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Date:
February 01, 2013

Legend:

Taxpayer =
State X =
Insurance Regulator =
State Y =
State Z =
State Z Regulatory Agency =
Court =
Affiliate =
Parent =
Insurer =
Entity 1 =
Entity 2 =

Entity 3 =

Year 1 =
Year 2 =
Year 3 =
Date s =
Date t =
Date u =
Date v =
Date w =

Date x =
O =
P =
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Figure a =
Figure b =
Figure c =
Figure d =
Figure e =
Figure f =

Dear :

This is in response to the letter submitted by your authorized representative, requesting rulings on the application of certain sections of the Internal Revenue Code (the "Code") to the insolvency of Taxpayer.

Taxpayer is a life insurance company domiciled in State X and since Year 1 has been under the direction of State X's Insurance Regulator as receiver, pursuant to the orders of Court.

Taxpayer's annual accounting period is the calendar year and its method of accounting is the accrual method.

Taxpayer was an affiliate of Affiliate, a State Y-domiciled life insurance company that became insolvent in Year 1, and of the parent company, Parent. In connection with the bankruptcy of Parent and the insolvency of Affiliate, all of the stock of Taxpayer was transferred in Year 3 to the trustee of a trust for the benefit of certain creditors of Affiliate. Since Year 3, Taxpayer has filed a separate federal income tax return on Form 1120L.

A plan of rehabilitation was submitted to the Court on or about Date t (the "Rehabilitation Plan"), and approved by an order of the Court dated Date u (the "Rehabilitation Plan Order").

The Rehabilitation Plan permitted the assumption of Taxpayer's existing policies by Insurer, except for structured settlement annuities and certain other non-surrenderable contracts (collectively, the "Contracts"), which remained with Taxpayer

under the supervision of the Insurance Regulator. The Contracts consist of the following types:

- Structured settlement annuities ("SSAs").
- Individual certificates ("Pension Close-Out Certificates"), delivered under O group annuity contracts issued by the Taxpayer in connection with the terminations of O defined benefit plans, which Taxpayer represents to have been qualified under section 401(a) of the Code.
- Other single premium immediate annuities not included in the above categories ("Individual SPIAs").

Since the Court's approval of the Rehabilitation Plan, the Insurance Regulator has been directing the affairs of Taxpayer pursuant to the terms of the Rehabilitation Plan. The Insurance Regulator initially expected that Taxpayer would be able to earn a sufficient return on its investments to satisfy its remaining obligations. The Rehabilitation Plan also provided that certain of Taxpayer's policyholders whose policies were assumed by Insurer and who surrendered their Insurer-issued policies before the applicable Insurer surrender charges had decreased to zero would be allowed a claim against Taxpayer with respect to such surrender charge (the "Claim-Overs"). The Rehabilitation Plan Order continued the deferral of notice by the Insurance Regulator to all creditors to present their claims, extending the deferral through the term of the Rehabilitation Plan.

Taxpayer retained certain assets (including the proceeds of a ceding commission received from Insurer in connection with Insurer's assumption of policies) and, pursuant to the Rehabilitation Plan, the Contracts were serviced and paid in accordance with their terms out of such assets and the investment income earned thereon.

It is estimated that as of January 1, 2012, Taxpayer had obligations to approximately P policyholders.

While efforts to rehabilitate Taxpayer have been ongoing for the past Q years, Taxpayer's financial condition is progressively deteriorating. Taxpayer's assets as of Date v totaled Figure a, but the value of Taxpayer's liabilities as of that date, determined using economically reasonable assumptions, was approximately Figure b. Accordingly, Taxpayer cannot continue to pay 100 percent on all Contracts indefinitely under the Rehabilitation Plan. The Insurance Regulator has determined that further efforts to rehabilitate Taxpayer would be futile.

For several years, the Insurance Regulator has been working with representatives from, and counsel for, various interested parties, including Entity 1, various state life and health insurance guaranty associations with statutory coverage obligations under the Contracts (the participating guaranty associations or "PGAs"), Entity 2, Entity 3, and other life insurance companies (collectively, the "Insurance

Industry") to reach a consensus on an Agreement of Restructuring in Connection with the Liquidation of Taxpayer (the "Plan") that is in the best interests of Taxpayer's policyholders and creditors, avoids disruption of annuity payments, and increases the amount of funds available for Taxpayer's policyholders and creditors.

