

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

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Date:  
December 6, 1999

Legend

X =

State A =

Sub1 =

State B =

Sub2 =

LLC1 =

LLC2 =

Sub3 =

Sub4 =

Possession A =

Date A =

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This letter responds to your letter dated May 20, 1999, requesting a ruling that X, and certain members of its consolidated group, Sub1, Sub2, and Sub3, are entitled to claim a 100 percent dividends received deduction pursuant to § 245(c) of the Internal Revenue Code of 1986 for their respective share of dividends received from a foreign sales corporation through a partnership.

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.

X is a United States corporation incorporated under the laws of State A.

Sub1 is a United States subsidiary of X, incorporated under the laws of State B.

Sub2 is a United States subsidiary of X, incorporated under the laws of State B.

Sub3 is a United States subsidiary of X, that is a member of X's consolidated group.

LLC1 is currently a single member limited liability company, formed under the laws of State B with X as its sole member, that is disregarded as an entity separate from its owner pursuant to § 301.7701-2(c)(2)(i) of the Administration and Procedure Regulations (a disregarded entity).

Sub1 and Sub2 are included in the consolidated United States federal income tax return filed by X.

X owns all of the outstanding stock of Sub4 which was incorporated in Possession A. Sub4 is operated as a foreign sales corporation ("FSC") in accordance with the provisions of § 922 and the regulations thereunder. All of Sub4's earnings and profits have been and will be attributable to "foreign trade income," as defined by § 923(b). Sub4 uses and will continue to use one of the administrative pricing methods described in § 925(a). X, Sub1, Sub2, and LLC1 pay a commission to Sub4, computed under the administrative pricing rules on income generated by their direct foreign sales and licensing activities.

Under the existing ownership structure, X holds all of Sub4's outstanding stock and, accordingly, is entitled to receive all dividend income from this stock. To the extent these dividends are attributable to earnings and profits ("E&P") from foreign trade income, X effectively excludes this income from United States taxable income by claiming a 100 percent dividends received deduction ("DRD") under § 245(c)(1)(A).

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X, Sub1, Sub2, and LLC1 (collectively, the “Partners”) will form LLC2, a limited liability company, under the laws of the State B. No election will be made under § 301.7701-3(c) with regard to LLC2 and, thus, it will be classified as a partnership for federal income tax purposes. See § 301.7701-3(b)(1).

After the formation of LLC2, LLC1 will change its form from a single member limited liability company to a state law partnership which will be classified as a partnership for federal income tax purposes (though still referred to as LLC1 for purposes of this ruling although the partnership will not be a limited liability company), with X and Sub 3 owning the partnership interests. No decision has been made regarding the steps that will be taken to form the partnership.

Sub1, Sub2, and LLC1 will each contribute cash to LLC2 in exchange for their partnership interests, and X will contribute all of the stock of Sub4 in exchange for its partnership interest, thereby causing Sub4 to become wholly owned by LLC2. LLC2 will perform the administrative activities previously performed by X, including record keeping (including the receipt and disbursement of Sub4 dividends), handling FSC qualification requirements, and coordinating the accounts receivable function of the Partners’ export operations.

The earnings of Sub4 will consist principally of commissions paid by the Partners. In addition, Sub4 may derive commissions from other affiliates of X.

The limited liability agreement for LLC2 makes two special allocations. First, any Sub4 dividends attributable to FSC commissions earned by Sub4 prior to the effective date of limited liability agreement for LLC2 are allocated to X. Second, any Sub4 dividends attributable to FSC commissions earned by Sub4 beginning after Date A that are identifiable to a particular Partner are allocated to that Partner. In addition, any Sub4 dividends attributable to FSC commissions earned by Sub4 beginning after Date A that are unidentifiable to a particular Partner (as well as any other income of LLC2) is allocated by LLC2 to the Partners based upon their respective interests in LLC2.

Section 245(c)(1)(A) provides that in the case of a domestic corporation, there shall be allowed as a deduction an amount equal to 100 percent of any dividend received from another corporation which is distributed out of earnings and profits attributable to foreign trade income for a period during which such other corporation was a FSC.

Section 701 provides that a partnership as such shall not be subject to the income tax imposed by chapter 1. Persons carrying on business as partners shall be liable for income tax only in their separate or individual capacities.

Section 702(a) provides that, in determining a partner’s income tax, each partner must take into account separately the partner’s distributive share of items enumerated

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in § 702(a)(1) through (8). Section 702(a)(5) provides that, in determining a partner's income tax, each partner must take into account separately the partner's distributive share of the partnership's dividends with respect to which there is a deduction under part VIII of subchapter B. Section 245(c)(1)(A) is within part VIII of subchapter B.

Section 1.702-1(a)(5) of the Income Tax Regulations provides that each partner shall take into account, as part of the dividends received by the partner from domestic corporations, the partner's distributive share of dividends received by the partnership, with respect to which the partner is entitled to a credit under § 34 (for dividends received on or before December 31, 1964), an exclusion under § 116, or a deduction under part VIII, subchapter B, chapter 1 of the Code.

Section 1.702-1(a)(8)(ii) provides that each partner must take into account separately the partner's distributive share of any partnership item which if separately taken into account by any partner would result in an income tax liability for that partner different from that which would result if that partner did not take the item into account separately.

Section 702(b) provides that the character of any item included in a partner's distributive share under paragraphs (1) through (7) of § 702(a) is determined as if the item were realized directly from the source from which realized by the partnership, or incurred in the same manner as incurred by the partnership.

Section 703(a)(1) provides that the taxable income of a partnership shall be computed in the same manner as in the case of an individual, except that the items described in § 702(a) shall be separately stated.

Rev. Rul. 86-138, 1986-2 C.B. 84, concludes that a subsidiary partnership in a multi-tiered arrangement must separately state those items of income, gain, loss, deduction, and credit, which, if separately taken into account by any partner of any partnership in a multi-tiered structure, would result in an income tax liability for that partner different from that which would result if that partner did not take those items into account separately.

Based on the facts and representations submitted, we conclude that under § 702(a)(5), (1) each of LLC2's partners shall take into account separately the partner's distributive share of LLC2's dividends received from Sub4 (both specially allocated and allocated based upon their respective interests in LLC2); and (2) similarly, each partner of LLC1 shall take into account separately the partner's distributive share of LLC1's distributive share of LLC2's dividends received from Sub4 (both specially allocated and allocated based upon LLC1's interest in LLC2). This ruling is conditioned on the special allocation of FSC dividends by LLC2 to the Partners, as described herein, having substantial economic effect within the meaning of section 704(b) and the regulations thereunder; however, no opinion is being provided on whether the special allocation has

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substantial economic effect.

In addition, each corporate partner of LLC2 (and each corporate partner of LLC1) will be entitled to a 100 percent DRD pursuant to § 245(c)(1)(A) for its distributive share of dividends that LLC2 receives from Sub4 that is identifiable to a Partner. The 100 percent DRD is available only to the extent that the distributions are out of earnings and profits attributable to foreign trade income, for a period during which Sub4 is a FSC.

This private letter ruling is restricted to the specific rulings requested, and expresses no opinion with respect to any other issue or Code section not specifically addressed herein. In particular, no opinion was requested and none is being provided (1) regarding the consequences of LLC1 converting from a disregarded single member limited liability company to a state law partnership classified as a partnership for federal income tax purposes, and (2) other than specifically addressed herein, regarding issues arising out of calculations of the taxable income of Sub4 and its related U.S. supplier(s), pursuant to § 925(a) or (b). In addition, no opinion is being provided regarding whether the corporate partners of LLC2 (or the corporate partners of LLC1) will be entitled to a 100 percent DRD pursuant to § 245(c)(1)(A) for their distributive shares of dividends that LLC2 receives from Sub4 that are unidentifiable to a Partner.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) 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 representative.

Sincerely,

Philip L. Tretiak  
Senior Technical Reviewer, Branch 4  
Office of Associate Chief Counsel (International)