

INTERNAL REVENUE SERVICE

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:
(202) 622-7770
Refer Reply To:
CC:CORP-PLR-100614-01
Date:
September 28, 2001

In Re:

Parent =

Acquiring =

State A =

State B =

Date 1 =

u =

v =

w =

x =

y =

z =

This is in response to your letter, dated December 26, 2000 on behalf of the above referenced taxpayer, requesting rulings concerning the federal income tax consequences of a proposed transaction. Additional information was supplied in subsequent submissions.

PLR-100614-01

The information submitted indicates that Parent is a State A mutual legal reserve insurance corporation that is the common parent corporation of a life-nonlife consolidated group. Parent is a Blue Cross and Blue Shield organization that was in existence on August 16, 1986, and was exempt from federal income taxation for its last taxable year beginning before January 1, 1987.

As a mutual company, Parent's equity is held by its members. Each policyholder of Parent is a member of Parent. (Parent's "policyholders" and "members" will be used interchangeably). Under Parent's bylaws, each policyholder has the right to a number of votes equal to the aggregate premium or other amounts attributable to such policyholder except that no member shall be entitled to votes in excess of u percent of the total votes available to all policyholders.

Acquiring was a State B stock insurance company which holds insurance licenses in v states. In addition to the insurance licenses, Acquiring retains assets sufficient to maintain its insurance licenses. Acquiring has only one remaining policyholder.

On Date 1, Parent purchased all of the Acquiring stock from an unrelated corporation. No election was made under Internal Revenue Code § 338. Parent wishes to acquire Acquiring's insurance licenses while remaining a State A mutual company. Under state law, the licenses cannot be transferred. In order to obtain the licenses, Parent must merge into Acquiring with Acquiring surviving.

To accomplish this goal, the following steps are proposed:

- i Acquiring has changed its domicile from State B to State A in a transaction intended to qualify as a reorganization under I.R.C. § 368(a)(1)(F) (the "Redomestication").
- ii Parent will purchase w insurance policies representing x percent of Acquiring's premiums from Acquiring for cash.
- iii Acquiring will convert to a mutual company ("Mutual Acquiring") in a transaction intended to qualify as a reorganization under I.R.C. § 368(a)(1)(E) (the "Mutualization").
- iv Approximately y days after Acquiring becomes a mutual company, Parent will merge into Mutual Acquiring with Mutual Acquiring surviving in a transaction intended to qualify as a reorganization under I.R.C.

PLR-100614-01

§ 368(a)(1)(A) (the “Merger”).¹ The current remaining Acquiring policyholder will retain his or her mutual interest in Mutual Acquiring while the members of Parent will become members of Mutual Acquiring. Mutual Acquiring will change its name to Parent’s name.

Parent will purchase the policies from Acquiring (Step ii) solely for the purpose of retaining control of Acquiring both before and after Acquiring converts to a mutual corporation. State A law requires that the policyholders approve the plan of Mutualization. For this purpose, State A law provides that each policyholder is entitled to one vote for each policy in force on the day of the meeting. Therefore, Parent will own w of the z policies and will approve the plan of Mutualization. Absent the newly issued policies, the one remaining Acquiring policyholder would be able to veto the Mutualization.

After Acquiring converts to a mutual company (Mutual Acquiring), by operation of State A law, each policyholder of Mutual Acquiring will have an equity interest in Mutual Acquiring. Mutual Acquiring’s by-laws will provide that each policyholder have the right to vote a number of votes equal to the aggregate premiums attributable to such policyholder. Therefore, after the conversion to a mutual company, Parent will hold policies with x percent of the vote in Mutual Acquiring and the current policyholder will have the remaining vote.

In connection with the transactions described above, it has been represented that:

- a Parent is a Blue Cross and Blue Shield organization that was in existence on August 16, 1986.
- b Parent was exempt from tax for its last taxable year beginning before January 1, 1987.
- c Parent has not changed its health benefits coverage for individuals or small groups since August 16, 1986, or its capital structure in any way that would result in a material change in operation or structure as described in the legislative history to I.R.C. § 833.

¹The taxpayer states that the y day delay is necessary to satisfy the requirements of State A law. Policyholders must approve each transaction separately and be given y days notice prior to voting on each transaction.

PLR-100614-01

- d Parent is an "existing Blue Cross or Blue Shield organization" as that term is used in I.R.C. § 833(c)(2).
- e Pursuant to State A law, the Mutualization will occur under a Plan of Mutualization approved by Acquiring's Board of Directors and policyholders before the transaction.
- f Each party to the Mutualization will pay its own expenses, if any, in connection with such transaction.
- g The Mutualization is not part of a plan to periodically increase the proportionate interest of any policyholder in the assets or earnings and profits of Parent or of any shareholder or policyholder in the assets or earnings and profits of Acquiring.
- h No new corporation will be formed as part of the Mutualization process. Accordingly, Acquiring will continue its corporate existence.
- i Following the Mutualization, Acquiring will not dispose of or transfer I.R.C. §§ 38, 1245, or 1250 property as part of the Mutualization.
- j The fair market value of the proprietary interests to be received in Acquiring by Parent will be approximately equal to the fair market value of its interest in Acquiring surrendered in exchange therefor.
- k Acquiring is not under the jurisdiction of a court in a Title 11 or similar case within the meaning of I.R.C. § 368(a)(3)(A).
- l The Merger of Parent into Acquiring will qualify as a reorganization within the meaning of I.R.C. § 368(a)(1)(A), provided that the Acquiring proprietary interests received by the Policyholders are continuing equity interests for purposes of satisfying the continuity of interest requirement.
- m Parent is an eligible corporation under Treas. Reg. § 1.1502-47(d)(12) because, for the five full taxable years of Parent preceding the current taxable year, Parent (i) was in existence and was a member of the affiliated group of which Parent was the common parent; (ii) was engaged in the active conduct of the insurance business; (iii) did not experience a change in tax character within the meaning of Treas. Reg. § 1.1502-47(d)(12)(vii); and (iv) did not undergo a disproportionate asset

acquisition within the meaning of Treas. Reg. § 1.1502-47 (d)(12) (viii).

- n Upon the Mutualization, the Policyholders of Acquiring will have similar rights to those that Parent's current policyholders have under State A law and Parent's organizational documents. The policies issued to Parent will represent greater than 80-percent of the voting rights of Acquiring's outstanding policies and greater than 80-percent of the value of Acquiring.
- o The business purpose for the Proposed Transaction is for Parent to gain access to the licenses of Acquiring, and the Merger is intended to be completed within approximately y days of the Mutualization.
- p Parent, as a policyholder of Acquiring, will own greater than 80-percent of all of the votes that can be cast for the election of members of the Board of Directors of Acquiring.
- q Parent, as a policyholder of Acquiring, will be entitled to greater than 80-percent of the proceeds upon liquidation of Acquiring.
- r Parent, as a policyholder of Acquiring, will control the votes sufficient to assure policyholder approval of the Merger.
- s Acquiring will acquire at least 90 percent of the fair market value of the net assets and at least 70 percent of the fair market value of the gross assets held by Parent immediately prior to the Merger.
- t The Parent Policyholders immediately before the Merger, as a result of being Parent Policyholders, will own more than 50-percent of the value of the proprietary interests in Acquiring immediately after the Merger.
- u Parent and Acquiring are, have been, and will be, engaged in the same insurance business activities or integrated business activities before consummation of the Proposed Transaction, and those business activities will continue unchanged and uninterrupted after the Proposed Transaction is consummated.
- v There were no sales or other dispositions of proprietary interests in Parent made in anticipation of the Proposed Transaction. For each Parent Policyholder, his or her proprietary interest in Acquiring after

the Merger will be virtually identical to his or her proprietary interest in Parent prior to the Merger. The only change will be attributable to the interests of the One Remaining Policyholder.

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

1. The Merger of Parent into Acquiring will not be considered a material change in operations or structure under I.R.C. § 833(c)(2).
2. After the Merger, Acquiring, the surviving entity in the Merger, will be treated as an existing Blue Cross or Blue Shield organization for purposes of I.R.C. § 833.
3. The Mutualization and Merger will not affect the qualification of the Redomestication as a reorganization described in I.R.C. § 368(a)(1)(F), provided that the Redomestication otherwise qualifies as such a reorganization.
4. The Mutualization of Acquiring will constitute a reorganization within the meaning of I.R.C. § 368(a)(1)(E), and the qualification for this treatment will not be affected by the Redomestication or the Merger. Acquiring, will be "a party to a reorganization" within the meaning of § 368(b).
5. No gain or loss will be recognized by Acquiring upon the issuance of proprietary interests to Parent in exchange for its prior stock interest in Acquiring. I.R.C. § 1032.
6. The Mutualization will not affect Acquiring's tax attributes. Specifically, the Mutualization will not affect Acquiring's basis in its assets, holding period for its assets, net operating loss and capital loss carryovers, earnings and profits, or accounting methods.
7. No gain or loss will be recognized by Parent on the receipt of Acquiring proprietary interests in exchange for Parent's interest in Acquiring in the Mutualization. I.R.C. § 354(a).
8. The Redomestication and Mutualization will not affect the qualification of the Merger as a reorganization described in I.R.C. § 368(a)(1)(A), provided that the Merger otherwise qualifies as such a reorganization.

PLR-100614-01

9. The continuity of interest requirement set forth in Treas. Reg. § 1.368-1(b) is satisfied in the Merger of Parent with and into Acquiring.
10. Pursuant to Section 381(a) and Treas. Reg. § 1.381(a)-1, Acquiring will succeed to and take into account the items of Parent described in I.R.C. § 381 (c). These items will be taken into account by Acquiring subject to the provisions and limitations specified in §§ 381, 382 and 383, and the regulations thereunder.
11. The consolidated group of which Parent was the common parent immediately before the Merger (the "Parent group") will remain in existence after the Merger with Acquiring, the surviving entity in the Merger, as the common parent of the Parent group. Treas. Reg. § 1.1502-75(d)(2)(ii).
12. The election of the Parent group to file a life-nonlife consolidated Federal income tax return under I.R.C. § 1504(c)(2) will remain in effect following the Merger.
13. After the Merger, Acquiring will be an eligible corporation under Treas. Reg. § 1.1502-47(d)(12). Treas. Reg. § 1.1502-47(d)(12)(vi).
14. All of the Parent group members that were eligible corporations under Treas. Reg. § 1.1502-47(d)(12) before the Merger will remain eligible corporations after the Merger. Treas. Reg. §§ 1.1502-75(d)(2)(ii) and 1.1502-47(d)(12)(vi).

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, we express no opinion whether the writing of new types of insurance by Acquiring following the proposed merger may affect Acquiring's future status as an existing Blue Cross and Blue Shield organization under I.R.C. § 833.

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

A copy of this letter must be attached to any income tax return to which it is relevant.

In accordance with the Power of Attorney on file with this office, a copy of this

PLR-100614-01

letter is being sent to the taxpayer.

The rulings contained in this letter are 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,
Jasper L. Cummings
Associate Chief Counsel, Corporate
Edward S. Cohen
Chief, Branch 2
Office of Associate Chief Counsel
(Corporate)