Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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Legend:

Company	=
Managing Member	=
Bank A	=
Parent A	=
Bank B	=
Parent B	=
Year	=
State X	=
State Y	=
State Z	=
Accounting Standards	=

Dear :

This is in response to the letter submitted by your authorized representatives, requesting rulings on the application of certain sections of the Internal Revenue Code (the "Code") to a transaction among the Company, Bank A, and Bank B (collectively, "Taxpayers").

FACTS

PARTIES

Company is a limited liability company that was organized under the laws of State X in Year. For federal tax purposes, Company's default entity classification is that of a partnership and it will not make an election to be taxed as a corporation. Company intends to file its federal income tax return on a calendar year basis using an accrual method of accounting.

Bank A is a State Y state-chartered commercial bank. Bank A files a consolidated federal income tax return with its parent company, Parent A.

Bank B is a State Z state-chartered commercial bank. Bank B files a consolidated federal income tax return with its parent company, Parent B.

TRANSACTION

Bank A and Bank B (collectively, the "Banks") own permanent, cash value life insurance contracts (the "Policies") that insure the lives of individuals who, at the time first covered by the contracts, were employees, officers, or directors of the Banks (or affiliates thereof), and under which the Banks (or trusts they have established) are the owners and beneficiaries. The Policies qualify as life insurance contracts under section 7702 of the Code, and some may be modified endowment contracts within the meaning of section 7702A. The Policies are "general account" life insurance contracts—meaning, they provide cash surrender values that are backed solely by the issuing life insurance company's general asset account, rather than by assets held by the insurer in a "separate account" under state law.

The Banks will transfer some of their respective Policies to the Company in exchange for percentage interests in Company ("Percentage Interests"). Upon such a transfer, a Bank will become a Percentage Member in Company. Company will accept only Policies that were issued to the Banks on or before the date that the first Policies are contributed by Company. The contributing Banks must irrevocably assign all ownership rights in the Policies to Company. Each Bank will receive a Percentage

Interest in Company, generally determined by dividing (1) the fair value of the Policies it contributes, by (2) the fair value of all Policies contributed to Company, with all such fair values determined under Accounting Standards. This determination will first be made on an "initial closing date," i.e., the date on which the first Policies are contributed, and it will be adjusted as necessary on subsequent quarterly closing dates to account for the contributions of additional Policies. The final determination of the Percentage Interests will be made on the final closing date, which will occur no later than two years after the initial closing.

Company will be governed by an operating agreement (the “Operating Agreement”). Managing Member will be the only member of Company who is not a Bank, but will not be a Percentage Member once Company commences business operations. Company will engage in the business of managing Policies for the benefit of Percentage Members.

The Operating Agreement and other relevant documents will reflect the parties’ intent that the transfers of Policies to Company are meant to be partnership contributions. In this regard, for federal income tax purposes, Company, the Percentage Members, and Managing Member intend to treat all contributions of Policies as contributions of property in exchange for partnership interests in Company, and will not treat such contributions as sales of the Policies to Company.

The Percentage Members will be entitled to receive distributions from Company in accordance with their Percentage Interests and to the extent of available cash, with such cash being attributable principally to death benefits that Company receives under the Policies it holds. Company also may receive cash attributable to earnings on death benefits invested in short-term instruments between the time the benefits are paid by insurers and the time they are distributed to Percentage Members. Except in this manner, a Bank will not receive any cash or other property in return for its contribution.

The business and affairs of Company will be managed, operated, and controlled by or under the direction of Managing Member. Except for decisions or actions for which Percentage Member approval is expressly required by non-waivable provisions of applicable law, and subject to certain express limitations and the other terms of the Operating Agreement, Managing Member will have the full and complete power, authority, and discretion to take such actions as it may in its sole discretion deem necessary or advisable to carry out any and all of the objectives and purposes of Company. Managing Member’s specific activities may include, but may not be limited to, the following:

- Manage the Policies that Company holds, including, but not limited to, manage and oversee credit risk exposure to insurance carriers, exercise all rights under the terms of the Policies, sell or otherwise dispose of Policies, surrender Policies to the insurer, borrow against Policies, and pay premiums under Policies;

- Cause Company to pay all required taxes, rents, assessments and other obligations of Company, including preparing and filing all federal and state income tax returns;

- On behalf of Company, execute and supervise contracts to be entered into by Company with third parties (including consultants) and execute all other instruments and documents necessary or appropriate, in the opinion of Managing Member, to the business of Company;

- Borrow money for Company from banks, other lending institutions, Percentage Members, or affiliates of Percentage Members, and in connection therewith, to hypothecate, encumber, and grant security interests in Company's assets to secure repayment of the borrowed sums;

- Purchase liability and other insurance to protect Company's property and business;

- Invest any Company funds temporarily in, for example, time deposits, short-term governmental obligations, commercial paper, or other investments;

- Calculate (or facilitate the calculation of) the fair value of the Policies under Accounting Standards for purposes of valuing the Percentage Interests;

- Provide periodic reports to Percentage Members regarding the financial status of Company and the various Percentage Interests therein;

- Collect and distribute death benefits under the Policies, including conducting (or arranging for) "sweeps" of available public records to determine when the individuals insured under the Policies have deceased and therefore when death benefits may be payable under the Policies;

- Ensure or facilitate compliance with any regulatory requirements applicable to the Policies and the Percentage Members' interests in Company, including interacting with bank regulators with respect to such matters; and

- Take any action and perform all other acts that are necessary or appropriate to the conduct of Company's business, including all actions necessary to fulfill Company's obligations to maintain Company's interest in any Policies.

The Operating Agreement also will include certain express limitations on Managing Member's authority absent consent by the Percentage Members, including limitations on selling, leasing, encumbering, or otherwise disposing of all or substantially all of Company's assets.

Managing Member will have an interest in Company that differs from the Percentage Interests that Banks will hold in Company. In particular, Managing Member will not contribute Policies to Company and therefore will not receive a pass-through of death benefits under the Policies in the same manner as the contributing Banks. Rather, the Operating Agreement will entitle Managing Member to receive, as compensation for management services, a quarterly "basis point" fee (the "Management Fee") expressed as a percentage of the fair value of the Policies that Taxpayer holds. The Management Fee will be paid by Company out of its available cash. In addition, the Operating Agreement will entitle Managing Member to receive one percent of the earnings (if any) of short-term investments of death benefits received by Taxpayer (the "Managing Member's Interest"); the Management Fee payable during any period will be reduced by the amount of the Managing Member's Interest for that period. Managing Member will treat both the Management Fee and any amounts paid to it pursuant to the Managing Member's Interest as taxable income.

The Operating Agreement will reflect the rights and obligations of Managing Member and the Percentage Members. For example, it will identify specific items on which a vote of the Percentage Members is needed and the manner in which voting rights will apply. It will provide that each Percentage Member is entitled to vote on such matters in accordance with its Percentage Interest in Company.

The Operating Agreement will provide the method for allocating the partnership distributions. More specifically, it will reflect that distributions to Percentage Members will be based on their Percentage Interests, and that such Percentage Interests will be based on the fair value of Policies at the time they are contributed. Further, as previously noted, the Operating Agreement, along with all other relevant documents, will reflect the intent of the parties that the transfers of Policies to Company are intended to be partnership contributions.

As Company receives cash flows in the form of death benefits paid under the Policies (or other income, if any), such amounts, net of Company's expenses, will be allocated to the Percentage Members in accordance with the Operating Agreement. Such allocations will be done in keeping with the Percentage Interest that each Percentage Member owns and with the intent that the requirements of section 704 (relating to partnership allocations) will be satisfied. However, there will not be a distribution that would make Taxpayer insolvent, i.e., a sufficient amount of cash must remain in Taxpayer to cover operating expenses.

Percentage Members will likely want to retain their Percentage Interests in Company, which will have significant value and which will continue to informally fund the Percentage Members' employee benefit liabilities. In this connection, the Operating Agreement provides that "each Member . . . confirms to" Company that its Percentage Interest is acquired "for investment and not with a view to resale or distribution."

However, transfers of Percentage Interests will not be prohibited. It may become necessary for a Percentage Member to sell some or all of its Percentage Interests, such as in a liquidity emergency for the Percentage Member or upon dissolution of the Percentage Member by a bank regulator. To facilitate such transactions, the Operating Agreement will provide that Percentage Interests are freely transferable among Banks for cash, and that any Bank that acquires a Percentage Interest from an existing Percentage Member will be admitted to Company with all attendant benefits and burdens of Percentage Interest ownership.

Thus, a Bank that acquires a Percentage Interest from a Percentage Member will be entitled to receive cash flows from Company in the form of distributions of death benefits that Company receives under the Policies it owns. Company will not offer a redemption right, although Company will retain the right to purchase Percentage Interests (at negotiated prices) from willing Percentage Members under certain circumstances. Any transfer of Percentage Interests will comply with any requirements that the bank regulators may impose.

ADDITIONAL REPRESENTATIONS

The Company makes the following additional representations:

1. To the extent that Company incurs any indebtedness, it will not deduct its interest expenses in accordance with section 264(f)(1).

2. The Policies comply with the requirements of section 7702 and otherwise are treated as life insurance contracts for federal tax purposes, the death benefits under the Policies prior to their contribution to Company are eligible for the exclusion from gross income provided by section 101(a)(1), and with respect to any Policies that are subject to the requirements of section 101(j), those requirements have been and will continue to be met at all times.

3. Percentage Interests in Company are not required to be registered under the Securities Act of 1933 or the Investment Company Act of 1940, and Company will not be registered under the Investment Company Act of 1940 as a management company or unit investment trust or have in effect an election under such Act to be treated as a business development company.

4. Company will not be a common trust fund or similar fund that is excluded under the Investment Company Act of 1940 from the definition of “investment company” which is not included in the definition of “common trust fund” by section 584(a).

5. No sales or transfers of any Percentage Interests in Company will result in a termination of Company within the meaning of section 708(b)(1)(B).

6. Company does not intend to engage in exchanges with respect to any of the Policies it owns or to acquire additional Policies other than through contributions of Policies by Percentage Members as described in the letter ruling request.

7. Company will follow generally accepted accounting principles (GAAP).

REQUESTED RULINGS

Company requests the following rulings:

1. No gain or loss will be recognized pursuant to section 721 upon the transfer of a Policy by a Bank that owns such Policy to Company in exchange for a Percentage Interest in Company.

2. A contribution of a Policy to Company in return for a Percentage Interest in Company will not be a transfer of the Policy for "valuable consideration" under section 101(a)(2) because the contribution will qualify for the "carryover basis" exception to the transfer for value rule in section 101(a)(2)(A).

3. The sale or exchange of a Percentage Interest in Company, whether by one of the original Percentage Members or any successor thereto, will not result in a transfer of a Policy that Company owns for "valuable consideration" under section 101(a)(2).

LAW AND ANALYSIS

Ruling Request 1

Section 721(a) provides that no gain or loss shall be recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership.

Section 721(b) provides that section 721(a) shall not apply to gain realized on a transfer of property to a partnership which would be treated as an investment company (within the meaning of section 351) if the partnership were incorporated.

The transfer of Policies to Company will not be treated as a transfer to an investment company (within the meaning of section 351) if Company were incorporated. Because of this, section 721(b) does not apply to the transfer. Therefore, neither Company nor Banks will recognize gain or loss under section 721 upon Banks' contribution of Policies to Company in exchange for an interest in Company.

Ruling Request 2

Section 101(a)(1) states the general rule that, absent a listed exception, "gross income does not include amounts received (whether in a single sum or otherwise) under a life insurance contract, if such amounts are paid by reason of the death of the insured."

Section 101(a)(2) provides that "[i]n the case of a transfer for a valuable consideration, by assignment or otherwise, of a life insurance contract or any interest therein, the amount excluded from gross income by [section 101(a)(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 by the transferee." One of the exceptions to this rule is that it "shall not apply in the case of such a transfer . . . if such a transfer or interest therein has a basis for determining gain or loss in the hands of a transferee determined in whole or in part by reference to such basis of such contract or interest therein in the hands of the transferor[.]" See section 101(a)(2)(A). This is often referred to as the carryover basis exception.

In connection with Ruling Request 1 we held that no gain or loss will be realized under section 721 because of the transfer of Policies to Company. Therefore, Company qualifies for the carryover basis exception in section 101(a)(2)(A).

Ruling Request 3

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

Because any sale or transfer of Percentage Interests in the Company will not result in the sale or transfer of the Policies owned by Company and because Taxpayers have represented that such sales or transfers of Percentage Interests in the Company would not result in a termination of the Company within the meaning of section 708(b)(1)(B), any sale or transfer of Percentage Interests in the Company will not result in a transfer of a Policy that Company owns for "valuable consideration" under section 101(a)(2).

HOLDINGS

1. No gain or loss will be recognized pursuant to section 721 upon the transfer of a Policy by a Bank that owns such Policy to Company in exchange for a Percentage Interest in Company.

2. A contribution of a Policy to Company in return for a Percentage Interest in Company will not be a transfer of the Policy for "valuable consideration" under section 101(a)(2) because the contribution will qualify for the "carryover basis" exception to the transfer for value rule in section 101(a)(2)(A).

3. The sale or exchange of a Percentage Interest in Company, whether by one of the original Percentage Members or any successor thereto, will not result in a transfer of a Policy that Company owns for "valuable consideration" under section 101(a)(2).

Except as expressly provided herein, no opinion is expressed concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. The rulings contained in this letter are based upon information and representations submitted by Taxpayers and accompanied by penalties of perjury statements executed by appropriate parties. 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. 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.

In accordance with the Powers of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

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

cc: