

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:DOM:CORP:Br4 PLR-118050-
Date:

March 27, 2001

- Company 1 =
- Company 2 =
- Company 3 =
- Corp =
- Foreign Sub =
- Domestic Sub =
- Mutual Holding 1 =
- Stock Holding 1 =
- Stock Holding 2 =
- Merger Sub =
- Merger Sub 2 =
- Mutual Holding 2 =
- New Name =
- State A =
- State B =
- Country C =

State D =

Date 1 =

Date 2 =

a =

This letter responds to your September 15, 2000 request for rulings on certain federal income tax consequences of a proposed transaction. Related transactions are addressed in PLR-118048-00 and PLR-118041-00, both issued this date.

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

Summary of Facts

Company 1 is a State A property and casualty mutual insurance company taxable under §§ 831 and 835 of the Internal Revenue Code (the "Code"). Company 1 is the common parent of a large affiliated group of corporations that files a consolidated federal tax return. Company 1 has one life insurance subsidiary.

Company 2 is a State A property and casualty mutual insurance company taxable under §§ 831 and 835. Company 2 has no subsidiaries.

Company 3 is a State B mutual insurance company taxable under §§ 831 and 835 and is the common parent of an affiliated group of corporations that files a consolidated return. Company 3 has no life insurance subsidiaries.

As mutual insurance companies, Company 1, Company 2, and Company 3 have membership interests rather than capital stock to reflect proprietary ownership. These membership interests, which are owned by policyholders, provide (i) the right to vote, (ii) the right to distributions of surplus upon liquidation, (iii) the right to dividends if and when declared by the board of directors, and (iv) such other rights as conferred by the company articles of incorporation or bylaws and by State A or State B law.

On Date 1, Company 3 sold all of its then owned subsidiaries to unrelated Company 1 (the "Date 1 Sales"). Also on Date 1, Company 3 issued an a dollar surplus note to Company 1 in exchange for a dollars in cash (the "Exchange"). Company 3 used the proceeds from the Date 1 Sales and the Exchange to repay two surplus notes held by unrelated Corp, with the remainder becoming part of the Company 3 surplus. On Date 2 (more than six months ago), a wholly owned subsidiary of Company 1 sold all the stock of Foreign Sub, a Country C company that reinsures certain insurance policies issued by Company 3, to Company 3 (the "Date 2 Sale"). The Date 2 Sale was undertaken to align the ownership of Foreign Sub with that of Company 3, the primary source of Foreign Sub's business. Following the Date 2 Sale, Foreign Sub elected under § 953(d) to be treated as a domestic corporation for purposes of Title 26. Company 3 recently formed Domestic Sub under State D law, and, before the transactions proposed below, will contribute to Domestic Sub all of the Foreign Sub stock (the "Formation" and the "Contribution," respectively). Company 3, Foreign Sub, and Domestic Sub will file a consolidated federal tax return.

Proposed Transactions

For what are represented to be valid business reasons, it is proposed that, pursuant to an overall plan, (i) Company 1 convert into a stock insurance company controlled indirectly by newly formed Mutual Holding 1 and (ii) Mutual Holding 1 then acquire Company 2 and Company 3. More specifically:

Company 1 Conversion and Restructuring:

Upon satisfaction of various conditions precedent, Company 1 will convert into a stock insurance company controlled indirectly by Mutual Holding 1 as follows (the "Company 1 Conversion and Restructuring"):

(i) Under the laws of State A, Mutual Holding 1 will be formed on behalf of the Company 1 members, and Company 1 will organize Stock Holding 1 and Stock Holding 2. At no time before completion of the Company 1 Conversion (defined in step (ii) below) will Mutual Holding 1 be a member of the Company 1 affiliated group.

(ii) Company 1 will convert under the laws of State A into a stock insurance company (the "Company 1 Conversion" and "Reorganized Company 1"). In the Company 1 Conversion, (a) the Company 1 membership interests will be extinguished, (b) the former Company 1 members will automatically become Mutual Holding 1 members, and (c) Reorganized Company 1 will initially issue

all of its stock to Mutual Holding 1. Company 1 members will receive no consideration in the Company 1 Conversion other than Mutual Holding 1 membership interests, and existing Company 1 insurance policies will not change (*i.e.*, premiums, policy benefits, or other obligations to policyholders will remain the same).

(iii) Mutual Holding 1 will contribute the stock of Reorganized Company 1 to Stock Holding 1 in exchange for all the stock of Stock Holding 1.

(iv) Stock Holding 1 will contribute the stock of Reorganized Company 1 to Stock Holding 2 in exchange for all the stock of Stock Holding 2.

Mutual Holding Company 1 Acquisition of Company 2:

As expeditiously as possible following the Company 1 restructuring described above, Mutual Holding 1 will acquire Company 2 as follows:

(v) Mutual Holding 1 will form Merger Sub as a State A property and casualty stock insurance company.

(vi) Company 2 will convert into a State A property and casualty stock insurance company (the "Company 2 Conversion" and "Reorganized Company 2").

(vii) Merger Sub will merge into Reorganized Company 2, with Reorganized Company 2 surviving (the "Company 2 Reverse Subsidiary Merger"). In the Company 2 Reverse Subsidiary Merger, (a) the Company 2 membership interests will be extinguished, (b) the former Company 2 members will automatically become Mutual Holding 1 members, and (c) Reorganized Company 2 will issue all of its stock to Mutual Holding 1. Company 2 members will receive no consideration in the Company 2 Reverse Subsidiary Merger other than Mutual Holding 1 membership interests, and existing insurance policies of Reorganized Company 2 will not change (*i.e.*, premiums, policy benefits, or other obligations to policyholders will remain the same). Mutual Holding 1 membership interests existing before the Company 2 Reverse Subsidiary Merger will remain outstanding.

(viii) After the Company 2 Reverse Subsidiary Merger, Mutual Holding 1 will contribute the Reorganized Company 2 stock to Stock Holding 1, and Stock Holding 1 will contribute the stock to Stock Holding 2.

Mutual Holding Company 1 Acquisition of Company 3:

As expeditiously as possible following the Company 1 Conversion and Restructuring, Company 3 will convert into a stock insurance company and be acquired by Mutual Holding 1 as follows (the "Mutual Holding Company 1 Acquisition of Company 3"):

(ix) Mutual Holding 1 will form Merger Sub 2 as a State B corporation.

(x) Company 3 will form Mutual Holding 2 under State B law and will convert into a State B property and casualty stock insurance company (the "Company 3 Conversion" and "Reorganized Company 3"). Mutual Holding 2 is being formed to facilitate the acquisition of Company 3 by Mutual Holding 1. In the Company 3 Conversion, (a) the Company 3 membership interests will be extinguished, (b) the former Company 3 members will automatically become Mutual Holding 2 members, and (c) Reorganized Company 3 will initially issue all of its stock to Mutual Holding 2. Company 3 members will receive no consideration in the Company 3 Conversion other than Mutual Holding 2 membership interests, and existing Company 3 insurance policies will not change (*i.e.*, premiums, policy benefits, or other obligations to policyholders will remain the same). With the consent of the Commissioner of Insurance of State B, Reorganized Company 3 will change its name to New Name.

(xi) Merger Sub 2 will merge with and into Reorganized Company 3, with Reorganized Company 3 surviving (the "Company 3 Reverse Subsidiary Merger"). Simultaneously, Mutual Holding 2 will merge with and into Mutual Holding 1, with Mutual Holding 1 surviving (the "Mutual Holding 2 Merger" and together with the Company 3 Reverse Subsidiary Merger, the "Merger"). In the Merger, the Mutual Holding 2 membership interests will be extinguished, and the former Mutual Holding 2 members will automatically receive membership interests in Mutual Holding 1. Mutual Holding 2 members will receive no consideration in the Merger other than Mutual Holding 1 membership interests, and the existing insurance policies of Reorganized Company 1 and Reorganized Company 3 will not change (*i.e.*, premiums, policy benefits, or other obligations to policyholders will remain the same). Following the Merger, Mutual Holding 1 will own all the stock of Reorganized Company 3. Mutual Holding 1 membership interests existing before the Merger will remain outstanding.

(xii) Mutual Holding 1 will contribute the Reorganized Company 3 stock to Stock Holding 1, which in turn, will contribute it to Stock Holding 2.

You have requested rulings (a) that the Company 3 Conversion and step (x)(a) above together be treated as if the Company 3 members had exchanged

their Company 3 membership interests for all the stock of Reorganized Company 3 in a reorganization qualifying under § 368(a)(1)(E), (b) that the formation of Mutual Holding 2 and the Mutual Holding 2 Merger described above in steps (x) and (xi) be disregarded, (c) that the Reorganized Company 3 stock deemed held by former Company 3 members be treated as exchanged for membership interests in Mutual Holding Company 1 in the Company 3 Reverse Subsidiary Merger, and (d) that the Company 3 Reverse Subsidiary Merger as recast be treated as a reorganization under § 368(a)(1)(A) and (a)(2)(E). As an alternative to request (d), you have asked us to rule that the deemed exchange of Reorganized Company 3 stock for membership interests in Mutual Holding 1 in the Company 3 Reverse Subsidiary Merger will not violate the continuity of interest requirement of § 1.368-1(b) of the Income Tax Regulations.

Under section 3.01(23) of Rev. Proc. 2000-3, 2000-1 I.R.B. 103, 105-106, the Service will not rule on whether a transaction qualifies as a reorganization under §§ 368(a)(1)(A) and (a)(2)(E). The Service has the discretion, however, to rule on significant subissues that must be resolved to determine whether the transaction qualifies under § 368(a)(1)(A) and (a)(2)(E). The Service will rule on such subissues only 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.

Should we rule favorably on your request that the transaction be recast as requested in (a), (b), and (c) above and that the deemed exchange of Reorganized Company 3 stock for membership interests in Mutual Holding 1 in the Company 3 Reverse Subsidiary Merger will not violate the continuity of interest requirement of § 1.368-1(b), Company 3 represents that, to the best of its knowledge and belief, the Company 3 Reverse Subsidiary Merger is a reorganization qualifying under § 368(a) (1)(A) and (a)(2)(E).

Other Representations

Company 3 has made the following additional representations concerning the Mutual Holding Company 1 Acquisition of Company 3:

(a) The fair market value of the Reorganized Company 3 stock treated as received by the Company 3 members will approximately equal the fair market value of the Company 3 membership interests surrendered in exchange therefor.

(b) The Company 3 Conversion is not part of a plan to periodically

increase the proportionate interest of any Company 3 member in the assets or earnings and profits of Company 3.

(c) Following the Company 3 Conversion, Reorganized Company 3 will continue, as a stock insurance company, in the same business that Company 3 conducted before the Company 3 Conversion.

(d) Each party to the Company 3 Conversion will pay its, his, or her own expenses, if any, incurred in the Company 3 Conversion.

(e) The Company 3 Conversion will occur under a plan agreed upon before the Company 3 Conversion.

(f) Company 3 is not under the jurisdiction of a court in a Title 11 or similar case within the meaning of § 368(a)(3)(A).

(g) Following the Company 3 Conversion, Reorganized Company 3 will be treated under the laws of State B as the same corporation as Company 3 before the Company 3 Conversion.

(h) Immediately after the Company 3 Conversion, Mutual Holding 1 and its direct and indirect subsidiaries will continue to own substantially all the assets that were held by Company 3 and its direct and indirect subsidiaries before the Company 3 Conversion.

(i) Neither Company 1, Company 2, nor Company 3 is a life insurance company within the meaning of § 801.

Domestic Rulings

Based solely on the information submitted and the representations set forth above, we rule as follows on the Mutual Holding Company 1 Acquisition of Company 3:

(1) For federal income tax purposes, the transactions described in steps (x) and (xi) will be treated as if (i) the formation of Mutual Holding 2 and the Mutual Holding 2 Merger had never occurred, (ii) Company 3 had converted from a mutual insurance company to a stock insurance company, with the Company 3 members exchanging their Company 3 membership interests for Reorganized Company 3 stock; (iii) Merger Sub 2 then had merged into Reorganized Company 3, with the holders of Reorganized Company 3 stock exchanging the stock for membership interests in Mutual Holding 1; (iv) Mutual

Holding 1 then contributed the Reorganized Company 3 stock to Stock Holding 1 in exchange for stock of Stock Holding 1; and (v) Stock Holding 1 then contributed the Reorganized Company 3 stock to Stock Holding 2 in exchange for stock of Stock Holding 2.

(2) Provided Reorganized Company 3 is considered under State B law to be the same entity as Company 3 before the conversion, the conversion of Company 3 from a mutual insurance company to a stock insurance company and the constructive exchange of Company 3 membership interests for Reorganized Company 3 stock will be a recapitalization under § 368(a)(1)(E). Company 3 will be “a party to a reorganization” under § 368(b).

(3) No gain or loss will be recognized by the Company 3 members on their constructive exchange of Company 3 membership interests for Reorganized Company 3 stock (§ 354(a)(1)).

(4) The basis of each Company 3 membership interest is zero (Rev. Rul. 71-233, 1971-1 C.B. 113; Rev. Rul. 74-277, 1974-1 C.B. 88). The basis of the Reorganized Company 3 stock constructively received in exchange for a Company 3 membership interest will equal the basis of the Company 3 membership interest surrendered therefor (§ 358(a)(1)).

(5) The holding period of the Reorganized Company 3 stock constructively received in exchange for a Company 3 membership interest will include the period the Company 3 member held the Company 3 membership interest (§ 1223(1)).

(6) No gain or loss will be recognized by Reorganized Company 3 on its constructive issuance of Reorganized Company 3 stock for Company 3 membership interests (§ 1032(a)).

(7) Provided the requirements of § 368(a)(2)(E) are satisfied, the tax consequences of the Company 3 Reverse Subsidiary Merger will flow from § 368(a)(2) (E) rather than § 351.

(8) The Mutual Holding 1 membership interests received by Company 3 members in exchange for their ownership interests in Reorganized Company 3 will be treated as stock within the meaning of § 368 (Rev. Rul. 69-3, 1969-1 C.B. 103).

(9) The constructive exchange of Reorganized Company 3 stock for membership interests in Mutual Holding 1 in the Company 3 Reverse Subsidiary

Merger will satisfy the continuity of interest requirement of § 1.368-1(b).

Foreign Ruling

(10) Pursuant to § 953(d)(3), any loss of Foreign Sub will be treated as a dual consolidated loss and may not be used in the federal consolidated return in which Company 3 is participating to offset the income of any other member of the consolidated group.

Caveats

No opinion is expressed about the tax treatment of the above transactions under other provisions of the Code or regulations, or the tax treatment of any conditions existing at the time of, or effects resulting from, the above transactions that are not specifically covered by rulings (1) through (10). In particular, no opinion is expressed concerning:

(i) The federal income tax consequences of the Date 1 Sales, the Exchange, the Date 2 Sale, the Formation, and the Contribution;

(ii) Whether the contributions of Reorganized Company 3 stock to Mutual Holding 1, Stock Holding 1, and Stock Holding 2 each will qualify under § 351(a); and

(iii) The federal income tax consequences of the transactions described in steps (i) through (viii). Rulings on these transactions appear in letter rulings PLR-118048-00 and PLR-118041-00, both issued this date.

Our ruling that the Company 3 Conversion qualifies as a reorganization under § 368(a)(1)(E) is conditioned on Reorganized Company 3 being considered, under State B law, the same entity as Company 3 before the Company 3 Conversion. No opinion is expressed on whether this requirement will be met.

Procedural Statements

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

Each taxpayer affected by the above transactions should attach a copy of this ruling letter to its, his, or her federal income tax return for the taxable year in

which the transactions are completed.

Under a power of attorney on file in this office, a copy of this letter is being sent to each of your authorized representatives.

Sincerely,
Associate Chief Counsel (Corporate)
By: Wayne T. Murray
Senior Technician/Reviewer
Branch 4