Legislation

Delaware State Senate

128th GENERAL ASSEMBLY
FIRST SESSION — 1975

Senate Bill No. 293
MAY 8, 1975

AN ACT TO AMEND CHAPTER 49, TITLE 18 OF THE DELAWARE CODE RELATING TO ORGANIZATION AND CORPORATE POWERS, PROCEDURES OF DOMESTIC STOCK AND MUTUAL INSURERS.
Be It Enacted by the General Assembly of the State of Delaware:

Section 1. Amend Chapter 49, Title 18 of the Delaware Code by renumbering current Sections 4943 and 4944 to 4944 and 4945 and adding a new Section 4943 as follows:

§ 4943. Preservation of Old Charter in Merger, Consolidation.

(a) In any merger or consolidation of a foreign stock or mutual insurer into or with a domestic insurer under Section 4930 of Part 1, Title 18, in accordance with this section, the continuing Delaware corporation shall for all purposes be deemed to be a continuation of the corporate existence of the foreign corporation with Delaware as the adoptive state of domicile and with date of corporate origin the same as the original date or incorporation of the foreign insurer in its original domiciliary state or country, subject to the following conditions:

(1) The plan and agreement for merger or consolidation shall provide for such continuation or corporate existence through designation of Delaware as the state of domicile of the foreign corporation by adoption, and shall specify the original date of incorporation of the foreign corporation in its original domiciliary state or country as being the date of incorporation of the Delaware corporation pursuant to this section.

(2) The certificate of incorporation of the Delaware corporation shall provide, or be amended to provide, that the corporation is a continuation of the corporate existence, through adoption of the State of Delaware as the corporate domicile, of the foreign corporation, and shall specify the original date of incorporation of the foreign corporation in its original domiciliary state or country as being the date of incorporation of the Delaware corporation pursuant to this section.

(b) The continuing Delaware corporation shall have all the rights and obligations of, and be given recognition in all respects as a corporation formed under the laws of this state as of the date of incorporation of the foreign corporation in its original domiciliary state or country. This provision shall not be deemed to impose upon the continuing Delaware corporation any liability or obligation with respect to filings, fees, taxes or otherwise which might have accrued prior to the effective date of the merger or consolidation.

(c) This section shall not be deemed in any manner to preserve, after the effective date of such merger or consolidation, the corporate existence of such foreign corporation as a corporation of its original domiciliary state or country.”
SYNOPSIS

This change makes it more attractive for old and established insurance companies to move to Delaware without sacrificing their continuity of existence.

George N. Hudson, Esq.

I. STATUTORY PURPOSE

Since the enactment of the Delaware Coastal Zoning Act, Chapter 70, Title 7 of the Delaware Code, the General Assembly of the State of Delaware has introduced legislation to encourage clean and non-polluting industries to locate and become domiciled in Delaware. Insurance companies being of this general nature have become a common target for state legislatures throughout the country, including Delaware. In pursuance of this objective, Senate bill 293 was enacted on July 2, 1975.1

The statutory purpose for the enactment of Senate bill 293 is to provide economic incentives in order to create a favorable climate for the insurance industry in Delaware. In effect, according to the bill's sponsor, Senator William Murphy of Dover, Delaware, "the bill provides 'a piece of bait' in which to induce foreign insurers to relocate in Delaware." This bill amends Chapter 49, Title 18 of the Delaware Code entitled "Organization and Corporate Powers, Procedures of Domestic and Mutual Insurers" which specifically designates the statutory organizational requirements for domestic stock and mutual insurers. Prior to this amendment there was no specific treatment for the continuance of corporate existence upon a merger or consolidation. Section 4930 of this Chapter only enumerated the procedure for merger with or consolidation by a domestic stock insurer with one of more domestic or foreign stock insurers and section 4934 outlines the procedure for mutual insurers. However to reiterate, neither of these sections dealt specifically with the continuity of corporate existence after a merger or consolidation.

II. POLICY CONSIDERATIONS

As indicated by the provisions of Senate bill 293, foreign stock or mutual insurers who merge into or consolidate with any domestic insurers in accordance with sec. 4930 of Part 1, Title 18 of the Delaware Code are allowed to retain their previous corporate existence in which they have done business since the time of their original incorporation. Such a provision authorized established insurance companies to relocate in Delaware without any loss of their existing and recognizable trade name and with-

---

1. 18 Del. C. § 4943 (1975).
2. Interview with William Murphy, Delaware State Senator, in Dover, Delaware, October 3, 1975.
out having to sacrifice their continuity of existence. It further provides an atmosphere of business stability for the foreign insurance companies that select Delaware as the state for their domicile by adoption.

Since Senate bill 293 is only part of a series of legislative inducements that are being considered by the State to encourage foreign insurers to relocate in Delaware, it is appropriate to note that at the present time other states in striving for the same objective are utilizing three basic methods and ideas.3

The first incentive is merely to reduce or eliminate the amount of premium taxes to be paid by the company if it locates within the state. As far as the administrative considerations are concerned, this method seems to be the least burdensome and costly to implement and by far the easiest to regulate.

The second method given consideration by some states is the reduction of real estate (property) taxes on the land where the physical plant would be located. Of course, a reduction in such a tax would mean a loss of revenues to county and local governments who may rely heavily on them for financial stability and would have to be a necessary consideration before such an incentive could be implemented. Limitations, usually in the form of reduction in taxes according to the percentage of occupancy by the company, are generally included in the statute to prevent obvious abuses of such a system.

The final idea that has been used by several states is to reduce the amount of premium taxes that are paid in relation to the percentage of the companies assets that are invested in securities of that state or other investments which are particularly specified by statute. Usually in these cases the allowable reduction is limited to a set figure by statute or is reduced on a graduated scale with the larger the investment, the smaller the amount of tax owed.

An example of one of the most innovative plans to bring new industry into a state (not only the insurance industry) was proposed by Governor Rhodes of Ohio. This plan, incorporated into a series of constitutional amendments would give new "industrial companies" moving into the state of Ohio an exemption from tangible personal property tax and corporation franchise tax for a period of fifteen years with an added incentive of a thirty year exemption if the company would locate in an area of "critical need" as defined by the amendment. To encourage the expansion of companies already existing within the state the amendments would also give those businesses who increase their capital investments in the state a fifty percent tangible personal property tax exemption along with a reduced corporation franchise tax. This program failed to pass the Ohio General Assembly and was then defeated in the November (1975) election ballot.

when proposed along with a general bond issue. However, it is the authors' opinion that the defeat of this plan was not upon a proper consideration of its merits but rather the result of the economic crisis facing municipal governments throughout the United States.

Of course any of these incentives must be formulated in accordance with the economic and political atmosphere of each particular state with consideration being given to whether such a loss of revenue would be outweighed by a gain in economic growth and employment opportunities.

III. Possible Legal Problems and Consequences

As a consequence of the enactment of this law, several legal problems may arise that should be considered in evaluating the advantages to be derived from its implementation.

One of the major problems to be considered is the effect of such a merger or consolidation under the federal income tax laws, specifically sec. 368 and sec. 381 of the Internal Revenue Code of 1954. The problem


5. 26 U.S.C. § 368:
Definitions Relating to Corporate Reorganizations.
(a) Reorganization.—
(1) In General. — For purposes of parts I and II and this part, the term "reorganization" means—

(A) a statutory merger or consolidation;

(B) the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange, solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of stock of another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation (whether or not such acquiring corporation had control immediately before the acquisition);

(C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of substantially all of the properties of another corporation, but in determining whether the exchange is solely for stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded;

(D) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor, or one or more of its shareholders (including persons who were shareholders immediately before the transfer), or any combination thereof, is in control of the corporation to which the assets are transferred; but only if, in pursuance of the plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction which qualifies under section 354, 355, or 356;

(E) a recapitalization; or

(F) a mere change in identity, form, or place of organization, however effected.
(2) Special Rules Relating to Paragraph (1).—

(A) Reorganizations Described in Both Paragraph (1) (C) and Paragraph (1) (D). — If a transaction is described in both paragraph (1) (C)
may be stated as whether the IRS will recognize and honor this amendment to Title 18, Chapter 49, of the Delaware Code so as to enable foreign

and paragraph (1) (D), then, for purposes of this subchapter, such transaction shall be treated as described only in paragraph (1) (D).

(B) Additional Consideration in Certain Paragraph (1) (C) Cases.—If—
(i) one corporation acquires substantially all of the properties of another corporation,
(ii) the acquisition would qualify under paragraph (1) (C) but for the fact that the acquiring corporation exchanges money or other property in addition to voting stock, and
(iii) the acquiring corporation acquires, solely for voting stock described in paragraph (1) (C), property of the other corporation having a fair market value which is at least 80 percent of the fair market value of all of the property of the other corporation,
then such acquisition shall (subject to subparagraph (A) of this paragraph) be treated as qualifying under paragraph (1) (C). Solely for the purpose of determining whether clause (iii) of the preceding sentence applies, the amount of any liability assumed by the acquiring corporation, and the amount of any liability to which any property acquired by the acquiring corporation is subject, shall be treated as money paid for the property.

(C) Transfers of Assets or Stock to Subsidiaries in Certain Paragraph (1) (A), (1) (B), and (1) (C) Cases.—A transaction otherwise qualifying under paragraph (1) (A), (1) (B), or (1) (C) shall not be disqualified by reason of the fact that part or all of the assets or stock which were acquired in the transaction are transferred to a corporation controlled by the corporation acquiring such assets or stock.

(b) Party to a Reorganization.—For purposes of this part, the term "a party to a reorganization" includes—
(1) a corporation resulting from a reorganization, and
(2) both corporations, in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another.
In the case of a reorganization qualifying under paragraph (1) (B) or (1) (C) of subsection (a), if the stock exchanged for the stock or properties is stock of a corporation which is in control of the acquiring corporation, the term "a party to a reorganization" includes the corporation so controlling the acquiring corporation. In the case of a reorganization qualifying under paragraph (1) (A), (1) (B), or (1) (C) of subsection (a) by reason of paragraph (2) (C) of subsection (a), the term "a party to a reorganization" includes the corporation controlling the corporation to which the acquired assets or stock are transferred.

(c) Control.—For purposes of part I (other than section 304), part II, and this part, the term "control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation. Aug. 16, 1954, C. 736, 68 A. Stat. 120; Feb. 26, 1964, Pub. L. 88-272, Title II, § 218 (a), (b), 78 Stat. 57.

CARRYOVERS IN CERTAIN CORPORATE ACQUISITIONS,

(a) General Rule.—In the case of the acquisition of assets of a corporation by another corporation—
(1) in a distribution to such other corporation to which section 332 (relating to liquidations of subsidiaries) applies, except in a case in which the basis of the assets distributed is determined under section 334 (b) (2); or
(2) in a transfer to which section 361 (relating to nonrecognition of gain or loss to corporations) applies, but only if the transfer is in connection with a reorganization described in subparagraph (A), (C), (D) (but only if the requirements or subparagraphs (A) and (B) of section 354 (b) (1) are met), or (F) of section 368 (a) (1),
the acquiring corporation shall succeed to and take into account, as of the close of the day of distribution or transfer, the items described in subsection (c) of the distributor
or mutual insurers merging or consolidating with domestic insurers to employ the federal corporate income taxation laws that provide favorable treatment of gains and losses.

or transferor corporation, subject to the conditions and limitations specified in subsections (b) and (c).

(b) Operating Rules. — Except in the case of an acquisition in connection with a reorganization described in subparagraph (F) of section 368(a)(1)—

(1) The taxable year of the distributor or transferor corporation shall end on the date of distribution or transfer.

(2) For purposes of this section, the date of distribution or transfer shall be the day on which the distribution or transfer is completed; except that, under regulations prescribed by the Secretary or his delegate, the date when substantially all of the property has been distributed or transferred may be used if the distributor or transferor corporation ceases all operations, other than liquidating activities, after such date.

(3) The corporation acquiring property in a distribution or transfer described in subsection (a) shall not be entitled to carry back a net operating loss for a taxable year ending after the date of distribution or transfer to a taxable year of the distributor or transferor corporation.

(c) Items of the Distributor or Transferor-Corporation. — The items referred to in subsection (a) are:

(1) Net Operating Loss Carryovers. — The net operating loss carryovers determined under section 172, subject to the following conditions and limitations: . . .

(2) Earnings and Profits. — In the case of a distribution or transfer described in subsection (a)—

(A) the earnings and profits or deficit in earnings and profits, as the case may be, of the distributor or transferor corporation shall, subject to subparagraph (B), be deemed to have been received or incurred by the acquiring corporation as of the close of the date of the distribution or transfer; and

(B) a deficit in earnings and profits of the distributor, transferor, or acquiring corporation shall be used only to offset earnings and profits accumulated after the date of transfer. For this purpose, the earnings and profits for the taxable year of the acquiring corporation in which the distribution or transfer occurs shall be deemed to have been accumulated after such distribution or transfer in an amount which bears the same ratio to the undistributed earnings and profits of the acquiring corporation for such taxable year (computed without regard to any earnings and profits received from the distributor or transferor corporation, as described in subparagraph (A) of this paragraph) as the number of days in the taxable year after the date of distribution or transfer bears to the total number of days in the taxable year.

(3) Capital Loss Carryover. — The capital loss carryover determined under section 1212, subject to the following conditions and limitations:

(A) The taxable year of the acquiring corporation to which the capital loss carryover of the distributor or transferor corporation is first carried shall be the first taxable year ending after the date of distribution or transfer.

(B) The capital loss carryover shall be a short-term capital loss in the taxable year determined under subparagraph (A) but shall be limited to an amount which bears the same ratio to the net capital gain (determined without regard to a short-term capital loss attributable to capital loss carryover), if any, of the acquiring corporation in such taxable year as the number of days in the taxable year after the date of distribution or transfer bears to the total number of days in the taxable year.

(C) For purposes of determining the amount of such capital loss carryover to taxable years following the taxable year determined under subparagraph (A), the net capital gain in the taxable year determined under subparagraph (A) shall be considered to be an amount equal to the amount determined under subparagraph (B). . . .
Sec. 368 defines corporate reorganization for purposes of providing for tax free exchanges of corporate enterprises. Under these reorganization provisions, the transaction must comply with a requirement that it be “in pursuance of the plan of organization.” Next, the “business purpose” requirement enumerated basically in Treasury Regulations 1.368-1(b) and (c) must be complied with by corporations in their reorganization plans so as not to serve a purpose other than tax avoidance. Finally, Treasury Regulation 1.368-1(b) provides that reorganization requires a “continuity of business enterprise under the modified corporate forms.”

In following the procedure for merger as provided in Senate bill 293, the most applicable section of the Internal Revenue Code of 1954 is sec. 368(a)(1)(A) which defines a statutory merger or consolidation. Generally in a merger, one corporation absorbs the corporate enterprise of a second corporation with the result that the acquiring corporation steps into the shoes of the acquired corporation as to assets and liabilities. However, the transferer corporation or corporations in a statutory merger or consolidation disappears as legal entities and the reorganization results in the technical dissolution of the acquired corporation.

After mergers have been effectuated, another tax consequence may arise in regard to sec. 381 of the Internal Revenue Code of 1954. The tax attributes of a corporation whose assets are acquired by another corporation in a merger or consolidation are usually inherited by the acquiring corporation. One of these tax attributes pertains to carryovers for net operating and capital losses which are governed by sec. 381 which was enacted essentially to protect the taxpayer corporation from the loss of any favorable tax attributes as well as to prevent tax avoidance of unfavorable losses by paper reorganizations. Applying specifically to carryovers of the transferor corporation’s tax attributes, in reference to Senate bill 293, this provision would affect the tax attributes of a foreign stock or mutual insurer. The transferee corporation must refer to other provisions of the tax laws in an effort to preserve any former advantageous tax situation, particularly to sections 382 and 269.

Further since Senate bill 293 particularly pertains to insurance companies, another section of the Internal Revenue Code of 1954 becomes

15. 26 U.S.C. § 382; Special Limitations on Net Operating Loss Carryovers.
relevant to the problem, i.e., subsec. (d) of sec. 381,17 entitled "Operations Loss Carrybacks and Carryovers of Life Insurance Companies." This last mentioned subsection indicates that these carrybacks and carryovers are controlled by sec. 812(f) of Subchapter L of the Internal Revenue Code of 1954.18 Under this section, life insurance companies merging under our new statute, 18 Del. C. § 4943, may take advantage of these loss carryback and carryover provisions.

State Premium Tax

Another problem that may arise as a result of the enactment of Senate bill 293 has to do with whether or not upon merger the newly formed corporate entity will be liable for the state premium taxes that would have been assessed against the former corporations. The majority of states have a statutory provision similar to sec. 702 of Title 18 of the Delaware Code which provides for a tax on the gross direct premium of all authorized insurers in that state. Because of the assessment of such premium taxes, the corporations that had existed as separate legal entities prior to merger may have incurred a tax liability in their former state of domicile or in any state where it was authorized to transact business. There seems to be dictum in the cases of The Great American Insurance Co. v. Commonwealth of Virginia,19 and Rhinehart v. Reliance Insurance Co.,20 which hold that a newly created corporation remains liable for the taxes that would have been assessed against the former corporations if they had continued to transact business as separate entities. Thus, when a corporation considers reorganization under the new sec. 4943, it must take into account the tax liabilities of the former corporations in evaluating the economic feasibilities of such a merger.

Certificates of Authority

A legal issue may arise as to whether the certificate of authority that has been granted to each company separately will be allowed to continue under the newly created entity. To help illustrate this problem, take for example that company A has been granted a certificate of authority to sell insurance in State X and Company B has authority from State Y. Com-

17. 26 U.S.C. § 381(d):
   (d) Operations Loss Carrybacks and Carryovers of Life Insurance Companies.— For application of this part to operations loss carrybacks and carryovers of life insurance companies, see section 812(f).

18. 26 U.S.C. § 812(f):
   (f) Application of Subtitle A and Subtitle F. — Except as provided in section 809(e), subtitle A and subtitle F shall apply in respect of operations loss carrybacks, operations loss carryovers, and the operations loss deduction under this part in the same manner and to the same extent as such subtitles apply in respect of net operating loss carrybacks, net operating loss carryovers, and the net operating loss deduction.


20. 142 So. 2d 254 (Ala. 1962).
pany A and Company B have decided to merge together and form a new Company, C. The question now arises whether upon merger, the new Company C will be allowed to retain the certificate of authority that had been granted Company A and Company B or will it become necessary to gain re-certification in each particular state. Obviously it would be very advantageous for the merging companies if re-certification was not required, since it could in essence allow the new company to double its effective operational range and growth potential without adding to the economic and administrative cost of the merger. On the other hand, if re-certification was required the cost of such a merger would have to be considered with the other economic factors in determining whether such a merger would be advisable. The fee schedule, set forth in 18 Del. C. § 701, indicates that the cost of gaining a new certificate of authority in Delaware would be approximately five hundred dollars and if this is multiplied by the number of states in which the newly merged company desires to transact business, the cost may become substantial.

Conflicting Statutory Language

There also seems to be a problem with the statutory language of this act, in that, it seems to run in conflict with other sections of Chapter 49 of Title 18 of the Delaware Code. This act cited as sec. 4943(a) pertains to the merger of a foreign stock or mutual insurer into or with a domestic insurer under sec. 4930 of Title 18. Since sec. 4930 deals with the merger of stock insurers we must presume that this new act will in essence allow foreign stock or mutual insurers to merge with domestic stock insurers. However this seems to run contrary to the intent and statutory language of sec. 4930, which allows the merger of domestic stock insurers with foreign stock insurers and sec. 4934 which allows a domestic stock insurers. merge with a foreign mutual insurer but explicitly prohibits the merger of stock insurers with stock insurers and mutual insurers with mutual insurers but not to allow the intermingling of the two (i.e., stock with mutual insurers). This new section, 4943 will however allow the merger of a foreign mutual insurer, with a domestic stock insurer, which though not strictly forbidden by statute does seem to run contrary to the intent set forth in other sections of Chapter 49.