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Department of the Treasury
Washington, DC 20224

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Date:
December 27, 2007

Ceding Company	=	
Assuming Company	=	
State A	=	
State B	=	
Jurisdiction C	=	
Date 1	=	
Date 2	=	
Date 3	=	
Date 4	=	

Date 5	=
Date 6	=
Date 7	=
Date 8	=
Date 9	=
Date 10	=
Date 11	=
Date 12	=
Date 13	=
Year AA	=
Amount <u>w</u>	=
Amount <u>x</u>	=
Amount <u>y</u>	=
Amount <u>z</u>	=
Number RR	=
Number TT	=
Number UU	=
Number VV	=
Number WW	=
Number XX	=
Number YY	=

Number ZZ =

Dear :

This is in response to your letter dated June 8, 2007 jointly submitted by the Ceding Company, a State A mutual life insurance company in rehabilitation, and Assuming Company, a State B domiciled stock life insurance company, requesting rulings on the federal income tax consequences of a proposed transaction. The proposed transaction arises in the context of a plan for the rehabilitation of Ceding Company (the Plan) and involves, among other actions, the transfer by assumption reinsurance of Ceding Company's life insurance and other contracts to Assuming Company. Additional information was received in letters dated July 3, 2007, September 4, 2007, September 25, 2007, October 1, 2007, and December 3, 2007.

Ceding Company is a mutual life insurance corporation organized to conduct a life insurance business in State A. Ceding Company issued life insurance policies in Number RR states and Jurisdiction C. Ceding Company is a mutual corporation and, therefore, has no shareholders. Instead, owners of its contracts, the contractholders, have a dual relationship to Ceding Company, as proprietary owners by reason of being members of the mutual corporation and as holders of contract rights under the contracts of Ceding Company. The mutual membership interests include voting rights, an undivided interest in divisible surplus, and a right to residual assets of Ceding Company upon liquidation. Mutual membership interests cannot be sold independently of the policy under which they arise, and terminate when the insurance contract terminates or matures. (Typically, a life insurance contract matures by reason of the death of an insured). For purposes of the Plan, Ceding Company's mutual members are those contractholders who had a contract or contracts in force on the record date of Date 9.

Ceding Company owns all of the stock of Number TT corporations. Ceding Company, as the common parent of the affiliated group of corporations, files a life-nonlife consolidated federal income tax return pursuant to an election under §1504(c)(2) of the Internal Revenue Code.

In response to a rapid increase in policy surrenders and loan requests for the period from Date 1 to Date 2 the State A Insurance Department and Ceding Company's board of directors petitioned the State A Court for an order of rehabilitation on the grounds that Ceding Company failed to file certain reports with the State A Insurance Department, and based on the fact that Ceding Company's board of directors consented to the rehabilitation.

Ceding Company was placed in rehabilitation by an order of rehabilitation issued by the State A Court on Date 3. A Rehabilitator was appointed. In that initial order the State A Court made it clear that the court was not making a declaration of Ceding Company's insolvency, however, the order provided for a moratorium on cash distributions, policy surrenders, withdrawals and policy loans, except in the case of certain hardship situations. The moratorium on policyholders' cash withdrawals began on Date 3 and continued until Date 10, for Number WW years, well in excess of 5 years, when on Date 10 it was lifted by the State A Court. On Date 4, the Rehabilitator filed an initial plan of rehabilitation with the State A Court, however, this plan was later abandoned. On Date 5, the Rehabilitator filed an amended rehabilitation plan with the State A Court (Amended Plan 1). This amended plan of rehabilitation was the subject of a private letter ruling, PLR 9544026 (issued on August 4, 1995). Objections of interested parties and changes in the financial condition of Ceding Company resulted in abandoning this amended plan of rehabilitation. On Date 7, the Rehabilitator filed a subsequent amended plan of rehabilitation with the State A Court (Amended Plan 2) and this plan was abandoned as well. On Date 8, a further amended plan was filed with the State A Court (Amended Plan 3). This plan was the subject of private letter ruling, PLR-199941023 (issued on July 14, 1999). As was the case with the earlier plans, this plan was abandoned and not implemented.

When Ceding Company was placed in rehabilitation, it had assets with a book value of Amount w dollars, a significant portion of which was comprised of real estate and mortgages that were nonperforming, illiquid and overvalued. As indicated above, the initial order imposed a moratorium on policyholder access to cash distributions, policy surrenders, withdrawals and policy loans under the contracts, except for certain hardship circumstances. Since that time Ceding Company has improved the investment quality of its assets and its financial strength. It has stabilized its revenue and has achieved levels of surplus in excess of minimum state regulatory requirements. Its current investment assets consist principally of fixed income assets, policy loans, cash and cash equivalents. As indicated above, the moratorium on policyholder cash withdrawals from contracts was lifted by the State A Court in an order of Date 10.

Ceding Company continued during its rehabilitation to pay at its discretion policyholder dividends under participating contracts and excess interest credits under certain other contracts (e.g., universal life and deferred annuity contracts). As Ceding Company's financial condition improved and in recognition of the fact that Ceding Company policyholder dividends and declared interest credits (together the policyholder dividends) generally were lower during the early years of its rehabilitation than policyholder dividends for comparable policies of other insurers, Ceding Company by order of the State A Court of Date 6 increased the policyholder dividend crediting rates of certain contracts. Subsequent orders of the State A Court approved the payment by

Ceding Company of policyholder dividends for each subsequent year in amounts consistent with its financial capacity to pay. Starting In Year AA, Ceding Company paid enhanced amounts of policyholder dividends, which have been reduced each year thereafter. In connection with policyholder dividends, Ceding Company has not been obligated under state or federal law to declare or pay any amount of policyholder dividends, no amount paid therefor has been fixed by the terms of the contracts, and the declaration, allocation and payment of the policyholder dividends is not inconsistent with the terms of the contracts. Finally, no change has been nor will have been made to the contracts by reason of the declaration, allocation and payment of policyholder dividends other than the exercise of a dividend payment option, if such exercise is permitted under the terms of the contract and is not subject to evidence of insurability or other consent of Ceding Company. Further, the contracts will be modified by an endorsement immediately before the assumption reinsurance transaction, and this endorsement will include modifications of the policyholder dividend provisions, prospectively.

Ceding Company will modify the contracts by endorsement immediately before the closing on the closing date, which is the closing date of the assumption reinsurance transaction. Immediately following the endorsement of the contracts, Assuming Company will assume and reinsure Ceding Company contracts, and thereafter Ceding Company will liquidate. The contractholders, creditors and mutual members will be provided benefits in accordance with priorities for distribution under the Plan.

The contracts subject to the Plan include traditional ordinary life insurance contracts, universal life insurance contracts, deferred and immediate annuity contracts, conversion fund and deposit administration fund contracts, health insurance contracts, disability income contracts issued or administered by Ceding Company, and contracts or agreements issued in substitution for or supplementary to any such contract.

All contracts in force on the closing date will participate under the Plan, as the Plan does not authorize an election to opt out of participation. Contractholders, however, may surrender their contracts in accordance with the terms of the contracts at any time before or after the closing, without extra contractual charges or penalties and without loss of the right to such compensation for extinguishment of mutual membership rights as they may be entitled to under the Plan. Any contractholder who rejected the assumption reinsurance transaction prior to the Date 13 final hearing of the State A Court on the Plan will have his policy cancelled at closing and will receive at closing the then-current surrender value as discussed below.

As indicted in the Plan, each contract which is in force on the closing date of the reinsurance transaction will be modified by Ceding Company through one or more endorsements, effective as of the closing date but immediately prior to the closing of the reinsurance of the endorsed contracts. This endorsement will not change, reduce, or restructure the death benefits, cash values (or account or policy values), dividend accumulations, minimum interest rate guarantees, maximum mortality charges, policy loan accounts, or contractual loan interest rate guarantees of the endorsed contract. Pursuant to the Plan, the endorsements will include the following provisions:

(1) The contract (including any riders) will no longer have voting rights or rights to participate in divisible surplus through dividends;

(2) In lieu of policyholder dividend provisions, each cash value contract (e.g., a traditional ordinary or universal life insurance contract or deferred annuity contract) which does not already have a provision for the payment or application of non-guaranteed elements will be modified to provide that such contract may be eligible annually for non-guaranteed elements in accordance with the Plan, to be applied as the contractholder may select in accordance with the same options as were available for the application of dividends before such contract modification;

(3) Each cash value contract will be modified to provide that any policyholder dividend or interest credit that has been declared, but not paid or applied, with respect to such contract by Ceding Company prior to closing will be converted into a credit to policy values of such contract that will be payable or applicable at or after closing in the same manner and as of the same date that such dividend or interest credit would have been payable or applicable absent this modification;

(4) Provisions will be added to provide for continued compliance with various tax provisions; and

(5) Certain “tax-qualified” contracts will be authorized to receive compensation for the extinguishment of mutual membership interests in the form of credits to the policy values (the Plan credits, described below).

Non-guaranteed elements are (a) discretionary contractual payments that are in excess of minimum contractual payments, (b) discretionary contractual charges (or premium amounts) that are below the maximum contractual charges, or (c) discretionary interest credits that are in excess of minimum guaranteed rates. These payments, credits, and charges with respect to non-guaranteed elements, being discretionary, can vary from year to year. A “statement of principles,” an attachment to the Plan, will govern the setting of the non-guaranteed elements. The endorsed contracts, along with the practices dictated by the statement of principles, are intended to provide approximately the same non-guaranteed values after closing as the unmodified contracts provided before closing.

The endorsements are subject to change before the closing as may be necessary to conform the endorsements to the State A Court's orders or to court-approved changes in the Plan, or to comply with the requirements of the various state regulators. In addition, the value, benefits and provisions of the contracts are subject to modification as of the closing date to reflect the application of Plan credits, non-guaranteed elements or other modifications provided for under the Plan or State A Court order with respect to such contracts.

As indicated in the Plan, Ceding Company will transfer its insurance business by transferring the endorsed contracts (i.e., after their endorsement) and other assets to support the contracts transferred to Assuming Company pursuant to an assumption reinsurance agreement and ancillary agreements. Assuming Company will assume obligations under the contracts and pay to Ceding Company a ceding commission, consisting of a fixed amount of Amount x dollars and a contingent payment of up to Amount y dollars. After the assumption reinsurance transaction and pursuant to an order of the State A Court, Ceding Company will eventually be dissolved.

In the assumption reinsurance transaction, Assuming Company will assume the obligations of Ceding Company to the same extent and with the same effect as if Assuming Company had issued the endorsed contracts directly, subject to regulatory approval. Ceding Company will be discharged of liability on those endorsed contracts that are assumed and Assuming Company will have the direct and sole liability for the endorsed Contracts assumed. Contractholders who did not reject the transfer of the endorsed contracts prior to the date of the Date 13 State A Court's hearing on the final adoption of the Plan or who pay premiums thereunder to the Assuming Company will be deemed to consent to the transfer.[1]

Within Number XX days after the closing date, Ceding Company will make a distribution to its mutual members, as described below with respect to the distribution of distributable equity. Certain liabilities to be retained by Ceding Company as set forth in the Plan (retained liabilities) and assets in an amount initially approved by the State A Court for the satisfaction of retained liabilities (less amounts previously paid in satisfaction of such liabilities) will be set aside in a distributing trust. The distributing trust will be established in the form of an irrevocable grantor trust under State A law. The rehabilitator will serve as the trustee of the distributing trust. Generally, certain

[1] As mentioned previously, the contracts of the contractholders who affirmatively rejected such assumption reinsurance in writing prior to the Date 13 hearing of the State A Court will have their contracts surrendered at the closing for the then-current surrender value. To the extent approvals from state regulators are not received for such an assumption reinsurance of the endorsed contracts, Assuming Company will 100 percent coinsure liabilities under the endorsed contracts with Ceding Company, provided that enough state approvals shall have been received for the assumption (reinsurance) transaction to permit the assumption on the closing date of policies representing at least Number VV percent of insurance in force measured by face value.

mutual members will be the beneficiaries of the distributing trust, except for holders of certain tax qualified contracts (defined below), foreign mutual members and mutual members who disclaim their membership interests. Any amount of distributable equity allocable to foreign mutual members and those that hold tax qualified contracts will be satisfied by Ceding Company before it transfers certain assets and liabilities to the distributing trust, and this obligation will not become a liability of the distributing trust. Instead, Ceding Company will pay the foreign mutual members directly, and will transfer amounts to the Assuming Company for application as plan credits to the tax-qualified contracts.

Upon its dissolution, Ceding Company will transfer certain assets (including the stock of its Number TT subsidiaries unless such stock is previously disposed of) to the distributing trust along with retained liabilities. Using these assets, the distributing trust will satisfy the retained liabilities. The distributing trust will be responsible for distributing generally to the remaining (and non-disclaiming) mutual members any remaining cash in the distributing trust.

With the possible exception noted above for the stock of its Number TT subsidiaries, the assets held by the distributing trust will be reinvested, if at all, only in cash, obligations issued or guaranteed by the United States or any agency thereof, or demand deposits with, or certificates of deposit issued by, federally insured banks or savings and loan institutions. The distributing trust will incorporate the characteristics of a traditional liquidating trust, and will not engage in the conduct of any trade or business. The activities of the trustee will be limited to those reasonably necessary for, and consistent with, the accomplishment of such limited purposes.

The distributing trust is expected to be liquidated and dissolved approximately Number TT years after the closing of the assumption reinsurance transaction, when all retained liabilities are expected to be paid or provided for and when, if any assets remain, a second distribution of the remaining assets of the distributing trust will be made to or for the benefit of mutual members (as beneficiaries of the distributing trust) upon application by the rehabilitator or any mutual member and approval by the State A Court. The distributing trust agreement provides that the distributing trust will terminate no later than Number UU years after the closing date, unless otherwise ordered by the State A Court. The beneficial interests of mutual members in the distributing trust may not be transferred or hypothecated, and will not be evidenced by the issuance of any certificates. Consistent with its role of the distributing trust in the Plan, the distributing trust agreement provides generally that the members who are the trust’s beneficiaries will be treated as the owners of the assets in the trust estate for all income tax purposes, and (b) the transfer by Ceding Company of net assets to the trust will be treated for all income tax purposes as a distribution of such assets to such beneficiaries followed by the transfer of such assets by such beneficiaries to the distributing trust in exchange for the beneficial interests in such trust.

The Plan specifies a classification of claims and interest and a priority of distributions under the Plan. The rights provided the contractholders will have a Class 3, following certain secured and administrative claims, which are classified as Class 1 and Class 2 Claims. Classes 4 through 9 claims provide for claims of governments, general creditors, employees, debt holders, etc. Class 10, the last and residual category, provides for the claims in respect of mutual membership interest of the mutual members. Allowed claims (claims approved by the State A Court) in Classes 1 through 9 will be paid in full in cash, including contractholders who have a claim for cash provided that, from and after the closing date, allowed claims in Classes 1-9, other than Class 3, will become retained liabilities to the extent remaining as of the closing date or determined to be such after the closing date. Assuming Company will not bear any of such liabilities.

Class 10 Claims will be satisfied by the allocation of distributable equity in exchange for the extinguishment of the mutual membership interests, as provided in the Plan. The distributable equity is the amount of net assets available for distribution to mutual members after providing for retained liabilities. Mutual members generally will receive a distribution as compensation for the extinguishment of mutual membership interests. The first distribution of distributable equity will be made by the ceding company within Number XX days after the closing date, and any subsequent distribution thereof generally will be made by the distributing trust. The distributable equity will be allocated to mutual members consisting of (1) a fixed portion based on voting rights of the contracts and (2) a variable portion based on contributions to surplus. Number YY percent of the distributable equity will be allocated in respect of voting rights, and Number ZZ percent of the distributable equity will be allocated based on contributions to surplus, as determined by an actuarial methodology set forth in the Plan and allocation report described therein. The amount of distributable equity allocable to each mutual member will be determined pursuant to a formula described in the allocation report which has been found to be fair and equitable and was approved by the State A Court by order of Date 12.

Mutual members who hold non-trusted tax qualified retirement funding contracts (e.g., individual retirement account contracts or §403(b) contracts), will not receive, or be entitled to receive, distributable equity (in the form of cash or other consideration) with respect to such tax-qualified contracts. Instead, they will receive credits to the policy value (Plan credits) in the form of additional paid-up insurance or account value credits. The value of the plan credits will be equal to the value of the cash otherwise allocable to the qualified contractholders with respect to their tax-qualified contracts.

Assuming Company will receive assets from Ceding Company for purposes of paying the Plan Credit amounts.

The Plan has been reviewed by the State A Court, which issued a final approval order on Date 13. Previously, State A Court issued a preliminary approval order on Date 11 which among other matters approved the Plan without modification and authorized the Rehabilitator to proceed with implementing the Plan, subject to final approval of the State A Court. The Rehabilitator has selected Assuming Company as the successful bidder, and a final approval order was issued by the State A Court on Date 13. The State A Court's review has included, among other matters, (a) final determination, after hearings available to the contract holders, creditors and other interested parties, of the procedural and substantive fairness of the terms and conditions of the allocation of distributable equity in exchange for mutual membership interests and (b) final approval of the modifications by the endorsements of the terms and conditions of the contracts. The State A Court will retain exclusive jurisdiction to enforce the provisions of the Plan, and to ensure that its intent and purposes are carried out and given effect.

The assumption reinsurance agreement provides that Ceding Company and Assuming Company will make a joint election to apply provisions of §1.848-2(i)(4) concerning an excess negative capitalization amount to any reinsurance agreement entered into between the parties, specifically including the assumption reinsurance agreement (sometimes referred to as the insolvent insurer election). The receipt of a favorable ruling concerning the eligibility of Ceding Company to make the insolvent insurer election will result in Assuming Company being obligated to pay up to an additional Amount y dollars as a ceding commission to Ceding Company under the terms of the assumption reinsurance agreement.

It is represented that Ceding Company will have net negative consideration (as that term is defined in §1.848-2(f) of the Income Tax Regulations) under the assumption reinsurance agreement because Ceding Company will transfer a substantial amount of assets (expected to exceed Amount z dollars) to Assuming Company as consideration for the assumption of Ceding Company's liabilities under the transferred contracts. Because Ceding Company has not written any new business since it was placed in rehabilitation on Date 3, and therefore has not received substantial premiums subject to §848, it also will have an excess negative capitalization carryover allocable to the assumption reinsurance agreement under §1.848-2(i)(4)(iii).

Applicable Law and Analysis

Deferred Acquisition Costs:

Section 848 of the Code provides that insurance companies must capitalize "specified policy acquisition expenses" and amortize these amounts on a straight-line basis, generally over ten taxable years. Instead of identifying the categories of acquisition expenses that must be capitalized and amortized, §848(c) requires an insurance company to capitalize an amount of otherwise deductible expenses for the taxable year equal to specified percentages of net premiums with respect to certain types of insurance contracts. The maximum amount of expenses required to be capitalized for any taxable year is generally limited to the insurance company's general deductions for that year.

Section 848(d)(1) provides that, with respect to each category of specified insurance contracts, net premiums equal the excess, if any, of (A) the gross amount of premiums and other consideration for the contracts, over (B) the sum of return premiums and other consideration incurred for the reinsurance of the contracts.

Section 848(d)(4)(B) authorizes the Treasury Department to prescribe regulations to ensure that premiums and other consideration for reinsurance are treated consistently by the parties of a reinsurance agreement in applying the provisions of §848. Pursuant to this authority, §1.848-2(f) provides special rules for determining the amount of premiums and other consideration for reinsurance for purposes or computing an insurance company's net premiums under §848(d)(1).

Under §1.848-2(f) of the Income Tax Regulations, all items of consideration transferred between a ceding company and a reinsurer pursuant to a reinsurance agreement are netted for purposes of determining each party's net premiums under §848(d)(1). The net negative consideration determined by one party to the reinsurance agreement reduces its net premiums under §848(d)(1)(B). The net positive consideration determined by the other party increases its net premiums under §848(d)(1)(A). The "net consideration" rules in §1.848-2(f) ensure that "premiums and other consideration with respect to reinsurance" are treated consistently by the parties in applying the capitalization requirements of §848.

Section 848(f) provides that if for any taxable year there is a negative capitalization amount with respect to a category of specified insurance contracts, the negative capitalization amount reduces the amount of specified policy acquisition expenses that would otherwise be capitalized with respect to other categories of insurance contracts for that year (but not below zero). Any remaining negative capitalization amount is then applied as a reduction of the company's previously capitalized expenses under §848 (with a corresponding ordinary deduction). For this purpose, the negative capitalization amount is determined by multiplying the negative net premiums for a category of specified contracts by the applicable percentage for that category. As a practical matter, a negative capitalization amount for a category of specified insurance contracts will generally only arise as a result of reinsurance agreements.

Section 1.848-2(i) of the Regulations provides that if an insurance company's negative capitalization amount for a category of specified insurance contracts for a taxable year cannot be utilized for that year because it exceeds the company's specified policy expenses for other categories of specified contracts for the year plus the unamortized balance of specified policy acquisition expenses from prior taxable years, the excess is carried over to future taxable years (as an excess negative capitalization amount).

Section 1.848-2(i)(4) provides that an insolvent insurance company, with an excess negative capitalization amount, and net negative consideration under a reinsurance agreement and the other party to the reinsurance agreement may make a joint election. If the election is made, the insolvent company may not claim a carryover with respect to the portion of the excess negative capitalization amount attributable to the reinsurance agreement. Correspondingly, the party with net positive consideration may reduce its specified policy acquisition expenses for the taxable year by an amount equal to the reduction in the insolvent company's excess negative capitalization carryover amount.

Section 1.848-2(i)(4)(v) provides presumptions relating to the insolvency of an insurance company undergoing a court supervised rehabilitation or similar state proceeding for purposes of determining the availability of the joint election under §1.848-2(i)(4) to reduce the insolvent company's excess negative capitalization carryover amount attributable to the reinsurance agreement and the other party's specified policy acquisition expenses. Under §1.848-2(i)(4)(v), an insurance company undergoing a rehabilitation, conservatorship, or similar state proceeding will be presumed to be insolvent if the state proceeding results in –

(A) an order by the court finding that the fair market value of the company's assets is less than its liabilities;

(B) the use of funds, guarantees, or reinsurance from a guaranty association;

(C) a reduction of the policyholders' account balances; or

(D) a substantial limitation on access to funds (for example, a partial or total moratorium on policyholder withdrawals or surrenders that applies for a period of 5 years).

As described above, during its rehabilitation period, Ceding Company was made subject to restrictions on its activities, and the contractholders were subject to substantial limitations on certain cash surrenders and withdrawals of funds under the Contracts for almost Number WW years, which was well in excess of 5 years. Pursuant to the order of rehabilitation issued by the State A Court on Date 3, a moratorium was imposed immediately on all cash distributions, policy surrenders, withdrawals and policy loans under the contracts, except in the case of certain hardship situations. Such moratorium remained in effect until the issuance of an order of the State A Court lifting the moratorium on Date 10 after the order restricting contractholders' access to their funds went into effect. Therefore, such moratorium satisfies the requirement for the presumption under the regulation that the Ceding Company is an insolvent employer for purposes of making their Insolvent Insurer Election. See §1.848-2(i)(4)(v)(D) of the regulations.

Grandfather Provisions:

Rev. Proc. 92-57, 1992-2 C.B. 410, address the effect on policyholders of the modification or restructuring of an annuity, life insurance, or endowment contract issued or assumed (through reinsurance) by a financially troubled insurance company. If the modification or restructuring is an integral part of the rehabilitation plan and is approved by the state insurance commissioner, state court, or other responsible state official, then the Internal Revenue Service will treat the modification or restructuring as not having an effect on the date that the contract was issued, entered into, or purchased for purposes of §§72, 101(f), 264, 7702, and 7702A, and will not require retesting or the start of a new test period under §§7702(f)(7)(B)-(E) and 7702A(c).

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 §72(b) is calculated with respect to the taxpayer's investment in the contract as defined by §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 include in gross income to the extent of the income on the contract. A taxpayer's investment in the contract as defined by §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, §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 annuity, §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.

Conclusions

Based upon the information submitted and the representations made, it is held as follows:

(1) Ceding Company qualifies an insolvent insurance company within the meaning of §1.848-2(i)(4)(v) of the regulations. Therefore, assuming that Ceding Company has net negative consideration which results in an excess negative capitalization amount under §1.848-2(i) as a result of the assumption reinsurance agreement, Ceding Company and Assuming Company are eligible to make the joint election set forth in §1.848-2(i)(4) with respect to the assumption reinsurance agreement. That election allows Ceding Company to forgo the carryover of the portion of the excess negative capitalization amount attributable to the assumption reinsurance agreement and allows Assuming Company to reduce its specified policy acquisition expenses for that taxable year by an amount equal to Ceding Company's excess negative capitalization amount that is not carried over.

(2) Provided that the contracts to be assumed by Assuming Company that are issued as life insurance contracts constitute "life insurance contracts" for federal income tax purposes and the contracts that are issued as annuity contracts to be assumed by Assuming Company are "annuity contracts" for federal income tax purposes, it is held as follows:

Neither (a) the modification of a contract by endorsement upon closing, nor (b) any amount paid or credited with respect to a contract pursuant to the State A Court's approval of the rehabilitator's petitions to approve policyholder dividends with respect thereto, nor (c) the assumption reinsurance of an endorsed contract pursuant to the Plan, if such assumption reinsurance transaction does not change the terms and conditions of such contract (other than the insurer) after such modification by endorsement:

(i) will have any effect on the date that such contract was issued, entered into, or purchased for purposes of §§ 72, 101(f), 101(j), 264, 7702, or 7702A, or

(ii) will require retesting or the start of a new test period for such contract under §§ 264(d)(1), 7702(f)(7)(B)-(E), or 7702A(c).

For purposes of (2)(i) and (ii) above, as each endorsed contract will be treated under Rev. Proc. 92-57 as a continuation of an unendorsed contract with respect to the contractholder for purposes of §72, the investment in the contract under §72 for each endorsed contract immediately after the assumption reinsurance transaction will remain the same as for the predecessor unendorsed contract immediately prior to its endorsement.

There are a number of requested holdings submitted in the ruling request dated June 8, 2007, to which this ruling letter does not respond. These rulings are not within the ruling jurisdiction of the Office of the Associate Chief Counsel (Financial Institutions & Products). It is expected that you will receive a second letter or other correspondence with respect to the matters not ruled upon in this ruling letter. (This includes requested rulings (1)(iii), (2), (3), (4), (5) and (6) as submitted in your ruling request of June 8, 2007.)

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

Pursuant to the powers of attorney on file with this office, copies of this letter are being sent to your authorized representatives. A copy of this letter must be attached to any income tax return to which it is relevant. (Alternatively, for a return(s) filed electronically this requirement is satisfied by attaching a statement to the return(s) that provides the date and control number of the letter ruling.)

The rulings contained in this letter are based upon information and representations submitted by the taxpayers 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 yours,

/S/

SHERYL B. FLUM
Chief, Branch 4
Office of Associate Chief Counsel
(Financial Institutions & Products)