

**Shares of Second-Tier U.S. Subsidiary
Not Passive For PFIC Testing**

Corp X is a publicly traded Country M corporation that was founded in Year 1. Approximately a% of its shares are currently held by United States persons. Corp X is not a controlled foreign corporation within the meaning of section 957(a). Corp X has requested a determination regarding the application of sections 1298(b)(7) and 1297(c) for purposes of determining whether Corp X is a PFIC. Corp X directly owns all of the outstanding shares of US Corp Y, a domestic corporation that was formed in Year 2. US Corp Y formed US Corp Z, a domestic corporation, in Year 3 with a capital contribution, and has directly owned all of the outstanding shares of US Corp Z since its formation. Corp X is engaged in a business involving the research, development, commercialization, and marketing of certain pharmaceutical treatments. US Corp Y conducts operations related to Corp X's pharmaceutical, research, and development business. Corp X holds an obligation of US Corp Y, which requires US Corp Y to pay or accrue U.S.-source interest expense in Year 5 and subsequent taxable years.

The treaty between the United States and Country M includes a provision that would prevent the United States from taxing (including under the accumulated earnings tax described in section 531) undistributed profits of a corporation that is a resident of Country M. However, the board of directors of Corp X has passed a resolution to formally and irrevocably waive any protection under the U.S.-Country M treaty against the imposition of the accumulated earnings tax, effective for the tax year ending December 31 of Year 4 and all future taxable years.

Section 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 section 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. Section 1298(b)(7) contains a look-through rule that provides that if a foreign corporation owns 25 percent or more (by value) of the stock of a domestic corporation ("first-tier domestic corporation"), and if the foreign corporation is either subject to the 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 not treated as 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 is not treated as passive income.

For purposes of determining whether Corp X is a PFIC: (1) Shares of US Corp Z are treated as an asset held directly by Corp X that does not produce passive income (and is not held for the production of passive income) for purposes of applying the asset test to Corp X. (2) Dividends paid by US Corp Z to US Corp Y are treated as received directly by Corp X and are not treated as passive income for purposes of applying the income test to Corp X. (3) The stock of US Corp Y and dividends paid by US Corp Y to Corp X and otherwise includible in Corp X's income are disregarded for purposes of applying the asset test and the income test, respectively, to Corp X. (4) The loan from Corp X to US Corp Y and interest paid or accrued pursuant to that loan are disregarded for purposes of applying the asset test and income test, respectively, to Corp X.

