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Person to Contact:

Telephone Number:

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Date:
February 9, 1999

Company =

Stock insurance company =

Holding =

Sub =

State A =

State B =

Transfer Agent =

Date 1 =

This responds to your letter requesting rulings as to certain income tax consequences of a proposed transaction. The information submitted is summarized below.

Company is a mutual property and casualty insurance company that provides a broad range of property and casualty insurance products for individuals and businesses. Company was organized under State A law and is a calendar year, accrual basis taxpayer. It is the common

parent of a consolidated group. Company has no capital stock and no shareholders. Its policyholders have membership interests that are attached to each policy and are not separately transferrable. The policyholders of Company have a right to policyholder dividends when and if they are declared by Company's Board of Directors. Policyholders of Company also have liquidation rights, the right to vote for the board of directors, and certain other voting rights.

For what are represented as valid business reasons, Company proposes to convert into a stock insurance company under state A law (the Conversion) and to restructure its group (the Restructuring). To implement the Conversion and Restructuring, the following transactions have been proposed:

(i) Company's Board of Directors adopted a plan of conversion on Date 1 ("Adoption Date").

(ii) Company, will form Holding as a State A business corporation and wholly-owned subsidiary of Company.

(iii) Company will cause Holding to form Subsidiary, a State B corporation, and wholly-owned subsidiary of Holding.

(iv) Company will amend and restate its Articles of Incorporation under State A's Insurance Code authorizing it to issue capital stock and it will change its name to stock insurance company.

(v) Company will issue a Global Stock Certificate to Transfer Agent to hold for the benefit of the policyholders who held an Insurance Policy In Force on the Adoption Date ("Eligible Policyholders") in sole consideration for the Eligible Policyholders' membership interests. The Global Stock Certificate will represent one share of stock for every Eligible Policyholder. References hereinafter to "Company" shall refer both to that company prior to its conversion into a stock insurance company and to the company after that conversion, as the context requires.

(vi) Holding will issue shares of its common stock to the Transfer Agent to hold on behalf of the Eligible Policyholders in exchange for the Global Stock Certificate which evidences the Eligible Policyholders' shares of stock in Company. One share of Holding common stock will be issued for each share of Company that is evidenced by the Global Stock Certificate.

(vii) The Transfer Agent will distribute the common stock in Holding to all Eligible Policyholders.

(viii) Company will surrender and deliver the shares of Holding held by it to Holding for no consideration. Holding then will cancel such shares.

(ix) Holding will contribute all of the shares of Company to Subsidiary.

(x) Holding may grant stock options to directors, officers, and key employees of Holding to purchase up to 20% of the total shares of Company outstanding on a fully diluted basis after giving effect to the Conversion and Restructuring. The exercise price will be equal to the book value of Company divided by the total number of outstanding shares of Holding stock after the Conversion.

(xi) Holding will issue shares of Convertible Preferred Stock in Holding (“Preferred Stock”) to the trustee of the Employee Stock Ownership Plan (“ESOP”) at a price per share equal to the book value of Company. The Preferred Stock shall be convertible into Holding common stock after the date of the Conversion and Restructuring at the election of the ESOP trustee into such number of shares of Holding common stock outstanding on a fully diluted basis that shall comprise 10% of the total capital stock of Holding .

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.

The following representations have been made in connection with the transaction:

(1) Company will issue only voting common stock in the Conversion.

(2) The fair market value of the Company stock deemed to be issued by it in exchange for the Eligible Policyholders’ membership rights approximately equals the fair market value of the membership rights surrendered in exchange therefor. Although there is not a market for the membership rights, the Commissioner of Insurance for State A is required by law to determine that the consideration paid to the Eligible Policyholders is fair and reasonable.

(3) Company has no plan to redeem or otherwise reacquire any of the stock issued in the proposed recapitalization.

(4) At the time of the proposed recapitalization, Company will not have outstanding any stock options, warrants, convertible securities or any other right that is convertible into any class of stock or securities of Company.

(5) Company will continue to conduct the property and casualty insurance business operations of Company after the proposed recapitalization.

(6) The Eligible Policyholders will not retain any rights in the membership interests transferred to the Company in exchange for shares of Company common stock.

(7) The Conversion is a single, isolated transaction and is not part of a plan to periodically increase the proportionate interest of any shareholder or policyholder in the assets or earnings and profits of Company.

(8) Each of the parties described in transactions above will pay its own expenses, if any, incurred in connection with the transactions.

(9) Company is not under the jurisdiction of a court in a Title 11 or similar case within the meaning of Section 368(a)(3)(A) of the Internal Revenue Code.

(10) Following the Conversion, Company's corporate existence will continue, and it will be treated under State A law as the same entity that existed as a mutual company.

(11) The conversion will not result in any fractional share interests in Company.

(12) Eligible Policyholders will not receive any property other than Company common stock in the Conversion.

(13) The distribution of Company common stock will be received by Eligible Policyholders in relinquishment of their membership rights in Company as part of a value for value exchange. Although there is no market for the membership rights, the Commissioner of Insurance for State A is required to determine that the consideration paid to the Eligible Policyholders is fair and reasonable.

(14) Immediately after the Conversion and Restructuring, Holding and its direct and indirect subsidiaries will continue to own substantially all of the assets that were held by Company, and its direct and indirect subsidiaries prior to the Conversion and Restructuring.

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

- (1) For Federal income tax purposes the Conversion and Restructuring, will be treated as the exchange by Eligible Policyholders of their membership rights in Company for Company stock followed by their transfer of such stock to Holding in exchange for newly issued common stock of Holding.
- (2) The change in the form of operation of Parent from a mutual insurance company to

a stock insurance company and the deemed exchange by Eligible Policyholders of their membership rights in Company for common stock of Company will constitute a recapitalization within the meaning of section 368(a)(1)(E) of the Code. Company will be “a party to a reorganization” within the meaning of section 368(b).

- (3) No gain or loss will be recognized by the Eligible Policyholders on the deemed exchange of their membership rights in Company for common stock of Company (section 354(a)(1)).
- (4) The basis of each Eligible Policyholder in its membership rights is zero. Rev. Rul. 71-233, 1971-1 C.B. 113; see Rev. Rul. 74-277, 1974-1 C.B. 88. The basis of Company common stock deemed to have been received in the hands of each Eligible Policyholder will be zero, the same as its basis in the membership rights surrendered in exchange therefor (section 358(a)(1)).
- (5) The holding period of the Company common stock deemed to have been received by each Eligible Policyholder will include the period during which the membership rights exchanged therefor were held, provided that the membership rights are held as a capital asset on the date of the exchange (section 1223(1)).
- (6) No gain or loss will be recognized by Company on its deemed issuance of Company common stock in exchange for the Membership rights of Eligible Policyholders (section 1032).
- (7) The conversion of Company from a mutual insurance company to a stock insurance company will not cause Company to realize income and Company’s basis in its assets, holding period for its assets, net operating loss carryovers, capital loss carryovers, earnings and profits, and accounting methods will not be changed by reason of the Conversion (sections 362(b), 1223(2) and 381(a)(2)).
- (8) The deemed transfer by the Eligible Policyholders of Company common stock to Holding in exchange for newly issued shares of Holding common stock together with the purchase by the ESOP of newly issued shares of the Preferred Stock will be treated as an exchange described in section 351.
- (9) The affiliated group of which the Company was the common parent immediately before the proposed transaction will remain in existence after the consummation of the proposed transaction with Holding as the common parent. (Section 1.1502-75(d)(2)(ii) of the regulations and Rev. Rul 82-152, 1982-2 C.B. 205).
- (10) For purposes of § 1.1502-31 and § 1.1502-33, the Restructuring will be a "group

structure change." Holding's basis in Company's stock immediately after the group structure change will be its 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 Holding, will be adjusted immediately after Holding becomes the new common parent to reflect the earnings and profits of Company immediately before Company ceases to be the common parent. See, § 1.1502-33(f).

No opinion is expressed as to the tax treatment of the transaction under other provisions of the Code or 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 ruling.

No opinion is requested and no opinion is expressed about whether the Convertible Preferred stock discussed in (xi) above is stock described in section 351(g). Moreover no opinion was requested and none is expressed about the transaction described in (ix) above.

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

This ruling is directed only to the taxpayer requesting it. Section 6110(j)(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 the taxpayer for the taxable year in which the transaction covered by this ruling is consummated.

Sincerely yours,

Assistant Chief Counsel (Corporate)

By: *Lewis K. Brickates*

Lewis K. Brickates

Assistant to Branch Chief, Branch 2