

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:CORP:2

PLR-123266-17

Date:

January 11, 2018

TY:

Legend  
Taxpayer =

Sub =

State A =

Regulator =

Preferred Stock =

Business =

Court =

Rehabilitator =

Account 1 =

Account 2 =

X Notes =

Y Notes =

Y Notes  
Security =

SPV =

Sub Note =

Sub Note  
Security =

Deferred  
Amounts =

Closing  
Agreement =

Private Letter  
Ruling =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

a =

b =

c =

d =

e =

f =

g =

h =

k =

Dear :

This letter responds to a letter dated July 26, 2017 from your authorized representative requesting rulings on certain federal income tax consequences under section 1504 of the Internal Revenue Code due to Notice 2004-37, 2004-1 C.B. 947. The information submitted in the request is summarized below.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalties 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.

#### SUMMARY OF FACTS

Taxpayer is a publicly-held U.S. corporation and the common parent of an affiliated group of corporations that file a consolidated federal income tax return (the "Taxpayer Consolidated Group"). Taxpayer owns all of the common stock of Sub, a State A

insurance company regulated by Regulator. Sub has outstanding Preferred Stock, all of which is held by third parties. When it was issued, the Preferred Stock represented stock described in section 1504(a)(4). Sub is included as a member of the Taxpayer Consolidated Group and primarily is engaged in Business.

In response to Sub's deteriorating financial condition and at the request of Regulator, Sub established Account 1 on Date 1. Sub allocated to Account 1 certain of Sub's assets and liabilities with material projected losses, including insurance policies (the "Policies," or individually, a "Policy") on certain bonds issued by third parties (the "Insured Bonds"). Also on Date 1, in response to a petition by Regulator, Court entered an Order for Rehabilitation, placing Account 1 into rehabilitation pursuant to State A statute. Court appointed Rehabilitator as rehabilitator of Account 1. Rehabilitator received full operational control and decision-making authority over Account 1. Sub's remaining assets and liabilities are in Account 2, subject to oversight by Regulator.

On Date 2, Account 2 issued the X Notes. Payment on the X Notes is subject to the approval of Regulator and is subordinate to insurance policy claims and other indebtedness of Sub upon any rehabilitation, liquidation, conservation, or dissolution or similar proceeding relating to Sub.

On Date 3, Sub had failed to make timely payments of dividends on the Preferred Stock for six consecutive dividend payment dates (the "Date 3 Event"). As a result, under the terms of the Preferred Stock, the holders of the Preferred Stock received the right to vote for two new members of Sub's board of directors within a days of the Date 3 Event. The holders of the Preferred Stock did not exercise this right. Notwithstanding this right, the common stock of Sub held by Taxpayer would have continued to satisfy the voting requirement under section 1504(a)(2) because the election of two new board members would represent less than 20 percent of Sub's board of directors. Thus, after the Date 3 Event, Taxpayer continued to hold at least 80 percent of the total voting power of Sub's stock under section 1504(a)(2), regardless of whether the right was exercised or becomes exercisable.

On Date 4, Court approved a plan of rehabilitation submitted by Rehabilitator that did not take effect.

On Date 5, Taxpayer entered into Closing Agreement with the Commissioner. Pursuant to Closing Agreement, the Commissioner and Taxpayer agreed that the Date 3 Event did not cause Sub to fail to be a member of the "affiliated group" of which Taxpayer was the common parent. In addition, the Commissioner agreed in Closing Agreement not to challenge Taxpayer's treatment of the X Notes as debt.

On Date 6, Court approved an amended plan of rehabilitation submitted by Rehabilitator (the "Rehabilitation Plan"). Under the Rehabilitation Plan, Account 1 is required to pay b percent of an approved claim on a Policy on an Insured Bond. The unpaid balance of the approved claim, including accretion, is called a "Deferred Amount." The Deferred

Amount represents an amount owed on an Insured Bond, cannot be transferred separately from the bond, and is payable at the discretion of Rehabilitator.

On Date 7, Taxpayer received Private Letter Ruling (PLR), which ruled that the Deferred Amounts (including accretion, over time) are taken into account in computing “losses incurred” under section 832(b)(5) and § 1.832-4(b).

Sub now seeks approval of Court to amend the Rehabilitation Plan so that Account 1 can exit rehabilitation (as amended, the “Rehabilitation Exit Plan”). The proposed transactions, described below, are part of or conditions precedent to the effectiveness of the Rehabilitation Exit Plan.

### PROPOSED TRANSACTIONS

- (1) SPV will issue the Y Notes with an aggregate principal amount of approximately \$d to Sub as consideration for the issuance of the Sub Note to the SPV. The Y Notes will be secured by the Y Notes Security. As a holder of Deferred Amounts, Sub will receive approximately \$c of the Y Notes in the transaction described in paragraph (3) below. The Sub Note will have the same principal amount, interest rate, and payment date as the Y Notes received by Sub. The Sub Note will be full recourse to Sub and will be secured by the Sub Note Security. The holders of the Y Notes, the Sub and the SPV agree to treat the issuance of the Y Notes and the Sub Note as the issuance by Sub of the Sub Note directly to the holders of the Y Notes, the Y Notes as evidencing beneficial interests in the Sub Note, and the Sub Note as indebtedness of Sub. The holders of the Y Notes will have no right to participate in the management of Sub or SPV by virtue of holding the Y Notes.
- (2) Sub will offer to repurchase a portion of the X Notes from third-party holders of the X Notes in which the holders will receive \$e in cash and \$f in Y Notes for each dollar of principal and accrued interest of X Notes exchanged and will agree to take a discount of \$g for each dollar of principal and accrued interest of the X Notes exchanged. The X Notes not repurchased by Sub will remain outstanding.
- (3) Sub will satisfy all Deferred Amounts held by Policyholders other than Taxpayer (including Deferred Amounts held by Sub itself) in exchange for \$e in cash and \$f in Y Notes for each dollar of Deferred Amounts paid and each Policyholder will agree to take a discount of \$g for each dollar of Deferred Amounts that it holds. Sub will satisfy all Deferred Amounts held by Taxpayer in exchange for \$h in Y Notes for each dollar of Deferred Amounts it holds and Taxpayer will take a discount of \$k for each dollar of Deferred Amounts that it holds. All Deferred Amounts will be satisfied in the transactions described in this paragraph (3).
- (4) Sub will exchange a portion of the Insured Bonds that it holds for tendered X Notes of equal value pursuant to an offer to exchange. Following amortization or

write-off in accordance with their terms, the Insured Bonds have no economic value aside from the Deferred Amounts.

None of the proposed transactions described above will alter the amount or terms of Sub's issued and outstanding equity.

### RULINGS

Based solely on the information submitted, we rule as follows:

1. The issuance of the Y Notes and Sub's transfer of the Y Notes, together with cash consideration, in exchange for certain outstanding X Notes will not be a "designated event" for purposes of Notice 2004-37.
2. The issuance of the Y Notes and Sub's transfer of the Y Notes, together with cash consideration, in satisfaction of the Deferred Amounts will not be a "designated event" for purposes of Notice 2004-37.
3. Sub's exchange of the Insured Bonds for X Notes will not be a "designated event" for purposes of Notice 2004-37.

### 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. Specifically, no opinion is expressed as to whether the X Notes, the Y Notes, the Sub Note, the Deferred Amounts, or the Insured Bonds constitute debt for federal tax purposes.

### PROCEDURAL STATEMENTS

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.

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling will be modified or revoked by the adoption of temporary or final regulations, to the extent the regulations are inconsistent with any conclusion in the letter ruling. See section 11.04 of Rev. Proc. 2017-1, 2017-1 I.R.B. 1, 60. However, when the criteria in section 11.06 of Rev. Proc. 2017-1, 2017-1 I.R.B. 1, 61 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

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.

Sincerely,

Gerald B. Fleming  
Senior Technician Reviewer, Branch 2  
(Corporate)

cc: