Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

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Refer Reply To:
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Fcorp A =

Corp B =

Corp C =
Corp D =
Corp E =
Corp F =

Fcorp G =
Fcorp H =
Fcorp I =
Fcorp J =

Country X =
Country Y =
State M =

City K =

Industry Q =

Date b =
Date c =
Date d =
Date e =
Date f =

b =
c =

d =
e =
f =
g =
h =
i =
j =
k =
m =
n =
o =
p =
q =

Amount A =
Amount B =
Amount C =

Stock Exchange 1 =
Stock Exchange 2 =
Stock Exchange 3 =
Stock Exchange 4 =

P Commission =
R Act =
S Office =
T Act =

Article U =

New Treaty =

Old Treaty =

This is in reply to your letter, dated May 15, 1998, requesting rulings concerning the federal tax consequences of a proposed transaction. Additional information was submitted in submissions dated August 7, 1998, August 12, 1998, August 24, 1998, September 4, 1998, September 16, 1998, October 9, 1998, October 26, 1998, October 30, 1998, November 23, 1998, November 24, 1998, November 30, 1998, December 1, 1998, December 4, 1998, December 8, 1998, December 17, 1998, December 21, 1998, and December 23, 1998. Requested rulings 8, 9, and 11 through 15 will be addressed in separate letter rulings.

Fcorp A is a Country X property and casualty insurance corporation that is taxable under Internal Revenue Code § 842(a). Fcorp A conducts a property and casualty insurance business (Insurance Business) in the United States through a branch operation ("Branch"). Fcorp A owns unencumbered office buildings ("Real Property") that represent a material portion of the assets that support the insurance liabilities ("Branch Insurance Liabilities") and statutory surplus of the Branch operations.

Fcorp A owns all of the common stock and all of the preferred stock of Corp B, a domestic holding company and common parent of an U.S. consolidated group. Corp B is not engaged in the Insurance Business. Corp B owns all the stock of Corp C as well as the stock of various domestic subsidiaries which form the Corp B consolidated group. Corp B owns b percent of Corp D. The remaining Corp D stock is owned by the Branch. Prior to the transactions described below, the Branch will remit to the home office of Fcorp A ("Home Office") the Corp D stock it owns.

To accomplish a domestication of Branch's business, the following steps have been taken or are proposed:

a. Corp B has formed a new corporation, Corp E, by contributing cash to Corp E in exchange for all of Corp E's stock. Corp B will also contribute all of the stock of Corp C to Corp E. Corp E will conduct the U.S. Insurance Business as a domestic corporation.

b. Fcorp A will mortgage the Real Property.

c. Fcorp A will form Corp F, a Real Property Holding Company, and will transfer the Real Property to Corp F in exchange for the constructive issuance of Corp F shares and Corp F's assumption of the new mortgage liability. Fcorp A will not be liable for the mortgage because Corp F will assume all liability under the loan agreement. The Branch will then remit the Corp F stock to the Home Office.

d. Fcorp A will transfer all of the U.S. insurance (Branch) assets and the Real Property mortgage proceeds directly to Corp E. Corp E will assume all of the Branch's liabilities. Fcorp A will contribute the Corp B preferred

stock to Corp B. Corp B will issue additional shares of Corp B stock to Fcorp A even though Fcorp A's transfer of U.S. insurance assets is directly to Corp E. Fcorp A will transfer the Real Property mortgage proceeds to Corp E to replace the value of the Real Property that left the insurance business. Corp E needs that value to satisfy the State M insurance commissioner that Corp E will be able to pay insurance claims.

To accomplish the transaction described in paragraph (d) above under state law, the Branch will file an application to domesticate with the State M Superintendent of Insurance. The Branch will ask each other jurisdiction to approve the transferring (or reissuing) of the Branch's licenses to Corp E and will arrange for any deposited funds to be held in the name of Corp E.

After the Branch has obtained the approval in principle from all of the other jurisdictions, the Branch will file a certified copy of the instrument of transfer and assumption with the State M Superintendent of Insurance, making the domestication effective. By this act, the Branch will transfer all its assets and liabilities to Corp E as a matter of State M law. The Branch's existence as an entity authorized to conduct the insurance business will cease, and its licenses will be reconstituted and reissued in the name of Corp E.

On Date d, Fcorp A and Fcorp G, a Country Y corporation, entered into a conditional merger agreement. Pursuant to this merger agreement, in general, Fcorp A and Fcorp G will combine their worldwide insurance and Industry Q businesses under a single Country X company, Fcorp H, on a planned closing date (the "Merger Transaction"). Fcorp A will become a subsidiary of Fcorp H pursuant to the planned Merger Transaction. Fcorp H will be owned c percent (by value) by Fcorp J, a publicly traded Country Y corporation (owned initially by the former Fcorp G shareholders), and d percent (by value) by Fcorp I, a publicly traded Country X corporation (owned initially by the former Fcorp A shareholders). In addition, Fcorp A and its Country X subsidiaries will undertake various reorganizational steps in connection with the planned Merger Transaction. The Merger Transaction's closing in the form described above is conditioned on receiving approvals for the transaction from (i) the shareholders of Fcorp A and Fcorp G; (ii) U.S., Country Y, and Country X regulators; and (iii) others. All such approvals were obtained, and the merger became effective on Date f.

The following representations have been made with respect to Fcorp A's transfer of Branch assets described above:

(1) Other than as described in Representation 4, below, no stock or securities will be issued for services rendered to or for the benefit of Corp B in connection with the proposed transaction. No stock or securities will be issued for indebtedness of Corp B that is not evidenced by a security or for interest on indebtedness of Corp B which accrued on or after the

beginning of the holding period of Fcorp A for the debt.

(2) All rights, title and interests for each copyright, in each medium of exploitation, will be transferred by Fcorp A to Corp B.

(3) The technical "know-how" in the form of computer software being transferred in exchange for stock under § 351 is "property" within the meaning of Rev. Rul. 64-56, 1964-1 C.B. 133, and as such is afforded substantial legal protection against unauthorized disclosure and use under the laws of Country X and/or the United States.

(4) Any services to be performed in connection with the transfer of the property are merely ancillary and subsidiary to the property transfer within the meaning of Rev. Rul. 64-56, or Fcorp A will be compensated by a fee negotiated at arm's length (in consideration other than stock or securities of Corp B unless such stock or securities are identified) for any other services to be performed on behalf of Corp B.

(5) The "know-how" is secret in that it is known only by Fcorp A and those confidential employees who require the "know-how" for use in the conduct of the activities to which it is related. Adequate steps have been taken to safeguard the "know-how" against unauthorized disclosure.

(6) While the "know-how" may or may not be patentable, it is original, unique and novel.

(7) The "know-how" is not revealed by a patent, is not the subject of a patent application, nor is it disclosed by the products of Fcorp A.

(8) The "know-how" does not represent mere knowledge, or efficiency resulting from experience, or mere skill in manipulation or total accumulated experience and skill of Fcorp A.

(9) While the "know-how" is in the form of computer software, the property being transferred amounts to more than the mere naked right to the tangible evidence (*i.e.,* the computer tape or discs) of that "know-how."

(10) The "know-how" has not been developed by Fcorp A specifically for Corp B.

(11) The "know-how" does not involve assisting in matters such as construction or design and layout of facilities.

(12) The "know-how" does not involve the training of Corp B's employees that

is essentially educational in nature.

(13) Technical information of a related or similar nature such as new developments in the field will not be furnished on a continuing basis without adequate compensation therefor in the manner prescribed for services in Representation 4, above.

(14) None of the stock to be transferred is “section 306 stock” within the meaning of § 306(c).

(15) The transfer is not the result of the solicitation by a promoter, broker or investment house.

(16) Fcorp A will not retain any rights in the property transferred actually or constructively to Corp B.

(17) The value of the stock deemed to be received in exchange for accounts receivable will be equal to the net value of the accounts transferred, *i.e.,* the face amount of the accounts receivable previously included in income less the amount of the reserve for bad debts, if any.

(18) The adjusted basis and the fair market value of the assets deemed to be transferred by Fcorp A to Corp B will, in each instance, be equal to or exceed the sum of the liabilities deemed to be assumed by Corp B plus any liabilities to which the transferred assets are subject.

(19) The liabilities of Fcorp A deemed to be assumed by Corp B were incurred in the ordinary course of business and are associated with the assets to be transferred.

(20) There will be no indebtedness created in favor of Fcorp A as a result of the transaction.

(21) The transfers and exchanges will occur under a plan agreed upon before the transaction in which the rights of the parties are defined.

(22) All exchanges will occur on approximately the same date.

(23) There is no plan or intention on the part of Corp B to redeem or otherwise reacquire any stock or indebtedness to be issued in the proposed transaction.

(24) Taking into account any issuance of additional shares of Corp B; any issuance of stock for services; any exercise of Corp B stock rights,

warrants or subscriptions; any public offering of Corp B stock; and any sale, exchange, transfer by gift or other disposition of any of the stock of Corp B to be received in the exchange, Fcorp A will be in "control" of Corp B within the meaning of § 368(c).

(25) Fcorp A will receive stock approximately equal to the net value of the property transferred to Corp B.

(26) Corp B will remain in existence and, apart from the deemed transfer of property to Corp E, will retain and use the property transferred to it in a trade or business.

(27) Apart from the deemed transfer of property to Corp E, there is no plan or intention by Corp B to dispose of the transferred property other than in the normal course of business operations.

(28) Each of the parties to the transaction will pay its own expenses, if any, incurred in connection with the proposed transaction.

(29) Corp B will not be an investment company within the meaning of § 351(e)(1) and Treas. Reg. § 1.351-1(c)(1)(ii).

(30) Fcorp A is not under the jurisdiction of a court in a title 11 or similar case (within the meaning of § 368(a)(3)(A)) and the stock or securities received in the exchange will not be used to satisfy the indebtedness of any debtor.

(31) Corp B will not be a "personal service corporation" within the meaning of § 269A.

The following representations have been made with respect to any transfer of Branch assets that may be deemed to be made by Corp B to Corp E:

(32) Other than as described in Representation 35 below, no stock or securities will be issued for services rendered to or for the benefit of Corp E in connection with the proposed transaction. No stock or securities will be issued for indebtedness of Corp E that is not evidenced by a security or for interest on indebtedness of Corp E which accrued on or after the beginning of the holding period of Corp B for the debt.

(33) All rights, title and interests for each copyright, in each medium of exploitation, will be deemed to be transferred by Corp B to Corp E.

(34) The technical "know-how" in the form of computer software being transferred in exchange for stock under § 351 is "property" within the

meaning of Rev. Rul. 64-56, 1964-1 C.B. 133, and as such is afforded substantial legal protection against unauthorized disclosure and use under the laws of Country X and/or the United States.

(35) Any services to be performed in connection with the transfer of the property are merely ancillary and subsidiary to the property transfer within the meaning of Rev. Rul. 64-56, or Corp B will be compensated by a fee negotiated at arm's length (in consideration other than stock or securities of Corp E unless such stock or securities are identified) for any other services to be performed on behalf of Corp E.

(36) The "know-how" is secret in that it is known only by Corp B and any confidential employees who require the "know-how" for use in the conduct of the activities to which it is related. Adequate steps have been taken to safeguard the "know-how" against unauthorized disclosure.

(37) While the "know-how" may or may not be patentable, it is original, unique and novel.

(38) The "know-how" is not revealed by a patent, is not the subject of a patent application, nor is it disclosed by any products of Corp B.

(39) The "know-how" does not represent mere knowledge, or efficiency resulting from experience, or mere skill in manipulation or total accumulated experience and skill of Corp B.

(40) While the "know-how" is in the form of computer software, the property being transferred amounts to more than the mere naked right to the tangible evidence (*i.e.,* the computer tape or discs) of that "know-how."

(41) The "know-how" has not been developed by Corp B specifically for Corp E.

(42) The "know-how" does not involve assisting in matters such as construction or design and layout of facilities.

(43) The "know-how" does not involve the training of Corp E's employees that is essentially educational in nature.

(44) Technical information of a related or similar nature such as new developments in the field will not be furnished on a continuing basis without adequate compensation therefor in the manner prescribed for services in Representation 35 above.

(45) None of the stock to be transferred is “section 306 stock” within the meaning of § 306(c).

(46) The transfer is not the result of the solicitation by a promoter, broker or investment house.

(47) Corp B will not retain any rights in the property transferred actually or constructively to Corp E.

(48) The value of the stock deemed to be received in exchange for accounts receivable will be equal to the net value of the accounts transferred, *i.e.,* the face amount of the accounts receivable previously included in income less the amount of the reserve for bad debts, if any.

(49) The adjusted basis and the fair market value of the assets deemed to be transferred by Corp B to Corp E will, in each instance, be equal to or exceed the sum of the liabilities deemed to be assumed by Corp E plus any liabilities to which the transferred assets are subject.

(50) The liabilities of Corp B deemed to be assumed by Corp E were incurred by the Branch in the ordinary course of business and are associated with the assets to be transferred.

(51) There is no indebtedness between Corp E and Corp B and there will be no indebtedness actually created in favor of Corp B as a result of the transaction.

(52) The transfers and exchanges will occur under a plan agreed upon before the transaction in which the rights of the parties are defined.

(53) All exchanges will occur on approximately the same date.

(54) There is no plan or intention on the part of Corp E to redeem or otherwise reacquire any stock or indebtedness to be issued in the proposed transaction.

(55) Taking into account any issuance of additional shares of Corp E; any issuance of stock for services; any exercise of Corp E stock rights, warrants or subscriptions; any public offering of Corp E stock; and any sale, exchange, transfer by gift or other disposition of any of the stock of Corp E to be received in the exchange, Corp B will be in “control” of Corp E within the meaning of § 368(c).

(56) Corp B will receive stock (actually and constructively) approximately equal

to the net value of the property deemed transferred to Corp E.

(57) Corp E will remain in existence and retain and use the property transferred to it in a trade or business.

(58) There is no plan or intention by Corp E to dispose of the transferred property other than in the normal course of business operations.

(59) Each of the parties to the transaction will pay its own expenses, if any, incurred in connection with the proposed transaction.

(60) Corp E will not be an investment company within the meaning of § 351(e)(1) and Regulations § 1.351-1(c)(1)(ii).

(61) Corp B is not under the jurisdiction of a court in a title 11 or similar case (within the meaning of § 368(a)(3)(A)) and the stock or securities received in the exchange will not be used to satisfy the indebtedness of such debtor.

(62) Corp E will not be a "personal service corporation" within the meaning of § 269A.

The following representations have been made with respect to the transfer of the Real Property in exchange for the constructive issuance of additional Corp F shares and Corp F's assumption of the mortgage liability:

(63) No stock or securities will be issued for services rendered to or for the benefit of Corp F in connection with the proposed transaction. No stock or securities will be issued for indebtedness of Corp F that is not evidenced by a security or for interest on indebtedness of Corp F which accrued on or after the beginning of the holding period of Fcorp A for the debt.

(64) The transfer is not the result of the solicitation by a promoter, broker or investment house.

(65) Fcorp A will not retain any rights in the property transferred to Corp F. If the transfer to Corp F occurs before the domestication, Fcorp A will retain a leasehold interest in the Real Property until the domestication.

(66) The value of the stock received in exchange for accounts receivable will be equal to the net value of the accounts transferred, *i.e.,* the face amount of the accounts receivable previously included in income less the amount of the reserve for bad debts, if any.

(67) The adjusted basis and the fair market value of the assets to be transferred by Fcorp A to Corp F will, in each instance, be equal to or exceed the sum of the liabilities to be assumed by Corp F plus any liabilities to which the transferred assets are subject.

(68) There is no indebtedness between Corp F and Fcorp A and there will be no indebtedness created in favor of Fcorp A as a result of the transaction.

(69) The transfers and exchanges will occur under a plan agreed upon before the transaction in which the rights of the parties are defined.

(70) All exchanges will occur on approximately the same date.

(71) There is no plan or intention on the part of Corp F to redeem or otherwise reacquire any stock or indebtedness to be issued in the proposed transaction.

(72) Taking into account any issuance of additional shares of Corp F; any issuance of stock for services; any exercise of Corp F stock rights, warrants or subscriptions; any public offering of Corp F stock; and any sale, exchange, transfer by gift or other disposition of any of the stock of Corp F to be received in the exchange, Fcorp A will be in “control” of Corp F within the meaning of § 368(c).

(73) Fcorp A will be deemed to receive stock approximately equal to the net value of the property transferred to Corp F.

(74) Corp F will remain in existence and retain and use the property transferred to it in a trade or business.

(75) There is no plan or intention by Corp F to dispose of the transferred property other than in the normal course of business operations.

(76) Each of the parties to the transaction will pay its own expenses, if any, incurred in connection with the proposed transaction.

