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Person To Contact:
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Refer Reply To:
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PLR-139002-16

Date:
June 15, 2017

Policyholder =
State =
Issuer =
Reinsurer =
Parent =
Date =

Dear :

This letter is in response to the submission by the authorized representative of Policyholder requesting a ruling that a transfer of a group flexible premium variable life insurance policy (“Policy”) from Issuer to Reinsurer pursuant to a reinsurance contract will not cause Policy to be materially changed and will not affect the date the Policy was issued or entered into for purposes of sections 101(j), 264(f), and 7702 of the Internal Revenue Code.

FACTS

Policyholder is a life insurance company incorporated in State and licensed to issue life insurance and annuity contracts in all states, the District of Columbia, and Puerto Rico. Policyholder is the common parent of a life-nonlife consolidated group. Policyholder files its life-nonlife consolidated return on a calendar year basis using an accrual method of accounting.

Issuer and Reinsurer are subsidiaries of Parent. On Date, Issuer issued Policy to Policyholder. The term “Policy” refers to the group policy and to each coverage of an

insured thereunder. At the time Policy was first issued, each insured was a director, highly compensated employee, or highly compensated individual of Policyholder within the meaning of section 101(j)(2)(A)(ii), and each individual covered was an officer, director, or employee of Policyholder within the meaning of section 264(f)(4)(A). Before Policy was issued, the notice and consent requirements of section 101(j)(4) were satisfied. The coverage of each insured under Policy (1) qualifies as a life insurance contract under section 7702 by meeting the requirements of the cash value accumulation test of section 7702(a)(1), and (2) is a modified endowment contract within the meaning of section 7702A.

Issuer proposes to enter into an assumption reinsurance contract (“Reinsurance Contract”) with Reinsurer to cede its interest in Policy. Under Reinsurance Contract, Reinsurer will deal directly with Policyholder concerning Policy, receive all premiums under Policy, assume all liabilities under Policy, and assume all administrative functions necessary for Policy. The terms and obligations under the reinsured Policy, including the amount and pattern of death benefits, the premium pattern, the interest rate or rates, and mortality and expense charges guaranteed under Policy, will be exactly the same as the terms and obligations under Policy as it existed prior to the proposed reinsurance transaction, with the exception that Reinsurer will replace Issuer as the insurer. After Reinsurance Contract is entered into, Policyholder will have no further recourse to or relationship with Issuer concerning Policy. Policyholder represents that, prior to entering into Reinsurance Contract, Policy will not have been changed in a manner that would cause it to be treated as newly issued or entered into for federal income tax purposes. Policyholder will not receive a new policy form in connection with the proposed assumption reinsurance transaction because the terms of Policy, and Policyholder's rights thereunder, will not be changed.

Upon receiving the required state approvals of the proposed assumption reinsurance transaction, Reinsurer will provide Policyholder with an assumption certificate evidencing the transaction. Although Policyholder did not initiate the proposed assumption reinsurance transaction, it will provide its consent to the transaction upon a favorable private letter ruling on this matter and upon receiving the required state approvals.

The assumption reinsurance transaction was represented as being necessary to accommodate a corporate restructuring. This corporate restructuring is intended to facilitate business specialization and to result in more stable cash flows. After the restructuring, Reinsurer will maintain the personnel, expertise, and resources to service group variable life insurance policies such as Policy.

ISSUE

For purposes of sections 101(j), 264(f), and 7702, whether the transfer of Policy from Issuer to Reinsurer pursuant to the Reinsurance Contract will cause Policy to be materially changed or will affect the date Policy was issued or entered into.

LAW

Section 101(a) provides that “[e]xcept as otherwise provided in ... [section 101(j)], gross income does not include amounts received ... under a life insurance contract, if such amounts are paid by reason of the death of the insured.”

Section 101(j)(1) provides that, in the case of an employer-owned life insurance contract, the amount excluded from gross income of an applicable policyholder under section 101(a)(1) shall not exceed an amount equal to the sum of the premiums and other amounts paid by the policyholder for the contract. In general, an employer-owned life insurance contract is a life insurance contract that is owned by a person engaged in a trade or business and under which that person is a beneficiary under the contract, and that covers the life of an insured who is an employee on the date the contract is issued. Section 101(j)(3)(A). An applicable policyholder is a person who owns an employer-owned life insurance contract, or a related person as described in section 101(j)(3)(B).

Section 101(j)(2) provides exceptions to the general rule of section 101(j)(1) in the case of certain employer-owned life insurance contracts with respect to which the notice and consent requirements of section 101(j)(4) are satisfied. Those exceptions are based either on (i) the insured's status as an employee at any time during the 12-month period before the insured's death, or as a director, a highly compensated employee or highly compensated individual at the time the contract is issued; or (ii) the extent to which death benefits are paid to (or used to purchase an equity interest in the applicable policyholder from) a family member, trust, or estate of the insured employee.

Section 264(f)(1) provides that no deduction is allowed for that portion of the taxpayer's interest expense that is allocable to unborrowed policy cash values.

Section 264(f)(2) states that, for purposes of section 264(f)(1), the portion of the taxpayer's interest expense that is allocable to unborrowed policy cash values is an amount that bears the same ratio to that interest expense as the taxpayer's average unborrowed policy cash values of life insurance policies, and annuity and endowment contracts, issued after June 8, 1997, bears to the sum of (i) in the case of assets of the taxpayer that are life insurance policies or annuity or endowment contracts, the average unborrowed policy cash values of those policies and contracts, and (ii) in the case of any other assets of the taxpayer, the average adjusted bases (within the meaning of section 1016) of those assets.

Section 264(f)(3) defines the term “unborrowed policy cash value” as, with respect to any life insurance policy or annuity or endowment contract, the excess of

(A) the cash surrender value of the policy or contract determined without regard to any surrender charge, over (B) the amount of any loan with respect to the policy or contract. If the amount described in (A) with respect to any policy or contract does not reasonably approximate its actual value, the amount taken into account under (A) is the greater of the amount of the insurance company liability or the insurance company reserve with respect to the policy or contract (as determined for purposes of the annual statement approved by the National Association of Insurance Commissioners) or another amount as determined by the Secretary.

Section 264(f)(4) provides an exception to the pro rata interest expense disallowance rule of section 264(f)(1) for certain policies and contracts. Under section 264(f)(4)(A), section 264(f)(1) does not apply to any policy or contract owned by an entity engaged in a trade or business if the policy or contract covers only one individual and if that individual is (at the time first covered by the policy or contract) (i) a 20-percent owner of the entity, or (ii) an individual (not described in (i)) who is an officer, director, or employee of the trade or business.

Section 7702 provides a statutory definition that a life insurance policy must meet to be treated as a life insurance contract for federal income tax purposes. More specifically, a contract must be a life insurance contract under applicable law and must also meet either of two alternative tests: (1) the cash value accumulation test of section 7702(a)(1), or (2) the guideline premium and cash value corridor test of section 7702(a)(2)(A) and (B). Also, under sections 7702(f)(7)(B) through (E), certain changes in benefits during the first 15 years beginning on the issue date of a life insurance contract may trigger cash distributions which receive less favorable tax treatment than distributions after that period.

Section 7702(c)(3)(B) sets limits on the amount of mortality and expense charges that may be taken into account in determining whether an insurance contract satisfies the definition of a life insurance contract under either the cash value accumulation test or the guideline premium test of section 7702.

Section 1.809-5(a)(7)(ii) of the Income Tax Regulations defines assumption reinsurance as “an arrangement whereby another person (the reinsurer) becomes solely liable to the policyholders on the contracts transferred by the taxpayer. Such term does not include indemnity reinsurance or reinsurance ceded.”

Describing assumption reinsurance, the United States Supreme Court stated:

[T]he reinsurer steps into the shoes of the ceding company with respect to the reinsured policy, assuming all its liabilities and its responsibility to maintain required reserves against potential claims. The assumption reinsurer thereafter

receives all premiums directly and becomes directly liable to the holders of the policies it has reinsured.

Colonial Am. Life Ins. Co. v. Commissioner, 491 U.S. 244, 247 (1989).

ANALYSIS

An assumption reinsurance agreement is not initiated by the policyholder and does not result in a change of the existing contractual obligations of the underlying life insurance policy. It merely allows the obligation of the original insurer under the existing policies to be assumed by the reinsurer. All terms of the reinsured underlying policies remain unchanged, including the amount and pattern of death benefit, the premium pattern, the rate guaranteed on issuance of the contract, and the mortality and expense charges. The substitution of the reinsurer for the original insurer is the only modification to the underlying contracts. The contracts that the policyholders will have after the assumption reinsurance transaction will be the same contracts the policyholders purchased originally except for the fact that the original insurer has been replaced. No formal exchange of contracts occur.

CONCLUSION

For purposes of sections 101(j), 264(f), and 7702, the transfer of Policy from Issuer to Reinsurer pursuant to Reinsurance Contract will not constitute a material change of the Policy and will not affect the date Policy was issued or entered into.

CAVEATS

The ruling contained in this letter is based upon the information and representations submitted by Taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the materials submitted in support of the ruling request, it is subject to verification on examination.

Except as provided above, no opinion is expressed or implied concerning the federal income tax consequences of any other aspect of this or other transactions or item of income of the Taxpayer. The ruling is directed only to the taxpayer who requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with a power of attorney on file in this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Alexis A. MacIvor
Branch Chief, Branch 4
Office of the Associate Chief Counsel
(Financial Institutions & Products)