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Department of the Treasury

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Date:
December 9, 1999

Shareholder =

Parent =

Distributing =

Controlled =

Disregarded Entity =

Operating =

Merger Sub =

Country X =

State Y =

State Z =

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Jurisdiction A =
Year 1 =
Year 2 =
Date 1 =
Date 2 =
a =
b =
c =
d =
e =
f =

This letter replies to a request for rulings, dated March 22, 1999, on the federal income tax consequences of a proposed transaction concerning § 355 of the Internal Revenue Code. We received additional information in letters dated April 9, May 26, June 21, June 24, (two letters with that date) July 15, August 25, September 3, September 22, and November 3, 1999. The information submitted for consideration is summarized below.

Parent is a Country X corporation which has one class of common stock outstanding. a percent of its stock is owned by Shareholder with the rest of the stock publicly traded. Shareholder's stock represents b percent of the vote in Parent. Parent has a number of classes of preferred stock which are publicly traded. Parent holds c percent of the common stock of Distributing, also a Country X corporation. The remainder of Distributing's common stock is held by d shareholders. Distributing has a number of series of preferred stock outstanding. e percent of the preferred stock is held by Parent. The remainder of Distributing's preferred stock is held by f shareholders.

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Distributing owns all of the stock of Disregarded Entity, a single-entity State A corporation. Distributing has unlimited liability with regard to Disregarded Entity which holds cash and all of the stock of _____, a State Y holding company. _____ owns all of the stock of Operating, a State Z insurance company. Distributing is a provider of _____ insurance plans in Country X. Distributing also has a small branch office that provides insurance in the United States. Most of the domestic insurance business is provided by Operating. Because Operating is indirectly owned by Distributing, a Country X insurance company, but conducts its insurance business in the United States, it is subject to regulation and minimum capital requirements in both the United States and Country X.

We have received financial information indicating that Distributing's and Operating's insurance businesses have each had gross receipts and operating expenses representative of the active conduct of a trade or business for each of the past five years.

To avoid problems that are caused by managing the Distributing and Operating businesses within a single affiliated group and to remove the competitive disadvantages that result from Operating being subject to minimum capital and regulatory burdens in both the United States and Country X, the following transaction has been proposed:

- (i) Parent will organize Merger Sub as a Country X corporation for nominal consideration.
- (ii) Parent will offer to acquire Distributing common stock from the remaining public shareholders of Distributing ("Minority Holders") for Parent common stock, Parent preferred stock, or cash. Accepting Minority Holders will have their shares exchanged or redeemed pursuant to the offer.
- (iii) If more than 90 percent of the shares held by the Minority Holders is acquired pursuant to the offer, Parent will acquire the remaining minority shares for the same consideration provided to the accepting Minority Holders pursuant to compulsory acquisition provisions of Country X Insurance law.
- (iv) If 90 percent or less of the shares held by the Minority Holders is acquired pursuant to step (iii), above, Distributing will issue one share of Distributing new common stock for each 10,000 shares of Distributing existing common stock owned. Only Parent will receive whole shares; the minority shareholders who would receive fractional shares will have their shares redeemed for cash.

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- (v) If step (iv) has occurred, Distributing will distribute shares of Distributing new common stock to Parent (which will then be the only holder of Distributing new common stock) such that after step (xii) Parent will own the same number of shares of Distributing common stock that it held before the transaction.
- (vi) Distributing will distribute to Parent one share of new non-voting redeemable preferred stock ("Distributing Special Preferred Stock") for each share of Distributing new common stock held by Parent.
- (vii) Merger Sub will amalgamate back into Parent (Steps (i) through (v) and (vii) may be referred to as the "Proposed Squeeze Out").
- (viii) Parent will organize Controlled as a Country X corporation and Controlled will organize a new subsidiary, Controlled Sub, as a Country X corporation, in each case for nominal consideration.
- (ix) Parent will transfer all of the shares of the Distributing Special Preferred Stock and a fixed percentage of the shares of Distributing new common stock to Controlled in exchange for additional shares of common stock of Controlled.
- (x) Distributing will transfer all of the stock of Disregarded Entity to Controlled Sub in exchange for a fixed number of shares of redeemable and retractable preferred stock of Controlled Sub having an aggregate redemption price set by a formula as equal to the fair market value of all of the stock of Disregarded Entity.
- (xi) Controlled Sub will redeem from Distributing all of the shares of Controlled Sub redeemable and retractable preferred stock issued in step (x) for debt redeemable on demand ("Controlled Sub Debt").
- (xii) Distributing will redeem its Distributing Special Preferred Stock and the Distributing new common stock held by Controlled by transferring the Controlled Sub Debt to Controlled in exchange for that stock.
- (xiii) Controlled Sub will amalgamate into Controlled, extinguishing the Controlled Sub Debt (Steps (vi) and (viii) through (xiii) may be referred to as the "Proposed Spin Off").
- (xiv) In Year 1, Controlled will offer to sell less than one percent of the stock of _____ to members of the management of _____ and/or Operating as a performance incentive ("Proposed Sale").

