



FINANCIAL SERVICES

- Insurance Tax Bulletin

PRICEWATERHOUSECOOPERS 

Blue Cross Conversion Is a Material Change

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The IRS released TAM 200607020 concluding that the conversion of a Blue Cross Blue Shield organization from a not-for-profit mutual insurance company to a for-profit stock insurance company constitutes a material change in its structure under Section 833(c)(2)(C).

Taxpayer was incorporated as a mutual insurance company. Taxpayer engaged in several acquisitive transactions in which a mutual insurance Company merged into Taxpayer such that the Company's business was transferred to Taxpayer's newly formed wholly owned subsidiary, which was a stock insurance company. Taxpayer converted from a mutual insurance company to a publicly traded stock insurance company, issuing stock and securities.

Taxpayer also acquired the outstanding stock of Company 5, a stock company. Company 5 had previously been a mutual insurance company that converted to a for-profit stock company. The assets of Company 5 were transferred to newly formed Subsidiary 5, also a stock company.

Prior to these transactions, Taxpayer and each Company were existing Blue Cross and Blue Shield organizations within the meaning of Section 833(c). In computing their taxable income, the Subsidiaries claimed the deduction provided by Section 833(a)(2) and Taxpayer and Subsidiaries used the method of computing basis provided by section 1012(c)(3)(A)(ii) of the Tax Reform Act of 1986.

Issues: (1) Whether the conversion of Taxpayer from a not-for-profit mutual insurance company to a for-profit stock insurance company, which involved the offering of stock and securities traded on a public exchange, constitutes a material change in its operations or structure under Section 833(c)(2)(C)?

(2) If such a conversion is a material change in structure, does it negate the application to the Taxpayer and its subsidiaries of Sections 833(a)(2) and (a)(3), relating to Taxpayer and its subsidiaries, respectively?

(3) If such a conversion is a material change in structure, does the change preclude application of the benefits of section 1012 of the Tax Reform Act of 1986, relating to Taxpayer and its subsidiaries?

Conclusions: (1) The conversion of Taxpayer from a not-for-profit mutual insurance company to a for-profit stock insurance company constitutes a material change in its structure under Section 833(c)(2)(C).

(2) Taxpayer's conversion negates the application of Sections 833(a)(2) and (a)(3) to Taxpayer and Taxpayer's subsidiaries for the years involved.

(3) The material change precludes application of the benefits of section 1012 of the Tax Reform Act of 1986.

PwC Observes: This TAM confirms the IRS' longstanding position that BCBS organizations that have undergone a material change can no longer utilize fresh start asset basis for purposes of sale or exchange.

For additional information please call Anthony DiGilio at (202) 414-1702 or contact your local insurance tax professional.

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