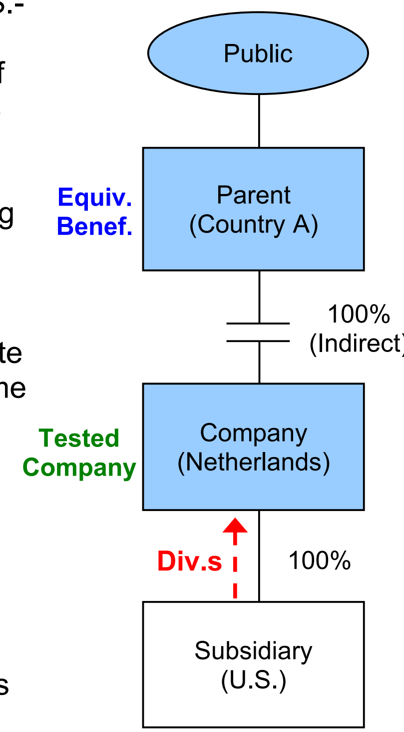
PLR 200551016

Exempt Dividends Included in "Gross Income" For Derivative Benefits Test

Company, a Netherlands holding company, was seeking the benefits of Article 10 (Dividends) of the U.S.-Netherlands income tax treaty (the "Treaty") with respect to dividends to be received from Subsidiary, a State B corporation and Company's U.S. subsidiary. Company is an indirect, wholly owned subsidiary of Parent, a publicly traded Country A company. Company represented that it will qualify for treaty benefits under the derivative benefits test contained in Article 26(3) of the Treaty if the dividends to be received from Subsidiary are included in "gross income" for purposes of determining whether Company satisfies the base erosion prong of that test in Article 26(3)(b). The issue arises because Company's shareholding in Subsidiary qualifies for the participation exemption regime in the Netherlands, under which dividends are exempt from corporate income tax.



The derivative benefits test in Article 26(3) of the Treaty generally entitles a resident of a contracting state to treaty benefits if the owner of the resident would have been entitled to the same benefit had the income in question flowed directly to that owner. Article 26(3) provides in part:

> [A company] shall be entitled to * * * benefits * * * with respect to an item of income if * * * a) shares representing at least 95 percent of the aggregate voting power and value * * * of the company are owned, directly or indirectly, by seven or fewer persons who are equivalent beneficiaries; and b) less than 50 percent of the company's gross income for the taxable year in which the item of income arises is paid or accrued, directly or indirectly, to persons who are not equivalent beneficiaries, in the form of payments that are deductible for the purposes of the taxes covered by this Convention in the State of which the company is a resident * * *.

The Memorandum of Understanding ("MOU") that accompanied the March 8, 2004, Protocol amending Article 26 of the Treaty defines the term "gross income" for purposes of Article 26. Paragraph XV of the MOU provides:

> It is understood that the term "gross income" means the total revenues derived by a resident of a State from its principal operations, less the direct costs of obtaining such revenues. * * *

The ruling concluded that the dividends Company expects to receive from Subsidiary are part of the total revenues derived by Company from its principal operations, notwithstanding that the dividends are exempt from corporate income tax in the Netherlands under a participation exemption regime. Accordingly, Company should include the amount of the dividends in "gross income" for purposes of applying the base erosion test under Article 26(3)(b).