

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:  
CC:DOM:CORP-PLR-102145-99  
Date:  
September 22, 1999

Mutual =  
Holding Company =  
Trustee =  
Custodian =  
State A =  
State B =  
Date 1 =

Dear :

This is in response to your letter dated January 13, 1999, regarding a proposed transaction. Additional information was supplied in subsequent submissions. In a letter dated May 18, 1999, you withdrew requested rulings (5) and (7), modified ruling request (8) and requested two additional rulings. In a letter dated August 2, 1999, you withdrew ruling request (2) of the May 18, 1999 supplement ruling request. In a letter dated September 9, 1999, you withdrew requested ruling (10) of the January 13, 1999 submission.

The facts submitted indicate that Mutual is a mutual life insurance company organized under the laws of State A. Mutual is the common parent of an affiliated group which files a life-nonlife consolidated return.

As a mutual insurance company, Mutual has no authorized, issued or outstanding stock. The policyholders of Mutual, through purchases of policies, acquire both insurance coverage and certain rights ("Membership Interests") in Mutual. These rights, which arise by operation of State A law, include the right to vote to elect directors of the company and rights to share in the surplus of the company, including the right to receive a share of the company's surplus upon a liquidation of the company.

PLR- 102145-99

Mutual has determined that it can raise capital more efficiently and have greater flexibility to make acquisitions if it becomes a stock company. This will enable Mutual to increase its market leadership and financial strength, providing additional security for existing and future policyholders. Therefore, the Mutual Board of Directors authorized the development of a plan of reorganization (the "Plan") for Mutual to convert to a stock life insurance subsidiary of a stock holding company ("Holding Company"). Under the Plan, Mutual's eligible policyholders will receive common stock of the Holding Company, cash or Policy Credits as consideration for the termination of their Membership Interests in Mutual (the "Demutualization"). The Holding Company common stock will be held through a trust (the "Trust") to be established for the benefit of the policyholders who are to receive stock under the terms of the Plan (also referred to as the "Beneficiaries"). Trust will be governed by the laws of State B.

To accomplish the Demutualization, the following transactions are proposed:

- i. Prior to the effective date of the Demutualization (the "Effective Date"), Mutual will form Holding Company as a wholly-owned subsidiary of Mutual.
- ii. On the Effective Date, the Mutual policyholders' Membership Interests in Mutual will be extinguished by operation of law.
- iii. Mutual will issue 100% of its common stock to the Trust on behalf and for the benefit of the Mutual policyholders (also referred to as Beneficiaries). The Beneficiaries will be issued "Trust Interests" reflecting their proportionate ownership of the shares held in the Trust.
- iv. Immediately thereafter, the Trust will exchange the shares of Mutual common stock that it received in step iii. above for shares of Holding Company common stock (also referred to as "Trust Shares"), such Holding Company common stock to be held for the exclusive benefit of the Beneficiaries.
- v. Mutual will surrender to the Holding Company, and the Holding Company will cancel, all of the remaining shares of Holding Company common stock held by Mutual immediately prior to the Effective Date.
- vi. Mutual will establish a liability on its books reflecting the aggregate amount that the Mutual Board of Directors anticipates will be credited to policyholders who are required to receive Policy Credits as consideration under the terms of the Plan and the aggregate amount of cash payable to policyholders who are entitled to receive cash under the terms of the Plan.

PLR- 102145-99

- vii. On the same date that the Plan becomes effective, the Holding Company will sell shares of its common stock to the public through an initial public offering (“IPO”). The Holding Company shares that will be sold in the IPO will have rights and preferences with respect to voting, dividends, sharing on liquidation and all other matters that are identical to those of the Holding Company shares issued to the Trust on the Effective Date.
- viii. Following the Demutualization, the number of outstanding shares of Mutual stock will be reduced pursuant to a recapitalization.

Under the terms of the Plan, all eligible policyholders will ultimately receive Holding Common stock (to be held by the Trust for the benefit of such eligible policyholders), except cash will be distributed by Mutual to (i) policyholders who elect to receive cash, (ii) policyholders with non-U.S. mailing addresses and (iii) policyholders with respect to which it is determined that it is not reasonable feasible to provide consideration in the form of stock. In addition, under the Plan, consideration will be paid through the addition of Policy Credits by Mutual in cash or stock for qualifying policies that are (i) tax-sheltered annuities within the meaning of section 403(b), (ii) individual retirement annuities within the meaning of section 408 or 408A, and (iii) individual annuity contracts and individual life insurance policies issued directly to a plan participant pursuant to a plan qualified under section 401(a) or 403(a). Policyholders who elect to receive cash will receive a cash payment from Mutual as soon as is reasonably practicable following the Plan Effective Date in consideration of the extinguishment of their Membership Interests.

Each Beneficiary will be issued a number of Trust Interests equal to the number of shares (“Trust Shares”) of Holding Company allocated to such Beneficiary under the terms of the Plan. All Trust Interests will be held in the name of a custodian (the “Custodian”) who will keep records of all Beneficiaries’ Trust Interests, including a list of the names of each Beneficiary and such Beneficiary’s Trust Interests.

In addition to the Trust Interests received by the Beneficiaries as described above, each Beneficiary that holds fewer than 1,000 Trust Interests may make an election to purchase additional shares of Holding Company common stock. The additional shares of Holding Company common stock that are purchased on behalf of a Beneficiary will be delivered to the Trustee of the Trust to be deposited in Trust in exchange for additional Trust Interests that will be distributed to the Beneficiary.

Beneficiaries of the Trust will be able to withdraw Trust Shares for sale (Sale Election) at prevailing market prices through a Purchase and Sale Program. Trust Shares will be sold through an independent agent in the market or, in Holding Company’s discretion, to Holding Company at market prices pursuant to a share repurchase program to be established by Holding Company’s board of directors (Board). In addition, a Beneficiary may withdraw (Withdrawal Election) the Trust

PLR- 102145-99

Shares allocable to the Beneficiary, in kind, from Trust in liquidation of all of the Beneficiary's Trust Interests beginning on the first anniversary of the Effective Date.

Following the Effective Date, Beneficiaries may also elect to participate in any tender or exchange offer for Holding Company common stock. If a Beneficiary elects to participate, the Beneficiary's allocable Trust Shares will be withdrawn from the Trust in liquidation of the Beneficiary's Trust Interest and the allocable Trust Shares will be tendered or exchanged on behalf of the Beneficiary. Further, in the event there is a transaction which would result in the exchange or conversion of Trust Shares for cash or other property, a Beneficiary may elect to receive consideration other than in the form of common stock of the acquirer. If the Beneficiary so elects, the Beneficiary's allocable Trust Shares will be withdrawn from Trust in liquidation of the Beneficiary's Trust Interests.

In addition, the Board may terminate the Trust if the number of Trust Shares falls below 25% of all outstanding shares of Holding Company common stock. In any event, the Trust will terminate when the number of Trust Shares held by Trust is less than 10% of the outstanding Holding Company common stock. Upon termination of Trust, all remaining Trust Shares, and any accumulated distributions thereon, will be distributed by the Trustee to the Beneficiaries. At that time, Holding Company may offer to purchase all or a portion of the Trust Shares to be distributed and Beneficiaries will be given the opportunity to elect to have Holding Company purchase all or some of their allocable Trust Shares.

Under the Trust Agreement, the Trustee has only the powers set forth in the Trust Agreement. The Trust Agreement provides that the Trust will hold Trust Shares of Holding Company. Except for the investment of distributions on the Trust Shares pending distributions to Beneficiaries, as described below, the Trustee has no power under the Trust Agreement to acquire other assets.

Under the Trust Agreement, on all matters other than Beneficiary Consent Matters, as defined in the Trust Agreement, the Trustee has the exclusive and absolute right to vote, assent, or consent the Trust Shares in favor of and in opposition to such matter, or abstain from voting on such matter, in accordance with the recommendation given by the board of directors of the Holding Company to its stockholders in respect of the matter, or, if no such recommendation is given, as directed by the board of directors of the Holding Company. With respect to any such matter other than a Beneficiary Consent Matter for which no such recommendation is provided to the Holding Company's stockholders, the board of directors of the Holding Company shall provide voting directions to the Trustee.

The Trustee must request instructions from the Beneficiaries in accordance with the Trust Agreement and must vote, assent, consent, or abstain on the matter in accordance with the conditions in the Trust Agreement if the matter is a Beneficiary

PLR- 102145-99

Consent Matter. Beneficiary Consent Matters include matters concerning:

- (1) the election or removal of directors of Holding Company, if a contesting stockholder of the Holding Company has in compliance with the provisions of the Holding Company's By-laws and applicable law given timely notice of the stockholder's proposal to (a) nominate one or more candidates or a slate of candidates for election as directors of the Holding Company, (b) oppose one or more nominees of the Holding Company's board of directors for election of directors, (c) remove one or more directors for cause, or (d) nominate one or more candidates for elections as directors of the Holding Company to fill the vacancy or vacancies resulting from the removal of one or more directors by the Holding Company's stockholders;
- (2) the merger or consolidation, of the Holding Company into or with any other person, the sale, lease or exchange of all or substantially all of the property or assets of the Holding Company, or the recapitalization or dissolution of the Holding Company, in each case which requires a vote of the Holding Company's stockholders under applicable State B law, or any other transaction that would result in an exchange or conversion of Trust Shares for cash, securities, or other property;
- (3) prior to the first anniversary of the Plan Effective Date, the issuance of common stock after the Plan Effective Date at a price materially less than the then prevailing market price, other than through an underwritten offering or to officers, employees or insurance agents of the Holding Company or an subsidiary of the Holding Company pursuant to an employee benefits plan;
- (4) any proposal requiring the Board of Directors of the Holding Company to amend or redeem the rights under the Holding Company's stockholder rights plan, other than a proposal with respect to which the Holding Company has received advice of nationally-recognized legal counsel to the effect that the proposal is not a proper subject for stockholder action under State B law.

If at any time during the term of the Trust, the Trustee shall receive cash dividends upon any Trust Shares, the Trustee shall distribute the same together with interest, if any, earned on such cash dividend by the Trust, to the Custodian, which shall promptly distribute such amounts to each Trust Beneficiary pro rata in accordance with the Beneficiary's interests on the Holding Company's record date for the payment of the dividend.

Under the Trust Agreement, the Trustee shall distribute to the Custodian any

PLR- 102145-99

cash dividends received upon any Trust shares, together with any interest earned. The Custodian shall promptly distribute such amount to each Trust Beneficiary pro rata in accordance with the Trust Beneficiary's Interests on the Holding Company's record date for the payment of the dividend. Distributions of all regular cash dividends, if any, received by the Trust during any six-month period ending June 30 or December 31 in any calendar year (together with any interest earned thereon) shall be made on the following July 31 or January 31 (or, if such day is not a business day, on the first business day thereafter). Notwithstanding the foregoing, the Holding Company shall set a payment date for such dividends so that they are distributed by the Custodian to Trust Beneficiaries within 90 days after their receipt by the Trustee. Distributions of all other cash dividends to the Custodian shall be made on the first business day following the 30<sup>th</sup> day after receipt thereof by the Trust, and the Custodian shall promptly thereafter distribute such amounts to the trust Beneficiaries. Alternatively, the Trustee may arrange with the Holding Company for the direct payment by the Holding company of such cash dividends to the Trust Beneficiaries.

Pending distribution to the Custodian, cash dividends (unless distributed directly by the Holding Company to the Trust Beneficiaries) shall be invested by the Trustee in short term obligations of or guaranteed by the United States, or any agency or instrumentality thereof, and in certificates of deposit of any bank or trust company having, at the time of the investment, a combined capital and surplus not less than \$500,000,000. Any such obligations or certificates of deposit shall mature prior to the next distribution date and shall be held by the Trustee until maturity. The Custodian shall make all calculations of interest on cash dividends required to be paid to Trust Beneficiaries hereunder.

The Holding Company shall reimburse the Trustee for all reasonable out-of-pocket expenses incurred by the Trustee in performance of its duties under the Agreement. However, the Holding Company shall not be required to reimburse the Trust or the Trustee for the expense of mailing to the Custodian any proxy and other materials received by the Trustee from persons other than the Holding Company, including mailings with respect to any Beneficiary Consent Matter.

The following representations have been provided:

- a. To the best of Mutual's knowledge and belief, under the law, regulations and IRS rulings in effect as of the date hereof, the policyholder's receipt of Mutual voting common stock as consideration for the termination of their Membership Interest pursuant to the Plan will constitute a recapitalization within the meaning of section 368(a)(1)(E), provided the requested below are issued.
- b. To the best of Mutual's knowledge and belief, under the law, regulations and IRS rulings in effect on the date hereof, the transfer by the Trust to

PLR- 102145-99

the Holding Company of Mutual common stock in exchange for newly-issued shares of Holding Company common stock will constitute a transfer described in section 351(a) of the Code, provided the rulings requested below are issued.

- c. The Trust will, through the Custodian, cause Form 1099's reporting the Trust's items of income and deduction to be mailed on an annual basis to all Beneficiaries in respect of whom Form 1099's are required to be issued.

Section 7701(a)(3) of the Code provides that the term "corporation" includes associations.

Section 301.7701-4(c)(1) of the Procedure and Administration Regulations provides that an "investment trust" will not be classified as a trust if there is a power under the trust agreement to vary the investment of the certificate holders. However, an investment trust with a single class of ownership interests representing undivided beneficial interests in the assets of the trust will be classified as a trust if there is no power under the trust agreement to vary the investment of the certificate holders.

In Commissioner v. North American Bond Trust, 122 F. 2d 545 (2d Cir. 1941), cert. denied, 314 U.S. 701 (1942), the court stated that a power to vary the investment of the certificate holders exists if there is managerial power under the trust instrument that enables a trust to take advantage of market variations to improve the investment of the investors. The court held that a power to acquire new bonds upon the admission of new investors, where existing investors would acquire a pro rata interest in the new bonds, was a power to vary the investment of the existing investors, as the power allowed the trustee to take advantage of market variations in a manner that could improve the investment of the original investors.

Although a trustee may not actually exercise all the powers and discretion granted under the trust agreement, the parties are not at liberty to say that their purpose was other or narrower than that which they formally set forth in the instrument under which their activities were conducted. Helvering v. Coleman-Gilbert Associates, 296 U.S. 369, 374, (1935), XV-1 C.B. 261 (1936).

In Rev. Rul. 75-192, 1975-1 C.B. 384, a trustee receives principal and interest payments on a pool of mortgages. Under the trust agreement therein the trustee will make quarterly distributions of all principal and interest payments received to each investor in proportion to its interest. During the period between quarterly distribution dates, the trustee is required to invest cash on hand in short-term obligations of (or guaranteed by) the United States (or any agency or instrumentality thereof) and in certificates of deposit of any bank or trust company having a minimum stated surplus and capital. The trustee is permitted to invest only in obligations maturing prior to the

PLR- 102145-99

next distribution date and is required to hold such obligations until maturity. All the proceeds received from the mortgage payments along with the interest earned on these short-term investments and deposits will be distributed to the investors quarterly. The trustee has no authority under the trust agreement to purchase new securities or mortgages, or to make any other new investments.

In Rev. Rul. 86-92, 1986-2 C.B. 214, a trust holds tax-exempt bonds and contracts to purchase tax-exempt bonds. The contracts provide that the bonds must be transferred to the trust within 90 days of the trust's creation. If a bond is not transferred for reasons beyond the control of the trustee or the trust's sponsor, the sponsor has 20 days within which to transfer different bonds of substantially the same character and quality. The revenue ruling concludes that neither the trustee nor the sponsor has a power to take advantage of market variations to improve the investment of certificate holders. The powers are incidental to the organization of the trust.

In Rev. Rul. 90-63, 1990-2 C.B. 270, the trustee of an investment trust has a power to consent to changes in the credit support of debt obligations held by the trust. The power is exercisable only to the extent the trustee reasonably believes the change is advisable to maintain the value of trust property by preserving the credit rating of the obligations. The revenue ruling concludes that although it is possible for the change in credit support to result in an increase in the value of the trust property, the increase would be incidental to maintaining the value of the trust property. Thus, the trustee's limited power under the circumstances does not constitute a power to vary the investment of the trust as the term is used in section 301.7701-4(c) of the regulations.

In Rev. Rul. 75-192, each investor-certificate holder-beneficiary is treated as the owner of an aliquot portion of the trust pursuant to section 677(a).

The powers of the Trustee to vote the Trust Shares does not enable the Trustee to take advantage of market conditions to change the investment of the Trust. Like the powers in Rev. Rul. 86-92 and Rev. Rul. 90-63, the Trustee's power to vote is incidental to the maintenance and preservation of the trust property and is independent of market consideration. The power of the Trustee to alter the make-up of the Trust corpus is restricted to situations set forth in the Trust Agreement, and the power to vote on corporate actions is not inconsistent with the Trust Agreement and does not constitute a power to vary the investment.

The short-term obligations in which the Trustee may invest are similar to those in Rev. Rul. 75-192. The Trustee may invest only in obligations maturing prior to the next distribution date and must hold such obligations until maturity, limiting the Trustee to a fixed return similar to that earned on a bank account.

Section 1001 provides that the gain from the sale or other disposition of property shall be the excess of the amount realized over the adjusted basis provided in § 1011

PLR- 102145-99

for determining gain, and the loss shall be the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized.

Section 1.1001-1(a) of the Income Tax Regulations provides that gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent, is treated as income or as loss sustained.

When a grantor is treated as the owner of an entire trust, the grantor is considered to be the owner of the trust assets for federal income tax purposes. Rev. Rul. 85-13, 1985-1 C.B. 184.

Rev. Rul. 90-7, 1990-1 C.B. 153, provides that a certificate holder in an investment trust that has a single class of ownership interests and a fixed portfolio of stock does not recognize gain or loss when the certificates are exchanged for a proportionate share of the stock held by the trust. However, gain or loss is realized and recognized to the extent cash received in lieu of fractional shares exceeds (or falls short of) the certificate holder's adjusted basis in the fractional shares.

Pursuant to section 3.01(22) of Rev. Proc. 99-3, 1999-1 I.R.B. 106, the Internal Revenue Service will not rule as to whether § 351 applies to an exchange of stock for stock in the formation of a holding company. However, the Service has discretion to rule on significant subissues that must be resolved to determine whether a transaction qualifies under § 351. 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.

Accordingly, based on the information provided and the representations given, and provided that no Beneficiary receives cash in lieu of a fractional share in Holding Company, it is held as follows:

1. Trust will be classified as a trust for federal income tax purposes under § 301.7701-4(c) of the regulations and not as a business entity under § 301.7701-2; and (2) each Beneficiary of the Trust will be treated by reason of § 677(a), as the owner of an aliquot portion of the Trust, and all income, deductions and credits attributable to that portion are to be treated as those of the beneficiaries under § 671.
2. For U.S. Federal income tax purposes, the Beneficiaries receipt of Trust Interests in the Trust, as classified in ruling 1 above, as consideration for the termination of their Membership Interests pursuant to the Plan will be treated as (i) the exchange by the Beneficiaries of their Membership Interest in Mutual for voting common stock of Mutual, followed by (ii) the

PLR- 102145-99

transfer by the Beneficiaries of the Mutual stock that they are deemed to receive under clause (i) above to the Trust in exchange for Trust Interests.

3. The fact that (i) Mutual common stock will be issued to the Trust, as classified in ruling 1 above, prior to the transfer of the Mutual common stock to the Holding Company in exchange for Holding Company common stock, and (ii) the Trust will hold the Holding Common stock received in such exchange for the benefit of the Beneficiaries, will not affect the qualification of the exchange of the Mutual common stock for newly-issued Holding Company common stock as a transfer described in section 351(a).
4. No gain or loss will be recognized by a Beneficiary on the contribution of Mutual voting common stock to the Trust in exchange for Trust Interests.
5. No gain or loss will be recognized by a Beneficiary upon the withdrawal of Trust Shares from the Trust pursuant to a Sale Election, a Withdrawal Election, or in connection with a tender or exchange offer or a cash-election merger. Any gain or loss recognized upon a subsequent sale, exchange or other disposition of the withdrawn Trust Shares by a Beneficiary will be recognized solely by that Beneficiary.
6. No gain or loss will be recognized by a Beneficiary upon the distribution of Trust Shares to the Beneficiary in liquidation of the Beneficiary's Trust Interests upon termination of Trust. Any gain or loss upon the subsequent sale, exchange or other disposition of Trust Shares by the Beneficiary will be recognized solely by that Beneficiary.
7. Beneficiaries who receive Trust Interests in exchange for their Mutual stock will have a basis in their Trust Interests equal to the basis in the Mutual stock transferred to Trust on their behalf. A Beneficiary that receives Trust Interests in exchange for Holding Company common stock purchased on behalf of the Beneficiary will have a basis in those Trust Interests equal to the basis of the Holding Company common stock transferred to the Trust on the Beneficiary's behalf. Provided all of a Beneficiary's Trust Interests are acquired by the Beneficiary on the same day and at the same cost, the Beneficiary's basis in the Trust Shares distributed from Trust to the Beneficiary is determined by ratably apportioning the Beneficiary's basis in the Beneficiary's Trust Interests among all assets owned by the Trust according to the relative values of those assets on the date the Beneficiary acquired the Beneficiary's Trust Interests. A Beneficiary's holding period in a Beneficiary's Trust Shares will include the time the Trust Shares are held in the Trust for the benefit

PLR- 102145-99

of that Beneficiary. See § 1.1012-1 (c) of the regulations for rules that apply if a Beneficiary's Trust Interests are acquired on different dates or at different prices.

8. Generally, the policyholder's basis in their Membership interests in Mutual is zero. Rev. Rul. 71-233, 1971-1 C.B. 113; see Rev. Rul. 74-277, 1974-1 C.B. 88.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed or implied concerning the application of I.R.C. § 302 and Treas. Reg. §§ 1.1502-31, 1.1502-33 and 1.1502-75(d). No opinion is expressed or implied as to whether the transactions otherwise qualify under I.R.C. §§ 351 and 368(a)(1)(E). No opinion is expressed concerning requested rulings 6 and 10. Specifically, no opinion is expressed as to whether the reimbursement of the Trust's expenses by the Holding Company will give rise to taxable income to the beneficiaries of the Trust.

Furthermore, we are unable to rule on issue 2 of the supplemental ruling request. Section 8.01 of Rev. Proc. 99-1, 1999-1 I.R.B. 6, at 23, requires the taxpayer to provide all pertinent facts, and to include copies of all documents pertinent to the ruling request. The taxpayer has not provided the documents it proposes to insert in the Form 1099 mailing. We will be pleased to consider this issue substantively if the taxpayer complies with Rev. Proc. 99-1.

This ruling is directed only to the taxpayer(s) 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 must be attached to any income tax return to which it is relevant. In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,  
Philip J. Levine  
Assistant Chief Counsel  
By: Lewis K Brickates  
Assistant to the Branch Chief