OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR
ATTORNEY

FROM: STEVEN J. HANKIN
BRANCH CHIEF CC:DOM:FS:CORP

SUBJECT: ACQUISITION MADE TO EVADE OR AVOID INCOME TAX

This Field Service Advice responds to your memorandum dated December 18, 1998. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

area 1 =
area 2 =
area 3 =
Country 1 =
Country 2 =
Date 1 =
Date 2 =
Date 3 =

[redacted]

Date 4	=	
Date 5	=	
Date 6	=	
Date 7	=	
Date 8	=	
Date 9	=	
Year 1	=	
Year 2	=	
Year 3	=	
Year 4	=	
Year 5	=	
Year 6	=	
Year 7	=	
Year 8	=	
Number A	=	
Number B	=	
Number C	=	
Number D	=	
Number E	=	
Company 1	=	
Company 2	=	
Company 3	=	
Company 4	=	
Company 5	=	
Company 6	=	
Company 7	=	

[redacted]

Company 8	=
Company 9	=
Company 10	=
Company 11	=
Company 12	=
Company 13	=
Company 14	=

Company 15	=
Company 16	=
Company 17	=
Company 18	=
Company 19	=
$a	=
$b	=
$c	=
$d	=
$e	=
$f	=
$g	=
$h	=
$i	=
$j	=
$k	=
$l	=
$m	=

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ISSUE(S):(1) Whether within the meaning of I.R.C. § 269(a) Company 1's acquisition of Company 2 had the principal purpose of avoidance of Federal income tax by securing the benefit of an allowance which Company 1 would not otherwise enjoy.

CONCLUSION: (1) It is our position that within the meaning of I.R.C. § 269(a) Company 1's acquisition of Company 2 had the principal purpose of the avoidance of Federal income tax by securing the benefit of a withholding exclusion allowance under I.R.C. §§ 1442 and 1441(c)(10) that it would not otherwise enjoy.

BACKGROUND**:**

This case involves several domestic holding corporations wholly owned by Company 3, a large area 1 corporation owning over Number A companies worldwide. Company 3 has effected several corporate reorganizations over a period of years that the Service believes occurred solely to structure an argument that distributions made by the top-tier domestic holding company to the foreign parent were not subject to withholding at source because the domestic holding company qualified as an 80/20 company under I.R.C. § 861(c)(1)(A).
This provision provides that an individual or corporation meets the 80-percent foreign business requirements of this paragraph if it is shown to the satisfaction of the Secretary that at least 80 percent of the gross income from all sources of such individual or corporation for a testing period is active foreign business income.

The pattern begins with the creation of a new top tier domestic holding company in Year 1, Company 2, followed by the acquisition of area 2 subsidiaries. It repeats with creation of another top-tier domestic holding corporation in Year 2, Company 4, and the acquisition of additional area 2 subsidiaries, and again with the creation of another top tier domestic holding company in Year 3, Company 5, and the acquisition of additional area 2 subsidiaries.

FACTS:

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Company 3 owns all of the stock of Company 1 and all of the stock of Company 6. Prior to Date 1, Company 1 owned all of the stock of domestic corporations Company 7 and Company 8, which were each the common parent of an affiliated group of corporations filing a consolidated Federal income tax return.

On Date 1, Company 1 contributed all of the stock of Company 7 and Company 8 to Company 2 in exchange for all of Company 2 shares in a transaction qualifying under I.R.C. § 351. With respect to the Company 9 consolidated group, this transaction was treated as a reverse acquisition, as defined in Treas. Reg. § 1.1502-75(d)(3). Assuming that this treatment was correct, the affiliated group of which Company 9 was the common parent was treated as remaining in existence with a new common parent, Company 2. The affiliated group of which Company 7 was the common parent ceased to exist on Date 1, and the former members of that group became members of the Company 2 consolidated group, which was a continuation of the Company 9 group.

The stated business purpose of combining Company 7 and Company 8 was to allow for financing under a “multi-option facility” lending arrangement that required a balance sheet of over $a.

On Date 2, Company 2 acquired Company 10. In Year 1 and Year 4, although the affiliated group had significant E&P, the only dividends received by Company 2 were from Company 10 in the amounts of $b and $c. During Year 1 and Year 4 Company 2 had income from deemed distributions, pursuant to elections under Treas. Reg. § 1.1502-32(f)(2), from Company 7 and Company 8. Then, in Year 2 Company 7, Company 8 and Company 11 distributed $d to Company 2, which then distributed it to Company 1 and withheld no tax based on its reliance on the 80/20 provisions under I.R.C. § 871(i)(2). This pattern repeated itself for distributions to Company 1 of $e in Year 5 and again of $f in Year 6.

Company 10 was acquired by Company 2 from its parent Company 1 for one share of stock valued at $g on Date 2. The stated purposes of this acquisition was that Company 2 had management responsibility for Company 10 and had given Company 10 bank guarantees. It is assumed that in Year 1 and Year 4, Number B percent of Company 10's income consisted of “active foreign business income,” as defined in I.R.C. § 861(c)(1).

Prior to Company 2 being created as the parent of Company 7 on Date 1, Company 7 had declared dividends on its books of over $h, which it rescinded on Date 3.

On Date 4, Company 1 contributed all of the stock of Company 2 in exchange for all of the stock of Company 4 shares in a transaction qualifying under I.R.C. § 351. This transaction resulted in a reverse acquisition as defined in Treas. Reg. §

1.1502-75(d)(3). Company 4 became the new common parent corporation of the affiliated group.

In Year 7, Company 4 acquired area 2 companies, Company 12, Company 13, and Company 14 from its parent Company 1. The stated business purpose of this acquisition is to include these companies in one regional center. Company 15, the taxing authority for Country 1 provided a letter from Company 4's accountant requesting a consent for the acquisition of these companies which provides as a purpose, the allowing of dividends to be paid to Company 3 without payment of the Number E percent U.S. withholding tax.

Company 2 owned all of the stock of Company 16, which owned all the stock of Company 17, which owned all of the stock of Company 18. Company 16 and Company 17 are domestic corporations. Company 18 is a area 1 company.

On Date 5 Company 17 sold all of the stock of Company 18 to Company 3 for $i in cash. The Commissioner claimed the value of the stock was $j and that the difference constituted a constructive dividend by Company 2 to Company 1 subject to withholding at the source under § 1442.

Company 19 is a area 3 Company formed under area 3 law in Year 8. Company 16 owns all of the stock of Company 19. On Date 6, Company 16 as the silent partner and Company 19 as the partner entered into a silent partnership under the laws of Country 2. Pursuant to a purchase and sale agreement dated as of Date 7, Company 16 sold (i) Number C shares of Company 19's capital stock, par value Number D per share, to Company 1, (ii) Number E shares of Company 19's capital stock, par value, Number D per share, to Company 6, and (iii) its interest in the silent partnership to Company 1. The total consideration for the foregoing transactions was $k cash. The Commissioner determined that the proper fair market value for these interests was $l and that the difference constituted a constructive dividend by Company 2 to Company 1 subject to withholding at the source under I.R.C. § 1442.

The petitioned cases of Company 16 and Company 17 present the issue of withholding at source on deemed dividends resulting from the sale of foreign subsidiaries to Company 3, Company 1 and Company 6. Notices of deficiency have been issued to Company 2 for withholding liability on the deemed dividends as well as the actual cash dividends made in Year 2 and Year 5. The examining agent's position is that a Number E percent tax of $m should have been imposed on these distributions and withheld by Company 2 (The 30 percent withholding tax was reduced to Number E percent because of a treaty.) A petition was filed on Date 8, on the Year 2 Company 2 case.

Law -The 80-20 provision

Relevant Code Provisions

IRC § 881(a)(1) provides for a tax of 30 percent of the amount received from sources within the United States by a foreign corporation as dividends, but only to the extent the amount so received is not effectively connected with the conduct of a trade or business in the United States.

I.R.C. § 881(d) provides that no tax shall be imposed under I.R.C. § 881(a)(1) on any amount described in I.R.C. § 871(i)(2).

I.R.C. § 871(i)(2)(b) provides that the amounts described in this paragraph include: "A percentage of any dividend paid by a domestic corporation meeting the 80-percent foreign business requirements of section 861(c)(1) equal to the percentage determined for purposes of section 861(c)(2)(A)."

I.R.C. § 861(c)(1)(A) provides that an individual or corporation meets the 80-percent foreign business requirements of this paragraph if it is shown to the satisfaction of the Secretary that at least 80 percent of the gross income from all sources of such individual or corporation for the testing period is active foreign business income.

