

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

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Refer Reply To:
CC:CORP:B03-PLR-168115-01
Date:
June 5, 2002

Re:

Corporation =

Subsidiary =

State A =

b =

Business C =

State Agency =

Year 1 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

\$x =

\$y =

\$z =

Dear

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We respond to your request dated December 10, 2001, for rulings about the Federal income tax consequences of a proposed transaction. Additional information was provided in a letter dated April 4, 2002. The information submitted for consideration is summarized below.

Corporation is a State A nonprofit membership organization whose approximately b members are primarily involved in Business C. Corporation is a holding company and owns all of Subsidiary's outstanding shares of stock. Subsidiary is a State A corporation that was organized to assist Corporation's members in obtaining affordable insurance coverage and whose business is to act as a reinsurer of Corporation's members' primary insurers.

Due to changes in market conditions, Subsidiary has not written insurance policies or engaged in any business activity since Year 1, although claims have been filed annually on policies previously issued by Subsidiary. Subsidiary's assets currently consist almost entirely of cash or cash equivalents. Corporation has decided to liquidate Subsidiary because the business purpose underlying Subsidiary's creation no longer exists, Subsidiary has not engaged in any business activities since Year 1, and Corporation has been unsuccessful in finding another insurance carrier to assume Subsidiary's liabilities.

Subsidiary is regulated by State Agency. State Agency will not allow Corporation to distribute any amounts to its members, including any liquidating distributions it receives from Subsidiary, unless the distributions are made in complete dissolution of Corporation. On Date 3, Corporation's board of directors and members approved a plan of liquidation for Subsidiary and Corporation ("Plan of Liquidation"). Pursuant to the Plan of Liquidation, all of Subsidiary's assets will be distributed to Corporation. Corporation will file articles of dissolution with State A and will then distribute all of its assets to its members.

However, because Subsidiary still faces the possibility of processing claims that have not yet been asserted, State Agency will not allow Corporation to completely dissolve Subsidiary and requires that Subsidiary retain a portion of its assets until such time State Agency is satisfied no other claims will be forthcoming. On Date 1, Subsidiary requested the permission of State Agency to distribute \$x to Corporation, which is approximately half the total value of all of Subsidiary's assets, \$y. State Agency refused to allow Subsidiary to distribute \$x, but did approve a distribution of \$z, or about one third the total value of all of Subsidiary's assets, \$y. Subsidiary made a liquidating distribution of \$z to Corporation on Date 2, and, having adopted a Plan of Liquidation on Date 3, Corporation proposes to distribute this amount to its members on or about Date 4.

With respect to the Plan of Liquidation, Corporation and Subsidiary have made the following representations:

- (a) On the date Corporation adopted the Plan of Liquidation, Corporation owned all of Subsidiary's issued and outstanding shares of common stock and will continue to own any of Subsidiary's issued and outstanding shares

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of common stock through the date Subsidiary is subsequently dissolved.

- (b) None of Subsidiary's shares have been redeemed within the three years preceding the date the Plan of Liquidation was adopted.
- (c) Subsidiary's assets consist almost entirely of cash and cash equivalents.
- (d) Subsidiary substantially terminated its business activities in Year 1.
- (e) In carrying out the Plan of Liquidation, Subsidiary will: (a) transfer the maximum amount of assets to Corporation the State Agency permits on the time table the State Agency allows and (b) retain only those assets for the minimum period that the State Agency requires.
- (f) Subsidiary will not engage in any activities after the Plan of Liquidation is implemented other than paying claims submitted by Subsidiary's primary insurer, as appropriate, and winding up its affairs.
- (g) The principal assets Subsidiary will hold after the Plan of Liquidation is implemented are cash and cash equivalents in an amount the State Agency requires Subsidiary to retain.
- (h) After the Plan of Liquidation is implemented, Subsidiary expects to earn only nominal amounts of income in the form of investment income to preserve the assets the State Agency requires it to retain.
- (i) Subsidiary will not invest its retained cash with the expectation or goal of earning substantial investment income.
- (j) After the Plan of Liquidation is implemented, Subsidiary will not bear any expenses other than payments on future claims and administrative expenses associated with Subsidiary's required existence.
- (k) Subsidiary will not benefit financially from or be burdened financially by the prosecution or defense of any lawsuits or legal claims following its liquidation other than the possible payment of yet unasserted claims.
- (l) Subsidiary's liquidation was not preceded and will not be followed by a reincorporation in, or a transfer or sale to, a recipient corporation of any of Subsidiary's assets or business where persons owning more than 20 percent in value of Subsidiary's stock own more than 20 percent in value of the stock of the recipient. For the purposes of this representation, ownership will be determined by application of the constructive ownership rules of § 318 of the Internal Revenue Code as in effect on the date the ruling is issued, as modified by § 304(c)(3).

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- (m) Subsidiary did not distribute any assets in kind or sell any assets to Corporation during the three years preceding the date the Plan of Liquidation was adopted.
- (n) Subsidiary will report all earned income represented by assets distributed to Corporation.
- (o) The fair market value of Subsidiary's assets exceeded its liabilities on the date the Plan of Liquidation was adopted and will continue to exceed its liabilities at the time any liquidating distributions are made.
- (p) Any indebtedness between Subsidiary and Corporation will be settled and not canceled, forgiven, or discounted in connection with the transaction.
- (q) There has not been any indebtedness between Subsidiary and Corporation canceled or forgiven within the three years preceding the date the Plan of Liquidation was adopted.
- (r) Corporation's liquidation is intended to be in furtherance of its complete dissolution.
- (s) Corporation's assets consist almost entirely of Subsidiary stock, cash and cash equivalents.
- (t) After the Plan of Liquidation is adopted, Corporation will cease to be a going concern, and Corporation's activities will be limited to the winding down of its affairs, paying its debts, and distributing its remaining assets to its members.
- (u) Any liquidating distribution a Corporation member receives will be toward the complete termination of the member's interest in Corporation and not as a debtor, creditor, or employee of Corporation.
- (v) Prior to the liquidation, neither Corporation nor Subsidiary will purchase any property in anticipation of the proposed liquidations.
- (w) Corporation's members will not lend any property to Corporation.
- (x) Any distributions Corporation pays will be in furtherance of its liquidation.
- (y) Corporation's members do not intend to reincorporate all or any part of the assets Corporation distributes to them nor do they intend to sell any asset, or contribute any cash Corporation distributes, to a corporation in which the members own more than 20 percent in value of the outstanding stock.

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- (z) Prior to the Plan of Liquidation's adoption, no Corporation member purchased a Corporation membership from another Corporation member in anticipation of the proposed liquidation.
- (aa) There are and will be at the time the Plan of Liquidation is implemented, no loans outstanding between the Corporation members as creditor and Corporation as debtor.
- (bb) The fair market value of Corporation's assets will exceed Corporation's liabilities and the liabilities to which its assets are subject on the date the Plan of Liquidation is implemented through the date the final liquidating distribution is made.
- (cc) There are no loans outstanding between Corporation as creditor and any of its members as debtors and there will be none on the date the Plan of Liquidation is implemented through the date the final liquidating distribution is made.

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

- (1) A person that is a member of Corporation on the date the Plan of Liquidation was adopted will be a "qualifying shareholder" within the meaning of § 1.453-11(b) of the Income Tax Regulations.
- (2) Each distribution Corporation makes to its members with respect to their membership interests after the Plan of Liquidation is adopted and ratified by its members will be treated as payment in exchange for the members' interests under § 331(a) rather than a distribution in respect of those interests. Accordingly, a member will recognize gain or loss to the extent of the difference between (a) the sum of the amount of cash received and the fair market value of the other property received and (b) their respective adjusted basis in their Corporation shares as provided by § 1001. Each of the series of distributions will be applied first in reduction of a member's basis in its shares and capital gain will be recognized after an amount equal to the member's adjusted basis has been fully recovered.

Except as expressly provided herein, no opinion is expressed or implied concerning the Federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express no opinion on the Federal tax consequences of the proposed liquidation of Subsidiary.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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It is important that a copy of this letter be attached to the Federal income tax returns of the taxpayers involved for the taxable year in which the transactions covered by this letter are consummated and to any income tax return to which it is relevant.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

Sincerely yours,

Filiz A. Serbes

Filiz A. Serbes
Chief, Branch 3
Office of Associate Chief Counsel
(Corporate)