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On Date 1 and on subsequent occasions continuing through Year 2, Distributing transferred substantially all of the assets used in its U.S. insurance branch to Operating in transactions intended to qualify under § 351. For each of the § 351 transfers, Operating elected under § 1.884-2T(d)(4) to increase its earnings and profits by an allocable portion of Distributing's effectively connected earnings and profits ("ECEP") and non-previously taxed accumulated ECEP. Distributing agreed that, upon the disposition of any of the stock of Operating (or a successor-in-interest), Distributing, under § 1.884-2T(d)(5)(i), would treat an appropriate amount as a dividend equivalent amount. Prior to Date 2, Distributing, as a foreign corporation engaged in an insurance business in the United States, was required to deposit its assets associated with its U.S. insurance business with a state officer in one of the states in which it was doing business. The assets were considered "trusteed" for the protection of the U. S. policyholders.

In a Date 2 transaction, for which a ruling letter has been issued (the "Date 2 Transaction Ruling"): (a) Distributing transferred stock to Disregarded Entity in exchange for additional Disregarded Entity stock; (b) Distributing transferred Operating's stock to Disregarded Entity in exchange for additional Disregarded Entity stock; and (c) Disregarded Entity transferred Operating's stock to in exchange for additional stock. The Date 2 Transaction Ruling provides that if certain conditions are satisfied: (a) Distributing's transfer of Operating's stock to will not constitute a "disposition" of Operating's stock for purposes of § 1.884-2T(d)(5)(i); and (b) Operating's earnings and profits will be reduced by an amount equal to the earnings and profits allocated to pursuant to a valid election under § 1.884-2T(d)(4). The Date 2 Transaction Ruling also rules that if Distributing disposes of any of the stock of either (or a successor-in-interest) or Disregarded Entity (or a successor-in-interest), or if disposes of any of the stock of Operating (or a successor-in-interest), Distributing must treat such disposition as a "disposition" for purposes of § 1.884-2T(d)(5)(i). Included in the Date 2 Transaction Ruling is a ruling that assuming there is no change in Distributing's use of stock, stock will not be treated as a "U.S. asset" of Distributing for branch profits purposes under § 884 and § 1.884-1(d)(1), and will not be treated as an "asset used in, or held for use in, the conduct of a trade or business in the United States" for purposes of § 864(c) and § 1.864-4(c).

The taxpayer has made the following representations in connection with the proposed transaction:

- (a) No part of the consideration to be distributed by Distributing will be received by Parent as a creditor, employee, or in any capacity other than that of a shareholder of the corporation.

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- (b) The five years of financial information submitted on behalf of Distributing and Operating are representative of each corporation's present operations, and there have been no substantial operational changes since the date of the last financial statements submitted.
- (c) Immediately after the deemed distribution, at least 90 percent of the fair market value of the gross assets of Controlled will consist of the stock of a controlled corporation, Immediately after the deemed distribution, at least 90 percent of the fair market value of the gross assets of will consist of the stock of a controlled corporation, Operating, that is engaged in the active conduct of a trade or business as defined in § 355(b)(2).
- (d) Except for a small number of employees of Operating who will remain officers of Distributing in order to provide services to Distributing's United States branch pursuant to an administrative services agreement, Distributing and Operating will each continue the active conduct of their respective businesses, independently and with their separate employees, following the Proposed Spin Off.
- (e) The deemed distribution of stock of Controlled is being carried out for the following corporate business purposes: to avoid problems that are caused by managing the Distributing and Operating businesses within a single affiliated group and to remove the competitive disadvantages that result from Operating being subject to minimum capital and regulatory burdens in both the United States and Country X.
- (f) There is no plan or intention by Parent to sell, exchange, transfer by gift, or otherwise dispose of any of its stock in either Distributing or Controlled after the Proposed Spin Off.
- (g) There is no plan or intention by either Distributing or Controlled, directly or through any subsidiary corporation, to purchase any of its outstanding stock after the transaction, other than through stock purchases meeting the requirements of § 4.05(1)(b) of Rev. Proc. 96-30.
- (h) There is no plan or intention to liquidate Distributing or Controlled, to merge either corporation with any other corporation, or to sell or otherwise dispose of the assets of either corporation subsequent to the Proposed Spin Off, except for the Proposed Sale described in step (xiv) and sales in the ordinary course of business.
- (i) Controlled is neither receiving any assets subject to liabilities nor assuming any liabilities in the Proposed Spin Off.

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- (j) No intercorporate debt will exist between Distributing and Controlled, Distributing and Disregarded Entity, or Distributing and _____ at the time of, or subsequent to, the Proposed Spin Off. No intercorporate debt will exist between Distributing and Operating at the time of or subsequent to the Proposed Spin Off other than certain short-term indebtedness that will remain outstanding. Any such indebtedness will not constitute stock or securities within the meaning of § 355.
- (k) Payments made in connection with all continuing transactions between Distributing and either Controlled, Operating, _____ or Disregarded Entity, if any, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's-length.
- (n) No two parties to the Proposed Spin Off are investment companies as defined in § 368(a)(2)(F)(iii) and (iv).
- (o) No party to the Proposed Spin Off is under the jurisdiction of a court in a title 11 or similar case within the meaning of § 368(a)(3)(A).
- (p) The distribution is not part of a plan or series of related transactions (within the meaning of section 355(e)) pursuant to which one or more persons will acquire directly or indirectly stock possessing 50 percent or more of the total combined voting power of all classes of stock of either Distributing or Controlled, or stock possessing 50 percent or more of the total value of all classes of stock of either Distributing or Controlled.
- (q) Distributing is a qualified resident of Country X within the meaning of § 1.884-5.
- (r) If Distributing were a domestic company, it would qualify as a life insurance company under § 816(a).
- (s) Operating is a life insurance company under § 816(a).
- (t) Neither Distributing nor Operating plans or intends to cease being a life insurance company after the Proposed Spin Off.
- (u) Although prior to Date 2 the Operating stock was trusted as a necessary asset of Distributing's U.S. branch insurance business, the Operating stock is not and will not be carried as an asset on the books of Distributing's U.S. branch, and is not and will not be used in connection with Distributing's U.S. insurance business or any other business.

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- (v) The stock held by Distributing is not and will not be carried as an asset on the books of Distributing's U.S. branch, and is not and will not be used in connection with Distributing's U.S. insurance business or any other business.
- (w) Disregarded Entity will not make an election under § 301.7701-3(c) to be treated as an association for federal income tax purposes.
- (x) Because Disregarded Entity has not made an election to be classified as an association, it will be disregarded as an entity separate from Distributing under § 301.7701-3(b)(2)(i)(C), § 301.7701-2(a) and § 301.7701-2(b)(8)(ii).
- (y) Disregarded Entity will remain a disregarded entity of Distributing for the 60-month period beginning on Date 2, except to the extent necessitated by a change in U.S. or Country X law relating to the classification of Disregarded Entity as (1) a disregarded entity for U.S. federal income tax purposes, or (2) an unlimited liability State A corporation for Country X purposes.
- (z) will not have been a United States real property holding corporation ("USRPHC") (as defined in § 897(c)(2)) at any time during the 5-year period ending on the date of the Proposed Spin Off, and will not be a USRPHC immediately after the Proposed Spin Off.
- (aa) Distributing and Controlled are foreign corporations that will not be passive foreign investment corporations (as defined in § 1296(a)) or controlled foreign corporations (as defined in § 957) either before or after the Proposed Spin Off.
- (bb) To the best of Distributing's knowledge, there is no foreign shareholder, other than Parent, that owns 5 percent or more of the value of the Distributing stock either before or after the Proposed Spin Off.
- (cc) Except for certain long-term debt securities issued to third parties, and except for Distributing's intent to have the stock of Disregarded Entity transferred to Controlled in the Proposed Spin Off, and Disregarded Entity's intent to offer to sell less than one percent of stock in the Proposed Sale, Distributing has no plan or intention to have additional investors, partners, shareholders, or owners in Operating, or Disregarded Entity. In addition, some of the preferred shareholders of Distributing may be given an opportunity to (a) sell their stock to Parent for cash, (b) exchange their stock for a new class of Parent preferred stock, or (c) retain their Distributing preferred stock but receive a higher dividend rate.
- (dd) In effectuating the Proposed Spin Off and the Proposed Sale, Distributing does

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not have a principal purpose to achieve different tax results or consequences under foreign or domestic law that are inconsistent with the purposes of U.S. tax law.

Based solely on the information submitted and on the representations set forth above, and provided that for U.S. federal income tax purposes under § 301.7701-3(b)(2)(i)(C), § 301.7701-2(a) and § 301.7701-2(b)(8)(ii), Disregarded Entity is not treated as an entity separate from Distributing, we rule as follows:

- (1) For federal income tax purposes, the separate steps of (vi) and (viii) through (xiii) (Proposed Spin Off) will be ignored and those steps will be treated as Distributing transferring all of the stock of _____ and cash to Controlled solely in exchange for all of the stock of Controlled, followed by a distribution by Distributing of the Controlled common stock to Parent.
- (2) The transfer by Distributing of all of the stock of _____ and cash to Controlled solely in exchange for all of the stock of Controlled followed by the distribution of all of the Controlled stock to Parent will constitute a reorganization within the meaning of § 368(a)(1)(D). Distributing and Controlled will each be "a party to a reorganization" within the meaning of § 368(b).
- (3) Distributing will recognize no gain or loss upon the transfer of cash and the stock of _____ to Controlled in exchange for Controlled stock, as described above (§ 361(a)).
- (4) Controlled will recognize no gain or loss on the receipt of cash and stock in exchange for Controlled stock (§ 1032(a)).
- (5) The basis of the _____ stock received by Controlled will be the same as the basis of the stock in the hands of Distributing immediately prior to the transaction (§ 362(b)).
- (6) The holding period of the _____ stock received by Controlled will include the period during which this stock was held by Distributing (§ 1223(2)).
- (7) Parent will recognize no gain or loss (and no amount will be included in the income of Parent) upon the receipt of the Controlled stock, as described above (§ 355(a)(1)).
- (8) Distributing will recognize no gain or loss upon the distribution of all of its Controlled stock (§ 361(c)).
- (9) Proper allocation of, and adjustments to, earnings and profits between

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Distributing and Controlled will be made in accordance with § 1.312-10(a).

- (10) Provided that Controlled attaches a statement to its timely filed (including extensions) federal income tax return agreeing that Controlled will treat a disposition of part or all of the stock or securities of either (or a successor-in-interest) or Disregarded Entity (or a successor-in-interest), as a “disposition” for purposes of § 1.884-2T(d)(5)(i), then Distributing’s transfer of the stock to Controlled will not be treated as a “disposition” of stock under § 1.884-2T(d)(5)(i). If in the future is liquidated into Controlled in a liquidation under § 332, such liquidation of will be treated as a “disposition” for purposes of § 1.884-2T(d)(5)(i), notwithstanding § 1.884-2T(d)(5)(ii).
- (11) Because stock will not be treated as a “U.S. asset” of Distributing for branch profits purposes under § 884 and § 1.884-1(d)(1), and will not be treated as an “asset used in, or held for use in, the conduct of a trade or business in the United States” for purposes of § 864(c) and § 1.864-4(c), Controlled’s sale of stock will not result in “effectively connected income” gain for purposes of § 882.
- (12) Controlled’s sale of stock is a “disposition” for purposes of § 1.884-2T(d)(5)(i), and Controlled must treat an appropriate amount as a dividend equivalent amount in accordance with § 1.884-2T(d)(5)(i).

No opinion is expressed about the tax treatment of any of the transactions described herein under other provisions of the Code and regulations, or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transactions not specifically covered by the above rulings. In particular, no opinion is expressed: (i) whether the Operating stock was an asset used in, or held for use in, the conduct of Distributing’s U.S. trade or business immediately prior to the transfer to (§ 1.864-4(c)(2)(iii)); and (ii) other tax consequences to Distributing and Controlled under § 884 due to the Proposed Spin Off and the Proposed Sale. In addition, no opinion has been requested and no opinion is expressed about the tax consequences of the proposed Squeeze-Out or whether the Proposed Spin Off or the Proposed Sale constitutes a direct or indirect distribution of Distributing’s shareholders’ surplus account, policyholders’ surplus account, or other accounts within the meaning of § 815.

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Each affected taxpayer must attach a copy of this letter to the taxpayer's federal income tax return for the tax year in which the transaction covered by this ruling letter is

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consummated.

We are sending a copy of this letter to the authorized representative specified in the power of attorney on file in this office.

Sincerely yours,

Assistant Chief Counsel (Corporate)

By Ken Cohen

Ken Cohen
Senior Technician Reviewer, Branch 3