

**Internal Revenue Service**

Department of the Treasury

Number: **200312016**  
Release Date: 3/21/2003  
Index No.: 61.15-06

Washington, DC 20224

Person to Contact:

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Refer Reply To:

PLR-134331-02

Date:

December 17, 2002

Employee Identification Number:

Legend

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|----------------------|---|
| Bank                 | = |
| Bank Holding Company | = |
| State                | = |
| Year                 | = |
| Date                 | = |
| A%                   | = |
| B%                   | = |
| C                    | = |
| D                    | = |

Dear \_\_\_\_\_ :

This private letter ruling responds to your letter dated June 6, 2002, requesting a ruling on behalf of Bank Holding Company, a corporation, concerning the federal income tax consequences of a waiver of dividends by Bank Holding Company.

**ISSUE:**

Will the waiver by Bank Holding Company of any part of its pro rata share of cash dividends declared by Bank result in gross income to Bank Holding Company under the circumstances described below?

**CONCLUSION:**

Based on the information submitted, the applicable law, and the representations made, we conclude that a bona fide business reason exists for the proposed waiver and that there is no direct business relationship between the waiving and non waiving shareholders. Accordingly, the waiver by Bank Holding Company of any part of its pro rata share of cash dividends declared by Bank during the period beginning on the date of this ruling through a period of three years after the issuance of this letter ruling will not result in gross income to Bank Holding Company.

**FACTS:**

Three years ago, Bank Holding Company requested and received a favorable ruling (PLR 199944021, August 15, 1999) that its waiver of dividends declared by Bank did not result in gross income to Bank Holding Company under facts substantially identical to the facts below. Because the previously issued ruling, by its terms, ceases to be effective three years after the issuance of the letter ruling, Bank Holding Company again requests that the same ruling be issued with respect to Bank Holding Company's waiver of dividends declared by Bank.

In Year, the original Bank reorganized from a mutual savings bank to a mutual holding company pursuant to the laws of State. Under the plan of reorganization, the original Bank transferred substantially all of its assets and liabilities, including all of its deposit liabilities, to a newly created capital stock bank ("Bank") in exchange for B% of Bank's common stock. The remaining A% of Bank common stock was sold through stock offerings to: (1) former depositors of the original Bank who became depositors of Bank as a result of the reorganization; (2) individuals residing in State; and (3) the general public. Also, as part of the reorganization, the original Bank changed its name to Bank Holding Company.

The purpose of the reorganization was to achieve an organizational structure that made it easier for Bank Holding Company and Bank to raise equity capital, to diversify geographically, to expand the financial products offered and to compete more effectively in the current marketplace.

Since the reorganization, Bank has operated as a capital stock bank and, subject to statutory and regulatory constraints, prevailing financial conditions and future earnings, Bank has declared and paid cash dividends on its common stock. The first dividend was declared and paid to the minority stockholders in the quarter following the reorganization. As one of the considerations in the decision to declare and pay dividends, the board of directors of Bank looks at its capital requirements, its economic forecasts and any other factors as it deems relevant. A portion of Bank's earnings will be retained by Bank in order to provide capital for its operations and expansion of its

banking business.

On Date, the officers and trustees of Bank Holding Company owned, directly and indirectly, C of the D outstanding shares of common stock of Bank or 1%. Bank has no outstanding preferred stock at this time. In addition, the officers and trustees of Bank Holding Company held, in the aggregate, less than .02% of the deposits in Bank on Date.

Bank Holding Company, as the majority stockholder, has in the past waived cash dividends declared by Bank. Bank Holding Company also anticipates that it will continue to waive, from time to time, certain of the future cash dividends declared and paid by Bank.

It is represented that the waiver of dividends allows Bank to make dividend distributions to minority shareholders who own the publicly traded common stock, thereby enhancing its market value and providing Bank with greater access to capital markets for future equity offerings, and still permits Bank to maintain adequate capital to support its operations and expand its banking business. However, the Board of Trustees of Bank Holding Company has fiduciary responsibilities that must be considered in determining whether a dividend will be waived, and each waiver is considered independently from each other waiver of dividends. Therefore, Bank Holding Company will waive its dividends only when its board of trustees determines that a bona fide business purpose exists for such waiver and that such waiver will enhance the value of Bank Holding Company's investment in Bank.

The following representations have also been made with respect to the dividend waiver:

- (1) Bank has in the past and is expected to continue to declare and pay cash dividends on a quarterly basis;
- (2) No dividend waivers will be made by Bank Holding Company with respect to stock dividends, if any, declared and paid by Bank;
- (3) Prior to the declaration of any cash dividend by Bank, Bank Holding Company will submit a written statement to Bank indicating the extent of its waiver of the anticipated dividend; and
- (4) Persons related to Bank Holding Company as the waiving shareholder (as defined in Rev. Proc. 67-14, 1967-1 C.B. 591) will not receive in the aggregate more than 20% of any cash dividend declared and paid to non-waiving shareholders of Bank.

#### LAW AND ANALYSIS:

Section 61(a)(7) of the Internal Revenue Code provides that except as otherwise provided in subtitle A, gross income means all income from whatever source derived, including dividends.

Generally, a majority shareholder who agrees to waive dividends while other shareholders receive theirs does not realize income if there is no family or direct business relationship between the majority and minority shareholders and the waiver is executed for valid business reasons. Rev. Rul. 45, 1953-1 C.B. 178. However, the waiver by a majority shareholder of the right to receive a pro rata share of any dividends paid by a corporation will not be recognized for income tax purposes where such dividends are paid to the relatives as minority shareholders in the form of increased dividends, and the waiver results primarily in a benefit to the relatives. Income is realized by the majority shareholder to the extent of the increased distribution to the related shareholders resulting from the waiver. See Rev. Rul. 56-431, 1956-2 C.B. 171.

Rev. Proc. 67-14, 1967-1 C.B. 591, lists the conditions under which the Service will consider a request for a ruling on a proposed waiver of dividends transaction when the waiving and nonwaiving shareholders are individuals. The following three conditions must be satisfied: (1) a bona fide business reason must exist for the proposed waiver of dividends; (2) the relatives (e.g., brothers, sisters, spouse, ancestors, and lineal descendants) of the waiving shareholder must not be in a position to receive more than 20% of the total dividends distributed to the nonwaiving shareholders; (3) the ruling is not effective if any change in stock ownership (other than death) enables nonwaiving relatives to receive more than 20% of the dividend; and (4) a ruling issued on a proposed waiver of dividends transaction will not be effective for a period longer than three years from the date of the ruling.

Because Bank Holding Company is a corporation, not an individual, Rev. Proc. 67-14 is not determinative of whether a ruling request on a proposed waiver of dividends transaction will be considered. However, some of the conditions listed in Rev. Proc. 67-14 are appropriate for determining whether the Service will consider a request for a ruling on a proposed waiver of dividends transaction when a waiving or nonwaiving shareholder is a corporation.

One condition that is applicable regardless of whether the waiving or nonwaiving shareholder is an individual or a corporation is the existence of a bona fide business reason for the proposed waiver of dividends. In this ruling request, it is represented that Bank Holding Company has a bona fide business reason for the proposed waiver of dividends because the waiver would allow Bank to make dividend distributions to minority shareholders who own the publicly traded common stock of Bank, thereby enhancing its market value and providing Bank with greater access to capital markets for future equity offerings, and still permit Bank to maintain adequate capital to support its operations and expand its banking business. The Board of Trustees of Bank Holding Company has certain fiduciary responsibilities that must be considered in determining whether a dividend will be waived. Consequently, Bank Holding Company will waive its dividends

only when its Board of Trustees determines that a bona fide business purpose exists for such waiver and that such waiver will enhance the value of Bank Holding Company's investment in Bank.

As stated above, Bank Holding Company is a corporation and, therefore, cannot have "relatives" as defined in Rev. Proc. 67-14 or a family relationship as referred to in Rev. Rul. 45. However, Rev. Rul. 45 also refers to whether or not there is a direct business relationship between the waiving and nonwaiving shareholders. With respect to Bank Holding Company and Bank it is represented that as of Date, the officers and trustees of Bank Holding Company own, directly and indirectly, 1% of the outstanding common stock of Bank. Bank has no outstanding preferred stock. Based on these facts the officers and trustees of Bank Holding Company do not hold a significant interest in Bank, and, thus, there is no direct business relationship between the waiving and nonwaiving shareholders.

Rev. Proc. 67-14 provides that a ruling issued on a proposed waiver of dividends transaction will not be effective for a period longer than three years from the date of the ruling. This restriction is also appropriate when the waiving or nonwaiving shareholder is a corporation.

Based on the information submitted, the applicable law, and the representations made, we conclude that a bona fide business reason does exist for the proposed waiver and that there is no direct business relationship between the waiving and nonwaiving shareholders. Accordingly, the waiver by Bank Holding Company of any part of its pro rata share of cash dividends declared by Bank during the period beginning on the date of this ruling through a period of three years after the issuance of this letter ruling will not result in gross income to Bank Holding Company. If the percentage of common stock of Bank held directly and indirectly by the officers and trustees of Bank Holding Company increases significantly during the waiver period, this ruling will no longer be applicable.

#### CAVEATS:

A copy of this letter must be attached to any income tax return to which it is relevant. We enclose a copy of the letter for this purpose. Also enclosed is a copy of the letter ruling showing the deletions proposed to be made in the letter when it is disclosed under § 6110.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any item discussed or referenced in this letter. This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

PAUL M. RITENOUR  
Chief, Branch 1  
Office of Associate Chief Counsel  
(Income Tax & Accounting)

Enclosures (2)