I.R.C. § 861(c)(1)(B) provides that, for purposes of I.R.C. § 861(c)(1)(A), the term "active foreign business income" means gross income which: (i) is derived from sources outside of the United States (as determined under this subchapter) or, in the case of a corporation, is attributable to income derived by a subsidiary of such corporation, and (ii) is attributable to the active conduct of a trade or business in a foreign country or possession of the United States by the individual or corporation (or by a subsidiary). For purposes of
I.R.C. § 861(c)(1)(B), the term "subsidiary " means any corporation in which the corporation referred to in I.R.C. § 861(c)(1)(B) owns (directly or indirectly) stock meeting the requirements of I.R.C. § 1504(a)(2) (determined by substituting "50 percent" for "80 percent" each place it appears.

I.R.C. § 861(c)(1)(C) provides that, for purposes of I.R.C. § 861(c), the term "testing period" means the 3-year period ending with the close of the taxable year of the individual or corporation preceding the payment. (or such part of such period as may be applicable) If the individual or corporation has no gross income for such 3 year period (or part there of), the testing period shall be the taxable year in which the payment is made.

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I.R.C. § 1442 provides that, in the case of foreign corporations subject to taxation under this subtitle, there shall be deducted and withheld at the source in the same manner and on the same items of income as is provided in section 1441 (Withholding of tax on nonresident aliens) a tax equal to thirty percent thereof.

I.R.C. § 1441(c)(10) provides that no tax shall be required to be deducted and withheld under § 1441(a) from any amount described in I.R.C. § 871(i)(2).

LAW AND ANALYSIS-Section 269 Issue

Relevant Code Provisions and Case Law

The pertinent provisions of I.R.C. § 269(a) provide as follows:

> If–
>
> (1) any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation,...
>
> and the principal purpose for which the acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction, credit or other allowance which such person or corporation would not otherwise enjoy, then the Secretary may disallow such deduction, credit or other allowance.

Treas. Reg. § 1.269-1 provides that the term "allowance" refers to any thing in the internal revenue laws which has the effect of diminishing tax liability. The term includes, among other things, a deduction, a credit, an adjustment, an exemption or an exclusion.

In Briarcliff Candy Corp. & Subs, T.C. Memo Year 1987-487, the Tax Court stated that: ... the legislative history of section 129 of the Internal Revenue Code of 1939 [which was the predecessor of section 269 of the Internal Revenue Code of 1954] . . . supports the proposition that section 269 is not limited to any particular form of transaction. (e.g., it even applies to the acquisition by a loss corporation of a profitable subsidiary)

In *Army Times Sales Company v. Commissioner*, 35 T.C. 688 (1961), the Tax Court held that the principal purpose of the shareholder for acquiring control of the corporate petitioner was to evade or avoid Federal income tax. I.R.C. § 269 was applied to convert a sole shareholder's claim for capital gains treatment on a redemption into ordinary income.

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In *Modern Home Life & Casualty Co. v. Commissioner*, 54 T.C. 839 (1970), the Tax Court held that denying the benefits of an S corporation election on the ground that control of the corporation was acquired under I.R.C. § 269 for tax evasion or tax avoidance purposes would thwart "the intent of Congress to allow shareholders of electing small business corporations to 'be taxed directly on the corporations earnings' and to report 'corporate income (whether or not distributed) as their own for tax purposes." The same principle has been used by the courts and the Service to avoid the application of I.R.C. § 269 where taxpayers have deliberately acquired control of a corporation for the principal purpose of qualifying the corporation as a Western Hemisphere Trade Corporation
(I.T. 3757, 1945 C.B. 200); Rev. Rul. 70-238, 1970-1 C.B. 61.

It is the taxpayer's motivation at the time of the acquisition that determines if I.R.C. § 269 applies, *Modern Home Fire & Casualty Insurance Company. v. Commissioner,* 54 T.C. 839 (1970). Thus, a tax-infected transaction following an innocent acquisition should not retroactively bring I.R.C. § 269 into force, if the two steps were not integral parts of a single transaction. *Hawaiian Trust Co. v. US*, 291 F2d 761 (9th Cir. 1961).

In *Key Buick Co. v. Commissioner*, T.C. Memo. 1976-303, the Tax Court was faced with the question of whether the acquisition of control of a corporation followed, over a year later, by the merger of that corporation with a profitable corporation constituted tax avoidance for I.R.C. § 269 purposes. The Tax Court held that the merger was not necessary to use the losses of the acquired corporation, and that both the acquisition and subsequent merger were not an "integral plan" that had the principal purpose of tax avoidance.

One of the criteria that has been considered in determining whether an acquisition has a principal purpose of tax avoidance is whether the acquisition of control is necessary or useful to the acquiring person's business or investment activities. *D' Arcy- MacManus & Masius, Inc v. Commissioner*, 63 TC 440 (1975).

A feature of I.R.C. § 269 that is easily overlooked because it is ordinarily satisfied is that the section applies only to tax allowances that the acquiring taxpayer "would not otherwise enjoy" but for the acquisition. Cromwell Corp v. Commissioner, 43 TC 313 (1964).

ANALYSIS:

I.R.C. § 269(a)(1) provides that, "if... any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation... and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income tax by securing the benefit of a deduction , credit or other allowance which such person or corporation would not otherwise enjoy, then the

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Secretary may disallow such deduction, credit or allowance”. Through the formation of Company 2, Company 1 acquired control of Company 2. Acquisition of control was accomplished when Company 1 contributed all of the stock of Company 7 and Company 8 to Company 2 in exchange for all of its stock.

Allowance Issue

Company 2 and Company 16 and Company 17 avoided the Number E percent withholding tax liability under I.R.C. § 1442.

Under Treas. Reg. § 1.269-1 the term “allowance” refers to anything in the internal revenue laws which has the effect of diminishing tax liability. The term includes, among other things, a deduction, a credit an adjustment, an exemption or an exclusion. Thus it appears that the “allowance” requirement of section 269 has been met.

Although § 269 has most frequently been applied to deny the carryover of net operating losses to a period following a change of control of a corporation or the acquisition of loss-generating assets in a tax-free transaction, its reach is considerably broader than these two tax benefits. In *Army Times Sales Company v. Commissioner*, 35 TC 688 (1961), I.R.C. § 269 was applied to convert a sole shareholder’s claim for capital gains treatment on a redemption into ordinary income. In the instant case, the taxpayer is seeking an exemption from income, which is like the reduction in income the taxpayer was seeking in *Army Times Sales v. Commissioner*, 35 T.C. 688 (1961). Therefore a court should rule that an “allowance” is indeed present here.

Principal Purpose tax avoidance Issue

It is the taxpayer’s motivation at the time of the acquisition that determines if there is a principal purpose of tax avoidance under I.R.C. § 269. *Modern Home Fire & Casualty Insurance Company. v. Commissioner*, 54 T.C. 839 (1970). Based on facts available to us, the principal purpose of the acquisition of Company 2 by Company 1 was the evasion or avoidance of Federal income tax. The creation of the new holding companies, Company 2, Company 4, Company 5, along with the associated movement of foreign subsidiaries under these domestic holding companies, together with the timing of the area 2 and domestic dividend payments, were integral parts of a single plan designed to avoid Federal taxes at the time of

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acquisition of Company 2 by Company 1. In *Key Buick Co. v. Commissioner*, T.C. Memo. 1976-303, the Tax Court held that the subsequent merger of an acquired loss corporation with a profitable corporation did not constitute tax avoidance for I.R.C. §269 purposes. The Tax Court held that the merger was not necessary to use the losses of the acquired corporation, and that both the acquisition and subsequent merger were not an "integral plan" that had the principal purpose of tax avoidance. In the instant case, the acquisitions following the initial Company 2 acquisition were necessary in order to avoid Federal withholding tax under I.R.C.§ 1442. In *Key Buick Company v. Commissioner*, T.C. Memo. 1976-303, the Tax Court held that the intent of the purchaser at the time of the acquisition must be determined by the examination of the events surrounding the acquisition and an evaluation of the entire record in the case. In the instant case, if we examine the events surrounding the Company 2 acquisition, there appears to be a principal purpose of avoiding Federal income tax. The creation of these new holding companies, along with the associated movement of foreign subsidiaries under these domestic holding companies, together with the timing of the area 2 and domestic dividend payments, were designed solely in an attempt to qualify the domestic holding companies under the provisions of I.R.C. § 881(d) to be exempt from withholding tax under chapter three on dividends paid to their area1 parent. This provision incorporates the 80/20 dividend sourcing rule which the taxpayer argues exempts the domestic holding company from withholding on dividends under §§ 1442 and 1441(c)(10).

In the instant case, in each of the years that U.S. source dividends were distributed by the holding companies, those dividends were never taken into consideration in the computation of the 80-20 rule (I.R.C. § 861(c)(1)(A). In Year 2 Company 2 made the distribution of U.S source dividends to Company 1 in the amount of $d. Company 2 originally received these dividends from Company 7, Company 8 and Company 11. These dividends were never taken into account in computing the 80-20 test because Company 2's testing period only included the 2 tax years preceding the payment. In those years only foreign dividends from Company 10 were received by Company 2. Therefore, Company 2 passed the 80-20 test in Year 2. Likewise, these same dividends were never taken into account when Company 4 distributed the $e in U.S. source dividends to Company 1 in Year 5. These dividends were received from Company 2, which became a subsidiary of Company 4, when Company 4 became a holding company on Date 4. The dividends distributed in Year 2 were never taken into consideration in computing the 80-20 test for the Year 5 distribution because these dividends were distributed by Company 2. The Year 5 test only relates to the currently distributing holding company, Company 4. Therefore the only income that Company 4 will take into consideration in computing its Year 5 80-20 test will be foreign income received from Company 13 in Year 7. Since Year 7 will be its only testing year, Company 4 will pass the 80-20 test and not be subject to withholding under §§ 1442 and 1441(c)(10) in Year 5.

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The creation of these holding companies as well as the manipulation of dividend payments appear to be part of an integrated plan to avoid Federal income tax or withholding tax. The acquisition of Company 2 by Company 1 must be made for the principal purpose of avoiding Federal income taxes. This purpose is obvious if the additional integrated transactions consisting of the acquisition of foreign subsidiaries and domestic holding companies and manipulative dividend transactions are taken into consideration.

Securing the benefit issue

Additionally, there is an issue of whether the loss or tax benefit must be secured or in existence at the time of acquisition. In *Zanesville Investment Co. v. Commissioner*, 335 F.2d 507 (1962), the appeals court held that section 269 did not prevent the utilization of post-acquisition losses of an acquired corporation. In addition the court stated: “The overall purpose of section 269 was to prevent distortion of a taxpayer’s income resulting from the utilization of someone else’s loss or a built-in but realized loss”. Even though section 269 is usually invoked to disallow tax benefits that were known to exist at the time of the acquisition, such as net losses incurred by another corporation, the legislative history of (section 129 of the Internal Revenue Code of 1939) . . . supports the proposition that section 269 is not limited to any particular form or transaction (e.g., the acquisition by a loss corporation of a profitable subsidiary). Rather, this section was broadly drafted to include any type of acquisition which constitutes a device by which one corporation secures a tax benefit to which it is not entitled . . . . *Briarcliff Candy Corp. & Subs v. Commissioner,* T.C. Memo 1987-487. Therefore this case arguably stands for the proposition that the loss or tax benefit does not necessarily have to be in existence at the time of the acquisition. In other words, section 269 can apply to other tax benefits besides built-in losses, and these other tax benefits may occur after the acquisition.

If the principal purpose of a transaction was the capture of a particular tax benefit, the Service seems authorized to disallow any other tax allowances stemming from the tainted acquisition. In *R.P. Collins & Co. v. US,* 303 F2d 142 (1st Cir. 1962), a deduction for post-acquisition operating losses was denied under I.R.C. § 269 because the losses were tainted by taxpayer’s pre-acquisition tax-avoidance purpose.

269 Immunity

Some tax benefits are immune to disallowance under § 269, even though they are “allowances” within the meaning of the statutory language. In some instances Congress intends to grant the benefit, if specified statutory conditions are met,

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regardless of the taxpayer's desire to reduce its tax burden. In *Modern Home Life & Casualty Co. v. Commisioner,* 54 T.C. 839 (1970), the Tax Court held that denying the benefits of an S corporation election on the ground that control of the corporation was acquired under I.R.C § 269 for tax evasion or tax avoidance purposes would thwart the "intent of Congress to allow shareholders of electing small business corporations to 'be taxed directly on the corporation's earnings' and to report 'corporate income (whether or not distributed) as their own for tax purposes.'"

In *Modern Home Life & Casualty Co. v. Commissioner*, 54 T.C. 839 (1970), the acquired corporation was doing business as an insurance company at the time of acquisition. The business had been on going for 5 years before acquisition. Congress intended that the corporations entitled to exemption from I.R.C. § 269 be corporations that were conducting a legitimate business at the time of their acquisition or at the time of their S corporation election. Congress did not intend for companies that were created as shells and remained as shells to be exempt from I.R.C. § 269. In the instant case Company 2 and the other created holding companies appear to have had no purpose other than to hold stock as a necessary first step to facilitate the avoidance of withholding tax. The sole purpose for creating these companies was the avoidance of Federal income tax.

Congress has not shown an intent to grant the tax benefit at issue in this case. Even though the taxpayer has literally complied with the testing period, the purpose of I.R.C. § 861(c)(1)(A) has not been served by its application to this case. The purpose of I.R.C. § 861(c)(1)(A) is to grant an exemption from withholding to companies whose gross income consists of a high percentage of foreign source income. In the instant case, the majority of the income that these domestic holding companies received over time from their subsidiaries was U.S. source income. However, by manipulating the three year testing period of I.R.C. § 861(c)(1)(C), these domestic holding companies were able to claim a exemption from withholding under I.R.C. § 1442. Congress did not intend this result.

Allowances that the acquiring company would otherwise not enjoy issue

I.R.C. § 269 only applies to tax allowances that the acquiring company "would otherwise not enjoy" but for the acquisition. In *Cromwell Corp. v. Commissioner*, 43 T.C. 313 (1964), the taxpayer was formed to effect a bootstrap acquisition. The taxpayer purchased the stock of the acquired company with borrowed funds and additional funds contributed by its shareholders. The taxpayer filed a consolidated return with its new subsidiary, and then had the subsidiary distribute a dividend that the taxpayer used to discharge its indebtedness on the purchased stock. The Service attacked this transaction under
I.R.C. § 269 alleging that the taxpayer was not entitled to file a consolidated return with the subsidiary (or if it was so entitled, that it was not entitled to eliminate the

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intercompany dividend, as is normal on consolidated returns) and that if a consolidated return was not proper, the dividend did not qualify for the dividend received-deduction of § 243. The Tax Court held that regardless of the taxpayer's purpose in structuring the transaction in this manner, the taxpayer did not obtain a tax benefit that it would have not otherwise enjoyed.
The Tax Court noted that other methods could have been used in making the acquisition, all of which would have produced the same net effect for tax purposes as the method chosen by the parties. In the instant case, the creation of Company 2, along with the associated movement of foreign subsidiaries under Company 2, together with the timing of the area 2 and domestic dividend payments to Company 2 was the only way in which Company 1 could have received all of the dividends distributed in Year 2 without Company 2 having to withhold tax on them. The dividends received by Company 2 from its subsidiaries as a dividend distribution were distributed by those subsidiaries in a particular tax year based upon the particular source of those dividends. The foreign source dividends were distributed up in tax years separate from the years in which the U.S. source dividends were distributed. The foreign source dividends would be distributed up only in tax years that would be included in the testing period for the 80-20 test. The U.S. source dividends were only sent up in tax years that would not be included in the testing period for the 80-20 test. This distribution pattern was done in order to manipulate the income of Company 2 so that they would pass the 80-20 test and not be subject to any withholding tax under §§ 1442 and 1441(c)(10). Additional holding companies were created in order to perpetuate this process. By structuring these transactions in this particular way, Company 1 obtained a tax allowance that it "would not otherwise enjoy". In *Cromwell Corp. v. Commissioner*, 43 TC 313 (1964), the acquisition could have been accomplished in a number of ways and the tax consequences would be the same as those in the actual transaction. The purchasers in this case merely obtained, through their use of an intervening holding company to effect the acquisition, control of the desired enterprise with a limited out-of-pocket investment. This was a result that did not go beyond the scope of I.R.C. § 269. In the instant case, Company 1's receipt of the domestic source dividends from Company 2 in Year 2 could not have been accomplished tax free without their initial acquisition of Company 2. This acquisition was the catalyst in series of transactions designed only to avoid tax. In *Cherry v. U.S.*, 264 F. Supp. 969 (1967), the court distinguished between a tax-motivated acquisition and a tax-motivated method used to effect a business-motivated acquisition, the court refused to apply § 269 to the latter method. In the instant case, we have a tax motivated method used to effect a non business motivated acquisition.

When Company 1 obtained control of Company 2 its principal purpose at the time of the acquisition was arguably to evade Federal Income tax. The creation of these new holding companies, along with the associated movement of foreign subsidiaries under these domestic holding companies, together with the timing of

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the area 2 and domestic payments was an integral plan to avoid withholding taxes by virtue of the exemption obtained under I.R.C. §§ 1442 and 1441(c)(10).

This evasion of taxes could only have been accomplished by the above mentioned transactions, and therefore was a benefit that Company 1 “would otherwise not enjoy”. It is our position that the § 269 argument should be raised in the answer already filed in the Company 2 case pertaining to distributions in Year 2.

DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

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If you have any further questions, please call the branch telephone number.

By: ______________________________
STEVEN J. HANKIN
Branch Chief
Corporate Branch

cc: Assistant Regional Counsel (TL) CC
Assistant Regional Counsel (LC) CC: