

Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Date:
December 8, 2000

RE:

Mutual Holding
Company =

Stock Holding =

Holding Sub 1 =

Company =

Sub 1 =

Sub 2 =

Sub 3 =

State A =

State B =

X =

This letter responds to your letter, dated June 8, 2000, requesting a ruling that the conversion of a mutual life insurance company to a stock life insurance company will qualify under section 368(a)(1)(E) of the Internal Revenue Code ("Code"). Additional information was submitted in letters dated August 16 and October 3, 2000. The information submitted is summarized below.

Company, a State A mutual life insurance company, offers a broad range of individual and group insurance, and annuity products and services. For federal income tax purposes, Company is a life insurance company taxable under section 816 of the

Code and is an accrual basis calendar year taxpayer. Company is the common parent of an affiliated group filing a consolidated Federal income tax return. Company owns all of the stock of Holding Sub 1 (a State A holding company), which in turn owns all of the stock of Sub 1 (a State A corporation).

As a mutual life insurance company, Company is an incorporated company controlled by its policyholders ("Company Members"). Company has no capital stock. Rather, Company Members own all of the proprietary interest in Company ("Company Membership Interests"). The Company Membership Interests include: right to vote on significant corporate actions; right to elect directors; right to receive all assets of Company upon liquidation or dissolution; rights to receive value of interest under State A law upon demutualization; and certain other rights conferred by State A law, or the Articles of Incorporation, Bylaws and historical practices of Company.

Mutual Holding Company will be a State A corporation formed by Company for purposes of the proposed transaction. Membership interests in Mutual Holding Company will be comparable to the Company Membership Interests that Company Members currently hold in Company, including certain rights to (a) vote for the directors of Mutual Holding Company; (b) distributions of assets upon any liquidation or dissolution of Mutual Holding Company; (c) receive value for their interests in Mutual Holding Company upon any demutualization, which may take the form of cash, stock, in-kind distributions, or any combination; (d) subscription rights to acquire voting stock in Stock Holding or Company; and other rights as provided by State A law ("Mutual Holding Company Membership Interests"). Under State A law, Mutual Holding Company members will not have the right to any distributions from Mutual Holding Company other than those provided for by contracts of insurance or annuities.

The following restructuring transactions have occurred or will on or about the effective date of the proposed transaction (described below):

- (i) Company will form Mutual Holding Company, which will form Stock Holding in order to own the stock of Company as described below.
- (ii) Holding Sub 1 formed Sub 2, a wholly owned State A corporation, and transferred its current business operations and all of its assets other than its ownership of Sub 1 to Sub 2 in exchange for all of the initial shares of capital stock of Sub 2.
- (iii) Company will transfer its stock in Holding Sub 1 to Mutual Holding Company so that Holding Sub 1 becomes a wholly owned subsidiary of Mutual Holding Company.
- (iv) Mutual Holding Company formed Sub 3, a wholly owned State B subsidiary.
- (v) Holding Sub 1 will be merged into Sub 3 with Sub 3 surviving, as a means

of converting Holding Sub 1 from a State A corporation to a State B corporation. The name of Sub 3 will then be changed to Holding Sub 1.

For what is represented as valid business reasons, Company now propose to convert from a mutual life insurance company to a stock life insurance company controlled indirectly by Mutual Holding Company ("proposed transaction"):

- Step 1: Company will convert into a stock life insurance company by amending its articles and restating its articles to authorize the issuance of up to x shares of capital stock ("Company Stock"). The Company Membership Interests will become Mutual Holding Company Membership Interests pursuant to State A law. Company Members will receive no consideration other than Mutual Holding Company Membership Interests. Existing Company insurance policies and annuity policies will not change except for minor conforming changes. There will be no decrease or increase in premiums, policy benefits, policy values, policy guarantees, or other obligations of Company Members ("Conversion").
- Step 2: Company will issue all of the Company Stock to Mutual Holding Company.
- Step 3: Mutual Holding Company will contribute all of the Company Stock to Stock Holding in exchange for all of the initial capital stock of Stock Holding.

At some time in the future, Company or Stock Holding may offer its stock for sale in a public offering and after any public offering may establish an employee stock option or ownership plan ("ESOP"). In addition, Company may affiliate with other insurance companies. As required by the State A law, however, Mutual Holding Company will at all times directly or indirectly own at least 51% of the issued and outstanding Company Stock.

The taxpayer requested the conversion of Company from a mutual life insurance company to a stock life insurance company be treated as an exchange by Company Members of their Company Membership Interests for stock in Company. Also, the taxpayer requested that the creation of the mutual holding company structure be treated as (i) the transfer of Company Stock by Company Members to Mutual Holding Company in exchange for Mutual Holding Company Membership Interests; and (ii) the transfer of Company Stock by Mutual Holding Company to Stock Holding in exchange for stock in Stock Holding.

Pursuant to section 3.01(22) of Rev. Proc. 2000-3, 2000-1 I.R.B. 103, 104, the Service will not rule on the application of section 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 section 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 taxpayer has represented that to the best of its knowledge and belief, the deemed transfers of Company Stock to Mutual Holding Company by Company Members in exchange for Mutual Holding Company Membership Interests and of Company Stock to Stock Holding by Mutual Holding Company constitute transfers described in section 351(a) of the Code. Also, the taxpayer has represented that the merger of Holding Sub 1 into Sub 3 qualifies as a reorganization under section 368(a)(1)(F).

The taxpayer has made the following representations with respect to the Conversion:

- (a) The fair market value of the Company Stock deemed to be received by Company Members in the deemed exchange approximately equals the fair market value of the Company Membership Interests surrendered in exchange therefor.
- (b) The Conversion is not part of a plan to increase the proportionate interest of any owner in the assets or earnings and profits of Company.
- (c) Following the Conversion, Company will continue, as a stock life insurance company, in the same business that Company conducted prior to the Conversion.
- (d) Each party to the Conversion will pay its, his or her own expenses, if any, in connection with the Conversion.
- (e) The Conversion will occur under a plan agreed upon before the transaction.
- (f) 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 Code.
- (g) Company is considered to be the same entity before and after the Conversion under State A law.
- (h) Immediately after the proposed transaction, Mutual Holding Company and its direct and indirect subsidiaries will continue to own substantially all of the assets of Company held directly and through its direct and indirect subsidiaries prior to the proposed transaction.
- (i) Company will issue only voting common stock in the proposed transaction.
- (j) Company has no plan to redeem or otherwise reacquire any of the Company Stock issued in the proposed transaction.

- (k) At the time of the proposed transaction, 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.
- (l) Company Members will not retain any rights in Company Membership Interests transferred to Company in the deemed exchange for shares of Company Stock.
- (m) The Conversion and deemed exchange of Company Membership Interests for Company Stock will not result in any fractional share interests in Company.

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

- (1) The proposed transaction described above will be treated as: (i) the Company Members exchanging their Company Membership Interests for Company Stock; (ii) those Company Members subsequently transferring the Company Stock to Mutual Holding Company in exchange for Mutual Holding Company Membership Interests; and (iii) Mutual Holding Company transferring the Company Stock to Stock Holding in exchange for stock in Stock Holding.
- (2) The Conversion from a mutual life insurance company to a stock life insurance company and exchange of Company Membership Interests for Company Stock will be a reorganization 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) Company Membership Interest holders will recognize no gain or loss on exchanging the Company Membership Interests for Company Stock (section 354(a)(1)).
- (4) The basis of Company Membership Interests is zero (Rev. Rul. 71-233, 1971-1 C.B. 113; Rev. Rul. 74-277, 1974-1 C.B. 88). The basis of the Company Stock received in exchange for Company Membership Interests will equal the basis of the Company Membership Interests surrendered therefor (i.e., zero) (section 358(a)(1)).
- (5) The holding period of Company Stock received in exchange for Company Membership Interests will include the period the holder thereof held such Company Membership Interests (section 1223(1)).
- (6) No gain or loss will be recognized by Company on the issuance of Company Stock in exchange for Company Membership Interests (section 1032(a)).
- (7) The proprietary rights received by Mutual Holding Company Membership Interests holders in exchange for their ownership in Company Stock will be

treated as stock within the meaning of section 351(a) of the Code. See Rev. Rul. 69-3, 1969-1 C.B. 103.

- (8) The affiliated group of which Company was the common parent immediately before the proposed transaction will remain in existence with Mutual Holding Company as the new common parent. See section 1.1502-75(d)(2)(ii) of the regulations; and Rev. Rul. 82-152, 1982-2 C.B. 205.
- (9) The proposed transaction will qualify as a "group structure change" under section 1.1502-33(f) of the regulations. Mutual Holding Company's basis in the Company Stock immediately after the group structure change will be Company's net asset basis as determined under section 1.1502-31(c) of the regulations, subject to the adjustments described in section 1.1502-31(d) of the regulations (section 1.1502-31(b)(2)). The earnings and profits of Mutual Holding Company and Stock Holding will be adjusted immediately after Mutual Holding Company becomes the new common parent to reflect the earnings and profits of Company immediately before Company ceases to be the common parent.
- (10) The proposed transaction will have no effect on the date each life insurance or annuity contract of the Company was issued, entered into, purchased or came into existence for purposes of sections 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 proposed transaction will not require retesting or the starting of new test periods for the contracts under sections 264(d)(1), 7702(f)(7)(B)-(E), and 7702A(c)(3)(A).
- (11) The proposed transaction will have no effect on each life insurance or annuity contract of Company for purposes of sections 72(e)(5), 401, 402, 403, 408, and 408A of the Code.
- (12) The proposed transaction will not result in any transaction that constitutes a distribution in violation of section 403(b)(11) of the Code or otherwise disqualifies a 403(b) contract under section 403(b). Similarly, the proposed transaction will not result in any transaction that constitutes a distribution in violation of section 401(k)(2) of the Code or otherwise disqualifies a qualified cash or deferred arrangement within the meaning of section 401(k) of the Code.
- (13) The proposed transaction will not constitute, with respect to policies issued by Company and in force prior to the effective date of the proposed transaction and that are tax qualified under sections 401(a), 403(b), or 408(b) of the Code, a distribution from or a contribution to any of these policies, plans or arrangements for federal income tax purposes.
- (14) The proposed transaction will not result in any transaction that constitutes a distribution and thus will not result in:

(a) any gross income to the employee or the beneficiary of a tax-qualified retirement contract as a distribution from a qualified retirement plan under section 72 of the Code, prior to an actual receipt of some amount therefrom by such employee or beneficiary;

(b) any 10 percent additional penalty tax under section 72(t) of the Code for premature distributions from a qualified retirement plan;

(c) any 6 percent or 10 percent excise tax under sections 4973 or 4979 of the Code, respectively, for excess contributions to certain qualified retirement plans;
or

(d) any designated distribution under section 3405(e)(1)(A) of the Code that is subject to withholding under section 3405(b) or (c).

In view of our conclusion with respect to your other ruling requests, it seems unlikely that the described transaction results in a prohibited transaction, however, section 102(a) of the White House Reorganization Plan Number 4 of 1978 43, Federal Register 47713 (October 17, 1978), generally provides that authority to issue rulings under section 4975 of the Code is transferred from the Secretary of the Treasury to the Secretary of Labor. Accordingly, we are unable to issue a ruling on this issue. However, it is our opinion that the proposed transaction will not otherwise cause an individual retirement account or an individual retirement annuity to lose its status under section 408 of the Code.

No opinion is expressed 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 directly covered by the above rulings. In particular, we express no opinion regarding the tax treatment of any of the restructuring transactions described in (i) through (v) and the transfer described in Step (3) of the proposed transaction. Also, no rulings were requested and no opinion is expressed concerning the federal income tax consequences under Subchapter L of the Code.

Our ruling that the Conversion constitutes a reorganization within the meaning of section 368(a)(1)(E) is conditioned on Company being considered the same entity before and after the Conversion under State A law. Also, the rulings provided herein are based upon the assumption that the plans described are tax-sheltered annuity plans that meet the requirements of sections 403(a) or 403(b) of the Code, IRAs that meet the requirements of section 408(b), or plans that meet the requirements of section 401(a).

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(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 returns of the taxpayers involved for the taxable year in which the transaction covered by this ruling letter is

consummated.

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

Pursuant to the power of attorney on file in this office, a copy of this letter has been sent to your authorized representatives.

Sincerely yours,
Associate Chief Counsel (Corporate)
By: Mark S. Jennings
Chief, Branch 1