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Mutual =

Group =

Company =

State A =

State B =

Court =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

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Closing Date =

X =

This letter replies to a request for rulings, dated October 6, 1998, on the federal income tax consequences of a proposed transaction concerning a plan of rehabilitation under § 368(a)(1)(G) of the Internal Revenue Code. We received additional information in letters dated November 16, 1998, February 3, February 9, March 17, and July 12, 1999. The information submitted for consideration is summarized below.

Mutual is a mutual life insurance corporation organized to conduct a life insurance business in State A. Mutual issued life insurance policies in 47 states and the District of Columbia. Mutual is a mutual corporation and, therefore, has no shareholders. Instead, owners of its contracts, (Contract Holders), have a dual relationship to the company, as proprietary owners by reason of being members of the mutual corporation and as holders of contract rights under the contracts of Mutual.

Mutual owns all the stock of Group, a State A holding corporation that is not an insurance company. Group owns all the stock of Company, a stock life insurance company chartered and domiciled in State A.

Mutual is the common parent of a consolidated group and files a life-nonlife consolidated federal income tax return with all the members of its consolidated group under § 1504(c)(2). Group and Company are members of Mutual's consolidated group and join in Mutual's consolidated return.

Mutual was placed in rehabilitation by Order of Court on Date 1, upon the joint petition of the Insurance Commissioner of State A and the Board of Directors of Mutual. Pursuant to the Order of Rehabilitation, a moratorium was imposed on cash distributions, policy surrenders, withdrawals and policy loans, except in the case of certain hardship situations. On Date 2, the Insurance Commissioner filed an amended rehabilitation plan with the Court (Plan 1). This amended plan of rehabilitation was the subject of a private letter ruling, PLR 9544026, issued on Date 3. Objections of interested parties and changes in the financial condition of Mutual resulted in the abandoning of this amended plan of rehabilitation. On Date 4 the Insurance Commissioner filed a subsequent amended plan with the Court (Plan 2). This plan was also abandoned. On Date 5, a further amended plan was filed with the Court (the

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Plan). The Plan is the subject of this ruling request.

Mutual is the issuer of a number of insurance and annuity contracts. These Contracts include traditional ordinary life insurance contracts, universal life insurance contracts, deferred and immediate annuity contracts, conversion fund and deposit administration fund contracts, term life insurance contracts, health insurance contracts, disability income insurance contracts issued or administered by Mutual, and contracts or agreements issued in substitution for or supplementary to any such Contract. The Contracts include contracts described in § 403(b) and individual retirement accounts described in § 408. All contracts in force as of the Closing Date will participate under the Plan as the Plan does not authorize an election to opt out of participation. Each contract in force as of the Closing Date will be modified by Mutual by an endorsement (Endorsed Contract) effective as of the Closing Date but prior to the contract's assumption by Company. The endorsement will (a) remove any provision providing for voting rights; (b) remove any provision providing for participation in divisible surplus through dividends; and, (c) provide for continued compliance with various tax provisions. Existing riders will also be modified through endorsement to remove any provision providing for voting rights or participation in divisible surplus through dividends. Company will assume and reinsure the obligations and rights of Mutual under the Endorsed Contracts with the same effect as if Company had issued the Endorsed Contracts directly.

Additionally, Cash Value Contracts (e.g., traditional ordinary and universal life insurance contracts and deferred annuity contracts) which are in force as of the Closing Date will be modified through one or more endorsements, as follows:

- (i) In lieu of dividends, Cash Value Contracts which do not already have a provision for the payment or application of Non-Guaranteed Elements (e.g., excess interest credits) will be modified to provide that each such Contract may be eligible annually for Non-Guaranteed Elements to be applied as the Contract Holder may select in accordance with the same options as were available for the application of dividends before such modification of the Contract;
- (ii) Each Cash Value Contract will be modified to provide that any policyholder dividend or interest credit which has been declared, but not paid or applied, with respect to such Contract by Mutual prior to the Closing will be converted into a credit to the policy values of such Contract that will be payable or applicable at or after Closing in the same manner and as of the same date that such dividend or interest credit would have been payable or applicable absent this modification.

Under the Plan, claimants' interests are divided into 10 classes. Secured and administrative claims are Class 1 and Class 2. Contract holders will have Class 3 status. Claims of governments, general creditors, employees, debt holders, etc. will be

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classes 4 through 9. Class 10, the residual class, provides for mutual membership interests of Mutual Members (Mutual Member Interest).

Under the Plan, the parties propose to accomplish the items set forth above through the following steps:

- (i) Mutual will transfer substantially all of its assets (tangible and intangible, including securities, bonds, mortgages, and rights in leases, agreements) except for the stock of Group, to Company and Company will assume Mutual's liabilities. The transfer and assumption will be effected by means of an assumption-reinsurance agreement. The approved policies (with associated reserves) will be transferred to Company on the date (Closing Date) state approval is received to transfer at least 85 percent of the policies. Mutual will retain any contracts not approved for transfer to Company by the Closing Date for up to one year (Retained Contracts). Contracts will be transferred to Company as state approval is received. Any Contracts not transferred to Company at the end of one year will be transferred to an unrelated insurance company in an assumption-reinsurance transaction. The proceeds will be transferred to Company. At the Closing Date, Company will enter into an agreement with Mutual through which Company will administer the Retained Contracts on behalf of Mutual. Any additional funds required by Mutual to administer the Retained Contracts will be provided by Company. Any proceeds or profits received from administering the Retained Contracts will benefit Company.
- (ii) Group will issue its stock (common and convertible preferred) to Class 10 Mutual Members in exchange for their Mutual Member Interests. The convertible preferred stock will represent approximately \underline{x} percent of the total value of the Group stock received by each Mutual Member who receives stock. Contract Holders of certain tax-qualified retirement funding contracts who would have impediments to holding stock generally will be entitled to have Plan Credits made to the Contracts instead of receiving stock. Plan Credits are (1) additional paid up insurance with a cash value equal to the Group stock otherwise receivable; or (2) for Contracts which are not traditional life Contracts, credits to their account values. All Mutual Members eligible to receive stock for their Mutual Member Interests will receive stock on the Closing Date (including members whose Contracts are retained by Mutual).
- (iii) An independent party approved by the Court (Investor) will purchase Group common stock from Group so that, immediately after the Closing Date, the Investor will own more than 50 percent of the Group common stock.
- (iv) After the final transfer to Company, Mutual will be liquidated and dissolved.

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The taxpayer has made the following representations in connection with the proposed transaction:

- (a) Company will acquire more than 50 percent of the fair market value of the gross assets held by Mutual as of Date 5, the date the Plan was filed in the Court, and more than 70 percent of the fair market value of the operating assets held by Mutual as of such date. For purposes of this representation, operating assets are all of Mutual's assets, other than cash and accounts receivable; however, assets of Mutual's held on Date 5 that were taken out of operation prior thereto, will not be considered operating assets.
- (b) Prior to Mutual's transfer to Company, Group will be in control of Company within the meaning of § 368(c).
- (c) Following Mutual's transfer to Company, Company has no plan or intention to issue additional shares of its stock that would result in Group losing control of Company within the meaning of § 368(c).
- (d) Mutual Members of Mutual will receive a number of shares of Group stock that have a value, as of the Closing Date, of at least 50 percent of the value of all of the formerly outstanding Mutual Member Interests of Mutual as of the same date. Group (or persons related to Group within the meaning of § 1.368-1(e)(3)) have no plan or intention to redeem or otherwise acquire shares of Group stock issued in the transaction for consideration other than Group stock that would reduce the Mutual Members ownership of Group stock to a number of shares having a value, as of the Closing Date, of less than 50 percent of the value of all of all of the formerly outstanding Mutual Member Interests as of the same date. For purposes of this representation, Mutual Member Interests exchanged for property other than Group stock, surrendered by dissenters, or exchanged for cash in lieu of fractional shares of Group stock in the transaction and Mutual Member interests redeemed during the five year period ending on the Closing Date will be treated as outstanding Mutual Member interests on the Closing Date. No Mutual Member Interests were acquired by persons related to Mutual within the meaning of § 1.368-1(e)(3) for consideration other than Mutual Member Interests or Group Stock, no Mutual Member Interests were acquired by Group (or persons related to Group within the meaning of § 1.368-1(e)(3)), and no extraordinary distributions on Mutual Member Interests were made during the five year period ending on the Closing Date.
- (e) No stock of Company will be issued in the transaction.
- (f) Company has no plan or intention to sell or otherwise dispose of any of the

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assets of Mutual acquired in the transaction, except for dispositions made in the ordinary course of business.

