Internal Revenue Service

Number: **202235004**
Release Date: 9/2/2022

Index Number: 1001.00-00, 1011.00-00, 104.00-00, 7702B.00-00, 803.00-00, 805.00-00, 807.00-00, 807.01-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:FIP:B04
PLR-124736-21

Date:
May 31, 2022

Legend

Insurer	=
Parent	=
Court	=
Plan	-
Restructuring Statement	=
State	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
Effective Date	=

Dear :

This letter is in response to the letter submitted by your authorized representative that requested rulings on the application of §§ 104, 108, 803, 805, 807, 1001, 1011, and 7702B of the Internal Revenue Code (the "Code") to the rehabilitation of Insurer. The material information submitted in that letter and subsequent correspondence is summarized below.

FACTS

Parent is the common parent of a consolidated group that includes Insurer. Parent owns all of the stock of Insurer. Insurer is a State-domiciled stock insurance company and a life insurance company under § 816.

Insurer has issued or assumed and novated guaranteed renewable long-term care insurance policies (the "Policies"). None of the Policies has any cash value. Some of the Policies are qualified long-term care insurance contracts under §7702B. Insurer has not written any new business since Date 1 but has been required to renew its existing Policies pursuant to and subject to the terms of the Policies and applicable law.

On Date 2, under approval by the Court, the State Insurance Commissioner (the "Commissioner") ordered Insurer into rehabilitation because Insurer's projected liabilities significantly exceeded its projected assets. The Court appointed the Commissioner as the statutory rehabilitator (the "Rehabilitator"). On Date 3, the Court approved the Plan, which is a plan for the rehabilitation of Insurer. The Plan requires the restructuring of certain insurance liabilities under the Policies (the "Policy Liabilities") and the adoption of certain policy modifications (the "Restructuring"), which will occur pursuant to the Restructuring Statement. On Date 4, the Court approved the Restructuring Statement as part of the Plan. The State guaranty association (the "GA") is not required to provide coverage to Insurer's policyholders for Policy benefits as a result of the rehabilitation or the Plan. However, the GA's obligations could be triggered if Insurer is placed in liquidation as a result of a separate Court order.

The Plan contemplates that the rehabilitation will occur in three phases.

In Phase One, the Rehabilitator will determine for which of the Policies Insurer is projected to have insufficient assets to fund Policy Liabilities because the Policies are underpriced. A Policy will be considered underpriced if the premium for the Policy is below the "If Knew Premium". The "If Knew Premium" is generally the premium Insurer would have charged from inception of the Policy had it known what it knows now. To address the underfunding of the Policies, the Policy Liabilities of each Policy as of the Effective Date and prior to any Restructuring (the "Unmodified Policy Value", which is equal to such Policy's gross premium reserve) will be notionally allocated between (1) an amount Insurer is projected to have sufficient assets to fund (the "Initial Funded Restructured Policy Value") and (2) an amount Insurer is projected to be unable to fund (the "Unfunded Benefit Liability").

To determine the Initial Funded Restructured Policy Value, liquid invested assets of Insurer will first be notionally set aside to pay administrative costs, unpaid claims, and certain other debts. The balance of such assets will be notionally allocated among the Policies based on the accumulated premiums for each Policy. Each Policy's Initial Funded Restructured Policy Value will be determined based upon such Policy's notionally allocated assets and its expected premiums. Each Policy's Unfunded Benefit Liability will be the excess of such Policy's Unmodified Policy Value over its Initial Funded Restructured Policy Value. The notional allocation of the assets among the Policies will be made separately for (1) Policies issued in states in which the senior insurance regulatory official of that state elects to "opt-out" of certain provisions of the Plan ("Opt-Out States") and (2) Policies issued in all other states ("Opt-In States").

As of the Effective Date, the Unfunded Benefit Liability will be eliminated from each Policy and its Policy Liabilities and treated as creating an equal amount of separate indebtedness of Insurer to the Policy's owner (a "Policy Owner"). Such indebtedness (the "Debt") will be a non-insurance, general creditor indebtedness and will not constitute a separate contractual obligation covered by the applicable GA if Insurer were to be liquidated. It is possible, but not guaranteed or projected, that Insurer will make partial payments on the Debt before the end of the rehabilitation.

As part of the Restructuring, Policy Owners of underfunded Policies will be required to elect one of four options added to the Policy for Phase One to increase the Policy's premiums or reduce its benefits, so that the premiums of such Policies will be adequate on an If Knew Premium basis. There is a default option for Policy Owners that do not make an election. The elections will generally be implemented as of the Effective Date after the Policy Liabilities have been restructured into their separate IFRPV and UBL components. The Plan has special provisions for Policies issued in Opt-Out States. Generally, the benefits of Policies issued in Opt-Out States will be reduced to correspond to the premiums approved in that state.

In Phase Two, the results of Phase One will be evaluated. If necessary, certain Policy Owners may be required to make additional elections (similar to those in Phase One) under options added to the Policy for Phase Two as part of its Restructuring as of the Effective Date that would further increase premiums or reduce benefits of their Policies. The Plan has special provisions applicable to Phase Two for the Policies issued in Opt-Out States.

In Phase Three, the Rehabilitator will complete the run-off of the Policies. If there are sufficient funds, the Rehabilitator may make payments under the Debt and pay other creditors on account of any amounts owed to them apart from Policy Liabilities. The Rehabilitator will request that any Debt that remains unsatisfied at the conclusion of the rehabilitation will be discharged by the Court at the time of the final discharge order.

LAW AND ANALYSIS

Section 104(a)(3) provides that except in the case of amounts attributable to (and not in excess of) deductions allowed under § 213 for any prior taxable year, gross income does not include amounts received through accident or health insurance (or through an arrangement having the effect of accident or health insurance) for personal injuries or sickness (other than amounts received by an employee, to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of the employee or (2) are paid by the employer).

Under § 213(d), premiums paid under a qualified long-term care insurance contract are generally treated as payments for insurance for purposes of the deduction allowed under § 213 for expenses paid for medical care.

Under § 7702B(a), a qualified long-term care insurance contract is treated as an accident and health insurance contract, and amounts received as benefits under such a contract generally are treated as amounts received for personal injuries and sickness and as reimbursement for expenses actually incurred for medical care. Section 7702B(b) defines a qualified long-term care insurance contract as an insurance contract that (1) provides protection only for coverage of qualified long-term care services; (2) does not pay or reimburse expenses incurred for certain services or items reimbursable under Title XVIII of the Social Security Act; (3) is guaranteed renewable; (4) does not provide for a cash surrender value; (5) permits premium refunds or policyholder dividends to be applied only as a reduction in future premiums or an increase in future benefits; and (6) meets the consumer protection requirements of § 7702B(g).

In Rev. Proc. 92-57, 1992-2 C.B. 410, the Service recognized that “[i]nsurance companies that issue or assume (through reinsurance) annuity, life insurance, or endowment contracts can become financially troubled and subject to rehabilitation, conservatorship, insolvency, or similar state proceedings” and that the “[o]rderly rehabilitation of these insurance companies may require modification or restructuring of these annuity, life insurance, or endowment contracts.” Rev. Proc. 92-57 provides administrative relief with respect to these contracts by treating the modification or restructuring of certain contracts as not resulting in a loss of “grandfathered” status for purposes of §§ 72, 101(f), 264, 7702, and 7702A, and as not requiring retesting or the beginning of a new test period under §§ 264([d])(1), 7702(f)(7)(B)-(E), and 7702A(c).

To qualify for this administrative relief, the modification or restructuring of an affected contract must satisfy the following conditions:

1) The modification or restructuring (by endorsement or otherwise) of the affected contract must occur as an integral part of the rehabilitation, conservatorship, insolvency, or similar state proceeding. Modification or restructuring may include, but is not limited to, reductions in benefits, adjustments to mortality or other expense charges, reductions in the rate of interest credited to the contract, and restrictions on the policyholder's ability to receive benefits under the affected contract.

2) The modification or restructuring of an affected contract must be approved by the state court, the state insurance commissioner, or any other responsible state official with authority to act in a rehabilitation, conservatorship, insolvency, or similar state proceeding.

Rev. Proc. 92-57, Sec. 2.02.

Under § 1001(a), the gain from the sale or other disposition of property is the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain, and the loss is the excess of the adjusted basis provided in such section for determining loss over the amount realized.

Section 1.1001-1(a) of the Income Tax Regulations provides that "the gain or loss realized from the conversion of property into cash, or from the exchange of property for other property differing materially either in kind or in extent, is treated as income or as loss sustained."

Section 1011(a) provides the general rule that the adjusted basis for determining the gain or loss from the sale or other disposition of property, whenever acquired, is the basis (determined under § 1012 or other applicable sections of subchapter O, subchapter C (relating to corporate distributions and adjustments), subchapter K (relating to partners and partnerships), and subchapter P (relating to capital gains and losses)), adjusted as provided in § 1016.

Under § 803(a), gross income of a life insurance company includes (1) the gross amount of premiums and other consideration on insurance and annuity contracts, less return premiums and premiums and other consideration arising out of indemnity reinsurance and (2) the net decrease in reserves which is required by § 807(a).

Under § 805(a), a life insurance company is entitled to a deduction for (1) all claims and benefits accrued, and all losses incurred (whether or not ascertained), during the taxable year on insurance and annuity contracts and (2) the net increase in reserves which is required by § 807(b).

Section 807(d) provides the method of computing the amount of life insurance reserves for purposes of part I of subchapter L (other than § 816).

RULINGS

1. Any Court-approved Policy restructuring or modification described in the Restructuring Statement will not affect the Policy's issue date for purposes of § 7702B.

2. Any Court-approved Policy restructuring or modification described in the Restructuring Statement will not be treated as a material change of the Policy or an exchange of property for other property differing materially either in kind or in extent, and thus will not result in a taxable disposition of any interest in such Policy by the Policy Owner under § 1001.

3. Any Court-approved Policy restructuring or modification described in the Restructuring Statement will not cause any amount otherwise excludible from gross income under § 104(a)(3) to become includible in gross income by the Policy Owner.

4. The Policy Owner's adjusted basis under § 1011 in any Policy will remain the same immediately after any Court-approved restructuring or modification described in the Restructuring Statement as such adjusted basis was immediately before such transaction.

5. When any Policy's Unmodified Policy Value is restructured as of the Effective Date to reduce the Policy's unfunded liabilities, for purposes of subchapter L of chapter 1 of the Code as of the Effective Date:

    a. Insurer will include in income under § 803(a)(2) the total amount of the existing tax reserves under § 807(d) attributable to the Policy's Unmodified Policy Value;

    b. Insurer will be able to deduct under § 805(a)(1) as accrued benefits an amount equal to the Policy's Unmodified Policy Value;

    c. Insurer will include in premium income under § 803(a) the restructured Policy's Initial Funded Restructured Policy Value; and

    d. Insurer will be able to deduct under § 805(a)(2) the increase in tax reserves under § 807(d) attributable to the restructured Policy's Initial Funded Restructured Policy Value coverage.

We decline to rule on whether Insurer excludes from gross income under § 108(a)(1)(B) any income from the discharge of indebtedness to the Policy Owner to the extent that Insurer is insolvent at the time of the discharge. See Rev. Proc. 2021-1, Sec. 6.11.

CAVEATS

The rulings contained in this letter are based upon information and representations submitted by the taxpayer, accompanied by penalty of perjury statements executed by

an appropriate party. This office has not verified any of the material submitted in support of the ruling request, and it is subject to verification on examination.

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the rehabilitation of Insurer under any other provision of the Code or federal tax regulations.

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

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

Pursuant to a power of attorney on file in this office, a copy of this ruling is being furnished to your authorized representative.

Sincerely,

_____
Daniel P. Phillips
Senior Counsel, Branch 4
Office of Associate Chief Counsel
(Financial Institutions & Products)

cc: