

INTERNAL REVENUE SERVICE

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November 23, 1999

Ancillary Receiver =

Company A =

Date B =

State C =

Reinsurer =

State F =

Number G =

Year H =

Date I =

Amount J =

Dear

This is in response to the ruling request of Date B, as supplemented, submitted by the Commissioner of Insurance of State C as Ancillary Receiver of Company A regarding the federal tax treatment under the Internal Revenue Code of certain transactions described below.

Company A is a State F life insurance company which was licensed to do business in more than Number G states, including State C. Company A became insolvent in Year H. On Date I, the insurance commissioner of State F, the state of Company A's domicile, obtained a court order placing Company A in conservatorship, where it still resides.

When Company A first sought a certificate of authority to conduct business in State C, Company A was required to place in the custody of the insurance commissioner for State C certain government guaranteed securities having a then-value of approximately Amount J (the Special Deposit). The Special Deposit was required to be increased from time to time based on the growth in Company A's business with State C policyholders. The purpose of the Special Deposit was to provide security for State C policyholders in the event of nonperformance of Company A's contractual obligations to the policyholders and their beneficiaries.

Accordingly, when Company A was placed in conservatorship in State F, the insurance commissioner of State C obtained an order from the State C court establishing an ancillary receivership. By that order, the Ancillary Receiver was appointed and directed to liquidate the Special Deposit and State C liabilities of Company A. From that point forward (after some litigation to settle the rights to the Special Deposit), the original conservatorship in State F and the ancillary receivership in State C have operated separately although information has been exchanged as necessary.

Pursuant to the court's order, the Ancillary Receiver has developed an overall plan (the Plan) to liquidate Company A. Pursuant to the Plan, the Ancillary Receiver has arranged, where possible, for the reinsurance of certain blocks of Company A's business by creditworthy insurance companies, including the Reinsurer. Reinsurer is a life insurance company subject to federal income taxation as a life insurance company under part I of subchapter L of the Code and is an accrual-basis, calendar-year taxpayer.

In order to accomplish the reinsurance of Company A's contracts, the Plan requires that Company A's contracts be, in some cases, restructured to correspond to contract forms currently in use by a reinsurer. Because the Special Deposit are expected to be sufficient to meet Company A's State C liabilities, the Plan does not require downward adjustments to the account values of Company A's contracts. Further, because there is no reduction in the value of the contracts, holders of Company A contracts were not given an opportunity to agree or disagree with the restructuring of their contracts or to the reinsurance of the restructured contracts.

The Ancillary Receiver plans to dispose, through assumption reinsurance, of blocks of business (the Contracts) to the Reinsurer. These life insurance and annuity Contracts will be restructured to match the Reinsurer's contract forms immediately before the reinsurance arrangement is consummated. The economic rights and benefits of the restructured Contracts immediately after the restructuring will be substantially similar to the economic rights and benefits of the Contracts immediately before the restructuring. The restructuring will be accomplished by endorsement.

The pending assumption reinsurance transactions were the result of a bidding process involving several potential reinsurers. Conversion of the assumed Contracts to

existing policy forms of a bidder had a material effect on the bidder's anticipated costs of administering the assumed contracts and was a material consideration in bidding. The Ancillary Receiver represents that the restructuring of these Contracts to conform with the Reinsurer's policy forms will occur as an integral part of the State C ancillary receivership of Company A, and will occur pursuant to the order and approval of the State C court.

No terms of any of the restructured Contracts to be assumed and reinsured by the Reinsurer will be changed by the assumption reinsurance transaction except that the Reinsurer will become the insurer of the Contracts. Under the Agreements, the Reinsurer will deliver to each policyholder of an assumed Contract a certificate confirming its assumption of all of Company A's liabilities under the Contract. A policyholder has no further claims against Company A upon the assumption of the Contract by the Reinsurer.

The Ancillary Receiver represents that the Contracts to be assumed that are issued as life insurance policies constitute "life insurance contracts" for federal income tax purposes. Further, the Ancillary Receiver represents that the Contracts to be assumed that are issued as annuity contracts constitute "annuity contracts" for federal income tax purposes.

Law and Analysis

Section 1035(a) of the Internal Revenue Code provides that no gain or loss is recognized on the exchange of -- (1) a contract of life insurance for another contract of life insurance or for an endowment or annuity contract; (2) a contract of endowment insurance either for another contract of endowment insurance that provides for regular payments beginning at a date not later than the date payments would have begun under the contract exchanged, or for an annuity contract; or (3) an annuity contract for an annuity contract. See also § 1.1035-1 of the Income Tax Regulations.

The legislative history of § 1035 states that exchange treatment is appropriate for "individuals who have merely exchanged one insurance policy for another better suited to their needs and who have not actually realized gain." H.R. Rep. No. 1337, 83d Cong., 2d Sess. 81 (1954).

Section 1031(b) provides in part that, if an exchange would be within the provisions of § 1035(a), if it were not for the fact the property received in exchange consists not only of property permitted by these provisions to be received without the recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

Section 1031(d) provides, for property acquired in an exchange described in § 1035(a), that the basis shall be the same as that of the property exchanged,

decreased in the amount of any money received by the taxpayer and increased in the amount of gain or decreased in the amount of loss to the taxpayer that was recognized on such exchange.

Rev. Proc. 92-57, 1992-2 C.B. 410, addresses the effect on policyholders of the modification or restructuring of an annuity, life insurance, or endowment contract issued or assumed (through reinsurance) by a financially troubled insurance company. If the modification or restructuring is an integral part of the rehabilitation plan and is approved by the state insurance commissioner, state court, or other responsible state official, then the Service will treat the modification or restructuring as not having an effect on the date that the contract was issued, entered into, or purchased for purposes of §§ 72, 101(f), 264, 7702, and 7702A and also as not resulting in retesting or the start of a new test period under §§ 7702(f)(7)(B)-(E) and 7702A(c).

Accordingly, based solely on the information submitted and on the representations made, it is held that the restructuring of the Contracts that are subject to the assumption reinsurance transaction which was entered into by the Ancillary Receiver with the Reinsurer in accordance with the Plan, pursuant to which the Reinsurer will assume the Contracts after the Contracts are restructured in Company A, will not have an effect on the date that each Contract was issued, entered into, or purchased for purposes of §§ 72, 101(f), 264, 7702, and 7702A, and will not require retesting or the start of a new test period under §§ 264(d)(1), 7702(f)(7)(B)-(E), and 7702A(c).

No opinion is expressed as to the tax treatment of the Contracts under the provisions of other sections of the Code and income tax regulations which may also be applicable thereto.

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

A copy of this letter should be attached to the federal income tax return to be filed by Company A for the taxable year that includes the date upon which the assumption reinsurance agreement covering the Contracts is closed.

Sincerely yours,
Assistant Chief Counsel
(Financial Institutions & Products)

By: _____
Donald J. Drees, Jr.
Senior Technician Reviewer
Branch 4