



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

OFFICE OF  
CHIEF COUNSEL

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[REDACTED]

Attention: Mr. [REDACTED]

Dear Senator [REDACTED]:

This letter is in response to your January 22, 2002 inquiry on behalf of your constituents, [REDACTED]. The [REDACTED] asked about the cost basis they received in company stock in exchange for their rights as policyholders as a result of the demutualization of their mutual life insurance company.

According to their letter, they had been paying premiums for a number of years when the mutual insurance company converted into a stock company (a process called demutualization). According to the [REDACTED]'s letter, the company notified them that the Internal Revenue Service said the cost basis in the common stock received as a result of the demutualization will be zero. The [REDACTED] believe our position is incorrect.

Our position is the basis in each policyholder's membership interest in a mutual insurance company is zero. As part of a tax-free reorganization, in this case the demutualization, a policyholder would, under section 358 of the Internal Revenue Code, take the same basis in the company stock as the aggregate basis the policyholder had in the mutual insurance company membership interests transferred to the stock company. Because the basis in each policyholder's membership interest is zero, the basis in the stock in a stock company received by a former mutual insurance company policyholder in a demutualization will be zero.

We treat the policyholder as having a zero basis in his membership interest in the mutual insurance company because the policyholder's premiums for the insurance contracts represents payment for the cost of insurance and an investment in a person's contract but not an investment in the assets of the mutual insurance company. A person's proprietary interest in the assets of the mutual insurance company arises solely because the person is a policyholder of the mutual insurance company. Therefore, the basis of each policyholder's proprietary interest in the mutual insurance company is zero.

In conclusion, as a result of the demutualization, the policyholder receives stock in the stock company, which has a zero basis. Our position can be found in two Revenue Rulings, which I attached for your review. See Revenue Ruling 71-233, 1971-1 C.B. 113, and Rev. Rul. 74-277, 1974-1 C.B. 88.

I hope this information is helpful. If you have any questions, please call me at (202) 622-7930.

Sincerely yours,

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Alfred C. Bishop, Jr.  
Branch Chief, Branch 6  
Office of Associate Chief Counsel (Corporate)

Enclosures (2)