Internal Revenue Service

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Date: December 20, 2007

Legend:

X =

Y =

M =

N =

a =

b =

c =

d =

e =

f =

State =

Dear

This is in response to a letter dated July 11, 2007, submitted on behalf of X, requesting a ruling under § 101(a)(2) of the Internal Revenue Code.

Facts

X is a limited liability company organized in State that is classified as a partnership for federal income tax purposes. X is engaged in the business of buying options on the real estate of homeowners pursuant to an options program. The options entitle X to a portion of the future appreciation, if any, of the homeowner's personal residence that has accrued from the time the option is purchased until it is exercised.

At the time of the proposed transaction described below, a percent of X's membership interests will be held by Y, a State corporation. At the time of the proposed transaction, the other b percent of X's membership interests will be held by M as a non-managing member indirectly through N, a State limited liability company that is disregarded as an entity separate from M within the meaning of §301.7701-3(b)(1)(ii) of the Procedure and Administration Regulations.

Under the program, X will, through investment agreements between X and homeowners, purchase call options from homeowners (who are over the age of c and have life expectancy of at least d years) with respect to their personal residences. Each option will allow X for an option premium (for example, e percent of the current present value of the personal residence) to acquire the owner's home (upon the occurrence of certain events) at a strike price equal to the fair market value of the home, plus a specified percentage of any subsequent appreciation in the home less an acquisition cost change capped at d percent of the fair market value of the home at the time that X exercises the option. Pursuant to these contractual arrangements, X will make either an initial lump-sum premium payment at the inception of the option contract or monthly payments to each of the homeowners until the earlier of (i) the time of such homeowner's death or (ii) the sale of such homeowner's personal residence. Upon the occurrence of either the homeowner's death or sale of the homeowner's personal residence, the option will become immediately exercisable. (However, if the personal residence has substantially depreciated from its initial appraisal value, X will not purchase the home.)

In initiating the transaction, X will, at its expense, arrange for two appraisals of each homeowner's property, with one appraiser selected by X and the other by the homeowner. The average of the two appraisals then determines the base-line fair market value of the home at the time the option is purchased.

If the homeowner qualifies and elects to participate in the program, X will purchase the option at a price that is dependent on the fair market value of the homeowner's property and his or her life expectancy, as well as the percentage of the future appreciation being purchased, prevailing interest rates and views on the general real estate climate. (However, in the event of certain specified "breaches" by the homeowner, the homeowner may be required to repay certain amounts.)

In order to protect itself against the risk that the homeowner may die before significant appreciation accrues in the value of the personal residence, X will acquire a life insurance policy from a commercial insurer on each individual homeowner and name itself as the beneficiary of the policy. For example, if the homeowner were to die shortly after the option was acquired, it presumably would have no value because the likelihood is that there would be no appreciation in the value of the home. However, the life insurance policy would have value in such case and the policy would provide liquidity for the exercise of the options under the program. X will pay all premium payments and costs incurred in creating and maintaining the policies. Upon the death of an individual homeowner, payments pursuant to the policy obtained with respect to such homeowner will be made directly to X, as beneficiary under the policy. If the homeowner's life insurance application is declined by the insurance company, the homeowner is declined for the program.

In general, the face amount of the policy is expected to be equal to approximately f times the fair market value of the home at the time the option is purchased. The homeowner must apply and be approved for a policy, e.g., the homeowner must submit a general and detailed statement of health and an attending physician's statement and/or health history file and in some cases the homeowner must also undergo a health exam.

The option and the life insurance policy operating together may be illustrated by the following hypothetical example. The home has a fair market value of $750x at the time that X purchases the option to acquire the home at a formula based strike price upon the homeowners death. X pays the homeowner (as an investment fee) $112.5x for that option. X secures a life insurance policy on the life of homeowner in the face amount of $1,500x. Pursuant to the option (investment agreement), X and homeowner each share equally in the future appreciation of the home. Over a ten year period, the home increases in value to $1,400x. When the homeowner dies, X will pay the homeowner's estate a strike price of $963x ($750x initial value + $213x (the homeowner's equal share of the appreciation of the ten year period of $325x less an acquisition cost charge of $112x)). A portion of the life insurance proceeds that X receives on the homeowner's death may be used to fund the payment of the strike price.

Once all of the policies are acquired and options issued (i.e., when X is fully funded), M, through N, intends to sell its membership interests in X to third-party investors for cash. The limited liability company agreement for X will contain provisions with respect to restrictions on transferability that are designed to avoid a termination of X under § 708(b)(1)(B).

X will either hold the options until they are exercised or lapse, or will sell them in the market to institutional purchasers. Upon the exercise of an option it holds, X will sell the related home as soon as possible and distribute the proceeds from the return on the option to the investors in accordance with their member interests. Once the life insurance proceeds are paid by the insurer, X will distribute the proceeds to investors in accordance with their respective membership interests in X. X has no plan or intention to transfer individual life insurance policies (or groups of policies) to controlled entities in nonrecognition transactions (i.e., a transfer to a controlled corporation under §351).

X represents that it has a valid "insurable interest" in each policy under applicable law. X further represents that it is properly classified as a partnership, and not as an association or publicly traded partnership taxable as a corporation, for U.S. federal income tax purposes and that no sales or transfers of any interests in X will result in a termination of X within the meaning of § 708(b)(1)(B).

Law and Analysis

Section 7702(a) provides that for purposes of Title 26 of the United States Code, the term "life insurance contract" means any contract which is a life insurance contract under the applicable law, but only if such contract – (1) meets the cash value accumulation test of §7702(b), or (2)(A) meets the guideline premium requirements of §7702(c), and falls within the cash value corridor of §7702(d).

Section 101(a) provides that gross income does not include amounts received under a life insurance contract (whether in a single sum or otherwise), if such amounts are paid by reason of the insured's death.

Section 101(a)(2) provides that in the case of a transfer for valuable consideration by assignment or otherwise, the amount excluded from gross income by paragraph (1) shall not exceed an amount equal to the sum of the actual value of such consideration and the premiums and other amounts subsequently paid to the transferee.

The term "transfer for a valuable consideration" is defined for purposes of §101(a)(2) in §1.101-(b)(4) of the Income Tax Regulations as any absolute transfer for value of a right to receive all or a part of the proceeds of a life insurance policy.

Section 708(b)(1) provides in part that for purposes of § 708(a), a partnership shall be considered as terminated only if – (A) …, or (B) within a 12-month period there is a sale or exchange of 50 percent or more of the total interest in partnership capital and profits.

Conclusion

Accordingly, based on the facts and representations set forth above, and provided that the life insurance policies referred to above, are “life insurance contracts” within the meaning of §7702(a), the sale or exchange of membership interests in X either by N or any of the Investors will not result in a transfer for a “valuable consideration” under §101(a)(2), provided there is no termination of the partnership under §708(b)(1)(B).

Except as specifically set forth above, we express no opinion concerning the federal income tax consequences of the transaction described above under any other provision of the Code.

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

Pursuant to the power of attorney on file with this office, a copy of this ruling will be sent to the taxpayer’s representative.

Sincerely,

/s/

David R. Haglund
Senior Technician Reviewer, Branch 1
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures (2):
Copy of this letter
Copy for § 6110 purposes