Revenue Ruling 81-132

Transferor Ownership Not Attributed in 351 Exchange for Treaty Purposes

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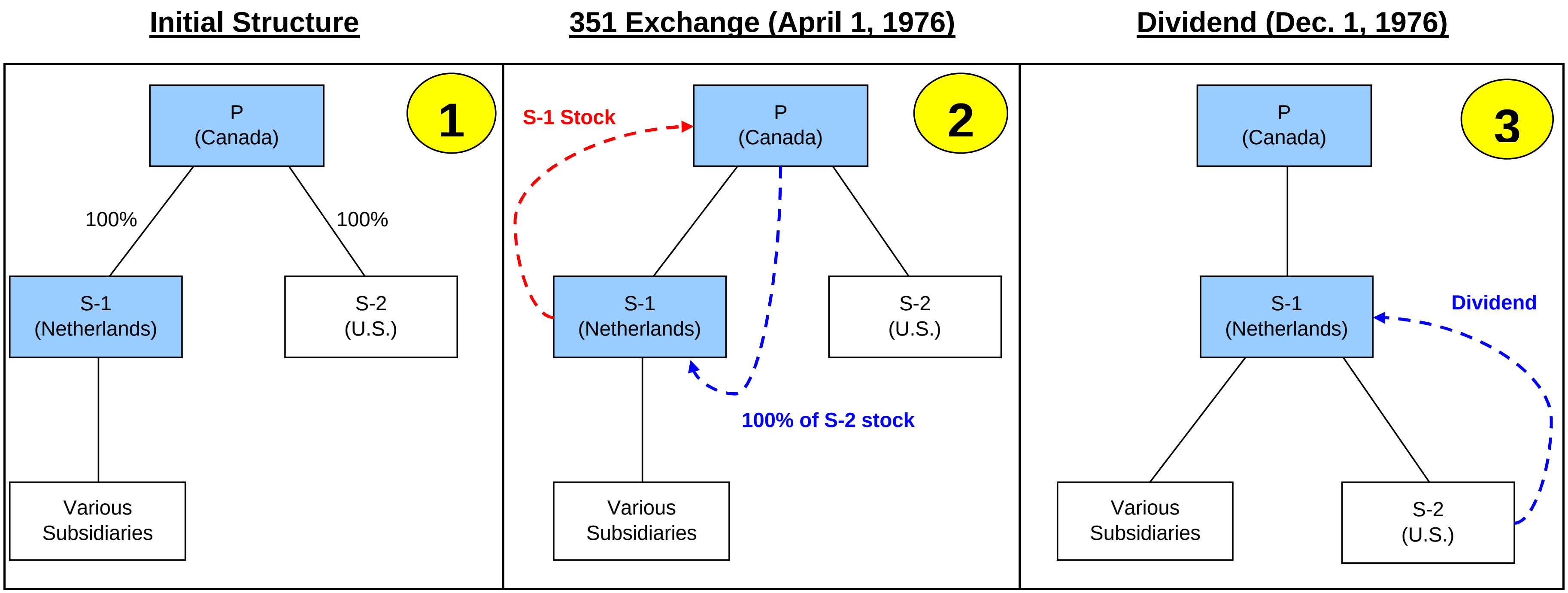

P, a Canadian corporation, owned all the outstanding shares of stock of S-1, a corporation organized under the laws of the Netherlands. P also owned all the outstanding shares of stock of S-2, a corporation organized in 1973 under the laws of the United States. S-2's taxable year is the calendar year. On April 1, 1976, P transferred all its stock of S-2 to S-1 in exchange for additional stock of S-1. This transaction constituted an exchange within the meaning of section 351. The transaction also met the applicable requirements of section 367. On December 1, 1976, S-2 paid a dividend to S-1.

Article VII(1)(b) of the Convention, as modified by the Supplementary Convention, provided, in part, that dividends paid by a corporation of one of the Contracting States to a resident or corporation of the other Contracting State shall be taxed at a rate not exceeding 5 percent (the reduced rate) in the State of the paying corporation if the following requirements are met. First, during the part of the paying corporation's taxable year that precedes the date of the dividend payment and during the whole of its prior taxable year (if any), the recipient is a corporation owning at least 25 percent of the voting stock of the paying corporation, either alone or in combination with another corporation of the same State as the recipient corporation, provided each recipient corporation owned at least 10 percent of such voting stock. Second, not more than 25 percent of the gross income of the paying corporation for the prior taxable year (if any) consisted of interest and dividends.

The ruling held that there was nothing in the language of Article VII(1)(b) or in the history of the Supplementary Convention to indicate that the terms "owning" or "owned" as used in Article VII(1)(b) should be interpreted to include any type of ownership other than direct ownership. S-1 did not own the voting stock of S-2 for the period of time prior to the payment of the dividend required by Article VII(1)(b) of the Convention, that is, all of 1975, and January through November 30 of 1976. Accordingly, the dividend paid by S-2 to S-1 on December 1, 1976, is not within the scope of Article VII(b)(1) and is not subject to the reduced rate of tax of 5 percent. The dividend paid is subject to a rate not exceeding 15 percent of the gross amount actually distributed in accordance with Article VII(1)(a).

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