

Internal Revenue Service

Department of the Treasury
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Person To Contact:
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Telephone Number:

Refer Reply To:
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Date:
June 14, 2007

LEGEND:

Parent =

Transferor =

Transferee =

Target Parent =

Target Sub 1 =

Target Sub 2
or Successor
Transferee =

Corp 1 =

Corp 2 =
Corp 3 =
Department =
State X =
State Y =
State Z =
Year 1 =
Year 2 =
Month A =
Date A =
Date B =
Date C =
Date D =
Date E =
Date F =

Dear :

This responds to your February 14, 2007 letter ruling request for federal income tax rulings on certain of the transactions described below. The material information provided in that request and in subsequent correspondence is summarized below.

SUMMARY OF FACTS

Transferor is a State Y stock life insurance company, incorporated in Year 1; it is licensed in 49 states and the District of Columbia as a life, accident and health

insurance company. It is also an accredited reinsurer in several states, including State X. Transferor is an accrual method, calendar year taxpayer and is a member of a life/nonlife consolidated group, the common parent of which is Parent.

Transferee is a State X stock life insurance company, incorporated in Year 2 and is a wholly owned subsidiary of Transferor and also a member of Parent's life/nonlife consolidated group. Transferee is an accrual method, calendar year taxpayer and is licensed as a life, accident and health insurance company in State X and State Y.

Transferor has engaged in reinsurance contracts with Corp 1 and Corp 2 (Reinsurance Contracts); in connection with those contracts, it capitalized certain specified policy acquisition expenses under section 848 (DAC Capitalization Amount), made or was deemed to have made related expenditures for intangibles that are amortized under section 197 (the Section 197 Amount), and capitalized certain ceding commissions (the Ceding Commission Amount).

Transferor has also entered into administrative services agreements with Corp 1 and Corp 2 in connection with the Reinsurance Contracts (the Reinsurance Administrative Service Agreements). Because it did not want to retain economic liability on certain of the underlying insurance policies (the Underlying Policies) related to the Reinsurance Contracts, Transferor entered into agreements (the Retrocession Agreements) with Corp 3 whereby Transferor retroceded certain of the Underlying Policies to Corp 3. As a result of those retrocessions, Transferor remains liable to Corp 1 and Corp 2 for claims under the Reinsurance Contracts; however, Transferor does not retain the economic liability or economic benefit of the retroceded Underlying Policies.

State X imposes significant regulatory requirements on all insurance companies licensed or accredited in State X. Transferor wished to terminate its State X accreditation so that it will not be subject to those requirements. However, many of the Reinsurance Contracts require that the ceding company continue to receive relief from the regulatory requirements associated with the Reinsurance Contracts. Such regulatory relief can occur if the contracts are reinsured with a State X licensed or accredited reinsurer or the parties implement alternative arrangements pursuant to regulation. Because the Reinsurance Contracts do not provide for any of the alternative arrangements, the ceding companies can only continue to receive regulatory relief for the Reinsurance Contracts if the reinsurer is a State X licensed or accredited reinsurer or the parties now implement alternative arrangements pursuant to regulation. To terminate Transferor's State X accreditation without breaching the Reinsurance Agreements requirement of regulatory relief for the ceding companies, Transferor determined that the best course of action was to transfer the Reinsurance Contracts to Transferee (a related entity that was subject to the State X regulatory requirements) and for the Transferee to assume the Transferor's rights and obligations under the

Reinsurance Contracts (the Asset Transfer). In Month A, Parent's executive steering committee approved the Asset Transfer. The Department must approve Transferor's capital transactions; accordingly, approximately two months after receiving the approval from its executive steering committee, Parent entered into informal discussions with the Department to secure its approval for the transfer of the affected assets. On Date A, Transferor filed a formal application with the Department seeking its approval for the Asset Transfer.

Almost a year after entering into discussions with the Department regarding the Asset Transfer, Parent acquired all of the assets of Target Parent. Those assets included the stock of Target Sub 1, which in turn owned all of the stock of Target Sub 2. (After the Merger described below, Target Sub 2 may sometimes be referred to as Successor Transferee.) Sometime after Parent's acquisition of the assets of Target Parent, and while the Department was still in the process of considering Parent's Asset Transfer request, Parent decided to simplify its corporate structure. As part of this plan, Parent began to explore the possibility of merging Transferee with and into Target Sub 2 with Target Sub 2 surviving (the Merger). On Date B, nearly six months after the acquisition of Target Parent's assets, Transferor filed an application with the Department seeking its approval for the Merger.

On Date C, the Department approved the proposed Asset Transfer. Transferor consummated the Asset Transfer, effective for State X regulatory purposes as of Date D. At the time Transferor consummated the Asset Transfer, the Department had not yet granted approval for the Merger. On Date E, the Department approved the Merger, which was implemented and effective for state regulatory purposes as of Date F.

THE ASSET TRANSFER

In order to carry out the Asset Transfer, and for what is represented to be valid business reasons, the following transactions have been consummated:

- (i) Transferor transferred to Transferee investment assets and other assets related to its rights and obligations under the Reinsurance Contracts, the Retrocession Agreements, and the Reinsurance Administrative Services Agreements (collectively, the Transferred Agreements) in constructive exchange for additional shares of Transferee stock and the assumption by Transferee of certain Transferor liabilities.
- (ii) Transferee assumed all of Transferor's rights and obligations under the Reinsurance Contracts.

- (iii) Corp 1 and Corp 2 agreed to Transferee's assumption of the rights and obligations described in (ii) above and to a novation of Transferor's rights and obligations under the Reinsurance Contracts.
- (iv) Transferee also assumed all of Transferor's rights and obligations under the Retrocession Agreements.
- (v) Corp 3 agreed to Transferee's assumption described in (iv) above and to a novation of Transferor's rights and obligations under the Retrocession Agreements.
- (vi) Transferor assigned to Transferee all of its rights and obligations under the Reinsurance Administrative Services Agreement.
- (vii) Corp 1 and Corp 2 agreed to the assignment described in (vi) above and to a novation of Transferor's rights and obligations under the Reinsurance Administrative Services Agreement.

REPRESENTATIONS

With respect to the Asset Transfer, the following representations have been made:

- (a) No stock or securities will be issued for services rendered to or for the benefit of Transferee in connection with the transaction.
- (b) No stock or securities will be issued for indebtedness of Transferee that is not evidenced by a security or for interest on indebtedness of Transferee, which accrued on or after the beginning of the holding period of Transferor for the debt.
- (c) The Asset Transfer is not the result of a solicitation by a promoter, broker, or investment house.
- (d) Transferor will not retain any rights in or relating to the property transferred to Transferee.
- (e) The adjusted tax basis and the fair market value of the assets transferred by Transferor to Transferee will in each instance be equal to or exceed the sum of the liabilities to be assumed by Transferee plus any liabilities to which the transferred assets are subject.
- (f) The adjusted tax basis and the fair market value of the assets transferred by Transferor to Transferee will in each instance be equal to or exceed the sum

- of the tax reserves associated with the Reinsurance Contracts (taking into account the Retrocession Agreements) plus any other liabilities to be assumed by Transferee and to which the transferred assets are subject.
- (g) The liabilities of Transferor to be assumed by Transferee were incurred in the ordinary course of business and are associated with the assets transferred.
 - (h) There is no indebtedness between Transferor and Transferee (other than payables arising in the normal course of business under the existing administrative services agreement between Transferor and Transferee, a tax sharing agreement, and other similar intercompany agreements), and there will be no indebtedness created in favor of Transferor as a result of the transaction.
 - (i) The transfers and exchanges will occur under a plan agreed upon before the transaction in which the rights of the parties are defined.
 - (j) All exchanges will occur on approximately the same date.
 - (k) There is no plan or intention on the part of Transferee or Successor Transferee to redeem or otherwise reacquire any stock or indebtedness issued in the transaction.
 - (l) Taking into account any issuances of additional shares of Transferee stock; any issuance of stock for services; the exercise of any Transferee stock rights, warrants or subscriptions; a public offering of Transferee stock; and any sale, exchange, transfer by gift, or other disposition of any of the stock of Transferee deemed to be received in the exchange, but disregarding the Merger, Transferor will be in "control" of Transferee under section 368(c) immediately after the transaction.
 - (m) Transferor will constructively receive stock with a value approximately equal to the net fair market value of the property transferred to Transferee.
 - (n) Transferee will merge with and into Successor Transferee in a transaction intended to satisfy the requirements of section 368(a)(1)(A), and following the Merger, (i) Transferor will control Successor Transferee within the meaning of section 368(c) and (ii) Successor Transferee will remain in existence and retain and use in a trade or business the property transferred to Transferee by Transferor.
 - (o) There is no plan or intention by Transferee to dispose of the transferred property other than in connection with the Merger Transaction, and there is no

- plan or intention by Successor Transferee to dispose of the transferred property other than in the normal course of business operations.
- (p) Each of the parties to the transaction will pay its own expenses, if any, incurred in connection with the proposed transaction.
 - (q) Neither Transferee nor Successor Transferee will be an investment company within the meaning of sections 351(e)(1) and 1.351-1(c)(1)(ii).
 - (r) Transferor is not under the jurisdiction of a court in a title 11 or similar case (within the meaning of section 368(a)(3)(A)), and any stock or securities received in the exchange will not be used to satisfy the indebtedness of such debtor.
 - (s) Neither Transferee nor Successor Transferee will be a “personal service corporation” within the meaning of section 269A.
 - (t) None of the assets to be transferred to Transferee was received by Transferor as part of a plan of liquidation of another corporation.
 - (u) No “income items” within the meaning of section 4.03(a)(1) of Rev. Proc. 83-59, 1983-2 C.B. 575, of Transferor that have not been or will not be included in its income were transferred to Transferee.
 - (v) The assets transferred by Transferor to Transferee did not involve any agreement that purports to furnish technical “know-how” in exchange for stock.
 - (w) No stock of another corporation is part of the assets transferred by Transferor to Transferee.
 - (x) There is no plan or intention to issue any additional stock of Transferee, or Successor Transferee following the Merger, to any other person.
 - (y) The value of the stock received in exchange for accounts receivable (if any) will be equal to the net value of the accounts transferred, i.e., the face amount of the accounts receivable previously included in income less the amount of the reserve for bad debt.

RULINGS

Based solely on the facts submitted and the representations described above, we rule:

1. The transfer of assets by Transferor in constructive exchange for additional Transferee stock and the assumption of the transferred liabilities by Transferee, as described above, will qualify as a transaction described in section 351. Section 351 and Rev. Rul. 94-45, 1994-2 C.B. 39.
2. No gain or loss will be recognized by Transferor upon the transfer of the Reinsurance Contract assets in constructive exchange for additional shares of Transferee stock and Transferee's assumption of the transferred liabilities. Sections 351(a) and 357(a).
3. No gain or loss will be recognized by Transferee upon its receipt of the Reinsurance Contract assets from Transferor in constructive exchange for additional shares of Transferee stock and the assumption of the transferred liabilities. Section 1032.
4. The basis of the stock of Transferee in the hands of Transferor will be increased by an amount equal to the sum of the bases of the Reinsurance Contract assets, plus the amount of any unamortized DAC Capitalization Amount, unamortized Section 197 Amount and unamortized Ceding Commission Amount, and decreased by the amount of transferred liabilities assumed by Transferee. Sections 358(a)(1) and (d)(1).
5. The holding period of the stock of Transferee constructively received by Transferor on the transfer will include the holding periods during which Transferor held the transferred assets, provided that the transferred assets were capital assets or were property described in section 1231. Section 1223(1); Rev. Rul. 85-164, 1985-2 C.B. 117.
6. The basis of each transferred asset in the hands of Transferee will be equal to the basis of such asset in the hands of Transferor immediately prior to the proposed transaction. Section 362(a)(1).
7. The holding period of each transferred asset in the hands of Transferee will be the same as the holding period of that asset in the hands of Transferor immediately prior to the proposed transaction. Section 1223(2).
8. For the taxable year in which Transferor transferred the Reinsurance Contracts, Transferor will include in its reserves as of the close of such year, for purposes of section 807(a) and (b), the ending balances of the reserves described in section 807(c) that Transferor held for the Reinsurance Contracts immediately before the transfer, and (ii) Transferor will not be entitled to a deduction under section 805(a)(6) for transferring assets to Transferee in consideration of the assumption by Transferee of the

- transferred liabilities under the Reinsurance Contracts. Rev. Rul. 94-45, supra.
9. For the first taxable year beginning after the transfer of the Reinsurance Contracts to Transferee, Transferor will not include in its reserves as of the beginning of such year, for purposes of section 807(a) and (b), the ending balances of the reserves described in section 807(c) that Transferor held for the transferred Reinsurance Contracts immediately before the transfers. Rev. Rul. 94-45, supra.
 10. For the taxable year in which Transferor transfers the Reinsurance Contracts to Transferee, (i) Transferee will include in its reserves at the beginning of such year, for purposes of section 807(a) and (b), the ending balances of the reserves described in section 807(c) that Transferor held for the Reinsurance Contracts immediately before the transfer, and (ii) Transferee will not take into premium income under section 803(a)(1) an amount with respect to the assets transferred to it in consideration of its assumption of liabilities under the Reinsurance Contracts. Rev. Rul. 94-45, supra.
 11. For purposes of section 848, Transferor and Transferee will not recognize net premiums as a result of the transfers of the Reinsurance Contracts or the Retrocession Agreements. The unamortized DAC Capitalization Amount and unamortized Ceding Commission Amount will be treated as transferred to Transferee and will continue to be amortized by Transferee over the remaining period as the amounts would have been deductible by Transferor. Rev. Rul. 94-45, supra. Similarly, the unamortized Section 197 Amount will be treated as transferred to Transferee and will continue to be amortized by Transferee under section 197 over the remaining period as the amounts would have been deductible by Transferor. Id.; section 197(f)(2).
 12. Any ceding commission amount paid by Transferee to Transferor and immediately contributed by Transferor to Transferee in connection with the Asset Transfer will be disregarded and not given effect for tax purposes. Rev. Rul. 83-142, 1983-2 C.B. 68; Rev. Rul. 78-397, 1978-2 C.B. 150. No Ceding Commission will be deemed paid by Transferee to Transferor under § 1.817-4(d) in connection with the transfer of the Reinsurance Contracts.

CAVEATS

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. We specifically express no opinion about whether the Merger satisfies the requirements of section 368(a)(1)(A). Additionally, we

specifically express no opinion about whether Target Sub 1 or Target Sub 2 is an eligible member of Parent's life/nonlife consolidated group.

PROCEDURAL MATTERS

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 representatives.

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 ruling contained in this letter is 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,

Alison G. Burns
Branch Chief, Branch 2
Office of Associate Chief Counsel (Corporate)