Internal Revenue Service

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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-128217-06

Date:
March12, 2007

Taxpayer =

Parent =

Date 1 =

Date 2 =

Date 3 =

State A =

State B =

New Company =

Dear :

This letter revises our prior letter to you of Date 1 which should be destroyed and not attached to any tax return. This letter is in response to the Date 2 letter and subsequent submissions by Taxpayer requesting a ruling concerning the application of sections 264(f) and 1035 of the Internal Revenue Code to life insurance contracts of which Taxpayer is the owner and beneficiary.[1]

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[1] On Date 3, Taxpayer withdrew its request for ruling regarding a third provision of the Code.

FACTS

Taxpayer is a stock life insurance company organized and operated under the laws of State A. Taxpayer is a life insurance company within the meaning of section 816(a) and is licensed to engage in the life insurance business in State B. Taxpayer files a consolidated federal income tax return with Parent on a calendar year basis using the accrual method of accounting.

Taxpayer presently is the owner and beneficiary of a number of life insurance contracts (Old Contracts) covering the lives of individuals who were employees, officers or directors of Taxpayer at the time the Old Contracts were first issued. Each of the Old Contracts is a "modified endowment contract" within the meaning of section 7702A of the Code (MEC). The Old Contracts are not certificates under a group or master contract.

Taxpayer is considering exchanging some of the Old Contracts for new life insurance contracts issued by New Company that better suit its needs (New Contracts). New Company is unrelated to Taxpayer. At the time of the proposed exchange, the insured and the amount of the death benefit under each New Contract will be identical to the insured and death benefit amount under the Old Contract that is being exchanged. Taxpayer will receive no consideration in the exchange other than the New Contracts. At the time of the exchange, the insureds will be employees of Taxpayer.

Taxpayer represents that Old Contracts and New Contracts are life insurance contracts as defined in section 7702. Taxpayer also represents that each of the Old Contracts was issued after June 8, 1997.

Issue 1

The first issue involves the application of section 264(f)(4)(A) to the New Contracts. Section 264(f)(1) states that no deduction shall be allowed for that portion of the taxpayer's interest expense that is allocable to unborrowed policy cash values. However, section 264(f)(8)(B) states that section 264(f) does not apply to an insurance company subject to tax under subchapter L. Accordingly, section 264(f) does not apply to Taxpayer.

Issue 2

The second issue is whether the exchange of the Old Contracts for New Contracts will qualify as tax-free exchanges under section 1035(a). Section 1035(a) of the Internal Revenue Code provides that no gain or loss is recognized on the exchange of -- (1) a contract of life insurance for another contract of life insurance or for an endowment or annuity contract; (2) a contract of endowment insurance either for another contract of endowment insurance that provides for regular payments beginning at a date not later than the date payments would have begun under the contract exchanged, or for an annuity contract; or (3) an annuity contract for an annuity contract. <u>See</u> <u>also</u> sections 1.1035-1(a), (b) and (c) of the Income Tax Regulations.

The House Committee Report to the Internal Revenue Code of 1954 indicates that section 1035 was designed to eliminate the taxation of individuals "who merely exchanged one insurance policy for another better suited to their needs but who have actually recognized no gain." H.R. Rep. No. 1337, 83rd Cong., 2d Sess. 81 (1954). Thus, section 1035 operates as the insurance analogue to section 1031, which relates to like-kind exchanges of certain types of property held for productive use in a trade or business or for investment. The similarity of sections 1031 and 1035 is evidenced in section 1035(c)(1) that provides that the recognition of gain or loss on an exchange that is not solely like-kind will be made under the terms of 1031(b) and (c).

Taxpayer proposes to exchange certain Old Contracts for New Contracts. The Taxpayer represents that the Old Contracts and New Contracts are life insurance contracts within the meaning of sections 1035(b)(3) and 7702. Taxpayer will not receive any consideration in the exchange other than the New Contract. In addition, each New Contract issued in exchange for an Old Contract will insure the life of the same individual who was insured under that Old Contract.

HOLDING

Accordingly, based on the facts and representations made by Taxpayer, we hold that:

1. Section 264(f) does not apply to Taxpayer; and

2. The exchange by Taxpayer of Old Contracts for New Contracts will qualify as a tax-free exchange under section 1035 and no gain or loss shall be recognized on the exchange.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect or item discussed or referenced in this letter, including but not limited to, sections 805, 807, 812, 832, or any other provision of subchapter L. The rulings contained in this letter are based upon information and representations submitted by Taxpayer. 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. The ruling is directed only to the taxpayer requesting it. Section 6110(k) 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 letter is being sent to your authorized representative.

Sincerely,

/S/

DONALD J. DREES, JR.
Senior Technician Reviewer, Branch 4
Office of Associate Chief Counsel
(Financial Institutions & Products)