

Internal Revenue Service

199928042
Department of the Treasury

Washington, DC 20224

Contact Person: S.I.N.#:
512.10-00

Telephone Number:

In Reference to:

Date: APR 20 1999

Employer
Identification Number:
Key District:

Legend:

M =

N =

Dear Applicant:

This letter is in reply to the letter from your authorized representative dated June 29, 1998, in which M requested a ruling with respect to whether a certain amount would be excluded from M's income by reason of section 512(b)(1) of the Internal Revenue Code as described below.

M is an organization recognized by the Internal Revenue Service as exempt from federal income tax under section 501(c)(6) of the Code. M owns (and has owned since shortly after its formation) all of the issued and outstanding stock of N, an insurance company located outside of the United States. N is not engaged in any trade or business in the United States, and, as a consequence, does not file any United States income tax returns.

Since its formation, N has been engaged in the trade or business of reinsuring workers compensation insurance written by a certain insurance company for the member agencies of M, and N would be subject to tax under subchapter L of the Code if it were a domestic corporation. As M is a "United States person" (as such term is defined in section 957(c) of the Code), N has been a "controlled foreign corporation" (as defined in sections 957(a) and 953(d)(1)(A)) since shortly after its formation. All of the income of N since its formation has constituted "insurance income" within the meaning of section 953(a).

M intends to cause N to make the election to be treated as a domestic corporation, as provided in section 953(d) of the Code, effective January 1, 1998.

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Section 501(c)(6) of the Code provides for the exemption from federal income tax of business leagues, chambers of commerce, real-estate boards, or boards of trade, not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(6)-1 of the Income Tax Regulations provides that a business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It is an organization of the same general class as a chamber of commerce or board of trade. Thus, its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons.

Section 511(a) of the Code imposes a tax on the unrelated business taxable income of organizations described in section 501(c).

Section 512(a)(1) of the Code defines the term "unrelated business taxable income" as the gross income derived by any organization from any unrelated trade or business regularly carried on by it, less certain allowable deductions and modifications.

Section 512(b)(1) of the Code provides that one of the modifications referred to in section 512(a) is that there shall be excluded from the term "unrelated business taxable income" all dividends and interest.

Section 512(b)(17)(A) of the Code provides, in general, that notwithstanding section 512(b)(1), any amount included in gross income under section 951(a)(1)(A) shall be included as an item of gross income derived from an unrelated trade or business to the extent the amount so included is attributable to insurance income (as defined in section 953) which, if derived directly by the organization, would be treated as gross income from an unrelated trade or business.

Section 367(b) of the Code and the regulations thereunder provide, in general, that in the case of a non-recognition exchange, such as a section 354 exchange, where the stock of a foreign corporation is exchanged by a U.S. person, the foreign corporation will be treated as a corporation (and the non-recognition provision will apply) to the extent provided in the regulations.

Section 951(a)(1)(A) of the Code provides, in relevant part, that, in general, if a foreign corporation is a controlled foreign corporation, every person who is a United States shareholder of such corporation and who owns stock in such corporation on the last day, in such year, on which such corporation is a controlled foreign corporation shall include in his gross income, for his taxable year in which or with which such taxable year of the corporation ends, his pro rata share of the corporation's subpart F income for such year.

Section 953(d)(1) of the Code provides, in relevant part, that, in general, if a foreign corporation is a controlled foreign corporation, and such foreign corporation makes an election to have this paragraph apply and waives all benefits to such corporation granted by the United States under any treaty, then for purposes of this title, such corporation shall be treated as a domestic corporation.

Section 953(d)(4) of the Code provides that for purposes of section 367, any foreign corporation making an election under section 953(d)(1) shall be treated as transferring (as of the 1st date of the 1st taxable year to which such election applies) all of its assets to a domestic corporation in connection with an exchange to which section 354 applies, with an exception for pre-1988 earnings and profit.

If N makes the election under section 953(d)(1) of the Code to be treated as a domestic corporation, N will be treated for federal income tax purposes as transferring all of its assets to a domestic corporation in connection with a section 354 exchange. Under the section 367(b) regulations, M will be required to include in gross income the section 1248 amount, with respect to earnings and profits accumulated in taxable years beginning on or after January 1, 1988, attributable to the N stock exchanged in the section 354 exchange, to the extent the fair market value of the stock exchanged exceeds its adjusted basis (see section 7.367(b)-7(c)(1)(i) of the regulations). The section 1248 amount attributable to the N stock will be treated as a dividend taxable under section 301 (see section 7.367(b)-3(b)).

Thus, any inclusion in gross income by reason of the domestic election under section 953(d)(1) is attributable to the application of section 367(b) rather than section 951(a)(1)(A). Since the application of section 512(b)(17) depends upon income described in section 951(a)(1)(A) only, it will not apply to M in this case.

Accordingly, based on the facts and circumstances as stated above, we rule that if N makes the election described in section

953(d)(1) of the Code, the amount, if any, required to be included in income by M pursuant to section 367(b) will not be included by M as an item of gross income in computing its unrelated business taxable income by reason of section 512(b)(17)(A), and, therefore, such amount would be considered as a dividend and excluded from M's income by reason of section 512(b)(1).

This ruling is based on the understanding that there will be no material changes in the facts upon which it is based. Any such change should be reported to the Ohio EP/EO key district office. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records. A copy of this ruling is being forwarded to the Ohio EP/EO key district office.

Except as we have specifically ruled herein, we express no opinion as to the consequences of this transaction under the cited provisions or under any other provisions of the Code.

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

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours,



Marcus S. Owens
Director, Exempt Organizations
Division