

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **201322008**

Release Date: 5/31/2013

Index Number: 368.06-00, 832.15-00

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:CORP:B02
PLR-128826-12
Date:
February 26, 2013

Legend

Taxpayer =

Parent =

State A =

X =

Dear :

This letter responds to your request for rulings, dated July 5, 2012, on certain federal income tax consequences of a proposed transaction. The information provided in that request and in subsequent correspondence is summarized below.

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. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

Facts

Taxpayer is a State A property and casualty insurance company whose sole class of stock is wholly owned by Parent, a State A limited liability company and risk purchasing group that has elected to be treated as a corporation for federal income tax purposes.

Taxpayer and Parent are calendar-year, accrual-method taxpayers that file separate federal income tax returns. Aside from approximately \$X in cash, Parent's only asset is Taxpayer stock.

Each of Parent's members (the "Members") is required to purchase certain types of insurance from Taxpayer, which issues insurance policies exclusively to Members. For purposes of State A law, each Member is an "industrial insured," and collectively the Members constitute an "industrial insured group." As an industrial insured group captive insurer, Taxpayer essentially functions as an interinsurer underwriter.

Proposed Transaction

For what are represented to be valid business reasons, Taxpayer intends to convert from a stock insurance company to a "reciprocal insurer" as permitted by State A law, pursuant to the following steps (the "Proposed Transaction"):

- (i) Parent will distribute approximately \$X in cash to the Members (the "Cash Distribution"), which funds will be used to form the reciprocal insurer's attorney-in-fact.
- (ii) Parent will merge into Taxpayer (with Taxpayer surviving) in accordance with State A law (the "Merger"). In connection with the Merger, membership interests in Parent will be converted into equity interests in Taxpayer on a proportionate basis.
- (iii) Immediately following the Merger, Taxpayer will undertake a transaction (the "Conversion") whereby it will convert into a State A industrial group captive risk retention group formed as a reciprocal insurer ("New Taxpayer"). As a result of the Conversion, Taxpayer shares that were issued to Members in connection with the Merger will be converted into Class A Subscriber interests in New Taxpayer on a proportionate basis (each New Taxpayer subscriber, a "Subscriber"). (Interests in New Taxpayer will not actually be distributed to Subscribers; rather, Subscribers will be deemed to receive New Taxpayer interests in the Conversion.) The intent is that Class A Subscribers will continue to have the same rights that Members currently possess, except to the extent modifications are necessary to fit within the reciprocal structure.

After the Conversion, New Taxpayer will be an unincorporated association for State A law purposes. New Taxpayer will have four types of accounts—contributed capital accounts, surplus capital accounts, special surplus accounts, and subscriber savings accounts. The latter are required in order for New Taxpayer to take the tax deduction allowable under section 832(f) of the Internal Revenue Code (the "Code").

Immediately following the Conversion, New Taxpayer will have two classes of Subscriber interests outstanding—Class A Subscriber interests and Class C Subscriber interests. The Class A Subscribers (which initially will consist exclusively of Parent's Members) will have voting rights and the four types of accounts mentioned above. In contrast, the Class C Subscribers (which will consist exclusively of certain subsidiaries or affiliates of Class A Subscribers) will have neither voting rights nor any of the four types of accounts mentioned above. The Class C Subscription interests are nominal interests that are being created by New Taxpayer solely to satisfy certain State A requirements concerning reciprocal insurers.

New Taxpayer will issue at least one additional class of Subscriber interests in the future, but such interests will not be issued or outstanding immediately after the date the Conversion is completed.

Representations

The following representations have been made with respect to the Conversion:

- (a) Taxpayer's shareholders will receive or will be deemed to receive solely New Taxpayer interests in the Conversion.
- (b) The fair market value of the New Taxpayer interests deemed received by each Taxpayer shareholder in the Conversion will be approximately equal to the fair market value of such shareholder's Taxpayer stock converted in the transaction.
- (c) Immediately after the Conversion, Class A Subscribers will own all of the outstanding interests in New Taxpayer (aside from the nominal interests held by Class C Subscribers) and will own such interests solely by reason of their ownership of Taxpayer stock immediately prior to the Conversion.
- (d) Immediately after the Conversion, New Taxpayer will hold the same assets and liabilities that Taxpayer held immediately before the Conversion, except for assets used to pay expenses incurred in connection with the Conversion. No assets will be distributed in the Conversion, and there will be no dissenting shareholders.
- (e) The fair market value of the assets deemed transferred from Taxpayer to New Taxpayer in the Conversion will equal or exceed the sum of the liabilities (as determined under section 357(d)) assumed by New Taxpayer.
- (f) The liabilities of Taxpayer to be assumed (within the meaning of section 357(d)) by New Taxpayer plus the liabilities, if any, to which the transferred assets are subject were incurred by Taxpayer in the ordinary course of its business and are associated with the assets deemed transferred to New Taxpayer.

- (g) Immediately after the Conversion, New Taxpayer will be eligible to elect to be treated as an association under Treas. Reg. § 301.7701-3 that is taxable as a corporation for federal income tax purposes, and it will make such an election effective the date of the Conversion.
- (h) At the time of the Conversion, Taxpayer will not be under the jurisdiction of a court in a Title 11 or similar case within the meaning of section 368(a)(3)(A), and it will not be subject to any state insolvency proceeding applicable to insurers.
- (i) Immediately after the Conversion, the proportionate interest held by each Class A Subscriber will be the same as the proportionate share of Taxpayer stock held by each such person immediately before the Conversion.
- (j) Each party will pay its own expenses, if any, incurred in connection with the Conversion.

The following representations have been made with respect to the application of section 832(f):

- (k) Immediately following the Conversion, New Taxpayer will be recognized as an “industrial insured” captive reciprocal insurer under State A law.
- (l) New Taxpayer will follow the procedures necessary to qualify for deductions and income recognition under section 832(f) for increases and decreases, respectively, in savings credited to its Subscriber Savings Accounts.

Rulings

Based solely on the information and representations set forth herein, we rule as follows with respect to the Conversion:

- (1) The Conversion will qualify as a reorganization within the meaning of section 368(a)(1)(F). Taxpayer and New Taxpayer each will be “a party to a reorganization” within the meaning of section 368(b).
- (2) The Cash Distribution and the Merger will not preclude the Conversion from qualifying as a reorganization within the meaning of section 368(a)(1)(F) (Rev. Rul. 96-29, 1996-1 C.B. 50).
- (3) No gain or loss will be recognized by Taxpayer upon the deemed transfer of all of its assets to New Taxpayer in exchange for New Taxpayer interests and the assumption of liabilities (sections 361(a) and 357(a)).

- (4) No gain or loss will be recognized by New Taxpayer upon its deemed receipt of Taxpayer assets in exchange for New Taxpayer interests (section 1032(a)).
- (5) New Taxpayer's basis in the assets deemed acquired from Taxpayer will be the same as Taxpayer's basis in such assets immediately before the Conversion (section 362(b)).
- (6) New Taxpayer's holding period for the assets deemed acquired from Taxpayer will include the period during which such assets were held by Taxpayer (section 1223(2)).
- (7) No gain or loss will be recognized by Taxpayer upon the deemed distribution to its shareholders of the New Taxpayer interests (section 361(c)(1)).
- (8) No gain or loss will be recognized by Taxpayer's shareholders upon the deemed receipt of New Taxpayer interests in exchange for Taxpayer stock (section 354(a)(1)).
- (9) The basis of the New Taxpayer interests in the hands of each Class A Subscriber will equal the basis of the Taxpayer stock treated as surrendered by such Subscriber in exchange therefor (section 358(a)(1)).
- (10) The holding period for the New Taxpayer interests in the hands of each Class A Subscriber will include the period during which such Subscriber held the Taxpayer stock deemed exchanged therefor, provided that the Subscriber held the Taxpayer stock as a capital asset on the date of the exchange (section 1223(1)).
- (11) Subject to the conditions and limitations of sections 381, 382, 383, and 384 and the Treasury regulations promulgated thereunder, New Taxpayer will succeed to and take into account the tax attributes of Taxpayer described in section 381(c) (section 381(a) and Treas. Reg. § 1.381(a)-1).

Based solely on the information and representations set forth herein, we rule as follows with respect to the application of section 832(f):

- (12) New Taxpayer will be allowed a deduction for the increase for the taxable year in savings credited to its Subscriber Savings Accounts (section 832(f)).
- (13) New Taxpayer will include as an item of gross income the decrease for the taxable year in savings credited to its Subscriber Savings Accounts (section 832(f)).

Caveats

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. In particular, no opinion is expressed regarding the application of section 301, section 368, or any other Code or regulatory provision to the Cash Distribution or the Merger.

Procedural Statements

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

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

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Isaac W. Zimbalist
Senior Technician Reviewer, Branch 5
Office of Associate Chief Counsel (Corporate)

cc: