P, a publicly held domestic corporation, owned all of the outstanding stock of foreign corporation FX, which it had held for more than 5 years. FX is incorporated under the laws of country C. FX had owned all the outstanding stock of foreign corporation FY for more than 5 years. FY is incorporated under the laws of country D. P's corporate policy required FY to distribute a substantial portion of its earnings to FX and, in turn, required FX to distribute such earnings to P to be used in P's worldwide operations. During the preceding 5 years, FY had had substantial earnings, and it was anticipated that FY would continue to have substantial earnings.

Country C does not impose a withholding tax on distributions of earnings from FX to P. Country D imposes a 25 percent withholding tax on distributions of earnings from FY to FX. However, under the tax treaty in effect between country D and the United States, country D imposes only a 15 percent withholding tax on distributions of earnings from country D corporations to United States corporations. To allow P to take advantage of this reduced withholding tax rate, FX distributed all of the FY stock to P. The reduction of Federal taxes, if any, as a result of the transaction is substantially less than the reduction of non-Federal taxes.

The requirements of section 367 and applicable regulations were met. A substantial reduction in the amount of foreign withholding tax imposed on FY will benefit the worldwide operations of the affiliated group that includes FX, FY, and P. Therefore, the distribution by FX to P of all the FY stock is carried out for a purpose germane to the business of the affiliated group within the meaning of section 1.355-2(b)(2) of the regulations. See Rev. Rul. 76-187.