

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
CC:CORP:1 PLR-162244-01
Date:
March 15, 2002

Mutual Company =

Stock Company =

Mutual Holding Company =

Stock Holding Company =

State A =

Dear :

This letter responds to your letter dated November 8, 2001, which requests rulings on certain Federal income tax consequences of a proposed transaction. Additional information was submitted in letters dated December 4, 2001, and February 22, 2002. The information submitted for our review is summarized below.

Mutual Company, a State A mutual insurance company, offers a wide array of property and casualty insurance products. Mutual Company has no capital stock and is controlled by its policyholders, who have membership interests in Mutual Company. These membership interests possess voting rights and liquidation rights as well as certain other rights conferred by State A law and Mutual Company's articles of incorporation and bylaws. The policyholder members also have certain contractual rights under the terms of their policies.

Mutual Holding Company will be a State A corporation formed for the purposes of the proposed transaction. Mutual Holding Company will not be authorized to engage in the business of insurance or to issue capital stock. Membership in Mutual Holding Company will be limited to persons who are members of Mutual Company prior to the conversion described below (the "Conversion") and persons holding or issued Mutual Company insurance policies after the Conversion. Under State A law, members of Mutual Holding Company will have rights comparable to the rights they held as

members of Mutual Company, including, among other things, voting rights and liquidation rights in Mutual Holding Company.

Stock Holding Company will be a State A stock company formed for the purposes of the proposed transaction. Stock Holding Company will be authorized to issue two classes of voting common stock (Class A and Class B). The Class A shares will have one vote per share and the Class B shares will have five votes per share.

For what is represented to be valid business reasons, Mutual Company proposes to convert from a mutual insurance company to a stock insurance company controlled indirectly by Mutual Holding Company. The Conversion will be effected pursuant to the following steps:

- (1) Mutual Company or a nominee acting on its behalf will form Mutual Holding Company.
- (2) Mutual Holding Company or a nominee acting on its behalf will form Stock Holding Company.
- (3) Pursuant to State A law, Mutual Company will convert into and become a stock property and casualty insurance company by amending its articles of incorporation to, among other things, change its name to Stock Company and authorize the issuance of capital stock. The membership interests in Mutual Company will automatically become membership interests in Mutual Holding Company, and all membership interests in Mutual Company will be extinguished. Every Mutual Company (hereinafter sometimes referred to as "Stock Company") insurance policy that is in force immediately prior to the Conversion will continue as a policy of Stock Company after the Conversion, and all contract rights of such policies will be as they existed immediately prior to the Conversion.
- (4) Stock Company will issue all of its initial shares of stock to Mutual Holding Company.
- (5) Mutual Holding Company will transfer all of the shares of Stock Company to Stock Holding Company in exchange for all of Stock Holding Company's Class B stock.

The taxpayer has requested that the Conversion be treated as (i) an exchange by the Mutual Company members of their membership interests in Mutual Company for stock of Stock Company (the "Deemed Recapitalization"), (ii) the transfer of the Stock Company stock by the former members of Mutual Company to Mutual Holding Company in exchange for membership interests in Mutual Holding Company, and (iii) the transfer of the Stock Company stock by Mutual Holding Company to Stock Holding Company in exchange for all of the Class B stock of Stock Holding Company.

Pursuant to section 3.01(29) of Rev. Proc. 2001-3, 2001-1 I.R.B. 111, the Service will not rule on whether a transaction qualifies for tax-free treatment under § 351 of the Internal Revenue Code. The Service, however, has the discretion to rule on significant subissues that must be resolved in order to determine whether the transaction qualifies under § 351.

The following representations have been made with respect to the Conversion:

- (a) The deemed exchange by the former Mutual Company members of their Stock Company stock for membership interests in Mutual Holding Company and the exchange by Mutual Holding Company of its Stock Company stock for all the Class B stock of Stock Holding Company will each qualify for tax-free treatment under § 351.
- (b) Each party to the Conversion will pay its, his or her own expenses, if any, in connection with the Conversion.
- (c) The Conversion will occur under a plan agreed upon before the transaction.
- (d) Mutual Company is not under the jurisdiction of a court in a Title 11 or similar case within the meaning of § 368(a)(3)(A).
- (e) Immediately after the proposed transaction, Mutual Holding Company, Stock Holding Company, and Stock Company will continue to own substantially all of the assets Mutual Company held prior to the Conversion.
- (f) Mutual Holding Company, Stock Holding Company, and Stock Company do not have any plan to redeem or otherwise reacquire any of the Stock Company stock issued in the transaction.
- (g) The fair market value of the Stock Company stock deemed received by the former Mutual Company members in the Deemed Recapitalization will be approximately equal to the fair market value of the Mutual Company membership interests deemed surrendered in exchange therefor.
- (h) The Conversion is not part of a plan to increase periodically the proportionate interest of any member in the assets or earnings and profits of Stock Company.
- (i) Stock Company will not transfer § 306 stock, within the meaning of § 306(c), to any person in connection with the Conversion.
- (j) Following the Conversion, Stock Company will continue in the same business that Mutual Company conducted prior to the Conversion and, under State A law,

Stock Company will be treated as the same corporation that existed as Mutual Company prior to the Conversion

- (k) The former Mutual Company members will not retain any rights in the Mutual Company membership interests they surrendered in the Deemed Recapitalization.
- (l) The Conversion will not result in any fractional share interests in Stock Company.

Based solely on the information submitted and the representations made, we rule as follows:

- (1) The Conversion will be treated as (i) an exchange by the Mutual Company members of their membership interests in Mutual Company for stock of Stock Company, (ii) the transfer of the Stock Company stock by the former members of Mutual Company to Mutual Holding Company in exchange for membership interests in Mutual Holding Company, and (iii) the transfer of the Stock Company stock by Mutual Holding Company to Stock Holding Company in exchange for all of the Class B stock of Stock Holding Company.
- (2) The conversion from a mutual insurance company to a stock insurance company and the deemed exchange of membership interests in Mutual Company for stock of Stock Company will be a reorganization within the meaning of § 368(a)(1)(E). Mutual Company/Stock Company will be “a party to a reorganization” within the meaning of § 368(b).
- (3) The former members of Mutual Company will recognize no gain or loss on the exchange of Mutual Company membership interests for stock of Stock Company. (Section 354(a)(1)).
- (4) The basis of a membership interest in Mutual Company is zero. (Rev. Rul. 71-233, 1971-1 C.B. 113; Rev. Rul. 74-277, 1974-1 C.B. 88). The basis of the Stock Company stock deemed received in exchange for the Mutual Company membership interests will be equal to the basis of the Mutual Company interests surrendered in exchange therefor (i.e., zero). (Section 358(a)(1)).
- (5) The holding period of the Stock Company stock deemed received in exchange for the Mutual Company interests will include the period the owner thereof held such Mutual Company interests, provided that the Mutual Company interests were held as capital assets at the time of the Conversion. (Section 1223(1)).
- (6) Stock Company will recognize no gain or loss on its issuance of stock in exchange for Mutual Company interests. (Section 1032(a)).

- (7) The membership interests in Mutual Holding Company received by the former Mutual Company members in exchange for their stock in Stock Company will be treated as stock within the meaning of § 351(a) of the Code. (See Rev. Rul. 69-3, 1969-1 C.B. 103).

This letter ruling is directed only to the taxpayer 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 returns of the taxpayers involved for the taxable year in which the transaction covered by this ruling letter is consummated.

The rulings contained in this letter are predicated upon facts and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by the appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the factual information, representations and other data may be required as part of the audit process.

In accordance with the power of attorney on file in this office, this letter is addressed to the taxpayer's representative. A copy of this letter will be sent to the taxpayer.

Sincerely Yours,
Michael J. Wilder
Senior Technician Reviewer, Branch 1
Office of Associate Chief Counsel
(Corporate)