

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:  
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Date:  
May 19, 1999

Government =

Insurance Business =

Unit =

Predecessor =

Newco =

Policyholders =

Interests =

Privatization Legislation =

Chief Elected Official =

Contracts =

Constitution =

Date A =

Date B =

Date C =

Dear :

This letter responds to your letter of April 12, 1999, as supplemented by letters of April 22, 1999 and April 27, 1999, requesting rulings on certain federal income tax consequences of proposed transactions.

### **Summary of Facts**

Government has conducted the Insurance Business through Unit or Predecessor since Date A. For purposes of this letter ruling, Government includes Unit.

For what are represented to be valid business reasons, Government proposes to move the Insurance Business from public to private ownership after the Privatization Legislation has been enacted into law and the Chief Elected Official of Government determines that certain requirements set forth in the Privatization Legislation have been satisfied. This move will be accomplished through the following transactions (the "Formation Transactions"):

- (i) As of Date B, Unit will transfer assets relating to the Insurance Business (the "Transferred Property") to Newco, and Newco will assume all of the liabilities related to the Transferred Property.
- (ii) Newco will issue all of its Interests directly to the Policyholders. The Interests will entitle holders to vote for a board of directors, to receive policyholder dividends if and when declared, and to share in the assets of Newco on liquidation. The Contracts issued by Unit will by operation of law become Contracts issued by Newco.

### **Representations**

The taxpayer has made the following representations concerning the Formation Transactions (based on the characterization of the Formation Transactions set forth in ruling (1)):

- (a) No stock or securities will be issued for services rendered to or for the benefit of Newco in connection with the Exchange (as defined in ruling (1) below), and no stock or securities will be issued for indebtedness of Newco that is not evidenced by a security or for interest on indebtedness of Newco that accrued on or after the beginning of the holding period of Government for the debt.

- (b) Government will not retain any significant power, right, or continuing interests, within the meaning of § 1253(b) of the Internal Revenue Code, in the trademarks or trade names being transferred.
- (c) The Exchange is not the result of the solicitation by a promoter, broker, or investment house.
- (d) Government will not retain any rights in the property transferred to Newco (other than as a Policyholder).
- (e) The fair market value of the assets transferred by Government to Newco will equal or exceed the sum of the liabilities assumed by Newco plus any liabilities to which the transferred assets are subject.
- (f) The liabilities of Government to be assumed by Newco were incurred in the ordinary course of business and are associated with the assets to be transferred.
- (g) There will be no indebtedness created in favor of Government as a result of the transaction. There may be indebtedness between Government and Newco as a result of dealings in the ordinary course of business.
- (h) The transfers and exchanges will occur under a plan agreed upon before the Exchange in which the rights of the parties are defined.
- (i) All exchanges will occur with an expedition consistent with orderly procedure.
- (j) There is no plan or intention on the part of Newco to redeem or otherwise reacquire any stock or indebtedness issued in the proposed transaction.
- (k) Taking into account any issuance of additional shares of Newco stock; any issuance of stock for services; the exercise of any Newco stock rights, warrants, or subscriptions; a public offering of Newco stock; and the sale, exchange, transfer by gift, or other disposition of any of the stock of Newco deemed received by Government in the Exchange, Government will be in "control" of Newco under § 368(c) immediately after the Exchange.
- (l) In the Exchange, Government will constructively receive equity interests in Newco approximately equal to the fair market value of the property transferred to Newco.
- (m) Newco will remain in existence and retain and use the property transferred

to it in a trade or business.

- (n) There is no plan or intention by Newco to dispose of the transferred property other than in the normal course of business operations.
- (o) Government and Newco each will pay its own expenses, if any, incurred in connection with the proposed transaction.
- (p) Newco will not be an investment company within the meaning of § 351(e)(1) and § 1.351-1(c)(1)(ii) of the Income Tax Regulations.
- (q) Government is not under the jurisdiction of a court in a title 11 or similar case (within the meaning of § 368(a)(3)(A)), and the stock or securities received in the Exchange will not be used to satisfy the indebtedness of such debtor.
- (r) Newco will not be a "personal service corporation" within the meaning of § 269A.
- (s) Unit would be permitted under the Constitution of Government to own all of the stock or other equity ownership interests in Newco.
- (t) Newco will report its operations on a calendar-year basis using the accrual method of reporting prescribed by the National Association of Insurance Commissioners.
- (u) Newco will adopt as the amount of its Date B opening balance of undiscounted unpaid losses the amount as of Date C of the undiscounted unpaid losses of Government.

### **Rulings**

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

- (1) For Federal income tax purposes, the Formation Transactions will be treated as if (a) Government had transferred the Transferred Property to Newco as of Date C in exchange for all of the Interests in Newco and the assumption by Newco of related liabilities (the "Exchange") and (b) Government had transferred the Interests to the Policyholders (see D'Angelo Associates, Inc. v. Commissioner, 70 T.C. 121 (1978)).
- (2) The Interests deemed received by Government in the Exchange will be treated as stock under § 351(a).

- (3) No gain or loss will be recognized by Government in connection with the Exchange (§ 351(a)). The requirement of § 351(a) that Government control Newco immediately after the exchange will be satisfied because Government has the right, in choosing the method of privatizing the Insurance Business, either to retain the Interests or to designate other persons to receive the Interests (see D'Angelo Associates, Inc. v. Commissioner).
- (4) No income, gain, or loss will be recognized by Newco as a result of the Exchange (§ 1032(a)).
- (5) The basis of each item of Transferred Property received by Newco in the Exchange will equal the basis of that item in the hands of Government immediately before the Exchange (§ 362 (a)).
- (6) The holding period of each item of Transferred Property received by Newco in the Exchange will include the holding period of that item in the hands of Government immediately before the Exchange (§ 1223(2)).
- (7) For the taxable year in which Government enters into the Formation Transactions, Newco will include in its reserves at the beginning of that year for purposes of § 832(b)(5) the ending balances of the reserves (determined pursuant to § 846 on a discounted basis) that Government held immediately before the transaction, in connection with the Contracts that were the subject of the transaction, and Newco will not take into premium income for purposes of § 832(b)(4) any amount with respect to the assets transferred to it in consideration of the assumption of liabilities in connection with the transaction (cf. Rev. Rul. 94-45, 1994-2 C.B. 39 (concerning a life insurance company's § 351 transfer of insurance and annuity contracts and investment assets to a subsidiary)).
- (8) The realization of the value of any insurance in force transferred in the exchange will not be subject to the provisions of § 832, nor will Newco be entitled to deduct as a deferred expense an amount equal to that value (cf. Rev. Rul. 94-45).

### **Caveats**

No opinion is expressed about the tax treatment of the transactions under other provisions of the Internal Revenue Code and Income Tax Regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the transactions that are not specifically covered by the above rulings. In particular no opinion is expressed regarding:

(a) The characterization for tax purposes of the deemed transfer by Government to the Policyholders of the Interests in Newco described above in ruling (1)(a) and

(b) The tax basis that the Policyholders will have in the Interests following the deemed transfer described above in ruling (1)(a).

### **Procedural Statements**

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

Each taxpayer involved in the transaction should attach a copy of this letter to the taxpayer's federal income tax return for the taxable year in which the transactions are completed.

In accordance with the power of attorney on file in this office, a copy of this letter is being sent to the taxpayer.

Sincerely,

Assistant Chief Counsel (Corporate)

By: \_\_\_\_\_  
Wayne T. Murray  
Senior Technician Reviewer  
Branch 4