



FINANCIAL SERVICES

- Insurance Tax Bulletin

PRICEWATERHOUSECOOPERS 

Blue Cross Blue Shield Conversions to For-Profit Status

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In a coordinated issue paper, LMSB-04-0408-024, the IRS has outlined its primary and alternative positions on the federal tax consequences resulting from conversions from non-profit to for-profit status by Blue Cross Blue Shield and similar taxable nonprofit organizations.

According to the issue paper, Blue Cross Blue Shield plans were originally established as tax-exempt, non-profit organizations. However, the Tax Reform Act of 1986 and later legislation changed the taxability of the organizations, and they were granted special benefits to ease their transition to taxation. Many Blue plans have maintained the same legal status as public benefit corporations, but some have converted into charitable trust organizations and others converted into for-profit stock companies. A common element with such conversion transactions is the assertion by state regulators that the conversions should result in a payment or transfer of value accreted during non-profit years by the organization to the state. Several plans claimed tax deductions for the payments or value transfers made. The Service's arguments for disallowing the deductions fall into various categories including the following:

- **No Deduction for Trustee Transfer.** A payment or transfer in satisfaction of a charitable trust obligation is a non-recognizable transaction. The transferor as trustee has no taxable interest in assets that are charged with a charitable trust, and does not engage in a recognizable transaction when it transfers the trust assets to a successor trustee.
- **No deduction for a capital expenditure.** To the extent the transaction is recognizable, it should be considered a capital expenditure connected with the restructuring or reorganization of the taxpayer from a non-profit to a for-profit entity and not an ordinary and necessary business expense.
- **No deduction for expenses allocable to tax-exempt income.** Under certain circumstances to the extent a payment or transfer is associated with the taxpayer's non-profit activities or non-profit status during a period in which it was exempt from federal income tax, any deduction would be barred by I.R.C. § 265.
- **No Deduction for Fees and Expenses where the Fair Market Value of Stock is Transferred in a Conversion Transaction.** In some cases, a non-profit or public benefit organization transfers stock in satisfaction of a charitable trust obligation. Whether the charitable trust obligation is satisfied by a payment in cash or by a transfer of other property or stock, no deduction is allowed; and
- **Where no deduction is claimed or allowed at the time of a conversion payment, no deduction is allowed at the time of a subsequent merger or acquisition.** In some cases, a non-profit or public benefit organization makes a payment or transfer for value in satisfaction of a charitable trust obligation, and later merges with or is acquired by a for-profit organization. The initial transfer is considered a non-recognizable transaction and no deduction is allowable, either at the time of the initial transfer, or at the time of a later transaction.

PwC Observes: This issue paper solidifies the Service's long-standing position on the deductibility of conversion payments or toll charges. It appears that by releasing the issue paper the Service is ensuring that taxpayers understand this guidance is alive and well and applicable to a broad range of situations. Although, the issue paper discusses the conversion of Blue Cross Blue Shield (BCBS) organizations, the IRS notes that the position described may apply to any taxable nonprofit organization that converts to for-profit status.

For additional information please call Anthony DiGilio at (202) 414-1702 or contact your local insurance tax professional. Please visit us at: <http://www.pwc.com/us/insurance/tax>

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