KPMG

TaxNewsFlash

United States

No. 2017-520
November 20, 2017

PLR: F reorganization, from Country A branch of U.S. life insurance company to Country A section 953(d) company

The IRS publicly released a private letter ruling* addressing the U.S. federal tax consequences of a reorganization of a U.S. company's life and health insurance business in Country A.

The IRS specifically ruled on issues related to whether the transfer of the company's Country A business from a Country A branch of a U.S. company to a newly formed Country A corporation—which then made an election under section 953(d)—was a reorganization under section 368(a)(1)(F) (an F reorganization). By treating the establishment of the new Country A section 953(d) company as an F reorganization, the taxpayer was permitted to continue to calculate its reserves as determined by the Country A financial regulator under section 807(e)(4).

Read **PLR 201746022** [PDF 90 KB] publicly released on November 17, 2017, and dated December 1, 2016.

*Private letter rulings are taxpayer-specific rulings furnished by the IRS Office of Chief Counsel in response to requests made by taxpayers and can only be relied upon by the taxpayer to whom issued. Pursuant to section 6110(k)(3), written determinations such as private letter rulings are not intended to be relied upon by third parties and may not be cited as precedent. These written determinations may, however, offer an indication of the IRS's position on the issues addressed.

Background

The taxpayer is the parent of a life-nonlife consolidated group that provides insurance products to customers in the United States and Country A. The Country A business was conducted through a Country A branch of a U.S. corporation, which also conducted business in the United States.

For a variety of business reasons, the taxpayer desired to transfer the Country A business to a newly formed Country A corporation. In particular, Country A regulators

wanted the taxpayer to conduct the business in Country A through a Country A corporation rather than through a Country A branch of a U.S. corporation, even though at the time the Country A business had first been established, the Country A regulators wanted the taxpayer to conduct business in Country A through a Country A branch of a U.S. corporation.

Section 807(e)(4), under which the reserves of a U.S. life insurance company operating in a foreign country in branch form may not be less than the minimum reserve required by the local regulatory authority, is available only for "qualified foreign contracts." In order for a life insurance contract issued by a foreign life insurance branch to be treated as a qualified foreign contract, the domestic life insurance company must have been required by the foreign country (as of the time it began operations in such country) to operate in such country through a branch.

In this letter ruling, in order for the Country A business to continue to be eligible to determine reserves under section 807(e)(4)—while also satisfying the requirement of Country A regulators that the taxpayer conduct business in Country A through a Country A corporation—the taxpayer had to treat the transaction as a "mere change in identity, form, or place of organization" under section 368(a)(1)(F). Also, the taxpayer needed to treat the operation of the business through the new section 953(d) company as a branch of a U.S. corporation that had been required to be in a branch format by the Country A regulator "as of the time it began operations in such country".

Issue

The issue addressed by the IRS in the letter ruling was: Whether a transaction in which the operations of a Country A branch of a U.S. corporation were transferred to a Country A corporation, which then elected to be a treated as a U.S. corporation under section 953(d), would be treated as an F reorganization, thereby allowing the taxpayer to continue to compute reserves of the Country A life business based on section 807(e)(4)?

IRS's findings

In order to preserve the benefit of section 807(e)(4), while simultaneously allowing the taxpayer to do business in Country A through a Country A corporation rather than through a Country A branch of a U.S. company, it was necessary to convert the U.S. corporation to a Country A corporation through a tax-free F reorganization. This was achieved by extracting out the U.S. assets in a transaction characterized as a divisive section 368(a)(1)(D) transaction and a spinoff of the new U.S. company, followed by an F reorganization into the new Country A company.

The IRS could not rule on whether the reorganization actually qualified as an F reorganization, but could only rule on whether certain issues would prevent the reorganization from qualifying as an F reorganization.

Nevertheless, it is apparent from the ruling that the IRS concluded that the reorganization of the Country A business from a Country A branch of a U.S. corporation to a section 953(d) company incorporated in Country A could qualify as an F reorganization even though the specific form of the reorganization was designed in part to allow the Country A business to continue to enjoy a tax benefit (i.e., being permitted to compute reserves under section 807(e)(4)).

In addition, it was essential to the conclusion that section 807(e)(4) would continue to apply to the operation of the Country A business through a section 953(d) company as if it were a Country A branch of a U.S. company.

Conclusion

The IRS concluded that the deemed liquidation of the U.S. corporation in the potential reorganization, the merger of the U.S. business into a newly formed U.S. company, and the fact that the Country A reorganization might be viewed as part of a split-up of the U.S. corporation under section 355 that is preceded by a transfer of assets to a newly formed U.S. company under section 351 or section 368(a)(1)(D), would not prevent the reorganization from qualifying as an F reorganization.

The IRS also ruled that the insurance contracts issued by the Country A corporation prior to, on, or after the date of the Country A reorganization would continue to be "qualified foreign contracts" for purposes of sections 807(e)(4) and 848(e).

KPMG observation

The IRS conclusion in the letter ruling depends, in part, on the ability of the taxpayer to demonstrate a non-tax business purpose for the transaction. Although the reorganization of the Country A business from a U.S. corporation to a Country A corporation was clearly motivated primarily by the needs of the Country A regulator, the precise form of the transaction was designed to preserve the availability of section 807(e)(4). It is clear from the ruling that the need to preserve an existing tax benefit, rather than to realize a new tax benefit, does not negate the existence of a valid non-tax business purpose.

The letter ruling is also noteworthy because of the intricate analysis necessary to identify the "bubble" in which the F reorganization took place, in order to ensure that the Country A corporation was the successor to the original U.S. corporation—even though the U.S. business of the U.S. corporation was spun off to a newly formed U.S. corporation.

In addition, the conclusion of the letter ruling requires a close reading of the ordering and timing rules governing reorganizations to ensure that the conversion of the U.S. corporation to a Country A corporation coupled with the section 953(d) election was effectively a "nothing" rather than an outbound reorganization followed by an inbound reorganization.

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