Internal Revenue Service

Department of the Treasury

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Person to Contact:

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Refer Reply To:
CC:DOM:CORP:Br4 PLR-118048-
Date:
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Company 1 =

Company 2 =

Company 3 =

Corp =

Foreign Sub =

Domestic Sub =

Mutual Holding 1 =

Stock Holding 1 =

Stock Holding 2 =

Merger Sub =

Merger Sub 2 =

Mutual Holding 2 =

New Name =

State A =

State B =

Country C =

State D =

Date 1 =

Date 2 =

a =

This letter responds to your September 15, 2000 request for rulings on certain federal income tax consequences of a proposed series of transactions. The tax consequences of related transactions are addressed in PLR-118050-00 and PLR-118041-00, both issued this date.

The rulings given 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

Company 1 is a State A property and casualty mutual insurance company taxable under §§ 831 and 835 of the Internal Revenue Code (the "Code"). Company 1 is the common parent of a large affiliated group of corporations that files a consolidated federal tax return. Company 1 has one life insurance subsidiary.

Company 2 is a State A property and casualty mutual insurance company taxable under §§ 831 and 835. Company 2 has no subsidiaries.

Company 3 is a State B mutual insurance company taxable under §§ 831 and 835 and is the common parent of an affiliated group with no life insurance subsidiaries.

As mutual insurance companies, Company 1, Company 2, and Company 3 have membership interests rather than capital stock to reflect proprietary ownership. These membership interests, which are owned by policyholders, provide (i) the right to vote, (ii) the right to distributions of surplus upon liquidation, (iii) the right to dividends if and when declared by the board of directors, and (iv) such other rights as conferred by the company articles of incorporation or bylaws and by State A or State B law.

On Date 1 (more than two years ago), Company 1 purchased several

subsidiaries from unrelated Company 3 (the "Date 1 Acquisitions"). Also on Date 1, Company 3 issued an a dollar surplus note to Company 1 in exchange for a dollars in cash (the "Exchange"). Company 3 used the proceeds from the Date 1 Acquisitions and the Exchange to repay two surplus notes held by unrelated Corp, with the remainder becoming part of the Company 3 surplus. On Date 2 (more than six months ago), a wholly owned subsidiary of Company 1 sold all the stock of Foreign Sub, a Country C company that reinsures certain insurance policies issued by Company 3, to Company 3 (the "Date 2 Sale"). The Date 2 Sale was undertaken to align the ownership of Foreign Sub with that of Company 3, the primary source of Foreign Sub's business. Following the Date 2 Sale, Foreign Sub elected under § 953(d) to be treated as a domestic corporation for purposes of Title 26. Company 3 recently formed Domestic Sub under State D law, and, before the transactions proposed below, will contribute to Domestic Sub all of the Foreign Sub stock (the "Formation" and the "Contribution," respectively). Company 3, Foreign Sub, and Domestic Sub will file a consolidated federal income tax return. Company 2, Company 3, Foreign Sub, and Domestic Sub are not life insurance companies. The value of Company 1 is more than twice that of either Company 2 or Company 3.

Proposed Transactions

For what are represented to be valid business reasons, it is proposed that, pursuant to an overall plan, (i) Company 1 convert into a stock insurance company controlled indirectly by newly formed Mutual Holding 1 and (ii) Mutual Holding 1 then acquire Company 2 and Company 3. More specifically:

Company 1 Conversion and Restructuring:

Upon satisfaction of various conditions precedent, Company 1 will convert into a stock insurance company controlled indirectly by newly formed Mutual Holding 1 as follows (the "Company 1 Conversion and Restructuring"):

(i) Under the laws of State A, Mutual Holding 1 will be formed on behalf of the Company 1 members, and Company 1 will organize Stock Holding 1 and Stock Holding 2. At no time before completion of the Company 1 Conversion (defined in step (ii) below) will Mutual Holding 1 be a member of the Company 1 affiliated group.

(ii) Company 1 will convert under the laws of State A into a stock insurance company (the "Company 1 Conversion" and "Reorganized Company 1"). In the Company 1 Conversion, (a) the Company 1 membership interests will be extinguished, (b) the former Company 1 members will automatically become

Mutual Holding 1 members, and (c) Reorganized Company 1 will initially issue all of its stock to Mutual Holding 1. Company 1 members will receive no consideration in the Company 1 Conversion other than Mutual Holding 1 membership interests, and the existing Company 1 insurance policies will not change (*i.e.*, premiums, policy benefits, and other obligations to policyholders will remain the same).

(iii) Mutual Holding 1 will contribute the stock of Reorganized Company 1 to Stock Holding 1 in exchange for all the stock of Stock Holding 1.

(iv) Stock Holding 1 will contribute the stock of Reorganized Company 1 to Stock Holding 2 in exchange for all the stock of Stock Holding 2.

Mutual Holding Company 1 Acquisition of Company 2:

As expeditiously as possible following the Company 1 restructuring described above, Mutual Holding 1 will acquire Company 2 as follows:

(v) Mutual Holding 1 will form Merger Sub as a State A property and casualty stock insurance company.

(vi) Company 2 will convert from a State A property and casualty mutual insurance company into a State A property and casualty stock insurance company (the "Company 2 Conversion" and "Reorganized Company 2").

(vii) Merger Sub will merge into Reorganized Company 2, with Reorganized Company 2 surviving (the "Company 2 Reverse Subsidiary Merger"). In the Company 2 Reverse Subsidiary Merger, (a) the Company 2 membership interests will be extinguished, (b) the former Company 2 members will automatically become Mutual Holding 1 members, and (c) Reorganized Company 2 will issue all of its stock to Mutual Holding 1. Company 2 members will receive no consideration in the Company 2 Reverse Subsidiary Merger other than Mutual Holding 1 membership interests, and existing insurance policies of Reorganized Company 2 will not change (*i.e.*, premiums, policy benefits, or other obligations to policyholders will remain the same). Mutual Holding 1 membership interests existing before the Company 2 Reverse Subsidiary Merger will remain outstanding.

(viii) After the Company 2 Reverse Subsidiary Merger, Mutual Holding 1 will contribute the Reorganized Company 2 stock to Stock Holding 1, and Stock Holding 1 will contribute the stock to Stock Holding 2.

Mutual Holding Company 1 Acquisition of Company 3:

As expeditiously as possible following the Company 1 restructuring described above, Mutual Holding 1 will acquire Company 3 as follows:

(ix) Mutual Holding 1 will form Merger Sub 2 as a State B corporation.

(x) Company 3 will form Mutual Holding 2 under State B law and will convert into a State B property and casualty stock insurance company (the "Company 3 Conversion" and "Reorganized Company 3"). Mutual Holding 2 is being formed to facilitate the acquisition of Company 3 by Mutual Holding 1. In the Company 3 Conversion, (a) the Company 3 membership interests will be extinguished, (b) the former Company 3 members will automatically become Mutual Holding 2 members, and (c) Reorganized Company 3 will initially issue all of its stock to Mutual Holding 2. Company 3 members will receive no consideration in the Company 3 Conversion other than Mutual Holding 2 membership interests, and the existing Company 3 insurance policies will not change (*i.e.*, premiums, policy benefits, and other obligations to policyholders will remain the same). With the consent of the Commissioner of Insurance of State B, Reorganized Company 3 will change its name to New Name.

(xi) Merger Sub 2 will merge into Reorganized Company 3, with Reorganized Company 3 surviving (the "Company 3 Reverse Subsidiary Merger"). Simultaneously, Mutual Holding 2 will merge into Mutual Holding 1, with Mutual Holding 1 surviving (the "Mutual Holding 2 Merger" and, together with the Company 3 Reverse Subsidiary Merger, the "Merger"). In the Merger, the Mutual Holding 2 membership interests will be extinguished, and the former Mutual Holding 2 members will automatically receive membership interests in Mutual Holding 1. Mutual Holding 2 members will receive no consideration in the Merger other than Mutual Holding 1 membership interests, and the existing insurance policies of Reorganized Company 3 will not change (*i.e.*, premiums, policy benefits, and other obligations to policyholders will remain the same). Following the Merger, Mutual Holding 1 will own all the stock of Reorganized Company 3. Mutual Holding 1 membership interests existing before the Merger will remain outstanding.

(xii) Mutual Holding 1 will contribute the Reorganized Company 3 stock to Stock Holding 1, and Stock Holding 1 will contribute the stock to Stock Holding 2.

You have requested a ruling that the Company 1 Conversion and restructuring be treated as if (a) the Company 1 members had exchanged their

Company 1 membership interests for all the stock of Reorganized Company 1 in a reorganization qualifying under § 368(a)(1)(E) and (b) the former Company 1 members then had transferred their Reorganized Company 1 stock to Mutual Holding 1 in exchange for Mutual Holding 1 membership interests in a transaction governed by § 351.

Under section 3.01(22) of Rev. Proc. 2000-3, 2000-1 I.R.B. 103, 104-105 (the revenue procedure in effect at the time this request was filed), the Service will not rule on the application of § 351 to an exchange of stock for the stock of a newly formed holding company. The Service has the discretion, however, to rule on significant subissues that must be resolved to determine whether the transaction qualifies under § 351. The Service will rule on a subissue only if it is 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.

Should we rule favorably on your request that the conversion be recast as described above, Company 1 represents that, to the best of its knowledge and belief, the deemed transfer of Reorganized Company 1 stock to Mutual Holding 1 and the actual transfers of this stock to Stock Holding 1 and Stock Holding 2 are transfers of property in exchange for stock under § 351(a).

Other Representations

Company 1 has made the following additional representations concerning the Company 1 Conversion and Restructuring:

(a) The fair market value of the Reorganized Company 1 stock treated as received by the Company 1 members will approximately equal the fair market value of the Company 1 membership interests surrendered in exchange therefor.

(b) The Company 1 Conversion is not part of a plan to periodically increase the proportionate interest of any Company 1 member in the assets or earnings and profits of Company 1.

(c) Following the Company 1 Conversion, Reorganized Company 1 will continue, as a stock insurance company, in the same business that Company 1 conducted before the Company 1 Conversion.

(d) Each party to the Company 1 Conversion will pay its, his, or her own expenses, if any, incurred in the Company 1 Conversion.

(e) The Company 1 Conversion will occur under a plan agreed upon before the Company 1 Conversion.

(f) Company 1 is not under the jurisdiction of a court in a Title 11 or similar case within the meaning of § 368(a)(3)(A).

(g) Following the Company 1 Conversion, Reorganized Company 1 will be treated under the laws of State A as the same corporation as Company 1 before the Company 1 Conversion.

(h) Immediately after the Company 1 Conversion, Mutual Holding 1 and its direct and indirect subsidiaries will continue to own substantially all the assets that were held by Company 1 and its direct and indirect subsidiaries before the Company 1 Conversion.

(i) Neither Company 1, Company 2, nor Company 3 is a life insurance company within the meaning of § 801.

Domestic Rulings

Based solely on the information submitted and the representations set forth above, we rule as follows on the Company 1 Conversion and Restructuring:

(1) For federal income tax purposes, the transactions will be treated as if (i) Company 1 had converted from a mutual insurance company to a stock insurance company, with the Company 1 members exchanging their Company 1 membership interests for Reorganized Company 1 stock, (ii) the Company 1 members then had contributed their Reorganized Company 1 stock to Mutual Holding 1 in exchange for Mutual Holding 1 membership interests, (iii) Mutual Holding 1 then contributed the Reorganized Company 1 stock to Stock Holding 1 in exchange for stock of Stock Holding 1, and (iv) Stock Holding 1 then contributed the Reorganized Company 1 stock to Stock Holding 2 in exchange for stock of Stock Holding 2.

(2) Provided Reorganized Company 1 is considered under State A law to be the same entity as Company 1 before the conversion, the conversion of Company 1 from a mutual insurance company to a stock insurance company and the constructive exchange of Company 1 membership interests for Reorganized Company 1 stock will be a recapitalization under § 368(a)(1)(E). Company 1 will be “a party to a reorganization” under § 368(b).

(3) No gain or loss will be recognized by the Company 1 members on

their constructive exchange of Company 1 membership interests for Reorganized Company 1 stock (§ 354(a)(1)).

(4) The basis of each Company 1 membership interest is zero (Rev. Rul. 71-233, 1971-1 C.B. 113; Rev. Rul. 74-277, 1974-1 C.B. 88). The basis of the Reorganized Company 1 stock in the hands of each former Company 1 member will equal the basis of the Company 1 membership interest constructively exchanged therefor (§ 358(a)(1)).

(5) The holding period of the Reorganized Company 1 stock constructively received in exchange for a Company 1 membership interest will include the period the Company 1 member held the Company 1 membership interest (§ 1223(1)).

(6) No gain or loss will be recognized by Reorganized Company 1 on its constructive issuance of Reorganized Company 1 stock for Company 1 membership interests (§ 1032(a)).

(7) The Mutual Holding 1 membership interests received by Company 1, Company 2, and Company 3 members in constructive exchange for their stock in Reorganized Company 1, Reorganized Company 2, and Reorganized Company 3, respectively, will be treated as stock within the meaning of § 351(a) (Rev. Rul. 69-3, 1969-1 C.B. 103).

(8) In determining whether the control requirement of § 351 has been satisfied, the former members of Company 1, Company 2, and Company 3 all will be considered "transferors" as that term is used in § 351.[1]

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[1] Section 351 does not apply to a transfer unless the transferor or transferors hold at least 80 percent of the stock of the transferee corporation immediately after the transfer. *See* § 368(c); Rev. Rul. 59-259, 1959-2 C.B. 115. In the present case, after completion of the Company 1 restructuring, the Company 2 acquisition, and the Company 3 acquisition, the former members of Company 1 will hold less than 80 percent of the membership interests of Mutual Holding 1. Therefore, standing alone, the transfer by Company 1 members of their Reorganized Company 1 stock to Mutual Holding 1 (under the requested recasting of the transaction) would not qualify for § 351 treatment and could cause the members to recognize gain or loss. However, because Merger Sub and Merger Sub 2 are transitory entities and will be disregarded in the Company 2 Reverse Subsidiary Merger and the Company 3 Reverse Subsidiary Merger, the former members of Company 2 and Company 3 will be viewed as having transferred property (Reorganized Company 2 stock and Reorganized Company 3 stock, respectively) to Mutual Holding 1 in exchange for Mutual Holding 1 membership interests. *See infra* ruling (9). Hence, in determining whether transfers by the former Company 1 members of their Reorganized Company 1 stock will qualify under § 351, the former members of Company 2 and Company 3 will be considered part of the transferor group. As a result, the transferor group (including the former Company 1 members) will own 80 percent of the Mutual Holding 1 interests immediately after the transaction. *See* § 1.351-1(a)(1) (“immediately after” does not necessarily require simultaneous

(9) For federal income tax purposes, (i) the formation of Mutual Holding 2 and the Mutual Holding 2 Merger described above in steps (x) and (xi) will be disregarded and (ii) the Company 3 Reverse Subsidiary Merger will be treated as if Mutual Holding 1 had acquired all the stock of Reorganized Company 3 in exchange for membership interests in Mutual Holding 1 (*see* Rev. Rul. 67-448, 1967-2 C.B. 144).

(10) The contribution by Stock Holding 1 of Reorganized Company 1 stock, Reorganized Company 2 stock, and Reorganized Company 3 stock to Stock Holding 2 in exchange for all the stock of Stock Holding 2 will not prevent the contribution by former Company 1 members of Reorganized Company 1 stock to Mutual Holding 1 from qualifying under § 351(a) (*see* Rev. Rul. 77-449, 1977-2 C.B. 110).

(11) The affiliated group of which Company 1 was the common parent immediately before the transactions will remain in existence with Mutual Holding 1 as the new common parent. Any prior election to file a life-nonlife consolidated federal income tax return under § 1504(c)(2) will remain in effect (*see* §§ 1.1502-47(d)(12)(vi) and 1.1502-75(d)(3) of the Income Tax Regulations). Section 1.1502- 47(d)(12)(ii)-(iv) will apply by treating Mutual Holding 1 as if it were the previous common parent of the Company 1 affiliated group. Mutual Holding 1 will be treated as having been a member of the group for purposes of determining the five-year base period described in §§ 1504 (c)(2)(A) and 1.1502-47(d)(12)(ii). Accordingly, all members of the Company 1 affiliated group on the effective date will determine their status as eligible corporations under § 1.1502-47(d)(12) (*see* § 1.1502- 47(d)(12)(vi)). The affiliated group of which Company 3 was the common parent before the transactions will cease to exist.

(12) For purposes of §§ 1.1502-31 and 1.1502-33, the Company 1 Conversion will qualify as a “group structure change” under § 1.1502-75(d)(3). Mutual Holding 1's basis in the Company 1 stock immediately after the group structure change will be the net asset basis of Company 1 as determined under § 1.1502-31(c), subject to the adjustments described in § 1.1502-31(d) (*see* § 1.1502-31(b)(2)). The earnings and profits of Mutual Holding 1, Stock Holding 1, and Stock Holding 2 will each be adjusted immediately after Mutual Holding 1

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exchanges by two or more persons, but comprehends a situation in which the rights of the parties have been previously defined, and the execution of the agreement proceeds with an expedition consistent with orderly procedure). However, since Congress adopted § 368(a)(2)(E) to address the tax consequences of reverse triangular mergers, that section will determine the tax consequences of the Company 2 Reverse Subsidiary Merger and the Company 3 Reverse Subsidiary Merger to the participants in those mergers. See related letter rulings PLR-118050-00 and PLR-118041-00, both issued this date.

becomes the new common parent to reflect the earnings and profits of Company 1 immediately before Company 1 ceases to be the common parent (*see* § 1.1502-33(f)).

Foreign Ruling

(13) Pursuant to § 953(d)(3), any loss of Foreign Sub will be treated as a dual consolidated loss and may not be used in the federal consolidated return in which Company 3 is participating to offset the income of any other member of the consolidated group.

Caveats

No opinion is expressed about the tax treatment of the above transactions under other provisions of the Code or regulations, or the tax treatment of any conditions existing at the time of, or effects resulting from, the above transactions that are not specifically covered by rulings (1) through (13). In particular, no opinion is expressed concerning:

(i) The federal income tax consequences of the Date 1 Acquisitions, the Exchange, the Date 2 Sale, the Formation, and the Contribution;

(ii) Whether the stock contributions described above in step (iii) will qualify under § 351(a); and

(iii) The federal income tax consequences of the transactions described in steps (iv) through (xii), other than as described in rulings (7) through (10) above. The tax consequences of these transactions are further addressed in letter rulings PLR-118050-00 and PLR-118041-00, both issued this date.

Finally, our conclusion in ruling (2) that the Company 1 Conversion qualifies as a reorganization under § 368(a)(1)(E) is conditioned on Reorganized Company 1 being considered, under State A law, the same entity as Company 1 before the Company 1 Conversion. No opinion is expressed on whether this requirement will be met.

Procedural Statements

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

Each taxpayer affected by the above transactions should attach a copy of

this ruling letter to its, his, or her federal income tax return for the taxable year in which the transactions are completed.

Under a power of attorney on file in this office, a copy of this letter is being sent to each of your authorized representatives.

Sincerely,
Associate Chief Counsel (Corporate)
By: Wayne T. Murray
Senior Technician/Reviewer
Branch 4