(77) Corp F will not be an investment company within the meaning of § 351(e)(1) and § 1.351-1(c)(1)(ii).

(78) Fcorp A is not under the jurisdiction of a court in a title 11 or similar case (within the meaning of § 368(a)(3)(A)) and the stock or securities received in the exchange will not be used to satisfy the indebtedness of any debtor.

(79) Corp F will not be a “personal service corporation” within the meaning of §

269A.

(80) The stock of Corp F represents an United States real property interest within the meaning of § 897(c)(1) and the regulations thereunder, immediately after the exchange.

(81) The filing requirements of Temp. Treas. Reg. § 1.897-5T(d)(1)(iii), as modified by Notice 89-57, will be met.

(82) Corp F will constitute a U.S. real property holding corporation within the meaning of § 897(c)(2) and the regulations thereunder.

(83) Each of the foreign entities referred to in the ruling request relating to Fcorp A and its subsidiaries is a corporation within the meaning of § 7701(a)(3).

(84) All of the assets to be transferred by Fcorp A to Corp F and Corp E are assets used by Fcorp A in its branch operation and are denominated in U.S. dollars which is the functional currency of the Branch.

(85) There is no plan or intention for the stock of either Corp F or Corp B to be transferred to or disposed of to any person.

The following representations have been made regarding the termination of the Branch:

(86) Following the Branch's remittance of its Corp D stock to Home Office, its transfer of the Real Property to Corp F and remittance of the Corp F stock to Home Office, its transfer of the Branch assets and liabilities to Corp E, and its transfer of Corp B preferred stock to Corp B, Fcorp A will no longer be engaged in business in the United States.

(87) Neither Corp B, Corp E, nor Corp F will elect under Temp. Treas. Reg. § 1.884-2T(d)(4) to carry over any of the Branch's effectively connected earnings and profits into their earnings and profits.

(88) Fcorp A is incorporated under the laws of Country X and is treated as a resident of Country X for Country X tax purposes.

(89) Fcorp A has only one class of shares outstanding.

(90) Fcorp A's shares are listed and traded on Stock Exchange 1.

(91) Stock Exchange 1 is officially recognized, sanctioned, or supervised by

the P Commission pursuant to the R Act.

(92) Stock Exchange 1 is the principal exchange in Country X.

(93) The annual value of all shares traded on Stock Exchange 1 exceeded $1 billion during 1996 and 1997, respectively.

(94) Stock Exchange 1 became operational in 1996 as successor to the Stock Exchange 2, Stock Exchange 3, and Stock Exchange 4 Exchanges.

(95) Fcorp A's shares were traded on the Stock Exchange 2 prior to their listing on the Stock Exchange 1.

(96) The annual value of all shares traded on the Stock Exchange 2 exceeded $1 billion during 1995 and 1996, respectively.

(97) Stock Exchange 1 does not have more than one tier or market level on which stock may be separately listed or traded.

(98) The number of Fcorp A's shares that will be traded on Stock Exchange 1 during 1998 will exceed the number of Fcorp A's shares that will be traded during 1998 on established securities markets in any other single country.

(99) Trades in Fcorp A's shares will be effected on Stock Exchange 1, other than in *de minimis* quantities, on at least 60 days during 1998.

(100) The aggregate number of Fcorp A's shares traded on Stock Exchange 1 during 1998 will be at least 10 percent of the average number of Fcorp A shares outstanding during 1998.

(101) As a result of the Merger Transaction, Fcorp A anticipates that substantially all of its stock will become wholly owned by a Country X holding company, Fcorp H, for more than 30 days during the last calendar quarter of 1998.

(102) During any period in 1998 when Fcorp A's stock is wholly owned by Fcorp H, another Country X corporation, Fcorp I, will own d percent of the value of the shares of Fcorp H.

(103) Fcorp I will be incorporated under the laws of Country X and treated as a resident of Country X for Country X tax purposes.

(104) Fcorp I will have only one class of shares outstanding during 1998.

(105) Fcorp I's shares will be listed and traded on Stock Exchange 1 beginning within a day after the closing of the Merger Transaction.

(106) The number of Fcorp I's shares that will be traded on Stock Exchange 1 during 1998 will exceed the number of Fcorp I's shares that will be traded during 1998 on established securities markets in any other single country.

(107) Purely because of a necessary time lag between Fcorp I's incorporation and the commencement of trading in its shares on Stock Exchange 1, trades in Fcorp I's shares may not be effected on Stock Exchange 1, other than in *de minimis* quantities, on at least 1/6th the number of days in Fcorp I's short taxable year ending on December 31, 1998.

(108) Purely because of a necessary time lag between Fcorp I's incorporation and the commencement of trading in its shares on Stock Exchange 1, the aggregate number of Fcorp I's shares traded on Stock Exchange 1 during Fcorp I's short taxable year ending on December 31, 1998 may not be a percentage of the average number of Fcorp I shares outstanding during that taxable year which is at least 10 percent of the number of days in that taxable year divided by 365.

(109) Fcorp A does not anticipate that any one or more persons, each of whom beneficially owns 5 percent or more of the outstanding shares of Fcorp I, will own, in the aggregate, 50 percent or more of the outstanding shares of Fcorp I for more than 30 days during 1998 after Fcorp I's shares become listed on Stock Exchange 1.

(110) Fcorp A's primary and predominant business activity is the issuing of insurance or the reinsuring of risks underwritten by insurance companies.

(111) Fcorp A is engaged in the active conduct of an insurance business in Country X.

(112) For 1998, the ratio of the value of Fcorp A's assets used or held for use in the active conduct of its business in Country X at the close of the taxable year to the value of all Fcorp A's assets at the close of the year will be approximately g percent.

(113) For 1998, the ratio of gross premiums received by Fcorp A from the active conduct of its business in Country X that are derived from Country X sources to the worldwide gross premiums of Fcorp A will be approximately h percent.

(114) For 1998, the ratio of Fcorp A's payroll expenses in Country X to its

worldwide payroll expenses, including commissions paid to agents, will be approximately f percent.

(115) Fcorp A was incorporated by Country X businessmen in Country X in Date b to provide commercial insurance in the local market.

(116) The building which houses Fcorp A's headquarters in City K was purchased in Date c, and Fcorp A has been headquartered at that address ever since.

(117) Fcorp A's premium income in Country X in 1996, the last year for which audited financial statements are currently available, was approximately Amount A, representing approximately e percent of the total Country X insurance market and placing Fcorp A as the q largest insurer in the Country X market.

(118) Fcorp A has approximately o employees worldwide, of whom approximately p are employed in Country X, representing approximately k percent of the worldwide total.

(119) Fcorp A operates at approximately m locations throughout Country X.

(120) Fcorp A is regulated in Country X as an insurance company by the S office pursuant to the T Act.

(121) The majority of Fcorp A's Board of Directors are individuals resident in Country X.

(122) Fcorp A also conducts insurance and other businesses in Country X through at least n wholly owned subsidiaries operating there.

(123) Fcorp A received a ruling dated Date e confirming that it would be treated as a qualified resident of Country X for its taxable years ending December 31, 1987, 1988 and 1989.

(124) Fcorp A received a letter from the IRS dated Date e declining to rule on Fcorp A's status as a qualified resident of Country X for its taxable years ending December 31, 1990, 1991 and 1992 on the grounds that "it is clear from the facts of the case that the corporation meets the requirements" of one of the three safe harbors in Treas. Reg. § 1.884-5.

(125) Fcorp A intends to file a treaty-based return position disclosure statement with its 1998 tax return pursuant to Treas. Reg. § 301.6114-1 and to include in that statement an election under Article U of the New Treaty to

continue to apply the provisions of the Old Treaty for the twelve-month period beginning on January 1, 1998.

Regarding the transaction described in paragraph (d) above, the Service recognizes that there are arguments favoring treatment of Fcorp A's transfer of assets to Corp E, and Corp E's assumption of liabilities, as a double drop of such assets and liabilities (first to Corp B and then to Corp E) each in exchange for transferee stock. Similarly, the Service recognizes that there are arguments favoring treatment of the transaction as a transfer of assets and liabilities from Fcorp A to Corp E in exchange for Corp E stock followed by Fcorp A's contribution of the Corp E stock to Corp B. Without expressing any opinion as to whether either of these recasts is more appropriate than the other, and based solely on the information submitted and the representations set forth above (which are intended to relate to both recasts), we rule as follows with respect to the transactions described in paragraphs (a) and (d) above:

(1) No gain or loss will be recognized by Fcorp A by reason of its transfer of Corp B preferred stock and Branch assets and the assumption of the Branch liabilities. I.R.C. §§ 351(a) and 357(a).

(2) Corp B shall not recognize gain or loss upon the constructive (if any) or actual receipt of Branch assets or Corp B preferred stock from Fcorp A. I.R.C. § 1032(a).

(3) Corp B shall not recognize gain or loss upon any transfer of Corp C stock, cash, or Branch assets that it made or may be deemed to have made to Corp E and Corp E's assumption of liabilities. I.R.C. §§ 351(a) and 357(a).

(4) No gain or loss will be recognized by Corp E on its receipt of Branch assets or Corp C stock and cash. I.R.C. § 1032(a).

(5) The basis of the Corp B stock received by Fcorp A will equal the sum of the bases of the Branch assets and Corp B preferred stock transferred by Fcorp A and decreased by the sum of the liabilities assumed by Corp E and the liabilities to which the transferred assets are subject. I.R.C.§ 358(a)(1) and (d)(1).

(6) The basis of the Corp E stock received by Corp B will equal the sum of (1) the cash transferred by Corp B, (2) Corp B's basis in the Corp C stock transferred by Corp B, and (3) Fcorp A's bases in the Branch assets transferred by Fcorp A, decreased by the sum of the liabilities assumed by Corp E and the liabilities to which the transferred assets are subject. I.R.C. § 358(a)(1) and (d)(1).

(7) Corp E's basis in each Branch asset transferred to Corp E will equal the basis of that asset in the hands of Fcorp A immediately before the exchange. Corp E's basis in the Corp C stock transferred to Corp E will equal the basis of that stock in the hands of Corp B immediately before the exchange. I.R.C. § 362(a).

(8) The holding period of each transferred Branch asset in the hands of Corp E will be the same as the holding period of that asset in the hands of Fcorp A immediately before the exchange. I.R.C. § 1223(2). The holding period of the transferred Corp C stock in the hands of Corp E will be the same as the holding period of the Corp C stock in the hands of Corp B immediately before the exchange. I.R.C. § 1223(2).

(9) Corp E will not be prohibited from joining in the filing of a consolidated return with the Corp B consolidated group immediately after the transaction by reason of the application of § 1504(a)(3)(A).

(10) Any Branch Insurance Liabilities that are assumed in the transaction and have not yet been taken into account by the Branch under its methods of accounting will be excluded for purposes of §§ 357(c) and 358(d). Rev. Rul. 95-74, 1995-2 C.B. 36.

(11) Any Branch Insurance Liabilities that are assumed in the transaction and have not yet been taken into account by the Branch under its methods of accounting will be deducted or capitalized by Corp E to the extent they would have been deducted or capitalized by the Branch had they not been assumed by Corp E. Rev. Rul. 95-74.

(12) The transfer of Branch assets and Branch Insurance Liabilities in the transaction as described above will not be treated as reinsurance transactions.

(13) For the taxable year in which Fcorp A transfers the Branch's insurance policies in the transaction, (i) the Branch will include in its reserves as of the close of the year, for purposes of § 832(b)(5), the ending balances of the reserves described in § 832(b)(5) that the Branch held for its insurance policies immediately before the transfer, and (ii) the Branch will not be entitled to a deduction under § 832(b)(4) for transferring assets in consideration of the assumption of Branch Insurance Liabilities under the transferred policies.

(14) For the taxable year in which the Branch's insurance policies are transferred to Corp E in the transaction, (i) Corp E will include in its reserves at the beginning of such year, for purposes of § 832(b)(5), the

ending balances of the reserves described in § 832(b)(5) that the Branch held for the policies immediately before the transfer, and (ii) Corp E will not take into premium income under § 832(b)(4) any amount with respect to the assets transferred to it in consideration of its assumption of Branch Insurance Liabilities under the transferred policies.

(15) Any stock or obligation transferred by Fcorp A and received by Corp E will be deemed acquired by Corp E for purposes of § 832(b)(5)(C)(i) on the date such stock or obligation was acquired by Fcorp A for purposes of § 832(b)(5)(C)(i).

(16) Nothing in this transaction shall cause Corp B to be treated as an insurance company for purposes of Subchapter L if it would not otherwise be so treated.

With respect to the transfer to Corp F described in paragraph (c) above, based solely on the information submitted and provided that (i) Corp F will constitute a U.S. real property holding corporation within the meaning of § 897(c)(2) and the regulations thereunder immediately after the exchange; and (ii) the filing requirements of Temp. Treas. Reg. § 1.897-5T(d)(1)(iii), as modified by Notice 89-57, will be met, it is held that:

(17) No gain or loss will be recognized by Fcorp A on the exchange of assets for Corp F stock and Corp F's assumption of liabilities. I.R.C. §§ 351(a), 357(a), 897(e)(1) and Temp. Treas. Reg. § 1.897-6T(a)(1).

(18) No gain will be recognized by Fcorp A by reason of § 357(b) as a result of the assumption of the new mortgage liability.

(19) No gain or loss will be recognized by Corp F on its receipt of assets from Fcorp A. I.R.C. § 1032(a).

(20) The basis of the Corp F stock in the hands of Fcorp A will be increased by the sum of the bases of the assets transferred by Fcorp A and decreased by the sum of the liabilities assumed and the liabilities to which the transferred assets are subject. I.R.C. § 358(a)(1) and (d)(1).

(21) The basis of each transferred asset in the hands of Corp F will equal the basis of that asset in the hands of Fcorp A immediately before the exchange. Section 362(a)(1).

(22) The holding period of each transferred asset in the hands of Corp F will be the same as the holding period of that asset in the hands of Fcorp A immediately before the exchange. I.R.C. § 1223(2).

Section 884(a) imposes a branch profits tax on a foreign corporation equal to 30 percent of the dividend equivalent amount for the taxable year for taxable years beginning on or after January 1, 1987.

Section 884(b) provides that the term "dividend equivalent amount" means the foreign corporation's effectively connected earnings and profits for the taxable year as reduced or increased by changes in the corporation's U.S. net equity for the taxable year (limited by the amount of the foreign corporation's accumulated effectively connected earnings and profits as defined in § 884(b)(2)(B)(ii), as of the close of its preceding taxable year).

Section 884(d)(1) provides that the term "effectively connected earnings and profits" means earnings and profits (without diminution by reason of any distributions made during the taxable year) which are attributable to income which is effectively connected (or treated as effectively connected) with the conduct of a trade or business within the United States.

Section 884(c) provides that the term "U.S. net equity" means U.S. assets reduced by U.S. liabilities. Section 884(c)(2)(A) defines the term "U.S. assets" to mean the money and aggregate adjusted bases of property of the foreign corporation treated as connected with the conduct of a trade of business in the United States under regulations prescribed by the Secretary.

Treas. Reg. § 1.884-1(d)(1) provides that the term "U.S. asset" means an asset of a foreign corporation that is held by the corporation as of the determination date if all income produced by the asset on the determination date is "effectively connected income" and all gain from the disposition of the asset would be effectively connected income if the asset were disposed of on that date and the disposition produced gain. Treas. Reg. § 1.884-1(d)(1) provides that, in the case of an asset that does not produce income, the determination of whether income from the asset would be effectively connected income will be made under the principles of § 864 and the regulations thereunder, but without regard to Treas. Reg. § 1.864-4(c)(2)(iii)(b).

Section 864(c)(2) provides that in determining whether gain or loss from sources within the United States from the sale or exchange of capital assets is effectively connected with the conduct of a trade or business within the United States, the factors taken into account will include whether the income, gain, or loss is derived from assets used in or held for use in the conduct of such trade or business (as described in Treas. Reg. § 1.864-4(c)(2)), or the activities of such trade or business were a material factor in the realization of the income, gain, or loss (as described in Treas. Reg. § 1.864-4(c)(3)).

Treas. Reg. § 1.864-4(c)(2)(iii)(a) provides that except as provided in Treas. Reg. § 1.864-4(c)(2)(iii)(b), stock of a corporation, whether domestic or foreign, 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. Treas. Reg.§ 1.864-4(c)(2)(iii)(b), "[s]tock held by foreign insurance companies," is reserved.

Treas. Reg. § 1.864-4(c)(3) provides that the business activities test for "effectively connected income" is satisfied with respect to an asset if it produces income relating to the active conduct of the taxpayer's trade or business in the United States.

Fcorp A represents that following Fcorp A's transfer of the Real Property to Corp F, and the Branch's assets and liabilities to Corp E, Fcorp A will no longer be engaged in business in the United States.

(23) Based solely on the information submitted, we conclude that following Fcorp A's transfer of the Real Property to Corp F, and the Branch's assets and liabilities to Corp E, Fcorp A will be deemed to have reduced its U.S. assets and liabilities, as defined in § 884(c)(2), to zero.

Section 884(a) imposes on a foreign corporation a tax equal to 30 percent of the dividend equivalent amount for the taxable year for taxable years beginning on or after January 1, 1987.

Temp. Treas. Reg. § 1.884-2T(d)(1) provides special rules that apply to the transfer by a foreign corporation engaged (or deemed engaged) in the conduct of a U.S. trade or business of part or all of its U.S. assets to a domestic corporation in exchange for stock or securities in the transferee in a transaction that qualifies under § 351(a) provided that immediately after the transaction, the transferor is in control (as defined in § 368(c)) of the transferee, without regard to other transferors.

Temp. Treas. Reg. § 1.884-2T(d)(2) provides that the exemption from the tax imposed by section 884(a) provided by Temp. Treas. Reg. § 1.884-2T(a)(1) for a complete termination of a U.S. trade or business is not available for a taxable year in which the foreign corporation transfers all or a part of its U.S. assets to a domestic corporation in a § 351 transaction.

Temp. Treas. Reg. § 1.884-2T(d)(3) provides that the transferor's dividend equivalent amount for the taxable year in which a § 351 transaction occurs will be determined under the provisions of Treas. Reg. § 1.884-1, as modified by Temp. Treas. Reg. § 1.884-2T(d)(3), provided that the transferee elects under Temp. Treas. Reg. § 1.884-2T(d)(4) to be allocated a proportionate amount of the transferor's effectively connected earnings and profits and non-previously taxed accumulated effectively connected earnings and profits and the foreign corporation files a statement as provided in Temp. Treas. Reg. § 1.884-2T(d)(5) and complies with the agreement included in such statement with respect to a subsequent disposition of the transferee's stock.

Temp. Treas. Reg. § 1.884-2T(d)(4) provides that pursuant to the termination or incorporation of a U.S. trade or business of a foreign corporation under § 351, the transferee may elect to be allocated a proportionate amount of the transferor's effectively connected earnings and profits.

Fcorp A represents that neither Corp B, Corp E, nor Corp F will elect under Temp. Treas. Reg. § 1.884-2T(d)(4) to carry over any of the Branch's effectively connected earnings and profits into their earnings and profits.

Fcorp A also represents that it intends to file a treaty-based return position disclosure statement with its 1998 tax return pursuant to Treas. Reg. § 301.6114-1 and to include in that statement an election under Article U of the New Treaty to continue to apply the provisions of the Old Treaty for the twelve-month period beginning on January 1, 1998.

(24) Based solely on the information submitted, provided that Fcorp A makes a valid election to apply the provisions of the Old Treaty for the twelve-month period beginning on January 1, 1998, and provided that such election extends the applicability of all provisions of the Old Treaty, and since it is concluded in ruling 23 that Fcorp A will have reduced its U.S. assets, as defined in § 884(c)(2)(A), to zero, it is concluded that Fcorp A's termination of the Branch will trigger a dividend equivalent amount, as defined in § 884(b), to Fcorp A for its 1998 taxable year in an amount equal to (i) the Branch's effectively connected earnings and profits for its 1998 taxable year, plus (ii) the decrease in Fcorp A's U.S. net equity between the close of its 1997 taxable year and the close of its 1998 taxable year (limited by the amount of Fcorp A's accumulated effectively connected earnings and profits as defined in § 884(b)(2)(B)(ii), as of the close of its 1997 taxable year).

The provisions of an income tax treaty between the United States and the country of residence of the foreign corporation may exempt a foreign corporation from the branch profits tax or reduce the applicable rate of tax. Section 1.884-1(g)(3) of the Income Tax Regulations provides that the branch profits tax will not be imposed if a foreign corporation satisfies the qualified resident requirements with respect to a country listed in that section so long as the income tax treaty between the United States and that country, as in effect on January 1, 1987, remains in effect and is not modified by subsequent agreement to expressly provide for the imposition of a branch profits tax. Country X is listed in Treas. Reg. § 1.884-1(g)(3) of the Income Tax Regulations.

In general, the provisions of an income tax treaty will apply only if the foreign corporation is a "qualified resident" of such foreign country. Section 884(e)(1)(B). A foreign corporation is a qualified resident of its country of residence if it satisfies one of the following requirements: (1) it meets both a stock ownership test and a base erosion

test, (2) it meets a “publicly traded corporation” test, that is, whether its stock, or the stock of its parent corporation, is primarily and regularly traded on an established securities market in its country of residence or in the United States, or (3) it meets an active trade or business test. In addition, Treas. Reg. § 1.884-5 provides that a corporation may be treated as a qualified resident of its country of residence if it obtains a ruling from the Commissioner to that effect.

A foreign corporation satisfies the stock ownership/base erosion safe harbor of Treas. Reg. § 1.884-5(b) if (1) more than 50 percent of its stock (by value) is beneficially owned (or is treated as beneficially owned by reason of Treas. Reg. § 1.884-5(b)(2)) during at least half of the number of days in the foreign corporation’s taxable year by one or more qualifying shareholders and (2) if it establishes that less than 50 percent of its income for the taxable year is used (directly or indirectly) to make deductible payments in the current taxable year to persons who are not residents of the foreign country of which the foreign corporation is a resident and who are not citizens or residents of the United States.

The “publicly traded” test of § 884(e)(4)(B) is satisfied by a foreign corporation for any taxable year in which (1) its stock is primarily and regularly traded (as defined in Treas. Reg. § 1.884-5(d)(3) and (4)) on one or more established securities markets (as defined in Treas. Reg. § 1.884-5(d)(2)) in that country, or in the United States, or both, or (2) at least 90 percent of the total combined voting power of all the classes of stock of such foreign corporation entitled to vote and at least 90 percent of the total value of the stock of such foreign corporation is owned, directly or by application of Treas. Reg. § 1.884-5(b)(2), by a foreign corporation that is a resident of the same foreign country or a domestic corporation and the stock of such parent corporation is primarily and regularly traded on an established securities market in that foreign country or in the United States, or both.

A foreign corporation satisfies the active trade or business test of Treas. Reg. § 1.884-5(e) only if either (1) it is engaged in the active conduct of a trade or business (within the meaning of Treas. Reg. § 1.884-5(e)(2)) in its country of residence, (2) it has a substantial presence (within the meaning of Treas. Reg. § 1.884-5(e)(3), and (3) either (A) its U.S. trade or business is an integral part (as defined by Treas. Reg. § 1.884-5(e)(4)) of an active trade or business conducted by the foreign corporation in its country of residence, or (B) in the case of interest received by the foreign corporation for which a treaty exemption or rate reduction is claimed pursuant to Treas. Reg. § 1.884-4(b)(8)(ii), the interest is derived in connection with, or is incidental to, a trade or business described in Treas. Reg. § 1.884-5(e)(1)(i).

Fcorp A does not meet the requirements of:

(1) the stock ownership/base erosion safe harbor of Treas. Reg. § 1.884-5(b) and (c) because its ownership is widely held and Fcorp A does not meet

the documentation requirements of Treas. Reg. § 1.884-5(b)(3). Additionally, Fcorp A does not expect to meet the base erosion test for 1998 because it does not anticipate being able to establish that less than 50% of its income was used to make deductible payments to persons who are not qualified residents of Country X or citizens or residents of the United States,

(2) the "publicly traded" test of § 884(e)(4)(B), because Fcorp A falls into the "closely held" exception of Treas. Reg. § 1.884-5(d)(4)(iii)(A), since it will be beneficially owned by Fcorp H, which is not a qualifying shareholder, for more than 30 days during the calendar year. As a result, Fcorp A is treated as not meeting the regularly traded requirement of Treas. Reg. § 1.884-5(d)(4)(i), or

(3) the active trade or business test of Treas. Reg. § 1.884-5(e) because its U.S. trade or business is not considered an integral part of the active trade or business conducted by Fcorp A in Country X and it is not considered to have a substantial presence in Country X.

Consequently, Fcorp A has requested a ruling under Treas. Reg. § 1.884-5(f) that it will be treated as a qualified resident of Country X for its taxable year 1998.

Under the ruling procedure of Treas. Reg. § 1.884-5(f), other factors may be considered in determining if Fcorp A is a qualified resident of Country X. These factors include, but are not limited to, the extent to which the corporation meets the requirements of Treas. Reg. § 1.884-5(b) through (e) and the extent to which the U.S. trade or business is dependent on capital, assets or personnel of the foreign trade or business.

In this case, Fcorp A would have met the requirements of the publicly traded test of Treas. Reg. 1.884-5(d) but for the merger of Fcorp A and Fcorp G on Date f.

Fcorp A does not meet the active trade or business test of Treas. Reg. 1.884-5(e) because its U.S. trade or business is not considered an integral part of the active trade or business conducted by Fcorp A in Country X and it is not considered to have a substantial presence in Country X. Thus, Fcorp A is able to meet the 20 percent requirement with regard to only two of the three ratios provided for in the substantial presence test within the active trade or business test. Approximately f% of Fcorp A's payroll expenses are incurred for employees and commission agents in Country X and approximately g% of the value of Fcorp A's assets, on an adjusted basis, are used or held for use in the active conduct of a trade or business in Country X. However, only h% of Fcorp A's income is derived from the active conduct of a trade or business in Country X, and the average of the three ratios does not exceed i%. Although Fcorp A

satisfies only two of the ratios within the substantial presence test, Fcorp A has a substantial presence in Country X in absolute terms. Fcorp A has Country X payroll expense of approximately Amount B, premium income from its Country X operations of approximately Amount C, and assets of approximately g% of the total value of its worldwide assets are held for use in its Country X insurance operations.

In addition, Fcorp A has been a resident of Country X since its date of incorporation over j years ago and has conducted an insurance business and related businesses since that time. Fcorp A employs approximately o employees worldwide, of whom approximately p are employed at approximately m locations throughout Country X. The majority of Fcorp A's Board of Directors consists of individuals resident in Country X.

(25) Based on the information submitted, it is our view that Fcorp A should be treated as a qualified resident of Country X within the meaning of § 884(e)(4) and Treas. Reg. § 1.884-5 for its taxable year 1998.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

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.

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling letter have not yet been adopted. Therefore, this ruling letter may be revoked or modified upon the issuance of temporary or final regulations (or a notice with respect to their future issuance). See section 12.04 of Rev. Proc. 98-1, 1998-1 I.R.B. 7, which discusses in greater detail the revocation or modification of ruling letters. However, when the criteria in section 12.05 of Rev. Proc. 98-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

No opinion is expressed concerning the application of the Income Tax Treaty between the United States and Country X to Corp F, or about the impact of § 163(j) on any "disqualified interest" paid or accrued by Corp F. In addition, no opinion is expressed about the tax treatment of the proposed transaction under any other provisions of the Code and regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transaction that are not specifically covered by the above rulings.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely yours,

Assistant Chief Counsel (Corporate)

By Richard L. Osborne
Richard L. Osborne Senior Technician Reviewer, CC:DOM:CORP:2