Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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TY:

Legend

Taxpayer =

X Corp =
Country A =
Stock Exchange 1 =
Country B =
Y Corp =
$C =
$D =
Year 1 =
Year 2 =
Year 3 =

Dear :

This responds to a letter dated August 28, 2003, requesting a ruling concerning two factors under Article 24 (Limitation on Benefits) of the United States-Luxembourg income tax treaty ("Treaty").

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 the request for rulings, it is subject to verification on examination.

FACTS

X Corp is incorporated under the laws of Country A, which is a member state of the European Union. The X Corp shares are listed and traded on Stock Exchange 1. Taxpayer, incorporated under the laws of Country B, is a wholly-owned subsidiary of X Corp. Taxpayer acts solely as a holding company for X Corp's U.S. and worldwide investments, and has no active trade or business activities in Country B. Y Corp is a wholly-owned U.S. subsidiary of Taxpayer.

Taxpayer expects to receive from Y Corp dividend income of approximately $C-$D million in each of tax years Year 1, Year 2, and Year 3. This income is not effectively connected to a U.S. trade or business conducted by Taxpayer.

RULINGS REQUESTED

1. That X Corp will be considered to be Taxpayer's "ultimate beneficial owner" for purposes of the derivative benefits test of Article 24(4) of the Treaty, within the meaning ascribed to such term under the Treaty.

2. That X Corp will be considered a qualified resident of a country that has a "comprehensive income tax convention" for purposes of applying Article 24(4)(a) of the Treaty.

LAW AND ANALYSIS

Section 881(a) of the Internal Revenue Code ("the Code") generally imposes a 30 percent tax on the amount received by a foreign corporation as dividends from sources within the United States to the extent that the dividends received are not effectively connected with the conduct of a trade or business in the United States. Section 1442 of the Code requires that a tax of 30% of any dividends paid to a foreign corporation from sources within the United States be deducted and withheld at the source.

Section 894(a) of the Code provides that the provisions of the Code shall be applied to any taxpayer with due regard to any treaty obligation of the United States which applies to such taxpayer. Moreover, section 1.1441-6(a) of the Treasury Regulations provides that the 30-percent rate of withholding shall be reduced as may be provided by a treaty with any country.

Article 10 (Dividends) of the Treaty provides that dividends paid by a company that is a resident of a Contracting State to a resident of the other Contracting State may be taxed by both countries. However, the Contracting State of which the company paying the dividends is a resident will tax the dividends at a reduced rate of 5% of the gross amount of the dividends if the beneficial owner is a company that owns directly at least 10% of the voting stock of the company paying the dividends. Thus, the reduced 5%

tax rate will apply to dividends derived and beneficially owned by a resident of Luxembourg that owns at least 10% of the voting stock of the U.S. company paying the dividends, provided the requirements of Article 24 of the Treaty are met.

Generally, benefits of the Treaty will be extended to a resident of a Contracting State only if the resident meets the specific criteria to be a “qualified resident”, as listed in paragraph 2 of Article 24. Because Taxpayer is wholly-owned by a non-Luxembourg company, it fails to meet the specific criteria to be a “qualified resident” of paragraph 2 of Article 24.

Paragraph 4 of Article 24 of the Treaty provides that, except as provided in Article 24(4)(c), a person that is not a qualified resident may nonetheless be entitled to benefits of the Treaty with respect to certain items of income if (in pertinent part):

> a) 95 percent of the company’s shares is ultimately owned by seven or fewer residents of a state that is a party to NAFTA or that is a member State of the European Union and with which the other State has a comprehensive income tax convention; and
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> * * *
>
> d) (i) The term “resident of a member State of the European Union” means a person that would be entitled to the benefits of a comprehensive income tax convention in force between any member State of the European Union and the Contracting State from which the benefits of this Convention are claimed, provided that if such convention does not contain a comprehensive Limitation on Benefits article (including provisions similar to those of subparagraphs 2(c) and 2(d) and paragraph 3), the person would be entitled to the benefits of this Convention under the principles of paragraphs 2 or 3 if such person were a resident of one of the Contracting States under Article 4 (Resident) of this Convention.
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> * * *

Ruling One

In order to satisfy the first clause of Article 24(4)(a), 95 percent of Taxpayer’s shares must be “ultimately owned” by seven or fewer residents of a state that is a party to NAFTA or that is a member State of the European Union.

The Treaty does not specifically define the term “ultimately owned.” However, the same term is used in subparagraph 2(c)(i) of Article 24 of the Treaty. The Technical Explanation to Article 24(2)(c) provides that:

> Subparagraph 2(c)(i) refers to persons who “ultimately” own the company’s principal class of shares. In general, this test requires that any intermediate owners of the company be disregarded and that ownership be traced to a person that is a qualified resident without reference to its owners (such as a publicly-traded company under subparagraph 2(d)).

Based on the use of the term “ultimately owned” elsewhere in the Treaty, it is concluded that for purposes of Article 24(4)(a), X Corp is the ultimate owner of Taxpayer without reference to the residence of the shareholders of X Corp.

Ruling Two

In order to satisfy the second clause of Article 24(4)(a), the ultimate owner(s) of the Taxpayer must be a resident of a state with which the United States has a comprehensive income tax convention. The term “comprehensive income tax convention” is not defined in the Treaty.

Subparagraph 8(h) of Article 26 (Limitation on Benefits) of the United States-Netherlands Income Tax Convention (the “Netherlands Treaty”) also uses the term in a similar context. The explanation of the Joint Committee on Taxation with respect to Article 26(8) of the Netherlands Treaty provides that:

> [t]o be considered an EC member country for this or any other purpose of the limitation on benefits article of the proposed treaty, the country generally must be either the Netherlands or a member of the EC with which both the United States and the Netherlands have in effect a comprehensive income tax treaty. Of the 12 current members of the EC, currently all but Portugal meet these criteria.

The Technical Explanation to subparagraph (8)(h) of Article 26 of the Netherlands Treaty explains that:

> [a]s of the date of this Explanation, the Netherlands has in effect a comprehensive income tax convention with all the members of the European Communities, and the United States has such Conventions in effect will [sic] all members except Portugal. Therefore, for purposes of this definition, all members of the European Communities are included except for Portugal. This definition is ambulatory; if both States and Portugal conclude a comprehensive income tax convention, Portugal would be included within the definition.

Further, Notice 2003-69, 2003-42 I.R.B. 851, sets forth a list of U.S. income tax treaties that are recognized as “comprehensive income tax treat[ies]” for purposes of Code Section 1(h)(11)(C)(i)(II). Country A is included on this list.

Based on the use of the term “comprehensive income tax convention” in the Treaty and the comparable usage in the Netherlands treaty and in Notice 2003-69, it is held that the income tax treaty between the United States and Country A is a “comprehensive income tax convention” for purposes of Article 24(4)(a) of the Treaty.

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.

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

Sincerely,

W. Edward Williams
Senior Technical Reviewer, Branch 1
Office of Associate Chief Counsel
(International)

cc: