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Person To Contact:

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Telephone Number:

Refer Reply To:

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Date:

July 27, 2004

Legend

Parent =

Target =

Common Parent =

Sub 1 =

Sub 2 =

Sub 3 =

Sub 4 =

State A =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

X =

Investment A =

Dear :

This letter responds to your January 23, 2004 request for rulings on certain federal income tax consequences of a proposed transaction. The information submitted in that request and in subsequent correspondence is summarized below.

The rulings contained 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

Common Parent is a mutual holding company and the parent of a consolidated group filing a life-nonlife consolidated return. Sub 1, a nonlife holding company, is a wholly owned subsidiary of Common Parent.

Sub 2 is a wholly owned subsidiary of Sub 1. Sub 2 is in the business of insuring life insurance, annuity, and other related risks. Sub 2 is taxed as a life insurance company under § 801 of the Internal Revenue Code (the "Code").

Sub 3 is a wholly owned nonlife subsidiary of Sub 2. Parent is a wholly owned nonlife subsidiary of Sub 3. Sub 3 and Parent are holding companies. Sub 1, Sub 2, Sub 3, and Parent are all members of Common Parent's life-nonlife consolidated group.

Parent wholly owns Target, which is in the business of insuring life insurance, annuity, and other related risks, and is taxed as a life insurance company under § 801.

Sub 4 is a wholly owned subsidiary of Target. Sub 4 is in the business of insuring life insurance, annuity, and other related risks and is taxed as a life insurance company under § 801. Sub 4 is a member of Target's life-life consolidated group.

On Date 1, Parent joined Common Parent's life-nonlife consolidated group. Target and Sub 4 file a life-life consolidated return.

Proposed Transaction

In order to promote efficiency by consolidating the insurance business and eliminating numerous federal and state regulatory and tax filings as well as to realize the value associated with Target's charters and licenses, the following transaction has been proposed (the "Proposed Transaction"):

- (i) Target will transfer assets, subject to liabilities, to Sub 4 in constructive exchange for Sub 4 stock and the assumption by Sub 4 of certain Target liabilities. Sub 4 and Target will enter into a reinsurance agreement whereby Sub 4 will assume Target's obligations to policyholders under Target's insurance and annuity contracts. After the receipt of the Target assets and liabilities, Sub 4 will continue the business transferred by Target with its existing business. In conjunction with the reinsurance transactions, Target plans to contribute additional cash and assets to Sub 4. To the extent that the policy obligations are assumed by Sub 4 under the Assumption Reinsurance Agreement (described below), there will be no continuing obligation to the policyholders on the part of Target.
- (ii) Target will adopt a plan of liquidation and distribute all of its remaining assets to Parent, except Target's corporate charter, state insurance licenses, and the minimum capital and surplus necessary to maintain in force the charter and licenses authorizing the conduct of the life insurance business (collectively, the "Retained Assets"). Parent will assume all of the liabilities of Target (other than those assumed by Sub 4 in step (i) above). As part of the liquidation of Target, the Sub 4 stock will be distributed to Parent. (The assets to be distributed to Parent before the sale described below are hereinafter referred to as the "Unwanted Assets" and the distribution of the Unwanted Assets is hereinafter referred to as the "Pre-Sale Distribution").
- (iii) Once the liquidating distributions are complete and Target holds only the Retained Assets, Parent will sell the stock of Target to an unrelated third party corporation ("Purchaser"). In conjunction with the sale of Target's stock, Parent and Purchaser will make a joint election to treat the stock sale as a deemed asset sale pursuant to § 338(h)(10).

To the extent necessary, the actual transfer of contracts from Target to Sub 4 will be governed by an indemnity agreement ("Coinsurance Reinsurance Agreement") as

well as an assumption reinsurance agreement (“Assumption Reinsurance Agreement”) (collectively, the “Reinsurance Agreements”). The Reinsurance Agreements entered into by Target and Sub 4 will be effective on the same day. The Reinsurance Agreements will be drafted in such a manner as to allow for the ultimate transfer of the Target business on an assumption reinsurance basis to Sub 4. However, for the period of time from the effective date of the Reinsurance Agreements until the assumption reinsurance transaction is complete, the Coinsurance Reinsurance Agreement will provide for the transfer of the economic benefit and obligations of the policies to Sub 4 through a 100 percent coinsurance agreement. Target and Sub 4 represent that this coinsurance arrangement is intended to be effective only until the necessary regulatory approvals or policyholder consents for the assumption reinsurance are obtained.

The Assumption Reinsurance Agreement will provide that Sub 4 will be the primary insurer of the risks, completely replacing Target. The agreement further will provide that the parties intend to effect a complete novation for contracts covered by the Assumption Reinsurance Agreement from the Target to Sub 4. Unless and until the Coinsurance Reinsurance Agreement is terminated, any contracts not yet subject to the Assumption Reinsurance Agreement, including those for which policyholder approval is not obtained, may revert to Target upon the occurrence of a number of events, including Sub 4’s insolvency. If a policyholder does not approve the assumption, that contract will not be subject to the Assumption Reinsurance Agreement.

Policyholder consent to the assumption of Target’s policies by Sub 4 is required in most states. However, some state insurance departments do not require policyholder approval of an assumption reinsurance transaction. Approval of the reinsurance transaction will be requested from the State A department of insurance since State A is Target’s state of domicile. After State A has approved the transaction, approval of the policyholders from whom consent is required will be requested if necessary.

Once the policy obligations are assumed by Sub 4 under the Assumption Reinsurance Agreement, there will be no continuing obligation to the policyholders on the part of Target.

Representations

The taxpayer has made the following representations in connection with step (i) above of the Proposed Transaction:

- (a) No stock or securities will be issued to Target for services rendered to or for the benefit of Sub 4 in connection with the Proposed Transaction, and no stock or securities will be issued for indebtedness of Sub 4 that is not evidenced by a security or for interest on indebtedness of Sub 4 which accrued on or after the beginning of the holding period of Target

for the debt.

- (b) No assets to be transferred to Sub 4 were received by Target as part of a plan of liquidation of another corporation.
- (c) Target neither accumulated receivables nor made extraordinary payment of payables in anticipation of the transaction. Sub 4 will report items which, but for the transfer, would have resulted in income or deduction to Target in a period after the transfer and such items will constitute income or deductions to Sub 4 when received or paid by it.
- (d) The proceeds received in collection of the income items will be included as ordinary income in computing the taxable income of Sub 4.
- (e) Stock of another corporation is not part of the property being transferred to Sub 4.
- (f) The transfer to Sub 4 is not the result of the solicitation by a promoter, broker, or investment house.
- (g) Target will not retain any rights in the property transferred to Sub 4.
- (h) The value of the stock received in exchange for accounts receivable will be equal to the net value of the account transferred, i.e., the face amount of the accounts receivable previously included in income less the amount of the reserve for bad debts.
- (i) The adjusted basis and the fair market value of the assets to be transferred by Target to Sub 4 will, in each instance, be equal to or exceed the sum of the liabilities to be assumed (within the meaning of § 357(d)) by Sub 4.
- (j) The liabilities of Target to be assumed by Sub 4 were incurred in the ordinary course of business and are associated with the assets to be transferred.
- (k) There is no indebtedness between Target and Sub 4, and there will be no indebtedness created in favor of

Target as a result of the transaction.

- (l) The transfers and exchanges will occur under a plan agreed upon before the transaction in which the rights of the parties are defined.
- (m) All exchanges between Target and Sub 4 will occur on approximately the same date. However, due to state approval limitations, the assumption of certain policyholder liabilities may occur on different dates.
- (n) There is no plan or intention on the part of Sub 4 to redeem or otherwise reacquire any stock or indebtedness to be issued in the proposed transaction.
- (o) Taking into account any issuance of additional shares of Sub 4 stock; any issuance of stock for services; the exercise of any Sub 4 stock rights, warrants, or subscriptions; a public offering of Sub 4 stock; and the sale, exchange, transfer by gift, or other disposition of any of the stock of Sub 4 to be received in the exchange, Target will be in "control" of Sub 4 within the meaning of § 368(c).
- (p) Although no additional shares of Sub 4 will be issued, the increase in value of Target's stock in Sub 4 will approximately equal the fair market value of the property transferred to Sub 4 or for services rendered or to be rendered for the benefit of Sub 4.
- (q) Sub 4 will remain in existence and retain and use the property transferred to it in a trade of business.
- (r) There is no plan or intention by Sub 4 to dispose of the transferred property other than in the normal course of business operations.
- (s) Each of the parties to the transaction will pay its own expenses, if any, incurred in connection with the proposed transaction.
- (t) Sub 4 will not be an investment company within the meaning of § 351(e)(1) and Treas. Reg. §1.351-1(c)(1)(ii).

- (u) Target 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.
- (v) Sub 4 will not be a "personal service corporation" within the meaning of § 269A .

The taxpayer has made the following representations in connection with steps (ii) and (iii) above of the Proposed Transaction:

- (w) Parent, on the date of adoption of the plan of liquidation and at all times until the final liquidating distribution is completed, will be the owner of at least 80 percent of the single outstanding class of Target stock.
- (x) No shares of Target stock will have been redeemed during the 3 years preceding the adoption of the plan of complete liquidation of Target.
- (y) Except as may occur in step (iii) above of the Proposed Transaction, all distributions from Target to Parent pursuant to the plan of complete liquidation will be made within a single taxable year of Target. In any event, Target will adopt a plan of liquidation specifying that the final liquidating distribution is to be completed within 3 years from the close of the taxable year of Target in which the first liquidating distribution is made.
- (z) As soon as the first liquidating distribution has been made, Target will cease to be a going concern and its activities will be limited to winding up its affairs, paying its debts, and distributing its remaining assets (other than the Retained Assets) to Parent. Target will remain in existence as an inactive subsidiary of Parent solely for the purpose of enabling Parent to protect the corporate charter, legal existence, and/or identity of Target. Target will retain its corporate charter and only those assets required under local law to maintain corporate existence (the "Minimum Capital"). Target will engage in no activity other than action required under local law to preserve its charter, legal existence, and/or identity.
- (aa) Target will retain its corporate charter and only those assets required under local law to maintain corporation existence and preserving its insurance licenses (Minimum Capital).
- (bb) The sole reason that Target will not be dissolved under local law is to isolate the value of Target's charter for resale to a purchaser that is not related to Target, Parent, or their shareholders. For purposes of this representation a purchaser that is not related is a purchaser that does not own, actually or constructively pursuant to § 318(a) of the Code as modified by § 304(c)(3), any stock of Target, Parent, or their shareholders.
- (cc) Target will retain no assets following the final deemed liquidating

distribution.

- (dd) Prior to the purchase of Target, Purchaser will not own, either actually or constructively pursuant to § 318 as modified by § 304(c)(3), any stock of Target or Parent or their shareholders.
- (ee) As soon as reasonably possible, and in any event within no more than 12 months from the date of the first liquidating distribution of the Unwanted Assets, Target will be dissolved under local law or sold to an unrelated purchaser.
- (ff) Other than the capital contribution by Parent of \$X in Date 2, the capital contribution of Investment A on Date 3, the § 351 transaction described in step (i) above, and the capital contribution by Parent of an amount necessary for Target to continue to meet the state minimum capital and surplus requirements, Target will not have acquired assets in any nontaxable transaction at any time, except for acquisitions occurring more than 3 years prior to the date of adoption of the plan of liquidation.
- (gg) Except for a cash dividend distribution on Date 4 and the transaction described in step (i) above, no assets of Target have been, or will be, disposed of by either Target or Parent except for dispositions in the ordinary course of business and dispositions occurring more than 3 years prior to adoption of the plan of liquidation.
- (hh) Except for the transaction described in step (i) above, the liquidation of Target will not be preceded or followed by the reincorporation, or transfer or sale to, a recipient corporation ("Recipient") of any of the businesses or assets of Target, if the persons holding, directly or indirectly, more than 20 percent in value of Target stock also hold, directly or indirectly, more than 20 percent in value of the stock in Recipient. For purposes of this representation, ownership will be determined by application of the constructive ownership rules of § 318 as modified by § 304(c)(3).
- (ii) Prior to the adoption of the liquidation plan, no assets of Target will have been distributed in kind, transferred or sold to Parent, except for (i) transactions occurring in the normal course of business; (ii) transactions occurring more than 3 years before adoption of the liquidation plan; and (iii) cash dividend distributions to Parent.
- (jj) Target will report all earned income represented by assets that will be distributed to Parent such as receivables being reported on a cash basis, unfinished construction contracts, and commissions due.
- (kk) The fair market value of the assets of Target will exceed their respective liabilities both at the date of the adoption of the plan of complete liquidation and immediately prior to the time the first liquidating distribution is made.
- (ll) There is no intercorporate debt existing between Parent and Target and

none has been cancelled, forgiven, or discontinued, except for transactions that occurred more than 3 years prior to the date of adoption of the liquidation plan.

- (mm) Parent is not an organization that is exempt from federal income tax under § 501 or any other provision of the Code.
- (nn) Both Parent and Target will file the statement described in Treas. Reg. § 1.381(b)-1(b)(3).
- (oo) Prior to the plan of complete liquidation described herein, no formal or informal plan of complete liquidation will ever have been adopted by Target.
- (pp) All other transactions undertaken contemporaneously with, in anticipation of, in conjunction with, or in any way related to, the proposed liquidation of Target have been fully disclosed.
- (qq) Throughout every day since Date 1, Sub 4:
 - (i) Was in existence and a member of the Common Parent group determined without the exclusions in § 1504(b)(2);
 - (ii) Was engaged in the active conduct of a trade or business;
 - (iii) Did not experience a change in tax character; and
 - (iv) Did not undergo disproportionate asset acquisitions. Treas. Reg. § 1.1502-47(d)(12)(i).

Rulings

Based solely on the information submitted and the representations set forth above, we rule as follows with respect to step (i) above:

- (1) The transfers described in step (i) above will qualify under § 351 as a tax-free transfer of assets by Target in constructive exchange for additional Sub 4 stock and the assumption by Sub 4 of the transferred liabilities. § 351; Rev. Rul. 94-45, 1994-2 C.B. 39.
- (2) No gain or loss will be recognized by Target upon the transfer of assets in constructive exchange for Sub 4 stock and the assumption by Sub 4 of liabilities, plus any liabilities to which the transferred assets are subject. § 357(a).
- (3) No gain or loss will be recognized by Sub 4 upon its receipt of assets from Target in constructive exchange for Sub 4 stock. § 1032.

- (4) The basis of Sub 4 stock in the hands of Target will increase by the sum of the basis of the assets transferred to Sub 4 increased by the amount of any unamortized policy acquisition expenses associated with those assets, and decreased by the amount of liabilities assumed by Sub 4 and liabilities to which the transferred assets are subject, including insurance reserve liabilities. § 358.
- (5) The basis of each asset in the hands of Sub 4 will equal the basis of such asset in the hands of Target immediately prior to the proposed transaction. § 362(a).
- (6) The holding period of each transferred asset in the hands of Sub 4 will, in each instance, be the same as the holding period of that asset in the hands of Target immediately before the proposed transaction. § 1223(2).
- (7) Because the actions in step (i) above effectuate the transfer of insurance or annuity contracts as part of a § 351 exchange, the transfer is not subject to the provisions of §§ 803 and 805 and Treas. Reg. §§ 1.817-4(d) and 1.848-2. Rev. Rul. 94-45, 1994-2 C.B. 39.
- (8) For the taxable year in which Target transfers the insurance and annuity contracts to Sub 4, Target will include in its reserves as of the close of that year, for purposes of § 807(a) and (b), the ending balances of the reserves described in § 807(c) that Target held for the contracts immediately before the transfer, and Target is not entitled to a deduction under § 805(a)(6) for transferring assets to Sub 4 in consideration of the assumption by Sub 4 of the liabilities under the insurance and annuity contracts. Rev. Rul. 94-45, 1994-2 C.B. 39.
- (9) For the first taxable year beginning after the transfer of the insurance and annuity contracts to Sub 4, Target will not include in its reserves as of the beginning of that year, for purposes of § 807(a) and (b), the ending balances of the reserves described in § 807(c) that Target held for the contracts immediately before the transfer. Rev. Rul. 94-45, 1994-2 C.B. 39.
- (10) For the taxable year in which Target transfers the insurance and annuity contracts to Sub 4, Sub 4 will include in its reserves at the beginning of such year, for purposes of § 807(a) and (b), the ending balances of the reserves described in § 807(c) that Target held for the contracts immediately before the transfer, and Sub 4 will not take into premium income under § 803(a)(1) any amount with respect to the assets transferred to Sub 4 in consideration of the assumption of liabilities under the insurance and annuity contracts. Rev. Rul. 94-45, 1994-2 C.B. 39.
- (11) Target and Sub 4 will not include in net premiums under § 848(d)(1) any amount with respect to Target's assets transferred to Sub 4 in consideration of the assumption by Sub 4 of liabilities under Target's "specified insurance contracts" (within the meaning of § 848(e)). Rev. Rul. 94-45, 1994-2 C.B. 39.

(12) The unamortized specified policy acquisition expenses of Target attributable to the insurance and annuity contracts transferred to Sub 4 will continue to be amortized by Sub 4 over the remaining period as the amounts would have been deductible by Target. Rev. Rul. 94-45, 1994-2 C.B. 39.

(13) The unamortized balance of any § 807(f) adjustment of Target attributable to the insurance and annuity contracts transferred to Sub 4 will be treated as transferred to Sub 4 and will continue to be amortized by Sub 4 over the remaining period as the amounts would have been amortized by Target. Revenue Ruling 94-45, 1994-2 C.B. 39.

(14) The assumption by Sub 4 of liabilities under insurance contracts issued by Target will have no effect on the date each life insurance or annuity contract of Target was issued, entered into, purchased, or came into existence for purposes of §§ 72(e)(4), 72(e)(5), 72(e)(10), 72(e)(11), 72(q), 72(s), 72(u), 72(v), 101(f), 264(a)(3), 264(a)(4), 7702, and 7702A. Moreover, the transfer of liabilities will not require retesting or the starting of new test periods for the contracts under §§ 264(d)(1), 7702(f)(7)(B) – (E), and 7702A(c)(3)(A). §§ 72(e)(4), 72(e)(5), 72(e)(10), 72(e)(11), 72(q), 72(s), 72(u), 72(v), 101(f), 264(a)(3), 264(a)(4), 7702, and 7702A.

It is held as follows with respect to steps (ii) and (iii), above:

(15) Provided (i) Purchaser makes a timely election under § 338(g) or (ii) Parent and Purchaser make a timely election under § 338(h)(10), Parent will not be treated as having sold Target stock, but rather Target will be treated for federal income tax purposes as if, while a wholly owned subsidiary of Parent, it sold all of its assets (except the assets actually distributed to Parent in the Pre-Sale Distribution) in a single transaction ("Deemed Sale") as of the day on which Purchaser purchases all of the stock of Target ("Acquisition Date") and as if, at the close of the Acquisition Date but after the Deemed Sale, it distributed to Parent the proceeds of the Deemed Sale. The actual Pre-Sale Distribution and the deemed distribution of the Deemed Sale proceeds will be treated as a series of distributions in a complete liquidation to which §§ 332 and 337 apply (§ 338(h)(10); Treas. Reg. §§ 1.338(h)(10)-1(a) and 1.338(h)(10)-1(e)(1) and (2)(ii)). Accordingly, gain (including any items of recapture) and loss from the Deemed Sale of Target's assets will be included in Target's federal income tax return for the taxable period that includes the Acquisition Date, and neither gain nor loss from the sale of Target stock will be included in income of any member of the Common Parent affiliated group. § 338(h)(10); Treas. Reg. § 1.338(h)(10)-1(e)(1) and (2).

(16) No gain or loss will be recognized by Parent on its actual or deemed receipt of the assets of Target pursuant to the plan of liquidation. § 332(a).

- (17) No gain or loss will be recognized by Target on its actual or deemed distribution of assets to Parent in complete liquidation. § 337(a).
- (18) The basis of each asset distributed in the Pre-Sale Distribution in the hands of Parent will be the same as the basis of the asset in the hands of Target immediately preceding its distribution. § 334(b)(1).
- (19) The holding period of each asset distributed by Target to Parent in the Pre-Sale Distribution will include the period during which such asset was held by Target. § 1223(2).
- (20) Pursuant to § 381(a) and Treas. Reg. § 1.381(a)-1, Parent will succeed to and take into account the items of Target described in § 381(c) and the regulations thereunder, subject to the conditions and limitations specified in §§ 381(b) and (c), 382, 383, and 384. § 381.
- (21) Provided that Parent makes the election under Treas. Reg. § 1.381(b)-1(b)(2), the date of the Pre-Sale Distribution shall be treated as the date on which (i) substantially all of the properties of Target to be distributed or transferred to Parent have been distributed or transferred, and (ii) Target has ceased all operations (other than liquidating activities). Thus, the date of the Pre-Sale Distribution shall be treated as the date of the distribution within the meaning of Treas. Reg. § 1.381(b)-1(b).
- (22) Provided that Parent makes the election under Treas. Reg. § 1.381(b)-1(b)(2), Parent will succeed to and take into account the earnings and profits or deficit in earnings and profits of Target as of the date of the Pre-Sale Distribution. Any deficit in earnings and profits of Target or Parent will be used only to offset earnings and profits accumulated after the date of the distribution. § 381(c)(2).
- (23) As of Date 1, Sub 4 will have met the eligibility requirements of paragraphs (A) – (D) of Treas. Reg. § 1.1502-47(d)(12)(i). The implementation of steps (i) through (iii) above will not restart the base period for determining Sub 4's eligibility to join Common Parent's consolidated group. Treas. Reg. § 1.1502-47(d).

Caveats

We express no opinion about the tax treatment of the Proposed Transaction under other provisions of the Code and regulations or about the tax treatment of any conditions existing at the time of, or effects resulting from, the Proposed Transaction that are not specifically covered by the above rulings. Specifically, we express no opinion about the validity of the § 338 election to be made in step (iii) above of the Proposed Transaction.

Procedural Matters

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

Temporary or final regulations pertaining to the issues addressed in this ruling have not yet been adopted. Therefore, this ruling will be modified or revoked by the adoption of temporary or final regulations to the extent the regulations are inconsistent with any conclusion in this ruling. See § 11.04 of Rev. Proc. 2004-1. However, when the criteria in § 11 of Rev Proc. 2004-1 are satisfied, a ruling may not be revoked or modified retroactively, except in rare or unusual circumstances.

A copy of this ruling letter should be attached to the federal income tax returns of the taxpayers involved in the Proposed Transaction for the taxable year in which the transactions are completed.

Under the power of attorney on file in this office, a copy of this letter has been sent to the taxpayer.

Sincerely,

Richard K. Passales

Richard K. Passales
Senior Counsel, Branch 4
Office of Associate Chief Counsel

(Corporate)

cc: