Internal Revenue Service

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Department of the Treasury

Washington, DC 20224 200136024

Contact Person:

Telephone Number:

In Reference to:
T:EP:RA:T3
Date:
SEP 18 2000

Legend:

Company A =

Company B =

Company C =

Fund M =

Fund N =

Fund O =

State P =

Statute Q =

Plan X =

Dear

This is in reply to your request for a ruling dated November 18, 1999, regarding certain federal income tax consequences of the proposed transaction under section 415 of the Internal Revenue Code of 1986, as amended (the "Code"). A letter dated May 9, 2000 supplemented the request.

Company A is a life insurance company within the definition of section 816(a) of the Code. Company A has elected under Code section 1504(c)(2) to file a life-nonlife consolidated federal income tax return with its life insurance and nonlife insurance subsidiaries.

Company A is a mutual life insurance company organized under the laws of State P. It is licensed to conduct insurance business in all 50 states and the District of Columbia.

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As a mutual life insurance company, Company A has no authorized, issued, or outstanding stock. Instead, the life insurance, endowment, annuity and certain other insurance and pension plan contracts combine both insurance coverage and so-called "Membership Interests."

In general, Membership Interests are defined by the State P demutualization statute as all rights and interests of a policyholder as a member of a mutual insurer arising under the mutual insurer's charter or certificate of incorporation and bylaws, by law or otherwise. These rights include the right, if any, to vote and the rights, if any, to surplus of the mutual insurer not apportioned or declared by the Board of Directors for policyholder dividends. Persons with Membership Interests are eligible to participate in the proposed demutualization and are hereinafter referred to as "Eligible Policyholders."

Company A proposes to demutualize under State P's demutualization statute to become a stock life insurance company. In this regard, it is proposed that Company A's Board of Directors adopt a plan of reorganization, under which Company A, subject to the approval of its policyholders and the Commissioner, will be reorganized as a stock life insurance company subsidiary ("Company C") of a new parent company, Company B. Simultaneously, Company B will raise funds from public investors through an initial public offering ("IPO"). Company B stock will be listed on the New York Stock Exchange.

The reorganization of Prudential will be accomplished in accordance with Statute Q. Pursuant to the Plan, the following steps will occur:

(i) Before the effective date of the demutualization ("Effective Date"), Company B will be created under State P law as a wholly owned subsidiary of Company A through the issuance of Company B voting common stock ("the Formation Shares") to Company A in exchange for a nominal capital contribution by Company A. As of the Effective Date, the following shall be deemed to occur simultaneously:

(ii) Company A will be converted to a stock company and its charter and by-laws, without further act or deed, will be amended and restated to authorize the issuance of stock.

(iii) Company A will issue and transfer to Company B 100 shares of its common stock in exchange for shares of Company B common stock to be provided to Eligible Policyholders and Company A shall surrender to Company B, and Company B shall cancel, the Formation Shares issued in (i).

(iv) All Membership Interests will be extinguished.

(v) In a fair and equitable manner, consideration in the form of Company B common stock, policy credits and/or cash, shall be distributed to all Eligible Policyholders upon extinguishment of their Membership Interests.

(vi) Additional Company B stock will be issued through the IPO. Shortly following the demutualization transaction, Company B will form a new subsidiary and will contribute all of the Company A stock to the new subsidiary.

Company A maintains Plan X, a qualified plan under section 401(a) of the Code. Plan X is a profit-sharing plan with a qualified cash or deferred arrangement under section 401(k). Plan X provides for both participant and employer contributions. Company A contributes $1.00 for each $1.00 the participant saves (up to 3 percent of earnings), plus an additional match for non-management level employees based on Company A's overall business performance.

Participants direct their investment into seven investment options including Fund M, Fund N and Fund O. In general, any earnings are reinvested in such funds, and credited to the participants accounts therein. Funds M, N. and O are provided under a Company A group annuity contract. Accordingly, Plan X is an eligible policyholder and is expected to receive a substantial amount of Company B stock in the proposed demutualization. Company A proposes to amend Plan X to provide for the allocation of this stock to all persons with accounts in Plan X. The trustee will allocate this stock to the accounts of each participant (active, inactive, and retired) and beneficiary that had a vested interest in matching contributions in his or her Plan X account on any date between February 10, 1998 and a date closer to the date of the demutualization and to nonvested employee-participants on the later date.

No actual exchange of contracts will take place as a result of the proposed transactions. The rights of participants under Plan X, including rights to benefits and dividends, will be unaffected by the exchange of their Membership Interests for stock or other consideration.

In a private letter ruling issued on June 12, 2000, the Internal Revenue Service ruled on issues involving, in part, sections 72(e), 72(t), 401(a), 3405, 4972, and 4973 of the Code, relating to this demutualization.

Based on the foregoing, you request a ruling that the proposed allocations of stock to participant accounts in Plan X will not be considered "annual additions" within the meaning of section 415 of the Code.

Section 415(c)(1) of the Code states that contributions and other additions with respect to a participant exceed the limitation of this subsection if, when expressed as an annual addition to the participant's account, such annual addition is greater than the lesser of (A) $30,000, or (B) 25 percent of the participant's account.

Section 415(c)(2) of the Code states that the term "annual addition" means the sum for any year of (A) employer contributions, (B) the employee contributions, and (C) forfeitures.

Section 1.415-6(b)(2)(i) of the regulations provides that the Commissioner may, in appropriate cases, considering all of the facts and circumstances, treat certain allocations to participant accounts as giving rise to annual additions.

Any membership interests in a mutual insurance company which arise from the purchase of an insurance contract are inextricably tied to the contract from the time of purchase. These membership interests are created by operation of state law solely as a result of the policyholder's acquisition of the underlying contract from a mutual insurance company and cannot be transferred separately from that contract. Prior to conversion, the membership interests have no determinable value apart from the insurance contract itself. Further, if the insurance contract is surrendered by the policyholder or, in the event an insurance contract is terminated by payment of benefits to the contract beneficiary, these membership interests cease to exist, having no continuing value. The membership rights associated with the tax qualified retirement contracts, are acquired as a direct result of tax-favored payments to a mutual insurance company. Indeed, these membership interests cannot be obtained by any purchase separate from an insurance contract issued by Company A. In view of the foregoing, such interests are part of Funds M, N, and O of Plan X.

While it has been recognized that consideration received in a demutualization transaction is in exchange for a membership interest in a mutual insurance company, and not from or under an insurance contract, such a distinction does not require the detachment of such consideration from the tax qualified retirement contracts, which consists of both the contracts and all other interests which arise with the purchase of such a contract. See, Revenue Ruling 71-233, 1971-1 C.B. 113. Rather, contracts and the related membership interests must be viewed as part of a program of "interrelated contributions and benefits" which are retained within the plans. Cf., Income Tax Regulation section 1.72-2(a)(3)(i).

The planned issuance of stock does not constitute a distribution of such credits to the Plan X participants. The conversion of membership interests in Company A to stock is a mere change in form of one element within the arrangement to another. Since the conversion increases the accumulation value of the annuity contracts under Plan X, the stock is treated, for purposes of sections 401(a), and 415(c) of the Code, in the same manner as any other return of, or return on, an investment within Funds M, N and O of Plan X, and is not regarded as having been received by the policyholder. Such amounts representing the stock will be considered as part of the respective balances to the credit of the participants and beneficiaries in Plan X.

Accordingly, with respect to your ruling request, we hold that the stock, as allocated, to participant accounts in Plan X will not be considered "annual additions" within the meaning of section 415 of the Code.

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

A copy of this letter is being sent to your authorized representative in accordance with a power of attorney on file in this office.

Sincerely Yours,

Frances V. Sloan

Frances V. Sloan, Manager
Employee Plans Technical Group 3
Tax Exempt and Government Entities Division

Enclosures:
Notice of Intention to Disclose
Deleted Copy of Ruling

CC: