

Internal Revenue Service

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LEGEND:

Target =

Mutual Holding =

Stock Holding =

Stock Holding 2 =

State A =

State B =

Year 1 =

This letter is in reply to a letter dated May 8, 1998, and supplemental correspondence, regarding the federal income tax consequences of a proposed transaction. Specifically, a ruling is requested that the conversion of a mutual insurance company to a stock insurance company will qualify under § 368(a)(1)(E) of the Internal Revenue Code (the "Code"). Additional information was received in letters dated May 26, 1998, June 29, 1998, June 30, 1998, October 27, 1998, and January 21, 1999.

The information submitted indicates that Target is a mutual insurance company organized under State A law. For federal tax purposes, Target is a life insurance company taxable under §

816 of the Code and is an accrual basis calendar-year taxpayer. Target is the parent of an affiliated group of corporations filing life-nonlife consolidated returns pursuant to an election under § 1504(c)(2) of the Code. Target has outstanding policies that are held as part of, or in connection with, tax-qualified retirement plans described in § 403(b) of the Code (§ 403(b) plan contract) and § 408(b) of the Code.

As a mutual company, Target has no capital stock. It is indicated that the policyholders of Target own the membership interest in Target. These policyholders of Target ("Target Members") have membership interests in Target conferred by State A law and Target's corporate charter and By-laws. The membership interests include voting rights, the right to receive from Target distributions of surplus that have not been apportioned or declared for policyholder dividends, and such other rights as are provided in Target's Articles of Incorporation, By-laws and under State A law. Membership interests do not include any other right conferred by the terms of any insurance policy or contract issued by Target. The rights continue only as long as the Target Member's related policy remains in force.

Mutual Holding is a State A corporation formed by a nominee of Target, and is to be included in Target's Year 1 consolidated return. Mutual Holding is not authorized to engage in the business of insurance and is not authorized to issue capital stock. Membership in Mutual Holding is limited to persons who prior to the conversion are Target Members and those persons issued certain policies by Target after the effective date of the described transactions (collectively, "Mutual Holding Members"). Under State A law, Mutual Holding Members have rights comparable to the interests they had as Target Members. However, Mutual Holding Members do not have the right to any distributions from Mutual Holding other than liquidating distributions. The corporate charter of Mutual Holding provides that Mutual Holding shall not pay dividends or make other distributions or payments of income or profits, except as authorized by the Insurance Commissioner of State A.

Stock Holding is a State B corporation formed by a nominee of Target, and Mutual Holding will initially own all of the outstanding stock of Stock Holding. Stock Holding 2 is a State B corporation authorized to issue two classes of common stock, Class A and Class B. Apart from voting rights, the two classes of stock will be identical. The Class A shares have one vote per share and the Class B shares have two votes per share. Stock Holding will initially own all of the outstanding Stock Holding 2 shares, which consists solely of Class B shares. The Class A shares of Stock Holding 2 may be offered to the public in the future. Both Stock Holding and Stock Holding 2 are to be included in Target's Year 1 consolidated return.

The Insurance Commissioner of State A will retain regulatory jurisdiction over Mutual Holding in order to assure that policyholder interests are protected.

For what are represented as valid business reasons, Target has decided to convert from a mutual life insurance company to a stock life insurance company controlled indirectly by a mutual holding company. Accordingly, Target proposes the following:

(i) A nominee of Target organized Mutual Holding, Stock Holding and Stock Holding 2.

(ii) On the effective date, Target will convert under State A law into a stock insurance company (the "Conversion"). The rights of Target Members will be extinguished and the Members will automatically become Mutual Holding Members and receive the Mutual Holding rights described above. Target Members will receive no consideration in the Conversion other than rights in Mutual Holding. Existing Target insurance policies and annuity policies will not change except for minor conforming changes, such as changing Target's name as issuer of the policy. Target will change its name with the consent of the State A authorities. The Conversion will not, in any way, increase or decrease premiums, policy benefits, policy values, policy guarantees or other obligations to Target policyholders.

(iii) On the effective date, Target will initially issue all of its shares to Mutual Holding. Mutual Holding will then transfer its Target shares to Stock Holding, who will transfer its Target shares to Stock Holding 2.

You have requested a ruling that the conversion of Target from a mutual company to a stock company be treated as the transfer of the membership interest in Target by the Target Members for all of the outstanding stock in Target. Additionally, you request that the creation of the mutual holding company structure should be treated as (i) the transfer of the Target stock by the Target Members to Mutual Holding in exchange for membership interest in Mutual Holding; (ii) the transfer of the Target stock by Mutual Holding to Stock Holding in exchange for all of the outstanding stock of Stock Holding; and (iii) the transfer of the Target stock by Stock Holding to Stock Holding 2 in exchange for all of the outstanding stock of Stock Holding 2.

Pursuant to § 3.01(22) of Rev. Proc. 98-3, 1998-1 I.R.B. 102-3, the Service will not rule on the application of § 351 of the Code to an exchange of stock in the formation of a holding company. However, the Service has the discretion to rule on significant subissues that must be resolved to determine whether the transaction qualifies under § 351 of the Code. The Service will only rule on such subissues if they are significant and not clearly addressed by a statute, regulation, decision of the Supreme Court, tax treaty, revenue ruling, revenue procedure, notice, or other authority published in the Internal Revenue Bulletin.

Target has represented that, to the best of its knowledge and belief, the deemed transfer of Target's stock by Target Members to Mutual Holding in exchange for a Mutual Holding membership interest constitutes a transfer of property in exchange for stock, described in § 351(a) of the Code.

With regard to the transaction, the taxpayer has made the following representations:

(a) The fair market value of the Target stock treated as constructively received by the Target Members will approximately equal the fair market value of the Target membership interests surrendered in the exchange.

(b) The recapitalization is not part of a plan to increase periodically the proportionate interest of any owner in the assets or earnings and profits of Target.

(c) Following the Conversion, Target will continue as a stock company the same business that it had conducted prior to the Conversion.

(d) Each party to the Conversion will pay its, his or her own expenses, if any, in connection with the Conversion.

(e) The Conversion will occur under a plan agreed upon before the transaction is implemented.

(f) Following its Conversion into a stock company, Target will be treated under State A law as the same corporation that previously existed as a mutual company.

(g) Target will not treat the issuance of any Target stock in the recapitalization as the payment of a deductible policyholder dividend within the meaning of § 808 of the Code.

(h) Immediately after the transaction, Mutual Holding and its direct and indirect subsidiaries will continue to own substantially all of the assets that were held by Target and its direct and indirect subsidiaries prior to the transaction.

(i) For the five taxable years of Target preceding the 1998 taxable year, Target (i) was in existence and was a member of the affiliated group of which Target was the common parent; (ii) was engaged in the active conduct of the insurance business; (iii) did not experience a change in tax character within the meaning of § 1.1502-47(d)(12)(vii) of the regulations; and (iv) did not undergo a disproportionate asset acquisition within the meaning of § 1.1502-47(d)(12)(viii) of the regulations.

(j) Target is not under the jurisdiction of a court in a Title 11 or similar proceeding within the meaning of § 368(a)(3)(A) of the Code.

Based solely on the information submitted and the representations made, we hold that:

(1) The proposed transaction described above will be treated as: (i) the Target Members exchange their membership interests in Target for stock in Target; (ii) those target Members subsequently contribute the Target stock to Mutual Holding in exchange for a membership interest in Mutual Holding; (iii) Mutual Holding contributes the Target stock to Stock Holding in exchange for stock in Stock Holding; and (iv) Stock Holding contributes the Target stock to Stock Holding 2 in exchange for stock in Stock Holding 2.

(2) The Conversion of Target from a mutual insurance company to a stock insurance company and the constructive exchange of Target membership interests for Target stock will

constitute a recapitalization and, therefore, qualify as a reorganization within the meaning of § 368(a)(1)(E) of the Code. Target will be "a party to a reorganization" within the meaning of § 368(b) of the Code.

(3) No gain or loss will be recognized by the Target Members on their constructive exchange of Target membership interests for Target stock. See, § 354(a)(1) of the Code.

(4) The basis of a Target membership interest is zero (Rev. Rul. 71-233, 1971-1 C.B. 113; Rev. Rul. 74-277, 1974-1 C.B. 88). The basis of the Target stock constructively received in exchange for a Target membership interest will equal the basis of the Target membership interest surrendered therefor. See, § 358(a)(1) of the Code.

(5) The holding period of the Target stock constructively received in exchange for a Target membership interest will include the period the owner held such Target membership interest. See, § 1223(1) of the Code.

(6) No gain or loss will be recognized by Target on its constructive issuance of Target stock in exchange for Target membership interests. See, § 1032(a) of the Code.

(7) The proprietary rights received by Mutual Holding Members in exchange for their ownership in Target will be treated as stock within the meaning of § 351(a) of the Code (Rev. Rul. 69-3, 1969-1 C.B. 103).

(8) The affiliated group of which Target was the common parent immediately before the proposed transaction will remain in existence with Mutual Holding as the new common parent. Any prior election to file a life-nonlife consolidated federal income tax return under § 1504(c)(2) of the Code will remain in effect. See, § 1.1502-47(d)(12)(vi) and § 1.1502-75(d)(2)(ii); and Rev. Rul. 82-152, 1982-2 C.B. 205. Treas. Reg. 1.1502-47(d)(12)(ii)-(iv) will apply by treating Mutual Holding as if it were the previous common parent of the Target affiliated group. Mutual Holding 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) of the Code and § 1.1502-47(d)(12)(ii). Accordingly, all members of the Target affiliated group on the effective date will determine their status as eligible corporations under § 1.1502-47(d)(12). See, § 1.1502-47(d)(12)(vi).

(9) For purposes of § 1.1502-31 and § 1.1502-33, the proposed transaction will qualify as a "group structure change" (under § 1.1502-75(d)(2) and/or (3)). Mutual Holding's basis in the Target's stock immediately after the group structure change will be Target's net asset basis as determined under § 1.1502-31(c), subject to the adjustments described in § 1.1502-31(d). See, § 1.1502-31(b)(2). The earnings and profits of Mutual Holding, Stock Holding, and Stock Holding 2 will each be adjusted immediately after Mutual Holding becomes the new common parent to reflect the earnings and profits of Target immediately before Target ceases to be the common parent. See, § 1.1502-33(f).

(10) The Conversion by Target will have no effect on the date each life insurance or annuity contract of Target was issued, entered into, purchased or came into existence for purposes of §§ 72(e)(4), 72(e)(5), 72(e)(10), 72(e)(11), 72(q), 72(s), 72(u), 72(v), 101(f), 264(a)(1), 264(a)(3), 264(a)(4), 264(f), 7702 and 7702A of the Code. Moreover, the conversion will not require retesting or the starting of new test periods for the contracts §§ 264(c)(1), 7702(f)(7)(B)-(E), and 7702A(c)(3)(A).

(11) The Conversion by Target will have no effect on each life insurance or annuity contract of Target for purposes of §§ 72(e)(4), 72(e)(5), 72(e)(10), 72(e)(11), 72(q), 72(s), 72(u), 72(v), 401, 402, 403, 408, and 408A of the Code.

(12) The proposed reorganization transaction pursuant to the plan will not cause an actual or deemed distribution under § 403(b)(11) or otherwise disqualify a § 403(b) plan contract.

(13) The proposed transaction will not constitute, with respect to policies issued by the taxpayer prior to the effective date of the reorganization and that are tax qualified under §§ 401(a), 403(b), or 408(b), a distribution from or a contribution to any of these policies, plans or arrangements for federal income tax purposes, although as discussed below, no specific ruling is being issued with regard to § 408(e).

Although the plan will not otherwise cause an IRA to lose its status under § 408, we decline to rule under § 408(e) since it is within the Department of Labor's jurisdiction. See, § 102(a) of the Reorganization Plan Number 4 of 1978, 43 Fed Reg. 47713 (October 17, 1978), which generally provides that the authority to issue rulings under § 4975 (the Code section relating to prohibited transactions) is transferred from the Secretary of the Treasury to the Secretary of Labor.

(14) The proposed transaction will not result in any transaction that constitutes a distribution and thus will not result in (a) gross income to the employee or other beneficiary of a contract as a distribution from a qualified retirement under §§ 72, 402, 403, 408, or 408A (except as provided above with regard to section 408(e)) of the Code; (b) a 10% or 25% additional income tax on early distributions from a qualified retirement plan under § 72(t); (c) a 6% or 10% excise tax under § 4973 or § 4979 for excess contributions to certain a qualified retirement plan; or (d) a designated distribution within the meaning of § 3405(e)(1)(A) that is subject to federal income tax withholding under § 3405(b) or (c).

The rulings contained in this letter are predicated upon information and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by the appropriate party. This office has not verified any of the material submitted in support of the ruling request. Verification of the factual information and other data may be required as part of the audit process. We express no opinion about the tax treatment of the transaction under other provisions of the Code or Income Tax Regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered

by the above rulings. In particular, we express no opinion, other than those above, about whether the contributions (as described above) of Target stock to Mutual Holding, Stock Holding and Stock Holding 2 will each qualify under § 351(a) of the Code.

Our ruling that the Conversion constitutes a reorganization within the meaning of § 368(a)(1)(E) of the Code is conditioned on Target being considered the same entity before and after the Conversion under State A law.

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

A copy of this letter should be attached to the federal income tax return of Target and Mutual Holding for the taxable year in which the transaction covered by this ruling letter is consummated.

Pursuant to a power of attorney on file in this office a copy of this letter is being sent to your Authorized Representative.

Sincerely yours,
Assistant Chief Counsel (Corporate)

By: Lewis K. Brickates

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