Indirect Distributions in Life Insurance Company Reorganizations

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In Revenue Ruling 95-19, 1995-10 I.R.B. 4, the IRS addresses whether assets retained by target stock life insurance company in a reorganization are distributions. When substantially all of the assets of a target stock life insurance company are transferred in a reorganization under section 368(a)(1)(D), the question is whether an amount equal to the fair market value of any assets retained by the company is a distribution for purposes of section 815.

Under the facts of the ruling, P, a life insurance company, owned all of the outstanding stock of two other life insurance companies, S1 and S2. The three companies were calendar-year taxpayers, and S1 had a balance in its existing policyholders surplus account.

Under a plan of reorganization, on December 31, 1993, S2 (the acquiring company) assumed all of the outstanding insurance contracts and related liabilities of S1 (the target stock life insurance company) and received substantially all of the assets of the company. The exchange qualified as a reorganization under section 368(a)(1)(D) and did not result in any taxable distributions under

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subchapter C in the 1993 tax year.

Minimal Assets Retained

In Situation 1, S1 retained its state charter, insurance license, and the amount of assets needed to satisfy the minimum capital requirements imposed by the state to remain in business. The purpose of having S1 maintain its corporate existence was to isolate its charter and license for resale by P to an unrelated purchaser.

In Situation 2, the only assets retained by S1 were the state charter and insurance license; simultaneously with the transfer, P contributed to S1 the amount needed to satisfy the state's minimum capital requirements.

In Situation 3, the only assets retained by S1 were the state charter and insurance license; simultaneously with the transfer, S2 loaned P the amount needed to meet S1's minimum capital requirements under state law, and P contributed that amount to S1. The loan is evidenced by a note and bears interest at the federal short-term rate. If S1's stock is sold to an unrelated purchaser, P will be able to use the sales proceeds to repay the loan from S2.

Indirect Distributions Found

Revenue Ruling 95-19 concludes that in Situation 1, there is an indirect distribution under section 815(a) at the time of the transfer of substantially all of the assets of the target stock life insurance company that is equal to the fair market value of the state charter, insurance license, and minimum capital retained by the company. Similarly, the Service ruled that there is an indirect distribution under section 815(a) in Situation 2 and Situation 3 that is equal to the fair market value of the charter and license retained by the company. However, the ruling concludes that there are no tax consequences under section 815 in the subsequent tax year if P sells the stock of S1 or repays the loan from S2 with the proceeds from the sale of S1's stock. ■