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Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Uniform Issue List: 72.00-00, 401.00-00, 403.00-00, 3406.00-00-00, 4972.00-00, 4973.00-00, 4979.00-00

Contact Person:

Telephone Number:

In Reference to:
T:EP:RA:T3

Date:
JUN 12 2000

Attention:

Legend:

Company A =

Company B =

Company C =

State P =

Statute Q =

Dear

This is in reply to your request for a ruling dated , regarding certain federal income and excise tax consequences of the proposed transaction under sections 72(e), 72(t), 401(a), 403(a), 403(b), 408(b), 3405, 4972, 4973, and 4979 of the Internal Revenue Code of 1986, as amended (the "Code").

Company A is a life insurance company within the definition of section 816(a) of the Code. Company A has elected under Code section 1504(c)(2) to file a life-nonlife consolidated federal income tax return with its life insurance and nonlife insurance subsidiaries.

Company A is a mutual life insurance company organized under the laws of State P. It is licensed to conduct insurance business in all 50 states and the District of Columbia. Its principal products include individual and group life insurance contracts, endowment contracts, insurance contracts, annuity contracts (including tax deferred annuities described in section 403(b) of the Code and individual retirement annuities described in section 408(b)), and a wide variety of other pension plan contracts. As of , as shown on its annual statement filed with the State P Insurance Commissioner, Company A had total assets of approximately $, total liabilities of approximately $

421

and capital and surplus of approximately $. As of , Company A had in force about individual and group insurance contracts issued to, or on behalf of, employee benefit plans.

As a mutual life insurance company, Company A has no authorized, issued, or outstanding stock. Instead, the life insurance, endowment, annuity and certain other insurance and pension plan contracts combine both insurance coverage and so-called "Membership Interests."

In general, Membership Interests are defined by the State P demutualization statute as all rights and interests of a policyholder as a member of a mutual insurer arising under the mutual insurer's charter or certificate of incorporation and bylaws, by law or otherwise. These rights include the right, if any, to vote and the rights, if any, to surplus of the mutual insurer not apportioned or declared by the Board of Directors for policyholder dividends. Persons with Membership Interests are eligible to participate in the proposed demutualization and are hereinafter referred to as "Eligible Policyholders."

Company A proposes to demutualize under State P's demutualization statute to become a stock life insurance company. In this regard, it is proposed that Company A's Board of Directors adopt a plan of reorganization, under which Company A, subject to the approval of its policyholders and the Commissioner, will be reorganized as a stock life insurance company subsidiary ("Company C") of a new parent company, Company B. Simultaneously, Company B will raise funds from public investors through an initial public offering ("IPO"). Company B stock will be listed on the New York Stock Exchange.

The reorganization of will be accomplished in accordance with Statute Q. Pursuant to the Plan, the following steps will occur:

(i) Before the effective date of the demutualization ("Effective Date"), Company B will be created under State P law as a wholly owned subsidiary of Company A through the issuance of Company B voting common stock ("the Formation Shares") to Company A in exchange for a nominal capital contribution by Company A. As of the Effective Date, the following shall be deemed to occur simultaneously:

(ii) Company A will be converted to a stock company and its charter and by-laws, without further act or deed, will be amended and restated to authorize the issuance of stock.

(iii) Company A will issue and transfer to Company B shares of its common stock in exchange for shares of Company B common stock to be provided to Eligible Policyholders and Company A shall surrender to Company B, and Company B shall cancel, the Formation Shares issued in (i).

(iv) All Membership Interests will be extinguished.

422

(v) In a fair and equitable manner, consideration in the form of Company B common stock, policy credits and/or cash, shall be distributed to all Eligible Policyholders upon extinguishment of their Membership Interests.

(vi) Additional Company B stock will be issued through the IPO. Shortly following the demutualization transaction, Company B will form a new subsidiary and will contribute all of the Company A stock to the new subsidiary.

Generally, Eligible Policyholders will receive shares of Company B common stock. (The policyholders who receive Company B common stock and the investors in the IPO are hereinafter referred to collectively as the "Transferors.") Also, cash will be (i) paid to other policyholders with mailing addresses outside the United States; (ii) held for policyholders whose addresses are unknown; and (iii) paid to policyholders who would otherwise receive or fewer shares of Company B in the demutualization (or such lower number of shares as may be fixed by the Board before the Effective Date), unless such policyholders elect to receive stock instead of cash. A portion of the proceeds from the IPO or debt financing will be used to replace the reduction in Company A's surplus caused by the policy credits and cash payments tc policyholders. Company B will use the remainder of the IPO proceeds to make the other demutualization cash payments.

Lastly, Company A will provide Policy Credits (rather than stock or cash) for certain tax-favored retirement plan contracts held by or for individuals (hereinafter referred to as "Qualified Annuities/Plans"). A Policy Credit is specifically defined under Sectior of the draft Plan and generally means either dividend accumulations/additions or increases in the account value. Qualified Annuities/Plans include:

(i) Individual or group holders of tax deferred annuities described in section 403(b) of the Code, and individually held life insurance policies issued and held as part of such tax deferred annuity to provide incidental life insurance protection (collectively, "TDAs"). Subject to exceptions for certain TDAs held in trust, Policy Credits will be allocated by the group contract-holder instead of directly to the individuals with interests under the contract.

(ii) Individual or group holders of an individual retirement annuity contract (including certain pre-November 8, 1978 endowment contracts, known as "Grandfathered Polices") described in section 408(b) of the Code, including an annuity contract held under an individual retirement account (as described in section 408(a)), a SEP (as described in section 408(k)), SIMPLE IRA (as described in Code section 408(p)), or Roth IRA (as described in Code section 408A) (collectively, "IRAs"). Subject to exceptions for certain IRAs held in trust, Policy Credits will be allocated by the group contract-holder instead of directly to the individuals with interests under the contract.

(iii) Individually held life insurance policies issued and held in connection with a plan qualified under section 401(a) or 403(a) of the Code to provide incidental life insurance protection.

(iv) Individually held annuity contracts issued and held in connection with an ongoing plan qualified under section 401(a) or 403(a) of the Code.

(v) Individually held annuity contracts that were previously distributed from a plan qualified under section 401(a) or 403(a) of the Code. (Items (iii), (iv), and (v) are collectively referred to as "Other Qualified Plans".)

Qualified Annuity/Plan policyholders will receive Policy Credits instead of Company B common stock or cash because no mechanism exists within a TDA, IRA, or Other Qualified Plan to accept a distribution of cash or stock, or to otherwise hold property other than the policies themselves. The addition of Policy Credits to Qualified Annuity/Plan contracts will permit those policyholders to participate equitably in the demutualization, and, as discussed further below, will permit affected TDAs, IRAs, and Other Qualified Plans to continue to operate in a manner consistent with federal tax laws.

Under State P insurance law, Company A will be treated as the same corporation before and after its conversion to stock form.

No actual exchange of contracts will take place as a result of the proposed transactions. The rights of Eligible Policyholders under their annuity and insurance contracts, including rights to benefits and dividends, will be unaffected by the exchange of their Membership Interests for stock or other consideration.

Based on the foregoing, you request the following rulings:

1.The addition of Policy Credits to "Qualified Annuities/Plans" pursuant to the Plan will not be treated as a distribution under, or a contribution to, such Qualified Annuities/Plans; consequently, the addition of Policy Credits will not result in the imposition of (a) income tax on distributions from qualified retirement plans pursuant to section 72(e) of the Code, (b) the 10% penalty tax on early distributions from qualified retirement plans pursuant to section 72(t), (c) the 10% tax on non-deductible contributions to Other Qualified Plans, SEPs and SIMPLE IRAs pursuant to section 4972, (d) the 6% tax on excess contributions to IRAs pursuant to section 4973, or (e) the 10% tax on excess contributions and excess aggregate contributions to certain TDAs, IRAs and Other Qualified Plans pursuant to section 4979.

2. Policy Credits will not result in current taxable income to the Qualified Annuity/Plan policyholders, but will be includible in the taxable income of the distributee, in the taxable year of actual distribution, pursuant to section 72 of the Code.

3. Policy Credits will not be treated for purposes of section 72(c)(1) or 72(e)(6) of the Code as part of the investment in the Qualified Annuity/Plan contract, but will be treated for purposes of sections 40l(a)(9), 403(b)(10), and 408(b)(3) as investment earnings under the Qualified Annuities/Plans, attributable to the year such Policy Credits are added to the Qualified Annuities/Plans.

4. The addition of Policy Credits to the TDAs or Other Qualified Plans pursuant to the Plan will not (i) be treated as a distribution from such TDAs in violation of section 403(b)(11) of the Code, which would cause such TDAs to fail to qualify as tax deferred annuities described in section 403(b) or (ii) be treated as a distribution from such Other Qualified Plans in violation of section 401(a) or 401(k)(2) of the Code, which would cause such Other Qualified Plans to fail to qualify as tax favored retirement plans described in section 401(a), 401(k) or 403(a) of the Code.

5. A pro rata portion of the Policy Credits added to TDAs and Other Qualified Plans containing contributions made pursuant to a salary reduction agreement will be treated as earnings attributable to such contributions, and will be treated as credited under such TDAs and Other Qualified Plans in the year such Policy Credits are added to such Qualified Annuities/Plans pursuant to the Plan, for purposes of restrictions on in service distributions.

6. The addition of Policy Credits to Qualified Annuities/Plans pursuant to the Plan will not constitute "designated distributions" within the meaning of section 3405(e)(1)(A) of the Code and will not be subject to withholding pursuant to section 3405(b) or reporting for contributions or distributions under sections 408(i), 408(l), or 6047(d). In the year of actual distribution from a TDA or an Other Qualified Plan, the Policy Credits may be included in an eligible rollover distribution pursuant to sections 402(c) and 3405(c).

7. The addition of Policy Credits to the Grandfathered Policies pursuant to the Plan will not cause the Grandfathered Policies to be deemed to be issued after November 7, 1978 for the purposes of section 157(d)(2) of the Revenue Act of 1978.

Section 72(a) of the Code generally provides that gross income includes any amount received as an annuity under an annuity, endowment, or life insurance contract. Section 72(e)(2) provides that any amount which is received under an annuity, endowment or life insurance contract and is not received as an annuity, (i) if received on or after the annuity starting date, shall be included in gross income, and (ii) if received before the annuity starting date, shall be included in gross income to the extent allocable to income on the contract and shall not be included in gross income to the extent allocable to the investment in the contract. Section 72(c)(1) defines the investment in a contract as the aggregate amount of premiums or other consideration paid for the contract, minus the aggregate amount received under the contract before such date, to the extent that such amount was excludable from gross income under this subtitle or prior income tax laws. Section 72(c)(4) defines the annuity starting date, in part, as the first day of the first period for which an amount is received as an annuity under the annuity contract. Section 72(e)(3) provides that an amount shall be treated as allocable to income on the contract to the extent that such amount does not exceed the excess of the cash value of the contract immediately before the amount is received, over the investment in the contract at the time. Section 72(e)(5) provides, in part, that, with certain exceptions, an amount distributed from a trust described in section 401(a), which is exempt from tax under section 501(a), or is received from a contract purchased by a trust described in section 401(a), purchased as part of a plan described in section 403(a) or described in section 403(b), that the proceeds shall be included in gross income, but only to the extent it exceeds the investment in the contract.

425

Section 72(e)(6) provides that the investment in the contract, as of any date, is the aggregate amount of premiums or other consideration paid for the contract as of such date, minus the aggregate amount received under the contract before such date to the extent such amount was excludable from income.

Section 72(t) of the Code provides, in part, that, if any taxpayer receives any amount from a qualified retirement plan (as defined in section 4974(c)) prior to certain dates or the occurrence of certain events specified in section 72(t)(2) the taxpayer's tax for the taxable year shall be increased by an amount equal to 10 percent of the portion of such amount which is includible in gross income.

Section 4979 of the Code imposes excise taxes on certain excess contributions made to plans described in sections 401(a) and 403(b). Excess aggregate contributions under section 4979 are defined, in part, as the sum of the employer matching contributions and employee contributions, actually made, on behalf of highly compensated employees, within the meaning of section 414(q), for a plan year in excess of the maximum amount of such contributions permitted under the actual contribution percentage test of section 401(m)(2) for such plan year

Section 4972 of the Code imposes a tax equal to 10 percent of the nondeductible contributions under a plan qualified under section 401(a). A nondeductible contribution is defined as the sum of (A) the excess (if any) of (I) the amount contributed for the taxable year by the employer to or under such plan, over (ii) the amount allowable as a deduction under section 404 for such contributions, and (B) the amount determined under this subsection for the preceding taxable year reduced by the sum of (i) the portion of the amount so determined returned to the employer during the taxable year, and (ii) the portion of the amount so determined deductible under section 404 of the taxable year.

Section 4973 of the Code imposes excise taxes equal to 6 percent on certain excess contributions made to IRAs and to certain tax-sheltered annuity plans described in section 403(b). Section 408(i) and 408(l) require, in part, an IRA trustee, with respect to its IRA, and an employer, with respect to its simplified employee pension plan to make reports as specified therein with respect to contributions. Because the addition of policy credits pursuant to the conversion occurs within the above arrangements, causing neither a distribution from, nor a contribution to such annuities, no excess contributions can be attributed to the addition of policy credits to the pension annuities. Similarly, the addition of policy credits will not impose the reporting requirements of sections 408(i) and 408(l) with respect to contributions. Distributions from plans qualified under section 401(a) must be made pursuant to section 401(a)(9). Sections 403(b)(10), 408(a)(6), and 408(b)(3) require distributions, under the respective plans, in compliance with rules similar to the minimum distribution requirements included in section 401(a)(9) and applicable to qualified plans under section 401(a) of the Code. Section 401(a)(9) and applicable regulations issued thereunder, contain the criteria for determining the minimum distribution amount for any year for which such minimum distribution is required. The minimum distribution amount is based in part on the total value of the retirement benefit. As the policy credits to be issued by Company A will be treated as increasing the value of the tax-qualified retirement funding

contracts in the year such policy credits are added to the tax-qualified retirement contracts, for purposes of determining the minimum required distributions for any calendar year, the value of the benefits attributable to such policy credits will first be required to be taken into account in the year such policy credits are added to the tax qualified contracts.

Section 401(a)(9) of the Code requires, in part, that the entire interest of an employee under a qualified retirement plan be distributed, beginning no later than April 1 of the calendar year following the later of the calendar year in which the employee attains age 70 ½ or the calendar year in which the employee retires, over the life or life expectancy of the employee (or over the joint lives or joint life expectancy of the employee and a designated beneficiary). Proposed Income Tax Regulations section 1.401(a)(9)-1, provides, in general, that the amount required to be distributed under section 401(a)(9) for each calendar year must be determined each year on the basis of the employee's, and any designated beneficiary's, life expectancy and the value of the employee's benefit. The proposed regulations also provide that in the case of a benefit in the form of an individual account, the benefit used in determining the minimum distribution for a distribution calendar year is the account balance as of the last valuation date in the calendar year immediately preceding the distribution calendar year.

Section 3405 of the Code requires the payor of a "designated distribution," within the meaning of section 3405(e)(1), to withhold certain amounts from such distributions. In general, absent an election under section 3405(b)(2) made by a recipient, section 3405 requires the payor to withhold on distributions from employer deferred compensation plans, IRAs, and commercial annuities. Section 3405(c) provides that in the case of an "eligible rollover distribution", as defined in section 3405(c)(3), the payor of such distribution shall withhold from such distribution an amount equal to 20 percent of such distribution. Section 3405(e)(1)(B)(ii) provides that the term "designated distribution" does not include the portion of any distribution which it is reasonable to believe is not includible in gross income.

Central to our analysis of your submitted ruling requests is the question of whether or not membership interests in a mutual insurance company are within the stated plans.

In this regard, any membership interests in a mutual insurance company which arise from the purchase of an insurance contract are inextricably tied to the contract from the time of purchase. These membership interests are created by operation of state law solely as a result of the policyholder's acquisition of the underlying contract from a mutual insurance company and cannot be transferred separately from that contract. Prior to conversion, the membership interests have no determinable value apart from the insurance contract itself. Further, if the insurance contract is surrendered by the policyholder or, in the event an insurance contract is terminated by payment of benefits to the contract beneficiary, these membership interests cease to exist, having no continuing value. The membership rights associated with the tax qualified retirement contracts, are acquired as a direct result of tax-favored payments to a mutual insurance company. Indeed, these membership interests cannot be obtained by any purchase separate from an insurance contract issued by Company A. In view of the foregoing, such interests are part of the tax qualified retirement

contracts, created pursuant to sections 401(a), 403(a), 403(b), and 408(b) of the Code respectively.

While it has been recognized that consideration received in a demutualization transaction is in exchange for a membership interest in a mutual insurance company, and not from or under an insurance contract, such a distinction does not require the detachment of such consideration from the tax qualified retirement contracts, which consists of both the contracts and all other interests which arise with the purchase of such a contract. See, Revenue Ruling 71-233, 1971-1 C.B. 113. Rather, contracts and the related membership interests must be viewed as part of a program of "interrelated contributions and benefits" which are retained within the plans. Cf., Income Tax Regulation section 1.72-2(a)(3)(i).

The planned issuance of policy credits does not constitute a distribution of such credits to the annuitants. The conversion of membership interests in Company A to policy credits, is a mere change in form of one element within the arrangement to another. Since the conversion increases the accumulation value of the annuity contracts, the policy credits are treated, for purposes of sections 401(a)(9), 403(b)(10), 403(b)(11), 408(b)(3), 408(a)(6) of the Code, in the same manner as any other return of, or return on, an investment within the arrangements described above, and are not regarded as having been received by the policyholder. Such amounts representing the policy credits will be considered as part of the respective balances to the credit of the employees in the plans.

Similarly, under sections 402(a), 403(a), 403(b)(1) and 408(d) of the Code, only amounts paid or distributed under the applicable plans, will be included in the gross income of the distributee under the rules of section 72. Section 72(e), dealing with the tax treatment of amounts not received as an annuity, provides for the inclusion of such amounts when received by the distributee. As policy credits will be issued in exchange for membership interests, such interests being held within the applicable plans, no amount is treated as received by, or includible in, the gross income of any policyholder, under such plans, of Company A. For purposes of section 72(e)(3), the value of policy credits which will be added to the tax-qualified retirement contracts will not be regarded as part of the investment in the contracts, an amount which under section 72(e)(6) consists of the aggregate amount of premiums or other consideration paid for the contract. In addition, as no amount is to be treated as having been distributed as a result of the issuance of policy credits, nor received by the tax-qualified retirement policyholders outside the plans, the additional 10 percent tax imposed by section 72(t) does not apply.

Similarly, for purposes of determining the applicability of section 403(b)(11) of the Code, the limitation on distributions of amounts attributable to salary reduction contributions, the policy credits added to the tax-sheltered annuity arrangements described in section 403(b) issued by Company A are treated as income received within the tax-sheltered annuity arrangement.

Likewise, for purposes of section 401(k)(2) of the Code, which prohibits the distribution of contributions made pursuant to a qualified cash or deferred arrangement prior to certain stated events, and for purposes of the prohibitions against in-service distributions

from section 401(a) qualified pension plans prior to an employee's attaining minimum retirement age, the policy credits added to the plans which are subject to such limitations, will be treated as income received by such plans.

Section 3405(b) of the Code requires a payor to withhold income taxes on certain "designated distributions" (as described in section 3405(e)(1)), including distributions from or under an employer deferred compensation plan, an individual retirement plan or a commercial annuity. Similarly, section 6047(d) generally requires that the employer maintaining, or the plan administrator of, a plan from which designated distributions may be made, and any person issuing a contract pursuant to which designated distributions may be made, to report payments under the plan or contract. The addition of policy credits within the tax-sheltered annuity arrangement described in section 403(b), IRA arrangement, or other qualifying plan, pursuant to the conversion, does not result in the distribution of any amounts to individual policyholders, within the meaning of section 3405(e)(1)(a), and thus, will not be subject to any requirement to withhold or the reporting requirements under section 6047(d).

Section 402(c) of the Code provides for tax-free rollover treatment of any portion of the balance to the credit of an employee in an eligible rollover distribution. This section defines an "eligible rollover distribution" as any distribution of all or a portion of the balance to the credit of the employee in a qualified trust, except that it does not include certain periodic payments or distributions required under section 401(a)(9). Section 3405(c) imposes mandatory 20 percent withholding on eligible rollover distributions. Since we have already determined that the additional policy credits are part of the respective balances to the credit in the applicable plans, such amounts may constitute, in whole or in part, an eligible rollover distribution if it other wise meets the relevant requirements thereto.

Pursuant to section 157(d) of the Revenue Act of 1978, fixed premium IRA contracts (endowment contracts) that were issued prior to November 8, 1978 were permitted to continue as IRAs. In this case such IRAs will not be reissued or materially modified in connection with the demutualization.

According with respect to rulings one through seven, we hold that

1.The addition of Policy Credits to "Qualified Annuities/Plans" pursuant to the Plan will not be treated as a distribution under, or a contribution to, such Qualified Annuities/Plans; consequently, the addition of Policy Credits will not result in the imposition of (a) income tax on distributions from qualified retirement plans pursuant to section 72(e) of the Code, (b) the 10% penalty tax on early distributions from qualified retirement plans pursuant to section 72(t), (c) the 10% tax on non-deductible contributions to Other Qualified Plans, SEPs and SIMPLE IRAs pursuant to section 4972, (d) the 6% tax on excess contributions to IRAs pursuant to section 4973, or (e) the 10% tax on excess contributions and excess aggregate contributions to certain TDAs, IRAs and Other Qualified Plans pursuant to section 4979.

2. Policy Credits will not result in current taxable income to the Qualified Annuity/Plan policyholders, but will be includible in the taxable income of the distributee, in the taxable year of actual distribution, pursuant to section 72 of the Code.

3. Policy Credits will not be treated for purposes of section 72(c)(1) or 72(e)(6) of the Code as part of the investment in the Qualified Annuity/Plan contract, but will be treated for purposes of sections 40l(a)(9), 403(b)(10), and 408(b)(3) as investment earnings under the Qualified Annuities/Plans, attributable to the year such Policy Credits are added to the Qualified Annuities/Plans.

4. The addition of Policy Credits to the TDAs or Other Qualified Plans pursuant to the Plan will not (i) be treated as a distribution from such TDAs in violation of section 403(b)(11) of the Code, which would cause such TDAs to fail to qualify as tax deferred annuities described in section 403(b) or (ii) be treated as a distribution from such Other Qualified Plans in violation of section 401(a) or 401(k)(2) of the Code, which would cause such Other Qualified Plans to fail to qualify as tax favored retirement plans described in section 401(a), 401(k) or 403(a) of the Code.

5. A pro rata portion of the Policy Credits added to TDAs and Other Qualified Plans containing contributions made pursuant to a salary reduction agreement will be treated as earnings attributable to such contributions, and will be treated as credited under such TDAs and Other Qualified Plans in the year such Policy Credits are added to such Qualified Annuities/Plans pursuant to the Plan, for purposes of restrictions on in service distributions.

6. The addition of Policy Credits to Qualified Annuities/Plans pursuant to the Plan will not constitute "designated distributions" within the meaning of section 3405(e)(1)(A) of the Code and will not be subject to withholding pursuant to section 3405(b) or reporting for contributions or distributions under sections 408(i), 408(l), or 6047(d). In the year of actual distribution from a TDA or a Other Qualified Plan, the Policy Credits may be included in an eligible rollover distribution pursuant to 402(c) and 3405(c).

7. The addition of Policy Credits to the Grandfathered Policies pursuant to the Plan will not cause the Grandfathered Policies to be deemed to be issued after November 7, 1978 for the purposes of section 157(d)(2) of the Revenue Act of 1978.

As discussed with your authorized representative, a ruling requested by you as it relates to employees will be addressed in a separate response.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

430

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

Sincerely Yours,

Frances V. Sloan

Frances V. Sloan, Manager
Employee Plans Technical Group 3
Tax Exempt and Government Entities Division

Enclosures:
Notice of Intention to Disclose
Deleted Copy of Ruling

CC: