Internal Revenue Service

Number: **200820009**
Release Date: 5/16/2008

Index Number: 72.02-00, 72.20-00, 401.00-00, 401.06-00, 402.00-00, 403.00-00, 408.06-00, 4973.00-00, 4979.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

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, ID No.
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Refer Reply To:
CC:FIP:4
PLR-127133-07

Date:
January 31, 2008

Ceding Company =

Assuming Company =

State A =

State B =

Date D =

Dear

This ruling letter supplements the letter ruling issued by this office on December 27, 2007 (CC:FIP:4 – PLR-127104-07) (Prior Letter Ruling). Together, the Prior Letter Ruling and the present ruling letter respond to your letter of June 8, 2007, requesting rulings on the federal income tax consequences of a then proposed transaction, which has now been consummated, in part, as of Date D. Your June 8, 2007, letter was jointly submitted by Ceding Company, a State A mutual life insurance company in rehabilitation, and Assuming Company, a State B domiciled stock life insurance company, requesting rulings on the federal income tax consequences of the transaction.

The transaction arose in the context of a plan for the rehabilitation of Ceding Company (the Plan) and involves, among other actions, the transfer by assumption reinsurance of Ceding Company's life insurance and other contracts to Assuming Company under the supervision of the State A Court. This ruling letter responds to the holdings requested by your office in your June 8, 2007, letter with respect to certain tax-qualified matters. The Prior Ruling Letter responded to the subchapter L and certain related annuity/insurance questions presented by your June 8, 2007, request. We are setting forth some of the background facts from the Prior Ruling Letter into this ruling letter.

As indicated in the Plan, each contract which is in force on the closing date of the reinsurance transaction will be modified by Ceding Company through one or more endorsements, effective as of the closing date but immediately prior to the closing of the reinsurance of the endorsed contracts. This endorsement will not change, reduce, or restructure the death benefits, cash values (or account or policy values), dividend accumulations, minimum interest rate guarantees, maximum mortality charges, policy loan accounts, or contractual loan interest rate guarantees of the endorsed contract. Pursuant to the Plan, the endorsements will include the following provisions. Certain "tax-qualified" contracts will be authorized to receive compensation for the extinguishment of mutual membership interests in the form of credits to the policy values (Plan credits).

Mutual members who hold non-trusteed tax qualified retirement funding contracts (e.g., individual retirement account contracts or §403(b) contracts), will not receive, or be entitled to receive, distributable equity (in the form of cash or other consideration) with respect to such tax-qualified contracts. Instead, they will receive credits to the policy value (Plan credits) in the form of additional paid-up insurance or account value credits. The value of the Plan credits will be equal to the value of the cash otherwise allocable to the qualified contractholders with respect to their tax-qualified contracts. Assuming Company will receive assets from Ceding Company for purposes of paying the Plan credit amounts.

Employee Plan Related Provisions

Section 402(a) of the Code provides, in pertinent part, that any amount actually distributed to any distributee by any employees' trust described in §401(a) which is exempt from tax under §501(a) shall be taxable to the distributee, in the taxable year of the distributee in which distributed, under §72 (relating to annuities).

Section 403(b)(1) provides, generally, that amounts contributed by certain tax-exempt employers to an annuity contract purchased from an insurance company by such an employer for an employee shall be excluded from the gross income of the employee for the taxable year of the contribution and that the amount actually distributed to any distributee under such contract shall be taxable to such distributee in the year distributed under §72. Section 403(b)(1) also imposes a limit on the maximum amount which may be contributed to a tax-sheltered annuity described in §403(b) on behalf of an employee in any taxable year. Section 403(b)(10) provides that the provisions of §403(b)(1) will not apply to an annuity unless requirements similar to the minimum distribution requirements of §401(a)(9) are met with respect to such annuity. Section 403(b)(11) provides that the provisions of §403(b)(1) will not apply to an annuity unless, under the annuity, distributions attributable to contributions made pursuant to a salary reduction agreement may be paid only when the employee attains age 59 and ½, separates from service, dies, becomes disabled, or in the event of hardship. Distributions in the event of hardship may not include income attributable to salary reduction contributions. The distribution limitations of §403(b)(11) do not apply to distributions attributable to assets held in the tax-sheltered annuity arrangement described in §403(b) as of the close of the last year beginning before January 1, 1989. P.L. 99-514 ("the Tax Reform Act of 1986") section 1123(e)(2), as amended by P.L. 100-647 ("TAMRA") section 1011A(c)(11).

Section 408(b) defines an individual retirement account (IRA) annuity as an annuity or endowment contract which is issued by an insurance company and which meets the requirements of §408(b). Section 408(b)(3) imposes requirements similar to the distribution requirements of §401(a)(9) on distributions of the entire interest of the contract owner. Section 219 permits an individual taxpayer to deduct from gross income amounts contributed to an IRA, subject to the maximum annual deduction limitations specified in §219(b). Sections 402(c) and 408(d)(3), relating to rollover contributions, permit an individual taxpayer to purchase an IRA annuity using funds distributed from other plans, subject to certain requirements relating to the nature and the amount of the distribution. Section 408(d) provides, in general, that any amount paid or distributed out of an IRA is included in gross income by the payee or distribute, as the case may be, in the manner provided under §72.

Section 72(a) generally provides that gross income includes any amount received as an annuity under an annuity, endowment, or life insurance contract. Section 72(e)(1)(B) provides that, for purposes of §72, any amount received which is in the nature of a dividend or similar distribution shall be treated as an amount not received as an annuity. Section 72(e)(2) provides that any amount which is received under an annuity, endowment or life insurance contract and is not received as an annuity, (A) if received on or after the annuity starting date, shall be included in gross income, and (B) if received before the annuity starting date, shall be included in gross income to the extent allocable to income on the contract and shall not be included in gross income to the extent allocable to the investment in the contract. Section 72(e)(5) provides, in part, that with certain exceptions, an amount distributed from a trust described in §401(a), which is exempt from tax under §501(a), or is received from a contract purchased by a trust described in §401(a), purchased as part of a plan described in §403(a) or described in §403(b) shall be included in gross income but only to the extent it exceeds the investment in the contract. Section 72(e)(6) provides that the investment in the contract, as of any date, is the aggregate amount of premiums or other consideration paid for the contract as of such date, minus the aggregate amount received under the contract before such date to the extent such amount was excludable from income.

In pertinent part, Rev. Rul. 2003-19, 2003-1 C.B. 468, provides guidance for transactions in which a mutual life insurance company demutualizes and converts to a stock life insurance company, and the holders of life and annuity contracts issued by the mutual company surrender their membership interests for consideration made available as part of the transaction. Holders of contracts that are covered by §403(b) or §408 of the Code, or that are part of a qualified plan within the meaning of §401(a), receive policy credits in exchange for their membership interests.

Rev. Rul. 2003-19 further provides that demutualization has:

> … no effect on each life insurance or annuity contract that is part of a qualified plan within the meaning of §401(a) or that meets the requirements of §403(b) or §408(b) for purposes of §§72(e), 401, 402, 403, 408, and 408A. These transactions do not result in a distribution in violation of §403(b)(11) or otherwise disqualify a §403(b) contract under §403(b). Similarly, these transactions do not result in an actual or deemed distribution in violation of §401(k)(2)(B) or otherwise disqualify a qualified cash or deferred arrangement within the meaning of §401(k). These transactions do not constitute, with respect to policies issued by [a mutual life insurance company] … and in force prior to the effective date of the reorganizations and are tax-qualified under §401(a) or meet the requirements of §403(b) or §408(b), a distribution from or a contribution to any of these policies, plans, or arrangements for federal income tax purposes. Finally, [demutualization] … does not result in: (a) any gross income to the employee or the beneficiary as a distribution from a qualified retirement plan under §72, prior to an actual receipt of some amount therefrom by such employee or beneficiary; (b) any 10% additional tax under §72(t) for premature distributions from a qualified retirement plan; (c) any 6% or 10% excise tax under §§4973 or 4979, respectively, for excess contributions to certain qualified retirement plans; or (d) a designated distribution under §3405(e)(1)(A) that is subject to withholding under §3405(b) or (c).

In this case, the Plan’s assumption reinsurance transaction will use Plan credits to facilitate the transfer of the life insurance and annuity contracts, issued by Ceding Company and held in qualified retirement programs under §§401(a), 403, or 408, to Assuming Company. In so doing, this transfer of assets is accomplished without the actual distribution of qualified plan assets to plan participants. The assumption reinsurance transaction requires that the obligations of the original insurer under existing policies be assumed by Assuming Company, as reinsurer. Other terms of the underlying policies remain unchanged, including the amount and pattern of death benefits, the premium pattern, the rate guaranteed on issuance of the contract, and the mortality and expenses changes. The substitution of the reinsurer for the original life insurance company and the elimination of future dividends are the only major modifications.

The authorized representatives of the taxpayer insurance companies (Ceding Company and Assuming Company) point out that Rev. Rul. 2003-19 does not specifically address the issues of demutualization and an assumption reinsurance transaction involving the life insurance and annuity contracts of an insurance company in rehabilitation. However, the assumption and reinsurance of life insurance or annuity contracts held by qualified retirement programs by a plan sponsor that actually is able to provide plan participants with death benefits, or with income for life after retirement as provided under those contracts, is not in conflict with the requirements of §§401(a), 403, or 408 of the Code.

Conclusions

Based solely upon the information submitted, the representations made and provided that the contracts to be assumed by Assuming Company that are issued as life insurance contracts constitute “life insurance contracts” for federal income tax purposes and the contracts that are issued as annuity contracts to be assumed by Assuming Company are “annuity contracts” for federal income tax purposes, it is held as follows:

(a) Neither (1) the modification of a contract by endorsement upon closing, nor (2) any amount paid or credited with respect to a contract pursuant to the State A Court’s approval of the rehabilitator’s petitions to approve policyholder dividends with respect thereto, nor (3) the assumption reinsurance of an endorsed contract pursuant to the Plan, if such assumption reinsurance transaction does not change the terms and conditions of such contract (other than the insurer) after such modification by endorsement, will, in the case of any life insurance or annuity contract that is part of a qualified plan within the meaning of §401(a) or that meets the requirements of §403(a) or (b) or §408, have any effect on such contract for purposes of §§72(e)(5), 401, 402, 403, 408, or 408A. As a result, the investment in the contract under §72 for each endorsed contract immediately after the assumption reinsurance transaction will remain the same as an unendorsed contract immediately prior to its endorsement.

(b) Neither the addition of a Plan credit nor the right thereto constitutes a distribution in violation of §403(a), §403(b)(11), §408(e) or otherwise disqualifies a §403(b) contract under §403(b) or an IRA contract under §408. In addition, in the case of any life insurance or annuity contract that is part of a qualified plan within the meaning of §401(a) or that meets the requirements of §403(a) or (b) or §408, neither the addition of a Plan Credit nor the right thereto will have any effect on such contract for purposes of §§72(e)(5), 401, 402, 403, 408, or 408A.

(c) The addition of a Plan credit to a Non-Trusteed Tax Qualified Retirement Funding Contract does not constitute a distribution thereunder nor a contribution thereto, and thus will not result in (a) any gross income to the employee or other beneficiary of such contract as a distribution from a qualified retirement plan under §72, prior to an actual receipt of some amount thereof by such employee or beneficiary, (b) any 10% additional tax under §72(t) for premature distributions from a qualified retirement plan, (c) any 6% or 10% excise tax under §4973 or §4979 for excess contributions to certain qualified retirement plans, or (d) any designated distribution under §3405(e)(1)(A) that is subject to withholding under §3405(b) or (c).

(d) For purposes of determining the investment in the contract under §72 for a non-trusteed tax-qualified retirement funding contract, a Plan credit will not be taken into account.

(e) For minimum distribution requirements under §401(a)(9), §403(b)(10), §408(a)(6), or §408(b)(3), a Plan credit will constitute investment earnings attributable to the year in which it is added to the account value for a Non-Trusteed Tax Qualified Retirement Funding Contract.

(f) For purposes of §403(b)(11) restrictions on distributions attributable to contributions under salary reduction arrangements and the income thereon, a pro rata portion of a Plan credit added to a §403(b) contract to which such contributions have been made constitutes earnings attributable to such contributions for the year in which such Plan credit is added.

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

Pursuant to the powers of attorney on file with this office, copies of this letter are being sent to your authorized representatives. A copy of this letter and the Prior Ruling Letter must be attached to any income tax return to which it is relevant. (Alternatively, for a return(s) filed electronically this requirement is satisfied by attaching a statement to the return(s) that provides the date and control number of the letter ruling.)

The rulings contained in this letter are based upon information and representations submitted by the taxpayers 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 yours,

/s/

SHERYL B. FLUM
Chief, Branch 4
Office of Associate Chief Counsel
(Financial Institutions & Products)