and (g).

Parent is a corporation organized under the laws of Country 1. For financial statement presentation purposes, Parent is subject to generally accepted accounting principles of Country 1. Taxpayer is a wholly-owned U.S. subsidiary of Parent. On Date 1, Parent entered into an agreement whereby Taxpayer would acquire all of the outstanding stock of New Subs ("the Acquisition"). The Acquisition was closed on Date 2. Prior to the Acquisition, Taxpayer also had other wholly-owned U.S. subsidiaries ("Old Subs"). Following the Acquisition, the activities of Parent, Taxpayer, and Taxpayer's subsidiaries (Old Subs and New Subs, collectively "Subs") are reported on the consolidated financial statements of Parent.

Taxpayer and Subs join in the filing consolidated U.S. federal income tax returns on a fiscal year ending each year on Date 3. Prior to the Acquisition, New Subs used the last-in, first-out (LIFO) method of valuing inventory for federal income tax purposes. Parent and Taxpayer currently use a non-LIFO method of valuing inventory for U.S. and Country 1 tax purposes.

Parent values its inventory in its worldwide consolidated financial statements, which previously included the balance sheets and operations of Taxpayer and Old Subs, and which will now include the balance sheet and operations of New Subs as well, on a first-in, first-out (FIFO) basis.

Taxpayer represents that the percentage of operating assets used by the worldwide group ("Group") in foreign operations, as reflected on the consolidated financial statements of Group constituted approximately Percentage 1 of the total operating assets of the consolidated group prior to the Acquisition, and Percentage 2 following the Acquisition.

Taxpayer requests that the following rulings be issued:

(1) That Parent has substantial foreign operations within the meaning of Rev. Rul. 78-246, 1978-1 C.B. 146; and

(2) Consequently, the issuance of consolidated financial statements by Parent to its shareholders and creditors reporting New Subs' operations on a non-LIFO basis does not violate the LIFO conformity requirement set forth in I.R.C. §§ 472(c), (e)(2), and (g).

Section 472(c) of the Code provides that a taxpayer that elects to use the LIFO inventory method for federal income tax purposes must establish to the satisfaction of the Commissioner that it has used no method other than LIFO in inventorying goods specified in its LIFO election to ascertain income, profit, or loss for the first taxable year for which the method is to be used, for the purpose of a report or statement covering such taxable year to shareholders, partners, or other proprietors, or to beneficiaries, or for credit purposes.

Section 472(e)(2) imposes a requirement similar to that contained in section 472(c) for taxable years subsequent to the year of the LIFO election and provides that the taxpayer may be required to discontinue the use of the LIFO inventory method if this requirement is violated.

Section 472(g) of the Code provides that all members of the same group of financially related corporations are treated as a single taxpayer for purposes of the LIFO conformity requirement of sections 472(c) and (e)(2). The term "group of financially related corporations" means any affiliated group as defined in section 1504(a), determined by substituting "50" percent for 80 percent each place it appears, and any group of corporations that consolidate or combine for purposes of financial statements.

Rev. Rul. 78-246 holds that the LIFO conformity requirement of section 472(c) and (e)(2) of the Code does not apply to consolidated financial statements issued by a foreign parent corporation provided that the foreign parent owns, either directly or through members of its consolidated group, operating assets of substantial value which are used in foreign operations. Operating assets are considered to be used in foreign operations if they are owned by, and used in the business of, corporations that: (1) are members of the consolidated group; (2) are foreign corporations; (3) do not use the LIFO method of accounting for federal income tax purposes; and (4) engage in a business outside the United States. Operating assets for purposes of this test are all the assets necessary for the conduct of an active operating company. The foreign parent corporation will be considered as owning substantial foreign assets if the total value of such assets constitutes 30 percent or more of the total operating assets of the consolidated group. This determination will be made annually and normally will be made on the basis of the asset valuation reflected in the consolidated financial statements of the group for the year.

Rev. Rul. 78-246 further holds that whether a foreign parent is engaged in substantial foreign operations will be decided on the basis of all the facts and circumstances presented if the consolidated group does not satisfy the 30 percent test previously discussed.

Prior to the Acquisition, the percentage of operating assets used by Group in foreign operations, as reflected on the consolidated financial statements of Group constituted approximately Percentage 1, which percentage exceeded the 30 percent threshold of the Rev. Rul. 78-246. However, following the Acquisition, the percentage dropped to Percentage 2, which percentage falls below the 30 percent threshold of the revenue ruling.

Consequently, Taxpayer concedes it does not meet the 30 percent standard for establishing substantial foreign operations under Rev. Rul. 78-246. For taxpayers not meeting that standard, the revenue ruling determines the substantiality of foreign operations based upon all the facts and circumstances. Taxpayer argues that, based upon this facts and circumstances test, the substantial foreign operations test is met.

While the revenue ruling states that the determination will “normally will be made on the basis of the asset valuation reflected in the consolidated financial statements of the group for the year,” Taxpayer argues that, as a result of the stepped up basis in the assets involved in the Acquisition, financial statement comparisons do not fairly represent its situation. The assets of New Subs reflect current value because the Acquisition was recorded as a purchase pursuant to generally accepted accounting principles.

Taxpayer proposes comparing the market values of the foreign operations to that of total operations. For the market value of New Subs, Taxpayer proposes using the purchase price of New Subs. For the market value of the remainder of Group, Taxpayer proposes using EBITDA (earnings before interest, taxes, depreciation, and amortization) as a basis for allocating Group’s market value, prior to the Acquisition, between its foreign and domestic operations. As a result of this analysis, Taxpayer represents that the percentage of foreign operations is approximately Percentage 3, which percentage is slightly below the 30 percent threshold set forth in Rev. Rul. 78-246.

Based upon the facts submitted, including the relative market value of Group’s foreign and domestic operations, as well as the impact of the Acquisition on the comparability of the financial statement values, it is ruled that, for federal income tax purposes:

(1) For Parent’s fiscal year ending Date 4, on the basis of all the facts and circumstances presented, Parent has substantial foreign operations within the meaning of Rev. Rul. 78-246, 1978-1 C.B. 146; and

(2) Consequently, for the fiscal year ending Date 4, the issuance of consolidated financial statements by Parent to its shareholders and creditors reporting New Subs’ operations on a non-LIFO basis does not violate the LIFO conformity requirement set forth in I.R.C. §§ 472(c), (e)(2), and (g).

This ruling applies only to the taxable year ending Date 4 and does not apply to any subsequent taxable year. Specifically, no opinion is stated as to whether Parent has substantial foreign operations for subsequent years, or whether Parent may issue consolidated financial statements for subsequent years reporting New Subs’ operations on a non-LIFO basis without violating the LIFO conformity requirements. Further, this letter should not be construed to approve the use of Taxpayer’s market value analysis for subsequent years.

In addition, Taxpayer and New Subs must otherwise comply with the conformity requirements of sections 472(c), (e)(2) and (g) of the Code in inventorying their goods to ascertain income, profit, or loss for the purposes of a report or statement (covering the taxable year for which the LIFO method is used) to shareholders, partners, or other proprietors, or to beneficiaries, or for credit purposes.

As provided under section 1.472-3(d) of the Income Tax Regulations, whether or not the LIFO method, once adopted, may be continued, and the propriety of all computations incidental to the use of such method, will be determined by the Commissioner in connection with the examination of the taxpayer's income tax returns. Accordingly, this letter should not be construed as a ruling as to whether Taxpayer’s or New Subs’ use of the LIFO inventory method and relevant computations are in accordance with section 472 of the Code and regulations thereunder.

Lastly, no opinion is expressed as to the tax treatment of the proposed transaction under the provisions of any other sections of the Code and regulations which may be applicable thereto, or the tax treatment of any conditions existing at the time of or effects resulting from the transaction, which are not specifically covered by the above ruling.

A copy of this letter should be attached to Taxpayer's consolidated federal income tax return for the taxable year ended Date 4. Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Jeffery G. Mitchell
Chief, Branch 6
(Income Tax & Accounting)

cc: