Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
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Date:
April 27, 2001

Legend

Holding =

Sub 1 =

Sub 2 =

Company =

State A =

State B =

Date C =

Period =

This letter responds to a letter from your authorized representative dated November 9, 2000, requesting rulings regarding the federal income tax consequences of a proposed transaction. We received additional information in letters dated February 16, March 19, March 27, and April 3, 2001. The information submitted is summarized below.

Holding is a State A mutual holding company that holds all the stock of Sub 1, a State A corporation that holds all the stock of Sub 2, a State A corporation that holds all the stock of Company. Company qualifies as an “insurance company” taxable under Subchapter L of the Code. Holding is the common parent of an affiliated group of corporations that has elected to file consolidated returns. The Holding consolidated group has a calendar year tax year end and reports its income on the accrual basis.

As a mutual holding company, Holding cannot issue common or preferred stock. Instead, Company policyholders have liquidation and voting rights in Holding.

For what have been represented to be valid business reasons, Holding's Board of Directors has decided to convert from a mutual holding company structure to a stock corporation (the "Conversion"). Prior to the Conversion, the following steps will occur:

(1) Holding will organize Newco 1, a State B corporation, as Holding's wholly-owned subsidiary.

(2) Newco 1 in turn will organize Newco 2, a State A corporation, as Newco 1's wholly owned subsidiary.

Holding proposes the following steps, all of which will be undertaken pursuant to a plan and will occur on approximately the same date (the "Effective Date"):

(3) To effect the Conversion, Holding will become a stock corporation by completing an administrative procedure under the laws of State A. Holding will initiate this procedure by filing an application with the State A insurance commissioner to convert to a stock company in a transaction whereby membership interests in Holding will be extinguished, and eligible policyholders will be deemed to receive voting common stock in Holding. Although there is no market for the membership interests, the State A insurance commissioner is required by State A law to determine that the plan of Conversion is fair and equitable to the Company policyholders before approving the plan. The Holding members will be deemed to receive, but will not actually receive Holding common stock.

(4) Holding will merge with and into Newco 2 in a forward triangular merger pursuant to State A law. As consideration for the termination of their deemed stock interests in Holding, members will receive Newco 1 common stock, cash, or policy credits. No less than 50% of the aggregate consideration paid or credited to the members will be in the form of Newco 1 common stock.
To the best knowledge and belief of Holding, the merger of Holding with and into Newco 2 will qualify as a reorganization within the meaning of section 368(a)(1)(A) and section 368(a)(2)(D), provided that the Service issues the rulings below.

(5) Sub 1 and Sub 2 will be merged in succession into Newco 2. Newco 2 will own all of the stock of Company.

(6) Newco 1 will sell shares of its common stock to the public in an initial public offering ("IPO"). Newco 1 may also raise capital through the private placement or public offering of other securities, or through borrowing.

(7) Newco 1 will contribute a portion of the cash raised in Step 6 to Company, in an amount at least equal to the amount Company will use to pay expenses resulting from the transaction that are properly allocated to Newco 1 and to fund

the payment and crediting by Company of mandatory cash payments and policy credits required to be paid or credited under the terms of the Conversion plan.

The taxpayer has submitted the following representations in connection with the conversion of Holding from a mutual insurance holding company to a stock company:

(a) The fair market value of the Holding shares deemed to be issued by it in exchange for the termination of the Holding membership interests approximately equals the value of the membership interests surrendered therefor.

(b) Holding has no plan to redeem or otherwise reacquire any of the stock deemed to be issued in the Conversion.

(c) At the time of the Conversion, Holding 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 Holding.

(d) The Conversion is not part of a plan to periodically increase the proportionate interest of any shareholder or policyholder in the assets or earnings and profits of Holding.

(e) Each of the parties to the transaction will pay its own expenses, if any, incurred in connection with the Conversion. Holding is required by State A law to pay costs attributable to the use of experts in connection with the review of the Conversion plan by the State A insurance commissioner. Although State A may be a member of Holding eligible to receive consideration in the transaction, no such costs will be paid to or on behalf of State A in its capacity as a member of Holding.

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

(g) Following its conversion to a stock company, Holding will be treated under State A law as the same corporation that existed as a mutual insurance holding company.

(h) Immediately before the recapitalization, Holding will be a membership organization under State A law. It will have outstanding a single class of membership interests, which will be held by Company policyholders. Other than membership interests, there will be no other classes of stock or securities of Holding surrendered or exchanged in the recapitalization. There will be no securities of Holding outstanding immediately before the recapitalization.

(i) There will be no securities of Holding issued in the recapitalization.

(j) There will be no securities of Holding outstanding immediately after the recapitalization.

(k) Assuming that required approvals are received and the proposed transaction is approved by a vote of the members of Holding, Holding expects the exchange to take place in Period. None of the stock deemed issued pursuant to the recapitalization will be placed in escrow and no stock will be issued later under a contingent stock arrangement.

(l) No stock issued or deemed issued in the Conversion will be issued for dividend or interest arrearages.

(m) No convertible preferred stock will be received in the exchange.

(n) Each membership interest in Holding will be converted into a whole number of shares of common stock. Accordingly, no member will be entitled to fractional shares as a result of the exchange.

Pursuant to section 3.01(23) of Rev. Proc. 2000-3, 2000-1 I.R.B. 103, 105, the Service will not rule as to whether a proposed transaction qualifies under section 368(a)(1)(A) by reason of section 368(a)(2)(D) of the Code. The Service has the discretion, however, to rule on significant subissues that must be resolved to determine whether the transaction qualifies under section 368(a)(1)(A) by reason of section 368(a)(2)(D).

Based solely on the information submitted and the representations set forth above, we rule as follows:

(1) The change in the form of operation of Holding from a mutual insurance holding company to a stock company and the deemed exchange by exchanging members of their membership interests for voting common stock of Holding will constitute a recapitalization within the meaning of section 368(a)(1)(E) of the Code. Holding will be a “party to the reorganization” within the meaning of section 368(b).

(2) No gain or loss will be recognized by the exchanging members on the deemed exchange of their membership interests for voting common stock of Holding. Section 354(a)(1).

(3) The basis of each exchanging member in its membership interest is zero. Rev. Rul. 71-233, 1971-1 C.B. 113. The basis of the Holding voting common stock in the hands of each exchanging member will be the same as its basis in the membership interest surrendered therefor. Section 358(a)(1). The holding period of the Holding common stock to be received by each eligible member will include the holding period of the membership interest surrendered in exchange therefor, provided that the membership interest was held as a capital asset as of the Effective Date. Section 1223(1).

(4) No gain or loss will be recognized by Holding on its deemed issuance of voting common stock in exchange for the membership interests of the members of Holding. Section 1032(a).

(5) Holding's tax attributes will remain unchanged as a result of the Conversion. Section 381(a)(2).

(6) The stock of Holding deemed to be received by each exchanging member and to be exchanged for stock of Newco 1 in the merger with and into Newco 2 constitutes a proprietary interest for purposes of determining whether the continuity of interest requirement set forth in section 1.368-1(b) will be satisfied.

(7) The merger of Holding with and into Newco 2 will not prevented from qualifying as a reorganization within the meaning of sections 368(a)(1)(A) and 368(a)(2)(D) by reason of the fact that Holding had been a mutual insurance holding company until immediately prior to such merger.

(8) The affiliated group of which Holding was the common parent immediately before the consummation of the proposed transaction will remain in existence , with Newco 1 as the common parent. Section 1.1502-75(d)(2)(ii).

(9) The consummation of the proposed transaction will qualify as a "group structure change" under section 1.1502-33(f). The earnings and profits of Newco 1 will be adjusted immediately after Newco 1 becomes the new common parent to reflect the earnings and profits of Holding immediately before Holding ceases to be the common parent.

(10) The Conversion by Holding from a mutual insurance holding company to a stock company will have no effect on the date that any Company policy was, or is deemed to have been, issued, purchased, or entered into 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)(1), 264(a)(3), 264(a)(4), 264(f), 7702, 7702A or 7702B, and will not require retesting or the start of a new test period for any Company policy under sections 264(d)(1), 7702(f)(7)(B)-(E) or 7702A.

We express no opinion about the tax treatment of the transaction under any other section of the Code or regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered in the above rulings.

The rulings in this letter are based on the facts and representations submitted under penalties of perjury in support of the request for rulings. Verification of that information may be required as part of the audit process.

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

In accordance with the power of attorney on file with this office, a copy of this letter is being forwarded to your authorized representative. Each taxpayer involved in the transaction must attach a copy of this letter to the taxpayer's federal income tax return for the taxable year in which the transaction is completed.

Sincerely,
Associate Chief Counsel (Corporate)
By: Christopher W. Schoen
Assistant to the Chief, Branch 1