- (g) Mutual will distribute any stock or stock interests and any securities and other property it receives or is deemed to receive in the transaction, and its other properties, in pursuance of the plan of reorganization.
- (h) The liabilities of Mutual assumed by Company and the liabilities of Mutual to which the transferred assets of Mutual are subject were incurred by Mutual in the ordinary course of its business.
- (i) Following Mutual's transfer to Company, Company will continue the historic business of Mutual or use a significant portion of its historic business assets in a business.
- (j) Company, Mutual, Group and the Contract Holders will pay their respective expenses, if any, incurred in connection with the transaction.
- (k) There is no intercorporate indebtedness existing between Company and Mutual that was acquired at a discount, discounted or will be settled at a discount.
- (l) No two parties to the transaction are nondiversified "investment companies" as defined in § 368(a)(2)(F)(iii) and (iv).
- (m) Mutual, Company and Group are under the jurisdiction of a court in a title 11 or similar case within the meaning of § 368(a)(3)(A).
- (n) The total fair market value and the adjusted basis of the assets of Mutual transferred to Company, as to the transfer on the Closing Date and the final transfer, if any, after the Closing Date, will equal or exceed the sum of the liabilities of Mutual assumed by Company, plus the amount of liabilities of Mutual, if any, to which the transferred assets are subject. In making this representation, the liabilities assumed plus the liabilities taken subject to include any Mutual liabilities forgiven in the transaction.
- (o) The fair market value of the Group stock received by the Mutual Members for their Mutual Member Interests will approximately equal the fair market value, as of the Closing Date, of the Mutual Member Interests surrendered in exchange therefor.
- (p) Investor will not be a related person to Group within the meaning of § 1.368-1(e)(iii).

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- (q) The Closing Date, as defined in the Plan, will constitute the "date of transfer" within the meaning of § 1.381(b)-1(b)(2).

Based solely on the information submitted and the representations set forth above, we hold as follows:

- (1) For federal income tax purposes, the transaction described above will be treated as a transfer by Mutual to Company of substantially all of its assets in exchange for stock of Group and the assumption by Company of Mutual liabilities and a transfer of the Group stock by Mutual to the Contract Holders in exchange for their Mutual Member Interests in Mutual. The transfer by Mutual to Company of substantially all of its assets in exchange for the stock of Group and the assumption by Company of liabilities of Mutual will constitute a reorganization within the meaning of § 368(a)(1)(G) and (a)(2)(D). Mutual, Company and Group will each be "a party to a reorganization" within the meaning of § 368(b).
- (2) No gain or loss will be recognized by Company upon the receipt of assets from Mutual in exchange for Group stock and the assumption by Company of liabilities of Mutual (§ 1032-2(b)).
- (3) The basis of the assets of Mutual in the hands of Company will be, in each instance, the same as the basis of such assets in the hands of Mutual immediately prior to the exchange (§ 362(b)).
- (4) Company's holding period for the assets received from Mutual will include, in each instance, the holding period of those assets in the hands of Mutual immediately prior to the exchange (§ 1223(2)).
- (5) Mutual will recognize no gain or loss on the transfer of substantially all of its assets to Company in exchange solely for Group stock and the assumption by Company of liabilities of Mutual (§§ 361(a) and 357(a)).
- (6) Mutual will recognize no gain or loss on the transfer of Group stock to Mutual Members in exchange for their Mutual Member Interests (§ 361(c)).
- (7) Mutual Members will recognize no gain or loss on the receipt of the Group stock in exchange for their Mutual Member Interests in Mutual (§ 354(a)).
- (8) The basis of the Mutual Member Interests of a Mutual Member is zero. The basis of the Group stock received in exchange for the Mutual Member Interests will equal the basis of the Mutual Member Interests exchanged therefor (i.e., zero) (§ 358(a)(1)).

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- (9) The holding period of the Group stock received in exchange for the Mutual Member Interests will include the period the Mutual Member held such Mutual Member Interests provided that such interest is a capital asset in the hands of the member (§ 1223(1)).
- (10) The Group preferred stock will not be "section 306 stock" within the meaning of § 306(c).
- (11) The reorganization between Mutual and Company under the Plan will be a transfer of assets to a subsidiary within the meaning of § 1.1502-75(d)(2)(ii) so that the consummation of the reorganization will not terminate the Mutual consolidated group. The Mutual consolidated group will continue in existence for consolidated return purposes, with Group becoming the new common parent on the Closing Date and Mutual remaining a member of such consolidated group. The election to file a life-nonlife consolidated return under § 1504(c)(2) will remain in effect. In addition, § 1.1502-47(d)(12)(ii) through (iv) will apply by treating Group as if it were also the previous common parent of the Mutual consolidated group. Company will be treated as having been a member of the group for purposes of determining the five-year base period described in §§ 1504(c)(2)(A) and 1.1502-47(d)(12)(ii). Accordingly, all members of the Mutual consolidated group on the Closing Date will determine their status as eligible corporations under § 1.1502-47(d)(12) as if there were no transaction (§ 1.1502-47(d)(12)(vi)).
- (12) Mutual will not close its taxable year on the Closing Date. All taxable years of Mutual ending on or before the Closing Date will be treated as taxable years of Company (§ 1.1502-75(d)(2)(iii)).
- (13) Company will close its taxable year on the Closing Date. All taxable years of Company ending on or before the Closing Date will be treated as taxable years of Mutual (§ 1.1502-75(d)(2)(iii)).
- (14) Mutual's transfer of substantially all of its assets to Company in exchange for Group stock and Company's assumption of Mutual liabilities is a group structure change for purposes of applying §§ 1.1502-31 and 1.1502-33(f) (§ 1.1502-33(f)(1)). Group's basis in Company is adjusted immediately after the group structure change to reflect Mutual's net asset basis as determined under § 1.1502-31(c) (§ 1.1502-31(b)(1)). See § 1.1502-31(d) for additional adjustments.
- (15) Group's earnings and profits will be adjusted immediately after Group becomes the new common parent of the Mutual consolidated group to reflect the earnings and profits of Mutual immediately after Mutual ceases to be the common parent.

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The adjustment will be made as if Group succeeds to the earnings and profits of Mutual in a transaction described in § 381 (§ 1.1502-33(f)(1)).

- (16) As provided by § 381(c)(2) and § 1.381(c)(2)-1, Company will succeed to and take into account the earnings and profits, or deficit in earnings and profits, of Mutual as of the Closing Date. Any deficit in earnings and profits of either Mutual or Company will be used only to offset the earnings and profits accumulated after the Closing Date.
- (17) As provided by § 381(a) of the Code and § 1.381(a)(1) of the regulations, and subject to the conditions and limitations specified in § 381(b) and (c), and §§ 382, 383, and 384, Company will succeed and take into account as of the close of the date of transfer (within the meaning of § 1.381(b)-1(b)(2)), the items and tax attributes of Mutual described in § 1.381(c)(22)-1, inter alia, the reserves described in § 807 (former § 810) transferred to Company as of the close of the date of transfer in accordance with the provisions of § 381(c)(4) and the regulations thereunder.
- (18) Subject to rulings (12) and (13) pursuant to the reorganization, (i) for purposes of §§ 807(a) and (b) of the Code, Mutual will include in its reserves at the close of the taxable year which includes the date of transfer the ending balance of the reserves described in § 807(c) that Mutual held immediately before the transfer; (ii) Mutual will not be entitled to a deduction under § 805(a)(6) for transferring assets to Company as consideration for the assumption by Company of liabilities under Mutual's insurance contracts; and, (iii) Mutual will not include in its reserves at the beginning of the first taxable year immediately following the taxable year that includes the date of transfer the ending balances of the reserves described in § 807(c) that Mutual held immediately before the transfer (other than the reserves with respect to Contracts not transferred to Company on the date of transfer). With respect to any contract not transferred to Company on the date of transfer but transferred to Company, pursuant to the reorganization, thereafter, Mutual will not be entitled to a deduction under § 805(a)(6) for transferring assets to Company as consideration for the assumption by Company of liabilities under such contract, and for purposes of §§ 807(a) and (b), (i) Mutual will include a reserve with respect to any such Contract in its reserves at the close of the taxable year that includes such transfer, and (ii) Mutual will not include a reserve with respect to any such Contract in its reserves at the beginning of the first taxable year immediately following the taxable year that includes such transfer.
- (19) Subject to rulings (12) and (13), at the beginning of its first taxable year beginning after the date of transfer, pursuant to the reorganization, Company will include in its reserves at the beginning of such year, for purposes of §§ 807(a)

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and (b), the ending balance of the reserves described in § 807(c) that Mutual held immediately before the transfer (other than reserves with respect to Contracts not transferred to Company on the date of transfer). With respect to any Contract not transferred to Company on the date of transfer but transferred to Company, pursuant to the reorganization, thereafter, for purposes of §§ 807(a) and (b), Company will include a reserve with respect to any such Contract in its reserves at the beginning of the taxable year that includes such transfer. Company will not take into premium income under § 803(a)(1) any amount with respect to Mutual's assets transferred to Company, pursuant to the reorganization.

- (20) Mutual will not be entitled to reduce its net premiums under § 848(d)(1) for the transfer of assets to Company in consideration of the assumption by Company of liabilities under Mutual's specified insurance contracts (within the meaning of § 848(e)). Company will not include in net premiums under § 848(d)(1) any amount with respect to Mutual's assets transferred to Company in consideration for the assumption by Company of liabilities under Mutual's specified insurance contracts (within the meaning of § 848(e)). Under § 381(c)(22), for the first taxable year beginning after the date of transfer, Company will succeed to any capitalized balances of specified policy acquisition expenses (within the meaning of § 848(c)(1)) as determined by Mutual under § 848(a) as of the close of the Closing Date and such balances will be continued to be amortized by Company under Mutual's amortization period.
- (21) The assumption reinsurance transaction between Mutual and Company, pursuant to which Company will assume the Contracts held by Contract Holders after they are modified by endorsement in Mutual on the Closing Date, will, if such transaction does not change the terms and conditions of any Contract after such modification by endorsement (other than the insurer): (i) not have any effect on the date that such Contract was issued, entered into, or purchased (prior to such modification by endorsement) for purposes of §§ 72, 101(f), 264, 7702 or 7702A; and (ii) not require retesting or the start of a new test period for such Contract under §§ 264(c)(1), 7702(f)(7)(B)-(E), or 7702A(c). As a result, the investment in the Contract under § 72 for such Contract immediately after the assumption reinsurance transaction will remain the same as it was for such Contract immediately prior to such modification by endorsement.

The following rulings are valid only if the plans described are tax-sheltered annuity plans that meet the requirements of § 403(a) and (b), or IRA's that meet the requirements of § 408(a) or 408(b).

- (22) Neither the addition of a Plan Credit nor the right thereto constitutes a distribution in violation of § 403(a) or 403(b)(11) or otherwise disqualifies a tax-

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sheltered annuity arrangement under § 403(b).

- (23) The addition of a Plan Credit to a Non-Trusteed Tax-Qualified Retirement Funding Contract does not constitute a distribution thereunder nor a contribution thereto, and thus will not result in (a) any gross income to the employee or other beneficiary of such contract as a distribution from a qualified retirement plan under § 72, prior to an actual receipt of some amount thereof by such employee or beneficiary, (b) any 10 percent additional penalty tax under § 72(t) for premature distributions from a qualified retirement plan, (c) any 6 percent or 10 percent excise tax under § 4973 or § 4979 for excess contributions to certain qualified retirement plans, or (d) any designated distribution under § 3405(e)(1)(A) that is subject to withholding under § 3405(b) or (c).
- (24) For purposes of determining the investment in the contract under § 72 for a Non-Trusteed Tax-Qualified Retirement Funding Contract, a Plan Credit will not be taken into account.
- (25) For minimum distribution requirements under §§ 401(a)(9), 403(b)(10), 408(a)(6) or § 408(b)(3), a Plan Credit will constitute investment earnings attributable to the year in which it is added to the account value for a Non-Trusteed Tax-Qualified Retirement Funding Contract.
- (26) For purposes of the § 403(b)(11) restrictions on distributions attributable to contributions under salary reduction arrangements and the income thereon, a pro rata portion of a Plan Credit added to a tax-sheltered annuity contract described in § 403(b) to which such contributions have been made constitutes earnings attributable to such contributions for the year in which such Plan Credit is added.

We express no opinion about the tax treatment of the proposed transaction under other provisions of the Code and regulations or about 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.

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

Each affected taxpayer must attach a copy of this letter to the taxpayer's federal income tax returns for the tax year in which the transaction covered by this ruling letter is consummated.

We are sending a copy of this letter to Deputy Insurance Commissioner as specified in the power of attorney on file in this office.

Sincerely yours,

Assistant Chief Counsel (Corporate)

By Victor L. Penico

Victor L. Penico
Branch Chief, Branch 3