On Date w the Insurance Regulator petitioned the Court to, among other things, declare Taxpayer to be insolvent; approve the provisions, terms, and conditions of the Plan; appoint the Insurance Regulator and its successors in office as liquidator of Taxpayer and to direct the Insurance Regulator to liquidate the business and affairs of Taxpayer. On Date x the Court approved the Plan.

The Contracts are not surrenderable and do not have explicit cash or account values. Pursuant to the Plan, the Insurance Regulator and Entity 1 will determine an implied account value for each Contract equal to the present value of Taxpayer's projected liabilities due and payable under each Contract as of the date of liquidation (the "Liquidation Value") using a R percent discount rate (subject to adjustment at the time of closing under a formula set out in the Plan), with all life contingent benefits for Contracts calculated based upon a jointly-agreed mortality table attached to the Plan. The same set of mortality and discount rate assumptions will apply uniformly across all Contracts. The Liquidation Value will be updated to a final value within 30 days after the closing date of the Plan or promptly thereafter.

The Liquidation Value assigned to each Contract will then be reduced by a percentage reflecting the ratio of the liquidation value of Taxpayer's assets to the aggregate Liquidation Value for all Contracts. That is, the benefit payments under each Contract will be reduced to a pro rata amount that could be supported by Taxpayer's assets as of the date of entry of an order of liquidation (the "Restructured Value"). Because the market value of the current assets of Taxpayer is significantly lower than the present value of Taxpayer's obligations, the Restructured Value of each Contract is expected to reduce benefit payments to approximately S percent of their pre-restructuring amount.

The Plan provides that the order approving the Plan will reduce the liabilities under each Contract to its Restructured Value, and that the difference between the Liquidation Value assigned to a Contract (i.e., its pre-restructuring value) and the Restructured Value for the Contract shall be deemed to be an indebtedness of Taxpayer to the policyholder. The Plan further provides that Taxpayer will then transfer substantially all of its assets to a newly-formed entity (" "), and shall cede and assign to Taxpayer's liability to make the reduced benefit payments under the restructured Contracts. In addition, the Plan provides that benefits under the restructured Contracts shall be immediately enhanced upon assumption of the Contracts.

Benefit enhancement will be supported by a variety of funding sources. First, the PGAs will provide financial support to supplement benefit payments made by Taxpayer and to make additional benefit payments with respect to those Contracts or portions of Contracts (the "Covered Contracts") eligible for guaranty association coverage under each state's respective statute. The PGAs will provide coverage up to the maximum amount allowable by their respective state laws. Those contracts with present values of benefits that fall within the applicable guaranty association limits (usually between Figure c and Figure d) will be paid in full in accordance with their terms.

In addition, Entity 2 has agreed to provide coverage for Contracts on a pro rata basis, up to its full statutory cap of Figure e (the "Enhancement"). The Enhancement will apply to all Contracts issued prior to Date s, regardless of where the owner, payee, or beneficiary resides, and not otherwise fully covered by another state life and health insurance guaranty association (the "Enhancement-eligible Contracts"). If, however, the Enhancement would, by operation of governing state law, reduce or eliminate another guaranty association's statutory obligations under a Covered Contract, then Entity 2 will not provide any benefits for such Covered Contract.

Not all of Taxpayer's policyholders are covered by a state insurance guaranty association. Those Contracts not covered at all by a state insurance guaranty association ("Orphaned Contracts"), or those portions of Contracts not eligible for state life and health insurance guaranty association coverage (collectively, "Uncovered Contracts"), are thus subject to some benefit reduction to the extent that Taxpayer's assets and guaranty association coverage do not support the payment of full benefits. The Plan, however, provides for further committed support by a consortium of life insurance companies. This consortium has agreed to supplement and guaranty the benefits under the Uncovered Contracts, including: (a) providing hypothetical guaranty association coverage of up to Figure c in present value of benefits under Orphaned Contracts: and (b) providing an enhancement of benefits to T percent of the amount that otherwise would have been payable under such Uncovered Contract (together, the "Wrapped Obligations").

It is anticipated that the Taxpayer assets transferred to plus the funding sources described above will result in full payment being made on approximately U percent of the Contracts. In addition, the Insurance Regulator and Entity 1 have continued to negotiate with certain of these life insurance companies and have reached an agreement for the provision of supplemental benefit enhancements that would increase the percentage of Contracts that will be fully paid under the Plan from U percent to V percent (the "Supplemental Benefit Enhancements"). Contracts that are subject to some benefit reduction after application of all of the benefit enhancements described above would receive Supplemental Benefit Enhancements to increase the total benefits to be paid by in respect of such Contract to the lesser of (a) total benefits with a present value of Figure f and (b) total benefits under the terms of the pre-restructured Contract.

For the information of all policyholders and interested parties, the Insurance Regulator will submit to the Court a schedule that sets forth information reasonably available to the Insurance Regulator regarding each Contract and describes, among others: (1) the Taxpayer estate assets to be allocated to each Contract; (2) the various portions of each Contract that qualify as a Covered Contract, an Enhancement-eligible Contract, or an Uncovered Contract; (3) for each Covered Contract, the PGA providing coverage and the amount of contribution to be provided; (4) for each Uncovered Contract, the amount of benefits that are part of the Wrapped Obligations; (5) for each Uncovered Contract, the amount of benefits that are Supplemental Benefit Enhancements; and (6) for each Enhancement-eligible Contract, the Enhancement coverage.

To administer the payments under Taxpayer's restructured contracts, the Plan provides for the formation of as a not-for-profit captive insurance company organized under the laws of State Z. has applied for and received exempt status under section 501(c)(6). Upon the closing of the Plan, substantially all of Taxpayer's current assets, along with the PGA coverage funds in the form of cash and notes, the Enhancement, the pre-funding by life insurance companies for Supplemental Benefit Enhancements, and the Wrapped Obligation guarantees, will be pooled in . will replace Taxpayer as the benefit provider and payor for each Contract.

will administer through a third-party administrator the payments on the restructured Contracts as they become due and payable. Policyholders under Contracts that are fully Covered Contracts will receive their full scheduled annuity payments from at the same time and in the same manner as specified in their original Taxpayer-issued Contracts. Policyholders under Contracts that include portions that are Uncovered Contracts will also receive their payments from according to the same payment schedule as specified in their original Taxpayer-issued Contracts, but at a reduced level. Each policyholder will receive an assumption certificate to evidence reinsurance and assumption of all or the appropriate portion of the Contract liabilities.

Insurance company professionals and other experienced individuals will operate and manage , which will be subject to regulatory supervision by State Z Regulatory Agency. The Insurance Regulator will also exercise additional oversight over to monitor and enforce compliance with the provisions, terms, and conditions of the Plan.

The Insurance Regulator and will also attempt to facilitate any efforts of certain SSA owners—many of whom are property and casualty insurance companies—that have obligations under structured settlement agreements funded by the SSAs and that propose to make supplemental payments to compensate for amounts that are not

paid by ("SSA Owners"), by coordinating such payments through as payment agent. This coordination would be expected to simplify and streamline annuity payments and minimize delays and disruption of any partial annuity payments.

The Taxpayer's estate in liquidation will retain a small amount of assets to preserve sufficient funds to pay certain priority claims under the State X insurance law, to fund the liquidation proceedings, and to fund the wind-up of the Insurance Regulator's receivership. When no longer needed, any remaining funds will be transferred to and allocated on the same basis as all other transferred assets.

The Plan contemplates that, at defined points in the future, will attempt to transfer all of liabilities to a financially strong, third-party commercial life insurer and remit the net proceeds (if any) of such transfer back to the Taxpayer's estate. Alternatively, if does not consummate a transfer of its liabilities before the time the last remaining obligation under the Contracts is satisfied in full, then to the extent there are remaining assets in at such time, such assets will be transferred back to the Taxpayer's estate.

In either circumstance, the Taxpayer's estate will then distribute all remaining assets, with the approval of the Court, in accordance with the priorities set forth in the State X insurance law and the Plan. Upon distribution of all of the Taxpayer estate assets, the Insurance Regulator will petition the Court to close the estate. As a result of the foregoing, Taxpayer will retain the liability for the Claim-Overs pending such distribution, if any, under the Rehabilitation Plan.

Taxpayer represents that the restructuring and assumption of the Contracts pursuant to the Plan will not change the terms and conditions of the Contracts, other than reducing benefits and substituting for Taxpayer.

LAW AND ANALYSIS

In Rev. Proc. 92-57, 1992-2 C.B. 410, the Service recognized that "[i]Insurance companies that issue or assume (through reinsurance) annuity, life insurance, or endowment contracts can become financially troubled and subject to rehabilitation, conservatorship, insolvency, or similar state proceedings" and that the "[o]rderly rehabilitation of these insurance companies may require modification or restructuring of these annuity, life insurance, or endowment contracts."

The Service set out to "provide administrative relief for taxpayers with respect to these contracts by treating the modification or restructuring of certain contracts as not resulting in a loss of "grandfathered" status for purposes of sections 72, 101(f), 264, 7702, and 7702A of the Internal Revenue Code and as not requiring retesting or the beginning of a new test period under sections 264([d])(1), 7702(f)(7)(B)-(E), and 7702A(c) of the Code." Rev. Proc. 92-57.

To qualify for this administrative relief, the Service requires that the modification or restructuring of an affected contract must satisfy the following conditions:

(1) The modification or restructuring (by endorsement or otherwise) of the affected contract must occur as an integral part of the rehabilitation, conservatorship, or similar state proceeding. Modification or restructuring may include, but is not limited to, reductions in benefits, adjustments to mortality or other expense charges, reductions in the rate of interest credited to the contract, and restrictions on the policyholder's ability to receive benefits under the affected contract.

(2) The modification or restructuring of an affected contract must be approved by the state court, the state insurance commissioner, or any other responsible state official with authority to act in a rehabilitation, conservatorship, or similar state proceeding.

Rev. Proc. 92-57, Sec. 2.02.

As long as the modification or restructuring of an affected contract satisfies these conditions, the Service treats the modification or restructuring as follows:

.01 The modification or restructuring will be treated as not having an effect on the date that the affected contract was issued, entered into, or purchased for purposes of sections 72, 101(f), 264, 7702, and 7702A of the Code.

.02 The modification or restructuring will be treated as not requiring retesting or the start of a new test period under section 264([d])(1), 7702(f)(7)(B)-(E), and 7702A(c) of the Code.

Rev. Proc. 92-57, Sec. 3.

Section 72 of the Code sets out various rules for the tax treatment of amounts received under an annuity, endowment, or life insurance contract. Section 72(a) provides in part that gross income includes any amount received under an annuity, endowment, or life insurance contract. The exclusion ratio for amounts received as an annuity determined under section 72(b) is calculated with respect to the taxpayer's investment in the contract as defined by section 72(c)(1). Section 72(e) applies to

amounts that are not received as an annuity, and provides, in general, that amounts not received as an annuity are included in gross income to the extent of the income on the contract. A taxpayer's investment in the contract, as defined by section 72(e)(6), is taken into account in determining that income. An exception to the general rule exists for life insurance contracts. The exception reverses the general income-out-first rule and allows amounts not received as an annuity to be treated first as a return of the investment in the contract and then as taxable income to the extent there are untaxed earnings in the contract.

For amounts not received as an annuity, section 72(e)(6) defines the term "investment in the contract" as of any date as (A) the aggregate amount of premiums or other consideration paid for the contract before such date, minus (B) the aggregate amount received under the contract before such date, to the extent that such amount was excludable from gross income. For amounts received as an annuity, section 72(c)(1) defines the term "investment in the contract" as of the annuity starting date as (A) the aggregate amount of premiums or other consideration paid for the contract before such date, minus (B) the aggregate amount received under the contract before such date, to the extent that such amount was excludable from gross income.

Section 401(a) of the Code sets forth the requirements that a trust forming part of a stock bonus, pension, or profit-sharing plan must meet in order to be a qualified trust under this section.

Section 402(a) of the Code states that, except as otherwise provided in this section, any amount actually distributed to any distributee by any employees' trust described in section 401(a) which is exempt from tax under section 501(a) shall be taxable to the distributee, in the taxable year of the distributee in which distributed, under section 72 (relating to annuities).

With respect to the second and third holdings below as they relate to the closeout certificates, section 402(a) of the Code provides that amounts distributed from plans qualified under section 401(a) are taxable under section 72. Taxpayer has represented that the defined benefit plans, which terminated in 1986 through 1988, were qualified under section 401(a). Therefore, payments made under these contracts are taxable under section 72 of the Code.

Under section 803(a), gross income of a life insurance company includes (1) the gross amount of premiums and other consideration on insurance and annuity contracts, (2) the net decrease in reserves which is required by section 807(a), and (3) all other amounts not included under (1) or (2) which are includible in gross income.

Under section 805(a), a life insurance company is entitled to a deduction for (1) all claims and benefits accrued, and all losses incurred (whether or not ascertained)

during the taxable year on insurance and annuity contracts, and (2) a net increase in reserves required by section 807(b) to be taken into account.

Section 807(b) permits an increase in the amount of life insurance reserves for the taxable year to be deducted under section 805(a)(2). For this purpose, section 807(d)(1) provides generally that the amount of the life insurance reserves for any contract shall be the greater of the net surrender value of such contract under section 807(e)(1) or the federally prescribed reserve determined under section 807(d)(2) capped, however, by the reserves taken into account for annual statement purposes. Section 807(e)(1) states that the net surrender value of any contract shall be determined with regard to any penalty or charge which would be imposed on surrender, but without regard to any market value adjustment on surrender. Section 807(d)(2) provides that the federally prescribed reserve for a contract is computed using (a) a tax reserve method applicable to such contract, (b) the greater of the applicable Federal interest rate or the prevailing State assumed rate, and (c) the prevailing commissioners' standard tables for mortality and morbidity.

Section 6.11 of Rev. Proc. 2013-1, 2013-1 I.R.B. 1, states in part that, generally, “a letter ruling will not be issued with respect to an issue that is clearly and adequately addressed by statute, regulations, decisions of a court, revenue rulings, revenue procedures, notices, or other authority published in the Internal Revenue Bulletin.”

HOLDINGS

1. The restructuring and assumption of the Contracts pursuant to the Plan will not have an effect on the date the Contract was issued, entered into, or purchased for purposes of section 130.

2. The investment in the contract under section 72 (or the basis determined under section 130) for each Contract immediately after assumption by will remain the same as for the pre-restructured Contract immediately prior to restructuring.

3. Pursuant to sections 72 and 451, no amount is includible in the gross income of any policyholder under a restructured Pension Close-Out Certificate or Individual SPIA (before or after its assumption by) by reason of (a) its restructuring, (b) any rights to receive any credits to the account value attributable to credits from the PGAs, or (c) amounts paid to for the benefit of the policyholder by any other party pursuant to the Plan, until and unless an amount is actually received by the policyholder.

4. Pursuant to sections 72 and 451, no amount is includible in the gross income of any policyholder or payee under a restructured SSA (before or after its assumption by) by reason of (a) its restructuring, (b) any rights to receive any credits to the account value attributable to credits from the PGAs, or (c) amounts paid to or for the

benefit of the policyholder or payee by any other party pursuant to the Plan, until and unless an amount is actually received by the policyholder or payee. (This ruling (4) should not be construed to cause any amount otherwise excludable from gross income under section 104(a)(2) to become includable in gross income.)

5. For purposes of Subchapter L, as of the effective date of the Plan, Taxpayer will include in income under section 803(a)(2) the total amount of the existing tax reserve under section 807(d) attributable to the pre-restructured Contracts, and will deduct under section 805(a)(1) accrued benefits equal to the full amount of the implied account values for the pre-restructured Contracts. In addition, Taxpayer will include in premium income under section 803(a) the restructured implied account values for the Contracts as of the effective date of the Plan and will deduct under section 805(a)(2) the increase in its tax reserves, as computed under section 807(d), attributable to the restructured Contracts.

6. We decline to rule on whether Taxpayer excludes from gross income under section 108(a)(1)(B), income from the discharge of debt obligations to policyholders by court order resulting from the restructuring of the Contracts to the extent that Taxpayer is insolvent at the time of discharge. See Rev. Proc. 2013-1, Sec. 6.11.

This ruling letter is based on the assumption that the defined benefit plans were qualified under section 401(a) of the Code upon their termination.

This ruling letter is also based on the assumption that the annuity contracts used to provide benefits under the defined benefit plans comply with any applicable requirements under section 401(a) of the Code; for example, section 1.401(a)-20, Q&A-2, of the Income Tax Regulations.

Except as expressly provided herein, no opinion is expressed concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. The rulings contained in this letter are based upon information and representations submitted by the Company 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. 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.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

/s/

DONALD J. DREES, JR.
Senior Technician Reviewer, Branch 4
Office of the Associate Chief Counsel
(Financial Institutions & Products)

cc: