INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification No.
Years Involved:
Date of Conference:

LEGEND:

Taxpayer =

Company B =

Company C =

Company D (Target) =

Company E =

Company F =

Company G =

Company H	=	
Company I	=	
State X	=	
State Y	=	
Year 1	=	
Year 1A	=	
Year 1B	=	
Year 1C	=	
Year 1D	=	
Year 2	=	
Year 3	=	
Year 3A	=	
Year 4	=	
Date 1	=	
Date 1A	=	
Date 1B	=	
Date 2	=	
Date 3	=	
Date 3A	=	
Date 4	=	
Date 5	=	
Date 6	=	

Date 7	=
Date 8	=
Date 9	=
Date 10	=
Date 11	=
Date 12	=
Date 13	=
Date 14	=
Date 15	=
Date 16	=
Date 17	=
Date 18	=
Date 19	=
Date 20	=
Date 21	=
Date 22	=
a	=
b	=
c	=
d	=
e	=
f	=
g	=

h	=
i	=
j	=
k	=
l	=
m	=
n	=
o	=
p	=
q	=
r	=
s	=
t	=
u	=
v	=
w	=
x	=
y	=
z	=
aa	=
bb	=
cc	=
dd	=

<u>ee</u>	=
<u>ff</u>	=
<u>gg</u>	=
<u>hh</u>	=
Taxpayer's Representative I	=
Taxpayer's Representative II	=
Taxpayer's financial advisors	=
Target's Executive Officer	=
Target's financial advisors	=
Fairness Opinion	=
Board Materials	=
Transcript I	=
Transcript II	=
Merger Binders	=
Statute	=
<u>ii</u>	=
<u>jj</u>	=
<u>kk</u>	=

ll =

mm =

nn =

oo =

pp =

qq =

rr =

ss =

Title =

ISSUE:

Whether the $d cash amounts paid to the former Company D ("Target") policyholders as part of the merger of Target into Taxpayer are "policyholder dividends" as defined in section 832(c)(11) of the Internal Revenue Code. Target contends the amounts are section 832(c)(11) dividends. Target, Company G, Company H, and Company I, deducted the amounts for the short tax years ending on the date of the merger. The IRS contends the amounts do not constitute policyholder dividends, but rather, boot paid to the former Target policyholders as part of the consideration in the exchange of their ownership interests in Target for ownership interests in Taxpayer.

CONCLUSION:

The $d cash amounts are part of the merger consideration paid to the former Target policyholders and are not deductible policyholder dividends under section 832(c)(11).

FACTS:

Target was organized as a mutual insurance company in State Y in Year 1A. At all relevant times, Target was engaged in the business of writing various forms of property and casualty insurance. Target had no stock or shareholders, but instead was owned by its policyholders. At Date 12, Year 2, Target had approximately $i in net written premiums and a surplus of approximately $j. Additionally, Target had approximately k members. Target filed a Form 1120 PC using a calendar year and the accrual method of accounting.

Target owned all of the b series preferred stock in Company E, and approximately l% of the total voting stock in Company E. Target also owned approximately m% of the total voting stock in Company F. Company E and Company F were publicly-held holding companies that owned various subsidiaries. Target, Company E, and Company F shared employees and facilities (which Target leased to the other two companies), marketing services, and agency forces. Target, Company E, and Company F also shared common officers. Target was a party to a reinsurance pooling agreement with three of Company E's subsidiaries: Company G, Company H, and Company I. This pooling agreement was executed on Date 13, Year 1B, with amendments of Date 14, Year 1C, Date 15, Year 1D, and Date 16, Year 3. The purpose of the agreement was to share the risk of loss among the participants, to reduce reinsurance costs, and to bring about for each participant the potential for added economies of operation, more uniform underwriting results, diversification as to the classes of insurance business written, and maximization of capacity. The terms of the agreement required that all insurance business conducted by the participants be pooled. This included, among other things, premiums, underwriting expenses, and dividends to policyholders (as reported on page 4, line 14A of the statutory annual statement).

Taxpayer was organized as a mutual insurance company in State X in Year 1. At all relevant times, Taxpayer was engaged in the business of writing various forms of property and casualty insurance. Taxpayer is the parent of the Taxpayer consolidated group. For the year ended Date 12, Year 2, Taxpayer had approximately $n in net written premiums and a surplus in excess of $o. Additionally, Taxpayer had approximately a policyholders. Taxpayer files a Form 1120 PC consolidated tax return using a calendar year and the accrual method of accounting.

On Date 1A, Year 3, Taxpayer announced a tender offer for the stock of Company E, as well as its offer to merge with Target.

An initial offer letter, dated Date 1A, Year 3, from Taxpayer to Target provided that Taxpayer would purchase from Target, prior to the merger, nn% of the b Series Preferred Stock of Company E held by Target for an aggregate purchase price of $c payable in cash.[1] The $c proceeds, " ."[2]

[1] The preferred stock that Target owned in Company E had enhanced voting power. Through Target's control of that preferred stock and the interlocking board of directors, the board to control nearly p percent of the voting shares of Company E.

[2] In its submission, the Taxpayer states that "[t]his initial offer was never accepted; instead [Taxpayer] received all the assets of [Target], including its stock in the [Target unaffiliated companies], in the merger."

During the Date 1 through Date 2, Year 3 discussions of the two companies' financial advisors, Target's financial advisors informed Taxpayer's financial advisors that any transaction between Target and Taxpayer would have to allow for a dividend to policyholders significantly in excess of Taxpayer's initial proposal of $c. Accordingly, the parties modified the initial proposal to instead reflect a dividend to policyholders of $d.

On Date 4, Year 3, Target and Taxpayer executed the merger agreement, as amended Date 3A, Year 3, regarding the merger of Target into Taxpayer, with Taxpayer surviving (the "Target Merger Agreement").

On Date 10, Year 3, Target merged into Taxpayer, with Taxpayer surviving. The parties treated the transaction as a reorganization under section 368(a)(1)(A). Upon the merger, Taxpayer assumed all rights and duties under all policies and contracts issued by Target, and Target policyholders became policyholders of Taxpayer.

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Under the Target Merger Agreement, an extraordinary dividend of $d in cash was to be declared prior to the closing of the Target Merger. The $d extraordinary dividend was to be "payable on or about" the closing date and paid "in connection with" the merger. Target declared the $d extraordinary dividend on Date 5, Year 3 (prior to the Target Merger). Target merged out of existence effective Date 10, Year 3. All assets and liabilities of Target became assets and liabilities of Taxpayer on that date, by operation of law. The dividend checks were cut and mailed on Date 11, Year 3 (after the Target Merger) from the Company H operating account to the former Target policyholders that had policies in force as of Date 4, Year 3. Company H was a wholly-owned subsidiary of Taxpayer on Date 11, Year 3.

On short year tax returns filed Date 17, Year 3A, for the period prior to the merger, Target and certain members of the former Target pooling arrangement claimed policyholder dividend deductions with respect to the payment of the $d in cash.[3] Specifically, Target claimed $e in policyholder dividend deductions, Company H claimed $f policyholder dividend deductions, Company G claimed $g in policyholder dividend deductions, and Company I claimed $h in policyholder dividend deductions.

A. Extraordinary Dividend

On Date 8, Year 3, Target requested approval from the State Y Insurance Commissioner for the payment of a $d "extraordinary dividend. "[4] The Commissioner granted approval of the extraordinary dividend on Date 18, Year 3. Pursuant to the request for approval filed with the Commissioner, the payment of the extraordinary dividend was contingent upon the fulfillment (or waiver) of all of the conditions to the proposed Target Merger, and the dividend was not to be paid unless the proposed merger of Target into Taxpayer was accomplished. The request indicated that the extraordinary dividend was to have a de minimis effect on the surplus of Taxpayer, as the surviving company, in relation to its outstanding liabilities after the merger.

The $d payment reflected approximately q% of the previous three years premiums paid by the Target policyholders as of Date 4, Year 3. In determining the allocation of the $d the parties relied, by analogy, on the State Y demutualization statute for direction as to what would be a fair and equitable allocation.[5] Historically, Target paid dividends solely with respect to certain workers compensation policies, and the previous two years dividends for these workers compensation policies were only approximately $r each year.

According to Target's financial advisors, Target did not have sufficient excess capital to support the $d cash amount. [6] On Date 4, Year 3, Target's financial advisors presented to the Target board an analysis of the potential payment of $d in cash, under alternatives that assumed Target had net written premiums to surplus ratios of s to t and certain excess capital amounts, and concluded that, "

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[3]The short year returns were filed after the merger and were filed when Taxpayer owned nn% of the stock of the entities claiming deductions under the pooling arrangement.

[4]Labels or names used for any particular amount, payment, or transaction(s) in this memorandum will not necessarily reflect the Service's view or characterization of such amount, payment, or transaction(s).

[5] State Y Statute.

[6] See Fairness Opinion and Board Materials.

" [7] Furthermore, Target's financial advisors stated that the ability of Target (which had a ratio of net premiums written to surplus ratio at [Date 12], Year 2, of ff) "

." [8]

Taxpayer stated that the $d "dividend" payment was "a negotiated term of the merger agreement" that was "a condition of the merger" offered by Target and accepted by Taxpayer "as a part of the final transaction." Target's financial advisors' Fairness Opinion, dated Date 4, Year 3, also stated that the $d "dividend," together with the issuance by Taxpayer of the policies and certificates of membership, constituted the "Aggregate Consideration" to the Target policyholders.

B. Separate Agreements

For various reasons (including the joint operations of the three entities), Taxpayer wanted to acquire all the Target organizations comprised of Company E, Company F, and Target.[9]

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[7] The Taxpayer contends that Target's financial advisors apparently were not aware that the extraordinary dividend was subject to the Target Pooling Agreement and that the impact on the premium to surplus ratio of Target would be considerably different than reported in their opinion. The Taxpayer maintains that Target had sufficient capital to fund the extraordinary dividend. In our view, however, the weight of the evidence does not support these facts. Target's financial advisors advised Target's board that the $d cash amount exceeded Target's excess capital, and Target's payment of the amount could impair Target's rating. Moreover, in forming their Fairness Opinion, Target's financial advisors provided that they relied on information furnished by Target's management, including a review and consideration of the pooling agreement. Target's financial advisors' Fairness Opinion is an exhibit in Target's proxy statement. Also, Target's Executive Officer not only presented Target's financial advisors' Fairness Opinion to the State Y Commissioner of Insurance, but also indicated Target's board recognized it had conflicts of interest and that is one of the reasons the board obtained the advice of the outside advisors, Target's financial advisors. Furthermore, Target's Executive Officer informed the State Y Commissioner of Insurance that Target's financial advisors were selected for their reputation and expertise in the insurance industry.

[8] Moreover, Target's financial advisors provided that: "

." See Board Materials at p. .

[9] See Transcript II, at p. , lines , p. , p. , p. , p. ; and Fairness Opinion, at Overview of the Revised Taxpayer Offer, p. .

On Date 4, Year 3, concurrently with the execution of the Target Merger Agreement, Taxpayer entered into separate merger agreements with Company E and Company F. These latter agreements contemplated that newly-formed acquisition subsidiaries of Taxpayer would make tender offers to purchase: (1) all of the outstanding voting shares of Company F; and (2) all of the common shares of Company E. The acquisition subsidiaries would then merge into Company E and Company F, with Company E and Company F, respectively, surviving.

Concurrently with these separate merger agreements, Target entered into shareholder agreements with Taxpayer with respect to Target's shares of common and preferred stock in Company E and Company F. In connection with the agreements, Target irrevocably granted to Taxpayer's designees, Target's proxy to vote any securities (including Target's preferred shares in Company E) owned by Target in favor of the mergers and against any alternative transaction or frustrating transaction. Additionally, according to the Form A filed by Taxpayer (dated Date 7, Year 3) and Target's financial advisors' presentation to the Target Board (dated Date 3, Year 3), Target planned, at the time of the execution of the merger agreement, to sell to Taxpayer all its common shares in Company F (which constituted approximately m% of all outstanding voting shares in Company F) and all its u% Series Preferred Shares in Company F. Similarly, according to Target's financial advisors' presentation to the Target Board (dated Date 3, Year 3) and a letter sent to the State Y Commissioner of Insurance on behalf of Taxpayer (dated Date 1B, Year 3), Target also planned, at the time of the execution of the merger agreement, to sell to Taxpayer its preferred stock in Company E.

On Date 10, Year 3, Taxpayer announced that Target had merged into Taxpayer and that it had accepted for purchase all the shares of Company E stock validly tendered. A total of v shares of Company E's common stock had been tendered, representing w% of the total outstanding shares. On Date 19, Year 3, Taxpayer paid $x for y shares of common stock in Company E in connection with the tender offer at $z per share. On or about Date 20, Year 3, Taxpayer's acquisition subsidiary, Company B, merged into Company E, with Company E as the survivor. All shares of Company E not previously purchased in the tender offer were converted into the right to receive $z in cash (subject to dissenters rights).

Additionally, on Date 19, Year 3, Taxpayer paid $aa for bb shares of Company F common stock in connection with the tender offer at $cc per share. On Date 21, Year 3, Taxpayer also paid $dd for ee shares of Company F common stock in connection with the Notice of Guarantee Tendered Shares at $cc per share. On or about Date 20, Year 3, Taxpayer's acquisition subsidiary, Company C, merged into Company F, with Company F as the survivor. The shareholders of Company F received $cc in cash for each share of Company F common stock tendered.[10]

[10] In addition to the facts presented in the Facts section of this TAM, the IRS has incorporated into the Analysis section of this TAM additional relevant facts from the Taxpayer's Merger Binders.

C. Additional Facts Submitted

Taxpayer submits the following disputed facts. These disputed facts are inconsistent with documents and testimony of the Taxpayer, and other pertinent facts, to the extent the disputed facts indicate members of the pooling agreement paid Target amounts representing portions of a "pooled dividend." As discussed below, the record in this case reflects the $d amount as additional consideration in the merger transaction.[11]

According to Taxpayer, the $d dividend was pooled between the parties in accordance with the pooling agreement. Target reported its share of the pooled dividend in its final statutory filing, on or about Date 22, Year 3A, for the nine months ended Date 5, Year 3 on page 4, line 14A as a dividend to policyholders. Company H, Company G, and Company I accounted for the dividend in the same manner in their statutory filings, on or about Date 22, Year 3A, for the year ended Date 12, Year 3.

According to the Taxpayer, prior to Date 5, Year 3, securities were sold from the Target Investment Account in anticipation of the payment of the dividend from its assets. Also according to the Taxpayer, after Date 10, Year 3, securities were sold from the accounts of Company H, Company G, and Company I to settle up under the pooling agreement that included the Target "dividend expense." Lastly, according to the Taxpayer, the impact was that ultimately each member of the pool sold assets to pay its portion of the pooled dividend.

Even if we accept Taxpayer's assertion that Target had sufficient surplus to provide funding for the payment of the $d amount, bearing in mind relevant regulatory constraints, we nonetheless conclude that having enough funds to pay a dividend is not dispositive of whether such payment is in fact a dividend. Rather, in this case the record shows that the $d million amount was a negotiated part of the consideration paid in the merger. Accordingly, the disputed facts concerning whether Target had sufficient surplus to pay the $d million amount is not material to the resolution of the TAM.

LAW AND ANALYSIS:

The Taxpayer relies principally upon Revenue Ruling 75-493, 1975-2 C.B. 108 and Revenue Ruling 56-184, 1956-1 C.B. 190 as authority for its position that the $d cash payment is a dividend, rather than boot in the reorganization. The Taxpayer's reliance on these rulings is misplaced.

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[11]As discussed elsewhere, the evidence in the record includes, but is not limited to, sworn testimony in Transcript II by Taxpayer's Representative II that the $d was part of the consideration paid in the merger, testimony by Target's Executive Officer set forth in Transcript I concluding the same, and the Board Materials and Fairness Opinion of Target's financial advisors.

In Revenue Ruling 75-493, the Service ruled that a cash amount to a sole shareholder prior to the sale of the stock was a dividend, where the buyer had no legal obligation to purchase the stock upon the declaration and payment of the dividend. In the ruling, A, an individual, owned all the stock of Y. X corporation entered into negotiations with A for the purchase of the Y stock. In negotiating the purchase price for the stock, X provided that it did not want to purchase what was essentially a large amount of cash within Y. As such, On November 1, 1974, Y declared and paid a cash dividend of the unwanted cash to A, who surrendered no stock. In addition, when the dividend was declared and paid, X was under no legal obligation to purchase the Y stock. Y had earnings and profits sufficient to pay the dividend. On November 2, 1974, A and X executed an agreement for the sale of the Y stock for a fixed dollar amount. The ruling provides that the payment of the dividend did not reduce X's obligation to pay the agreed upon purchase price and was not part of the consideration paid by X to A for the Y stock.

Besides involving a reorganization (rather than a sale), the instant case is distinguishable from Rev. Rul. 75-493 because the facts indicate that the \$d cash amount was part of the consideration in the merger transaction.

First, Target's financial advisors, Taxpayer's Representative II, and Target's Executive Officer each separately indicated that the \$d cash amount was part of the consideration in the merger transaction. The Target's financial advisors' materials presented at the Target board of directors' meeting of Date 4, Year 3, at which the directors approved the merger, provide: "

" These same materials also disclose that,

" Additionally, Target's financial advisors, in its Fairness Opinion, states that the "Dividend," together with the issuance by Taxpayer of the policies and certificates of membership, constitute the "

" to the Target policyholders.[12]

Also, Taxpayer's Representative II, in testimony before the State X Commissioner of Insurance, states, "

." (See Transcript I, p.). The \$d cash amount "

." (See Transcript I, p.). Similarly, in a Date 6, Year 3 letter addressed to the State X Department of Insurance, Taxpayer provides, "

[12] The Fairness Opinion is an exhibit in Target's proxy statement.

" Taxpayer's Representative II also provides, in testimony before the State Y Commissioner of Insurance (see Transcript II, p.), that "

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In addition, Target's Executive Officer testified before the State Y Commissioner of Insurance, at p. , that Target's financial advisors "advised" Target's board that the "aggregate consideration" to be received by the Target policyholders under the merger agreement was fair to the Target's policyholders, and the "aggregate consideration" included the "extraordinary dividend."[13] Target's Executive Officer also testified before the State Y Commissioner of Insurance, at p. , that an extraordinary dividend such as the $d cash was not typical in mergers of mutual insurance companies, particularly when it was paid at the time of consummation of the merger of the mutual insurance companies.

Moreover, the progress and culmination of the negotiations surrounding the merger, as reflected in the Taxpayer proxy, also support treating the $d cash amount as part of the consideration in the merger transaction. According to the Taxpayer's proxy, Taxpayer and Target had initially discussed just merging Target into Taxpayer (with the Target policyholders receiving only mutual equity interests in Taxpayer). Sometime later, the negotiations progressed to Target not only merging into Taxpayer, but also Taxpayer separately purchasing Target's preferred stock in an unaffiliated subsidiary (i.e., one of Target's assets) for $c.[14] Upon the merger, the net cash proceeds from this purchase would be paid to the Target policyholders as a "policyholder dividend." This purchase of the preferred stock would be consummated only in connection with the merger. During the Date 1 through Date 2, Year 3 discussions of the two companies' financial advisors,

[13] Target's Executive Officer, in testimony before the State Y Commissioner of Insurance, at pages , indicates that Target's board of directors recognized the board had conflicts of interest, and that is one of the reasons the board obtained the advice of outside financial advisors, Target's financial advisors. He further testified, at page , that Target's financial advisors were selected for their reputation and expertise in the insurance industry.

[14] As already indicated, the preferred stock that Target owned in the unaffiliated subsidiary had enhanced voting power. Through Target's control of that preferred stock and the interlocking board of directors, the board

to control nearly p percent of the voting shares of Company E.

Target's financial advisors then informed Taxpayer's financial advisors that any transaction between Target and Taxpayer would have to allow for a "policyholder dividend" significantly in excess of Taxpayer's initial proposal of $c. Thereby, the parties modified the initial proposal (involving a $c "policyholder dividend") to instead reflect a $d "policyholder dividend."

Thus, Target negotiated that its policyholders receive not only cash in addition to mutual equity interests in Taxpayer, but also cash in an amount significantly in excess of the $c Taxpayer was initially willing to pay. It was at the insistence of Target and Target's financial advisors that Taxpayer agreed to modify its "initial proposal" to instead pay the $d cash amount as the "policyholder dividend."

The above proxy discussion, together with Taxpayer's Form A filing and certain materials of Target's financial advisors (discussed below), indicate that Taxpayer may have been willing to pay the additional $d consideration because Target's assets included stock in two unaffiliated Target subsidiaries, the stock of which Taxpayer was purchasing, for cash, from all shareholders other than Target.[15] Taxpayer's Form A filing and these materials of Target's financial advisors indicate that, at the time of the execution of the Date 4, Year 3 merger agreement, Target and Taxpayer planned to have Target sell to Taxpayer stock in these two unaffiliated subsidiaries (i.e., assets of Target). According to Taxpayer's Form A filing with the State Y Commissioner of Insurance (dated Date 7, Year 3) and Target's financial advisors materials (dated Date 3, Year 3), Target agreed to sell to Taxpayer all its common shares in Company F (which constituted approximately m% of all outstanding voting shares in Company F) and all its u% Series Preferred Shares in Company F. Additionally, according to Target's financial advisors' materials (dated Date 3, Year 3), Taxpayer's proxy, and a letter sent to the State Y Commissioner of Insurance on behalf of Taxpayer (dated Date 1B, Year 3), Target also agreed to sell to Taxpayer its preferred stock in one of the unaffiliated subsidiaries. According to the above facts, Target was to sell to Taxpayer not only the preferred stock in one unaffiliated subsidiary (for which Taxpayer was willing to pay $c), but also the preferred stock and common stock in the other unaffiliated subsidiary. These same Target's financial advisors materials specify the amount of Target's after-tax gain on the sale of each of the three classes of stock in the two subsidiaries (apparently sold for $d), and also reflect Taxpayer paying $d cash in the transaction.[16]

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[15] At or about the date of the merger, Taxpayer, through newly-formed acquisition subsidiaries, effected separate tender offers in which Taxpayer purchased for cash, from shareholders other than Target, a majority of the common stock in two unaffiliated Target subsidiaries. Taxpayer then merged the acquisition subsidiaries into the two subsidiaries, cashing out the remaining shareholders. Thereby, Taxpayer became the sole owner of the two subsidiaries.

[16]See page of the Date 3, Year 3, discussion materials prepared for Target's board of directors by Target's financial advisors captioned, "Title." This page shows an estimated amount for total gains, total available "excess capital" and a "[Taxpayer] Cash Payment" of "[$d]" for each of three computations using net written premiums to surplus

Thirdly, the fact that the $d cash amount was contingent on the merger is consistent with the $d cash amount being part of the consideration in the merger. In its request for approval of the extraordinary dividend before the Commissioner of Insurance of State Y, as received by the State Y Commissioner on Date 8, Year 3, the Taxpayer provided that "

." Thus, if the merger of the Target into the Taxpayer had not been consummated, no payment would have been made to the former Target policyholders.

Rev. Rul. 75-493 is distinguishable from the instant case in other respects, all of which are consistent with regarding the $d cash as part of the consideration in the merger transaction. In Rev. Rul. 75-493, the target declared and paid a dividend prior to the execution of a legal obligation to sell the target stock. In the instant case, however, the $d amount was not declared until all the conditions for closing had been satisfied, and was not paid until after the merger. As discussed below, Target did not declare the $d "extraordinary dividend" until eight hours before the merger. Additionally, Taxpayer (not Target) paid the $d amount to the former Target policyholders fourteen days after the merger. In testimony before the State Y Commissioner, Taxpayer's Representative II, testified that "

" (see Transcript II, p.).[17] Clearly, Target did not make the payment because it did not exist when the payment was made. As planned, Taxpayer made the payment.

Furthermore, Target did not have sufficient capital to make the payment.[18] Target's financial advisors advised Target's board of directors, at the time Target's board approved the merger agreement, that Target did not have sufficient capital to make the

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ratios of s, oo and pp.

[17] The $d cash was actually paid from an account of Company H, a lower-tier subsidiary of Taxpayer. The account, which had a zero balance, was funded daily based on checks presented from the Cash Concentration Account, an account managed for member companies. To the extent the $d cash is viewed as actually made by one or more subsidiaries of Taxpayer (rather than Taxpayer), the $d cash is treated as made on behalf of Taxpayer.

[18] As already indicated, Taxpayer contends that Target had sufficient capital to make the $d payment. Assuming we accept this disputed fact, the conclusions in this TAM remain the same. That is, even assuming Target had sufficient capital to make the payment (which is inconsistent with the record previously discussed), the facts still indicate that the $d cash amount is part of the consideration in the merger transaction (and not a deductible policyholder dividend).

payment without impairing its rating as a reliable [P&C insurance carrier]. Similarly, Target filed its request for approval of the "extraordinary dividend" with the State Y Commissioner of Insurance indicating that Taxpayer (not Target) had the ability to make the payment without impairing Taxpayer's (not Target's) surplus.

Overall, the facts of the instant case are more similar to those in Waterman Steamship Corporation v. Commissioner, 430 F.2d 1185 (5th Cir. 1970), rev'g, 50 T.C. 650 (1968), cert. denied, 401 U.S. 939 (1971), (see below), rather than Rev. Rul. 75-493. In addressing Waterman, Rev. Rul. 75-493 provides that, "[b]ecause the funds to pay the dividend were actually furnished by the buyer [in Waterman], that amount was considered as part of the purchase price paid by the buyer for the stock of the subsidiary." In the instant case, consistent with Waterman, Taxpayer (not Target) furnished the cash to pay the "extraordinary dividend."

Taxpayer also relies, in error, on Revenue Ruling 56-184 in support of its position. In Revenue Ruling 56-184, Z corporation, pursuant to a plan of reorganization, acquired all of the outstanding stock of Y corporation by issuing in exchange therefore certain shares of voting common stock of Z. The number of shares of Z stock issued in the exchange was based on the value of Y's assets as of a specified date. The earnings of Y from that date to the date of closing were distributed to the shareholders of Y as dividends prior to the exchange of the Y stock for the Z stock. The ruling provided that the cash so received was taxable as a dividend under section 301 of the Internal Revenue Code and not as cash received as part of the reorganization under section 356.

Revenue Ruling 56-184 focused on whether the cash distributed by the target to the target shareholders would destroy the B reorganization. The ruling concluded that the cash distributed was not received in connection with the exchange of stock and was not part of the consideration for the stock. In contrast, the facts in the instant case indicate the $d amount was part of the consideration in the merger transaction. Moreover, in Rev. Rul. 56-184, the target paid the amount from its own funds prior to the exchange of stock. In the instant case, Target did not have sufficient capital to make the payment. The $d amount was contingent on the merger and, as planned, Taxpayer paid the $d amount after the merger. Cf. Rev. Rul. 75-360, 1975-2 C.B. 110 (transaction structured as a B reorganization was part of a taxable sale or exchange in the case of McDonald v. Commissioner, 52 T.C. 82 (1969), where a redemption and stock exchange were steps of a single integrated transaction and the acquiring company was the source of the cash paid to the majority target shareholder).

In its more recent submission of Date 9, Year 4, the Taxpayer cites, as additional support for its position, TAM 200335032, Rev. Rul. 57-134, 1957-1 C.B. 210, Rev. Rul. 72-597, 1972-2 C.B. 403, and Gilmore v. Commissioner, 25 T.C. 1321 (1956). Each of these authorities can be distinguished and do not provide support for Taxpayer's position.

In TAM 200335032, the Service held that a distribution under section 305(b)(1), followed by a recapitalization, was a dividend. There, the taxpayer was a common parent of a consolidated group which acquired a ii% interest in the common stock of a target corporation. The remaining jj% was owned by an unrelated individual. The taxpayer and the individual's relationship became contentious. At or about this time, the taxpayer was negotiating the sale of its stock, as well as alternatively discussing an exchange of its stock for preferred stock. After numerous negotiations, the parties agreed that the target corporation was to declare a dividend payable, at the election of the shareholders, in either cash or additional shares of the target stock. The taxpayer elected to receive cash. The individual contributed its holdings in the target to a newco, and the newco elected to take additional shares of the target stock. The taxpayer reported the amount as a dividend under 301(c)(1) and took a dividends received deduction under section 243(c). Over a year later, the parties agreed that the target corporation would effect a recapitalization, pursuant to which the taxpayer exchanged all of its target common stock for target preferred stock. Later, the target corporation redeemed the taxpayer's preferred stock in four separate transactions, after which the newco owed nn% of the stock in target. The IRS Agent and Appeals Officer challenged the dividend reported by the taxpayer. TAM 200335032 held in favor of the taxpayer.

First, as TAM 200335032 clearly states, section 6110(k)(3) provides that TAM 200335032 may not be used or cited as precedent. Additionally, even assuming TAM 200335032 could be used or cited as precedent, TAM 200335032 is distinguishable from Taxpayer's case. TAM 200335032 concluded that, even assuming the distribution and the exchange took place at the same time, the distribution was, in substance, a separate transaction from the recapitalization. In contrast, not only do the facts of the instant case involve a merger of Target into Taxpayer (and not a recapitalization), but the facts indicate Taxpayer's payment of the $d in cash was not, in substance, a separate transaction from the merger. As discussed above, the facts indicate the $d cash amount was part of the consideration in the merger transaction. As such, TAM 200335032 would not support Taxpayer's position, even if TAM 200335032 could be cited or used as precedent.

Taxpayer also cites, as authority for its position, Rev. Rul 57-134 and Rev. Rul. 72-597. Taxpayer's reliance on these rulings is also misplaced.

Rev. Rul 57-134, 1957-1 C.B. 210, held that a mutual casualty insurance company may deduct dividends to policyholders in the year of declaration even though such dividends are declared in unspecified amounts representing all or a part of a net profit for such year and are not paid until the following year under the Subchapter L provisions of the Code. Similarly, Rev. Rul. 72-597, 1972-2 C.B. 403 held that dividends on workmen's compensation policies, which were not declared by the insurance company's board of directors until after such policies are expired, are deductible in the taxable year of the dividend. Neither of these rulings provide support for the Taxpayer's position. For example, the rulings address amounts that were undisputedly policyholder dividends. Additionally, the dividends were not contingent on any merger and no acquiring corporation furnished the cash to pay the dividends. The rulings are therefore distinguishable from the instant case.

Lastly, Taxpayer maintains that Gilmore supports treating the $d cash payment as a dividend. In Gilmore, shareholders of a corporation sold their stock to buyers. The buyers' purchase price for the stock reflected the corporation's hotel property the buyers wanted to purchase, but excluded the corporation's cash and U.S. bonds. The buyers waived any claim to the corporation's cash and U.S. bonds and were willing to have the cash and proceeds of the U.S. bonds, after payment of the corporation's debt (including income taxes) for the year, paid to the selling shareholders. In accepting the buyers' offer, the board directed that the balance of the corporation's money on hand and proceeds of the sale of U.S. bonds (i.e., after the payment of indebtedness, including income taxes) be paid to the target shareholders. The actual payment of these amounts did not occur until after the stock was assigned to the buyers. However, the mechanics of the sale necessitated waiting until after the assignment to ascertain the amount to distribute to the shareholders. The amount to distribute to the shareholders could not be determined until the end of the year when the corporation's earnings (rental income) and liabilities (including tax liability) for the year became known. The court concluded that the agreement entered into by the buyers and sellers set forth what the purchase price would be for the stock of the corporation, and such price did not include the cash and bond proceeds distributed to the taxpayers. The court found the case similar to Coffey v. Commissioner, 14 T.C. 1410 (1950) which involved the payment of unwanted assets the purchaser had negotiated to exclude from the assets of target at the time of the purchase of target stock. The Gilmore court concluded that the assets received from the corporation were dividend amounts to the sellers and not part of the consideration received from the sale of stock.

Besides involving a reorganization (rather than a sale), the instant case is distinguishable from Gilmore because the facts indicate that the $d cash amount was part of the consideration in the merger transaction. The $d cash was not an unwanted asset that the acquirer had negotiated to exclude from Target's assets at the time of the acquisition. Instead, the $d cash was a term of the merger negotiated by Target. Target had conditioned the merger on the payment of the $d to its former policyholders, and the $d cash was to be paid only if the merger was consummated. Furthermore, the mechanics of the transaction did not necessitate waiting until after the merger to ascertain the amount to be paid to the Target policyholders. The amount of the payment to the policyholders was fixed, at $d, in the Date 4, Year 3 merger agreement executed approximately ss months before the Date 10, Year 3 merger date. Accordingly, Gilmore does not support Taxpayer's position.

A. Dividends vs. Additional Sales Proceeds

In further distinguishing Taxpayer's cited authority involving sales transactions, we turn to the following sales cases. We note that some of these cases involve corporate (rather than individual) sellers, and thus, may be further distinguished from the instant case.

In Waterman Steamship Corporation v. Commissioner, 430 F.2d 1185 (5th Cir. 1970), rev'g, 50 T.C. 650 (1968), cert. denied, 401 U.S. 939 (1971), the Fifth Circuit concluded that the purchase price for stock of a subsidiary was paid to the seller in the form of a dividend by the subsidiary. In that case, the purchaser offered to pay approximately $3.5 million for the stock of two subsidiaries of seller. The seller rejected the offer as made, but said it would instead sell the stock for $700,000 cash after the declaration of a dividend of approximately $2.8 million. The subsidiary did not have $2.8 million in cash to distribute to its shareholders. Instead, it distributed a note. Immediately after the sale of the stock, the purchaser loaned cash to the subsidiary to retire the note. The events transpired over a period of ninety minutes.

The court, in disregarding the purported dividend, noted that the cash to pay for the purported dividend came from the purchaser. In fact, the court concluded that the transaction was restructured to include a dividend solely for tax purposes. The court held that the subsidiary was merely a conduit for the amount of sale proceeds to the seller. In general, Waterman applies where the target corporation is a conduit for cash transferred from the buyer to the seller. Cf. Thor Resources v. Commissioner, T.C. Memo. 1995-505 (amount conceded to be a dividend from a subsidiary, purportedly declared before but paid after the sale of stock in the subsidiary, treated as part of purchase price under Waterman); Basic Incorporated v. United States, 549 F.2d 740 (Ct. Cl. 1977) (purported dividend not respected for purposes of taxing sale of stock where, for tax avoidance reasons, first-tier subsidiary distributed stock in second-tier subsidiary to sole shareholder which then sold the stock in the two subsidiaries).

As indicated above, the instant case is similar to Waterman. In the instant case, Target declared the $d “extraordinary dividend” eight hours before the merger, and Taxpayer furnished the funds to pay the “dividend” fourteen days after the merger. In contrast to Waterman, however, Target did not purport to make a dividend distribution of a note, with the buyer furnishing the funds to pay off the note. Instead, Target simply declared a $d cash dividend, with Taxpayer furnishing the cash to make the purported $d cash dividend.

In Litton Industries, Inc. v. Commissioner, 89 T.C. 1086 (1987), acq. in result only 1988-2 C.B.1, a wholly owned subsidiary declared a dividend and paid for it through the issuance of a promissory note prior to the parent’s disposition of its subsidiary stock. The purchaser of the subsidiary’s stock paid cash to the shareholder of target for the stock of target. The purchaser also paid cash to the shareholder of target for the promissory note. The court held that the dividend was to be respected. Contrasting Litton to Waterman, the Tax Court distinguished Waterman from Litton on grounds that the dividend in Waterman was declared as part of the stock sale agreement, and “no dividend would have been declared if all of the remaining steps in the transaction had not been lined up in order on the closing table and did not in fact take place.” In Waterman, the declaration of the dividend and the execution of the sales contract took place at virtually the same time. In contrast, in Litton when the dividend was declared, no formal action had been taken to initiate the sale of target, and no definite purchaser was “waiting in the wings.” In addition, the dividend declaration and the execution of the contract were separated by more than six months. Id. Target declared the dividend, issued the promissory note, and definitely committed itself to the dividend before even making a public announcement that its stock was for sale. Furthermore, target committed itself to the dividend and accepted the consequences regardless of the outcome of the proposed sale of stock. The Tax Court therefore respected the form of the transaction as structured by the taxpayer.

The instant case is similar to Waterman, rather than Litton. The $d cash "dividend" was declared as part of the merger, and it would not have been declared if all of the remaining steps in the transaction had not been lined up on the closing table and the merger did not in fact take place. Specifically, on Date 5, Year 3, the Target board of directors held a special meeting, at which Taxpayer's Representative I "

." Taxpayer's Representative I further "

." The board then declared the extraordinary dividend. As already discussed, the Request for Approval of Extraordinary Dividend also stated that, "

," and "

."

In TSN Liquidating Corporation, Inc. v. U.S., 624 F.2d 1328 (5th Cir. 1980), rev'g Civil Action No. CA 4-2441 (U.S.D.C. N.D. Tex, 1977), dividend treatment was respected where a purchaser required the target corporation to distribute unwanted investment assets to the selling shareholders prior to purchasing the target stock, and the purchaser thereafter contributed investment assets different "in kind" to the target after purchasing the stock.

TSN Liquidating does not provide authority for Taxpayer's position and is clearly distinguishable. In TSN Liquidating, target distributed the unwanted assets before the sale of the stock and the assets were not included in the purchase price. In addition, the amount was not contingent on the transaction. Unlike in TSN Liquidating, the facts indicate the $d amount in the instant case was part of the consideration and was not an unwanted asset. Target (not Taxpayer) required, as part of the negotiated transaction, that the $d cash be paid to the former Target shareholders. Additionally, Taxpayer (not Target) paid the $d cash amount, which was contingent on the merger, after the merger. On these facts, the instant case is clearly distinguishable from TSN Liquidating.

In Uniroyal Inc. v. Commissioner, 65 T.C.M. 2690 (1993), the court held that a cash distribution was a dividend where the distribution by a target corporation, Rubicon, to a 50% shareholder (seller), was followed by the sale of the target stock by the 50% shareholder (seller) to the remaining 50% shareholder (buyer). In Uniroyal, two corporate shareholders each owned 50% of the target corporation. After extensive negotiations, it was decided that each shareholder would receive 50% of the earnings and profits of the target in a dividend distribution and that one shareholder, Uniroyal, would then sell its stock to the remaining shareholder, Imperial. However, no formal binding agreement was reached.

In late December of 1981, target transferred $16.5 million in cash to Uniroyal and a $16.5 million note to Imperial. On January 16, 1982, Imperial paid $13.7 million to Uniroyal in exchange for the target stock held by Uniroyal. In addition, Imperial also assumed an $800,000 loan from the target to a related corporation owned 50% by Uniroyal and 50% by Imperial. The court held that the transaction should be taxed according to its form. That is, the receipt of the $16.5 million distribution was held to be a dividend, followed by the sale by Uniroyal of its stock in target to Imperial. In reaching its decision, the court concluded, among other things, that: a.) the shareholders had committed the corporation to the dividend before the sale occurred;
b.) neither shareholder could unilaterally change the dividend commitment in the event the sale of the target stock was not consummated; and c.) no binding sales agreement existed at the time of the declaration and payment of the dividend.

Uniroyal does not support the Taxpayer's position. As already indicated, the facts indicate the $d amount in the instant case was part of the consideration in the merger transaction. Target (not Taxpayer) required, as part of the negotiated transaction, that the $d cash be paid to the former Target shareholders. The $d cash payment was contingent on the merger, and the Target board did not declare the dividend until all the various conditions for closing had been satisfied. Additionally, Taxpayer (not Target) paid the $d cash to the former Target policyholders after the merger. Cf. Steel Improv. and Forge Co. v. Commissioner, 314 F.2d 96 (6th Cir. 1963), rev'g, 36 T.C. 265 (1961), (where the Sixth Circuit, in reversing the Tax Court, concluded that a cash amount in the technical form of a dividend to seller was taxed as a dividend to buyer and part of the purchase price paid to seller on seller's stock sale); Miller v. Commissioner, 247 F.2d 206 (7th Cir. 1957), rev'g, Miller v. Commissioner, 26 T.C. 151 (1956) (where the Seventh Circuit, in reversing the Tax Court, concluded that cash amounts structured as dividends to seller were taxed as dividends to buyers and part of proceeds paid to seller on seller's stock sale); Casner v. Commissioner, 450 F.2d 379 (5th Cir. 1971), rev'g, in part, Casner v. Commissioner, 28 T.C.M. (CCH) 535 (1969) (where the Fifth Circuit, in reversing the Tax Court, concluded that unwanted cash dividends to selling shareholders, paid prior to the signing of any binding stock purchase contracts, were taxed as dividends to buyer and part of the purchase price paid to sellers on sellers' stock sale); Rev. Rul. 75-493 (Service will not follow the Fifth Circuit's decision in Casner).[19]

In summary, we believe Revenue Ruling 75-493, Revenue Ruling 56-184, as well

[19] We believe an appropriate application of the case law in this area supports a finding that the $d amount is consideration paid in the merger. The Service will not follow this case law to the extent it is inconsistent with Rev. Rul. 75-493 or other Service positions in the area.

as the additional authority offered by the Taxpayer, do not support Taxpayer's position that the $d cash paid to the former target policyholders was a dividend, rather than boot in the reorganization.

B. Subchapter L and Policyholder Dividends

Taxpayer also contends that the $d amount is a policyholder dividend under the plain meaning of Section 832(c)(11) which provides:

> In computing the taxable income of an insurance company subject to tax imposed by section 831, there shall be allowed as deductions:
>
> (11) dividends and similar distributions paid or declared to policyholders in their capacity as such, except in the case of a mutual fire insurance company described in subsection (b)(1)(C). For purposes of the preceding sentence, the term "dividends and similar distributions" includes amounts returned or credited to policyholders on cancellation or expiration of policies described in subsection (b)(1)(D). For purposes of this paragraph, the term "paid or declared" shall be construed according to the method of accounting regularly employed in keeping the books of the insurance company.

Target is a property and casualty insurer and, in the reorganization context, the courts have not defined policyholder dividends in any written opinion related to property and casualty insurers.[20] However, the courts have decided a case, UNUM Corp. v. United States, 130 F.3d 501 (1st Cir. 1997), which interprets policyholder dividend as contained in a statute, i.e., section 808, worded similarly to section 832(c)(11). Section 808 provides:

(a) Policyholder dividend defined. For purposes of this part, the term "policyholder dividend" means any dividend or similar distribution to policyholders in their capacity as such.

(b) Certain amounts included. For purposes of this part, the term "policyholder dividend" includes–

> (1) any amount paid or credited (including as an increase in benefits) where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management, (2) excess interest, (3) premium adjustments, and (4) experience-rated refunds.

In UNUM, the court interpreted section 808 and determined that the taxpayer could not deduct policyholder dividends paid at the time of a demutualization of the

[20] A policyholder dividend includes amounts returned to policyholders where the amount is not fixed in the insurance contract but depends upon the experience of the company or the discretion of the management. See Treas. Reg. § 1.822-12(a).

insurance company in that case. In that case, UNUM Corp. (“UNUM”) distributed cash and stock to policyholders when it converted from a mutual company to a stock corporation. UNUM deducted $652 million as policyholder dividends. The amount was the value of UNUM's accumulated surplus. UNUM deducted the payments as policyholder dividends under section 808. The IRS challenged the deduction.

UNUM argued the cash and stock distributed during the demutualization constituted "policyholder dividends" under the plain language of section 808(b). The court disagreed with the taxpayer and applied general corporate tax provisions to the insurance company in the absence of specific provisions to the contrary. Under those corporate tax provisions, UNUM was not entitled to any deduction for its reorganization. The IRS further argued that nothing in section 808 or its legislative history indicates that Congress envisioned section 808 as encompassing capital transactions such as UNUM's demutualization. The court determined that under section 808(a), in order for a distribution to qualify as a "policyholder dividend," the distribution must occur to policyholders "in their capacity as such" --i.e., in their capacity as policyholders, not owners. The distribution must also fundamentally be a "dividend or similar distribution." The court opined that the cash distribution constituted a nondeductible distribution in redemption, while the stock distribution was part of a non-recognition exchange.

The reasoning used by the UNUM court applies to the instant case which involves a property and casualty insurance company and section 832. The language of the two relevant Code sections (808 and 832) is almost identical. Section 832(c)(11) applies to property and casualty companies, while section 808 applies to life companies. The Target Merger is a capital transaction and the cash amount paid to the former Target policyholders is part of the value-for-value exchange, similar to the demutualization transaction and the cash amounts in UNUM. As stated in UNUM, Congress did not envision the very favorable Subchapter L provisions as encompassing capital transactions and cash amounts paid as part of value-for-value exchanges. Target should be treated like any other corporate taxpayer. The $d cash amount was a condition of the merger. If the merger did not take place, the $d amount would not have been paid. In addition, the $d payment could not have been a net return of premium to the former Target policyholders as sufficient surplus was not available.[21] According to Target’s financial advisors, Target did not have sufficient excess capital to support the $d payment. The $d cash could not have been paid without the merger and Taxpayer’s available surplus of over $o.

Similar to UNUM, the Target policyholders received cash payments. The cash received was in addition to the ownership interests in the company, both of which were parts of a value-for-value exchange in a capital transaction. As Target’s financial advisors, Taxpayer, and Target indicated, the $d payment was part of the consideration

[21]Moreover, worker’s compensation policies were the only policies that historically received dividends each year, and Target only paid approximately $r in policyholder dividends over the last two years on the worker’s compensation policies.

paid to the Target policyholders in the merger transaction in the value-for-value exchange. Just as the court decided in UNUM, the cash amounts paid to the policyholders should not be deductible as policyholder dividends.

We agree with the Field that the $d cash amounts paid are not policyholder dividends as defined in section 832(c)(11), but rather, boot paid to the former Target policyholders as part of the consideration in the exchange of their ownership interests in Target for ownership interests in Taxpayer.

The next issue the TAM addresses is whether, under the rationale of Clark v. Commissioner, 489 U.S. 726 (1989), cash boot treated as received by the Target policyholders in redemption of their ownership interests in Taxpayer, has the “effect of the distribution of a dividend” (within the meaning of section 356(a)(2)).

C. The Clark Analysis

In Clark, the Supreme Court determined whether gain recognized under section 356 of the Code on the receipt of boot in an acquisitive reorganization should be treated as a dividend. In that case, the shareholder of a target corporation exchanged target stock for stock of an acquiring corporation and cash. The issue in Clark was whether the cash payment of boot should be treated as if it were made (1) by the target corporation in a hypothetical section 302 redemption of a portion of the shareholder's target stock prior to and separate from the reorganization exchange, or (2) by the acquiring corporation in a hypothetical section 302 redemption of the acquiring stock that the shareholder would have received in the reorganization exchange if there had been no boot distribution. The court concluded that the treatment of a boot distribution is determined "by examining the effect of the exchange as a whole," and held that the latter approach better tested the effect of the payment of boot as a component in the overall exchange. The court stated, “this approach acknowledges that there would have been no cash payment absent the exchange and also that, by accepting the cash payment, the taxpayer experienced a meaningful reduction in his potential ownership interests.” 489 U.S. at 737, 739.

The Supreme Court then applied the dividend equivalency rules for redemptions under section 302 to determine whether the boot payment had the effect of a dividend distribution under section 356(a)(2). The Court determined whether the boot payment had the effect of a dividend distribution by comparing the interest the taxpayer actually received in the acquiring corporation with the interest the taxpayer would have had if solely stock of the acquiring corporation had been received in the reorganization exchange. In applying section 302 to the hypothetical section 302 redemption of the acquiring corporation stock that the shareholder would have received in the reorganization transaction (i.e., had it received additional stock rather than boot), the court concluded that the boot payment did not have the effect of a dividend and that the payment was properly treated as capital gain.

Under the test adopted by the Supreme Court in Clark, whether the boot payment in the instant case to the former Target policyholders had the effect of a dividend distribution is determined by treating the former Target policyholders as having received additional ownership interests in Taxpayer (to the extent of the cash boot received) and then as having those additional ownership interests redeemed. See Rev. Rul. 93-61, 1993-2 C.B. 118. In applying section 302 to the redemption of those additional ownership interests, the Target policyholders experienced reductions in their proportionate interests in the corporation, resulting in section 302(b)(1) exchange treatment.[22]

One purpose for the enactment of section 302(b)(1) of the Code was to provide capital gain treatment for redemptions of stock held by certain minority shareholders, especially minority holders of preferred stock who exercise no control over corporate affairs. See S. Rep. No. 1622, 83rd Cong., 2d Sess., 44-45 (1954). The redemption in the instant case falls within the category of redemptions Congress intended to exclude from dividend treatment through the enactment of section 302(b)(1) of the Code since the redemption involves minority shareholders whose relative ownership interests are minimal and who exercise no control over the affairs of the corporation. The transaction, which involves the acquisition of Target having approximately k policyholders by Taxpayer having approximately gg policyholders and significantly greater value than Target[23], results in a meaningful reduction of the policyholders' proportionate interests in the corporation under section 302(b)(1). See Rev. Rul. 76-385,1976-2 C.B. 92; Rev. Rul. 75-502, 1975-2 C.B. 111; see also, Bittker& Eustice, Federal Income Taxation of Corporations and Shareholders, ¶12.44[2][c] (7^{th} ed. 2002) (where, as a result of Clark, "the Supreme Court impos[ed] virtually an automatic-capital-gain finding in the case of boot paid in a typical two-party acquisitive reorganization transaction"). Accordingly, the boot payments to the former Target policyholders do not have the effect of the distribution of a dividend under section 356(a)(2). Consequently, the Service believes this TAM does not need to further address Taxpayer's argument that even if the $d amounts are viewed as a component of the exchange, the amounts are boot taxable as dividends under section 356 and (in Taxpayer's view) deductible as policyholder dividends.

The $d cash amounts are not policyholder dividends as defined in section 832(c)(11), but rather, cash amounts paid to the former Target policyholders as part of the merger consideration. Therefore, the cash amounts are not deductible.

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[22]Section 302 contains rules for determining whether payments in redemption of stock are treated as payments in exchange for the stock or as amounts to which section 301 applies. Under section 302, a redemption will be treated as an exchange if it satisfies one of the tests of section 302(b). Section 302(b)(1) provides that section 302(a) will apply if the redemption is not essentially equivalent to a dividend.

[23]After the merger transaction, the former Target policyholders represented approximately mm% - hh% of the Taxpayer policyholders. See Testimony of Taxpayer's Representative II, before State Y Commissioner of Insurance, at p. .

CAVEAT(S)

A copy of this technical advice memorandum is to be given to the Taxpayer. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.