STATE OF CALIFORNIA
FRANCHISE TAX BOARD
Legal Division MS A260
PO Box 1720
Rancho Cordova, CA 95741-1720

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FTB NOTICE 2019 - 01

SUBJECT: Internal Revenue Code Section 367 and Related Regulations Applicable to California Revenue and Taxation Code Section 24465

PURPOSE

The purpose of this Notice is to identify those federal regulations that will be applied in cases involving the transfer of appreciated property to an insurer when California Revenue and Taxation Code (RTC) section 24465 applies to the transfer.

BACKGROUND

The underlying purpose of RTC section 24465 is to protect California's corporate franchise and income tax base by preventing the tax-free export of appreciated property from the corporate franchise and income tax base to an insurance company subject to the gross premiums tax in a tax-free transaction where the insurance company's subsequent sale of the appreciated property escapes taxation under Part 11 of the RTC. RTC section 24465 states, generally, that transfers of appreciated property from a corporation subject to taxation under Part 11 of the RTC to an insurer in a commonly controlled group (normally subject to nonrecognition provisions) is a transaction in which gain is recognized. If the appreciated property continues to be actively used in the insurer's insurance business, then the recognition of the gain will be deferred, but never completely eliminated. When the property ceases being utilized in the active conduct of the insurance business or is transferred out of the combined group, the gain will be recognized by the original transferor. In such instance, apportionment of the recognized gain to California is determined based on the apportionment factor(s) applicable to the original transferor in the year that the deferred gain is recognized. The gain recognized is the lesser of the deferred gain on the original transfer or the gain realized in the transaction in which gain is required to be recognized under RTC section 24465(b)(1).

RTC section 24465 is based on IRC section 367 concerning the transfer of appreciated property to certain foreign corporations. Like RTC section 24465, IRC section 367 provides an end of deferred gain treatment for transferring appreciated property to an entity that does not pay the otherwise applicable income tax.

One of the critical differences between RTC section 24465 and IRC section 367 is the treatment of complete liquidations of insurance companies, otherwise governed by California's conformity to IRC section 332. Specifically, RTC section 24465(h)(2)(B) overrides IRC section 332, and the liquidating distribution is treated as a dividend under RTC section

24410. Treating the liquidating distribution as a dividend prevents overcapitalized ("stuffed") insurance companies from moving assets back into the Part 11 tax base without a toll charge by liquidating the insurer under the deferral provisions of IRC section 332, instead requiring such liquidating distributions to be tested under RTC section 24410 to determine the applicable dividends-received deduction when the assets come back into the tax base.

APPLICATION OF IRC SECTION 367 AND APPLICABLE REGULATIONS

The principles of the regulations promulgated under IRC section 367, which is generally applied in the context of foreign corporations, will apply to RTC section 24465 in the context of the transfer of appreciated property to an insurance company under RTC section 24465. In the absence of regulations promulgated by the FTB under RTC section 24465, the FTB intends to rely upon federal regulations promulgated under IRC section 367 to the extent those latter regulations address similar substantive transactions to those described under RTC section 24465. FTB staff intends to eventually open a new regulation project to address any outstanding issues concerning use of the IRC section 367 regulations in administering RTC section 24465.

The principal author of this Notice is Michael R. Laisné of the Franchise Tax Board, Legal Division. For further information regarding this Notice, contact Mr. Laisné at P.O. Box 1720, Rancho Cordova, CA 95741-1720, or at Michael.Laisne@ftb.ca.gov.