PLR 201322009

Application of PFIC Look-Through Rules to Foreign Corporation with U.S. Subsidiaries

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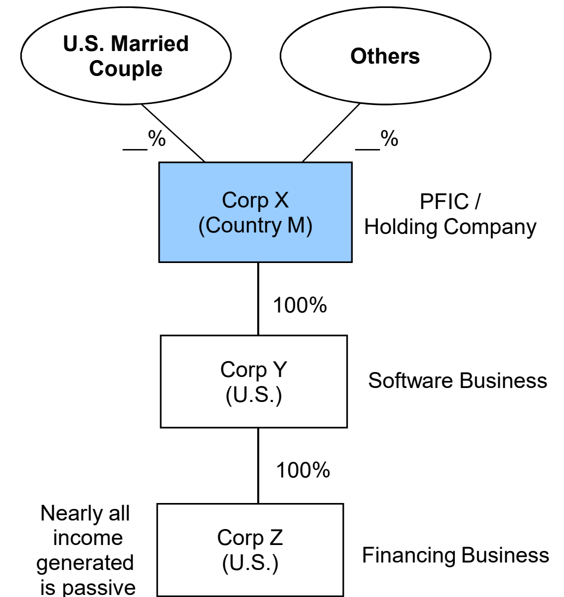

Taxpayers are a married couple who own shares in Corp X. Corp X is a Country M corp. and is a passive foreign investment company (PFIC) within the meaning of Code §1297. Corp X owns all of the outstanding shares of US Corp Y, a domestic corporation. US Corp Y owns all the outstanding shares of US Corp Z.

The board of directors of Corp X has adopted a resolution confirming that Corp X has irrevocably waived any protection under the U.S.-Country M treaty against the imposition of the U.S. accumulated earnings tax, effective for all prior, current, and future taxable years.

Code §1297(c) contains a look-through rule that provides that if a foreign corporation owns, directly or indirectly, at least 25 percent of the value of the stock of another corporation, then the foreign corporation is treated (for purposes of Code §1297(a)) as holding its proportionate share of the assets, and as receiving directly its proportionate share of the income of, the 25-percent owned subsidiary.

Code §1298(b)(7) contains a look-through rule that provides that if a foreign corporation owns 25 percent or more of the shares of a domestic corporation (first-tier domestic corporation), and if the foreign corporation is either subject to the U.S. accumulated earnings tax or waives any benefit under any treaty which otherwise would prevent the imposition of the accumulated earnings tax, then for purposes of determining whether the foreign corporation is a PFIC: (1) any shares of another domestic corporation, other than a regulated investment company or real estate investment trust (second-tier domestic corporation), that are held by the first-tier domestic corporation are treated as not being a passive asset; and (2) any amount included in the gross income of the first-tier domestic corporation with respect to the shares of such second-tier domestic corporation are treated as not being passive income.

Unless an income tax treaty provides otherwise, a foreign corporation (other than a PFIC) that has any shareholder who is a U.S. citizen or resident is subject to the accumulated earnings tax with respect to the corporation's U.S.-source income (including U.S.-source dividend and interest income that is not effectively connected with a trade or business conducted within the United States by the foreign corporation). See Code §532; Treas. Reg. §§ 1.532-1(c) and 1.535-1(b).

The IRS ruled that for purposes of determining whether Corp X is a PFIC: (1) Pursuant to Code §1298(b)(7), Corp X is treated as not receiving any portion of the income earned by US Corp Z, and Corp X is treated as not owning the assets held by US Corp Z. (2) Any dividend received by US Corp Y from US Corp Z, and any other income received by US Corp Y, is treated under Code §1297(c) as being received directly by Corp X. (3) The shares of US Corp Z that are held by US Corp Y, and any other assets held by US Corp Y, are treated under Code §1297(c) as being owned directly by Corp X. (4) Pursuant to Code §1298(b)(7), any dividend received by US Corp Y from US Corp Z is treated as not being passive income, and the shares of US Corp Z that are held by US Corp Y are treated as not producing passive income and as not being held for the production of passive income.

Interestingly, the PLR states that Corp X is a PFIC, while at the same time it is determining whether Corp X is a PFIC. Presumably, Corp X was a PFIC in a prior year and has remained a PFIC under the "once-a-PFIC-always-a-PFIC" rule of Code §1298(b)(1). Possibly, Corp Y moved its passive assets into Corp Z and Corp X may no longer meet the 50% asset test or the 75% income test. As a result of Corp X no longer meeting the PFIC tests, the U.S. married couple may be seeking to make a purging election under Code §1298(b)(1) and Treas. Reg. §1.1298-3(b) to purge the PFIC taint.

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