

as defined by section 264(f)(4)(E) of the Internal Revenue Code (Code). All of Taxpayer's BOLI policies that are the subject of this ruling request are general account policies that insure the lives of Taxpayer's active employees. In the group contract policies issued by Company 1, the individually covered employees are identified by separate policy certificates. The group contract policies are single premium modified endowment contracts and the individual BOLI policies are flexible universal life insurance contracts. No policy loans exist currently, or in the past, with respect to any of the BOLI policies currently held by Taxpayer.

Taxpayer proposes to exchange the BOLI policies associated with its current, active employees. First, Taxpayer proposes to exchange the individual certificates issued by Company 1 under the group BOLI policy on its general account for individual, separate account BOLI policies under a variable adjustable life insurance group policy also issued by Company 1. Second, Taxpayer proposes to exchange the individual general account BOLI policies issued by Company 2 for individual separate account BOLI policies issued by Company 3. Each of the new separate account BOLI policies will be issued to the same policyholder and on the same lives as the certificates surrendered in the exchange. There will be no change in the face value of the policies except to the extent necessary to continue to comply with the cash value accumulation test or the guideline premium requirements under section 7702(a) of the Code. Taxpayer does not now intend to surrender or make distributions from either the existing policies or the new policies. Prior to the proposed exchange, Taxpayer will obtain written consent from each active employee for which an exchange is proposed.

Taxpayer represents that all BOLI contracts to be exchanged are modified endowment contracts (MECs). Taxpayer further represents that neither Taxpayer nor the insureds will receive any of the cash surrender value of the current general account BOLI contracts exchanged for the general account BOLI contracts.

REQUESTED RULINGS

Taxpayer requests the following rulings: (1) that the proposed exchanges be treated as tax free exchanges under § 1035 of the Internal Revenue Code, and (2) that upon completion of the proposed exchanges, the basis and the investment in the contract of the new policies issued by Companies 1 and 3 will be the same as Taxpayer's basis and investment in the contract in the exchanged policies.

LAW AND ANALYSIS

Section 1035(a)(1) provides that no gain or loss is recognized on the exchange of a contract of life insurance for another contract of life insurance. Section 1035(b) defines life insurance contract as a contract with an insurance company which depends in part on the life expectancy of the insured and is not ordinarily payable in full during the life of the insured. Section 1.1035-1 of the regulations provides that "section 1035 does not

apply to such exchanges if the policies exchanged do not relate to the same insured." The legislative history indicates that section 1035 was designed to eliminate the taxation of individuals "who merely exchanged one insurance policy for another better suited to their needs but who have actually recognized no gain." H.R. Rep. No. 1337, 83rd Cong., 2d Sess. 81 (1954).

Section 1035 (d) (2) references section 1031 for the rules to determine the basis of property acquired in a section 1035 exchange. Section 1031(d) provides that property acquired in a section 1035 exchange has the same basis as that of the property exchanged, decreased by the amount of any money received by the taxpayer and increased by any gain (or decreased by any loss) recognized by the taxpayer on the exchange.

Section 1.1031(d)-1 provides, in part, that in a section 1035 exchange, the basis of the property acquired is the same as the basis of the property transferred by the taxpayer with proper adjustments to the date of the exchange.

Taxpayer proposes to exchange certificates issued pursuant to the group general account BOLI policy issued by Company 1, for individual certificates issued pursuant to a group separate account BOLI policy issued by Company 1 with respect to currently active employees. Taxpayer also proposes to exchange individual general account policies issued by Company 2 with respect to currently active employees, for individual, separate account BOLI policies issued by Company 3 with respect to those same individuals. Taxpayer represents that the certificates issued for a single insured pursuant to a group account BOLI policy are treated as separate contracts for purposes of state insurance laws, and that Taxpayer does treat each certificate issued under the group account BOLI policies as a separate contract for purposes of sections 817(h), 7702, and 7702A.

Section 7702A defines a modified endowment contract (MEC) as a contract that meets the requirement of section 7702 but fails to meet the 7-pay test of section 7702A(b), or that is received in exchange for a contract that is a MEC. Under section 7702A(b), a contract fails to meet the 7-pay test if the accumulated amount paid under the contract at any time during the first seven contract years exceeds the sum of the net level premiums that would have been paid on or before that time if the contract provided for paid-up future benefits after the payment of seven level annual premiums.

Thus, all of the newly issued BOLI contracts will also be MECs.

Taxpayer represents that, in its proposed exchanges, it will not make any material increase in the death benefit or other material change.

RULING

Taxpayer's proposed exchanges of (1) certificates issued pursuant to the general account BOLI policies issued by Company 1 with respect to currently active employees, for individual, separate account BOLI policies issued by Company 1 with respect to those same individuals; and (2) individual general account BOLI policies issued by Company 2 with respect to currently active employees for individual separate account BOLI policies issued by Company 3, meet the requirements of section 1035(a)(1). The basis and the investment in the contract of the newly issued contracts will be the same as that of the contract for which they were exchanged.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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 sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return 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 taxpayer 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,

Sheryl B. Flum
Sheryl B. Flum
Branch Chief, Branch 4
(Financial Institutions & Products)