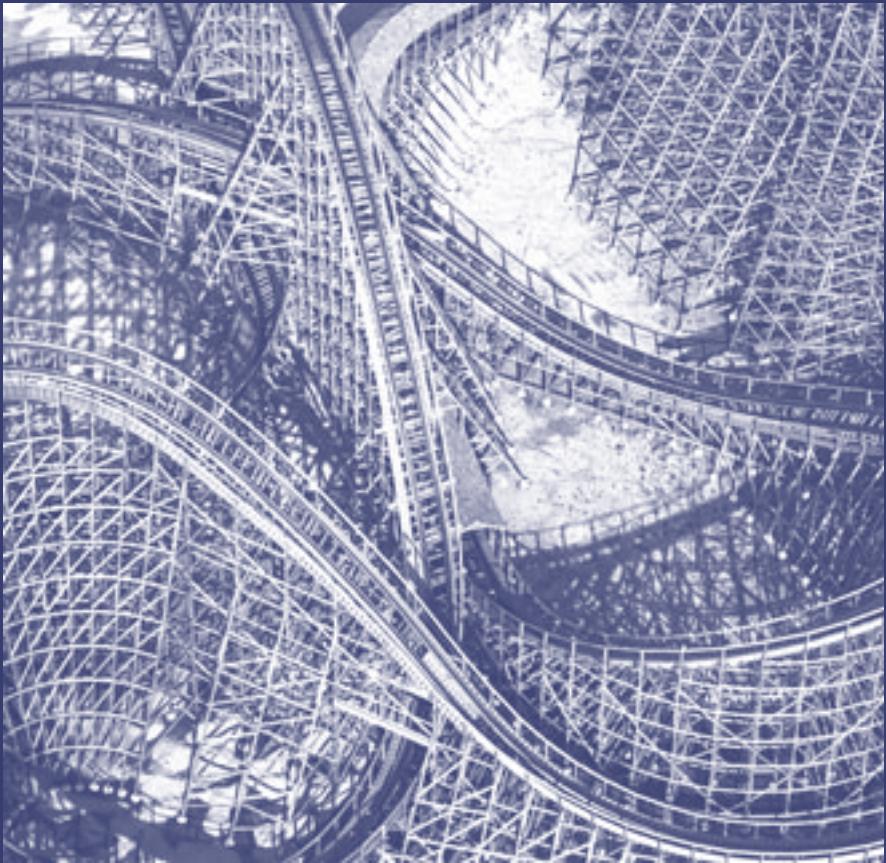


# Continuing Developments in the Taxation of Insurance Companies



1986 - 2004: A History

# Continuing Developments in the Taxation of Insurance Companies



1986 - 2004: A History

Forward



*The taxation of insurance companies and products has always been a unique and, for some, strange proposition. Since the Tax Reform Act of 1986 introduced a whole new scheme of taxation, the industry has had to deal with legislators who, while often marginally knowledgeable about the business of insurance, have passed broad and complicated tax provisions, frequently with vague definitions, under a perception that the industry doesn't pay sufficient tax. Washington is not completely to blame. Industry growth, consolidation, and the development of new organizational structures and sophisticated products has made the taxation of both the companies and their products more complicated. Moreover, a great deal of bad press over the use, and perceived abuse, of insurance products and offshore insurance vehicles for sheltering income, in addition to other non-tax related issues, has done little to elicit sympathy for the industry.*

*This monograph has, for the last ten years, provided an overview of developments affecting the taxation of insurance companies. While cases and rulings increase our knowledge and provide clarity, they often generate as many questions as they answer. In this edition, our tenth, we have immortalized the often rollercoaster-like tax ride the industry has been on since the Tax Reform Act of 1986. The up of a reserve deduction, the down of required discounting. The down of including advanced premiums in the unearned premium haircut, the up of accelerating related expenses. The down of the economic family theory, the up of its subsequent abandonment*

*The up of a tax-free demutualization, the down of no policyholder dividend deduction. The up of a freshstart basis for intangibles for the Blues, the down of an uncertain valuation negotiation. The down of no negative DER, the up of its repeal in 2005. The down of a DAC computation, the up of... well sometimes there is no up.*

*We have attempted to chronicle for you these tax technical ups and downs in this monograph. This guide is not all encompassing. Non-insurance specific developments have not been included. Nonetheless, as is evidenced by the fact the policyholder surplus account issue continues to see development some 20 years later, we trust that you will find it a valuable reference guide for many years to come.*

PricewaterhouseCoopers LLP

Global Insurance Industry Services Group, Americas

Washington National Tax Services

January 2005

This publication is produced by experts in this particular field at PricewaterhouseCoopers. It is not intended to provide specific advice on any matter, nor is it intended to be comprehensive. If specific advice is required, or if you wish to receive further information on any matter referred to in this publication, please speak to your usual contact at PricewaterhouseCoopers or those listed in this publication.

*forward*



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# Legislation



1

chapter

*For various economic, regulatory, legal, and policy reasons, insurance companies are taxed under a special set of overriding rules, namely Subchapter L,<sup>1</sup> in addition to the general rules applicable to all other corporations.*

*The Tax Reform Act of 1984 (1984 Act) replaced the three-phased taxation regime of the Life Insurance Company Tax Act of 1959 (1959 Act) with a single-phase regime patterned after general U.S. corporate taxation. Although the 1984 Act repealed and replaced the 1959 Act, many of the rules carried over to the 1984 Act and, in fact, the regulations, rulings, and case law issued under the 1959 Act often still serve as interpretative and authoritative guidance today.*

*The most significant piece of legislation affecting non-life insurance company taxation through the present day was the enactment of the Tax Reform Act of 1986 (TRA 1986). Before the TRA 1986, insurance companies were divided and taxed as either life insurers, non-life insurers, or mutual insurers. TRA 1986 eliminated the mutual insurer category and, as a result, U.S. tax law now delineates only between life and non-life insurance companies.*

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1. Sections 801-848 of the Internal Revenue Code ("IRC Sections 801-848"). Unless otherwise stated, statutory references are to the Internal Revenue Code of 1986, as amended.

Virtually every significant tax law enacted since 1986 has had some impact on the insurance industry either creating new rules, such as The Omnibus Budget Reconciliation Act of 1990 which created Section 848 and the rules related to deferred acquisition costs (“DAC”), or revising or eliminating old ones such as the recently-passed Pension Funding Equity Act of 2004, which revised the rules under Section 501(c)(15) for small property/casualty insurers and also repealed the differential earnings adjustment under Section 809.

The newest piece of tax legislation affecting the insurance industry is the American Jobs Creation Act of 2004 (the “JOBS Act”). The JOBS Act was signed into law by President Bush during October 2004 and represents the most comprehensive tax legislation since TRA 1986. While there are few insurance-specific Subchapter L provisions, the international and tax shelter provisions will impact large, multinational insurers.

The insurance industry has played a major role in influencing tax legislation over the past twenty years by being proactive in the political process. In the 2004 presidential election, the insurance industry ranked 8th out of approximately 80 industries in total campaign-giving. In addition, it ranked 1st in total lobbying expenditures in 2000 within the Financial sector. Based on the insurance industry’s influence in the past, it is likely that the industry will continue to play a major role in future tax legislation.

2000 Data: Lobbyist Spending: Finance/Insurance/Real Estate	
<b>Industry</b>	<b>Total spending</b>
Insurance	\$86,975,440
Real Estate	\$37,833,009
Securities & Investment	\$37,154,550
Commercial Banks	\$25,815,440
Finance/Credit Companies	\$14,642,000
Accountants	\$12,365,725

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Source: Center for Responsive Politics.

*In 2004, two tax acts were enacted which contained provisions affecting the insurance industry, the American Jobs Creation Act of 2004 and the Pension Funding Equity Act of 2004.*

## **American Jobs Creation Act Of 2004, Pub. L. 108-357<sup>2</sup>**

### **Title VII. Miscellaneous Provisions**

- Section 705. Distributions to Shareholders from Policyholders Surplus Account of Life Insurance Companies

### **Title VIII. Revenue Provisions**

#### **Subtitle A. Provisions to Reduce Tax Avoidance Through Individual and Corporate Expatriation**

- Section 803. Reinsurance of U.S. risks in foreign jurisdictions

#### **Subtitle B. Provisions Relating to Tax Shelters, Part I. Taxpayer-Related Provisions<sup>3</sup>**

- Sec. 816. Failure to furnish information regarding reportable transactions
- Sec. 817. Modification of penalty for failure to maintain lists of investors

## **Pension Funding Equity Act Of 2004, Pub. L. 108-218<sup>4</sup>**

### **Title II. Other Provisions**

- Section 205. Repeal of Reduction of Deductions for Mutual Life Insurance Companies
- Section 206. Clarification of Exemption from Tax for Small Property and Casualty Insurance Companies

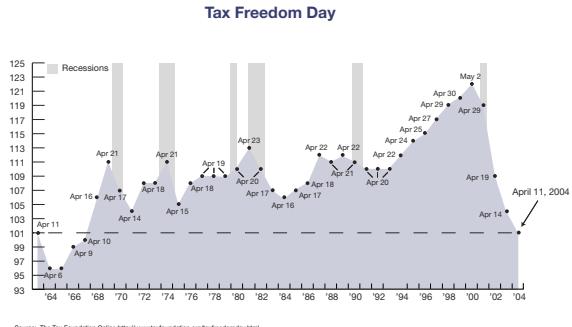
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2. H.R. CONF. REP. 108-755.

3. The American Jobs Creation Act of 2004 made substantial changes in disclosure of reportable transactions, list maintenance requirements, and tax shelter penalties. Most of these changes are beyond the scope of this publication.

4. PENSION FUNDING EQUITY ACT OF 2004, Pub. L. 108-218.

*Beginning with the Tax Reform Act of 1986, and continuing through the Jobs And Growth Tax Relief Reconciliation Act of 2003, the following pages chronicle legislative developments in the taxation of insurance companies. The Sections are referred to as originally included in the various bills. The legislation below is not intended to be a comprehensive list of all provisions which may impact insurance companies, but rather a list of specific insurance provisions which uniquely impact either insurers or their products.*



Source: The Tax Foundation Online, <http://www.taxfoundation.org/taxfreedom.html>.

## Tax Reform Act Of 1986, Pub. L. 99-514<sup>5</sup>

### Title X. Insurance Products and Companies

#### Subtitle A. Policyholder Issues

- Section 1001. Repeal of exclusion for interest on installment payments of life insurance proceeds
- Section 1002. Exclusion from income with respect to structured settlements limited to cases involving physical injury
- Section 1003. Denial of deduction for interest on loans from certain life insurance contracts
- Section 1004. Deduction for non-business casualty losses covered by insurance allowable only if claim filed

#### Subtitle B. Life Insurance Companies

- Section 1011. Repeal of special life insurance company deduction
- Section 1012. Repeal of tax-exempt status for certain organizations providing commercial-type insurance

5. H.R. CONF. REP. 99-841, 1986 U.S.C.C.A.N. 4075.

- Section 1013. Operations loss deduction of insolvent companies may offset distributions from policyholders surplus account

#### Subtitle C. Property and Casualty Insurance Companies

- Section 1021. Inclusion in income of 20 percent of unearned premium reserve
- Section 1022. Treatment of certain dividends and tax-exempt interest
- Section 1023. Discounting of unpaid losses and certain unpaid expenses
- Section 1024. Repeal of protection against loss account; Revision of special treatment for small companies

#### Subtitle D. Miscellaneous Provisions

- Section 1031. Physicians' and surgeons' mutual protection and inter-indemnity arrangements or associations

### **Omnibus Budget Reconciliation Act Of 1987, Pub. L. 100-203<sup>6</sup>**

#### Title II. Business Tax Provisions

##### Subtitle F. Insurance Provisions

1. Interest rate used in computing tax reserves for life insurance companies
2. Treatment of foreign insurance companies
3. Treatment of mutual life insurance company policyholder dividends for purposes of the alternative minimum tax book preference
4. Treatment of certain insurance syndicates

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6. H.R. CONF. REP. 100-495, 1987 U.S.C.C.A.N. 2313-1245.

## **Technical And Miscellaneous Revenue Act Of 1988, Pub. L. 100-647<sup>7</sup>**

### **Title IV. Revenue-Increase Provisions**

#### **Subtitle B. Life Insurance Provisions**

1. Treatment of single premium and other investment-oriented life insurance contracts
2. Limitation on unreasonable mortality and expense charges for purposes of the definition of life insurance
3. Valuation of group term life insurance

### **Title V. Other Substantive Revenue Provisions**

#### **Subtitle D. Insurance Provisions**

1. Church self-insured death benefit plans treated as life insurance
2. Minimum tax treatment of structured settlement arrangements
3. Repeal of general creditor requirement for certain personal injury liability assignments
4. Treatment of certain workers' compensation funds
5. Prepaid tax certificates
6. Phase-in of property and casualty insurance company discounting rules for certain hospital insurers
7. Diversification requirements for variable annuity and life insurance contracts

## **Omnibus Budget Reconciliation Act Of 1989, Pub. L. 101-239<sup>8</sup>**

### **Title VII. Revenue Reconciliation Provisions**

#### **Subtitle N. Technical Corrections**

1. Tax Technical Corrections.

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7. H.R. CONF. REP. 100-1104, 1988 U.S.C.C.A.N. 5048.

8. H.R. CONF. REP. 101-386, 1989 U.S.C.C.A.N. 3018.

3. Insurance provisions. Whether an amount not received as an annuity under a modified endowment contract (or under an annuity contract) is includable in gross income

## **Omnibus Budget Reconciliation Act Of 1990, Pub. L. 101-508<sup>9</sup>**

### Title XI. Revenue Provisions

#### Subtitle C. Other Revenue Increases

- Subpart A. Provisions related to policy acquisition costs
- Section 11301. Capitalization of policy acquisition expenses
- Section 11302. Treatment of certain non-life reserves of life insurance companies
- Section 11303. Treatment of life insurance reserves of insurance companies which are not life insurance companies

#### Subpart B. Treatment of Salvage Recoverable

- Section 11305. Treatment of salvage recoverable
- Section 11307. Waiver of estimated tax penalties

## **Tax Extension Act Of 1991, Pub. L. 102-227<sup>10</sup>**

There were no specific insurance provisions included in this law.

## **Revenue Act Of 1992<sup>11</sup> - Vetoed**

### Title IV. Simplification Provisions, Part V. Insurance Provisions

#### Subtitle F. Other Income Tax Provisions

- Section 4641. Treatment of certain insurance contracts on retired lives
- Section 4642. Treatment of modified guaranteed contracts

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9. H.R. Conf. Rep. No. 964, 101st Cong., 2nd Sess. 1990, 1990 U.S.C.C.A.N. 2374.

10. TAX EXTENSION ACT OF 1991, PL. 102-227, December 11, 1991.

11. H.R. CONF. REP. 102-1034. Vetoed by President Clinton, November 5, 1992.

## **Omnibus Budget Reconciliation Act of 1993, Pub. L. 103-66<sup>12</sup>**

### **Part VI. Treatment of Intangibles**

- Section 13261-Amortization of goodwill and certain other intangibles
  - f. Special Rules
  - 5. Treatment of certain reinsurance transactions

## **Social Security Domestic Employment Reform Act Of 1994, Pub. L. 103-387<sup>13</sup>**

There were no specific insurance provisions included in this law.

## **Balanced Budget Act Of 1995<sup>14</sup> - Vetoed**

### **Title XI. Revenue Provisions**

#### **Subtitle C. Health Related Provisions**

- Chapter 1. Long-term Care Provisions
  - Subchapter A. Long-term Care Services and Contracts
    - Part I. General Provisions
    - Section 11041. Treatment of long-term care insurance
    - Section 11042. Qualified long-term care services treated as medical care
    - Section 11043. Certain exchanges of life insurance contracts for qualified long-term care insurance contracts not taxable

#### **Subtitle J. Tax simplification**

- Chapter 5. Other income tax provisions

#### **Subchapter E. Insurance Provisions**

- Section 11571. Treatment of certain insurance contracts on retired lives

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12. H.R. REP. NO. 353, 103rd Cong., 1ST Sess. 1993.

13. SOCIAL SECURITY DOMESTIC EMPLOYMENT REFORM ACT OF 1994, Pub. L. 103-387, October 22, 1994.

14. H.R. CONF. REP. 104-350. Vetoed by President Clinton December 6, 1995.

- Section 11572. Treatment of modified guaranteed contracts

## **Small Business Job Protection Act Of 1996, Pub. L. 104-188<sup>15</sup>**

### Title I. Small Business and Other Tax Provisions

#### Subtitle A. Expensing, Etc.

- Section 1114. Treatment of certain charitable risk pools

#### Subtitle D. Pension Simplification

- Section 1401. Repeal of 5-year income averaging for lump sum distributions
- Section 1402. Repeal of \$5,000 exclusion of employees' death benefits
- Section 1403. Simplified method for taxing annuity distributions under certain employer plans

#### Subtitle F. Revenue Offsets

- Section 1603. Apply look-through rule for purposes of characterizing certain subpart F insurance income as unrelated business taxable income
- Section 1611. Treatment of certain insurance contracts on retired lives

## **Health Insurance Portability Act Of 1996, Pub. L. 104-191<sup>16</sup>**

### Title V. Revenue Offsets

#### Subtitle A. Corporate-owned Life Insurance

- Section 501. Denial of deduction for interest on loans with respect to corporate-owned life insurance

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15. SMALL BUSINESS JOB PROTECTION ACT OF 1996, P.L. 104-188, August 20, 1996, 110 Stat 1755. This bill is part of the Tax Reform Act of 1996.

16. HEALTH INSURANCE PORTABILITY ACT OF 1996, Pub. L. 104-191, August 21, 1997. This bill is part of the Tax Reform Act of 1996.

## **Taxpayer Relief Act Of 1997, Pub. L. 105-34<sup>17</sup>**

### **Title IX. Miscellaneous Provisions**

#### **Subtitle C. Provisions Relating to Employment Taxes**

- Section 922. Clarification of exemption from self-employment tax for certain termination payments received by former insurance salesmen

### **Title X. Revenues**

#### **Subtitle F. Provisions Relating to Tax-Exempt Entities**

- Section 1042. Termination of certain exceptions from rules relating to exempt organizations which provide commercial-type insurance

#### **Subtitle I. Other Revenue Provisions**

- Section 1082. Modification of taxable years to which net operating losses may be carried
- Section 1084. Expansion of denial of deduction for certain amounts paid in connection with insurance (i.e., corporate-owned life insurance)

### **Title XII. Simplification Provisions Relating to Individuals and Businesses**

#### **Subtitle B. Provisions Relating to Businesses Generally**

- Section 1212. Minimum tax treatment of certain property and casualty insurance companies

## **Tax And Trade Relief Act Of 1998, Pub. L. 105-277<sup>18</sup>**

### **Division J. Revenues and Medicare**

#### **Title I. Extension and Modification of Certain Expiring Provisions**

##### **Subtitle A. Tax Provisions**

- Section 1005. Subpart F exemption for active financing income

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17. H.R. CONF. REP. No. 220, 105th Cong., 1st Sess. 1997.

18. OMNIBUS CONSOLIDATED AND EMERGENCY SUPPLEMENTAL APPROPRIATIONS ACT, P.L. 105-277, October 21, 1998, 112 Stat 2681.

**Ticket To Work And Work Incentives Improvement Act Of 1999, Pub. L. 106-70<sup>19</sup>**

Title V. Tax Relief Extension Act of 1999

Subtitle C. Revenue Offsets, Part I-General Provisions

- Section 537. Denial of charitable contribution deduction for transfers associated with split-dollar insurance arrangements

**FSC Repeal And Extraterritorial Income Exclusion Act Of 2000, Pub. L. 106-519<sup>20</sup>**

There were no specific insurance provisions included in this law.

**Economic Growth And Tax Relief Reconciliation Act Of 2001, Pub. L. 107-16<sup>21</sup>**

There were no specific insurance tax provisions included in this law.

**Job Creation And Worker Assistance Act Of 2002, Pub. L. 107-147<sup>22</sup>**

Part I. Life Insurance Companies

- Distributions to shareholders from pre-1984 policyholders surplus account

Part II. Provisions of General Application

- Special Estimated Tax Payments
- Capitalization of certain policy acquisition expenses

**Jobs And Growth Tax Relief Reconciliation Act Of 2003, Pub. L. 108-27<sup>23</sup>**

There were no specific insurance provisions included in this law.

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19. H.R. CONF. REP. 106-478.

20. S. REP. 106-416.

21. H.R. CONF. REP. 107-84.

22. H.R. REP. 107-251, 2002 U.S.C.C.A.N. 20.

23. H.R. CONF. REP. 108-126, 2003 U.S.C.C.A.N. 730.

# Accounting



# 2

chapter

# Accounting

*The most significant accounting-related development of the past twenty years is the National Association of Insurance Commissioner's ("NAIC's") codification project and, more specifically, its promulgation of Statement of Statutory Accounting Principles Number 10 ("SSAP 10").*

*The purpose of the codification of statutory accounting principles ("SAP") was to produce a comprehensive guide to SAP for use by insurance departments, insurers, and auditors. SAPs, as they existed prior to codification, did not always provide a consistent and comprehensive basis of accounting and reporting. The prescribed or permitted statutory accounting model resulted in practices that could have varied from state to state. Insurance companies were sometimes uncertain about what rules to follow and regulators were sometimes unfamiliar with the accounting rules followed by insurers in other states. As a result, insurers' financial statements were frequently not prepared on a comparable basis.*

*The codification project resulted in more complete disclosures and more comparable financial statements, which has made insurance departments' analysis techniques more meaningful and effective. The project has provided state examiners and analysts with uniform accounting rules against which companies' financial statements can be evaluated. For example, risk-based capital ("RBC"), an important tool used by the states to measure solvency of insurers, is now reported more consistently with the benefit of codification.*

From a tax standpoint, statutory accounting rules<sup>24</sup> now require insurance companies to capture the tax effects of the cumulative basis differences inherent in their balance sheet accounts. That is, insurance companies must now account for the deferred taxes associated with the book-tax basis differences on their assets and liabilities. This requirement necessitates an analysis of an insurance company's tax basis in its assets and liabilities, utilizing the U.S. tax rules outlined throughout this compendium. This is the bridge where insurance taxation meets insurance accounting. For further details, we recommend you consult with the PricewaterhouseCoopers' publication *Deferred Taxes for Insurance Companies: A Comparison of FAS 109 and SSAP 10*.<sup>25</sup>

## Codification and SSAP 10

Statement of Statutory Accounting Principles Number 10 is entitled "Income Taxes" and is the product of the original Issue Paper No. 83 entitled "Accounting for Income Taxes." For SSAP purposes insurers must now recognize the future tax consequences of items that have been included in their financial statements or tax returns. The statement substantially relies upon Statement of Financial Accounting Standards No. 109 (FAS 109), "Accounting for Income Taxes," the deferred tax standard for Generally Accepted Accounting Principles (GAAP).

## FAS 109

FAS 109 focuses on differences between the GAAP and tax balances of assets and liabilities (a "balance sheet" approach) and represents a strict departure from its predecessor, Accounting Principles Bulletin (APB) 11. Under APB 11 companies would book a deferred tax asset or liability based upon amounts that have or will have an impact upon the income statement only. Companies would effectively book a total provision based upon pre-tax book income after permanent tax adjustment items (such as tax-exempt interest, disallowed meals and entertainment, etc.). Deferred taxes would be booked to the extent the total provision differed from the current (tax-return based) provision.

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24. Please consult Statement of Statutory Accounting Principle Number 10, which is a codification of the accounting for deferred taxes for insurance companies.

25. You may also wish to consult with your local PwC insurance tax partner.

FAS 109 changed the focus of deferred tax accounting to a balance sheet approach. Under this standard deferred taxes are recognized to the extent there are differences between the book and tax bases of assets and liabilities. Deferred taxes are also recognized for carry-forward items (i.e., net operating losses, capital loss carry-overs, charitable contribution carry-overs, etc.) and credits (i.e., alternative minimum tax credits, foreign tax credits, etc.). As a result, deferred tax assets and liabilities would include not only items that impact a company's income statement, but also items that have tax consequences, but are retained earnings or surplus adjustments for financial reporting purposes (i.e., certain unrealized gains and losses on securities).

SSAP 10 requires companies to calculate their "temporary differences" and "carry-forward items" in accordance with FAS 109. Deductible temporary differences (i.e., items that will generate a tax benefit when they reverse) are tax affected in arriving at the deferred tax asset. Items such as tax credits are, by definition, tax affected and are added to the deferred tax asset. Taxable temporary differences (i.e., items that will generate a tax charge when they reverse) are tax affected in arriving at the deferred tax liability. At this point, however, SSAP 10 and FAS 109 diverge.

### Valuation Allowance v. Admissibility Standard

FAS 109 relies upon a qualitative analysis of the company's temporary differences, past financial history, and future earnings projections to determine how much of a deferred tax asset can be recognized. Companies with positive earning trends that have been heavy regular taxpayers will likely be able to book an entire deferred tax asset without reduction by a "valuation allowance." Companies with trends of poor GAAP earnings or a history of expiring unused net operating losses will likely have to reduce a deferred tax asset by a valuation allowance. A deferred tax liability can never be reduced by a valuation allowance.

For SAP purposes, the valuation allowance is replaced with a more mechanical admitted asset test which effectively serves the same purpose. Deferred tax liabilities, as in the FAS 109 calculation, must be recognized in full. Deferred tax assets are admitted in an amount which, in many cases, will equal the portion of the deferred tax asset that will be realized within one year of the SAP financial statement date plus the remainder of the asset to the extent of deferred tax liabilities.

## Income Statement/Surplus Impact

Another point of divergence between the two regimes is that SSAP 10 requires that all changes in deferred balances be included as surplus adjustments. Whereas FAS 109 mandates income statement treatment (with the exception of tax consequences related to certain unrealized gains and losses on securities and other surplus related adjustments).

There are several key observations that can be made, in general, regarding the two deferred tax regimes. First, the absence of a temporary difference for deferred acquisition costs (DAC) for SSAP 10 purposes for property and casualty insurers will typically increase the statutory net deferred tax asset as compared to its GAAP counterpart. For a life insurer, the taxable temporary difference for GAAP is much smaller than for property and casualty companies as life companies do have tax DAC under Section 848 (which is typically smaller than GAAP DAC). For SSAP 10 purposes, a life company will have a deductible temporary difference to the extent of tax DAC.

Companies that typically have not been required to offset their FAS 109 deferred tax asset by a valuation allowance because of historically strong earnings and positive earnings outlooks will not fare as well under SSAP 10. SSAP 10 will usually result in some reduction in the tentative deferred tax asset.

One of the means available under FAS 109 to avoid or reduce the valuation allowance is to develop a tax planning strategy that, if

employed, would ensure the realization of a tax benefit with respect to a deferred tax asset item. Such a tax strategy need only be prudent and feasible; it is not required that the company employ such a strategy. Under SSAP 10, however, this option is not available as companies must instead examine which deductible temporary differences, carry-forwards, and credits are projected to reverse in the subsequent year. This seemingly is a higher standard.

### Tax Accrual Workpapers

During 2002 the IRS developed a plan to routinely requested tax accrual workpapers during audits. The plan, formally announced in Announcement 2002-63, strengthens the bridge between taxation and accounting by giving the IRS greater authority to request workpapers relating to the tax reserve for deferred tax liabilities and to footnotes disclosing contingent tax liabilities appearing on audited financial statements.

### Securities and Exchange Commission, Public Company Accounting Oversight Board, and Financial Accounting Standards Board Developments

The Securities and Exchange Commission (SEC) and Public Company Accounting Oversight Board (PCAOB) have issued statements related to accounting for income taxes.<sup>26</sup> These statements express the view that it is generally inappropriate to recognize the benefit of a tax deduction in the financial statements unless the registrant concludes that it is probable, as defined in FAS 5, that the deduction will be sustained under an IRS audit.

The SEC has also emphasized the disclosure of recorded and unrecorded tax contingencies, particularly FAS 5 regarding disclosures of loss contingencies. The SEC stated that confidentiality concerns are not valid reasons for non-compliance with GAAP or the SEC's disclosure rules. In considering the appropriate level of disclosures in this area, registrants

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26. See Securities and Exchange Commission, Current Accounting and Disclosure Issues in the Division of Corporation Finance, December 28, 2004 and The 2004 AICPA National Conference on Current SEC and PCAOB Developments, J Poulin, December 6, 2004.

should consider FAS 5 and SOP 94-6, as well as the materiality of recorded and unrecorded (i.e., reasonably possible) tax contingencies in accordance with SAB 99.

The FASB is also currently working on an interpretation related to income tax contingencies that should clarify the SEC and PCAOB accounting model. Until the FASB interpretation is issued, the SEC expects registrants to use a consistent method, have a reasoned basis for their accounting, and provide adequate disclosures.

The FASB announced its intent to issue an Exposure Draft of an Interpretation of FASB Statement No. 109, *Accounting for Income Taxes*, which would address initial recognition and measurement, subsequent accounting, classification and disclosure, and interim reporting considerations related to uncertain tax positions.<sup>27</sup>

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27. See [http://www.fasb.org/project/uncertain\\_tax\\_positions.shtml](http://www.fasb.org/project/uncertain_tax_positions.shtml).



# Blue Cross Blue Shield

chapter

# 3



## Blue Cross Blue Shield

*Prior to the Tax Reform Act of 1986<sup>28</sup> (TRA 1986), Blue Cross Blue Shield ("BCBS") Plans were exempt from Federal income taxation. For years after 1986, BCBS Plans became taxable as stock property and casualty (P&C) insurance companies pursuant to Sections 501(m) and 833. However, unlike P&C insurance taxpayers, BCBS Plans are not subject to the 20% haircut on their unearned premium reserve deduction. Furthermore, BCBS Plans are allowed a "special" deduction equal to 25% of their claims and expenses for the year over adjusted surplus at the beginning of the year. The special deduction is a preference item for alternative minimum tax purposes.*

*Shortly after the enactment of TRA 1986, the IRS announced that BCBS Plans would be allowed to file consolidated returns with their subsidiaries beginning for the taxable year 1987.<sup>29</sup> As a result, other peripheral issues had to be addressed, including assessing "material changes," and the determination of proper "ordering rules" of Section 833(b) in the context of the "special deduction" when other deductions (e.g., NOLs, charitable contributions, etc.) are at stake.*

*In 1990, Congress enacted another provision that affected BCBS Plans.<sup>30</sup> The Act amended Section 832(b)(5)(A) to change the treatment of salvage in the computation of losses incurred. Since some companies were already reflecting salvage for tax purposes, they were allowed to deduct 87% of the year-end 1989 salvage recoverable over 4 years to accord these companies equal treatment with those companies using the 87% "fresh start."*

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28. TAX REFORM ACT OF 1986, Pub. L. No. 99-514.

29. See Notice 88-107.

30. OMNIBUS BUDGET RECONCILIATION ACT OF 1990, Pub. L. 101-508.

Some BCBS plans questioned whether the differences between what they would have paid as a primary insurer on all claims and what they actually paid as a secondary insurer (e.g., coordination of benefits (COBs)) constituted estimated salvage recoverable for purposes of the 87% special deduction rule. Both the IRS and the courts ruled on this issue.<sup>31</sup>

Even as Congress and the Treasury were modifying the taxation of BCBS companies, market forces were changing the health insurance industry. In the 1990s Blues plans sought to convert to for-profit entities as a way to raise capital. Those early conversions met little opposition from state officials. However, as Blues have regained members and financial health, state and consumer representatives have become more adverse to conversions, denying those that they believe are not in the best interests of the state and its citizens. The IRS also became involved, eventually challenging deductions claimed by BCBS Plans for payments made to charitable foundations or to the state as a condition of converting from a not-for-profit to a for-profit organization.<sup>32</sup>

These themes have driven the bulk of the BCBS tax cases over the past twenty years, but the one which will probably become more prevalent and taxpayer-focused in the future relates to the taxpayer's ability to support its valuations of intangible assets. Such valuations serve to support the deductibility of intangibles under Section 165 pursuant to the "Fresh Start" transition rule in the TRA 1986. The valuations of abandoned intangibles must be accurate and reliable, sufficient enough to persuade the court as directed in the recent Trigon<sup>33</sup> and Capital Blue Cross<sup>34</sup> cases.

## Step-up in Basis

*The Tax Reform Act of 1986 instituted significant changes in the taxation of Blue Cross Blue Shield companies. In the years following the legislation, many of the court cases and Service rulings involved the basis step-up under TRA 1986.*

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31. See *Blue Cross and Blue Shield of Texas, Inc. and Subsidiaries v. Commissioner of Internal Revenue*, 328 F.3d 770 (2003).

32. See Notice 2000-34.

33. *Trigon Insurance Company (Formerly Blue Cross and Blue Shield of Virginia) v. United States of America*, 215 F.Supp.2d 687 (2002).

34. *Capital Blue Cross v. Commissioner*, 122 T.C. No. 11 (2004).

*Trigon Insurance Company (Formerly Blue Cross and Blue Shield of Virginia) v. United States of America, 215 F.Supp.2d 687 (2002).* The U.S. District Court for the Eastern District of Virginia ruled that Trigon cannot deduct carry-over losses from cancelled subscription and provider contracts because it did not meet its burden of proof when valuing the contract.

*Capital Blue Cross v. Commissioner, 122 T.C. No. 11 (2004).* The Tax Court favorably ruled that the basis step-up provision of the Tax Reform Act of 1986 is not limited to “sale or exchange” transactions, but also applies to determining the amount of loss relating to the “termination” of assets.

### **Notice 2000-34**

The IRS informed Blue Cross Blue Shield Plans that the IRS will challenge deductions for losses for the termination of individual customer, provider, or employee contracts or relationships associated with customer lists, provider networks, and workforce in place with respect to which the taxpayer claims an adjusted basis derived from Section 1012(c)(3)(A)(ii) of the Tax Reform Act of 1986.

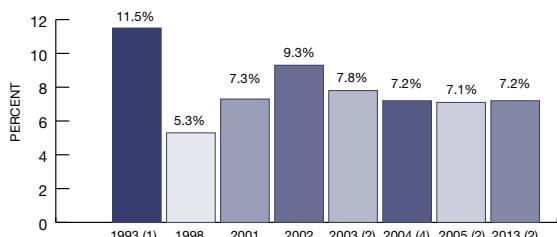
### **TAM 9533003**

The Tax Reform Act of 1986 revoked the tax-exempt status of certain medical insurers. The Act

provides that, to determine gain or loss, the basis of the affected entities' assets is adjusted to equal fair market value as of January 1, 1987.

Thus, the IRS held that a medical insurer to which Section 833 applied was entitled to use fair market value as of January 1, 1987, in determining the amount of its deduction for software abandonment.

National Health Expenditures,  
Average Annual Percent Growth from Prior Year, 1993-2013



(1) Average annual growth from 1970 through 1993; marks the beginning of the shift to managed care.

(2) Projected.

Source: Centers for Medicare and Medicaid Services, Office of the Actuary; U.S. Department of Commerce, Bureau of Economic Analysis and Bureau of the Census and the Insurance Information Institute Online, <http://www.ii.org/media/facts/statsbyissue/health>.

#### ***FSA 200001002***

The IRS disallowed BCBS companies a deduction under Section 165 for abandonment losses relating to subscriber lists, employees, and computer software.

#### ***FSA 200001005***

The IRS disallowed BCBS companies a deduction under Section 165 for abandonment losses relating to subscriber lists, employees, and computer software.

### **Special Deduction**

*The special Blue Cross Blue Shield deduction of Section 833, also a result of the Tax Reform Act of 1986, is another area that has drawn several rulings.*

#### ***TAM 9537001***

Taxpayer is an “existing Blue Cross or Blue Shield organization” as defined in Section 833(c)(2). On January 1, 1987, Taxpayer became a taxable entity and thus became eligible for the special deduction as provided under Section 833(a)(2). To determine the amount of the special deduction for 1992 and 1993, the IRS agreed with Taxpayer’s position that Section 833(b)(3)(B) provides that Taxpayer use as its adjusted surplus the December 31, 1986, balance.

#### ***FSA 200149009***

The IRS concluded that each Blue Cross Blue Shield member of a consolidated group should separately calculate the income limitation on the Section 833 deduction.

### **Material Changes**

*Blue Cross Blue Shield organizations in many states sought to merge operations, reorganize into holding company structures, or convert to mutual company or stock company status. The IRS addressed whether these reorganizations would constitute material changes in the following rulings.*

### **PLR 8929023**

A merger between two Blue Cross Blue Shield organizations would not be a material change.

### **PLR 9125037**

The sale of the subsidiary did not constitute a material change in operations or structure of the organization, but only involved a taxable disposition to an unrelated third party.

### **PLR 9138039**

Conversion to mutual company status would not be treated as a material change in structure and, consequently, the organization would continue to be taxable under Section 833.

### **PLR 9833032**

The formation of a common holding company by two licensed, not-for-profit Blue Cross Blue Shield organizations does not constitute a material change in operation or structure under Section 833(c)(2). The companies, in response to financial difficulties caused by increased competition in the health insurance market, agreed to conduct combined operations through a newly formed holding company, which was organized and licensed as a not-for-profit, nonstock health service plan.

### **PLR 200201004**

The merger of a Blue Cross Blue Shield insurer with another insurance company is not a material change in operation or structure under Section 833(c)(2).

## **Blue Conversions**

*Conversions of Blue Cross Blue Shield companies in some states lead to litigation and to the retroactive revocation of previous Service rulings. Below, the Service addressed conversions of Blue companies and the resulting tax consequences.*

**PLR 9853007**

The Service concluded that a settlement payment made to a charity by a non-profit organization in connection with its reorganization was deductible under Section 162. This ruling was later revoked.

**TAM 200405005**

The IRS retroactively revoked an earlier TAM where it determined that a nonprofit mutual health insurer's payment to a state as part of a conversion to a for-profit stock insurer was deductible under Section 162.

**TAM 200418009**

The IRS determined that a corporation formed to acquire Blue Cross Blue Shield companies in a Section 368(a)(1)(A) reorganization must combine the adjusted surplus of the acquired companies for its first taxable year.

**TAM 200439042**

The IRS concluded that Taxpayer may not deduct payments made to settle certain lawsuits as ordinary and necessary business expenses under Section 162.

**TAM 200453014**

The IRS determined that a former Blue Cross Blue Shield organization continues to qualify under section 833 for taxable years after it lost its Blue Cross Blue Shield Association license, as the loss of its license is not a material change in operation or structure.

## **Coordination of Benefits**

*The Service and courts ruled several times on whether the coordination of benefit savings between companies could qualify as a special deduction for salvage recoverable.*

*Blue Cross & Blue Shield of Texas Inc., v. Commissioner of Internal Revenue, 115 T.C. No. 12 (2000).* The Tax Court ruled that coordination of benefit savings between health insurance companies would not qualify as a special deduction for estimated salvage recoverable under the Omnibus Budget Reconciliation Act of 1990.

*Blue Cross & Blue Shield of Texas, Inc. and Subsidiaries v. Commissioner of Internal Revenue, 328 F.3d 770 (2003).* The 5th Circuit Court of Appeals affirmed the Tax Court ruling that coordination of benefit savings between health insurance companies would not qualify as a special deduction for estimated salvage recoverable under the Omnibus Budget Reconciliation Act of 1990.

#### **TAM 9717009**

The Service concluded that “coordination of benefits” under a “pay and pursue” plan qualified as salvage and subrogation, whereas “coordination of benefits” under a “pursue and pay” plan did not.

#### **FSA 199947008**

The Service disallowed a Blue Cross Blue Shield’s special deduction under Section 11305(c)(3) of the 1990 Act for “pursue and pay” of coordination of benefits.

#### **Reserves**

*The Service and the courts addressed various reserve questions for Blue Cross Blue Shield companies in the following rulings.*

**Top Ten Largest Health Insurers, 2003 (1)  
(\$ millions)**

Rank	Company	Revenues (2)
1	UnitedHealth Group Inc.	\$21,300
2	WellPoint Health Networks Inc.	14,830
3	CIGNA Corp.	14,307
4	Aetna Inc.	13,402
5	Anthem Inc.	12,477
6	Humana Inc.	9,073
7	Health Net Inc.	8,282
8	PacificCare Health Systems Inc.	8,212
9	Oxford Health Plans Inc.	4,078
10	WellChoice Inc.	4,006

(1) Based on companies rated by Standard and Poor's.  
(2) As of third quarter 2003.

Source: Standard and Poor's and The Insurance Information Institute Online, <http://www.iii.org/media/facts/statsbyissue/health/>

***Blue Cross & Blue Shield United of Wisconsin v. U.S., 56 Fed.Cl. 697 (2003).*** The Federal Court of Claims ruled that Blue Cross & Blue Shield of Wisconsin must use the actuarial estimate of unpaid loss reserves as of December 31, 1986, as reported on its annual statement to calculate the Section 832(c)(4) deduction for tax year 1987.

***Blue Cross & Blue Shield United of Wisconsin & Subsidiaries v. U.S., 94 A.F.T.R.2d (unpublished) (Fed. Cir., 2004).*** The Circuit Court of Appeals reversed the Court of Federal Claims' grant of summary judgment for the United States and remanded Blue Cross and Blue Shield Wisconsin to the Claims' Court.

#### ***TAM 9330002***

The IRS accepted a BCBS Plan's ability to adjust its ending 1986 incurred-but-not-reported reserve using actual paid claims data for 1987.

#### ***TAM 9710002***

The IRS ruled that a Blue Cross Blue Shield organization is not required to include additions to the contingency reserve held by the Office of Personnel Management in gross premiums written until the reserve is released to its control.

## **Net Operating Losses**

*The IRS addressed the use of net operating losses in consolidated returns and in the context of the special deduction limits under Section 833.*

#### ***TAM 9638003***

The IRS ruled that a Blue Cross Blue Shield organization was required to take into account its portion of consolidated NOLs when calculating taxable income used to determine the special deduction limit under Section 833(b)(2).

## ***FSA 199933008***

The Service concluded that the taxable income of a Blue Cross Blue Shield organization should be reduced by a Section 833 special deduction before computing an NOL carry-over.

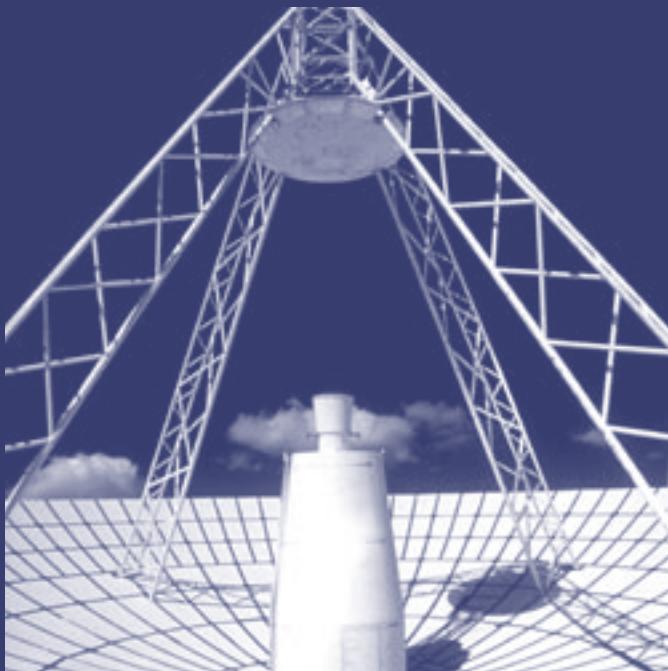
## **IRS Compliance Issues**

In *Revenue Procedure 87-51*, the IRS provided guidance for existing Blue Cross Blue Shield organizations and certain other organizations that provide “commercial-type insurance” for obtaining consent to change their method of accounting.

In *Revenue Procedure 2004-41*, the Service gave health insurance companies and health maintenance organizations more than two and a half months from the end of their tax year to make incentive payments and still take the related deduction.

In *Notice 88-107*, the IRS announced that Blue Cross Blue Shield Organizations will be allowed to file consolidated returns, and in *PLR 8913029*, the Service found that a non-stock Blue Cross Blue Shield corporation was eligible to join a non-stock insurance company in filing a consolidated return.

# Captives



# 4

chapter

# Captives

*Based on premium volume and admitted assets, the foreign and domestic captive industry has grown substantially in the last two decades. Over the five-year period ending 2003, net premiums written grew by 45% and admitted assets by nearly 29%. This growth, which led to a concurrent increase in loss reserves of nearly 35%, has been accompanied by a considerably smaller increase in surplus levels of 2%. As a result, while the underwriting risk covered by captives has grown, it has come at the cost of increasing leverage.<sup>35</sup>*

*As the captive industry has grown, so has the industry's administrative oversight. The IRS has historically viewed captive insurance arrangements as no more than a form of self-insurance. For many years, the IRS took the position that you could not have "insurance" in a captive insurance arrangement because you could not achieve a shifting of risk outside of the "economic family." If the risk was merely transferred within an economic family, then the IRS argued that no economic shifting of risk had occurred and no "insurance" existed and premiums were not deductible.<sup>36</sup> The courts however often took a different view. The courts developed two theories in finding risk shifting in a related party insurance context. First, in several Tax Court rulings including AMERCO, Sears, and the Harper Group, if sufficient unrelated risks were insured by the captive, then the courts generally found risk shifting from related insureds (both the parent company and brother/sister affiliates). Secondly, in Humana, Hospital Corporation of America, and Kidde Industries, the Courts have found risk shifting based upon the "balance sheet" theory between a captive and brother/sister affiliates. In the context of parent/subsidiary arrangements, where no insurance was issued to unrelated third parties, courts generally concluded no insurance exists, although they did not adopt the IRS's economic family theory.*

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35. See A.M. Best Special Report: Can Solid Results Be Sustained in Domestic Captives? August 9, 2004.

36. See Rev. Ruls. 77-316 and 88-72.

Because no court fully accepted its economic family theory, the IRS announced in Revenue Ruling 2001-31 that it would no longer invoke the theory with respect to captive insurance arrangements. However, the IRS has indicated that it would pursue captives which were thinly capitalized or parental guarantees existed and it would pursue parent/subsidiary structures. For the balance of captives, the Service will apply a “facts and circumstances” test to such arrangements.

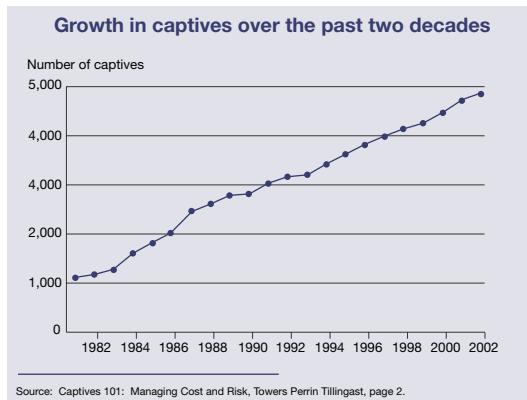
Since abandoning the economic family theory, the IRS has turned to “abusive tax avoidance transactions” as its primary tool for challenging what it perceives to be tax-abusive transactions, including captive arrangements. In 2002, the IRS issued Notice 2002-70 which identified as “listed transactions” certain producer-owned reinsurance arrangements used by taxpayers to shift income to related insurance companies that are subject to little or no U.S. income tax. After two years of compiling tax shelter lists and examining PORC transactions, the IRS admitted that examinations had revealed fewer future abusive transactions than anticipated. Further, the Pension Funding Equity Act of 2004<sup>37</sup> amended Section 501(c)(15) to curtail potential future abuses of captive transactions by providing that P&C insurers are eligible to be exempt from Federal income tax if their gross receipts for the taxable year do not exceed \$600,000, and more than 50 percent of their gross receipts for the taxable year consist of premiums.

As a result of these developments, the IRS removed PORCs from the list of transactions identified as “listed transactions” for purposes of the tax shelter disclosure, list-maintenance, and registration requirements.<sup>38</sup> Notwithstanding the de-listing of PORC transactions, the IRS noted in Notice 2004-64 that it will continue to challenge the exemption of any entity that claims to be described in Section 501(c)(15), but that does not meet the requirements of that Section, regardless of whether the exemption is claimed pursuant to an existing determination letter or on a return filed with the IRS.

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37. PENSION FUNDING EQUITY ACT OF 2004, Pub. L. 108-218.

38. See Notice 2004-65.



## Deductibility of Insurance Premiums

*The Courts and the Service have ruled numerous times regarding the deductibility of insurance premiums paid to a captive insurance company.*

*Anesthesia Service Medical Group Employee Protective Trust v. Commissioner, 85 T.C. 1031 (1985).* The Tax Court ruled that a trust's medical malpractice self-insurance premiums were not deductible.

*General Dynamics Corp. v. United States, 773 F. 2d 1224 (1985).* The U.S. Court of Appeals ruled that a self-insured employer could deduct an estimate of its liability to pay for covered medical services already obtained by its employees.

*General Dynamics Corp. v. United States, 107 S.Ct. 1732 (1987).* The Supreme Court reversed the Court of Appeals and ruled that General Dynamics could not deduct an estimate of its liability to pay for covered medical services already obtained by its employees.

*Stearns-Roger Corp. v. United States, 774 F. 2d 414 (1985).* The U.S. Court of Appeals denied a parent's deduction for insurance premiums paid to its wholly-owned subsidiary.

*Beech Aircraft Corp. v. United States*, 797 F. 2d 920 (1986). The U.S. Court of Appeals denied a parent's deduction for insurance premiums paid to its wholly-owned subsidiary.

*Clougherty Packing Company v. Commissioner*, 811 F.2d 1297 (1987). The Circuit Court of Appeals ruled that amounts paid by Clougherty to Fremont Indemnity Company, and then paid to Clougherty's wholly-owned subsidiary, are not insurance premiums and thus may not be deducted as ordinary and necessary business expenses.

*Gulf Oil Corporation v. U.S.*, 89 T.C. No. 70 (1987). The Tax Court denied Gulf's deductions for premiums paid to a captive insurance company.

*Gulf Oil Corp. v. Commissioner*, 914 F.2d 396 (1990). The Third Circuit held that the Tax Court correctly denied a business expense deduction for insurance premiums paid to Gulf's captive insurance subsidiary. Additionally, the Circuit Court held that the insurance premiums paid by Gulf's foreign affiliates and claims paid to Gulf's domestic affiliates were not constructive dividends. The court noted that the 2% unrelated premiums insured by the captive were insufficient to achieve risk shifting for Gulf's affiliated risks.

*Kurt Orban Company, Inc. v. Commissioner T.C. Memo. 1987-518* (1987). The Tax Court found that payments made by the parent to its captive insurance subsidiary are not deductible because no risk-shifting between the parent and the subsidiary occurred.

*Black Hills Corp. v. Commissioner*, 101 T.C. No. 11 (1993). An offshore group captive insurance company issued workers compensation insurance. The parent paid premiums, which were set to assure that the present value of premiums received were sufficient to offset the present value of projected liabilities. The Tax Court noted that a portion of the premiums paid were essential pre-funding of future periods and held that those premiums were not currently deductible.

*Black Hills Corp. v. Commissioner, 73 F. 3d 799 (1996).* The Eighth Circuit upheld the Tax Court's decision denying a current deduction for annual premiums paid by a mine operator to a captive for insurance covering liability to employees for black lung benefits.

*Stevedoring Services of America, Inc. v. Commissioner, T.C. Memo 1997-160 (1997).* The Tax Court denied the taxpayer's attempt to claim a deduction for premiums previously paid to an affiliated insurer in prior years after disaffiliation from the insurer due to a restructuring.

*Stevedoring Services of America v. Commissioner, (unpublished opinion), 166 F.3d 1218 (1999).* The Ninth Circuit affirmed a Tax Court decision that Stevedoring was not entitled to a deduction under Section 162 for amounts paid to a related insurer prior to disaffiliating from that insurer.

*Kidde Industries, Inc. v. U.S., 40 Fed. Cl. 42 (1997).* The Court of Federal Claims held that Kidde was entitled to deduct payments to a fronting company that were ceded to Kidde's wholly-owned subsidiary to cover claims against Kidde's other wholly-owned subsidiaries. Payments made to cover Kidde's losses, however, were not deductible.

Domiciles	Number of Captives
Bermuda	1,426
Cayman Islands	642
Vermont	438
Guernsey	408
Luxembourg	280

Source: Captives 101: Managing Cost and Risk, Towers Perrin Tillingast, page 2.

#### *Revenue Ruling 88-72*

The IRS denied a deduction for premiums between a captive and its parent and subsidiaries. The ruling specified that no level of unrelated risk would create risk-shifting for related premium's paid to the captive.

***Revenue Ruling 89-61***

The IRS withdrew a portion of Revenue Ruling 88-72 and clarified its position on risk distribution.

***Revenue Ruling 2002-89***

The IRS addressed whether amounts paid by a domestic parent corporation to its wholly owned insurance subsidiary were deductible as “insurance premiums” under Section 162.

***Revenue Ruling 2002-90***

The IRS considered whether amounts paid for professional liability coverage by domestic operating subsidiaries to an insurance subsidiary of a common parent were deductible as “insurance premiums” under Section 162.

***Revenue Procedure 2002-75***

The IRS announced it will consider ruling requests related to captive insurance arrangements.

***PLR 8830066***

The IRS determined that premiums paid to a captive were not deductible, and the corporation’s payments to the captive would not be subject to excise tax.

***PLR 8837057***

The IRS denied a deduction for premiums paid by a domestic corporation to its wholly-owned foreign captive.

***PLR 8844001***

The IRS denied a deduction for premiums paid to a captive insurance company.

**PLR 8941032**

The IRS ruled that payments from medical malpractice insurers to their related captive insurance company would be deductible from insurance company gross income as premiums paid for reinsurance.

**PLR 9624028**

The IRS ruled that premiums paid by 36 mutual funds as policyholders to a captive are deductible insurance premiums.

**TAM 8637003**

The IRS denied a deduction for liability insurance premiums billed on a policy that provided for a refund based only on the insured's own loss experience.

**TAM 8638003**

The IRS denied a deduction for liability insurance premiums billed on a policy that provided for a refund based only on the insured's own loss experience.

**TAM 200323026**

The IRS found that amounts paid by a parent and its subsidiaries to a related captive insurance company for pollution liability coverage are not deductible insurance premiums under Section 162.

**Chief Counsel Advice Memorandum 199932007**

The Service concluded that there was sufficient unrelated business to allow an auto dealership a deduction of the insurance premiums it paid to a captive, of which it was the sole owner.

**FSA 200029010**

The IRS agreed with Appeal's recommendation to concede brother-sister captive insurance premiums within a transaction.

**FSA 200047021**

The IRS concluded that a former parent should continue to deduct losses paid with respect to "insurance" policies entered into prior to disaffiliation.

***FSA 200105014***

The taxpayer deducted the premium amounts paid from it and its subsidiaries to its wholly-owned insurance subsidiary. The IRS disallowed these deductions, concluding that the transactions did not constitute “insurance.”

***FSA 200125009***

Taxpayer deducted the premium amounts paid to a sibling subsidiary of a common parent. The IRS did not disagree with the recommendation to concede the case.

***Legal Memorandum ILM 200442031***

The IRS determined that necessary risk distribution is absent in certain indemnity arrangements between LLCs and Captive, leading to the conclusion that they are not insurance contracts for federal tax purposes.

## Insurance Company Qualification

*The Pension Funding Equity Act of 2004 amended Section 831 to define “insurance company” within the non-life insurance company provisions of the Code to have the same meaning as it has in the life insurance company provisions. In the following rulings and court cases, the IRS and the courts addressed the question of whether a captive insurance company was an insurance company for federal tax purposes.*

*AMERCO and Subsidiaries and Republic Western Insurance Co.*

*v. Commissioner, 96 T.C. No. 3 (1991).* Tax Court held that the arrangement between the insurance company and the parent (and affiliates) constituted valid insurance.

*AMERCO Inc. v. Commissioner, 979 F.2d 162 ( 1992).* The Ninth Circuit affirmed the Tax Court, agreeing that a corporation can have a bona fide insurance arrangement with its wholly owned insurance subsidiary as long as the subsidiary does substantial business with unrelated parties.

*The Harper Group and Includible Subsidiaries v. Commissioner, 96 T.C.*

*No. 4 (1991).* Tax Court held that the arrangement between the insurance company and the parent (and affiliates) constituted valid insurance.

*The Harper Group v. Commissioner, 979 F.2d 1341 (1992).* The Ninth Circuit agreed that an arrangement between a parent and its wholly-owned subsidiary was insurance.

*Sears, Roebuck and Co. and Affiliated Corporations v. Commissioner, 96 T.C. No. 5 (1991) modified by, 96 T.C. No. 26 (1991).* Sears was the parent of three wholly owned insurance company subsidiaries, S1, S2, and S3. S1 issued policies to Sears. Sears' premium payments to S1 represented .25 of one percent of the total premiums earned by S1. S1 conducted business with P in the same manner as it did with unrelated insureds.

On consolidated returns, S1 deducted reserves based on premiums received from Sears. S2 and S3 insured lenders against losses on mortgage loans. S2 and S3 did not pay a loss until the insured lender acquired title to the mortgaged property and filed a claim for loss. S2 and S3 estimated unpaid loss reserves based on loans in default, loans in the process of foreclosure, and loans that resulted in the conveyance of property to an insured lender. S2 and S3 reported those amounts as losses incurred under Section 832(b)(5). The Tax Court held that the arrangement between Sears and S1 is insurance but that S2 and S3 did not incur a loss under Section 832(b)(5) until the insured lender acquired title to the mortgaged property.

*Sears v. Commissioner, 972 F.2d 858 (1992).* The Seventh Circuit Court of Appeals held that: (1) sales of insurance by wholly owned subsidiary to parent corporation constituted "insurance" for tax purposes; (2) mortgage insurer was entitled to deduct loss reserves, even though policies did not require insurer to pay until lender had good title to property securing loans; and (3) default by mortgagor was event triggering coverage under mortgage insurance policies entitling insurer to deduct loss reserves from income in year of default.

*Ocean Drilling and Exploration Co. v. United States, 24 Cl.Ct. 714 (1991).* The Federal Court of Claims found that the taxpayer's captive arrangement satisfied the three-prong analysis, and held that premium payments by the taxpayer to the captive constituted insurance and were currently deductible.

*Ocean Drilling & Exploration Co. v. United States, 988 F.2d 1135 (1993).* The Federal Circuit Court, applying the three-prong test determined that the arrangement between the taxpayer and the captive constituted valid insurance, and that payments made by the taxpayer to the captive were deductible as business expenses.

#### ***Revenue Ruling 92-93***

A domestic manufacturing company purchased \$100,000 of group-term life insurance for each of its employees from its wholly-owned insurance subsidiary. The IRS determined that the arrangement between the parent and its wholly-owned subsidiary constituted insurance.

#### ***Revenue Ruling 2002-91***

The IRS ruled on whether a "group captive" formed by a group of unrelated businesses involved in a highly concentrated industry to provide insurance coverage is an insurance company under Section 831.

#### ***PLR 9043039***

An exempt domestic holding company formed a controlled offshore insurance company which is not tax-exempt. The IRS ruled that the premium income received by the captive insurance company is not insurance income under Sections 952(a)(1) and 953, but is treated as a contribution to the capital of the insurance company.

#### ***PLR 199926033***

The Service ruled that contracts between an automobile club and various manufacturers constituted insurance since their primary business involved both risk shifting and risk distribution.

***TAM 200149003***

The IRS ruled that an insurance subsidiary that provides workers' compensation coverage for its sibling companies is an insurance company for tax purposes.

***TAM 200453012 and TAM 200453013***

The IRS addressed whether two foreign companies providing reinsurance for vehicle service agreements qualify as insurance companies and are eligible to elect to be treated as domestic corporations under section 953(d).

***FSA 200043008, FSA 200043011, FSA 200043012***

The IRS conceded the issue of whether the captive arrangements constituted valid insurance.

***FSA 200202002***

The IRS determined that additional development is warranted before conclusions concerning deductions can be reached. The underlying issue of the FSA is whether the contracts between Insurance Subsidiary and other members of Grandparent's group of affiliated companies are insurance contracts for the purpose of federal income tax.

***FSA 200209017***

The IRS recommended further factual development to determine whether a retroactive insurance agreement is insurance for tax purposes.

## **Economic Family Theory**

*The Service and the Courts ruled on the economic family theory, finally abandoning it in Revenue Ruling 2001-31.*

***Humana Inc. v. Commissioner, 881 F.2d 247 (1989).*** The Sixth Circuit Court of Appeals affirmed the Tax Court ruling that a captive arrangement between Parent and Captive did not constitute insurance, but that arrangements between Captive and its sister subsidiary did constitute insurance.

***Malone & Hyde Inc., et al v. Commissioner, T.C. Memo. 1993-585 (1993).***

Tax Court reaffirmed its earlier decision denying any deduction for premiums that were attributable to the taxpayer's own risk. However, it reversed its earlier ruling regarding the subsidiaries and allowed a deduction for amounts paid for insurance coverage for the taxpayer's subsidiaries.

***Malone & Hyde Inc. v. Commissioner, 62 F.3d 835 (1995).*** Malone & Hyde created a Bermuda captive to reinsure selected risks underwritten by it and its subsidiaries' primary insurer. M&H deducted the premiums it paid on behalf of its subsidiaries to the primary insurer. The IRS denied the deductions, and M&H filed suit in light of the Humana case. The Tax Court allowed the deductions, and the Court of Appeals reversed and remanded, holding that the Tax Court failed to find a valid insurance arrangement first before examining the brother/sister relationship found in Humana.

***Hospital Corp. of America, et al. v. Commissioner, T.C. Memo. 1997-482 (1997).*** The Tax Court, respecting Moline Properties, Inc. v. Commissioner with regard to the treatment of sister subsidiaries as separate corporations, yet mindful of Malone & Hyde, Inc. v. Commissioner's "legitimate business purpose" standard, followed Humana, and held that transactions between Hospital Corp. of America, its sister subsidiaries and its captive insurance subsidiary were insurance transactions, and that the sister subsidiaries shifted risk to the captive.

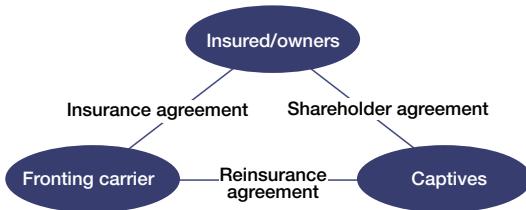
***Revenue Ruling 2001-31***

The IRS concluded that it would no longer challenge captive transactions using the "economic family" theory. However, it stressed that such transactions would continue to be examined based on specific facts and circumstances.

***FSA 200125005***

The IRS recommended that the brother-sister structure be conceded. While this FSA noted that no court had fully accepted the "economic family," it was decided prior to Revenue Ruling 2001-31 in which the IRS noted officially that it would no longer use the "economic family" theory in attacking captives.

### Group captive operational schematic



Source: Captives 101: Managing Cost and Risk, Towers Perrin Tillingast, page 15.

## Producer-Owned Reinsurance Companies

*In the following notices, the IRS addressed producer-owned reinsurance companies.*

### **Notice 2002-70<sup>99</sup>**

The IRS identified as listed transactions certain reinsurance arrangements used by taxpayers to shift income to related companies purported to be insurance companies that are subject to little or no U.S. federal income tax.

### **Notice 2004-65**

The IRS Modified Notice 2002-70 and Notice 2003-76 by removing the identification of transactions that are the same as, or substantially similar to, “listed transactions” in Notice 2002-70.

## Tax Shelters

*The IRS examined “tax-avoidance” transactions related to captive insurance companies.*

### **TAM 9339001**

A reinsurance transaction had a significant tax avoidance effect and

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39. This Notice is part of a detailed set of rules that were strengthened in the JOBS Act of 2004, the details of which are beyond the scope of this monograph.

the IRS attributed the unearned premium reserves to the captive, which caused it to be taxed as a property and casualty company.

#### ***FSA 200027008***

A transaction involving a wholly-owned insurance subsidiary and an unrelated insurance company was not considered a "sham transaction."

### **Tax Exempt Entities**

*The IRS examined captive insurance companies with tax exempt issues.*

#### ***PLR 9108016, PLR 9119060***

The creation and ownership of an insurance subsidiary would not jeopardize a tax-exempt association's tax-exempt status and any dividend distribution to the association would not result in UBIT.

#### ***PLR 9310045***

A tax exempt captive insurance company provided coverage only to organizations that were affiliated with a religious organization. The IRS determined that the captive was not required to file a Form 990 information return.

#### ***PLR 9407007***

A Section 501(c)(5) exempt labor organization established a wholly owned insurance company to provide coverage exclusively for the organization and its members. The IRS ruled that the labor organization's ownership of a captive foreign insurance company does not affect its exempt status.

### **Self-Insurance Pools Formed by Governmental Entities**

*In the following rulings, the IRS found that a self-insurance pool formed by a governmental entity was engaged in the exercise of an essential governmental function and its income would be excludable from gross income.*

Continuing Developments in the Taxation of Insurance Companies: A History

<i>PLR 8803020</i>	<i>PLR 8839083</i>	<i>PLR 8939047</i>
<i>PLR 8803033</i>	<i>PLR 8842070</i>	<i>PLR 8940032</i>
<i>PLR 8803037</i>	<i>PLR 8845065</i>	<i>PLR 8941079</i>
<i>PLR 8804058</i>	<i>PLR 8850037</i>	<i>PLR 8942037</i>
<i>PLR 8814018</i>	<i>PLR 8850038</i>	<i>PLR 8943051</i>
<i>PLR 8815009</i>	<i>PLR 8850063</i>	<i>PLR 8944008</i>
<i>PLR 8815010</i>	<i>PLR 8851032</i>	<i>PLR 8944032</i>
<i>PLR 8815027</i>	<i>PLR 8908055</i>	<i>PLR 8948057</i>
<i>PLR 8816022</i>	<i>PLR 8920023</i>	<i>PLR 8950033</i>
<i>PLR 8816040</i>	<i>PLR 8920037</i>	<i>PLR 8951012</i>
<i>PLR 8819046</i>	<i>PLR 8921055</i>	<i>PLR 8952036</i>
<i>PLR 8823034</i>	<i>PLR 8925028</i>	<i>PLR 9043017</i>
<i>PLR 8823035</i>	<i>PLR 8930036</i>	<i>PLR 9043035</i>
<i>PLR 8824015</i>	<i>PLR 8931061</i>	<i>PLR 9140046</i>
<i>PLR 8824034</i>	<i>PLR 8931068</i>	<i>PLR 9204040</i>
<i>PLR 8825100</i>	<i>PLR 8931069</i>	<i>PLR 9207016</i>
<i>PLR 8826026</i>	<i>PLR 8933011</i>	<i>PLR 9218014</i>
<i>PLR 8826048</i>	<i>PLR 8934026</i>	<i>PLR 9243044</i>
<i>PLR 8831047</i>	<i>PLR 8936028</i>	<i>PLR 9247014</i>
<i>PLR 8832020</i>	<i>PLR 8938018</i>	<i>PLR 9324028</i>
<i>PLR 8834031</i>	<i>PLR 8938044</i>	<i>PLR 9903035</i>

***PLR 9101005***

The Section 115 exclusion from income granted to nonprofit corporations that are organized under state law to establish and administer a group liability insurance pool for its members, extends to the ACE adjustment for AMT purposes.

***TAM 199906036***

A state-created fund to provide windstorm and hail damage was not an integral part of the state and was not entitled to tax-exemption under Section 115.

*In these rulings, the Service determined that income could not be excluded under Section 115.*

***PLR 9109031***

A medical malpractice insurer's income could not be excluded under Section 115.

### ***TAM 9347001***

The IRS determined that an association's income was not excludable under Section 115 because the association's sole purpose was to provide commercial-type insurance for private entrepreneurs. The IRS also found that the association was not entitled to an unearned premium reserve for a retrospective rate credit under Section 832.

# Consolidated Returns



# 5

chapter

## Consolidated Returns

*Corporate reorganizations, mergers, and acquisitions have increased the filing of Federal consolidated corporate income tax returns. The consolidated return regulations represent the authoritative guidance in this area. When applied to insurance companies these already detailed and extensive regulations often result in a complex set of dependent, interrelated calculations stemming from the tension between the unique set of tax rules applicable to insurance companies under Subchapter L, and the general corporate rules under Subchapter C. In the consolidated return context, some of the most significant tax issues confronted in the past twenty years have included traditional corporate issues (e.g., triggering of deferred inter-company gains/losses, utilizing pre-merger losses, etc.), as well as insurance-specific issues.*

*The mandatory five-year waiting period before a life insurance company can consolidate with non-life insurance companies and the statutory limitation on the ability to utilize non-life losses against life insurance company taxable income (LICTI) represent a few of the complexities insurance companies face in filing consolidated returns. The courts and the Service have addressed both of these issues multiple times.*

In *Connecticut General Life Insurance Company v. Commissioner*<sup>40</sup>, the Tax Court decided whether the acquiring group, which consisted of a life member and had a valid election to file a life/non-life consolidated return, could net the income and losses of the acquired non-life subgroups to calculate an aggregated loss or income amount to be subject to the life/non-life limitations. The Tax Court ruled in favor of the IRS, employing the rationale that the only method prescribed by the regulations was a separate entity approach rather than a subgroup approach to the acquired non-life members. This decision upholds the judicial trend of upholding the literal interpretation of a consolidated return provision over policy-based arguments.

In *George Nichols III v U.S.*<sup>41</sup>, the Kentucky District Court upheld the life/non-life consolidated regulations prohibiting the carry-back of life losses against non-life income. The court concluded that the Section 1504 regulations were valid and a reasonable method for preventing tax avoidance based on its readings of the legislative history and the directive adopted by the Supreme Court in *Chevron USA, Inc. v. Natural Resource Defense Council*<sup>42</sup> that legislative regulations such as those under Section 1504 are to be granted greater deference than interpretive regulations.

More recently, in the context of computing certain deductions in a life/non-life consolidated return, the IRS determined that each life/non-life subgroup should compute its own charitable contribution deduction limitation based on that subgroup's consolidated taxable income because Treas. Reg. Section 1.1502-47(r) provides that the subgroup approach pre-empts any other consolidated return regulation.<sup>43</sup>

In 1995, the IRS issued final regulations regarding consolidated intercompany transactions. The final regulations are designed to more closely reflect the consolidated income of the group by providing the same tax treatment to a consolidated group as if the group's activities were conducted through separate divisions of a single corporation. The final regulations have specific provisions for intercompany insurance.

40. *Connecticut General Life Insurance Company v. Commissioner*, 177 F. 3d. 136 (3rd Cir., 1999), cert. den., 120 S.Ct. 496 (1999).

41. *George Nichols III*, in his capacity as Liquidator of Kentucky Central Life Insurance Company v. United States 260 F. 3d 637 (2001).

42. *Chevron USA, Inc. v. Natural Resource Defense Council* 104 S.Ct. 2778 (1984).

43. See TAM 200323002.

### Use of Life and Non-Life Net Operating Losses

*One of the most important issues for insurance companies filing consolidated returns is the use of life losses against non-life income and visa versa. That issue has been litigated many times and the Service has issued several rulings. Several examples follow.*

*Norwest Corporation and Subsidiaries v. Commissioner, 110 T.C. 454 (1998).* The U.S. District Court for the Eastern District of Kentucky, on a summary judgment motion, upheld the life/non-life consolidated regulations prohibiting the carry back of life losses against non-life income.

*Connecticut General Life Insurance Company v. Commissioner, 177 F. 3d. 136 (1999), cert. den., 120 S.Ct. 496 (1999).* The Third Circuit upheld the Tax Court's determination that a group's ability to use losses of non-life companies to offset life company income is determined on a company by company rather than a subgroup basis.

*George Nichols III, in his capacity as Liquidator of Kentucky Central Life Insurance Company v. United States 260 F. 3d 637 (2001).* The United States Court of Appeals for the Sixth Circuit ruled that the Secretary did not exceed its authority under Sections 1502 and 1503 in creating the anti-carry-back legislation relating to life/non-life consolidated returns.

*United Dominion Industries v. Commissioner, 121 S.Ct. 1934 (2001).* In an 8-1 decision, the Supreme Court reversed and remanded the Fourth Circuit in United Dominion Industries v. Commissioner, holding that an affiliated group's product liability losses (PLL) must be figured on a consolidated "single-entity" basis, and not by segregating PLLs on a company-by-company basis.

#### **PLR 8840035**

The IRS determined that net operating loss carry-forwards for a non-life subgroup may offset the income of a life subgroup without limitation after restructuring.

***PLR 9009002***

The IRS determined that the parent of a consolidated group must treat each member of its acquired groups separately for purposes of applying the limitations on non-life consolidated net operating losses (NOLs).

***PLR 9109012***

NOL carry-overs of subsidiaries were subject to the “35%” and “recent non-life affiliate” limitations prescribed by Section 1503(c).

***PLR 9133006***

Taxpayer computed the non-life losses of acquired groups on an aggregate basis, rather than on a separate-company basis in its life/non-life consolidated return. The Service denied the taxpayer’s request on the grounds that the preamble had not presented a position on which the taxpayer might have relied.

***PLR 9210018***

The IRS ruled that the taxable years of the life company that occurred before a 1985 acquisition would constitute SRLY’s and that, as a result of the deemed dividend election, the parent corporation would have to reduce its basis in the life company stock by the amount of the life company’s earnings and profits — including earnings and profits attributable to the life company’s fresh start adjustment — accumulated in pre-acquisition years.

***PLR 9630038***

In the absence of regulations, the IRS ruled that a loss company demonstrates no tax avoidance purpose, but that the company’s fair market value must be reduced by the value of non-business assets when computing the Section 382 limitation.

The Taxpayer Relief Act of 1997 adopted a 2-year carryback and a 20-year carryforward for net operating losses. The provision did not apply to specified liability losses or to NOLs arising from casualty losses of individuals. The Act further restricted the ability to carry unused business credits under Section 39 back 1 year and forward 20 years. Section 810, which provides a 3-year carryback and a 15-year carryforward for operating loss deductions for life insurers, remained unchanged. The industry expected the oversight to be corrected in a technical corrections bill, but the provision has remained unchanged.

### Permission to file Life/Non-life Consolidated Returns

*Another very important issue to insurance companies filing consolidated returns is the ability to join in filing a life/non-life consolidated return. In the following rulings the Service has allowed certain companies to discontinue filing consolidated returns. In other instances the Service has allowed companies to become includible corporations, refused to terminate certain groups, and waived the five-year affiliation rule.*

#### *General Permission to File a Consolidated Return*

##### ***Notice 88-107***

The IRS announced that Blue Cross Blue Shield Organizations will be allowed to file consolidated returns.

##### ***PLR 8650054***

The IRS ruled that following the distribution of a life company's stock to its sister property casualty company, pursuant to the election under Section 1504(c)(2), the life insurance company will be an includible corporation in an affiliated group and can join in filing a life/non-life consolidated tax return.

***PLR 8744032***

The IRS calculated Parent corporation's consolidated net capital gain and tax. Parent is the common parent of an affiliated group which files consolidated returns and proposes to elect to include in its affiliated group the life insurance company subsidiaries.

***PLR 8913029***

The IRS found that a non-stock Blue Cross Blue Shield corporation was eligible to join a non-stock insurance company in filing a consolidated return.

***PLR 9132066***

The IRS found that Taxpayer was allowed to amend consolidated returns to include an insurance subsidiary.

***PLR 9211050***

The Service ruled that New Target is an eligible member of the life/non-life group.

***PLR 9314011***

The IRS granted an election to make a consolidated return filing election.

***PLR 9441021***

The IRS found that a non-life insurance company's change to life insurance company status does not preclude affiliated group membership.

***PLR 9605015***

The IRS ruled that a subsidiary of a health insurance company is the beneficial owner of stock in three professional corporations engaged in the practice of medicine, and that the corporations are includable in the affiliated group for purposes of filing a consolidated return.

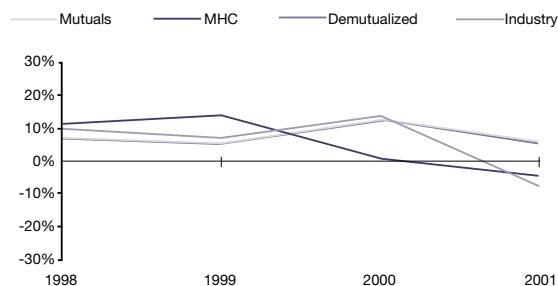
***PLR 9611014***

The IRS ruled that the merger of a parent life insurance company into a new non-life holding company does not result in a new life/non-life affiliated group.

**PLR 9706013**

The IRS ruled that an acquired life company is an “includible corporation” for consolidated return purposes following a reverse acquisition.

### **Total Revenue by Organizational Structure Percentage Change, Year-to-Year**




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Source: Life Insurance Demutualization: An Interim Report Card 2002, Conning Research & Consulting, Inc. Page 33.

**Five-Year Affiliation Rule****PLR 8923003, PLR 9115028, PLR 9140040**

The IRS waived the five-year affiliation rule.

**PLR 9206023**

The Service waived the five-year reconsolidation rule of Section 1504(a)(3)(A) and allowed the parent and the taxpayer to join in the filing of a life/non-life consolidated return.

**PLR 9240027**

The Service ruled that the 5-year reconsolidation rule did not prevent the inclusion of the non-life subsidiaries in a subsequent life/non-life consolidated return.

**PLR 9314037**

The IRS granted a waiver of the five-year reconsolidation rule under Section 1504(a)(3), so that it could consolidate with its subsidiaries again.

***PLR 9419023***

The IRS determined that after the date that is five years after the first-tier sub's purchase of the group of life insurance companies, the parent corporation and its life insurance companies are not allowed to file a life/non-life consolidated return unless the parent files an election under Section 1504(c)(2)(A).

***Termination of Consolidation***

***Revenue Procedure 95-11***

As a result of new regulations, this procedure permits specific consolidated groups to discontinue filing consolidated returns without showing that the net effect of the final regulations on the group's consolidated tax liability is substantially adverse.

***PLR 8833013***

The IRS determined that a life/life group would not be terminated.

***PLR 9327033***

The IRS granted an extension to request discontinuance of filing a consolidated return.

***TAM 9207006***

The IRS found that for purposes of the five year affiliation requirement under Section 1502(c)(4), the life insurance company was a member of the affiliated group.

***Determination of Tax Year***

***PLR 8838017***

The IRS determined when an Insurance subsidiary must join in the consolidated return of the Parent affiliated group and when it must file a separate return.

### ***PLR 8842020***

An insurance subsidiary was allowed to adopt a 52-53 week year along with its non-insurance company parent.

### ***PLR 8948006***

The IRS ruled that insurance subsidiaries may use the calendar year even though the affiliated group filed a fiscal year return.

### ***PLR 9536004***

This ruling allowed a life insurance and property and casualty insurance company subsidiary permission to change from a calendar year-end to the non-insurance parent's fiscal year-end.

## **Adjustments Determined on a Consolidated Basis**

*In the following rulings, the Service determined whether the AMT adjustment, charitable contribution deduction, and foreign tax credit should be determined on a consolidated basis.*

***State Farm Mutual Automobile Insurance Co., et al. v. Commissioner, 119 T.C. No. 21 (2002).*** The Tax Court determined that the AMT book income adjustment for a consolidated life/non-life group must be made using a consolidated approach, with a single adjustment for the entire group.

***State Farm Mutual Automobile Insurance Company v. United States, 94 A.F.T.R.2d 2004-5155 (unpublished) (2004).*** The U.S. Seventh Circuit Court of Appeals affirmed the Tax Court ruling for State Farm Mutual Automobile Insurance Company in its decision that the AMT book income adjustment for a consolidated life/non-life group must be made using a consolidated approach, with a single adjustment for the entire group.

**PLR 8843007**

A life/life affiliated group elected to have intercompany dividends included in the shareholder surplus of the parent company. The IRS found that any determination of intercompany dividends is to be made as if the companies are not filing a consolidated return.

**TAM 9637001**

The IRS withdrew TAM 9227005, dealing with the foreign tax credit limitation in a life/non-life consolidated return context.

**TAM 200323002**

Taxpayer's calculation of the limitation on the charitable contributions deduction was inappropriate and a life/non-life consolidated group must determine its consolidated taxable income on a sub-group basis in accordance with Treas. Reg. Section 1.1502-47(a)(2).

**TAM 200404034**

The excess inclusion rules of Section 860E(a)(1) are applied at the consolidated group level for an affiliated group including life and non-life insurance subgroups.

## **Miscellaneous Consolidated Return Rulings**

*In the following the Service provides guidance on return issues from "Fresh Start" adjustments to the duplicated loss factor.*

*Lone Star Life Insurance Co. v. Commissioner, T.C. Memo. 1997-465 (1997).* The Tax Court held that a Form 872, Consent to Extend Time to Assess Tax, filed by a parent corporation applies to a subsidiary, ruling that Treas. Reg. Section 1.1502-77(a) does not preclude a parent from acting as the subsidiary's agent when the subsidiary can also act for itself.

*Rite Aid Corp. v. United States, 225 F.3d 1357 (2001).* The Court of Appeals for the Federal Circuit reversed a decision by the Court of Federal Claims and concluded that the duplicated loss factor was not within the authority delegated by Congress under Section 1502.

### ***PLR 9234020***

The IRS granted the group's request that it be permitted to defer gains and losses on all deferred inter-company transactions beginning in the specified tax year, and for all subsequent consolidated return years.

### ***PLR 9246031***

An insolvent insurance subsidiary and a corporate subsidiary did not terminate their membership in the parent's consolidated group by reason of the court-ordered liquidation.

### ***PLR 9420003***

A consolidated group may not defer income resulting when a P&C affiliate designated payees on structured settlement annuities.

### ***TAM 9346004***

The IRS used related party reinsurance rules to limit a life sub-group's interest deduction.

### ***FSA 200215002***

A parent corporation must increase its basis in a subsidiary's stock under Treas. Reg. Section 1.1502-32 by the amount of the subsidiary's "Fresh Start" adjustment.

# Insurance Agent Issues



# 6

chapter

## Insurance Agent Issues

*For insurance companies and agents alike, the issues of worker classification, compensation income and deferred compensation continue to be prominent areas of interest. Due to the widespread use of agents, programmers and other outside consultants by insurers, the classification of workers as either employees or independent contractors has a major effect on withholding obligations, as well as on the tax treatment of pensions and other deferred compensation.*

*Companies that engage independent contractors are not required to withhold federal taxes from payments to the contractors or to match the Social Security tax or pay unemployment taxes and workers' compensation premiums. Further, independent contractors may be partially or totally excluded from eligibility for many fringe benefits available to employees, including health insurance and pensions.*

*Perhaps 1996 produced the most major changes affecting independent insurance agents in recent history. The banking community's overall expansion into the business of life insurance sales forced agents to reexamine their role in providing insurance products to customers. The expansion of insurance sales via the internet, coupled with bank sales of insurance, both increased market opportunities for agents and produced concerns regarding their new role in a modified financial services landscape.*

The Small Business Job Protection Act of 1996 (“the Act”) revised Section 530 of the Revenue Act of 1978, which deals with worker classification for employment tax purposes. Among other things, the Act shifted the burden of proof upon the taxpayer’s *prima facie* showing that it was “reasonable” not to treat a worker as an employee, to the IRS and made Section 530 applicable, whether or not a determination has been made that a worker is an “employee” under the common law test (this provision contradicts the IRS position that, in order to use the safe harbor, there must have been a prior determination that a worker was an “employee”). Further, the Act modified the industry practice safe harbor to consider 25% or more of the taxpayer’s industry as a “significant segment;” disallowed taxpayer reliance on audits commencing after December 31, 1996, unless the audit involved an employment tax examination of the worker in question or a worker with a “substantially similar” position; and required the IRS to provide companies with written notice of the provisions of Section 530 at, or prior to, the commencement of audits involving worker classification issues.

## Independent Contractors

*In the following rulings, the Service and the courts addressed whether certain agents were employees or independent contractors.*

***Security Associates Agency Insurance Corporation v. Commissioner, T.C. Memo 1987-317 (1987).*** The Tax Court found that commissions were includable in income in the year of receipt, not when actually “earned” under the contract.

***Albert Ware, et ux. v. United States 850, F.Supp. 602 (1994).*** The U.S. District Court ruled that an insurance salesman was an independent contractor and ordered tax refunds.

***Ware v. U.S., 67 F.3d 574 (1995).*** This case detailed the contractual agreement between taxpayer and the Automobile Association of America. The Appeals court held the taxpayer to be an independent contractor, rather than an employee of AAA.

*Butts v. Commissioner and Smithwick v. Commissioner, 49 F.3d 713 (1995).* In two separate Circuit Court opinions involving these Allstate Insurance Company agents, it was held that the agents were independent contractors after a thorough analysis of the services performed for Allstate. Based on the factual findings and reasoning of the Tax Court's decision in Butts, the Eleventh Circuit affirmed both Tax Court opinions.

*Lozon v. Commissioner, T.C. Memo 1997-250 (1997).* The Tax Court held that contributions by an insurance company to pension and profit-sharing plans on behalf of its independent contractor agents are not taxable until the funds are distributed.

### ***Revenue Ruling 90-93***

The IRS determined that a full-time life insurance salesman, designated a "statutory employee," is not an employee for purposes of Sections 62 and 67 and should file a Schedule C.

### ***PLR 8617094***

The IRS ruled that an insurance agent was an independent contractor.

### ***TAM 9518001***

An insurance agent sold insurance products and magazine subscriptions for a corporation. He performed all work off firm premises, was responsible for his own work schedule and business expenses, and his compensation was commission based. The IRS ruled that he was an independent contractor subject to self-employment tax and was not a statutory employee.

### ***TAM 9736002***

The IRS determined that workers engaged to sell insurance and other financial products are independent contractors, not employees.

## Self-employment Tax

*The Service and courts also addressed whether agents would be subject to self-employment taxes.*

*Robert E. Milligan v. Commissioner* 38 F.3d 1094 (1994). The Ninth Circuit Court ruled that termination payments were not derived from taxpayer's employment, and thus were not subject to self-employment tax under Section 1402.

*Gump v. U.S.*, 86 F. 3d 1126 (1996). The U.S. Court of Appeals for the Federal Circuit ruled that "extended earnings" payments were not self-employment income.

*Jackson v. Commissioner*, 108 T.C. 130 (1997). The Tax Court followed the Ninth Circuit and held that payments to a retired insurance agent are not self-employment income and thus are not subject to self-employment taxes.

*Robert Schelble, et ux. v. Commissioner*, 130 F.3d 1388 (1997). The Tenth Circuit upheld a Tax Court decision holding that post-termination "extended earnings" payments made to an independent agent constituted self-employment income.

*Edgar L. Parker, et ux. v. Commissioner*, T.C. Memo 2002-305 (2002). The Tax Court ruled that payments from insurance companies to a district manager as a result of the termination of his contract constituted ordinary income subject to self-employment tax.

*Orin F. Farnsworth and Mary L. Farnsworth v. Commissioner of Internal Revenue*, T.C. Memo 2002-29 (2002). The Tax Court held that the taxpayers are not entitled to exclude from income any portion of the District Manager's Appointment Agreement (DMAA) contract value termination payments because the taxpayer had no basis in the DMAA contract. Further, the Court held that the termination payments are subject to self-employment tax under Section 1401.

### **Notice 90-72**

The IRS provided guidance regarding the effect on Social Security benefits of commissions paid to self-employed insurance salespersons and agents.

### **Character of Income/Deductions**

*The Service and courts ruled on the character of insurance agents' income and deductions in the following rulings.*

***Deveaux Clark, et ux. v. Commissioner T.C. Memo 1994-278 (1994).*** The Tax Court ruled that payments by an insurance company to its district manager who terminated contracts is ordinary income.

***Ben Cox v. Commissioner, T.C. Memo 1996-241 (1996).*** The Tax Court ruled that commissions credited against a life insurance agent's advances were taxable income in the year credited, although the agent did not receive any cash in that year.

***Dennis v. Commissioner, T.C. Memo 1997-275 (1997).*** The Tax Court ruled that an insurance agent's advance commissions are not includable in income to the extent they represent loan proceeds.

***Warren L. Baker, Jr. and Dorris J. Baker v. Commissioner of Internal Revenue, 118 T.C. No. 28 (2002).*** The Tax Court found that the petitioners were not entitled to capital gain treatment for the termination payment received from State Farm Insurance Company and must treat the payment as ordinary income.

***Raymond Davis v. Commissioner of Internal Revenue, T.C. Summ.Op. 2004-64 (2004).*** The Tax Court found that payments from an insurance salesman's former employer were pension income and that the salesman was not entitled to claim deductions for an insurance business that he was not carrying on.

**PLR 9052016**

The IRS ruled that an agent who enters into a deferred compensation agreement will not be in constructive receipt of income deferred under the agreement.

**PLR 9519002**

The taxpayer sold life insurance policies for an insurance company. The company paid the taxpayer commissions as the policyholder paid the premium, either all at once or ratably over time. The company paid the taxpayer “advances” against unearned commissions. The IRS held that the advances made after the taxpayer sold the policies were includable in gross income under Sections 61 and 451.

## **Kickbacks**

*In the following rulings the Service and the courts addressed insurance kickbacks and deductions for agents’ commissions.*

*The Home Group, Inc. v. Commissioner, 875 F.2d 377 (1989).* The U.S. Appeals Court upheld a Tax Court ruling and found that amounts claimed as a current deduction for agents’ commissions did not meet the all-events test and were therefore, not deductible.

*Mickey L. Worden, et ux. v. Commissioner, T.C. Memo. 1994-193 (1994).* The Tenth Circuit reversed the Tax Court, reasoning that, under insurance agent’s contracts with his clients, he was never in constructive receipt of the basic commissions; and therefore paid the amounts he received from his clients, and received no kickbacks.

*Wentz v. Commissioner, 105 T.C. No. 1 (1995).* The taxpayer entered into agreements with insurance agents whereby the premiums paid for whole life insurance policies sold by the agents were kicked back to them after the agents received their commissions, which were in excess of the premiums. The result was that the taxpayer was provided with insurance at no cost. The Tax Court ruled that the kickbacks were gross income to the taxpayer.



# International



# 7

## chapter

# International

*The insurance industry has long been a global industry and international developments have become increasingly important in companies' decision-making, risk-managing, and compliance functions. The events of September 11, 2001 and the prevalence of corporate "scandals" have increased the demand for increasing transparency associated with international transactions and the call for curbing harmful tax avoidance practices by companies and countries.*

*These events led the OECD<sup>44</sup> to release its status report regarding the elimination of harmful tax practices, in which it listed 35 nations which had not cooperated with the attempt to remove harmful tax practices. In 2002, only 7 jurisdictions remained on the list, largely because of sanctions from the OECD's member states.*

*As the OECD worked to end harmful tax practices, the United States made moves to renew and modify several of its treaties. In 2003, the U.S. entered into a new income tax treaty with the U.K. which includes an "anti-conduit" rule to disallow the excise tax exemption for risks ultimately reinsured outside the U.K. Most of the treaties that the U.S. has renegotiated contain such a provision, which is designed to increase transparency and decrease tax avoidance. Additionally, in 2004, the U.S. Congress passed the JOBS Act of 2004<sup>45</sup>, which repealed the FSC/ETI regime found to violate international trade standards by the WTO.<sup>46</sup>*

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44. "OECD" denotes the Organization for Economic Cooperation and Development.

45. AMERICAN JOBS CREATION ACT OF 2004, Pub. L. 108-357.

46. "WTO" denotes the World Trade Organization.

Not all guidance in the international sector resulted from increased transparency and tax avoidance. The IRS and courts also addressed commonplace international issues, such as excise tax, reinsurance, and use of losses in consolidated groups. As a result of deregulation and soft markets in the late 1990s, insurers were focusing their efforts on “access to capital” and “movement of capital across national borders,” both of which were key factors in the insurance industry’s global expansion and competitiveness.

Regarding the Section 4371 excise tax on foreign insurance premiums, in 2003 the IRS issued Revenue Procedure 2003-78 which formalized the procedures to establish exemption from the excise tax. Under this guidance, a person may consider premiums exempt if the premiums are paid to an insurer that is a resident for treaty purposes of a country with which the U.S. has a treaty containing an excise tax exemption and, prior to filing the return, the person knows that there was in effect a closing agreement between the IRS and the foreign insurer.

In June 1996, the Supreme Court held in *U.S. v. IBM*<sup>47</sup> that the Section 4371 foreign insurance premium excise tax cannot constitutionally be applied to goods in transit. The court reasoned that the Constitution’s Export Clause prohibited Federal taxation of goods in export transit. The decision seems to apply only to P&C insurance premiums paid to insure tangible goods in transit. This decision led to an immediate IRS response in Notice 96-37 on the procedure to obtain an excise tax refund. The decision resulted in many refunds.

## Excise Taxes

### *Exemption Rulings*

*The IRS and the Courts examined whether insurance companies are exempt from the excise tax and established procedures for establishing exemption from excise tax in the following rulings.*

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47. U.S. v. IBM, 116 S. Ct. 1793 (1996).

*Neptune Mutual Association, LTD. of Bermuda v. United States, 13 Cl.Ct. 309 (1987).* The U.S. Court of Claims ruled that the taxpayer is liable for excise tax because the association is not exempt from the tax under either the preemption theory or the exception theory.

*Neptune Mutual Association, LTD. of Bermuda v. U.S., 862 F.2d 1546, (1988).* The U.S. Appeals Court upheld the Circuit Court and ruled that Neptune was liable for excise tax even though it paid income tax under Section 842.

*Phillips Petroleum Co. v. Commissioner of Internal Revenue, 92 T.C. 55 (1989).* The Tax Court declined to rule on whether excise taxes paid as a result of insurance premiums paid to a captive foreign insurance subsidiary were deductible.

*International Business Machines Corp. v. U.S., 31 Fed Cl. 500 (1994).* The Federal Court of Claims ruled that excise tax on foreign insurance premiums violates the export clause of the Constitution.

*International Business Machines Corp. v. U.S., 59 F.3d 1234 (1995).* IBM sold information processing systems to foreign customers. IBM's foreign subsidiaries purchased some insurance for the goods during shipment from foreign insurers. Since IBM was listed as an insured beneficiary, the IRS determined that the premiums paid to the foreign insurer were subject to the excise tax pursuant to Section 4371. The Court of Appeals for the Federal Circuit upheld the Court of Federal Claims ruling that the excise tax imposition was, in effect, tax on the goods and, therefore, is invalid under the export clause of the Constitution.

*U.S. v. IBM, 116 S. Ct. 1793 (1996).* The U.S. Supreme Court affirmed the U.S. Court of Appeals, ruling that the Export Clause of the Constitution does not permit a nondiscriminatory federal tax on goods in export transit.

***Revenue Ruling 89-91***

The IRS ruled that insurance premiums that are subject to excise tax are not subject to premium tax under Section 881.

***Revenue Procedure 87-13***

The IRS issued procedures for establishing an exemption from the excise tax on insurance policies issued by a Barbados insurer or reinsurer.

***Revenue Procedure 92- 39***

The IRS released procedures for establishing exemption from excise taxes under the U.S./Germany tax treaty exemption.

***Revenue Procedure 2003-78***

The IRS provided instructions for establishing exemption from the Section 4371 excise tax on insurance premiums paid to a foreign insurer or reinsurer when the exemption is based on the provisions of an income tax treaty to which the United States is a party.

***Notice 90-40***

The IRS waived the need to report on a tax return a treaty exemption of Section 4371 excise tax.

***PLR 8918020***

The IRS ruled that amounts paid by a ceding company would be subject to excise tax.

***Closing Agreements***

*In the following rulings, the IRS required Taxpayer to enter into a closing agreement to obtain an excise tax exemption.*

***PLR 8802048***

***PLR 8823004***

***PLR 8837080***

***PLR 8812027***

***PLR 8825045***

***PLR 8842064***

***PLR 8820007***

***PLR 8831001***

***PLR 8843006***

***PLR 8823003***

***PLR 8831008***

***PLR 8848034***

<i>PLR 8802048</i>	<i>PLR 8908018</i>	<i>PLR 8936071</i>
<i>PLR 8812027</i>	<i>PLR 8913049</i>	<i>PLR 8940049</i>
<i>PLR 8820007</i>	<i>PLR 8913058</i>	<i>PLR 8942036</i>
<i>PLR 8823003</i>	<i>PLR 8913059</i>	<i>PLR 9218020</i>
<i>PLR 8823004</i>	<i>PLR 8913060</i>	<i>PLR 9218021</i>
<i>PLR 8825045</i>	<i>PLR 8913061</i>	<i>PLR 9225018</i>
<i>PLR 8831001</i>	<i>PLR 8914047</i>	<i>PLR 9229040</i>
<i>PLR 8831008</i>	<i>PLR 8914050</i>	<i>PLR 9229041</i>
<i>PLR 8837080</i>	<i>PLR 8918073</i>	<i>PLR 9229042</i>
<i>PLR 8842064</i>	<i>PLR 8920064</i>	<i>PLR 9238022</i>
<i>PLR 8843006</i>	<i>PLR 8928062</i>	<i>PLR 9245008</i>
<i>PLR 8848034</i>	<i>PLR 8928063</i>	<i>PLR 9246021</i>
<i>PLR 8852040</i>	<i>PLR 8928071</i>	<i>PLR 9246025</i>
<i>PLR 8908010</i>	<i>PLR 8933035</i>	

### *Foreign Insurers*

*The Service ruled that premiums paid to foreign insurers are exempt from excise tax in the following rulings.*

<i>PLR 8703046</i>	<i>PLR 9326029</i>	<i>PLR 9731025</i>
<i>PLR 8723021</i>	<i>PLR 9326058</i>	<i>PLR 200046034</i>
<i>PLR 8744012</i>	<i>PLR 9326060</i>	<i>PLR 200321013</i>
<i>PLR 9104049</i>	<i>PLR 9336059</i>	<i>PLR 200323016</i>
<i>PLR 9308008</i>	<i>PLR 9337005</i>	<i>PLR 200327047</i>
<i>PLR 9311017</i>	<i>PLR 9338031</i>	<i>PLR 200410012</i>
<i>PLR 9314048</i>	<i>PLR 9406025</i>	
<i>PLR 9319037</i>	<i>PLR 9427019</i>	
<i>PLR 9320013</i>	<i>PLR 9526026</i>	
<i>PLR 9322040</i>	<i>PLR 9527022</i>	
<i>PLR 9325058</i>	<i>PLR 9533022</i>	

**PLR 9302011**

Both the reductions allowed in computing the reinsurance premium payable to the foreign retrocessionnaire and the experience rated refund were return premiums that reduce gross premiums for purposes of calculating the premium subject to the Section 4371 excise tax.

Conversely, in **TAM 9621001**, the IRS ruled that reinsurance premiums paid by a foreign insurer to a foreign reinsurer for coverage of U.S. risks were subject to the 1% excise tax under Section 4371, although a 4% excise tax under Section 4371 had already been paid by the U.S. insured.

**Refunds of Excise Tax**

*The Service provided guidance for refunds of excise tax in the following rulings.*

**Revenue Procedure 89-24**

The IRS announced procedures for refund claims under the U.S./Bermuda treaty for excise taxes.

**Revenue Procedure 92-14**

The IRS released procedures for claiming refunds of excise taxes under the U.S./Germany tax treaty exemption.

**Notice 89-44**

The IRS announced that it would accept protective claims for refunds of excise tax under the U.S./Bermuda tax treaty.

**Notice 96-37**

Pursuant to IBM, the IRS specified the procedure for obtaining a refund of excise taxes paid on insurance premiums for goods in export transit from the U.S.

**Announcement 2001-98**

The IRS issued final regulations on the requirements for excise tax returns, payments, and deposits, effective for calendar quarters beginning September 30, 2001.

### **TAM 9215004**

The Service determined that the taxpayer was eligible for a refund of excise taxes.

### ***Other Excise Tax Related Issues***

*The Service ruled on several additional issues related to the excise tax.*

#### ***Notice 89-89***

The IRS announced that all closing agreements with insurers residing in Bermuda or Barbados regarding excise taxes were modified to reflect that those exemptions will not apply to premiums allocable to insurance coverage.

#### ***PLR 9006029***

The IRS ruled that premiums or other consideration returned to a reinsured life insurance company for indemnity reinsurance are to be treated as return premiums. As a result, excise tax will be overpaid.

#### ***PLR 9302012***

The IRS revoked a prior ruling in ***PLR 9006029*** and determined that initial and annual expense allowances and reimbursements of amounts allowed on surrender of policies are life insurance deductions under Section 805, and do not constitute return premiums for purposes of Section 803(a)(1).

#### ***PLR 200219002***

The IRS ruled that the payment of demutualization proceeds by Trust to Taxpayer will not result in Taxpayer incurring an excise tax pursuant to Section 4976(b)(1)(C).

#### ***FSA 199952018***

The IRS discussed several issues regarding the application of the excise tax under Section 4371 to the premium payments between foreign insurance brokers and both foreign and domestic insurance companies.

International Corporate Rates 1990-2002													
Top Corporate Tax Rates by Country, Source: Office of Tax Policy Research (www.OTPR.org), University of Michigan													
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Australia	39%	39%	39%	39%	33%	33%	36%	36%	36%	36%	34%	30%	30%
Austria	30%	30%	30%	30%	34%	34%	34%	34%	34%	34%	34%	34%	34%
Belgium	41%	39%	39%	39%	39%	39%	39%	39%	39%	39%	39%	39%	39%
Canada	38%	38%	38%	38%	38%	38%	38%	38%	38%	38%	38%	38%	38%
Czech Republic		40%	40%	45%	42%	41%	39%	39%	35%	35%	35%	31%	31%
Denmark	40%	38%	38%	34%	34%	34%	38%	34%	34%	32%	32%	30%	30%
Finland	25%	23%	19%	25%	25%	25%	28%	28%	28%	28%	29%	29%	29%
France	37%	34%	34%	33.3%	33.3%	33.3%	33.3%	33.3%	33.3%	33.3%	33.3%	33.3%	33.3%
Germany	50%	50%	50%	50%	45%	45%	30%	30%	30%	30%	45%	25%	25%
Greece	46%	46%	46%	35%	35%	35%	40%	40%	35%	35%	40%	40%	35%
Hungary	40%	40%	40%	40%	36%	18%	18%	18%	18%	18%	18%	18%	18%
Iceland		50%	40%							33%	30%	30%	18%
Ireland	43%	43%	40%	40%	40%	40%	40%	36%	32%	32%	24%	20%	16%
Italy	36%	36%	36%	36%	36%	36%	37%	37%	37%	37%	37%	36%	36%
Japan	40%	37.5%	37.5%	37.5%	37.5%	37.5%	37.5%	37.5%	37.5%	35%	30%	30%	30%
Korea, Republic of	30%	34%	34%	34%	32%	30%	28%	28%	28%	28%	28%	28%	27%
Luxembourg	34%	33%	33%	33%	33%	33%	33%	32%	31%	30%	30%	30%	30%
Mexico	36%	35%	35%	35%	34%	34%	34%	34%	34%	35%	35%	35%	35%
Netherlands	35%	35%	35%	35%	35%	35%	37%	36%	35%	35%	35%	35%	34.5%
New Zealand	33%	33%	33%	33%	33%	33%	33%	33%	33%	33%	33%	33%	33%
Norway	27.8%	27.8%	28%	28%	28%	28%	28%	28%	28%	28%	28%	28%	28%
Poland		40%	40%	40%	40%	40%	40%	40%	36%	34%	28%	28%	28%
Portugal	36.5%	36%	36%	36%	36%	36%	39.6%	36%	39.6%	37%	34%	32%	30%
Slovak Republic				45%		40%	40%	40%	40%	40%	40%	29%	25%
Spain	35%	35%	35%	35%	35%	35%	35%	35%	35%	35%	35%	35%	35%
Sweden	40%	30%	30%	30%	28%	28%	28%	28%	28%	28%	28%	28%	28%
Switzerland	9.8%	9.8%	9.8%	9.8%	9.8%	9.8%	9.8%	9.8%	9.8%	9.8%	32%	32%	8.5%
Turkey	46%	46%	46%	46%	25%	25%	25%	25%	25%	30%	30%	30%	30%
United Kingdom	35%	35%	33%	33%	33%	33%	33%	33%	31%	31%	30%	30%	30%
United States	34%	34%	34%	35%	35%	35%	35%	35%	35%	35%	35%	35%	35%
Average	36%	36%	35%	36%	34%	33%	33%	33%	32%	33%	33%	30%	29%

Source: The Tax Foundation Online, <http://www.taxfoundation.org/internationaltax/intlcorporates.html>.

### **FSA 200032002**

The IRS concluded that excise tax on foreign reinsurance did not apply to reinsurance covering items actively in export transit outside the U.S.

### **Foreign Tax Credit<sup>48</sup>**

*The Service and the Courts have ruled on issues related to the foreign tax credit.*

*Compaq Computer Corp. and Subsidiaries v. Commissioner, 113 T.C. No. 17 (1999).* The Tax Court agreed with the Service that foreign tax credits earned by Compaq in a dividend-strip transaction should be disallowed.

*Travelers Insurance Company v. United States, 303 F.3d 1373 (2002).*

The Federal Circuit Court of Appeals ruled against Travelers Insurance Company, holding that the policyholders' share of income should have been excluded from LICTI for purposes of foreign tax credit calculation and that Travelers' method of translating foreign currency failed to clearly reflect income.

*Travelers Insurance Company v. United States, 124 S.Ct. 101 (2003).* The Supreme Court denied Certiorari to Travelers Insurance Company in its suit with the IRS involving the policyholders' share of investment income excluded in calculating Travelers Insurance Co.'s foreign tax credit.

### **PLR 8739001**

Foreign interest income is not subject to the separate Section 904(d) foreign tax credit limitation for interest income.

### **PLR 9528004**

A U.S. mutual life insurance company established pooled separate

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48. The American Jobs Creation Act of 2004 revised the foreign tax credit carry-over rules to allow corporations to carry forward foreign tax credits to any of the 10 succeeding years and back one year. The carryforward extension was effective for excess foreign tax credits that may be carried to tax years ending after October 22, 2004; the carryback reduction was effective for excess foreign tax credits arising in tax years beginning after October 22, 2004

accounts in which only qualified retirement plans and certain non-life pension plans could invest. These accounts primarily invested in foreign equities. The IRS ruled that the company may claim a foreign tax credit under Section 841 for foreign taxes creditable under Section 901 related to the income generated by the accounts, without reduction for the policyholders' share.

**TAM 9227005**

Foreign taxes paid by members of the non-life subgroup were creditable against U.S. income taxes.

**TAM 9637001**

The IRS withdrew TAM 9227005, dealing with the foreign tax credit limitation in a life/non-life consolidated return context.

**TAM 9817001**

The IRS has analyzed the interaction between the United Kingdom's Advance Corporation Tax (ACT), U.S. Subpart F law, the foreign tax credit (FTC) regime and the existing U.S./U.K. tax treaty to conclude, among other things, that a refundable tax credit received by a U.S. parent with respect to ACT paid by a subsidiary of a U.K. holding company owned by the U.S. parent must be treated as a distribution down the U.K. ownership chain.

## **Effectively Connected Income**

*In determining effectively connected income, the Service and the courts have issued the following guidance.*

***The North West Life Assurance Co. of Canada v. Commissioner, 107 T.C. No. 19 (1996).*** Section 842(a) requires a foreign life insurance company to calculate its taxable income that is "effectively connected" with its conduct of a U.S. trade or business. The Tax Court has held that a life insurance company may calculate its effectively connected investment income without regard to the Section 842(b) formula.

### ***Revenue Ruling 2003-17***

The IRS addressed the issue of whether a foreign life insurance company carrying on an insurance business in the U.S. determines the amount of income effectively connected with its U.S. business based exclusively on the amount of income reported on the NAIC annual statement.

### ***Revenue Procedure 92-27***

The Service issued percentages to be used by foreign insurance companies to compute their minimum effectively connected net investment income for taxable years beginning after 1991 under Section 842(b).

### ***Revenue Procedure 92-95***

The Service issued percentages to be used by foreign insurance companies to compute their minimum effectively connected net investment income for taxable years beginning after 1990 under Section 842(b).

### ***Notice 87-50***

The IRS announced that the election to treat “related person insurance income” as effectively connected with a U.S. trade or business may be made any time after July 10, 1987.

### ***Notice 89-96***

The IRS announced that the net investment income of a foreign insurance company with effectively connected income will be determined by reference to certain items as reported on the NAIC annual statement.

### ***PLR 8948003***

The IRS determined that the dividends of Corp X, the domestic subsidiary of foreign corporation Y, are not effectively connected with the Corp Y branch, and are subject to taxation under Section 881(a).

***TAM 9209001***

The IRS ruled that Foreign corporation would likely be found to be engaged in the conduct of a trade or business in the U.S.

***TAM 200147007***

The IRS ruled that a foreign insurer may not rely on income reported on its NAIC annual statement to determine its effectively connected income.

***TAM 200210028***

The IRS concluded that Taxpayer is not entitled to relief under Section 7805(b) from the retroactive application of the TAM requiring taxpayer to determine its effectively connected income under the standards set forth in Section 864(c).

## **953(d) Elections**

*The Service issued the following guidance under Section 953(d).*

***Revenue Procedure 90-65***

The IRS granted an extension for certain controlled foreign corporations engaged in insurance to elect under Section 953(d) to be treated as domestic after becoming a member of an affiliated group that files a consolidated return.

***Revenue Procedure 2003-47***

The IRS provided new procedural rules for the 953(d) election which allows certain foreign insurance companies to elect to be treated as domestic corporations for U.S. tax purposes.

***Notice 88-111***

The IRS granted an automatic six-month extension for companies with a 953(d) election.

***Notice 89-79***

The IRS provided rules for the 953(d) election.

### ***PLR 9411030***

The IRS ruled in ***PLR 9345006***<sup>49</sup> on a transaction concerning the federal income tax consequences of a proposed transfer by a foreign life insurance company to a wholly owned domestic life insurance subsidiary, which is a wholly owned domestic life insurance subsidiary of the foreign life insurance company, of certain insurance and annuity contracts written by the foreign company in the U.S. through its U.S. branch. After receiving additional information, the IRS issued this ruling.

### ***PLR 9526008***

A foreign mutual insurance company wanted to revoke its Section 953(c)(3)(C) election (to treat related person insurance income as income effectively connected with the conduct of a U.S. trade or business), and invoke a Section 953(d) election (to be treated as a U.S. corporation for tax purposes). The IRS allowed the company to do so and held that the company's members would not be subject to tax under Sections 953(d)(4), and 367(b) on interest and dividend income.

### ***PLR 9811041***

The IRS ruled that a reinsurance company, incorporated under another country's laws and not filing an NAIC statement in any state in the United States or the District of Columbia, should use its undiscounted GAAP reserves for purposes of Section 846. The company, for unknown reasons, made an election under Section 953(d) to be taxed as a U.S. domestic insurance company.

### ***PLR 199906016***

The Service concluded that the capital losses of a foreign insurance company that made a Section 953(d) election were not dual consolidated losses within the meaning of Section 1503(d)(2)(A).

### ***TAM 200453012 and TAM 200453013***

The IRS addressed whether two foreign companies providing reinsurance for vehicle service agreements qualify as insurance companies and are eligible to elect to be treated as domestic corporations under section 953(d).

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49. This PLR was focused on a different issue and can be found in the Reorganizations chapter.

## Withholding on Insurance Payments

*The IRS issued the following guidance on withholding tax under life insurance and annuity contracts.*

### ***Revenue Ruling 2004-75***

Income received by nonresident alien individuals under life insurance or annuity contracts issued by a foreign branch of a U.S. life insurance company is U.S.-source income that is subject to 30% tax and withholding. Income received by Puerto Rican residents under life or annuity contracts issued by a Puerto Rican branch of a U.S. life insurance company is U.S.-source income that is subject to the U.S. income tax.

### ***Revenue Ruling 2004-97***

This ruling amplifies Revenue Ruling 2004-75, issued on July 12, 2004. The Revenue Ruling addresses the U.S. tax treatment of certain payments made to nonresident alien individuals or residents of Puerto Rico under life insurance or annuity contracts issued by foreign or Puerto Rican branches of U.S. life insurance companies. The guidance issued addresses the timing of application of Revenue Ruling 2004-75 by providing that it will not apply to payments made before 2005 with respect to binding contracts issued on or before July 12, 2004.

### ***Revenue Procedure 2004-59***

The IRS announced a temporary voluntary compliance initiative with respect to tax, withholding, and reporting obligations that apply to withholding agents in connection with payments to foreign persons.

### ***Notice 2001-11***

The IRS issued special rules under the new withholding regulations for financial institutions organized under the laws of a U.S. possession (possessions financial institutions).

## Subpart F

*The Service ruled on various Subpart F issues, and provided guidance under Section 954.*

### ***Notice 88-52***

The IRS announced that it would not impose penalties for underpayment of estimated tax on foreign insurance companies for installments required in the first taxable year after December 31, 1987.

### ***Notice 2002-69***

The IRS provided interim guidance on determining the interest rates and appropriate foreign loss payment patterns to be used by controlled foreign corporations in calculating their qualified insurance income under Section 954(i).

### ***TAM 8920001***

The IRS determined that Section 1248 did not apply to a Bermuda insurance company that transferred its assets to a U.K. insurance company in exchange for stock and then liquidated into a domestic corporation.

### ***PLR 200327052***

The IRS determined that the financial reserve calculations of two foreign insurance companies, prepared for local regulatory purposes, are an appropriate means of measuring income for purposes of Subpart F.

### ***PLR 200341019***

The Service found that certain reserves held by a foreign subsidiary required to be set forth on the financial statements and filed with the life insurance regulator of its country of domicile are an appropriate means of measuring income within the meaning of Section 954(i)(4)(B)(ii).

## Transfer Pricing

*The Service and the Courts addressed the reasonableness of transfer pricing determinations in the following rulings.*

*United Parcel Service of America v. Commissioner, T.C. Memo 1999-268 (1999).* The Tax Court held that United Parcel Service of America must include in its 1984 income certain customer charges that the court determined the company had earned but improperly assigned to a related offshore insurance company.

*United Parcel Service of America v. Commissioner 254 F.3d 1014 (2001).* The U.S. Court of Appeals for the 11th Circuit, in a 2-1 decision, sided with the taxpayer, finding that the taxpayer had sufficient business purpose to “neutralize any tax avoidance motive.” The case was reversed and remanded to the Tax Court for consideration of the IRS’s alternative arguments under Sections 482 and 845(a), which had not been addressed in the Tax Court’s 1999 opinion.

### *FSA 200023010*

The IRS determined it could challenge the taxpayer’s claim of insurance provided by its captive, due to the release of *United Parcel Service of America v. Commissioner, T.C. Memo 1999-268*.

*In January 2003, the IRS issued a directive mandating that transfer pricing documentation will be an area of focus in any current or prospective audit. As of January 22, 2003, any company under the Large and Midsize Business Division’s jurisdiction will be asked at the initial IRS audit conference to produce transfer pricing documentation within 30 days of the request.*

## Qualified Dividends Under 2003 Tax Act

*The Jobs and Growth Tax Relief Reconciliation Act of 2003 (P.L. 108-271, 117 Stat. 752)* generally provided that a dividend paid to an individual

shareholder from either a domestic corporation or a “qualified foreign corporation” is subject to tax at the reduced rates applicable to certain capital gains.

Subject to certain exceptions, a qualified foreign corporation is any foreign corporation that is either incorporated in a possession of the United States, or eligible for benefits of a comprehensive income tax treaty with the United States which the Secretary determines is satisfactory for purposes of the 15-percent dividends rate and which includes an exchange of information program. The following Notices contain the Services’ clarifications of certain definitions under the 2003 Jobs Act.

### ***Notice 2003-69***

The Service listed the U.S. income tax treaties that are acceptable for determining whether dividends paid by foreign companies resident in a treaty country can qualify for the new maximum 15-percent rate of tax on qualified dividends received by U.S. non-corporate taxpayers.

### ***Notice 2003-71***

The Service defined “readily tradable on an established U.S. securities market” for purposes of determining whether dividends paid by foreign companies can qualify for the new maximum 15 percent rate of tax on qualified dividends received by U.S. noncorporate taxpayers.

### ***Notice 2004-70***

The Service released procedures regarding the extent to which distributions, inclusions, and other amounts received by, or included in the income of, individual shareholders as ordinary income from foreign corporations which are subject to certain anti-deferral regimes and may be treated as qualified dividend income for purposes of Section 1(h)(11).

### ***Notice 2004-71***

The Service provided guidance on 2004 information reporting of dividends from foreign corporations that are paid to individuals, and that may be eligible for reduced rates of tax.

## Domestic Asset/Liability Percentages

*In the following Revenue Procedures, the IRS announced the domestic asset/liability percentages and domestic investment yields used by foreign life insurance companies and foreign property and liability insurance companies to compute their minimum effectively connected net investment income under Section 842(b).*

*Revenue Procedure 94-14*

*Revenue Procedure 95-26*

*Revenue Procedure 96-23*

*Revenue Procedure 97-16*

*Revenue Procedure 98-31*

*Revenue Procedure 99-30*

*Revenue Procedure 2000-32*

*Revenue Procedure 2001-48*

*Revenue Procedure 2002-58*

*Revenue Procedure 2003-70*

*Revenue Procedure 2004-55*

*The Service also released two Notices regarding the domestic asset/liability percentages.*

*Notice 88-60*

The IRS released the rate to be used for calculating the income tax liability of foreign life insurance companies doing business in the U.S.

*Notice 90-67*

The IRS released the domestic asset/liability percentages for the first taxable year beginning after December 31, 1989.

## IRS Compliance

*The following Notice and Announcement address IRS compliance issues.*

### ***Notice 87-48***

The IRS released the rates used in determining the Section 813 “minimum figure” used to calculate foreign life insurance company income tax liability for 1986.

### ***Announcement 2004-4***

The IRS proposed new Form 8858 requiring information reporting by U.S. persons that own foreign entities that are disregarded for U.S. tax purposes.

## Miscellaneous International Issues

*The Service ruled on the following miscellaneous international insurance issues.*

### ***TAM 9243009***

The Service denied a fronting company’s request for a refund, stating that the fronting company could not offset the corporation’s liability (for tax on denied deductions for premiums) with its refunds.

### ***PLR 9302013***

The IRS revoked a prior ruling and determined that initial and annual expense allowances and reimbursements of amounts allowed on surrender of policies are life insurance deductions under Section 805, and do not constitute return premiums for purposes of Section 803(a)(1).

# Mutual Insurance Companies



## 8 chapter

## Mutual Insurance Companies

*In general, insurance companies have two forms of ownership: stock and mutual. Although the bulk of the major insurance companies are now stock companies, this was not always true. Changes in the insurance industry and in the marketplace have led many mutual insurance companies, which are owned by their policyholders, to “demutualize,” or change their status from mutual to stock form.*

*In 1987, UNUM Life Insurance Company received the first insurance “demutualization” ruling from the IRS.<sup>50</sup> Being the first of its kind, the IRS ruled in detail on every aspect of the transaction including 1) the tax-free exchange of proprietary interest in the mutual for stock of UNUM Holding Company; 2) the tax-free recapitalization of the new stock company; and 3) the character of the amounts received by the shareholders, which the IRS ruled were not deductible policyholder dividends under Section 808(c).*

*Although many companies have followed UNUM's lead in demutualizing, there still remains a dynamic minority of insurance companies owned by their policyholders. For these companies, in contrast to stock companies, there is generally no common or preferred stock evidencing ownership. Rather, ownership is evidenced by an insurance policy whereby each policyholder holds a proprietary interest in the mutual.<sup>51</sup>*

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50. PLR 8711121.

51. A mutual insurance company also has the following characteristics: the right of policyholders to choose management and to be members of the mutual to the exclusion of others; business purpose of supplying insurance to members at cost; the right of members to the return of premiums in excess of amounts needed to cover losses/expenses; and common equitable ownership of the assets by the members.

Prior to the Tax Reform Act of 1986<sup>52</sup>, there were significant differences in the Federal taxation of mutual non-life insurance companies and stock non-life insurance companies. However, the 1986 Tax Act removed the distinction for Federal tax purposes and, as a result, all insurance companies other than life insurance companies are taxed uniformly under part II of Subchapter L.

Although the taxation of mutual insurance companies changed in 1986, Congress retained the concept that some portion of policyholder dividends paid by mutuals represents a distribution of earnings, and that such a distribution generally is not deductible. The 1984 Act<sup>53</sup> imposed a Section 809 add-on tax to accomplish two goals: 1) tax mutuals on the amount of income deemed distributed to policyholders as earnings, and 2) achieve tax fairness between stock and mutual life insurance companies. The amount of income “added-on” to the taxable income of a mutual is termed the “differential earnings amount” (DEA). The DEA is the product of the company’s average equity base and the industry’s differential earnings rate (DER). Controversy has arisen over the appropriateness of a negative recomputed differential earnings rate (RDER) and differential earnings rate. Both the Eighth Circuit Court of Appeals and the Court of Federal Claims have held that a negative DER and RDER is not permitted.<sup>54</sup> The Pension Funding Equity Act of 2004 repealed the Section 809 differential earnings adjustment on policyholder dividends of mutual life insurance companies, making the question of a negative differential earnings amount moot. The provision is effective for taxable years beginning after December 31, 2004.

In addition to the mutual-specific issues which have been addressed by the legislature, courts, and IRS, mutual companies are also subject to most of the same issues that stock companies have found troublesome, including questions of reserve adequacy and reasonableness, net operating losses, and changes in accounting methods.

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52. TAX REFORM ACT OF 1986, Pub. L. No. 99-514.

53. DEFICIT REDUCTION ACT OF 1984, Pub. L. No. 98-369.

54. See *American Mutual Life Insurance Company v. U.S.* 267 F.3d 1344 (2001) and *CUNA Mutual v. Commissioner* 39 Fed.Cl. 660 (1997).

### Definition of Mutual Insurance Company

*In the Pan American Life case, the District and Circuit Courts addressed the definition of a mutual insurance company. The Service later released several rulings related to the question.*

*Pan American Life Insurance Co. v. U.S., 79 A.F.T.R.2d 97-2414 (unpublished), April 17, (1997).* The District Court concluded that Pan Am was subject to Section 809 as a mutual life insurer stating that the critical feature distinguishing stock and mutual companies for the purpose of Section 809 is the form of ownership of the company, i.e., that mutual insurance companies do not have stockholders.

*Pan American Life Insurance Co. v. United States, 174 F.3d 694 (5th Cir., 1999).* The Fifth Circuit upheld the District Court's determination that that Pan American Life Insurance Company was a mutual and not a stock insurance company.

#### *Revenue Ruling 99-3*

The Service ruled that a life insurance subsidiary of a mutual holding company was not a mutual life insurance company.

#### *PLR 8816030*

A company formed to provide deposit insurance to credit unions is a mutual insurance company.

#### *PLR 8845011*

The IRS determined that a mutual insurance program administered through a trust is taxable as an insurance company.

#### *PLR 200242005*

The IRS ruled that Taxpayer is a mutual insurance company that is a reciprocal underwriter within the meaning of Section 832(f).

## Reserves

*The Service and the Courts ruled on reserve issues related to mutual insurance companies.*

*Phoenix Mutual Life v. Commissioner, 96 T.C. 18 (1991).* The Tax Court held that a reserve was a life insurance reserve under prior-law Section 801(b)(1) (currently Section 807(c)(1)) and that the net valuation portion of the company's reserve for deferred and uncollected premiums qualified as a life insurance reserve.

*Principal Mutual Life Insurance Co. v. U.S., 26 Cl.Ct. 616 (1992).* The Federal Court of Claims rejected the taxpayer's claim that the reserves should be treated as life insurance reserves because the coverage became noncancelable when the employee became disabled.

*Principal Mutual Life Insurance Co. v. U.S., 50 F.3d 1021 (1995).* Principal Mutual provided group health and accident insurance to individuals employed by its policyholders. The Appeals court held that disabled lives reserves established by Principal for the disabled employees of group policyholders under cancelable health and accident insurance policies are not deductible as life insurance reserves. The court also held that amounts paid to the state insurance department for routine inspection of financial condition are deductible as "investment expenses."

*Principal Mutual Life Insurance Company and Subsidiaries v. United States, 295 F. 3d 1241 (2002).* The U.S. Court of Appeals for the Federal Circuit ruled that an insurance company must include excess interest guaranteed beyond the end of the tax year in its statutory reserves.

*Mutual Assurance Inc. v. U.S. 56 F.3d 1353, (1995).* In April 1991, Mutual filed claims for refund for the 1987-1989 tax years pursuant to Revenue Procedure 91-21 allowing insurance companies to use special schedules for discount factors. The IRS allowed the 1987 claim. A 1991 audit

revealed an understatement of the refund claim. Mutual filed another claim for refund after the expiration of the statute of limitations for the 1987 tax year. The IRS disallowed the subsequent claim for the 1987 year resulting in this suit. The Court of Appeals affirmed the district court's decision that the subsequent claim was an amendment to the timely filed first claim.

*Western National Mutual Insurance Co. v. Commissioner*, 65 F.3d 90 (1995). The Tax Reform Act of 1986 required companies to discount unpaid loss reserves. The Act contained a transitional rule allowing for "fresh start" equal to the difference between the discounted and undiscounted unpaid losses at the end of 1986. This "fresh start" is not applicable to the "reserve strengthening" amount, which was not defined by statute. The Eighth Circuit affirmed a Tax Court decision that held that the definition of reserve strengthening set forth in Treas. Reg. Section 1.846-3 was invalid because it conflicted with the commonly understood meaning of the term in the insurance industry.

*Atlantic Mutual Ins. Co. v. Comm'r*, T.C. Memo 1996-75 (1996). The Tax Court followed Western National and upheld the taxpayer's definition of "reserve strengthening," holding that the taxpayer's net increase in loss reserves was not due to impermissible reserve strengthening, but to "routine adjustments . . . consistent with past reserving practices."

*Atlantic Mutual Insurance Co. v. Commissioner*, 111 F.3d 1056 (1997). The Third Circuit reversed the Tax Court and upheld Treas. Reg. Section 1.846-3, which defines "reserve strengthening" for purposes of the "fresh start" provisions.

*Atlantic Mutual Insurance Co. v. Commissioner*, 118 S. Ct. 1413 (1998). The Supreme Court upheld Treas. Reg. Section 1.832-3(c), finding it a reasonable interpretation of the statute.

*Minnesota Lawyers Mutual Insurance Company and Subsidiaries v. Commissioner, T.C. Memo 2000-203 (2000).* The Tax Court ruled that Minnesota Lawyer's Mutual Insurance Company's reserves for unpaid losses and related loss adjustment expenses were unreasonable.

*Minnesota Lawyers Mutual Insurance Company and Subsidiaries v. Commissioner of Internal Revenue, 285 F. 3d 1086 (2002).* The Appeals Court for the Eighth Circuit affirmed the Tax Court ruling and found that Minnesota Mutual's unpaid loss reserve estimates were not "fair and reasonable."

*American Mutual Life Insurance Co. v. United States, 46 Fed. Cl. 445 (2000).* The Federal Claims Court ruled that the Section 111 tax benefit rule did not allow a life insurance company to exclude from income decreases in life insurance reserves.

*American Mutual Life Insurance Co. v. United States, 267 F. 3d 1344 (2001).* The Court of Appeals for the Federal Circuit affirmed a decision of the Court of Federal Claims, holding that a life insurer cannot assert the Section 111 tax benefit rule to exclude decreases in reserves from income.

#### **TAM 9452001**

A mutual life insurance company issues single premium deferred annuity contracts with varying guaranteed interest payment periods selected by the policyholder. The taxpayer reported the policyholders' fund value as a life insurance reserve computed without a reduction for surrender charges on its tax return. The IRS ruled that the taxpayer properly considered the actual guaranteed nonforfeiture values at the end of the guaranteed interest period in computing its life insurance reserves for the contracts under Section 807.

#### **FSA 200145004**

The IRS supported the comments of the Appeals Court in the American Mutual case, that, if in fact no tax benefit is received, the tax benefit rule will be applicable.

## Demutualizations

### *Ability to Deduct Payments in Demutualization*

*UNUM Corporation's suit against the Internal Revenue Service for the ability to deduct distributions of cash and stock to policyholders as part of its demutualization was decided in one Private Letter Ruling, followed by four court cases. The case set the standard for the deduction of policyholder dividends in demutualizations.*

#### *PLR 8711121*

The IRS ruled that UNUM Insurance Company's demutualization was an exchange within the meaning of Section 351 and that the change in form from a mutual life insurance company to a stock life insurance company and the exchange of proprietary interests in mutual received by the stock holding company for voting common stock is a reorganization within the meaning of Section 368(a)(1)(E). Further, cash received by policyholder in redemption of proprietary interests in the mutual company is not deductible by the mutual company or the stock company as policyholder dividends.

***UNUM Corporation v. U.S., 886 F.Supp. 150 (1995).*** In 1984, UNUM's predecessor demutualized into a stock company pursuant to a tax-free recapitalization for which the IRS issued a private letter ruling. UNUM did not file its tax return claiming a policyholder dividend deduction in 1986 but subsequently amended its return to file a refund claim stating that the cash and stock distributions related to the demutualization were policyholder dividends. The refund request was denied. UNUM filed an action in federal district court, and the IRS moved for summary judgment. The court denied the motion, holding that the evidence shows that the IRS knew UNUM had a continuing right to amend its return and seek a refund.

***UNUM Corp. v. U.S., 929 F. Supp. 15 (1996).*** A federal District Court held that stock and cash distributions to policyholders upon demutualization were not deductible policyholder dividends.

***UNUM Corp. v. U.S., 130 F.3d 501 (1997).*** The First Circuit Court of Appeals, affirming a District Court decision, held that distributions of cash and stock to policyholders as part of a demutualization were not deductible policyholder dividends.

***UNUM Corp. v. U.S., 119 S.Ct. 42 (1998).*** The Court declined to review the First Circuit's decision that distributions of cash and stock to policyholders as part of a demutualization were not deductible.

*The IRS issued this subsequent ruling related to the issues in the UNUM case:*

**PLR 8726009**

A mutual firm converted to a stock company and restructured itself as a subsidiary of a holding company. The IRS ruled that the amount received by the cash option policyholders is treated as received in redemption of their proprietary interest in the mutual firm.

**Ten Largest Life Insurer Groups -  
By Admitted Assets (1991 and 2001)**

Company/Group	1991 Admitted Assets	Stock/Mutual	Company/Group	2001 Admitted Assets	Stock/Mutual
Prudential	\$ 154,239	Mutual	MetLife	\$ 226,718	Stock
MetLife	\$ 115,416	Mutual	American International Group	\$ 222,030	Stock
Equitable Axa	\$ 69,482	Mutual	Prudential	\$ 204,952	Stock
Aetna Life and Casualty	\$ 66,726	Stock	Hartford Life	\$ 142,922	Stock
Teachers Insurance & Annuity NY	\$ 55,576	Stock	AEGON	\$ 137,668	Stock
New York Life	\$ 53,791	Mutual	Teachers Insurance & Annuity NY	\$ 130,816	Stock
CIGNA	\$ 44,470	Stock	ING	\$ 125,413	Stock
John Hancock	\$ 38,113	Mutual	New York Life	\$ 112,695	Mutual
Travelers	\$ 37,266	Stock	Northwestern Mutual	\$ 98,453	Mutual
Northwestern Mutual	\$ 35,758	Mutual	Nationwide	\$ 86,291	Stock
Universe Total	\$ 670,837		Universe Total	\$ 1,487,958	
Stock Subtotal	\$ 204,038		Stock Subtotal	\$ 1,276,810	
Mutual Subtotal	\$ 466,799		Mutual Subtotal	\$ 211,148	
Stock % of Total	30.4%		Stock % of Total	85.8%	
Mutual % of Total	69.6%		Mutual % of Total	14.2%	

Source: Life Insurance Demutualization: An Interim Report Card 2002, Conning Research & Consulting, Inc.  
Page 15.

### ***Tax-Free Demutualizations***

*The IRS continues to issue rulings finding that the conversion of a mutual insurance company into a stock insurance company is a tax-free reorganization under Section 368(a)(1). The following Revenue Ruling comments on three such situations, as do the Private Letter Rulings which follow.*

#### ***Revenue Ruling 2003-19***

The IRS described the tax consequences resulting from three fact patterns involving a mutual company conversion.

In the following rulings, the IRS determined that the demutualization of a combined stock and mutual life insurance company would be a tax-free "E" reorganization.

<i>PLR 8901035</i>	<i>PLR 9835039</i>	<i>PLR 200208017</i>
<i>PLR 9106049</i>	<i>PLR 9839021</i>	<i>PLR 200213001</i>
<i>PLR 9142014</i>	<i>PLR 9852011</i>	<i>PLR 200213002</i>
<i>PLR 9413041</i>	<i>PLR 199919016</i>	<i>PLR 200213003</i>
<i>PLR 9540004</i>	<i>PLR 200111013</i>	<i>PLR 200240051</i>
<i>PLR 9635034</i>	<i>PLR 200114002</i>	<i>PLR 200333024</i>
<i>PLR 9834019</i>	<i>PLR 200144001</i>	

#### ***PLR 9235007, PLR 9235008, PLR 9235009, PLR 9235010***

The taxpayer, a mutual life insurance company that was the parent of an affiliated group which filed life/non-life consolidated returns, planned to convert to a stock company. In four related rulings, the IRS ruled that the transfer of the proprietary interests of the policyholders, the cash of the underwriters, and the surplus notes of the lender would all be treated as an exchange under Section 351. The Service also ruled that the proposed demutualization of the taxpayer would qualify as a tax-free reorganization under Section 368(a)(1)(E).

***PLR 9512021***

The tax aspects of a demutualization and corporate restructure involving surplus notes are discussed in this ruling. The IRS found a valid Section 368(a)(1)(E) reorganization and held that receipt of cash by the mutual policyholders will constitute a taxable sale of the policyholders' membership interests for which they have a zero basis. The mutual insurance company will recognize cancellation of indebtedness income to the extent the fair market value of the stock issued in exchange for the surplus note is less than the issue price of the note when acquired by the holding company involved in the transaction.

***PLR 9534017***

Taxpayer is a widely held not-for-profit malpractice insurance corporation with no capital stock. Policyholders obtain a proprietary interest in Taxpayer upon acquisition of insurance coverage. Taxpayer will convert into a stock company. The IRS held that the conversion and exchange is characterized as a reorganization pursuant to Section 368(a)(1)(E).

In the following Private Letter Rulings, the IRS ruled that a demutualization qualified as a tax-free recapitalization.

***PLR 8912054***

***PLR 9140007***

***PLR 9710015***

## Demutualization Timeframes and Costs

Company	Duration (Months)	Cost (Millions)
AmerUs	13	\$16
John Hancock	20	\$119
MetLife	16	\$496
MONY	14	\$41
Phoenix	16	\$48
Principal	19	\$30
Prudential	34	\$807
StanCorp	8	\$11
<b>Average</b>	<b>17.5</b>	<b>\$196</b>

Source: Life insurance Demutualization: An Interim Report Card 2002, Conning Research & Consulting, Inc. Page 24.

## *Holding Company Structures in Demutualizations*

*The IRS also ruled on the formation of a stock holding company in the context of a mutual company conversion in the following two rulings:*

### ***PLR 9232037***

Two property and casualty reciprocal inter-insurance exchanges planned to convert to stock companies, and become the wholly-owned subsidiaries of a new holding company. The Service ruled that the proposed conversions would qualify as a tax-free reorganization under Section 368(a)(1)(E).

### ***PLR 9745013***

The IRS ruled that a mutual insurance company's conversion to a stock corporation holding structure is tax-free under Sections 351(a) and 368(a)(1)(E).

## ***Other Demutualization Structures***

*In addition to these rulings, the IRS ruled on various other reorganization structures, including the following:*

### ***PLR 8640050***

The reorganization of two mutual life insurance companies and the conversion of one of the companies into a stock life insurance company would be a 368(a)(1)(C) reorganization.

### ***PLR 9508013***

A self-insurance trust formed to provide workers' compensation insurance to members of an association wanted to demutualize pursuant to a plan qualifying as a Section 368(a)(1)(F) reorganization. The association members must execute indemnity agreements, making them liable to pay fund premiums and assessments, be entitled to liquidation proceeds upon dissolution, and be entitled to an annual premium if one is warranted. Based on these facts, the IRS held that the members continue sufficient proprietary interests to satisfy the continuity of interest requirement of Section 368(a)(1)(F).

### ***TAM 9333001***

A fraternal benefit society converted to a mutual life insurance company, and later demutualized. During the years at issue, the taxpayer was subject to Section 809. In determining its average equity base, the taxpayer subtracted amounts representing fraternal benefit society surplus from its equity base. The Service ruled that this computation method was correct, and that the adjustment did not constitute a tax preference item for purposes of the AMT. Further, the Service determined that the adjustment was not subject to either Section 162 or Section 446.

## ***Foreign Company Demutualizations***

*During 2000, the IRS held that the demutualization of a foreign insurance company would be considered a recapitalization under Section 368(a)(1)(E) for the companies in PLR 200002010 and PLR 200011035.*

### Reorganizations of Mutual Companies

*In the following rulings, the Service ruled on reorganizations of mutual companies and the related tax consequences:*

#### ***PLR 8813015***

When five mutual insurance companies merged, the IRS determined that the overall method of accounting used by the surviving company is that used by the parties having the greatest total adjusted basis of assets and total gross receipts.

#### ***PLR 9137024***

The IRS determined that a change from non-stock to mutual company format would not result in an ownership change within the meaning of Section 382(g)(1).

#### ***PLR 9328008***

The IRS ruled that a liquidation involving a mutual life parent was tax-free.

#### ***PLR 9334016***

The IRS determined that a mutual merger is a tax-free “C” reorganization.

#### ***PLR 9623031***

The IRS ruled on the effects of the merger of two mutual life insurers. The ruling is consistent with **PLR 9616031**, and reaffirms the treatment of DAC balances in the context of tax-free transactions.

#### ***PLR 9746056***

The IRS ruled that the merger of two foreign mutual insurance companies will be tax-free.

#### ***PLR 200307080***

The IRS determined that the liquidation of a mutual holding company following the sale of its subsidiaries produces capital gain for members who held policies through the insurance subsidiary.

## ***Net Operating Losses***

*In the following rulings, the Service ruled on net operating losses in mutual reorganizations.*

### ***PLR 9011020***

The IRS determined that a mutual life insurance company could use Section 332 liquidations to utilize excess net operating loss carry-overs held by liquidated subsidiaries.

### ***PLR 9029030***

In **PLR 9011020** the IRS ruled that a mutual life insurance company could use complete liquidations to release subsidiaries' NOL carry-overs. The company changed its plan and decided to liquidate three subsidiaries. The IRS ruled that the distributions by the subsidiaries of their assets are complete liquidations. Additionally, NOL carry-overs will be available to offset life insurance company taxable income.

## ***Policy Acquisition Expenses***

*The IRS ruled on the treatment of policy acquisition expenses in the following mutual reorganization.*

### ***PLR 9217051***

The IRS ruled that the unamortized balances of the subsidiaries' capitalized policy acquisition expenses would carry over to — and be amortizable by — the mutual life parent.

## Differential Earnings Rates

*The Service and the courts addressed negative differential earnings rates of mutual insurance companies in the following rulings.*

*American Mutual Life Insurance Co. v. United States* 73 A.F.T.R.2d 94-301 (unpublished) (1993). American Mutual, a mutual life insurance company, claimed a deduction attributable to a negative recomputed differential earnings rate for 1986. The District Court upheld the use of a negative recomputed differential earnings amount.

*American Mutual Life Insurance Co. v. U.S.*, 116 S.Ct. 335, *rev denied* (1995). The U.S. Supreme Court let stand an appeals court ruling that the differential earnings rate could not be negative, thus limiting mutual life insurance companies dividend deductions to no more than the dividends paid to policyholders in any given year.

*Indianapolis Life Ins. Co. v. U.S.*, 940 F. Supp. 1370 (1996). A U.S. District Court in Indiana upheld Treas. Reg. Section 1.809-9, which expressly disallows the use of a negative differential earnings rate.

*Indianapolis Life Insurance Co. v. U.S.*, 115 F.3d 430 (1997). The U.S. Court of Appeals for the Seventh Circuit affirmed the District Court's decision, which disallowed the use of a negative differential earnings amount in computing a mutual life insurer's policyholder dividend deduction.

*CUNA Mutual Life Insurance Company v. U.S.*, 39 Fed.Cl. 660 (1997). The Court of Federal Claims, following the Seventh and Eighth Circuits, has held that a mutual life insurance company may not use the "negative excess" differential earnings amount in determining its deductible policyholder dividends.

***John Hancock Financial Services, Inc. v. U.S., 57 Fed.Cl. 643 (2003).***

The Federal Court of Claims ruled that John Hancock Insurance Company may not use recomputed differential earnings amounts not allowable as deductions to exclude future income.

***John Hancock Mutual Life Insurance Company v. Commissioner 378 F.3d 1302 (2004).*** The Federal Circuit Court affirmed the Federal Court of Claims ruling that John Hancock Insurance Company may not use recomputed differential earnings amounts not allowable as deductions to exclude future income.

### ***Publication of Differential Earnings Rates***

In the following Revenue Rulings, the Service published the differential earnings rates for mutual life insurance companies and the recomputed differential earnings rates.

Tax Year	Differential Earnings Rate	Recomputed DER
1984	Tax Reform Act of 1984	Revenue Ruling 86-114 <sup>55</sup>
1985	Revenue Ruling 86-114	Revenue Ruling 87-92
1986	Revenue Ruling 87-92	Revenue Ruling 88-80
1987	Revenue Ruling 88-80	Revenue Ruling 89-106
1988	Revenue Ruling 89-106	Revenue Ruling 90-73
1989	Revenue Ruling 90-73	Revenue Ruling 91-52
1990	Revenue Ruling 91-52	Revenue Ruling 92-78
1991	Revenue Ruling 92-78	Revenue Ruling 93-59
1992	Revenue Ruling 93-59	Revenue Ruling 94-53
1993	Revenue Ruling 94-53	Revenue Ruling 95-60
1994	Revenue Ruling 95-60	Revenue Ruling 96-42
1995	Revenue Ruling 96-42	Revenue Ruling 97-35
1996	Revenue Ruling 97-35	Revenue Ruling 98-38
1997	Revenue Ruling 98-38	Revenue Ruling 99-35
1998	Revenue Ruling 99-35	Revenue Ruling 2000-37
1999	Revenue Ruling 2000-37	Revenue Ruling 2001-33
2000	Revenue Ruling 2001-33	Revenue Ruling 2003-4
2001	Revenue Ruling 2003-4	None

55. Revenue Ruling 86-114 was corrected by Revenue Ruling 86-157 and Revenue Ruling 87-20.

*The Job Creation and Worker Assistance Act of 2002 amended Section 809 to provide that the DER should be treated as zero for purposes of computing both the DEA and the recomputed differential earnings amount for a mutual life insurance company's taxable years beginning in 2001, 2002 or 2003. As a result of this amendment to Section 809, the IRS did not compute the DER and RDER for 2001, 2002 or 2003.*

*The Pension Funding Equity Act of 2004, signed into law in April 2004, repealed Section 809 for tax years beginning after December 31, 2004. Subsequently, the American Jobs Creation Act of 2004, enacted on October 22, 2004, repealed the Section 809 differential earnings adjustment on policyholder dividends of mutual life insurance companies, leaving 2004 as the final year that a differential earnings adjustment is required.*

### ***Computation of Differential Earnings Adjustment in Mergers***

*The following rulings discuss the computation of the differential earnings amount in a merger.*

#### ***PLR 9425044***

The IRS determined the differential earnings amount for a short tax year when two mutual insurance companies merged.

#### ***PLR 9510010***

The IRS discussed the proper computation of the Section 809 differential earnings amount, by which the Section 808 deduction for policyholder dividends must be reduced when two mutual life insurance companies are merged in a transaction satisfying the requirements of Section 368(a)(1)(A).

## **Miscellaneous Mutual Rulings**

*The following rulings address miscellaneous issues for mutual insurance companies.*

### ***TAM 9131003***

The IRS denied a request for retroactive relief involving the tax treatment of premiums received by a mutual insurance company under perpetual insurance policies.

### ***PLR 9530029***

The IRS granted permission for a mutual life insurance company parent of an affiliated group to change its method of allocating tax liability pursuant to Treas. Reg. Sections 1.1552-1 and 1.1552-33.



# Products



# 9

chapter

# Products

*Typically, the insurance products which have received the most attention by the taxing authorities and popular press are life insurance and annuity contracts. Life insurance is intended to provide income to a beneficiary upon the death of the insured. Annuity contracts, on the other hand, serve as retirement vehicles since they provide income over a certain period or for the life of the annuitant.*

*Perhaps most litigated life insurance product has been corporate-owned life insurance (COLI). COLI litigation has principally concerned the deductibility of interest expense by a corporate taxpayer on indebtedness used to fund insurance policies on its employees. Tax legislation passed in 1996<sup>56</sup> (1996 Act) generally repealed the interest deduction for interest paid after 1995. Numerous court decisions arose subsequent to the 1996 Act contesting the IRS's denial of interest deductions associated with COLI policies for years prior to 1996 (e.g., Winn Dixie Stores<sup>57</sup>; CM Holdings<sup>58</sup>; AEP<sup>59</sup>; and Dow Chemical<sup>60</sup>), of which the IRS prevailed in all but the Dow Chemical case.*

*In one of the most high-profile COLI cases, Wal-Mart was sued by the family of a former employee alleging a violation of the Texas insurable interest doctrine. Although not a tax issue, insurable interest has become an important topic in the COLI debate. Wal-Mart settled the lawsuit hours before the Appeals Court ruled against Wal-Mart; however, the Appeals Court decided to release the opinion because it had already been drafted. Terms of the deal were not disclosed. Separately, in Delaware state court, Wal-Mart sued its advisors over the failed COLI plan.*

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56. Health Insurance Portability Act of 1996, Pub. L. 104-191.

57. Winn-Dixie Stores, Inc. v. Commissioner, 254 F.3d 1313 (2001).

58. In re CM Holdings, Inc., Camelot Music, Inc., G.M.G. Advertising and Grapevine Records and Tapes, Inc. Internal Revenue Service v. CM Holdings, Inc. 301 F.3d 96 (2002).

59. American Electric Power, Co., Inc. v. U.S. 326 F.3d 737 (2003).

60. Dow Chemical Co. and Subsidiaries v. U.S. 250 F.Supp.2d 748 (2003).

Though not as high profile as COLI, split-dollar arrangements have also been a litigious area for products. Several variations of these arrangements exist, whereby the employer and employee share in the benefits and premiums of a contract. In general, the employee is taxed on the value of the economic benefit received from the employer's participation in the arrangement, and the employer may not deduct its portion of the premiums.<sup>61</sup> The Treasury issued final regulations applicable to all new split-dollar arrangements entered into on or after September 17, 2003, and to existing arrangements that are materially modified on or after that date.<sup>62</sup>

Though rarely present in the courts, tax-free exchanges of insurance policies comprise the bulk of IRS issuances in the products arena. In general, under Section 1035, a life insurance contract may be exchanged for either a life, endowment, or annuity contract; an endowment contract may be exchanged for either an endowment or annuity contract; and an annuity contract may be exchanged for an annuity contract. In the wake of recent insolvencies of insurance companies, exchanges have become more prominent, with the Service addressing exchanges of policies issued by troubled insurers.<sup>63</sup> Likewise, in *Conway v. Commissioner*<sup>64</sup>, exchanges involving less than 100% of the policyowner's interest in an annuity contract may also qualify for tax-free treatment.

Since the 1984 Act<sup>65</sup> provided a definition in Section 7702 of "life insurance contract," insurance companies have invested significant resources to insure that contracts meet this definition. If a policy does not meet the guidelines, income on the policy is currently taxed to the policyholder, and only the excess of the death benefit over cash value is eligible for exclusion. In promulgating Section 7702, the legislature anticipated that certain policies would fail the tests and provided that the IRS may waive the failure to meet the tests if it was due to reasonable error and reasonable steps were taken to correct the error. With few exceptions, the IRS has granted these waivers liberally.

61. See Revenue Ruling 64-328.

62. T.D. 9092.

63. See Revenue Ruling 92-43 and Revenue Procedure 92-44, as amended by 92-44A.

64. *Conway v. Commissioner*, 111 T.C. No. 20 (1998).

65. DEFICIT REDUCTION ACT OF 1984, Pub. L. No. 98-369.

## Corporate-Owned Life Insurance

### Economic Substance

*The primary focus of corporate-owned life insurance cases was whether there was an economic purpose to the transaction or whether it was a sham.*

*Campbell v. Cen-Tex, 377 F. 2d 688 (1967).* The Fifth Circuit affirmed the District Court's ruling that the transactions relating to the purchase of insurance policies for the corporation's officers had a true business purpose.

*Cecil H. Shirar, et ux. v. Commissioner, 916 F.2d 1414 (1990).* The Ninth Circuit reversed the Tax Court and held that the interest on borrowing from an insurance policy to pay for premiums is not barred by Section 264.

*Winn-Dixie Stores, Inc. v. Commissioner, 113 T.C. No. 21 (1999).* The Tax Court ruled that a leveraged corporate-owned life insurance program was a sham transaction and Winn-Dixie was not entitled to deduct the interest on the policy loans nor the program's administrative fees.

*Winn-Dixie Stores, Inc. v. Commissioner, 254 F.3d 1313 (2001).* The 11th Circuit Appeals Court affirmed the Tax Court ruling that Winn-Dixie was not entitled to deduct interest and fees incurred in borrowing against insurance policies that it owned on the lives of its employees. The Appeals Court concluded that there was no business need for the program, and the COLI program lacked economic substance to be respected for tax purposes.

*Winn-Dixie Stores Inc. v. Commissioner, U.S., 122 S.Ct. 1537 (Mem), cert. Denied (2002).* The U.S. Supreme Court denied certiorari for an 11th Circuit Court decision which held that loans that Winn-Dixie took against whole life insurance policies it purchased on the lives of 36,000 full-time employees were substantive shams.

***IRS v. CM Holdings, Inc. (In re CM Holdings Inc.) 254 B.R. 578 (2000).***

The U.S. District Court for the District of Delaware ruled that the corporate-owned life insurance policies developed by the company were shams in both fact and substance and disallowed the interest deductions relating to the policies.

***In re CM Holdings, Inc., Camelot Music, Inc., G.M.G. Advertising and Grapevine Records and Tapes, Inc. Internal Revenue Service v. CM Holdings, Inc. 301 F.3d 96 (2002).*** The Third Circuit Court of Appeals affirmed the decision of the District Court, concluding that Camelot Music's COLI program was a sham in fact, and that the program as a whole lacked economic substance.

***American Electric Power v. United States, 136 F. Supp 2d 762 (2001).***

The District Court for the Southern District of Ohio ruled that the leveraged COLI program maintained by American Electric Power was a sham in substance. Accordingly, the court disallowed claimed deductions for interest paid on policy loans.

***American Electric Power. Co., Inc. v. U.S., 326 F.3d 737 (2003).*** The Sixth Circuit Court of Appeals affirmed the District Court decision that American Electric Power's corporate-owned life insurance program was an economic sham.

***Dow Chemical Co. and Subsidiaries v. U.S., 250 F.Supp.2d 748 (2003).***

The District Court ruled that the IRS improperly disallowed Dow Chemical's deductions for interest claimed on Dow's tax returns in connection with its corporate-owned life insurance plans and ordered the IRS to refund \$22,209,570 plus interest.

***TAM 200213010***

The IRS ruled that Taxpayer purchased its COLI programs pursuant to a plan that lacked economic substance and business purpose.

## ***Insurable Interest***

*The Courts also addressed the question of insurable interest in the following case.*

***WalMart v.Sims, settled out of court (2004).*** The Fifth Circuit Court of Appeals affirmed a District Court ruling that Wal-Mart, as a Texas employer, must have an “insurable interest” in an employee’s life before owning a life insurance policy on the employee.

## ***Four-of-Seven Rule***

*The Service determined the applicability of the four-of-seven rule below.*

### ***PLR 9109018***

Affiliated employers established a trust for a nonqualified deferred compensation plan and transferred life insurance policies to the trust. The policies were “life insurance,” and borrowings against the policies satisfied the “four out of seven” rule. The IRS ruled that the transfer was not a purchase under Section 264 or a sale or disposition of the policies.

### ***FSA 200210010***

The taxpayer did not fail the 4 of 7 exception under Section 264(d)(1) where no premiums were paid after the end of the third policy year.

## ***Deductibility of Interest***

*The Service addressed the deductibility of interest related to COLI transactions.*

### ***PLR 9138049***

A bank holding company maintained a group term life insurance plan for its employees. The IRS ruled that interest on the policy loans was deductible under Section 264(c)(4).

**TAM 9812005**

The interest on leveraged COLI debt is not deductible.

**TAM 199901005**

Loans against a COLI policy did not constitute valid indebtedness; thus, the interest payments were not deductible under Section 163.

**TAM 200452033**

The IRS determined that amounts that Taxpayer receives as income from the termination of its corporate-owned life insurance contracts are ordinary income, not subject to gain or loss attributable to the termination of a right or obligation with respect to property which is a capital asset under section 1234A.

***Miscellaneous COLI Rulings***

*The Service issued the following rulings related to corporate-owned life insurance.*

***Announcement 2002-96***

The IRS announced that it will end the settlement initiative for broad-based leveraged COLI plans purchased after June 20, 1986.

***PLR 9720038***

The IRS ruled that restructured BOLI and COLI contracts of a U.S. branch of a foreign life insurance company in liquidation are continuations of the original contracts.

***FSA 200202028***

The IRS concluded that loans on corporate-owned life insurance contracts purchased before June 20, 1986 are not aggregated with debt after that date for determining whether the \$50,000 limit of former Section 264(a)(4) has been exceeded.

## Split-Dollar

*The Service modified and clarified its position on split-dollar insurance in the following rulings.*

*Addis v. Commissioner, 374 F.3d 881 (2004).* The Ninth Circuit Court of Appeals confirmed a Tax Court ruling disallowing charitable contribution deductions for payments to the National Heritage Foundation because the receipts substantiating the transfers to the NHF stated the individuals received no consideration, though they expected the NHF to use their funds to pay part of the premiums on life insurance benefiting their trust pursuant to a split-dollar arrangement.

*Roark v. C.I.R., T.C. Memo. 2004-271 (2004).* The Tax Court held that David and Irene Roark may not claim charitable deductions for amounts given to a section 501(c)(3) charitable organization and subsequently used to pay the premiums on an insurance policy on David's life that was owned by a trust benefiting the Roark family.

### ***Notice 99-36***

The Service denied a deduction for charitable split-dollar transactions.

### ***Notice 2001-10***

The IRS Notice requires a significant change in the taxation of split-dollar life insurance policies.

### ***Notice 2002-8***

The IRS revoked an earlier notice, 2001-10, which provided interim guidance regarding the tax treatment of parties entering into split-dollar life insurance arrangements.

### ***Notice 2002-59***

The IRS explained the standard for valuing current life insurance protection under a split-dollar arrangement, including guidance on arrangements where parties attempt to avoid taxes by understating the value of policy benefits.

**PLR 9037012**

The IRS ruled in a split-dollar arrangement with an irrevocable trust, the transferred property will not constitute interests in an enterprise for purposes of the estate freeze rules, and the transferred life insurance policies will not be includable in the individual's gross estate.

**TAM 9604001**

The IRS ruled that the one-year term cost of split-dollar term life insurance purchased for a trust is includable in the insured's current income.

**TAM 199918060**

The Service ruled that a corporation could not use the premium rates provided for in a split-dollar contract because those rates were inconsistent with the PS 58 rates.

**FSA 200040001**

The IRS determined the use of a split-dollar life insurance transaction in connection with an asset sale would be considered a Section 7872 interest-free loan.

***Legal Memorandum 20031501F (Field Attorney Advice)***

The IRS found that life insurance premium payments by a closely held corporation on the lives of the corporation's officers, who were its shareholders, are not deductible business expenses of the corporation. Further, the IRS determined that no constructive dividend will be deemed to arise to the insured shareholder by the corporation's payment of the premiums.

## Service Contracts

Perhaps the most common product ruling involves the question of whether extended service contracts constitute insurance for federal tax purposes and whether the issuing company is an insurance company. In the following rulings, the IRS determined that extended service contracts were insurance and that the taxpayer was considered insurance company.

**PLR 9811055**

**PLR 199903024**

**PLR 199931030**

**PLR 200029018**

**PLR 200042018**

**PLR 200119039**

**PLR 200138010**

**PLR 200140057**

**PLR 200237010**

**PLR 200242027**

**PLR 200340011**

**PLR 200403024**

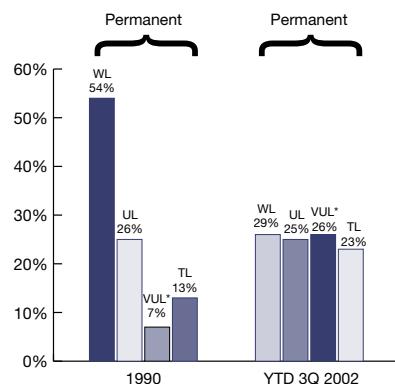
**PLR 200416006**

**TAM 9225003**

**TAM 9251007**

**TAM 9601001**

**Annualized New Premium by Product  
(% portion of U.S. Today)**



\* Includes Variable Life

Source: Life Insurance Demutualization: An Interim Report Card 2002, Conning Research & Consulting, Inc. Page 58.

**PLR 9416001**

Home warranty contracts are insurance contracts.

**PLR 200402001**

An S Corporation is an insurance company and the contracts it writes to cover equipment are insurance for federal income tax purposes.

**TAM 9218004**

Payments by customers purchasing extended service plans constituted prepayments for services to be rendered. Therefore, the payments should have been included in the dealer's gross income for the tax year in which they were received.

*In the Toyota Town case and the rulings that follow, the Service examined extended service contracts and their related issues.*

***Toyota Town, Inc. v. Commissioner, T.C. Memo 2000-40 (2000).*** The Tax Court ruled that the proper period of deduction of insurance premiums relating to extended warranty agreements was as of the first date of policy inception.

#### ***Revenue Procedure 92-98***

The Service issued a revenue procedure which allows taxpayers to change their accounting method for multi-year insurance policies purchased in conjunction with the sale of multi-year service warranty contracts.

### **Exchanges of Annuities and Life Insurance**

*The Service issued several rulings and litigated two cases regarding the tax-free exchange of annuities and life insurance policies. Generally, the exchange of annuities was found to be tax-free. In Notice 2003-51 the Service announced that it would consider promulgating regulations to prescribe the tax treatment of tax-free exchanges of annuity contracts.*

*In the following rulings, the Service ruled that an exchange of annuities or life insurance policies would be tax-free, generally.*

*PLR 8604033*

*PLR 9017062*

*PLR 9709002*

*PLR 8604095*

*PLR 9044022*

*PLR 9820018*

*PLR 8806058*

*PLR 9644016*

*PLR 200342003*

*PLR 8816015*

*PLR 9708016*

***Greene v. Commissioner, 85 T.C. 1024 (1986).*** The Tax Court ruled that the surrender of one annuity and reinvestment in another annuity was tax-free.

***Revenue Ruling 2002-75***

The IRS described a situation where the transfer of an entire annuity contract into another pre-existing annuity contract qualifies as a tax-free exchange under Section 1035.

***Revenue Procedure 92-26***

The Service relieved insurance companies from the burden of reporting certain exchanges of life, endowment, and annuity contracts.

*In the following rulings, the IRS ruled that an exchange would be tax-free but also ruled on other aspects of the transaction.*

***PLR 9012063***

The IRS determined that proceeds from a transfer of life insurance policies from a corporation to a partnership in payment for rent will be excludable from gross income.

***PLR 9319024***

The IRS ruled that the exchange of a domestic annuity for a foreign annuity would be tax-free.

***PLR 9330040***

The IRS determined that an exchange of annuities would be tax-free, and that the trust's basis in the new policy would be the same as its basis in the old policy.

***PLR 9335054***

The IRS ruled that the exchange of the insolvent insurer's contract for a new contract by contractholders electing to opt out and the timely reinvesting of cash payments received, would be treated as a tax-free exchange.

***PLR 9852041***

The IRS ruled that life insurance policies an individual proposes to acquire will not be treated as having been transferred to the individual for a valuable consideration.

### **GCM 39588**

The IRS ruled that a transaction will be treated as a tax free exchange of annuity contracts where the second contract may be funded by installment payments attributable to a surrender option available to the policyholder under a contract with an insurance company in rehabilitation.

### ***Partial Exchanges***

*In the following rulings, the Service and the courts ruled on partial exchanges of annuity and life insurance contracts.*

***Conway v. Commissioner, 111 T.C. No. 20 (1998).*** The Tax Court held that the partial exchange of an annuity contract for another annuity contract is tax-free under Section 1035.

### ***Revenue Ruling 2003-76***

The transfer of a portion of Contract B to Company C for new Contract C is a tax-free exchange under Section 1035. The continued existence of Contract B with its reduced cash value does not affect the tax-free exchange.

### ***Insolvent Companies***

*In the following rulings, the Service ruled on exchanges of annuity and life insurance contracts with insolvent insurance companies.*

### ***Revenue Ruling 92-43***

Taxpayer exchanged an annuity contract issued by a troubled life insurance company for an annuity contract issued by another life insurance company. The IRS ruled that the exchange was tax-free under Section 1035, even though the new annuity was funded by a series of payments from the original company's annuity.

***Revenue Ruling 92-44***

The IRS determined that if a taxpayer receives a cash payment upon the surrender of a contract issued by a troubled insurance company and invests the cash in a similar contract issued by another company, the exchange will be tax-free, as long as the other requirements of Section 1035 are met.

***Tax Attributes in Exchanges***

*The Service addressed the effect of certain exchanges on the tax attributes of the policies.*

***GCM 39728***

The purchase date of a policy acquired in a 1035 exchange is the date of the exchange.

***Revenue Ruling 92-95***

An individual taxpayer exchanged a deferred annuity for an immediate annuity in a Section 1035 transaction, and began to receive monthly distributions within 2 months of the exchange. Because of the tax-free nature of the exchange, the IRS determined that the characteristics of the old (deferred) annuity carried over to the new annuity.

***Notice 2003-51***

Treasury announced that it is considering whether to promulgate regulations that would prescribe the tax treatment of tax-free exchanges of annuity contracts under Sections 72(e) and 1035.

***Taxable Exchanges***

*In the following rulings, the Service ruled that an exchange of life insurance policies would result in taxable income.*

***PLR 8726022***

An individual who owned two whole life insurance policies surrendered them for a gain, after having held the policies for over 10 years. The IRS determined that the gain is ordinary income under Section 72(e)(5).

**PLR 8810010**

Purchasing a policy in anticipation of surrendering another policy is not a tax-free exchange.

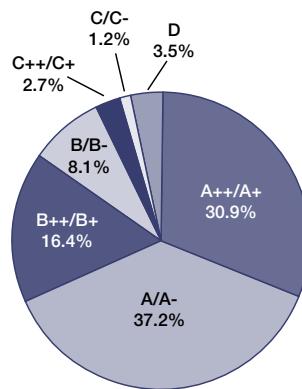
**PLR 9141025**

Taxpayer's exchange of an endowment policy would constitute a like-kind exchange and Taxpayer would have to recognize the amount of outstanding policy loan as "boot."

**TAM 8905004**

The IRS allowed the tax-free swap of annuity contracts but ruled that the taxpayers must recognize gain equal to the fair market value of the life insurance contracts received in exchange.

**Historical Rating Distribution<sup>1</sup>**  
U.S. life/health and property/casualty data from 1977 to 2002.



1. In 2002, the ratings distribution (excluding the "E," "F" and "NA-10" impaired categories) was as follows: "A++/A+" at 22.8%; "A/A-" at 50.7%; "B++/B+" at 18.0%; "B/B-" at 6.0%; "C++/C+" at 1.8%; "C/C-" at 0.4%; "D" at 0.2%.

Source: A.M. Best Company Special Report: Best's Insolvency Study, Property/Casualty U.S. Insurers 1969-2002, May 2004, Page 87.

## Grandfathered Life Insurance Contracts

*Because changes in policy loan interest rates, reinsurance of contracts, certain endorsements, or other changes to life insurance policies can change the policies' tax treatment, or even cause them to fail to be insurance contracts, many companies request rulings for any changes that must be made.*

### Policy Dates

*In these rulings, the Service ruled that changes in the policy loan interest rate provisions of Taxpayer's whole life insurance policies would be economically equivalent to the existing policy loan interest provisions, and the change would not trigger a new policy date.*

**PLR 9117011**

**PLR 9150045**

**PLR 9203009**

**PLR 9412023**

**PLR 9445013**

**PLR 9305013**

A mutual life insurance company was placed into rehabilitation by court order. Under a proposed plan of rehabilitation, the mutual company planned to enter into two assumption reinsurance transactions. The IRS ruled that the assumption reinsurance transaction would not have an effect on the date that a contract was issued, entered into, or purchased and would not require retesting or a new test period.

***PLR 9338018***

In a supplemental ruling to **PLR 9305013**, the IRS addressed the income tax implications of certain amendments to certain of the ceding company's life insurance contracts prior to the assumption by one of the assuming companies.

***PLR 9312013***

Pursuant to a state approved plan of rehabilitation, the state conservator entered into an agreement with an unrelated company that agreed to form a life insurance company that would assume the restructured contracts of the insolvent company. The IRS ruled that after completion of the assumption reinsurance transaction, the transaction would not affect the date that the contracts were issued, entered into or purchased.

***PLR 9828016***

The IRS ruled that the assumption of a long-term care insurance contract will not alter the issuance date of the contract.

***Reinsurance and Endorsements***

*Here, the Service found that the grandfathered status of certain contracts would not be affected by restructuring or assumption reinsurance and that certain endorsements and riders would not change the tax treatment of life insurance contracts.*

***Revenue Procedure 92-57***

The IRS set forth the conditions under which an annuity, life insurance, or endowment contract will retain its grandfathered status despite restructuring or modification in connection with the liquidation, rehabilitation, or conservatorship of a troubled life insurance company.

***PLR 9034014***

The IRS ruled that an insurance company's divestiture of insurance contracts to a reinsurer will not cause the contracts to lose their grandfathered status and an assumption reinsurance agreement does not change the existing contractual obligations of the underlying life insurance policy.

***PLR 9106050***

Amounts withdrawn from the basic policy's cash value to pay for the long-term care rider were treated as distributions from the basic policy.

***PLR 9239026***

The taxpayer was placed in conservatorship in April 1991, and filed a plan of rehabilitation that includes three phases: (1) restructuring of the contracts; (2) assumption reinsurance of specified contracts; and (3) discharge of the taxpayer's indebtedness. The IRS found that the grandfathered status of the contracts would not be affected by the restructuring.

***PLR 9323022***

An assumption reinsurance transaction would not cause the contracts to be treated as reissued and no new test period would be needed.

***PLR 9430043***

The Service found that contracts of a life insurance company placed in receivership remain unchanged on transfer.

***PLR 9530027***

A life insurance company will cede its entire interest in certain insurance contracts to another life insurance company in an assumption

reinsurance transaction. The ruling details the transaction and holds that the assumption reinsurance agreement will not change the contract's issuance, premium payment or annuity starting dates.

#### ***PLR 9615037***

The IRS ruled that an insolvent insurer's insurance and annuity contracts that were restructured to accommodate an assumption reinsurance transaction are grandfathered.

#### ***PLR 9714029***

The IRS ruled that an endorsement to life insurance contracts, which provides that interest on policy loans be paid "in arrears" rather than "in advance," will not change the tax treatment of the contracts.

#### ***PLR 9737007***

The IRS determined that the income tax treatment of life insurance contracts will not change if an endorsement is added to each contract to modify the loan provision so that interest is paid in arrears, rather than in advance.

#### ***PLR 9832026***

In the last of three private letter rulings (**PLRs 9615037, 9720038** and **9832026**), the IRS ruled that, upon liquidation of a life insurance company, restructured life insurance contracts will be continuations of existing, non-restructured contracts under Section 72.

### ***Ownership***

*In these letter rulings, the Service determined that contracts held by trust would be considered owned by natural persons.*

#### ***PLR 9639057***

An annuity held in trust is treated as held by a natural person, thus the inside buildup was not currently taxable.

**PLR 199905015**

The Service ruled that three annuity contracts held by a trust were considered owned by natural persons for purposes of Section 72(u) and that the distribution of the annuities by the trust to the three beneficiaries would not be considered as an assignment of income without full and adequate consideration under Section 72(e)(4)(C).

**Waivers Under Section 7702**

*The Service issued the following rulings regarding the failure of certain life insurance or endowment contracts to meet the statutory definition of a life insurance contract, or the failure of a variable contract to meet the diversification requirements. In the majority of the rulings, the Service waived the failures.*

**Guideline Premium Requirements**

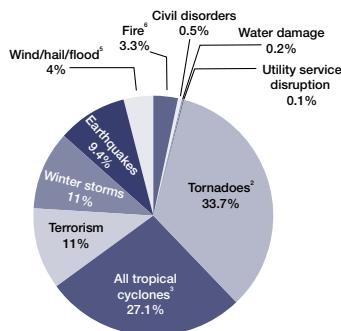
*In the following rulings the Service waived failure of certain policies to meet the guideline premium requirements.*

**PLR 9202008**

The Service waived the failure to meet the guideline premium limitation for the clerical errors, finding that the company's errors were reasonable, but did not waive failure of certain programming errors.

**PLR 8844043**  
**PLR 9042039**  
**PLR 9144009**  
**PLR 9144020**  
**PLR 9146011**  
**PLR 9146016**  
**PLR 9203049**  
**PLR 9214039**  
**PLR 9235013**  
**PLR 9244010**  
**PLR 9801042**  
**PLR 9833033**  
**PLR 9834020**  
**PLR 200006030**  
**PLR 200006032**  
**PLR 200438005**  
**PLR 200446001**

**Inflation-Adjusted U.S. Catastrophe Losses  
by Cause of Loss, 1984-2003 (1)**



(1) Catastrophes are all events causing direct insured losses to property of \$25 million or more in 2003 dollars Adjusted for inflation by ISO.

(2) Excludes terrorism.

(3) Includes hurricanes and tropical storms.

(4) Includes other geologic events such as volcanic eruptions and other earth movement.

(5) Does not include flood damage covered by the federally administered National Flood Insurance Program.

(6) Includes wildland fires.

Source: ISO and Insurance Information Institute Online, <http://www.iii.org/media/facts/statsbyissue/catas1>

### ***Life Insurance Contract Definition Requirements***

*In the following rulings, the Service waived the failure of certain products to satisfy the life insurance contract definition requirements.*

**PLR 9322023**  
**PLR 9416017**  
**PLR 9436037**  
**PLR 9438015**  
**PLR 9441022**  
**PLR 9441023**

**PLR 9601039**  
**PLR 200143008**  
**PLR 200150014**  
**PLR 200150018**  
**PLR 200219022**  
**PLR 2002230037**

**PLR 200320020**  
**PLR 200327037**  
**PLR 200328027**  
**PLR 200350001**

### ***PLR 9452023***

A mutual life insurance company issued level annual premium contracts that can be surrendered for their tabular guaranteed surrender values only on the contract anniversary date. If surrendered on another date, the company is not obligated to pay an amount in excess of the value from

the previous anniversary date, consequently causing the contract to fail to qualify as a life insurance contract under Section 7702(b). The IRS ruled that the requirements to meet the provisions of Section 7702(b) were waived under Section 7702(f) since this was an unintended result.

#### ***Revenue Ruling 91-17***

Income received by a policyholder under a life insurance or endowment contract that fails to meet the statutory definition of a life insurance contract, or under a variable contract that does not meet statutory diversification requirements, is considered a nonperiodic distribution under Section 3405.

#### ***Cash Value Accumulation Test***

*In the following rulings, the IRS found that certain policies satisfied the cash value accumulation test of Section 7702 and qualify as life insurance contracts.*

*PLR 8839021*

*PLR 8839022*

*PLR 8839028*

*PLR 8839030*

*PLR 8839032*

*PLR 8839033*

Finally, in this ruling, *PLR 8816047*, the IRS waived failure to properly state interest rates.

#### ***Compliance Under Section 7702***

*The Service has released several Revenue Procedures providing updated procedures for obtaining a closing agreement to correct the “inadvertent non-egregious” failure to comply with the modified endowment contract rules of Section 7702A. Revenue Procedure 99-27 was updated by Revenue Procedure 2001-42 and Revenue Procedure 2002-42.*

#### ***Notice 99-48***

The Service specified the tax rates to compute the amount due pursuant to a closing agreement that concerns failed life insurance contracts under Section 7702.

### ***Notice 2004-61***

IRS supplemented Notice 88-128 by providing safe harbors regarding the use of either the 1980 Commissioners' Standard Ordinary mortality and morbidity tables (1980 CSO tables) or the 2001 Commissioners' Standard Ordinary mortality and morbidity tables (2001 CSO tables) by taxpayers to determine whether mortality charges are reasonable. The safe harbors are designed to assist taxpayers in complying with the requirements of Section 7702(c)(3)(B)(i).

In a ruling related to Notice 2004-61, ***PLR 9540047***, the Service detailed the aspects of flexible premium, nonparticipating, variable life insurance contracts. The IRS held that mortality charges under the 1980 C.S.O. tables should be used to determine their cost for purposes of Section 7702(c)(3)(B)(i).

### ***Rev. Rul. 2005-6***

The IRS held that for purposes of determining whether a contract qualifies as an life insurance contract or as a modified endowment contract, charges for qualified additional benefits should be taken into account under the expense charge rule of Section 7701(c)(3)(B)(ii).

## **Separate Accounts/Section 817**

*The Secretary of the Treasury prescribes diversification requirements for the investments underlying a variable annuity, endowment, or life insurance contract and provides that a variable contract generally is not treated as an annuity, endowment, or life insurance contract unless those requirements are satisfied. The following rulings address the satisfaction of the diversification requirements.*

### ***Diversification***

#### ***Revenue Procedure 92-25***

The Service provided procedures that issuers of variable contracts must follow to obtain the Commissioner's concurrence that a failure to diversify was inadvertent.

***Notice 87-47***

The IRS issued guidance on the effective date of the diversification requirements for variable annuity, endowment, and life insurance contracts.

***Announcement 88-68***

The IRS extended exceptions to the diversification requirements in temporary and proposed regulations.

***Notice 2000-9***

The IRS provided reduced rates on variable annuity contracts that do not meet the diversification requirements of Section 817(h) for insurers seeking closing agreements between January 13 and August 1, 2000.

***PLR 9125038***

For purposes of applying the diversification requirements of Section 817(h), the Service characterized repurchase agreements as loans and ruled that they would be treated as having been issued, not by the issuers of the securities, but by the brokers.

***PLR 9211021***

The IRS determined that the diversification requirements of Section 817 do not apply to contracts that qualify as pension plan contracts.

***PLR 9230023***

The Service ruled that the product qualified as a variable contract under Section 817 because it was segregated from the general accounts of the taxpayer; the product was a pension plan contract within the meaning of Section 818(a); it was treated as an annuity; and amounts payable from the separate accounts were reflective of market value.

***PLR 9403024***

The IRS ruled that a life insurance company meets the diversification requirements of Section 817.

**PLR 9422006**

The IRS ruled that funds that sell interests to life insurance companies' segregated asset accounts may meet diversification requirements.

**PLR 9437026**

The IRS clarified prior rulings on RICS and life insurance diversification requirements.

**PLR 9437027**

The IRS clarified prior rulings on life insurance diversification requirements.

**PLR 200206047**

The IRS ruled that certain group annuity contracts satisfy the requirements of Section 817(d)(1)-(3) to qualify as "variable contracts."

On July 30, 2003, the Department of the Treasury issued proposed regulations under Section 817(h) on diversification requirements for variable annuity, endowment, and life insurance contracts. The regulations propose removing provisions of the Income Tax Regulations that apply a look-through rule to assets of a nonregistered partnership for purposes of satisfying the diversification requirements of Section 817(h). The Treasury received many comments from industry trade groups, investment managers, and individual corporations regarding the proposed regulations, which have not been finalized.

REG 163974-02, 68 FR 44689-02.

**Separate Accounts Issues**

*The following Section addresses diversification requirements, look-through rules, and investor control in the context of segregated asset accounts, in addition to other separate account issues.*

## Look-through Rule

### *Rev. Rul. 2005-7*

The IRS provided guidance as to how, for purposes of determining whether a segregated asset account is adequately diversified under Section 817(h), the look-through rule of Treas. Reg. Section 817(h)(4) applies to an investment in a regulated investment company that, in turn, owns an interest in another regulated investment company.

### *PLR 8710022*

Unit investment trusts held in separate accounts will be treated as owning undivided shares in Treasury securities by virtue of holding receipts or certificates.

### *PLR 8743005*

The IRS revised a prior ruling, **PLR 8710022**, that unit investment trusts that fund variable life insurance policies are treated as holding undivided shares in treasury debt securities.

### *PLR 9820004*

The IRS ruled that an administrator qualifies as a “fund manager” for purposes of Section 817(h)(4)(B) and that a series of shares will not lose the look-through treatment of that Section by virtue of an affiliate’s ownership of beneficial interests of the series.

### *PLR 9828015*

The IRS ruled that, for purposes of the Section 817(h)(1) diversification requirements, separate company accounts holding interests in mutual funds are treated as owning a ratable interest in the assets of the funds.

### *PLR 9847017*

The IRS ruled that the look-through rule of Section 817(h) applies to the portfolio series that was developed to be the investment vehicle for an insurance company’s separate account, but does not apply to a separate series with the same investment objectives.

***PLR 200010020***

The IRS determined that the Section 817(h) diversification rules would apply to insurance variable contract sub-accounts that invested in specific mutual funds, through Regulated Investment Companies.

***PLR 200115028***

The IRS determined that the Section 817 “look-through” rule applied to a mutual fund that invested in another mutual fund. Therefore, the accounts invested in would own a proportionate amount of the assets from the funds below.

***PLR 200308032***

Ownership of interests in institutional mutual funds by Section 457(b) deferred compensation plans will not prevent satisfaction of the look-through rule.

***PLR 200443029***

The IRS found that the look through rule of Treas. Reg. Section 1.817-5(f) will apply to the direct and indirect investments by certain segregated asset accounts or sub-accounts in Portfolios and the assets of the Portfolios will be treated as assets of the segregated asset account or sub-account for purposes of applying the diversification test of Section 817(h).

**Investor Control*****Revenue Ruling 2003-91***

The IRS ruled that the holder of a variable contract will not be considered to be the owner, for federal income tax purposes, of the assets that fund the variable contract.

***Revenue Ruling 2003-92***

The IRS ruled that the holder of a variable annuity or life insurance contract will be considered to be the owner of the partnership interests that fund the variable contract if interests in the partnerships are available for purchase by the general public.

***PLR 8820044, PLR 8820045, PLR 8820046, PLR 9433030***

The IRS determined that assets held in separate accounts were owned by the insurance company and not the policyholder.

***PLR 200244001***

The IRS ruled that the contract holder, rather than insurer, is the owner of an interest held as a sub-account underlying a variable life contract, and that the earnings from the interest are includable in the Contract holder's gross income under Section 61(a).

***PLR 200420017***

The IRS ruled that distributions of stock that were received by a stock life insurance company's variable contract segregated-asset accounts will be treated as owned by the insurance company.

**Transfers of Assets from Separate Accounts**

***PLR 9138029***

The IRS found that Taxpayer would not recognize gain or loss on the surrender of separate account assets to a single trust, but would recognize gain or loss on assets transferred from general account to a single trust.

***PLR 9201012***

The IRS determined that neither the executed temporary transfer nor the proposed permanent transfer would cause the contracts to be treated as reissued, because the contracts gave the taxpayer the right to invest the assets of the separate accounts in shares of other investment companies.

***TAM 9807001***

The IRS ruled that a mutual insurance company did not trigger gain when it transferred appreciated partnership interests from its general account to a segregated asset account.

## Proration

### *TAM 200038008*

The IRS determined that the taxpayer's method for calculating net investment income and thus, company share and policyholders' share for purpose of the dividends received deduction was appropriate.

### *TAM 200339049*

The IRS determined that the "amount retained" includes all of the contractual charges and fees that Taxpayer subtracts from the separate account, including mortality and expense charges, annual maintenance fees, administrative fees, and premium tax charges.

## Other Separate Accounts Issues

### *Revenue Ruling 94-62*

The IRS provided a list of arrangements that qualify as "qualified pension or retirement plans" for purposes of the diversification requirements for variable products.

### *PLR 8629002*

The IRS ruled that accrued dividends must be excluded from separate account reserves.

### *PLR 8808047, PLR 8835059*

The IRS determined that if state law required amounts under policies to be allocated to separate accounts, then the contract would be a life insurance contract.

### *PLR 9410039*

The IRS ruled that the admittance of new partners to, or withdrawal of existing partners from, a law firm will not result in a transfer of a life insurance contract.

***PLR 9528004***

A U.S. mutual life insurance company established pooled separate accounts in which only qualified retirement plans and certain non-life pension plans could invest. These accounts primarily invested in foreign equities. The IRS ruled that the company may claim a foreign tax credit under Section 841 for foreign taxes creditable under Section 901 related to the income generated by the accounts, without reduction for the policyholders' share.

***PLR 200246022***

The IRS ruled that amounts received under annuity and life insurance contracts allocated to an account segregated from the general account of Taxpayer, in accordance with foreign law, will be treated as amounts segregated from the general account "pursuant to state law or regulation," and therefore variable contracts, for purposes of Section 817(d)(1).

## **Miscellaneous Product Issues**

***Revenue Ruling 2003-95***

The Revenue Ruling discusses three situations where the policyholder surrenders a percentage of a life insurance contract and receives a cash distribution and where the death benefit decreases as a result.

***Notice 93-37***

The IRS extended the effective date of qualified accelerated death benefit regulations.

***PLR 9044072***

The IRS ruled that a foreign trust funded with domestic life insurance policies qualifies as a qualified domestic trust.

***PLR 9115032***

The IRS ruled that an annuity contract would qualify as a variable contract under Section 817(d).

***PLR 9338023***

The IRS ruled that an increase in the mortality charges (or other charges used to determine the guideline premium limitation) would be an adjustment event under Section 7702(f)(7).

***PLR 9519023***

The taxpayer is contemplating purchasing a nonparticipating level premium life insurance contract that qualifies as such by meeting the cash value accumulation test under Sections 7702(a)(1) and (b). In a detailed ruling, the IRS determined the amount of future benefit for purposes of applying the seven pay test under Section 7702A.

***PLR 199929028***

The Service concluded that the annual rates established after a policy's issue are not taken into account for determining the net single premium under Section 101(f)(1)(B) or Section 7702(b).

***PLR 200313016***

A life insurer's proposed distribution methods on the death of an annuity owner will satisfy the requirements of Section 72.

***TAM 9117005***

The IRS ruled that proceeds from an employer-provided and funded Disability and Survivorship Plan do not constitute life insurance income.

***TAM 199924001***

The Service concluded that the portion of an insurance premium allocated by an insurance company to a redemption account held for the taxpayer was deductible.

***TAM 200330002***

Short-term capital gains included within dividends paid by a regulated investment company are not taken into account under the basis adjustment rules of Section 817(b).

# Reinsurance



# 10

chapter

# Reinsurance

*Reinsurance is often referred to as “insurance” for insurance companies and can take various forms, including assumption, indemnity, and co-insurance. Reinsurance is the assumption by an insurer (e.g., the reinsurer) of all or a part of an insurance risk of another insurer (e.g., the reinsured or ceding insurer). In consideration for assuming the insurance risks, the reinsurer generally receives from the ceding company a reinsurance premium. On the other hand, the ceding insurer is generally paid a ceding commission for reimbursement of costs incurred in acquiring and administering the ceded insurance risks. The accounting for reinsurance transactions differs depending not only on the form of reinsurance, but also on the particular set of books involved (e.g., GAAP, statutory, or tax).*

*In order for a reinsurance arrangement to be treated as “insurance” for U.S. tax purposes, the arrangement must provide for both “risk shifting” and “risk distribution” as initially adopted by the U.S. Supreme Court in *Helvering v. Le Gierse*.<sup>66</sup> Additionally, the IRS may use its discretion to recharacterize reinsurance transactions entered into for “tax avoidance purposes.” The IRS has tested this power only once. In the 1996 case *Trans City Life Insurance Company v. Commissioner*,<sup>67</sup> the Court concluded that reinsurance agreements had an overriding business purpose. In 2004, JOBS Act of 2004<sup>68</sup> amended Section 845(a) relating to the Treasury Secretary’s power to reallocate income between related parties in a reinsurance agreement, to allow the Secretary to make an adjustment if he determines that it is necessary to reflect the proper amount, source, and character of the taxable income.*

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66. *Helvering v Le Gierse*, 61 S. Ct. 646 (1941).

67. *Trans City Life Insurance Co. v. Commissioner*, 106 T.C. No. 15 (1996).

68. AMERICAN JOBS CREATION ACT OF 2004, Pub. L. 108-357.

Previously the Secretary could make an adjustment if he determined that it was necessary to reflect the proper source and character only. This regulation could be the subject of more controversy in the future as transfer pricing becomes a more significant issue in the international insurance arena.

Litigation and IRS rulings have not been limited to the questions of risk shifting, risk distribution, and proper allocation. The appropriate tax treatment of uncollectible reinsurance and insurance reserves has also been addressed. Over the years, the IRS has argued that unrecoverable reinsurance should be deducted as bad debt under Section 166. However, in 1997, the IRS National Office rejected this argument in **LTR 9732004** and sided with the approach supported by insurance companies. That is, uncollected reinsurance may be written off as “losses incurred.”

## Assumption Reinsurance

*The Service litigated one case and issued three Private Letter Rulings relating to assumption reinsurance transactions.*

**Oxford Life Insurance Co. v. United States, 790 F. 2d 1370 (1986).** The Ninth Circuit Court of Appeals ruled that in an assumption reinsurance transaction the reinsurer must include in gross income the excess of reserves over investments received as consideration, but that income did not need to be adjusted to include the revaluation of reserves.

### **PLR 9507039**

An insurance company entered into assumption reinsurance agreements with another insurance company pursuant to a plan of rehabilitation. Under the agreement, both companies were required to file a joint election under Treas. Reg. Section 1.848-2(i)(4), requiring the transfer of the rehabilitated company's negative excess capitalization amount.

**PLR 9511025**

This ruling outlines the tax consequences of an assumption reinsurance transaction, a de facto liquidation whereby a brother corporation will acquire a sister corporation and then assume all the assets and liabilities of the sister corporation's insurance subsidiary. The IRS held that this transaction satisfied the requirements of Section 332 and outlined the resulting carry-over of insurance attributes.

**PLRs 9516055 and 9516056**

In two complex rulings involving the same insolvent stock life insurance company, which issued life insurance and annuity contracts, the IRS ruled on several issues related to an assumption reinsurance transaction. Under Section 7702, the issue dates of the life insurance contracts were unaffected and will not require a new test period. Under Section 72, investment in the contract would remain the same for each restructured contract immediately after the assumption reinsurance transaction as for the unstructured contracts. In addition, under Sections 72 and 451, no gross income would be recognized by any contract holder of a restructured contract by reason of receiving certain rights and enhancements. Under Sections 803 and 848, the amount paid to the reinsurer was treated as a premium, which enabled both companies to make a joint election with respect to the negative excess capitalization amounts.

**Modified Co-Insurance**

*The Service ruled on various modified coinsurance agreements and litigated issues related to those agreements in Modern American and Gulf Life.*

*Modern American Life Insurance Company, Successor in Interest to Dynamic Security Life Insurance Company v. Commissioner of Internal Revenue Service, 830 F.2d 110 (1987).* The Circuit Court of Appeals ruled that a reinsurance payment must be amortized over the 10-year term during which the reinsurer will share in the gain realized from the policies it has reinsured. Because the reinsurer in a modified coinsurance

transaction would not include anything in gross premiums as a result of the transaction, no reduction under Section 809(c) is appropriate.

*Gulf Life Ins. Co. v. U.S., 35 Fed. Cl. 12 (1996).* The Court of Federal Claims ruled that reimbursements for policyholder dividends, paid to a life insurer from a reinsurer pursuant to a modified indemnity agreement, should be treated as dividends paid by the reinsurer.

*Gulf Life Insurance Co. v. U.S., 118 F.3d 1563, (1997).* A Federal Circuit panel upheld the lower court's decision that reimbursements for policyholder dividends, paid to a life insurer from a reinsurer pursuant to a modified indemnity (modco) agreement, should be treated as dividends paid by the reinsurer.

#### **TAM 9113002**

A life insurance company would not be treated as having transferred its policyholder dividend deductions to the reinsurer in a modified coinsurance agreement.

#### **TAM 9147066**

Taxpayer sought, and was denied, Section 7805(b) relief for the IRS's ruling that Taxpayer would not be treated as having transferred its policyholder dividend deductions to the reinsurer in a modified coinsurance agreement.

## **Indemnity Reinsurance and Ceding Commissions**

*In 1989, the Supreme Court ruled in Colonial American that ceding commissions in an indemnity reinsurance arrangement must be capitalized and amortized. The majority of the following indemnity reinsurance rulings relate to this decision.*

*Individual Life Assurance Co. v. Commissioner, T.C. Memo 1986-201 (1986).* The Tax Court held that ceding commissions paid in indemnity reinsurance are not deductible.

The Ten Most Costly World Insurance Losses, 1970-2004 (1) (\$ Millions)				
Rank	Date	Country	Event	Insured loss in 2003 U.S. dollars (2)
1	Aug. 23, 1992	U.S., Bahamas	Hurricane Andrew	\$20,900
2	Sep. 11, 2001	U.S.	Terrorist attack on WTC, Pentagon and other buildings	19,532
3	Jan. 17, 1994	U.S.	Northridge earthquake	17,312
4	Sep. 27, 1991	Japan	Typhoon Mireille	7,598
5	Aug. 13, 2004	U.S.	Hurricane Charley (3)	6,755
6	Jan. 25, 1990	France, U.K., et al.	Winterstorm Daria	6,441
7	Dec. 25, 1999	France, Switzerland, et al.	Winterstorm Lothar	6,382
8	Sep. 15, 1989	Puerto Rico, U.S. et al.	Hurricane Hugo	6,203
9	Sep. 16, 2004	U.S.	Hurricane Ivan (3)	6,000
10	Oct. 15, 1987	France, U.K., et al.	Storm and floods	4,839

(1) Property and business interruption losses, excluding life and liability losses. As of November, 2004.

(2) Adjusted to 2003 dollars by Swiss Re.

(3) ISO preliminary estimate, expressed in 2004 dollars.

Note: Loss data shown here may differ from figures shown elsewhere for the same event due to differences in the date of publication, the geographical area covered and other criteria used by organizations collecting the data.

Source: Swiss Re, sigma, No. 1/2004. Insured losses for natural catastrophes in the United States and the Sept.11 terrorist attack from ISO. Insurance Information Institute Online <http://www.iii.org/media/facts/statsbyissue/catastrophes>.

***Merit Life Insurance Co. v. Commissioner, 853 F.2d 1435 (1988).***

The U.S. Court of Appeals ruled that a reinsurer may deduct ceding commissions currently in indemnity reinsurance transactions.

***Commissioner v. Merit Life Insurance Co., 109 S. Ct. 3208 (1989).*** The Supreme Court determined that an insurance company may not deduct currently ceding commissions paid under an indemnity reinsurance agreement.

*Colonial American Life Insurance Co. v. Commissioner, 843 F.2d 201 (1988).* The Fifth Circuit Court reversed the Tax Court and ruled that ceding commissions paid under an indemnity reinsurance agreement are an investment in the future stream of income from reinsurance policies and must be capitalized and amortized.

*Colonial American Life Insurance Co. v. Commissioner, 109 S. Ct. 2408 (1989).* The Supreme Court held that ceding commissions paid under an indemnity reinsurance agreement are an investment in the future stream of income from reinsurance policies and must be capitalized and amortized.

#### ***Revenue Procedure 90-36***

In response to the Supreme Court's decision in Colonial American, the IRS provided procedures for life insurance companies to obtain IRS consent to change their method of accounting for ceding commissions.

#### ***Announcement 89-89***

The IRS will provide guidance for changes in accounting method for ceding commissions related to Colonial American.

#### ***PLR 8550004***

The IRS ruled that amounts reimbursed to ceding companies by the reinsured for commissions were deductible reinsurance expenses to the reinsurer.

#### ***PLR 8817008***

The IRS determined that the gross amount of consideration, including premiums, reduced by return premiums arising out of indemnity reinsurance, could be less than zero.

#### ***PLR 9409007***

The IRS ruled that a company which entered into a reinsurance agreement in which the reinsurer agreed to reinsure a portion of the

company's risks that exceeded a specified dollar amount, must currently report the amount of contingent commission income.

### **TAM 9141001**

The IRS determined that ceding commissions paid by the taxpayer did not have to be capitalized.

### **TAM 9208006**

The IRS determined that the ceding commissions paid by the taxpayer did not have to be capitalized pursuant to Colonial American.

### **TAM 9306004**

The IRS rejected a reinsurer's argument that its annual statement treatment of the ceding commission was controlling.

### **TAM 9608005**

The IRS ruled that a reinsurer must reduce its amortizable basis in ceding commissions paid by taking into account the estimated amount of fees recoverable upon recapture.

### **FSA 200144028**

The IRS concluded that a life insurer may determine basis in a reinsurance ceding commission by using the Section 338 residual allocation method.

## **Reserves in Reinsurance Transactions**

*The Service and the courts ruled in several instances that certain amounts in reinsurance transactions were reserves. The Service also ruled on a question of unpaid losses in the rulings below.*

### ***Anchor National Life Insurance Co. v. Commissioner, 93 T.C. 34 (1989).***

The Tax Court held that reserves in a reinsurance transaction do not have to be reflected in the gross premium income of the assuming company.

**GCM 39417**

The IRS reversed a previous GCM that concluded that a life insurance company with a yearly renewable term reinsurance contract could not take a deduction with respect to nonparticipating policies reinsured.

**PLR 8602016**

Taxpayer proposed to reinsurance structured settlement annuity contracts. The IRS ruled that amounts needed to satisfy Taxpayer's obligation would be considered amounts under Section 807(c)(3) and annuity contracts would be considered qualified funding assets, despite the reinsurance arrangement.

**PLR 8831021**

The IRS determined that amounts necessary to satisfy certain obligations under reinsured annuity contracts would be Section 807(c)(3) reserves.

**TAM 8951001**

The IRS determined that a Taxpayer that entered into an indemnity reinsurance contract is not required to recompute its life insurance reserves according to the reserve method of the ceding company.

**TAM 9147006**

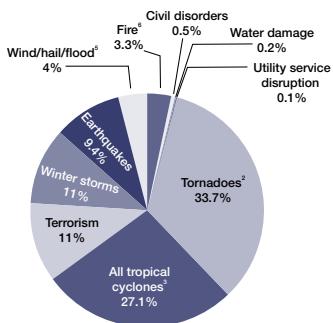
The IRS determined that an increase in unpaid losses could not be claimed in 1986, because the information from the arbitration panel was not available as of the end of 1986.

## Uncollectible Reinsurance

*The Service examined the question of whether a bad debt deduction would be allowed for uncollectible reinsurance in the following rulings.*

**Credit Life Insurance Co. v. United States, 948 F.2d 723 (1991).** The U.S. Court of Appeals reversed the Claims Court decision, which had permitted the taxpayer a bad debt deduction for uncollectible reinsurance.

Inflation-Adjusted U.S. Catastrophe Losses by Cause of Loss, 1984-2003 (1)



(1) Catastrophes are all events causing direct insured losses to property of \$25 million or more in 2003 dollars. Adjusted for inflation by ISO.

(2) Includes tornados.

(3) Includes hurricanes and tropical storms.

(4) Includes other geologic events such as volcanic eruptions and other earth movement.

(5) Does not include flood damage covered by the federally administered National Flood Insurance Program.

(6) Includes wildland fires.

Source: ISO and Insurance Information Institute Online, <http://www.iii.org/media/facts/statsbyissue/catastrophes>.

### PLR 9121017

The income realized from a discharge of indebtedness was excludable under Section 108(a)(1)(B).

### TAM 9732004

The IRS allowed the deduction of uncollectible reinsurance on both paid and unpaid losses as a component of the losses incurred deduction.

## Section 845

*Section 845 was enacted in the Deficit Reduction Act of 1984 to allow recharacterization of reinsurance transactions entered into for tax avoidance purposes. It has been tested only once. In the 1996 case *Trans City Life Insurance Company v. Commissioner*, the Court concluded that reinsurance agreements had an overriding business purpose. The Court analyzed the reinsurance transactions according to 7 criteria*

*derived from the legislative history of Section 845. In the American Jobs Creation Act of 2004 the provision was modified to expand IRS discretion in adjusting the amount, source, and character of taxable income in a reinsurance transaction.*

***Trans City Life Insurance Co. v. Commissioner, 106 T.C. No. 15 (1996).***

The Tax Court held that the IRS abused its discretion in determining that two reinsurance agreements had a “significant tax avoidance effect.” The reinsurance agreements enabled Trans City to claim the small life company deduction pursuant to Section 806.

***TAM 9308003***

The IRS found that all of the facts and circumstances of a reinsurance agreement demonstrated that the reinsurance agreements had a tax avoidance effect.

***TAM 9346004***

The IRS used related party reinsurance rules to limit a life subgroup’s interest deduction.

***PLR 9335056***

The Service determined that the reinsurance agreement between the taxpayer and the insolvent company did not result in a significant tax avoidance effect.

## **Miscellaneous Reinsurance Rulings**

*In the following rulings the Service addresses issues from renewable term reinsurance to transferee liability.*

***Gerling International Insurance Co. v. Commissioner, 98 T.C. No. 44 (1992).*** The Tax Court held for the taxpayer, expressly allowing the reinsurer to report income and deductions from its reinsurance transactions on a delayed basis, i.e., in a taxable year after the ceding company’s activities had occurred.

### ***TAM 8906004***

A ceding company's treatment of experience rating refunds could not be recharacterized by the IRS.

### ***PLR 9029002***

The IRS held that reinsurance contracts entered into by a property casualty insurance company are not insurance contracts because there was no transfer of risk. Nor do the contracts give rise to income from the discharge of indebtedness since Taxpayer remained liable to its contract holders and had only purchased the right to indemnification for payouts on certain contracts.

### ***PLR 9340042***

The IRS determined that taxpayer, a mutual life insurance company, would not be subject to transferee liability in an assumption reinsurance agreement because the taxpayer did not agree to assume the insolvent company's tax liability and neither the taxpayer nor the insolvent company intended to defraud the insolvent company's creditors.

### ***PLR 9407019***

A reinsurance transaction between a foreign company and its wholly-owned subsidiary will not affect the date a contract was issued, entered into, or purchased.

# Reorganizations



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chapter

## Reorganizations

*The trend in the 1990s up until the passage of the Gramm-Leach-Bliley Act of 1999<sup>69</sup> (GLB 1999) was increased consolidation through rampant merger and acquisition (M&A) activity throughout the insurance industry. Once GLB 1999 authorized mergers between banks and insurance companies, it was anticipated that financial services companies would merge their separate business operations to take advantage of market distribution channels and other economic efficiencies inherent in the marketplace. While there was some significant activity initially, it quickly slowed. Rather than the anticipated widespread consolidation resulting in a small number of dominant players, the insurance industry saw and continues to see a marketplace comprised of a significant number of smaller, regional insurers. Nonetheless, corporate reorganizations have played and will continue to play an important role in the insurance industry, particularly given the continued changes in the insurance market since September 11, 2001.*

*As the insurance industry has reacted to changes in the insurance market, so-called “save-the-charter” rulings and demutualizations have been fairly common. The IRS has generally looked favorably on each of these transactions. In save-the-charter transactions, where the insurance company subsidiary is liquidated despite retention of the charter and licenses, the IRS has issued guidance regarding the specific details of the transactions and their effect on companies’ tax attributes.<sup>70</sup> In demutualizations, the IRS has generally ruled that the conversion of a mutual insurance company into a stock insurance company is a tax-free reorganization, although the IRS and the courts have continued to deny deductions for distributions of cash and stock to policyholders as part of a demutualization.<sup>71</sup>*

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69. GRAMM-LEACH-BLILEY FINANCIAL MODERNIZATION ACT, Pub. L. 106-102.

70. See PLR 9624014.

71. See UNUM Corp. v. U.S., 119 S.Ct. 42 (1998).

In acquisitions where tax-free treatment is not possible, companies have continued to make Section 338(h)(10) elections whereby a buyer and seller mutually elect to treat a stock purchase as an asset purchase for Federal tax purposes. In 1999, the Treasury released proposed regulations under Section 338 which clarified the tax aspects of deemed asset sales and which indicate that if a target is an insurance company for which a Section 338 election is made, the deemed asset sale would be characterized and taxed as an assumption reinsurance transaction for Federal tax purposes.<sup>72</sup> The IRS published final regulations under Section 338 in 2001<sup>73</sup> and issued additional proposed regulations specific to insurance companies in March 2002.<sup>74</sup>

Whether a save-the-charter transaction, a stock purchase using a 338(h)(10) election, a liquidation, or a merger, parties incur many types of acquisition-related costs which may or may not be currently deductible.<sup>75</sup> Parties must also take into account the effect of certain transactions on insurance reserves, triggering of policyholder surplus accounts, the use of net operating losses, and implications on underlying insurance contracts. The IRS has issued numerous rulings regarding tax attributes in corporate reorganizations.

## **“Save-the-Charter” Transactions**

### **“D” Reorganizations**

*The IRS released several Private Letter Rulings, in addition to a Revenue Ruling, concluding that mergers of affiliated insurance companies would be “D” reorganizations, even though the transferor retained the charter and business licenses.*

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72. REG-107069-97, 64 FR 43462-01.

73. T.D. 8940, 66 FR 17466-04.

74. REG-118861-00.

75. See TAM 9825005 where certain investigatory expenses incurred in acquiring a bank were not start-up costs eligible for Section 195 amortization. See also TAM 9903020 where the IRS concluded expenditures incurred by the taxpayer in the course of a general or preliminary investigation in order to determine whether to acquire a subsidiary were Section 195 start-up costs and *Norwest Corporation and Subsidiaries v. Commissioner*, 110 T.C. 454 (1998), where the Tax Court held that a target was required to capitalize certain legal expenses in connection with the acquisition of its stock.

<i>PLR 8617088</i>	<i>PLR 8924034</i>	<i>PLR 9112026</i>
<i>PLR 8812040</i>	<i>PLR 8928052</i>	<i>PLR 9114012</i>
<i>PLR 8822053</i>	<i>PLR 8945043</i>	<i>PLR 9124058</i>
<i>PLR 8823105</i>	<i>PLR 9045058</i>	<i>PLR 9220046</i>
<i>PLR 8830016</i>	<i>PLR 9109011</i>	<i>PLR 9229019</i>

#### *PLR 9016006*

In **PLR 8812040** the IRS held that the merger of two lower-tier life insurance subsidiaries of a holding company is a reorganization under Section 368(a)(1)(D). The company requested a postponement of the stock sale dates, and the IRS ruled that this change will not alter its previous holdings.

#### *Revenue Ruling 95-19*

This ruling describes three different Section 368(a)(1)(D) reorganization structures. In each situation, the insurer retained the charter, licenses and minimum capital necessary under state law. The ruling held that in certain situations there is a deemed distribution from the policyholder's surplus account equal to the fair market value of any retained assets when substantially all of the assets of a life insurance company are transferred in a Section 368(a)(1)(D) reorganization.

#### *Liquidations*

In **Revenue Procedure 89-36**, the IRS announced that it would issue advance rulings associated with stock-purchase/liquidation transactions involving life insurance companies. Several of those rulings, including a few that precede Revenue Procedure 89-36 follow.

#### *Revenue Procedure 89-36*

The IRS will issue advance rulings associated with stock-purchase/liquidation transactions involving life insurance companies.

***Revenue Procedure 89-50***

The IRS announced that representations must be made before the issuance of favorable private letter rulings on certain tax-free reorganizations of insurance companies.

*In each ruling the IRS determined that a transaction involving a save-the-charter transaction would be a liquidation under Section 332.*

*PLR 8735015*

*PLR 8925084*

*PLR 9150014*

*PLR 8808049*

*PLR 8933009*

*PLR 9208035*

*PLR 8817044*

*PLR 8945068*

*PLR 9215016*

*PLR 8829065*

*PLR 9013054*

*PLR 9245039*

*PLR 8852025*

*PLR 9103023*

*PLR 9309048*

*PLR 8911058*

*PLR 9111037*

*PLR 8912050*

*PLR 9129009*

***PLR 9124052***

The IRS ruled that the liquidation of subsidiary would constitute a tax-free complete liquidation despite retention of charter and licenses. In addition, distributions would not be treated as distributions out of policyholder surplus accounts.

***Extensions of Time to Liquidate***

*When a company could not sell the assets of a subsidiary within the 12-month time period allotted by the IRS in a save-the-charter ruling, it applied for an extension of time. The IRS granted those extensions in several instances including those that follow.*

In *PLR 9051042*, the IRS granted an extension to the company in *PLR 8945043* to sell the stock of the target insurance company within six months.

*In these rulings, the IRS extended by twelve months the time in which the stock must be sold or liquidated in a save-the-charter transaction.*

*PLR 9126038*

*PLR 9122079*

*PLR 9212004*

## Holding Company Structures

Occasionally, save-the-charter transactions involve the creation or reorganization of a holding company structure. Two such rulings follow.

### PLR 9520054

P1 owns all the stock of P2. Together they own all the stock of S1 and S2. P1 will contribute its S1 stock to P2. S1 and S2 will be liquidated although they will retain their charters, licenses and minimum capital and surplus requirements sufficient to meet state law. The IRS held that the transaction qualified as a tax-free liquidation under Section 332.

### PLR 9542042

This ruling discusses a proposed plan of liquidation of insurance subsidiaries by the holding company parent. Based on the facts in the ruling, the IRS held that the transaction qualifies as a valid Section 332 liquidation even though the subsidiaries retained their charters, insurance licenses and minimum capital to satisfy state law requirements.

Top Ten Completed Deals			
Date	Target Name	Acquiror Name	Value of Transaction (\$mil)
07/12/95	Allstate Corp.	Shareholders	11,761
10/08/98	Citicorp	Travelers Group Inc.	72,558
12/21/98	General Re Corp.	Berkshire Hathaway Inc.	22,300
01/01/99	SunAmerica Inc.	AIG	18,117
01/03/01	AXA Financial Inc.	AXA Group	11,189
08/30/01	American General Corp.	AIG	23,398
08/20/02	Travelers Property Casualty	Shareholders	12,213
04/28/04	John Hancock Financial Services Inc.	Manulife Financial Corp.	11,063
11/30/04	WellPoint Health Networks Inc.	Anthem Inc.	16,442
04/01/04	Travelers Property Casualty Corp.	St. Paul Companies Inc.	16,136

Source: Securities Data Corporation

## Mergers

*The Service ruled on a number of mergers, including “A” reorganizations, “C” reorganizations, “D” reorganizations, “E” reorganizations, “F” reorganizations, “G” reorganizations, liquidations, and mergers of foreign insurance companies.*

### **“A” Reorganizations**

#### ***PLR 8725040***

The IRS ruled that the merger of a personal holding company into a holding company that holds all of the stock of a life insurance company and several “non-life” insurance companies will be a reorganization under Section 368(a)(1)(A).

#### ***PLR 9121048***

Mergers of subsidiaries would be a tax-free reorganization under Section 368(a)(1)(A).

#### ***PLR 9444010***

Merger of insurance groups is a tax-free reorganization under Section 368(a)(1)(A).

#### ***PLR 9502025***

The IRS revoked **PLR 8827061**, granting the taxpayer insurance company and parent of an affiliated group favorable treatment, where the taxpayer entered into a reverse triangular merger to facilitate the formation of a holding company structure pursuant to Sections 368(a)(1)(A) and 368(a)(2)(E).

#### ***PLR 9510010***

This ruling discusses the proper computation of the Section 809 differential earnings amount, by which the Section 808 deduction for policyholder dividends must be reduced when two mutual life insurance companies are merged in a transaction satisfying the requirements of Section 368(a)(1)(A).

### ***PLR 9527028***

Two mutual life insurance companies were parents in a consolidated group filing life/non-life consolidated returns. These two companies merged, and the IRS held that the continuity of interest test of Section 368(a)(1)(A) is satisfied, and the annuity contracts remain unaffected.

### ***PLR 9616031***

The IRS ruled that the interests received by target policyowners as part of a statutory merger of two mutual life insurance companies are “continuing equity interests” for purposes of the continuity of interest requirement.

### ***“C” Reorganizations***

#### ***PLR 9334016***

The IRS determined that a mutual merger is a tax-free “C” reorganization.

### ***“D” Reorganizations***

*In the following Private Letter Rulings, the Service ruled that a transaction would be a tax-free “D” reorganization.*

***PLR 9109045***

***PLR 9122080***

***PLR 9139004***

***PLR 9306014***

***PLR 9335045***

***PLR 9837002***

***PLR 200011041***

#### ***PLR 8734026***

The IRS ruled that the transfer of insurance business to a new foreign corporation followed by the dissolution of the existing insurance corporation will qualify as a ‘D’ reorganization.

### ***“E” Reorganizations***

*In the following Private Letter Rulings, an affiliated group with an insurance company parent was reorganized into a holding company structure and qualified as a merger under Section 368(a)(2)(E).*

***PLR 8812047***

***PLR 8824037***

***PLR 8827061***

### ***“F” Reorganizations***

In ***PLR 9042022*** and ***PLR 9038055***, the IRS determined that a change in the state of incorporation of a life insurance company is a change in the identity, form, or place of incorporation, and will qualify as a tax-free reorganization under Section 368(a)(1)(F).

***PLR 9241056***

The IRS determined that a reorganization under Section 368(a)(1)(F) maintained the interests of the policyholders in the taxpayer and the new corporation and constituted a sufficient proprietary interest for purposes of satisfying the continuity of interest requirement.

### ***“G” Reorganizations***

***PLR 9313020***

The IRS determined that a rehabilitation was a tax-free “G” reorganization.

### ***Liquidations***

***PLR 9216027***

The IRS determined that the merger of a subsidiary into its parent qualified as a complete liquidation of the subsidiary under Section 332.

***PLR 9412044***

The IRS determined that the mergers of subsidiaries into parent are distributions in complete liquidation.

## Distributions

*The Service has ruled on the character of distributions in certain reorganizations.*

*In these rulings, the Service determined that the distribution of the subsidiary's assets to the parent would constitute a complete liquidation pursuant to Section 332.*

*PLR 9246036*

*PLR 9431049*

*PLR 9438027*

*PLR 9609049*

*PLR 9624014*

***PLR 9212005***

The IRS determined that a distribution of common stock would be tax-free under Section 355.

***PLR 9839005***

The IRS ruled that life insurance contracts restructured under a plan of liquidation will not result in income to policyholders or the insurance company.

***FSA 200238032***

The IRS ruled that distributions made by Sub to Parent are consideration paid to purchase Parent's stock in Sub.

## Tax Attributes in Reorganizations

*Occasionally the Service has ruled on certain tax attributes involved in reorganizations, particularly policyholder surplus accounts, contracts, net operating losses, policy acquisition expenses, reserves, and the character of any gain or loss resulting from a transaction.*

## ***Miscellaneous Tax Attributes***

In the following rulings, the Service ruled that a parent company would generally succeed to the subsidiary's tax attributes.

***PLR 8919008***

***PLR 8926020***

***PLR 9142015***

## ***Policyholder Surplus Accounts***

*In the following rulings, the Service ruled on policyholder surplus accounts.*

***PLR 8623025***

The IRS supplemented **PLR 861708**<sup>76</sup>, ruling that Acquiring will succeed to the tax attributes of Target and must carry over the ending amounts of Target's shareholder and policyholder surplus accounts.

***PLR 8624011***

The IRS supplemented **PLR 8550065** ruling that Acquiring must carry over the ending amounts of Target's shareholder and policyholder surplus accounts and that Acquiring would succeed to Target's tax attributes.

***PLR 8825013***

The IRS determined that a subsidiary's merger into its parent would not trigger Phase III tax.

## ***Contracts***

*The Service ruled on the tax consequences of a reorganization to the underlying insurance contracts.*

***Revenue Ruling 94-45***

The IRS ruled on the tax consequences of an exchange of insurance contracts for subsidiary's stock.

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76. The original PLR focused on the "save-the-charter" transaction and can be found earlier in this chapter.

### **PLR 9145013**

Parent owned key-man and split-dollar life insurance policies. Parent's wholly-owned subsidiary acquired Parent's assets, including life insurance policies. The IRS ruled that the acquisition of parent by subsidiary does not trigger the policies' effective dates.

### **PLR 923552**

The Service determined that the redomestication of the acquiring company would qualify as a Section 368(a)(1)(E) reorganization, and that the redomestication would not cause the contracts issued by the acquiring company on or before the redomestication to be treated as newly issued contracts.

### **PLR 200303028**

The liquidation of two life insurance subsidiaries into their parent will not modify the subsidiaries' life insurance or annuity contracts.

## ***Net Operating Losses***

*In the following rulings, the Service ruled on net operating losses.*

### **PLR 9011020**

The IRS determined that a mutual life insurance company could use Section 332 liquidations to utilize excess NOL carry-overs held by liquidated subsidiaries.

### **PLR 9029030**

In **PLR 9011020** the IRS ruled that a mutual life insurance company could use complete liquidations to release subsidiaries' NOL carry-overs. The company changed its plan and decided to liquidate three subsidiaries. The IRS ruled that the distributions by the subsidiaries of their assets are complete liquidations. Additionally, NOL carry-overs will be available to offset life insurance company taxable income.

***PLR 9138029***

The IRS ruled that a combination of trusts did not result in an ownership change within the meaning of Section 382(g).

***Reserves***

*In the following rulings, the Service ruled on insurance reserves.*

***PLR 8747004***

The IRS determined that life insurance reserves are liabilities that are fixed and determinable, and should be included in the purchase price of the assets of Target for purposes of determining basis under Section 334.

***PLR 9223027***

The IRS determined that an acquiring company in a save-the-charter transaction would succeed to Target's life insurance reserves.

***PLR 9229026***

The IRS determined that pursuant to Section 381(c)(22), the acquiring company in a save-the-charter transaction would succeed to and take into account the reserves held by the target immediately prior to the transaction.

***Policy Acquisition Expenses***

*In the following rulings, the Service ruled on policy acquisition expenses.*

***PLR 9149040, 9126062***

The IRS determined that Target may not reduce its net premiums for purposes of the deferred acquisition costs capitalization rules for the transfer of assets to Acquiring, and Acquiring may not include in net premiums any amount with respect to assets transferred to it.

### ***PLR 9217051***

The IRS ruled that the unamortized balances of the subsidiaries' capitalized policy acquisition expenses would carry over to — and be amortizable by — the mutual life parent.

### ***PLR 9552030***

The IRS ruled that the acquiring company would succeed to the target's DAC balances pursuant to the merger of two stock life insurance companies.

### ***Tax-free Transactions***

*In the following rulings, the Service ruled on tax-free gains.*

### ***PLR 9014028***

The IRS ruled that the transfer to the acquiring company of substantially all of the Target life insurance company's assets, in constructive exchange for acquiring company stock, is a tax-free reorganization.

### ***PLR 9201010***

A foreign parent proposed to transfer U.S. insurance business and certain other assets through its first-tier U.S. subsidiary to a second-tier U.S. subsidiary. The Service ruled that the income and deductions resulting from the reinsurance transaction would be equal, and that any other gain from the transaction would be tax-free under Section 351.

### ***PLR 9212014***

The Service ruled that the income and deductions for the reinsurance transaction between a foreign insurance company and its U.S. branch would be equal and that any other gain from the transaction would be tax-free under Section 351.

### ***TAM 9331002***

The IRS concluded that Old Target had to recognize income from the sale of its insurance in force and that New Target had acquired an asset.

In addition, the gain was not free from tax, even though Old Target was deemed to have liquidated into the Taxpayer.

***PLR 9345006***

The IRS ruled that the transfer of the Insurance Liabilities, Insurance Assets, and the Additional Assets from Transferor to Transferee and the assumption of related liabilities will be treated as the transfer of such assets from Transferor to Sub in constructive exchange for additional stock of Sub and the assumption of related liabilities, followed by the transfer of such assets and liabilities from Sub to Transferee in constructive exchange for additional stock of Transferee and the assumption of related liabilities pursuant to Section 351 of the Code. No gain or loss will be recognized.

***PLR 9409041***

The IRS ruled that no gain or loss would be recognized in double drop down in association with assumption reinsurance transaction.

***PLR 9608019***

The IRS ruled that a transfer of diversified assets from a stock life insurance company to a regulated investment company, solely in exchange for RIC shares, qualified as a tax-free transfer under Section 351(a). This result was later codified.

***PLR 9642061***

The IRS ruled that a structured settlement subsidiary's asset transfer to a newly created subsidiary was tax-free under Section 351.

***PLR 199914012***

The Service concluded that the transfer of the insurance assets and liabilities of the taxpayer's U.S. branch to a newly formed U.S. subsidiary was tax-free under Section 351.

***PLR 200307080***

The liquidation of a mutual holding company following the sale of its

subsidiaries produces capital gain for members who held policies through the insurance subsidiary.

### *Acquired Assets*

*In the following rulings, the Service and Courts ruled on various asset distributions.*

*Decker v. Commissioner, 864 F.2d 51 (1988).* The U.S. Appeals Court ruled that the taxpayer acquired a seller's goodwill in an acquisition.

*INDOPCO, Inc. v. Commissioner, 112 S. Ct. 1039 (1992).* The Supreme Court ruled that since a variety of takeover fees produced long-term benefits to the target corporation, the fees were nondeductible capital expenditures.

#### *PLR 9105033*

A property and casualty insurance subsidiary may distribute its assets to its affiliate in a tax-free Section 355 distribution.

#### *PLR 9701032*

The IRS ruled on the consequences of a liquidation of a life insurer's subsidiary followed by the contribution of the subsidiary's assets to an LLC.

### **338(h)(10) Issues**

#### *Qualification for a Section 338(h)(10) Election*

*In several instances the Service ruled on whether a transaction qualified for a Section 338(h)(10) election.*

#### *PLR 9434009*

The IRS ruled that Parent and the purchasing corporation are entitled to make the Section 338(h)(10) election.

***PLR 9646016***

The IRS ruled that the selling parent of a life insurance company was a “selling affiliate” for purposes of Section 338(h)(10).

***PLR 9735038***

The IRS ruled that, in a Section 338(h)(10) transaction, Parent will not be treated as having sold Sub stock, but Sub will be treated for federal income tax purposes as if, while a member of the Parent affiliated group, it sold all of its assets in a single transaction.

***PLR 9847027***

The IRS concluded that the sale of the stock of a life insurance company was a qualified sale, enabling the taxpayer to make the elections under Sections 338(g) and 338(h)(10).

***PLR 9852022***

The IRS ruled that the stock sale of a stock life insurance subsidiary will qualify for deemed asset sale treatment under Sections 338(g) and 338(h)(10).

In March 2002, the IRS released proposed regulations under Section 338(h)(10) that reflect the IRS position that the proper model to be utilized in the acquisition of an insurance business is that of an assumption reinsurance transaction. The Regulations include the impact of 338(h)(10) transactions on Sections 197, 381, 846, 847, and 1060. The regulations have not been finalized. REG-118861-00.

***Miscellaneous 338(h)(10) Rulings***

*GE Life and Annuity Co. v. United States, 127 F.Supp.2d 794 (2000).* The District Court for the Eastern District of Virginia ruled that a Section 338 election was not a policyholder surplus account triggering event.

### ***Announcement 86-47***

The IRS announced it would consider whether to include amounts released from certain reserves in connection with a 338 election in an insurance company's taxable income.

### ***PLR 9427001***

The IRS ruled that the unamortized balance of insurance in force is currently deductible in a deemed Section 338 sale.

### ***PLR 9601041***

The IRS ruled that a stock sale with Section 338(g) and 338(h)(10) elections did not affect grandfather status of life insurance contracts for which Target remained the insurer.

### ***FSA 200018004***

The IRS determined that a Section 338(h)(10) deemed asset sale should be characterized as an assumption reinsurance transaction.

## **Reorganizations of Insolvent Companies**

### ***PLR 199905018***

The Service concluded that a company undergoing state-ordered rehabilitation was insolvent within the meaning of Section 1.848-2(i)(4)(v) of the regulations, and that a joint election was available.

### ***PLR 199910016***

The Service ruled that the subsidiary of a company undergoing State-ordered rehabilitation was insolvent for purposes of Section 1.848-2(i)(4)(v) of the regulations, and that a joint election under that provision was available to the subsidiary.

Primary Cause of Insolvency		
	1969-1990 <sup>1</sup>	1969-2002
Years of Study	22	34
Total # of Insolvencies	481	871
Avg. # of Insolvencies per Year	21.9	25.6
# Companies w/Insolvency Indentifies	305	562
Primary Cause of Insolvency		
Deficient Loss Res. (a)	50%	54%
Fraud (b)	20	16
Significant Change in Bus.	9	5
Reinsurance Failure	7	4
Catastrophe Losses	6	7
Other	8	14
	100%	100%
Footnotes		
(a) Deficient Loss Reserves were usually associated with rapid growth and inadequate pricing.		
(b) Includes companies with Overstated Assets.		
1. As published in the second edition (May 2004) of Best's Insolvency Study, reflecting revisions to the data from the first edition (June 1991).		
Source: A.M. Best Company Special Report: Best's Insolvency Study, Property/Casualty U.S. Insurers 1969-2002, May 2004. Page 2.		

### ***Conversions of Non-stock, Non-mutual Corporations<sup>77</sup>***

*Conversions of non-stock, non-mutual companies were addressed in the following rulings:*

#### ***PLR 8938072***

The IRS ruled that a conversion of a fraternal benefit society to a mutual life insurance company would be a reorganization.

#### ***PLR 9137024***

A change from non-stock to mutual company format would not result in an ownership change within the meaning of Section 382(g)(1).

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77. For guidance related to mutual company reorganizations, see the Mutual Insurance Companies chapter.

### ***PLR 9742020***

The continuity of interest requirement is met in the conversion of a group self-insurer from an unincorporated association into a not-for-profit corporation.

### ***PLR 200317019***

The conversion of a nonprofit nonstock public benefit corporation to a for-profit stock corporation qualifies as a tax-free recapitalization under Section 368(a)(1)(E).

For guidance related to mutual company reorganizations, please see the Mutual Insurance Companies chapter.

Reserves



# 12

chapter

# Reserves

*The ability to deduct loss reserves is perhaps the most significant factor that distinguishes the taxation of insurance companies from other corporate taxpayers. State insurance regulators are concerned with the sufficiency of reserves, the IRS is concerned with the reasonableness of reserves, and taxpayers are concerned with maximizing their reserve-related deductions. The combination of these objectives often makes the determination of sufficient and reasonable reserves an especially significant point of contention for all parties.*

*The most significant reserve-related legislation to impact the P&C insurance industry continues to be the mandatory discounting of unpaid loss reserves brought about by the Tax Reform Act of 1986<sup>78</sup>. While the life insurance industry has also been impacted by the discounting rules, the life insurance company qualification test has been the primary reserve issue, with the most pressing issues being which types of reserves qualify as life insurance reserves and how they impact the qualification test under Section 816.*

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78. TAX REFORM ACT OF 1986, Pub. L. No. 99-514.

Under the Tax Reform Act of 1986, P&C insurers were given a “fresh start” adjustment (e.g., a forgiveness of income) for the reduction of the year-end 1986 reserves for unpaid losses and expenses from an undiscounted to a discounted basis. However, The 1986 Act denied the fresh start to the extent of any reserve strengthening. The Treasury promulgated regulations under the statute in Treas. Reg. Section 1.846-3<sup>79</sup>, providing that all 1986 increases in estimated losses for pre-1986 accident years constitute reserve strengthening. Taxpayers challenged the regulation, but it was ultimately upheld in the Supreme Court.<sup>80</sup>

Under Treas. Reg. Section 1.832-4(b), reserves for unpaid losses must be “a fair and reasonable estimate of the amount that the company will be required to pay.” The definition of “fair and reasonable” has evolved in the courts through cases such as *Utah Medical Insurance Association v. Commissioner*<sup>81</sup>, and *Minnesota Lawyers Mutual Insurance Company v. Commissioner*<sup>82</sup>.

A recent development of interest in the area of tax reserves includes the IRS’s utilization of actuarial software instead of its own actuaries to determine whether life insurance reserves are reasonable.<sup>83</sup> No doubt, the assessment of the reasonableness and sufficiency of reserves will continue to be a significant issue in the insurance company industry for the years to come as reasonable minds continue to disagree as to the appropriate value.

## Life Reserves

### Qualification as a Life Insurance Reserve

*In the following rulings, the Courts found that reserves were life insurance reserves. The Service also ruled in several Private Letter Rulings and Revenue Rulings that reserves were life reserves.*

79. T.D. 8433, 57 FR 40845.

80. In *Western National Mutual Insurance Co. v. Commissioner*, 65 F.3d 90 (1995), the regulation was held invalid. However, in *Atlantic Mutual Insurance Co. v. Commissioner*, 118 S. Ct. 1413 (1998), the Supreme Court affirmed the Third Circuit and held the regulation valid. Accordingly, Atlantic Mutual’s attempt to construct a definition of reserve strengthening as used in the P&C industry failed. 81. *Utah Medical Insurance Association v. Commissioner*, T.C. Memo 1998-458 (1998).

82. *Minnesota Lawyers Mutual Insurance Company and Subsidiaries v. Commissioner of Internal Revenue*, 285 F.3d 1086 (8th Cir. 2002).

83. This development was announced at the Tax Executives Institute Financial Services Industry Conference in October 2003.

*American General Life and Accident Insurance Co. v. U.S., No. 82-3817 (unpublished) (1989).* The U.S. District Court ruled that reserves for term life insurance qualified as life insurance reserves.

*Aetna Life Insurance Company v. United States, 16 Cl.Ct. 364 (1989).*

The U.S. Claims Court held that disability reserves on disabled lives were life insurance reserves.

*Aetna Life Insurance Co. v. United States, 935 F.2d 280 (F. Cir. May 7, 1991).* The Federal Circuit affirmed the Claims Court ruling that a reserve for continuation of life insurance coverage for disabled employees was a life insurance reserve under prior-law Section 801(b)(1)(B) (current Section 807(c)(1)).

*UNUM Life Insurance Co. v. United States, 709 F.Supp. 13 (1989).* The District Court ruled that annuity contracts that allowed “deposit funds” did not constitute life insurance reserves or pension plan reserves.

*UNUM Life Insurance Co. v. United States; 897 F2d 599 (1990).* The First Circuit Court of Appeals affirmed the District Court’s decision, holding that an amount cannot be a pension plan reserve unless the company actually calculates its liabilities using mortality tables, irrespective of the existence of a mortality risk.

*USAA Life Insurance Company v. Commissioner 94 T.C. 499 (1990).*

The Tax Court ruled that a reserve maintained by USAA for its universal life insurance policies was a net level reserve and not eligible for a revaluation under Section 818(c).

*USAA Life Insurance Co. v. Commissioner, 937 F.2d 606 (1991), rev’g and rem’g, 94 T.C. 499 (1990).* The U.S. Court of Appeals for the Fifth Circuit reversed and remanded the Tax Court’s decision, requesting that the Tax Court enter judgment permitting the taxpayer a Section 818(c) deduction on its universal life insurance contracts.

*Phoenix Mutual Life v. Commissioner*, 96 TC 18 (1991). The Tax Court held that a reserve was a life insurance reserve under prior-law Section 801(b)(1) (currently Section 807(c)(1)) and that the net valuation portion of the company's reserve for deferred and uncollected premiums qualified as a life insurance reserve.

*Principal Mutual Life Insurance Co. v. U.S.*, 26 Cl.Ct. 616 (1992). The Federal Court of Claims rejected the taxpayer's claim that the reserves should be treated as life insurance reserves because the coverage became noncancelable when the employee became disabled.

*Principal Mutual Life Insurance Co. v. U.S.*, 50 F.3d 1021 (1995). Principal Mutual provided group health and accident insurance to individuals employed by its policyholders. The court held that disabled lives reserves established by Principal for the disabled employees of group policyholders under cancelable health and accident insurance policies are not deductible as life insurance reserves. The court also held that amounts paid to the state insurance department for routine inspection of financial condition are deductible as "investment expenses."

*Metropolitan Life Insurance Co. v. United States*, 30 Fed.Cl. 195 (1993). The Federal Claims Court found that an accelerated death benefit reserve qualified as a life insurance reserve.

#### *Revenue Ruling 89-43*

The IRS ruled that long term health care reserves are life insurance reserves.

#### *PLR 8601013*

The IRS ruled that because a company had the right to cancel accident and health policies, the reserves for the policies were not life insurance reserves.

***PLR 8715038***

The IRS ruled that reserves for annuities with an initial interest guarantee period during the contract's accumulation phase constitute life insurance reserves.

***PLR 8716002***

The IRS ruled that life insurance reserves held on the taxpayer's current value whole life policy are not reserves computed on a recognized preliminary term basis.

***PLR 8817022***

The IRS ruled that amounts for deposit administration contracts are life insurance reserves.

***PLR 9033001***

The IRS determined that reserves for a group immediate annuity contract are includable in life insurance reserves in the year the reserves are reported on the annual statement.

***PLR 9103008***

To clarify a previous ruling, **PLR 8825016**, the Service reiterated that the annual life insurance company qualification test under Section 816 must be based on the facts and circumstances for an entire year.

***PLR 9245006***

The IRS ruled that: 1) the policy was a noncancelable accident and health insurance contract for Federal income tax purposes, 2) the additional reserve qualified as a life insurance reserve, and 3) the net surrender value of the contract was to be determined without regard to the market value adjustment but with regard to surrender charges.

***PLR 9442001***

The Service found that a convertibility benefit did not constitute a qualified supplemental benefit under Section 807(e)(3)(c); consequently,

the company is not entitled to compute reserves separately for the benefit as though the benefit were under a separate contract.

***PLR 9452001***

The Service ruled that reserves for deferred annuities are computed without adjustment for surrender charges.

***PLR 9609033***

The IRS ruled that reserves set aside for long-term care policies held by a life insurance company qualify as Section 816(b) life insurance reserves.

***PLR 9826023***

The IRS ruled that reserves on contracts containing permanent guarantees for life contingencies are life insurance reserves.

***TAM 8624001***

The IRS concluded that reserves for annuities are life insurance reserves, and Taxpayer could retroactively correct reserves misstated due to clerical errors.

***TAM 200325001***

The IRS ruled that Taxpayer's Funding Agreements do not constitute insurance or annuity contracts for tax purposes. Accordingly, the accumulated funds held by Taxpayer did not constitute a reserve item under Section 807(c).

***TAM 200427024***

The IRS ruled that a company's statutory reserves for deferred variable annuity contracts, to the extent of the reserves required by the Commissioners Annuity Reserve Valuation Method, are qualified as life insurance reserves under Section 816(b)(1).

***Calculation of Life Insurance Reserves***

*In the following rulings, the Service and the Courts ruled on the proper calculation of life insurance reserves.*

*Harco Holdings, Inc. v. United States, 754 F.Supp. 130 (1991).* Harco Holdings sought to exclude certain liabilities from the denominator of the life insurance company qualification test under prior-law Section 801(a). The District Court concluded that the term “unpaid losses” did not include accrued unpaid losses on cancelable accident and health insurance policies.

*Harco Holdings v. United States, 977 F. 2d 1027 (1992).* The Court of Appeals for the Seventh Circuit concluded that the term “unpaid losses” did not include accrued unpaid losses on cancelable accident and health insurance policies.

*USAA Life Insurance Company v. Commissioner, T.C. Memo. 1993-12 (1993).* The Tax Court allowed a deduction for cash value in excess of the exhibit 8A reserve.

*Best Life Assurance Company of California v. Commissioner, T.C. Memo 2000-134 (2000).* The Tax Court ruled that the company was a life insurance company under Section 816(a) and that accrued unpaid losses on cancelable accident and health policies should not be included in reserves for the purposes of determining whether a company qualifies as a life insurance company.

*Best Life Assurance Co. of California v. Commissioner, 281 F 3d 828 (2002).* The Appeals Court held that the term “unpaid losses” in Section 816(c)(2) as understood in the life insurance industry, includes only unaccrued unpaid losses.

#### ***PLR 8727007***

The IRS determined that life insurance reserves on flexible premium universal life insurance policies cannot be revalued under Section 818(c).

#### ***PLR 9112011***

The IRS revoked an earlier ruling in which the IRS had treated losses

under certain riders as excludible from the numerator of the life insurance qualification test.

**PLR 9118024**

The taxpayer sought relief for its misinterpretation of a provision of the Tax Reform Act of 1984 that allowed companies to avoid revaluing insurance reserves. Section 216(c)(1) provided that small companies could elect to continue using statutory reserves on contracts issued before 1984, instead of recapturing those reserves under Section 807(d) of the Code. The Service granted the taxpayer's request with regard to its Section 216(c)(1) election, since the taxpayer had shown the correct (i.e., statutory) reserve amount, stating that the failure to attach an affirmative election to the income tax return was "the omission of a ministerial act."

**TAM 9128011**

The IRS ruled that Taxpayer may only deduct the guaranteed interest credited to the reserve fund under prior-law Section 805(e)(2).

**PLR 9316017**

The IRS ruled that amounts set aside and held at investment with respect to contracts were not included in total reserves under Section 816 for purposes of determining the taxpayers' life insurance company status.

**TAM 9452001**

A mutual life insurance company issues single premium deferred annuity contracts with varying guaranteed interest payment periods selected by the policyholder. The taxpayer reported the policyholders' fund value as a life insurance reserve computed without a reduction for surrender charges on its tax return. The IRS ruled that the taxpayer properly considered the actual guaranteed nonforfeiture values at the end of the guaranteed interest period in computing its life insurance reserves for the contracts under Section 807.

December 31, 1996 the Department of the Treasury issued proposed regulations on the computation of life reserves under Section 801. The proposed regulations would give the IRS the authority to redetermine life reserves for purposes of the qualifying ratio. The regulations have not been finalized.

REG-246018-96, 62 FR 71-01.

**PLR 9533004**

A life insurance company offered a group health insurance contract to employers to provide benefits to retirees and their dependents. The IRS held it to be a noncancelable accident and health insurance contract. Additionally, the IRS held that the reserves for the contract held by the insurance company in addition to the unearned premium reserves constituted insurance reserves under Section 816(b).

**TAM 200435015**

The IRS determined that a life insurance company must reduce tax reserves that are based on the net surrender value (NSV) of insurance contracts by the net value of risks reinsured on a yearly term, and even if NSVs exceed the reserves that are calculated under Section 807(d)(2).

***Reasonableness of Life Insurance Reserves***

*In the following TAM, the Service ruled on the reasonableness of life insurance reserves.*

**TAM 9620001**

The IRS ruled that a life insurance company's reserves set aside for a guaranteed insurability benefit option rider were reserves for "qualified supplemental benefits," and that deduction of the full amounts of statutory reserves was reasonable.

**Non-life Reserves*****Qualification as a Non-Life Insurance Reserve***

*In the following rulings, the Courts found that reserves were non-life insurance reserves. The Service also ruled in several Private Letter Rulings and Revenue Rulings that reserves were non-life reserves.*

*State Of Maryland Deposit Insurance Fund Corporation v. Commissioner, 88 T.C. No. 59 (1987).* The Tax Court found that claimed incurred-but-not-

reported losses were not based on loss experience, but, instead, were based on the company's loss exposure in the future.

***PLR 8744057***

The IRS ruled that a group health and accident policy is a guaranteed renewable health and accident insurance policy and increases in the reserve are deductible.

***PLR 200044028***

The IRS ruled that an insurance contract qualified as a cancellable accident and health insurance contract.

***Calculation of Non-Life Insurance Reserves***

*In the following rulings, the Service and the Courts ruled on the proper calculation of non-life insurance reserves.*

***American International Group, Inc., et al v. U.S., 38 Fed.Cl. 274 (1997).*** The Court of Federal Claims ruled that mortgage guaranty insurers can claim losses in accordance with NAIC standards.

***PLR 9106041***

For purposes of Section 807(e)(1), the net surrender value of certain long-term care policies is the balance of the Fund without regard to any market value adjustment on surrender.

***PLR 9212009, PLR 9216005***

Taxpayer's tax return preparer failed to make the election under Revenue Procedure 91-21 to use Composite Schedule P in discounting unpaid losses for medical and other professional liability. The IRS determined that taxpayer had demonstrated "good cause," and granted an extension to make the election.

**PLR 9233022**

In determining the amount of tax and loss bonds that the mortgage insurers would have to purchase, the tax benefit of the Section 832(e) deduction is determined using the 20% AMT rate.

**PLR 9504010**

Pursuant to Revenue Procedure 92-78 and Treas. Reg. Section 1.832-4(d)(2), the taxpayer failed to make an election on its tax return to gross up unpaid loss reserves of its property and casualty insurance subsidiary to include accrued salvage from insurance pools and associations. The taxpayer sought and the IRS granted an extension of time to comply, ruling that good cause was shown for granting such relief under Treas. Reg. Section 301.9100-1.

***Reasonableness of Non-Life Insurance Reserves***

*In the following cases, the courts ruled on the reasonableness of certain non-life insurance reserves.*

*Utah Medical Insurance Association v. Commissioner, T.C. Memo 1998-458 (1998).* The Tax Court determined that the taxpayer's loss reserves were reasonable.

***Minnesota Lawyers Mutual Insurance Company and Subsidiaries v. Commissioner, T.C. Memo 2000-203 (2000).*** The Tax Court ruled that Minnesota Lawyers Mutual Insurance Company's reserves for unpaid losses and related loss adjustment expenses were unreasonable.

***Minnesota Lawyers Mutual Insurance Company and Subsidiaries v. Commissioner of Internal Revenue, 285 F. 3d 1086 (2002).*** The Appeals Court for the Eighth Circuit affirmed the Tax Court ruling and found that Minnesota Mutual's unpaid loss reserve estimates were not "fair and reasonable."

## Unpaid Loss Reserves

September 11, 2001 Insurance Industry Loss Estimate<sup>(1)</sup>

*The Service has also ruled on the composition and reasonableness of unpaid loss reserves.*

### PLR 8817001

The IRS gave its position on auditing reserves for unpaid losses and loss adjustment expenses.

### TAM 8614003

The IRS allowed a property casualty insurance company to restate its unpaid loss reserves when its unpaid loss reserves were misstated due to failure to reflect changes in a reinsurance agreement.

### TAM 9228003

The IRS ruled that although an examining agent may not disregard a taxpayer's election to use its historical experience in discounting unpaid losses, the agent does have the authority to adjust the amounts of unpaid losses as shown on the taxpayer's annual statement.

### TAM 200115002

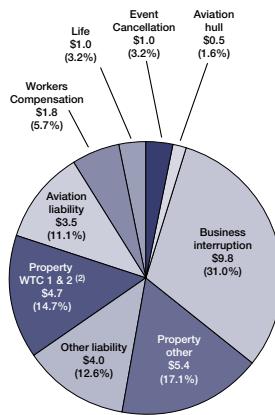
The IRS reversed its historical litigating position and made several determinations on the Section 832 unpaid loss reserves.

### FSA 199952011

The IRS determined it would be difficult to litigate the reasonableness of reserves for unpaid losses in light of the Utah Medical case.

### FSA 200023008

The IRS concluded that a mortgage guaranty insurer could increase its



(1) As of December, 2004. Dollar amounts and percentages do not add to total due to rounding.

(2) Includes \$1.1 billion due to a December 2004 federal jury decision that the World Trade Center losses resulted from two separate attacks; subject to appeal.

Source: Insurance Information Institute Online,  
<http://www.iii.org/media/facts/statsbyissue/catastrophes>.

unpaid loss reserve once the insurer had been informed that the borrower had defaulted on the loan.

## Unearned Premium Reserves

*The Service issued the following guidance on unearned premium reserves:*

### ***Revenue Ruling 91-22***

Title insurance companies may take a deduction for increases in the unearned premium reserve or deduct only estimates of incurred-but-not-reported losses.

### ***Revenue Ruling 97-5***

Rev. Rul. 97-5 revokes Rev. Rul. 70-480, which held that it was not proper to include a stabilization reserve in the unearned premium reserve for purposes of computing premiums earned in accordance with Section 832(b)(4).

### ***GCM 39609***

Reserves held for payment in the event of the cancellation or termination of a minimum premium plan do not constitute “losses incurred” or “unearned premiums.”

### ***PLR 9106040***

The Service ruled that the reserves held in addition to the unearned premium reserve met the requirements of Section 816(b).

### ***PLR 9209029***

The IRS ruled that pension plan contracts containing permanent life annuity purchase rate guarantees and life contingencies are not subject to the 20% unearned premiums haircut.

### ***PLR 9447006***

The IRS ruled that Insurer’s estimates of additional premiums on retrospective rate policies are added to its earned premiums.

***TAM 9124003***

The IRS ruled that a title insurance company that does not include incurred-but-not-reported losses as a deduction may deduct increases in the unearned premium reserve for tax years beginning prior to 1987.

***TAM 9327008***

The IRS ruled that prior year's tax reserves must be used when changing the method of calculating unearned premium reserves.

***TAM 9623005***

The IRS ruled that the value of a new life insurance contract, pursuant to an internal exchange, is not required to be included in net premiums for years prior to the effective date of Treas. Reg. Section 1.848-2(c)(3)(i).

***TAM 9647002***

The IRS ruled that advance premiums, estimated retrospective rate credits and estimated liabilities under payback riders were required to be included in determining unearned premiums under Section 832(b)(4)(B).

***TAM 9648002***

The IRS ruled that gross retrospective rate credits must be included in unearned premiums.

***FSA 199946004***

The Service determined that a P&C insurer that issued claims-made medical malpractice insurance policies was required to establish an unearned premium reserve for the "projected cost of providing tail coverage during the extended reporting period triggered by the insured's death, when the insured is not deceased at the end of the taxable year."

## Loss Reserve Discounting

*The following rulings represent Service and Court determinations on loss reserve discounting.*

***Mutual Assurance Inc. v. U.S., 56 F.3d 1353 (1995).*** In April 1991, Mutual filed claims for refund for the 1987-1989 tax years pursuant to Revenue Procedure 91-21 allowing insurance companies to use special schedules for discount factors. The IRS allowed the 1987 claim. A 1991 audit revealed an understatement of the refund claim. Mutual filed another claim for refund after the expiration of the statute of limitations for the 1987 tax year. The IRS disallowed the subsequent claim for the 1987 year resulting in this suit. The Court of Appeals affirmed the District Court's decision that the subsequent claim was an amendment to the timely filed first claim.

In the following Revenue Rulings, the IRS set forth the industry payment patterns and discount factors to be used in computing discounted reserves under Section 846.

***Revenue Ruling 87-34***

***Revenue Ruling 88-63***

***Revenue Ruling 89-66***

***Revenue Ruling 90-26***

***Revenue Ruling 91-42***

In the following Revenue Procedures, the Service issued the loss payment patterns and discount factors to be used to discount unpaid losses under Section 846.

***Revenue Procedure 92-47***

***Revenue Procedure 93-29***

***Revenue Procedure 94-47***

***Revenue Procedure 95-40***

***Revenue Procedure 96-44***

*Revenue Procedure 98-11*

*Revenue Procedure 99-15*

*Revenue Procedure 99-36*

*Revenue Procedure 2000-44*

*Revenue Procedure 2001-60*

*Revenue Procedure 2002-74*

*Revenue Procedure 2003-17*

*Revenue Procedure 2004-9*

*Revenue Procedure 2004-70*

*Revenue Procedure 91-21*

The IRS allowed malpractice insurers to use composite Schedule P.

*Revenue Procedure 92-76*

The Service extended the historical experience election to property and casualty companies that are otherwise not eligible to make the election for taxable years beginning in 1992.

*PLR 9317043, PLR 9317045*

Taxpayer in the first ruling mistakenly believed that its tax return preparer had made an election to use composite discount factors on amended returns. However, Taxpayer discovered that the tax returns had not been amended and the election had not been made. Taxpayer requested an extension within which to elect to use the composite discount schedule. The IRS granted the extension.

*TAM 9715005*

The IRS ruled that a property and casualty company is not required to reduce its 1989 deduction for its discounted gross-up in reserves by an earlier “fresh start” deduction.

*Notice 88-100*

The IRS issued guidance on discounting unpaid loss reserves.

## Salvage and Subrogation

*The IRS and Courts have ruled on reserve issues related to salvage and subrogation.*

***Allstate Insurance Company v. United States, 20 ClsCt 308 (1990).***

The Claims Court held that Allstate Insurance Co. may not exclude subrogation recoveries from its “losses incurred” deduction under the tax benefit rule.

***Allstate Insurance Co. v. United States 936 F.2d 1271 (1991).*** Reversing a Claims Court decision, the Federal Circuit concluded that the tax-benefit rule applies to salvage and subrogation recoveries.

The following Revenue Procedures provide factors for discounting salvage and subrogation recoverable to be used by property and casualty insurance companies in connection with the computation of losses incurred.

***Revenue Procedure 91-48***

***Revenue Procedure 92-52***

***Revenue Procedure 93-30***

***Revenue Procedure 94-50***

***Revenue Procedure 95-41***

***Revenue Procedure 96-45***

***Revenue Procedure 98-12***

***Revenue Procedure 99-16***

***Revenue Procedure 99-37***

***Revenue Procedure 2000-45***

***Revenue Procedure 2001-61***

***Revenue Procedure 2003-18***

***Revenue Procedure 2004-10***

***Revenue Procedure 2004-70***

***Revenue Procedure 92-77***

The Service provided rules that permit certain property and casualty insurance companies to gross up their unpaid losses for tax purposes by the amount of estimated salvage recoverable taken into account for taxable years beginning in 1992 or later.

***Revenue Procedure 92-78***

The Service issued guidance to insurers participating in insurance pools in situations where the pools were unable to provide information to the insurer relating to the amount of estimated salvage recoverable attributable to participation in the pools, including whether estimated salvage recoverable had been taken into account as a reduction of unpaid losses by those pools.

***Announcement 88-99***

The IRS announced that it will issue a revenue procedure giving procedures for insurance companies to change their method of accounting for salvage and subrogation.

***IRS 88-1***

The IRS applied the salvage and subrogation regulations to life insurance company reserves.

***Notice 92-1***

The Service announced that the final regulations under Section 832 would provide relief from double-counting estimated salvage recoverable for “netters.”

***PLR 9233023***

The IRS ruled that Taxpayer was required to net its underestimates and overestimates of salvage recoverable on lines of business within the company to determine whether, on a company-wide basis, it had overestimated its salvage recoverable, requiring it to recapture a portion of its special deduction.

***TAM 200006007***

The IRS determined that a property and casualty company did not have to increase its 1992 taxable income due to a statutory change in accounting method to accrue salvage and subrogation on the auto physical damage line of business.

## State Assumed Interest Rates and Standard Mortality and Morbidity Tables

*The following Revenue Rulings contain the state assumed interest rates and standard tables of mortality and morbidity to be used by insurance companies in computing their life insurance reserves under Section 807(d).*

*Revenue Ruling 87-26*

*Revenue Ruling 92-19*

*Revenue Ruling 93-58*

*Revenue Ruling 94-11*

*Revenue Ruling 95-4*

*Revenue Ruling 98-2*

*Revenue Ruling 99-10*

*Revenue Ruling 2001-38*

*Revenue Ruling 2003-24*

*In these Rulings, the IRS released the applicable Federal interest rates for use in calculating reserves under Section 807.*

*Revenue Ruling 88-16*

*Revenue Ruling 99-48*

*Revenue Ruling 99-17*

*In these rulings, the IRS provided new rates for calculating the reserves for life insurance and supplementary total and permanent disability benefits, individual annuities and pure endowments, and group annuities and pure endowments.*

*Revenue Ruling 2000-17*

*Revenue Ruling 2004-14*

**Notice 97-32**

In **Notice 97-32**, the IRS announced interim rules for determining the

interest rates applicable to the computation of reserves for modified guaranteed contracts.

***TAM 9246001***

The IRS ruled that life insurance reserves' required interest is computed using the prevailing state assumed interest rate.

***TAM 200416009***

The IRS determined that Taxpayer improperly adjusted a standard mortality table for use under Section 807(d)(2) because the risks incurred in connection with the company's annuity contracts had already been taken into account.

## **Methods of Calculating Reserves**

*When the method of calculating insurance company reserves has come into question, the Service has issued rulings on the appropriateness of those calculations.*

### ***Change in Basis***

*The Service has issued the following rulings related to a change in basis for insurance reserves.*

***Revenue Ruling 94-74***

The IRS addressed what adjustments are required in computing a life insurance company's taxable income when the company changes the manner of computing its life insurance reserves.

***Revenue Ruling 2002-6***

The IRS determined that a change in the computation of existing life insurance reserves to take into account specific factors set forth in Actuarial Guideline 33 is a change in basis subject to Section 807(f).

***TAM 200328006***

Actuarial Guideline 33 may not be used in computing Taxpayer's Commissioners' Annuities Reserve Valuation Method tax reserves for annuity contracts that were issued before the date on which the guideline took effect.

On May 7, 2003, the Department of the Treasury issued final regulations under Section 817A. The regulations define the appropriate interest rate to be used in the determination of tax reserves and required interest for certain modified guaranteed contracts.

TD 9058, 68 FR 24350.

***Other Methods Issues***

*The Service and the Courts ruled on the following methods of calculation of insurance reserves.*

***Time Insurance Co. v. Commissioner, 86 T.C. 298 (1986).*** The Tax Court ruled that the "claim lag" method was a reasonable method for determining reserves.

***Principal Mutual Life Insurance Company and Subsidiaries v. United States, 295 F. 3d 1241 (2002).*** The U.S. Court of Appeals for the Federal Circuit ruled that an insurance company must include excess interest guaranteed beyond the end of the tax year in its statutory reserves.

***Revenue Ruling 2003-120***

The IRS clarified the amount of reserves used to calculate "required interest" under Section 812(b)(2)(A).

***PLR 8822002***

The IRS determined that life insurance reserves for certain policies could not be revalued.

***PLR 9018001***

The IRS ruled that a life insurance company's reserve liability on its annual statement cannot be divided between tabular reserves and a cash surrender value, but must be viewed in its entirety.

***PLR 9118027***

The taxpayer sought relief for its misinterpretation of a provision of the Tax Reform Act of 1984 that allowed companies to avoid revaluing insurance reserves. Section 216(c)(2) of the Act permitted small companies (in certain circumstances) to elect to use statutory reserves — with modifications — instead of tax reserves for contracts issued before 1989. The IRS denied the taxpayer's request with regard to its Section 216(c)(2) election.

***TAM 9251005***

The IRS allowed a reserve adjustment because Section 807 requires insurers to use the prevailing commissioners' standard tables adjusted as appropriate to reflect risks to determine the Federal income tax reserves, irrespective of whether the insurer uses the tables to compute its annual statement reserves. As a consequence, the IRS ruled that the recomputation of the reserve constituted a change in basis, and therefore, the deductible portion of any increase in the tax reserves must be taken into account ratably over 10 years.

***TAM 200108002***

The IRS concluded that the use of graded valuation interest factors to compute tax reserves under Section 807(d) was appropriate for structured settlements.

**FSA 200143003**

The IRS ruled that it may not correct an error in a closed tax year unless the Taxpayer's position is sustained in a determination for an open tax year.

## Fresh Start

*The following rulings relate to the "fresh start" provisions of the Tax Reform Act of 1986.*

***Western National Mutual Insurance Co. v. Commissioner, 65 F.3d 90 (1995).*** The Tax Reform Act of 1986 required companies to discount unpaid loss reserves. The Act contained a transitional rule allowing for "fresh start" equal to the difference between the discounted and undiscounted unpaid losses at the end of 1986. This "fresh start" is not applicable to the "reserve strengthening" amount, which was not defined by statute. The Eighth Circuit affirmed a Tax Court decision that held that the definition of reserve strengthening set forth in Treas. Reg. Section 1.846-3 was invalid because it conflicted with the commonly understood meaning of the term in the insurance industry.

***Atlantic Mutual Ins. Co. v. Commissioner, T.C. Memo. 1996-75 (1996).***

The Tax Court followed Western National and upheld the taxpayer's definition of "reserve strengthening," holding that the taxpayer's net increase in loss reserves was not due to impermissible reserve strengthening, but to "routine adjustments . . . consistent with past reserving practices."

***Atlantic Mutual Insurance Co., et al. v. Commissioner, 111 F.3d 1056 (1997).*** The Third Circuit reversed the Tax Court and upheld Treas. Reg. Section 1.846-3, which defines "reserve strengthening" for purposes of the "fresh start" provisions.

***Atlantic Mutual Insurance Co. v. Commissioner, 118 S. Ct. 1413 (1998).*** The Supreme Court upheld Treas. Reg. Section 1.832-3(c), finding it a reasonable interpretation of the statute.

## Miscellaneous Reserves Issues

*The Service has issued the following rulings on miscellaneous reserves issues.*

*North Central Life Insurance Co. v. Commissioner*, 92 T.C. 15 (1989). The Tax Court determined that retroactive rate credit reserves did not meet the all-events test and could not be taken into account in determining the company's commission deduction.

*Equitable Life Assurance Society of the Untied States v. United States*, 89 A.F.T.R. 2d, (unpublished) (2002). The District Court held that the tax benefit rule does not serve to exclude from income certain decreases in life insurance reserves that are otherwise required to be included as income.

### **PLR 9840046**

The IRS ruled that a consolidated group containing a member that claims the special reserve deduction computes the benefit from the special reserve deduction by means of a "with and without" calculation.

### **TAM 8702007**

The IRS affirmed an earlier TAM and determined that life insurance reserves, calculated for years prior to the enactment of The Tax Equity and Fiscal Responsibility Act (TEFRA), which account for "excess interest" guaranteed for future periods beyond the taxable year contain deficiency reserves.



# Tax-Exempt & Small Insurance Companies



# 13

chapter

# Tax-Exempt And Small Insurance Companies

*Three provisions within the Internal Revenue Code benefit small insurers meeting certain thresholds. Two alternatives exist for non-life insurance companies and one alternative exists for life insurance companies as follows:*

- Section 501(c)(15) tax exemption for P&C insurers;
- Section 831(b) election for P&C insurers to be taxed solely on investment income; and
- Section 806 small life insurance company deduction.

*Section 501(c)(15) exempts P&C insurers from Federal income tax if gross receipts for the taxable year do not exceed \$600,000, one half of which must be derived from premiums (rather than investment income). In addition, under Section 831(b), P&C insurers with net written premiums (or direct written premiums, if greater) in a taxable year that do not exceed \$1.2 million could elect to be taxed only on their taxable investment income. Under Section 806, a small life insurance company with assets of \$500 million or less is allowed a deduction equal to 60% of the first \$3 million of tentative LICTI. The deduction is reduced by 15% of tentative LICTI in excess of \$3 million, and is phased out entirely when tentative LICTI equals or exceeds \$15 million.*

Several legislative and administrative changes have been made to the taxation of these small insurance companies. The IRS issued proposed regulations in 1997 under Section 337(d) which potentially impact Section 501(c)(15) insurers<sup>84</sup>. When final, the regulations would disallow the tax-free contribution of corporate assets to a tax-exempt organization and would require recognition of gain/loss on asset transfers to a tax-exempt organization by the transferor corporation, including a conversion from a taxable to a tax-exempt entity.

In 2001, the IRS issued three rulings regarding Section 831(b) election revocations, all of which were granted.<sup>85</sup> In each ruling, the IRS required the taxpayer to show that there had been a change in the character of its business. Simply having a higher tax liability with the election was insufficient.

In April 2004, President Bush signed the Pension Funding Equity Act of 2004<sup>86</sup> (PFE), which changed the taxation of certain small insurers. The PFE amended Section 501(c)(15)(A) and codified a new provision applying only to mutual insurers. The PFE also modified Section 831. These provisions are effective for taxable years beginning after December 31, 2003.

## **Pension Funding Equity Act of 2004**

*The Pension Funding Equity Act of 2004, enacted April 12, 2004, amended Sections 501(c)(15) and 831.*

Section 501(c)(15)(A) was amended to provide that a property and casualty insurance company would be eligible to be exempt from Federal income tax if its gross receipts for the taxable year do not exceed \$600,000, one half of which must be derived from premiums (rather than investment income).

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84. REG-209121-89, 62 FR 2064-02.

85. See PLRs 200121040, 200133020, and 2001142014.

86. PENSION FUNDING EQUITY ACT OF 2004, Pub. L. 108-218.

In the case of a company which is in receivership, liquidation, or similar proceeding on April 1, 2004, and which meets the requirements of Section 501(c)(15)(A) in effect for the last taxable year beginning before January 1, 2004, the provisions of the pension bill apply to taxable years beginning after the earlier of the date the liquidation proceedings end or December 31, 2007.

For such a company, limitations on the carry-over of net operating losses to or from years in which the company was not subject to tax (including Section 831(b)(3)) continue to apply.

The provision was effective for taxable years beginning after December 31, 2003.

A new provision, applying only to mutual insurers, provided that a company may also be eligible for exemption if its gross receipts for the taxable year do not exceed \$150,000, and more than 35 percent of the gross receipts consist of premiums. The provision further required that no employee of the company, or a member of the employee's family, be an employee of another company exempt from taxation under Section 501(c)(15). The provision allows certain very small mutual companies to be exempt with a smaller ratio of premiums to gross receipts, 35% instead of 50%.

The Act amended Section 831 to allow non-life insurance companies whose net written premiums (or if greater, direct written premiums) for the taxable year do not exceed \$1,200,000 to be taxed only on their investment income.

The provisions were effective for taxable years beginning after December 31, 2003.

## IRS-Registered 501(c) Tax-Exempt Organizations by Code Section and Year

Section 501(c)	1975	1995	1999	2000	2001	2002
(1) Corporations organized under an act of Congress	665	2	18	20	48	88
(2) Title-holding corporations	3,263	2,990	7,042	7,009	6,984	6,998
(3) Religious, charitable, and similar orgs [1,2]	82,048	108,931	773,934	819,008	865,096	909,974
(4) Social welfare organizations	28,064	21,983	138,927	137,037	136,882	137,526
(5) Labor, agriculture organizations	28,258	21,242	63,716	63,456	62,944	62,246
(6) Business leagues	17,530	25,460	81,493	82,246	82,706	83,712
(7) Social and recreation clubs	18,228	15,919	67,044	67,246	67,289	68,175
(8) Fraternal beneficiary societies	12,066	7,973	84,519	81,980	81,112	80,193
(9) Voluntary employees' beneficiary associations	4,285	9,818	13,886	13,595	13,292	13,173
(10) Domestic fraternal beneficiary societies	4,674	2,581	22,802	23,487	23,531	23,096
(11) Teachers' retirement funds	49	5	14	15	15	15
(12) Benevolent life insurance associations	4,975	3,333	6,462	6,489	6,500	6,553
(13) Cemetery companies	1,518	1,862	9,963	10,132	10,269	10,424
(14) State-chartered credit unions	1,610	1,645	4,408	4,320	4,409	4,471
(15) Mutual insurance companies	864	691	1,296	1,342	1,423	1,608
(16) Corporations to finance crop operations	36	14	23	22	23	24
(17) Supplemental unemployment benefit trusts	496	166	518	501	490	477
(18) Employee-funded pension trusts	42	2	2	2	1	1
(19) War veterans' organizations	1,921	5,941	35,428	35,249	35,263	35,227
Other organizations, including (20)-(25)	9,605	4,826	1,152	1,239	1,281	1,324

### Small Insurance Company Deduction

*The following rulings relate to the small insurance company election under Section 501(c)(15).*

#### ***Notice 2003-35***

The IRS reminded taxpayers that an entity must be an insurance company for federal income tax purposes in order to qualify as an exempt organization described in Section 501(c)(15).

#### ***Notice 2004-64***

The IRS advised taxpayers that amendments to Section 501(c)(15) made in the Pension Funding Equity Act of 2004 may affect the qualification of entities as tax-exempt property and casualty insurance companies described in Section 501(c)(15) for taxable years beginning after December 31, 2003.

#### ***GCM 39864***

The IRS determined that a non-life insurance company's premiums must be annualized under Section 443(b)(1) to determine whether it meets the limitations under Section 501(c)(15).

#### ***PLR 9149012***

The IRS permitted a small insurance company election to be made late.

#### ***PLR 9853026***

The Service ruled that the sale of the charter of an insolvent insurer exempt from Federal income tax under Section 501(c)(15) was not unrelated business taxable income under Section 512(b)(5).

### Alternative Tax on Property and Casualty Companies

*The Service also issued rulings related to the alternative tax for small property and casualty companies under Section 831(b)(2)(A).*

***PLR 9127048***

The IRS found that a property and casualty insurance company that qualifies for the Section 831(b)(2)(A) alternate tax for small property and casualty insurance companies had demonstrated good cause for the failure to make a timely election, and granted an extension.

***PLR 9211051***

The IRS granted an extension for filing a small company election under Section 831(b)(2)(A).

***PLR 9322027***

The Service permitted the taxpayer to revoke its election under Section 831(b)(2) to be taxed only on its investment income.

***PLR 9540059***

A property and casualty insurance company sought an extension of time to file after failing to timely file a Section 831(b)(2)(A)(ii) election for the year ended December 31, 1993. The election would allow it to pay an alternative tax only on its investment income. Acting pursuant to discretionary authority under Treas. Reg. Section 301.9100-1, the IRS found that good cause was shown based on the facts for failing to timely file the election and an extension was granted.

***PLR 200121040, PLR 200133020, PLR 200332014***

The IRS granted a Section 831(b) election revocation.

***PLR 200142014***

In **PLR 200121040**, a taxpayer was given permission to revoke its Section 831 election for the 2001 tax year; however, the request for revocation of election for the 2000 tax year was denied.

## Small Life Insurance Company Deduction

*The Service issued the following rulings regarding the small life insurance company deduction under Section 806.*

*Trans City Life Insurance Co. v. Commissioner, 106 T.C. No. 15, (1996).*

The Tax Court held that the IRS abused its discretion in determining that two reinsurance agreements had a "significant tax avoidance effect."

The reinsurance agreements enabled Trans City to claim the small life company deduction pursuant to Section 806.

**TAM 9104004**

The IRS denied the small life insurance company deduction to a disaffiliated member of a consolidated group.

## Section 501(m)

*The Service ruled on the requirements of Section 501(m) in the following rulings.*

*Florida Hospital Trust Fund, et al. v. Commissioner, 103 T.C. No. 10 (1994).*

The Tax Court ruled that organizations pooling resources to provide insurance to hospitals are not tax exempt.

*Nonprofits' Insurance Alliance of California v. United States 32 Fed.Cl. 277 (1994).* The Court of Federal Claims ruled that a group self-insurance risk pool was not tax-exempt under Section 501(m).

**Notice 2003-31**

The IRS announced that the Treasury Department and the IRS intend to propose regulations providing guidance under Section 501(m), which will define the term "commerical-type insurance" and address how Section 501(m) applies to organizations described in Section 501(c)(3) and Section 501(c)(4), including health maintenance organizations.

**GCM 39655**

The IRS found that annuities offered by the taxpayer do constitute “pension business” as defined in Section 1012(c)(4)(D) of the Tax Reform Act of 1986. Therefore, taxpayer must meet the requirements of Section 501(m), which the IRS concluded the organization failed to meet.

**PLR 9407008**

The IRS ruled that an exempt organization’s sale of deferred annuities will not be considered commercial-type insurance.

## **Miscellaneous Tax Exempt Issues**

*In this case the Tax Court ruled on the question of whether a taxpayer qualified for tax exempt status.*

*Paratransit Insurance Corp. v. Commissioner 102 T.C. No. 34 (1994).* The Tax Court denied exemption for an entity that provides insurance for charitable transportation providers.



Other



# 14

chapter

## Other

*This eighteen-year compendium has attempted to capture and organize the significant insurance company taxation areas into separate and distinct chapters. Individual chapters have included legislation, reserves, captives, tax shelters, reorganizations, international, BCBS, products, reinsurance, consolidated returns, mutuals, small insurers, and accounting. Many important areas of insurance company taxation which did not warrant separate coverage have been combined into this final chapter. Even though subjects such as policyholder surplus accounts, taxation of premium income, surplus notes, policy acquisition expenses, and policyholder dividends are not covered in separate and distinct chapters, they are, nevertheless, significant developments in the taxation of insurance companies.*

*In October 2004, The American Jobs Creation Act of 2004<sup>87</sup> amended Section 815 to suspend policyholder surplus accounts (PSAs) during 2005 and 2006.*

*In any taxable year beginning after December 31, 2004, and before January 1, 2007, direct and indirect distributions from the PSA would be treated as zero, and distributions would be made first out of the PSA, then the shareholder surplus account (SSA), then out of other accounts. The provision is effective for taxable years beginning after December 31, 2004.*

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87. AMERICAN JOBS CREATION ACT OF 2004, Pub. L. 108-357.

In 1999, the final unearned premium regulations under Section 832 were issued.<sup>88</sup> The regulations forced insurers to analyze their accounting methods with respect to premium and acquisition recognition for tax years beginning after December 31, 1999. However, insurers continue to have difficulty applying the regulations on a “contract-by-contract” basis, and matching accelerated acquisition expenses to premiums earned.

In 1997, the IRS ruled in TAM 9714003 that a P&C insurer’s surplus notes are debt for tax purposes, but that the “advanced amounts” charged to policyholders are premium income. The TAM cites State Farm Automobile Insurance Co.<sup>89</sup> which held that membership fees collected from policyholders as a prerequisite to obtaining insurance were includable in premium income. The TAM highlights the importance of the insurer’s characterization of amounts received from policyholders.

The 1990 Act<sup>90</sup> enacted Section 848, which provides for the capitalization and amortization of “specified policy acquisition costs.” Rather than measure actual costs, Section 848(c)(1) uses specified percentages of “net premiums” as a proxy in the computation of specified policy acquisition costs. Prior caselaw had established that ceding commissions paid by the reinsurer on reinsurance contracts must be capitalized and amortized over the life of the policies. However, Section 848(g) provides that such commissions are no longer subject to the caselaw and, as a result, must be amortized under the rules of Section 848.

Controversies have arisen concerning the timing of deductions for amounts “credited” or “reserves” for self-insurance. Often, the issue is whether a taxpayer has “paid” an insurance “premium.” A payment to the taxpayer’s segregated bank account does not qualify. Likewise, a “payment” to an insurance agent does not qualify.<sup>91</sup> Even premium payments to an insurance company may not qualify if the arrangement is not insurance.<sup>92</sup>

88. T.D. 8857, 65 FR 706.

89. *State Farm Automobile Insurance Co. v. U.S.*, 314 F.2d 363 (1963).

90. OMNIBUS BUDGET RECONCILIATION ACT OF 1990, Pub. L. 101-508.

91. See *Spring Canyon Coal Co. v. Commissioner*, 43 F.2d 78 (1930).

92. See *Steere Tank Lines, Inc. v. U.S.*, 99 S.Ct. 1424 (1979).

Other issues addressed have included the following: Policyholder dividends; insurance agent payments; separate accounts; and other traditional corporate-related issues such as NOLs; tax accounting methods; R&D credits; employee benefits and plans; investment income; capital gains/losses; and IRS matters.

## Accounting Methods and Periods

The Service has issued several Revenue Procedures regarding changes in accounting methods. The automatic accounting method change procedure was applied to depreciation, commissions, and premium acquisition expenses, in addition to general changes in accounting methods. Those Procedures, and several Technical Advice Memoranda which put them into practice, follow.

### *Revenue Procedure 96-31*

The IRS provided an automatic accounting method change procedure to recoup missed depreciation until June 28, 1996. The negative Section 481(a) adjustment would be taken into account in one year.

### *Revenue Procedure 97-27*

The IRS issued Rev Proc 97-27 to revise the general procedures under Section 446 for obtaining the Commissioner's consent for a change in method of accounting. The procedure effectively replaces Rev Proc 92-20, and is generally effective for Forms 3115 filed on or after May 15, 1997 (with some transitional rules).

### *Revenue Procedure 98-60*

The IRS updated procedures for taxpayers to use when seeking automatic consent to change certain specified methods of accounting and supersedes Revenue Procedure 97-37.

### *Revenue Procedure 2001-24*

The IRS provided procedures by which an insurance company may obtain automatic consent to change its method of accounting for certain

cash advances on commissions paid to its agents from deducting a cash advance in the taxable year paid to the agent to deducting a cash advance in the taxable year earned by the agent.

***Revenue Procedure 2002-46***

The IRS provided insurance companies with a safe harbor method of accounting for premium acquisition expenses and provides for automatic consent in changing to the safe harbor method.

***PLR 9026002***

The IRS ruled that commissions paid on advance premiums are deductible in the year paid, not the year the policy becomes effective.

***TAM 9302003***

The IRS denied an insurer's request to change accounting methods.

***TAM 9516001***

As required by the Omnibus Budget Revenue Reconciliation Act of 1990, the property and casualty insurance company changed its method of accounting to include estimated salvage recoverable when determining losses incurred. The company claimed the Section 481(a) adjustment and the special deduction provided in the Act. The company failed to attach the schedule required by Revenue Procedure 91-48 to its return. Consistent with Revenue Procedure 91-48 and Treas. Reg. Section 1.832-4, the IRS held that the taxpayer could not claim both the Section 481(a) adjustment and the special deduction.

***FSA 200203016***

The IRS found that an insurer must change its method of accounting for its payments to and from an experience account which is part of a reinsurance contract.

*The Service also released the following miscellaneous Revenue Procedures regarding accounting methods.*

***Revenue Procedure 97-50***

The IRS issued guidance on year 2000 costs.

***Revenue Procedure 2002-54***

The IRS clarified Revenue Procedure 2002-19 regarding the application of the one-year Section 481 adjustment period.

## **Capitalization v. Deduction**

*In the following rulings the Service and the courts determined whether salaries and commissions, interest expenses, start-up and investigatory expenditures, and insurance costs should be currently deductible or capitalized.*

### ***Capitalization***

***PNC Bancorp v. Commissioner, 110 T.C. No. 27 (1998).*** The Tax Court held that loan origination expenditures were not deductible under Section 162 and must be capitalized under Section 263(a).

***PNC Bancorp Inc. v. Commissioner, 212 F. 3d 822 (2000).*** The Third Circuit, in reversing the Tax Court, held that certain costs incurred by banks for marketing, researching, and originating loans were deductible as ordinary and necessary expenses under Section 162.

***Lychuk v. Commissioner, 116 T.C. 374 (2000).*** The Tax Court ruled that a taxpayer who acquired and serviced multi-year installment contracts in the ordinary course of business must capitalize salaries and benefits directly related to its acquisition.

***Globe Life and Accident Insurance Company v. United States, 54 Fed. Cl. 132 (2002).*** The Court of Federal Claims found that Globe was not entitled to amortization deductions claimed because it failed to provide an accurate estimate of the useful life of its “agency force.”

***Revenue Ruling 95-53***

The ruling holds that the allocable amount of interest on a mortgage loan collateralized by a single premium annuity contract is not deductible based on Section 264(a)(2) and Revenue Ruling 79-41.

***TAM 9810001***

The IRS ruled that payments made by a state-mandated insurance pool to a trust created by the state to provide a catastrophe reserve for the members of the pool must be capitalized rather than deducted currently.

***TAM 9825005***

The IRS addressed the deductibility of investigatory expenses incurred in acquiring a bank. In the TAM, the IRS National Office concluded that certain investigatory expenses incurred in acquiring a bank are not start-up expenses eligible for amortization under Section 195.

***TAM 9830001***

The IRS ruled that an automobile leasing company should amortize the premiums it pays for residual value insurance on the automobiles it leases over the term of the insurance contracts.

***FSA 199925007***

The Service determined that an insurance premium paid for “prior acts coverage” was a capital asset and was therefore not deductible.

***Deduction***

***U.S. Freightways Corp., et al. v. Commissioner; 113 T.C. No. 23 (1999).***

The Tax Court held that premiums for prepaid insurance must be deducted pro-rata over the period of insurance coverage.

***U.S. Freightways Corp., et al. v. Commissioner 270 F.3d 1137 (2001).***

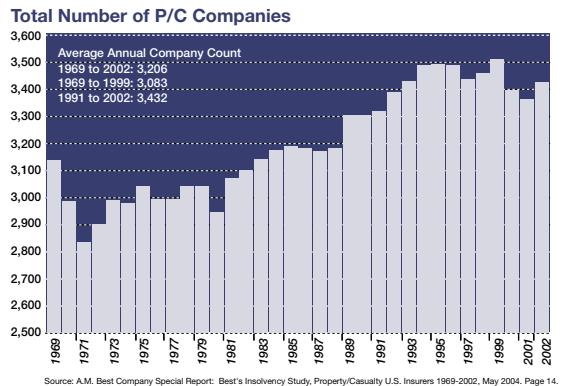
The Seventh Circuit Court of Appeals reversed and remanded the case to the Tax Court.

**TAM 199903020**

The Service ruled that only the investigatory expenditures that could be amortized were those that were incurred in order to determine whether to enter into a transaction and which transaction to enter into.

**TAM 9627002**

The IRS reversed itself and allowed the deduction of engineering fees, legal fees, and consulting fees pertaining to environmental cleanup costs. The IRS relied on Revenue Ruling 94-38 for the principle that payments made by a landowner for the purpose of restoring land to its “pre-contaminated” condition are not payments made for “improvements” to land, and thus are not capital expenditures.

**TAM 200334005**

Expenses incurred by Taxpayer to diversify its life insurance and annuity products, and expand its distribution channels, are ordinary and necessary business expenses, not capital expenditures under Section 263(a).

**Definition of Insurance Company**

*The Pension Funding Equity Act of 2004 amended Section 831 to define “insurance company” within the non-life insurance company provisions of the Code to have the same meaning as it has in the life insurance company provisions. For this purpose, the term “insurance company” means any company, more than half of the business of which during the taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies. A company*

*whose investment activities outweigh its insurance activities is not considered to be an insurance company for this purpose. The provision is effective for taxable years beginning after December 31, 2003.*

*The Service ruled in several instances on whether a company issued insurance contracts and whether the company was an insurance company for federal tax purposes.*

***PLR 8825016***

A holding company qualifies as a life insurance company even though it had little insurance income.

***PLR 9412002***

Individual practice association model HMOs are insurance companies.

***PLR 199952038***

The IRS concluded that once insolvent, a life insurer would not be considered a life insurance company and its adjustments and deductions must be considered under non-life rules.

***TAM 9540001***

The taxpayer, an insurance pool in state Y, was formed to provide catastrophe-type insurance. All licensed property and casualty insurers in state Y are required to join the pool. In 1974, the IRS issued a written determination concluding that the pool should be treated as a partnership for federal tax purposes. In this ruling, that decision was reconsidered, and the IRS concluded that the Taxpayer was an insurance company taxable as a corporation under Subchapter L. In addition, the IRS ruled that a premium paid under a retrospectively rated policy was deductible when paid.

## **Employee Benefits, Pension Plans, and Workers Compensation**

*The service and the courts have ruled on the following deferred compensation issues.*

***PLR 8843018***

The IRS found that the transfer of deferred compensation to a trust was not a purchase.

***PLR 9713006***

The IRS ruled that amounts paid by an employer for a group annuity contract pursuant to a plan of nonqualified deferred compensation are includable in plan participants' income.

*The Service and the courts have ruled on the following employee benefits issues.*

***Connecticut Mutual Life Ins. Co. v. Comm'r, 106 T.C. No. 27 (1996).***

The Tax Court denied a business expense deduction for a \$20 million contribution to a VEBA trust used to fund holiday pay.

***Revenue Ruling 92-94***

A non-life insurance company charged itself premiums for insurance and annuity benefits that it provided to its employees. On its 1991 annual statement, the insurer included the premiums in gross written premiums. The Service ruled that the premiums were properly included in gross written premiums for Federal income tax purposes.

***PLR 9603011***

The IRS ruled that health benefits offered by a law firm to domestic partners of employees were includable in the employees' income.

***PLR 200210024***

The IRS ruled that the income from a multi-employer insurance program that reimburses medical expenses is excludable from gross income under Section 115.

***TAM 9602001***

The IRS ruled that an employer that provided subsidized meals to employees in onsite cafeterias failed to meet the tests set forth in Section 119 and that the value of meals were not excludable from the employees' gross income.

*The Service ruled on the following retirement and stock plan issues.*

***Revenue Ruling 2004-20***

The IRS ruled that a qualified pension plan cannot be a Section 412(i) plan if the plan holds life insurance and annuity contracts for the benefit of a participant that provide for benefits in excess of the participant's benefits under the terms of the plan.

***Revenue Procedure 2004-16***

The IRS issued this Revenue Procedure in connection with proposed regulations under Section 402(a) regarding the valuation of life insurance contracts upon distribution from a qualified retirement plan and proposed regulations under Sections 79 and 83 regarding the valuation of life insurance contracts.

***PLR 9014068***

The IRS ruled that a defined contribution plan may use employee contributions to purchase life insurance policies without being disqualified.

***PLR 9026041***

The IRS ruled that proceeds of a life insurance policy bought by an individual's employer paid to someone other than the individual or his estate are includable in the individual's estate.

***PLR 9033023***

The IRS determined that neither the transfer of life insurance policies from company to trust nor the return of the policies from the trustee to the company is treated as a purchase.

***PLR 9042023***

The IRS ruled that the transfer of a key-man life insurance policy from a corporation to a partnership is a transfer described in Section 101(a)(2)(B).

***PLR 9045004***

The IRS ruled that proceeds from key-man life insurance policies will be excludable from gross income.

***PLR 9618028***

The IRS ruled that Section 72(e)(2) applies to amounts received by the beneficiary of a deceased employee's defined contribution plan, and that the deceased insured's "investment" in the plan includes PS-58 costs incurred and the net death benefit payable.

***PLR 9746039***

The IRS ruled that a life insurance company may deduct payments for reimbursement of losses sustained by the company's profit-sharing plan.

***PLR 200002030***

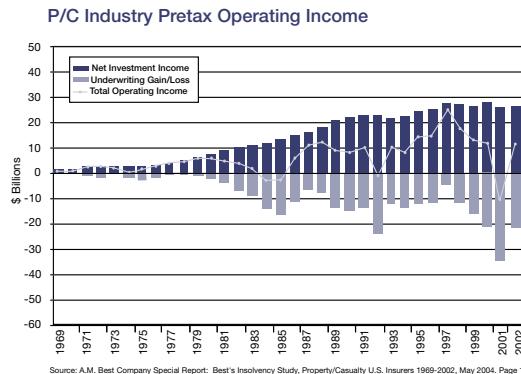
The IRS concluded that death benefits, accidental death benefits, burial benefits, and death benefits payable from an employee welfare benefit plan to a retiree on a spouse's death constituted excludable insurance contract benefits.

***PLR 200210065***

The IRS ruled that transactions as part of the liquidation of an insolvent insurance company will not be annual additions under Section 415 or cause a loan to the company's ESOP to fail.

***PLR 200327063, PLR 200327066***

The Service released two substantially identical rulings regarding the tax consequences of two Companies' proposed transfers of assets held in retired health reserves to voluntary employees' beneficiary associations.



## Investment Income Issues

*The Service and the courts ruled on the allocation, character, and treatment of investment income and expense in the following rulings.*

***Liberty National Life Insurance Company v. United States 816 F.2d 1520 (1987).*** The Eleventh Circuit Court of Appeals overturned the District Court decision in ruling on the proper method for allocating profit sharing contributions between investment expense and underwriting expense.

***Southwestern Life Insurance Co. v. United States 9 Cl.Ct. 102 (1985).*** The Claims Court ruled that escrow receipts were part of Southwestern's assets and disallowed an investment expense deduction. The Court also ruled that Southwestern was not required to maintain reserves for deferred premiums.

***Northwestern Mutual Life Insurance Co. v. United States, 795 F. 2d 74 (1986).*** The Federal Court of Appeals allowed Northwestern to take state income and excise taxes paid as investment expenses.

***Lutheran Mutual Life Insurance Co. v. United States 816 F.2d 376 (1987).*** The Eighth Circuit of Appeals ruled that the portion of state taxes paid by Lutheran Mutual Life Insurance Company may be deducted as investment expense.

*Prudential Insurance Company of America v. Commissioner, 90 T.C. 36 (1988).* The Tax Court ruled that prepayments penalties must be included in gross investment income.

*Prudential Insurance Co. of America v. Commissioner, 882 F.2d 832 (1989).* The Third Circuit Court reversed the Tax Court and ruled that prepayment penalties are characterized as amounts received in exchange for mortgages that qualified for long-term capital gain treatment, not investment income.

*Life Insurance Co. of Georgia v. United States, 16 Cl.Ct. 359 (1989).* The U.S. Court of Claims held that taxpayer must allocate contributions to an employee benefit plan on the basis of compensation paid instead of the ratio of investment department income to total net income.

*Phoenix Mutual Life v. Commissioner, 96 T.C. 17 (1991).* The Tax Court held that prepayment premiums received for early retirement of loans are capital gain and are not included as gross investment income under Section 804(b)(1)(C).

*The Travelers Insurance Co. v. United States, 25 Cl.Ct. 141 (1992).* The Federal Court of Claims ruled that prepayment fees on loans are excludable from investment income.

*ACM Partnership v. Commissioner, 157 F.3d 231 (1998).* It was ruled that an investment partnership's dealings relating to installment sales lacked economic substance for tax purposes.

#### **Revenue Procedure 92-67**

The Service provided procedures for taxpayers to elect, for tax years ending after July 18, 1984, to include market discount in income currently under Section 1278(b), and to use a constant interest rate to compute accrued market discount on a bond before the holder disposes of the bond under Section 1276(b).

In 1997, the IRS issued final regulations concerning contingent debt instruments with original issue discount under Section 1275. These regulations in effect convert the policy loan interest received in advance from being currently included in taxable income, to treating the interest as OID which is included in taxable income as accrued. As a result, the inclusion of unearned interest on policy loans can be excluded from taxable income.

***PLR 8740001***

The IRS allowed an interest deduction unless there was direct evidence that borrowing was related to tax-exempt obligations.

***PLR 8745024***

The IRS allowed an interest expense deduction even though taxpayer held tax-exempt obligations.

***PLR 8952001***

A refundable insurance premium was found to be a below-market loan.

***PLR 9006001***

The IRS determined that in computing its AMT book income adjustment, an insurance company may not exclude any amount other than investment income from the income it reports on its financial statements.

***TAM 8702002***

The IRS determined that guaranteed amounts credited under the Company's deposit administration contracts and immediate participation guarantee contracts constitute interest paid under Section 805(e)(1).

***TAM 9307002***

The IRS ruled that Section 811 did not require the taxpayer to treat a sale-leaseback transaction the same for financial accounting and federal income tax purposes.

**TAM 9622004**

The IRS ruled that Section 812(g) applies to the total amount of ESOP interest for purposes of determining “gross investment income” and for computing “life insurance gross income.”

**TAM 9609003**

The IRS ruled that a property and casualty insurer’s method of allocation of expenses to investment, based on the ratio of gross investment income to gross income, was unreasonable.

**TAM 9823004**

The IRS ruled that an insurance company that guarantees interest and principal on the issuance of tax-exempt bonds earns any remaining unearned premium when the issue is refunded. This result holds even if the company reduces its premium for coverage of the refunding issue by a “refunding credit” equal to the remaining unearned premium on the original bond issue.

**TAM 200420002**

The IRS found that Taxpayer was entitled to gross up interest deductions from an investment partnership.

***Capital and Ordinary Losses***

*In the following rulings the Service determined whether certain losses were capital or ordinary and that certain market discount bonds were entitled to a lower tax rate for capital gains.*

***Revenue Ruling 85-166***

The IRS determined that a property casualty insurance company that sold stocks held for investment at a loss had capital losses that would be deductible in the year incurred. Any losses exceeding taxable income would become capital loss carry-backs or carry-forwards.

***Notice 2003-34***

The IRS addressed certain offshore insurance companies which invest in hedge funds and use the arrangements to defer recognition of ordinary income or to characterize ordinary income as a capital gain.

***TAM 9538005***

The IRS ruled that the parent company was entitled to an ordinary loss for worthless subsidiary stock under Section 165(g)(3).

***TAM 9817002***

The IRS ruled that the loss incurred by an investment company on an insurance subsidiary's stock is a capital loss. The IRS concluded that interest, dividends and capital gains received by the insurance company are not considered from sources other than dividends, interest and gains from stock or securities under Section 165(g)(3)(b).

***TAM 199928003***

The Service ruled that a taxpayer that recorded gains on "grandfathered" market discount bonds called for redemption were not considered to be gains recognized on "redemption at maturity" and entitled to a lower alternative tax rate for capital gains.

## **IRS Compliance Issues**

*In the following rulings the Service addressed Section 847, the Fast Track Settlement Program, and the Industry Issue Resolution Program.*

***Revenue Ruling 2003-34***

The IRS released Revenue Ruling 2003-34 ruling that if an insurance company takes a deduction under Section 847 in a taxable year, the company is not required to request the permission of the Secretary or his delegate in order to discontinue using Section 847 in a subsequent year.

***Revenue Procedure 96-12***

The IRS announced that it will not rule on certain issues raised in connection with the formation of a life insurance partnership, where

substantially all of the organization's assets consist of, or will consist of, life insurance policies on the lives of the members.

#### ***Revenue Procedure 2003-41***

The IRS made the Fast Track Settlement program for large and mid-size businesses permanent. The Revenue Procedure contains guidance designed to help taxpayers and the IRS reach agreement on tax disputes more quickly.

#### ***Notice 2000-65***

The IRS detailed the launch of its Industry Issue Resolution Pilot Program, designed to provide guidance for resolving frequently disputed tax issues common to a significant number of large or mid-size business taxpayers.

## **Policyholder Dividends**

### ***Deductibility***

*In the following rulings the Service and the courts addressed the deductibility of policyholder dividends.*<sup>93</sup>

*Prairie States Life Insurance Co. v. United States* 828 F.2d 1222 (1987). The Eighth Circuit of Appeals reversed the District Court and held that distributions to Prairie's participating policyholders are not deductible "return premiums" under Section 809(c)(1).

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93. See Mutual Insurance Companies for issues related to policyholder dividends in reorganizations.

*Gulf Life Ins. Co. v. U.S., 35 Fed. Cl. 12 (1996).* The Court of Federal Claims ruled that reimbursements for policyholder dividends, paid to a life insurer from a reinsurer pursuant to a modified indemnity agreement, should be treated as dividends paid by the reinsurer.

*Gulf Life Insurance Co. v. U.S., 118 F.3d 1563, Fed.Cir. (1997).* A Federal Circuit panel upheld the lower court's decision that reimbursements for policyholder dividends, paid to a life insurer from a reinsurer pursuant to a modified indemnity agreement, should be treated as dividends paid by the reinsurer.

*Provident Life v. Commissioner 334 F.Supp.2d 1029 (2004).* The U.S. District Court granted Provident Life's motion for summary judgment for a refund of 1984 income tax and found that the decrease in open-year experience rating credit reserves computed as of December 31, 1984, is properly treated as unaccrued policyholder dividends rather than as income.

#### *Revenue Ruling 57-134*

The Service ruled that accrual insurance companies could deduct dividends to policyholders in the year declared, even if the amounts were not specified as a portion of net profits of that year and were not paid until the following year.

#### *PLR 8714005*

The IRS determined that the crediting of excess interest to policyholders' accounts constitutes a "dividend to policyholders." The policy is a participating contract, for which no deduction under Section 809(d)(5) is allowable.

#### *PLR 9715013*

The IRS ruled that a property and casualty insurance company may deduct a distribution from its unassigned surplus as a policyholder dividend, but may not deduct a repayment of paid-in surplus.

**TAM 9143001**

In **TAM 8314009**, the IRS granted 7805(b) relief and ruled that the guaranteed endowment benefit is a distribution similar to a policyholder dividend and consequently, is properly deductible under Section 809(d)(2) as a dividend to policyholders. In this TAM, the IRS withdrew the Section 7805(b) relief.

**TAM 199913031**

The Service determined that declared policyholder dividends subject to a contingency were not deductible until that contingency is satisfied.

**TAM 200415004**

The IRS determined that amounts paid to former insurance policyholders of a target corporation are not deductible policyholder dividends under Section 832(c)(11).

**Qualification**

*In several cases the Service and the courts determined that certain amounts were policyholder dividends, or were not policyholder dividends.*

**Modern American Life Insurance Co. v. Commissioner, 92 T.C. 80 (1989).** The Tax Court found that guaranteed benefit payments were policyholder dividends, not benefits paid.

**TAM 9130009**

The IRS held guaranteed endowment benefits to be policyholder dividends.

**TAM 9110002**

The IRS revoked an earlier TAM and found that policy update programs should have been characterized as exchanges of policies, because they were voluntary and they materially changed the relationship between the policyholders and the companies.

**TAM 9206007**

In **PLR 8431022**, the Service determined that the taxpayer's policy update program was reserve weakening accompanied by policyholder dividends. However, in **PLR 9143004**, the Service revoked that prior ruling. Taxpayer applied for relief under Section 7805(b), and the IRS granted the relief, and allowed the taxpayer to continue to treat its 1983 update program as involving a reserve weakening and a policyholder dividend.

**TAM 9347004**

The IRS granted the taxpayer relief under Section 7805(b) for transactions covered by a 1985 ruling and permitted the taxpayer to treat those transactions as involving a reserve weakening and a policyholder dividend.

**TAM 9347005**

The IRS granted the taxpayer relief under Section 7805(b) for transactions covered by a 1985 ruling and permitted the taxpayer to treat those transactions as involving a reserve weakening and a policyholder dividend.

**TAM 9732003**

The IRS ruled that the excess of the value of new policies issued pursuant to an update program over the value of the old policies exchanged is a policyholder dividend.

The Service concluded that payments made by worker's compensation pools to participating employers were properly characterized as policyholder dividends and not return premiums on retrospectively rated insurance programs.

**PLR 199922010**

**PLR 199922013**

**PLR 199922015**

**PLR 199922017**

**PLR 199922018**

**PLR 199922019**

**PLR 199922020**

**TAM 9707004**

The IRS ruled that policyholder charges collected by a state-sponsored workers' compensation insurer are premiums, rather than capital contributions.

**Miscellaneous Policyholder Dividends Rulings**

*The following rulings address fresh start and other policyholder dividend questions.*

**National Life Insurance Co, et al. v. Commissioner, 103 F.3d 5 (1996).** The Tax Court determined that National was required to apply the accrual method and could not claim a deduction in 1984 for a liability accrued in 1983. Nothing in the fresh-start provision indicates that National is relieved from using the accrual method consistently through 1984.

**TAM 9224001**

A life insurance company may not claim the fresh start adjustment provided by the 1984 Act for policyholder dividends that were guaranteed upon termination.

**PLR 8608025**

The IRS extended a waiver of dividends between subsidiaries.

**Policyholder Surplus Accounts**

*The Service and the courts released the following rulings on policyholder surplus accounts, including triggering events and use of PSAs to reduce taxable income.*

**World Service Life Insurance Company, etc. v. Commissioner 89 T.C. No. 8 (1987).** The IRS determined that the smaller of unused loss carry-forwards or additions to policyholders' surplus accounts should reduce the company's taxable income and be used to determine amounts included in income from the failed insurer's policyholder surplus account.

*Continental Bankers Life Insurance Co. of the South v. Comissioner, 93 T.C. 6 (1989).* The Tax Court ruled that the company's deemed distributions result in Phase III taxable income to the extent made out of policyholder surplus.

*Monat Capital Corp. v. Commissioner 869 F.Supp. 1513 (1994).* The District Court ruled that the insolvency of a life insurance company does not trigger taxation of the policyholder surplus account if no funds go to shareholders.

*Bankers Life & Casualty Co. v. U.S., 1996 WL 137646 (unpublished) (1996).* The U.S District Court ruled that, in determining whether distributions from a Policyholder Surplus Account (PSA) have occurred, fair market value, and not adjusted basis, must be considered and that a Section 338(g) election triggers a "constructive" distribution from the company's PSA.

*Bankers Life and Casualty Co. v. U.S., 142 F.3d 973 (1998), cert. den. 119 S. Ct. 403 (1998).* The Seventh Circuit upheld Treas. Reg. Section 1.815-2(b)(3) and ruled that fair market value, and not adjusted basis, must be considered in determining whether distributions from a Policyholder Surplus Account have occurred, and that a Section 338(g) election triggers a "constructive" distribution from the company's PSA.

*GE Life and Annuity Co. v. United States, 127 F.Supp.2d 794 (2000) modified by GE Life and Annuity Co. v. United States; No. 3:00CV148 (2002).* The District Court for the Eastern District of Virginia ruled that a Section 338 election was not a policyholder surplus account triggering event.

#### **PLR 8825013**

The IRS ruled that a subsidiary's merger into its parent would not trigger Phase III tax.

**PLR 9409028**

The IRS ruled that the policyholder surplus account is not distributed as a result of transfer of life insurer's stock.

*The American Jobs Creation Act of 2004, enacted October 22, 2004, amended Section 815 to suspend policyholder surplus accounts during 2005 and 2006. In any taxable year beginning after December 31, 2004, and before January 1, 2007, direct and indirect distributions from the PSA will be treated as zero, and distributions will be made **first** out of the PSA, then the shareholder surplus account, then other accounts. The provision is effective for taxable years beginning after December 31, 2004.*

## Priority of Statutes

*Greene v. U.S., 62 Fed.Cl. 418 (Fed. Cl., 2004).* The U.S. Court of Federal Claims determined that the IRS must refund taxes paid by Great Global Assurance Company on the company's Phase III income because the state guaranty fund that was obligated to pay the failed insurer's policyholder claims held priority status over the government's tax claim.

*Department of Treasury v. Fabe, 113 S.Ct. 2202 (1993).* The Supreme Court held that the Ohio priority statute relates to the business of insurance to the extent that it protects the rights of the policyholders, and thus overrides the federal priority of claims statute.

## Reciprocal Insurance Companies

**PLR 8929004**

The IRS ruled that a reciprocal was allowed to revoke its election under Section 835.

**PLR 9836023**

The IRS defined "savings credited to subscriber accounts" and ruled on the proper tax treatment of excess contributions to subscriber accounts for reciprocal underwriters under Section 832(f).

## Research Credit

*Insurance companies have often sought to use the research credit for development of internal-use software. In most cases, the Service and the courts have ruled that insurance companies have not satisfied the requirements for a tax credit under Section 41.*

*United Stationers, Inc. v. U.S.*, 982 F.Supp. 1279 (1997). Upon a de novo review, the case was decided against United Stationers based on a failure to show that their activities satisfied the requirements for a tax credit under Section 41.

*United Stationers, Inc. v. United States*, 163 F.3d 440 (1998). The Seventh Circuit affirmed the district court's holding that the taxpayer had failed to show that costs to develop internal-use software were eligible for the R&E tax credit.

*Tax and Accounting Software Corp. v. U.S.*, 111 F. Supp. 2d 1153 (2000). The U.S. District Court for the Northern District of Oklahoma rejected the IRS's "discovery" test for the Section 41 research credit.

*Nicholas E. Eustace, et al. v. Commissioner* T.C. Memo 2001-66 (2001). The Tax Court, in agreement with the IRS, concluded that an S corporation, Applied Systems Inc., was not eligible for the Section 41 research credit relating to insurance software.

### *Revenue Procedure 2000-50*

The IRS provided guidelines regarding the treatment of computer software.

## Specified Liability Losses

*In the following rulings the Service addressed specified liability losses.*

***Sealy Corporation v. Commissioner, 107 T.C. 177 (1996).*** The Tax Court ruled that fees paid for professional services were not “specified liability losses,” thus were not entitled to a special ten-year carryback under Section 172(f).

***Sealy Corp. v. Commissioner, 107 T.C. 177 (1996), aftd., 171 F.3d 655 (1999).*** The Ninth Circuit upheld the Tax Court’s determination that certain expenses were not specified liability losses and thus not eligible for the ten-year carryback under Section 172(f)(1)(B).

### **Notice 97-36**

The IRS released Notice 97-36, addressing the “improper characterization” by some companies of net operating losses as specified liability losses under Section 172(f)(1)(B)(i).

## Surplus Notes

### **TAM 9714003**

The IRS ruled that a property and casualty insurer’s surplus notes are debt for tax purposes, but that “advanced amounts” charged to policyholders are premium income.

### **TAM 199942005**

The National Office ruled that the taxpayer properly excluded its surplus notes from surplus and capital from Section 809(b)(2)(A) for purposes of calculating taxpayer’s equity base under Section 809(b)(2) for the tax year.

### **PLR 9042043**

The IRS ruled that income from the sale of deferred gift annuities is not subject to the unrelated business income tax.

***PLR 9441001***

Income from a group insurance program is subject to unrelated business income tax.

***PLR 9436003***

A tax-exempt labor union sponsors a health insurance plan and receives back from the insurance company 13 percent of premiums paid. Fees paid to the labor union from the insurer are unrelated business taxable income.



# Tabulation of Rulings and Court Cases



appendix A

*This appendix lists, by Internal Revenue Code section, each development in this monograph. The appendix is divided by type of guidance: Revenue Rulings, Revenue Procedures, Private Letter Rulings, Announcements, Legal Memorandums, General Counsel Memorandums, Internal Revenue Releases, Notices, Technical Advice Memorandums, Field Service Advice, and Cases.*

## Revenue Rulings

# Revenue Rulings

Applicable Code Section	Revenue Ruling Number	Monograph Chapter
62, 67	90-93	Agent
72	92-95	Products
72	2003-95	Products
162	88-72	Captives
162	89-61	Captives
162	92-93	Captives
162	2002-89	Captives
162	2002-90	Captives
162, 118	2001-31	Captives
264	95-53	Other
351	94-45	Reorganizations
368	95-19	Reorganizations
368	2003-19	Mutual Insurance Companies
412	2004-20	Other
807	87-26	Reserves
807	88-16	Reserves
807	92-19	Reserves
807	93-58	Reserves
807	94-11	Reserves
807	94-74	Reserves
807	95-4	Reserves
807	98-2	Reserves
807	99-10	Reserves
807	2000-17	Reserves
807	2001-38	Reserves
807	2002-6	Reserves
807	2003-24	Reserves
807	2004-14	Reserves
809	57-134	Other

Applicable Code Section	Revenue Ruling Number	Monograph Chapter
809	86-114	Mutual Insurance Companies
809	86-157	Mutual Insurance Companies
809	87-20	Mutual Insurance Companies
809	87-92	Mutual Insurance Companies
809	88-80	Mutual Insurance Companies
809	89-106	Mutual Insurance Companies
809	90-73	Mutual Insurance Companies
809	91-52	Mutual Insurance Companies
809	92-78	Mutual Insurance Companies
809	93-59	Mutual Insurance Companies
809	94-53	Mutual Insurance Companies
809	95-60	Mutual Insurance Companies
809	96-42	Mutual Insurance Companies
809	97-35	Mutual Insurance Companies
809	98-38	Mutual Insurance Companies
809	99-3	Mutual Insurance Companies
809	99-35	Mutual Insurance Companies
809	2000-37	Mutual Insurance Companies
809	2001-33	Mutual Insurance Companies

# Revenue Rulings

Applicable Code Section	Revenue Ruling Number	Monograph Chapter
809	2003-4	Mutual Insurance Companies
812	2003-120	Reserves
816	89-43	Reserves
817	94-62	Products
817, 61	2003-91	Products
817, 61	2003-92	Products
831	2002-91	Captives
832	85-166	Other
832	91-22	Reserves
832	92-94	Other
832	97-5	Reserves
842	2003-17	International
846	88-63	Reserves
846	89-66	Reserves
846	91-42	Reserves
846, 807	99-48	Reserves
847	2003-34	Other
861, 7805	2004-97	International
862, 933	2004-75	International
881	89-91	International
1035	92-43	Products
1035	92-44	Products
1035	2002-75	Products
1035	2003-76	Products
7702	91-17	Products
7872	99-17	Other

## Revenue Procedures

Applicable Code Section	Revenue Procedure Number	Monograph Chapter
101	96-12	Other
162, 267	2000-50	Other
162, 805	90-36	Reinsurance
162, 816	2002-75	Captives
332	89-36	Reorganizations
368	89-50	Reorganizations
402	2004-16	Other
404, 446	2004-41	BCBS
446	97-27	Other
446	97-50	Other
446	98-60	Other
451	92-98	Products
451, 481	2001-24	Other
481	96-31	Other
481	2002-54	Other
501	87-51	BCBS
817	92-25	Products
831	2002-46	Other
832	91-48	Reserves
832	92-52	Reserves
832	92-77	Reserves
832	92-78	Reserves
832	93-30.	Reserves
832	96-45	Reserves
832	98-12	Reserves
832	99-16	Reserves
832	99-37	Reserves
832	2000-45	Reserves
832	2001-61	Reserves
832	2003-18	Reserves
832	2004-69	Reserves

# Revenue Procedures

Applicable Code Section	Revenue Procedure Number	Monograph Chapter
832, 846	2002-74	Reserves
832, 846	2004-10	Reserves
842	92-27	International
842	92-95	International
842	94-14	International
842	95-26	International
842	96-23	International
842	97-16	International
842	98-31	International
842	99-30	International
842	2000-32	International
842	2002-58	International
842	2003-70	International
842	2004-55	International
846	91-21	Reserves
846	92-47	Reserves
846	92-76	Reserves
846	93-29	Reserves
846	94-47	Reserves
846	94-50	Reserves
846	95-40	Reserves
846	95-41	Reserves
846	96-44	Reserves
846	98-11	Reserves
846	99-15	Reserves
846	99-36	Reserves
846	2000-44	Reserves
846	2001-60	Reserves
846	2003-17	Reserves
846	2004-9	Reserves
846	2004-70	Reserves
953	90-65	International
953	2003-47	International

Applicable Code Section	Revenue Procedure Number	Monograph Chapter
1035	92-26	Products
1035	92-44	Products
1276	92-67	Other
1441	2004-59	International
1502	95-11	Consolidated Returns
4371	87-13	International
4371	89-24	International
4371	92-14	International
4371	92-39	International
4371	2003-78	International
6103	2003-41	Other
7702	92-57	Products
7702	99-27	Products
7702	2001-42	Products
7702	2002-42	Products

# Private Letter Rulings

## Private Letter Rulings

Applicable Code Section	Private Letter Ruling Number	Monograph Chapter
56	9006001	Other
61	200420017	Products
61	9519002	Agents
61	9603011	Other
72	199905015	Products
72	200313016	Products
72	8726022	Products
72	9407019	Reinsurance
72	9530027	Products
72	9618028	Other
72	9639057	Products
72	9832026	Products
72, 264	8604033	Products
72, 7702	9239026	Products
72, 7702	9305013	Products
72, 7702	9312013	Products
72, 7702	9338018	Products
72, 451	9516055	Reinsurance
72, 1035	9644016	Products
72, 1035	9708016	Products
72, 101	9720038	Products
101	199903020	Other
101	9012063	Products
101	9042023	Products
101	9045004	Other
101	9852041	Products
101, 807	9410039	Products
101, 7702	200002030	Other
101, 7702	9801042	Products
108	9121017	Reinsurance
108	9323022	Products

Applicable Code Section	Private Letter Ruling Number	Monograph Chapter
115	199903035	Captives
115	200210024	Other
115	8803020	Captives
115	8803033	Captives
115	8803037	Captives
115	8804058	Captives
115	8814018	Captives
115	8815009	Captives
115	8815010	Captives
115	8815027	Captives
115	8816022	Captives
115	8816040	Captives
115	8819046	Captives
115	8823034	Captives
115	8823035	Captives
115	8824015	Captives
115	8824034	Captives
115	8825100	Captives
115	8826026	Captives
115	8826048	Captives
115	8831047	Captives
115	8832020	Captives
115	8834031	Captives
115	8839083	Captives
115	8842070	Captives
115	8845065	Captives
115	8850037	Captives
115	8850038	Captives
115	8850063	Captives
115	8851032	Captives
115	8908055	Captives
115	8920023	Captives
115	8920037	Captives

# Private Letter Rulings

Applicable Code Section	Private Letter Ruling Number	Monograph Chapter
115	8921055	Captives
115	8925028	Captives
115	8930036	Captives
115	8931061	Captives
115	8931068	Captives
115	8931069	Captives
115	8933011	Captives
115	8934026	Captives
115	8936028	Captives
115	8938018	Captives
115	8938044	Captives
115	8939047	Captives
115	8940032	Captives
115	8941079	Captives
115	8942037	Captives
115	8943051	Captives
115	8944008	Captives
115	8944032	Captives
115	8948057	Captives
115	8950033	Captives
115	8951012	Captives
115	8952036	Captives
115	9043017	Captives
115	9043035	Captives
115	9101005	Captives
115	9109031	Captives
115	9140046	Captives
115	9204040	Captives
115	9207016	Captives
115	9218014	Captives
115	9243044	Captives
115	9247014	Captives
115	9324028.	Captives

Applicable Code Section	Private Letter Ruling Number	Monograph Chapter
130	8831021	Reinsurance
162	8830066	Captives
162	8837057	Captives
162	8844001	Captives
162	9310045	Captives
162	9624028	Captives
162	9746039	Other
162	9853007	BCBS
264	8843018	Other
264	9033023	Other
264	9109018	Products
264	9117011	Products
264	9138049	Products
264	9145013	Reorganizations
264	9150045	Products
264, 7702	9714029	Products
264, 7702	9737007	Products
265	8745024	Other
302	8726009	Mutual Insurance Companies
331	200307080	Reorganizations, Mutual Insurance Companies
332	200303028	Reorganizations
332	8735015	Reorganizations
332	8808049	Reorganizations
332	8817044	Reorganizations
332	8829065	Reorganizations
332	8852025	Reorganizations
332	8852025	Reorganizations
332	8911058	Reorganizations
332	8912050	Reorganizations
332	8925084	Reorganizations
332	8933009	Reorganizations

# Private Letter Rulings

Applicable Code Section	Private Letter Ruling Number	Monograph Chapter
332	8945068	Reorganizations
332	9011020	Reorganizations, Mutual Insurance Companies
332	9013054	Reorganizations
332	9029030	Reorganizations, Mutual Insurance Companies
332	9103023	Reorganizations
332	9111037	Reorganizations
332	9122079	Reorganizations
332	9124052	Reorganizations
332	9126038	Reorganizations
332	9129009	Reorganizations
332	9150014	Reorganizations
332	9208035	Reorganizations
332	9212004	Reorganizations
332	9215016	Reorganizations
332	9216027	Reorganizations
332	9217051	Reorganizations, Mutual Insurance Companies
332	9229019	Reorganizations, Consolidated Returns
332	9245039	Reorganizations
332	9246036	Reorganizations
332	9309048	Reorganizations
332	9328008	Mutual Insurance Companies
332	9412044	Reorganizations
332	9431049	Reorganizations
332	9438027	Reorganizations
332	9511025	Reinsurance
332	9520054	Reorganizations
332	9542042	Reorganizations
332	9624014	Reorganizations
332	9701032	Reorganizations
334	8747004	Reorganizations

Applicable Code Section	Private Letter Ruling Number	Monograph Chapter
338	9427001	Reorganizations
338	9434009	Reorganizations
338	9601041	Reorganizations
338	9646016	Reorganizations
338	9735038	Reorganizations
338	9847027	Reorganizations
338	9852022	Reorganizations
351	199914012	Reorganizations
351	9201010	Reorganizations
351	9212014	Reorganizations
351	9345006	Reorganizations
351	9409041	Reorganizations
351	9534017	Mutual Insurance Companies
351	9608019	Reorganizations
351	9642061	Reorganizations
351	9709002	Products
351, 368	200002010	Mutual Insurance Companies
351, 368	200011035	Mutual Insurance Companies
351, 368	200011041	Reorganizations
351, 368	200111013	Mutual Insurance Companies
351, 368	200114002	Mutual Insurance Companies
351, 368	200333024	Mutual Insurance Companies
351, 368	8711121	Mutual Insurance Companies
351, 368	9706013	Consolidated Returns
351, 368	9710015	Mutual Insurance Companies
351, 368	9745013	Mutual Insurance Companies
354	8617088	Reorganizations

# Private Letter Rulings

Applicable Code Section	Private Letter Ruling Number	Monograph Chapter
355	9105033	Reorganizations
355	9212005	Reorganizations
368	199919016	Mutual Insurance Companies
368	200144001	Mutual Insurance Companies
368	200208017	Mutual Insurance Companies
368	200213001	Mutual Insurance Companies
368	200213002	Mutual Insurance Companies
368	200213003	Mutual Insurance Companies
368	200240051	Mutual Insurance Companies
368	8640050	Mutual Insurance Companies
368	8725040	Reorganizations
368	8812040	Reorganizations
368	8812047	Reorganizations
368	8822053	Reorganizations
368	8823105	Reorganizations
368	8824037	Reorganizations
368	8825013	Reorganizations, Other
368	8827061	Reorganizations
368	8830016	Reorganizations
368	8901035	Reorganizations, Mutual Insurance Companies
368	8912054	Mutual Insurance Companies
368	8919008	Reorganizations
368	8924034	Reorganizations
368	8926020	Reorganizations
368	8928052	Reorganizations
368	8938072	Reorganizations

Applicable Code Section	Private Letter Ruling Number	Monograph Chapter
368	8945043	Reorganizations
368	9014028	Reorganizations
368	9016006	Reorganizations
368	9038055	Reorganizations
368	9042022	Reorganizations
368	9045058	Reorganizations
368	9051042	Reorganizations, Mutual Insurance Companies
368	9106049	Mutual Insurance Companies
368	9109011	Reorganizations
368	9109045	Reorganizations
368	9112026	Reorganizations
368	9114012	Reorganizations
368	9121048	Reorganizations
368	9122080	Reorganizations
368	9124058	Reorganizations
368	9126062	Reorganizations
368	9139004	Reorganizations
368	9140007	Mutual Insurance Companies
368	9142014	Mutual Insurance Companies
368	9149040	Reorganizations
368	9220046	Reorganizations
368	9223027	Reorganizations
368	9229026	Reorganizations
368	9232037	Mutual Insurance Companies
368	9235007	Mutual Insurance Companies
368	9235008	Mutual Insurance Companies
368	9235009	Mutual Insurance Companies

# Private Letter Rulings

Applicable Code Section	Private Letter Ruling Number	Monograph Chapter
368	9235010	Mutual Insurance Companies
368	9235052	Reorganizations
368	9241056	Reorganizations
368	9306014	Reorganizations
368	9313020	Reorganizations
368	9334016	Reorganizations, Mutual Insurance Companies
368	9335045	Reorganizations
368	9413041	Mutual Insurance Companies
368	9444010	Reorganizations
368	9502025	Reorganizations
368	9508013	Mutual Insurance Companies
368	9512021	Mutual Insurance Companies
368	9527028	Reorganizations
368	9540004	Mutual Insurance Companies
368	9609049	Reorganizations
368	9635034	Mutual Insurance Companies
368	9742020	Reorganizations
368	9746056	Mutual Insurance Companies
368	9834019	Mutual Insurance Companies
368	9835039	Mutual Insurance Companies
368	9837002	Reorganizations
368	9839021	Mutual Insurance Companies
368	9852011	Mutual Insurance Companies
368, 809	9425044	Mutual Insurance Companies

Applicable Code Section	Private Letter Ruling Number	Monograph Chapter
368, 809	9510010	Reorganizations, Mutual Insurance Companies
368, 1502	200317019	Reorganizations
381	8813015	Reorganizations, Mutual Insurance Companies
381	9142015	Reorganizations
381, 848	9552030	Reorganizations
382	9137024	Reorganizations
382	9138029	Reorganizations, Products
382	9630038	Consolidated Returns
382, 368	9616031	Reorganizations
386	8734026	Reorganizations
401	9014068	Other
404	9713006	Other
415	200210065	Other
419, 4976	200219002	International
451	9052016	Agent
501	8740001	Other
501	9407008	Other
501	9853026	Tax Exempt and Small Insurance Companies
501, 953	9407007	Captives
501, 4976	200327063	Other
501, 4976	200327066	Other
511	9042043	Other
511	9043039	Captives
511	9441001	Other
512	9108016	Captives
512	9119060	Captives
512	9436003	Other
801	8629002	Products
801	9018001	Reserves
801	9033001	Reserves

# Private Letter Rulings

Applicable Code Section	Private Letter Ruling Number	Monograph Chapter
801	9112011	Reserves
803	8817008	Reinsurance
803, 807	9430043	Products
803, 848	9516056	Reinsurance
805	8624011	Reorganizations, Mutual Insurance Companies
805, 807	8623025	Reorganizations
805, 807	9411030	International
805, 832	199952038	Other
807	8602016	Reinsurance, Products
807	8744057	Reserves
807	9106041	Reserves
807	9118024	Reserves
807	9118027	Reserves
807	9442001	Reserves
807, 816	9826023	Reserves
807, 816	8715038	Reserves
809	8550004	Reinsurance
809	8714005	Other
815	8608025	Other
815	8843007	Consolidated Returns
815	9409028	Other
816	8601013	Reserves
816	8817022	Reserves
816	8825016	Reserves, Other
816	8839021	Products
816	8839022	Products
816	8839028	Products
816	8839030	Products
816	8839032	Products
816	8839033	Products
816	9106040	Reserves
816	9245006	Reserves

Applicable Code Section	Private Letter Ruling Number	Monograph Chapter
816	9316017	Reserves
816	9533004	Reserves
816	9609033	Reserves
817	200010020	Products
817	200115028	Products
817	200206047	Products
817	200443029	Products
817	8710022	Products
817	8743005	Products
817	8808047	Products
817	8820044	Products
817	8820045	Products
817	8820046	Products
817	8835059	Products
817	9115032	Products
817	9125038	Products
817	9201012	Products
817	9211021	Products
817	9230023	Products
817	9403024	Products
817	9422006	Products
817	9433030	Products
817	9437026	Products
817	9437027	Products
817	9820004	Products
817	9828015	Products
817	9847017	Products
817, 457	200308032	Products
817, 7702	200244001	Products
817, 953	200246022	Products
818	8716002	Reserves
818	8727007	Reserves
818	8822002	Reserves

# Private Letter Rulings

Applicable Code Section	Private Letter Ruling Number	Monograph Chapter
831	199926033	Captives
831	200029018	Products
831	200042018	Products
831	200119039	Products
831	200121040	Tax Exempt and Small Insurance Companies
831	200133020	Tax Exempt and Small Insurance Companies
831	200138010	Products
831	200140057	Products
831	200142014	Tax Exempt and Small Insurance Companies
831	200237010	Products
831	200242027	Products
831	200332014	Tax Exempt and Small Insurance Companies
831	200340011	Products
831	200402001	Products
831	200403024	Products
831	8816030	Mutual Insurance Companies
831	9127048	Tax Exempt and Small Insurance Companies
831	9149012	Tax Exempt and Small Insurance Companies
831	9211051	Tax Exempt and Small Insurance Companies
831	9322027	Tax Exempt and Small Insurance Companies
831, 832	199931030	Products
831, 9100	9540059	Tax Exempt and Small Insurance Companies
832	199903024	Products
832	199922013	Other
832	199922015	Other
832	199922017	Other

Applicable Code Section	Private Letter Ruling Number	Monograph Chapter
832	199922018	Other
832	199922019	Other
832	199922020	Other
832	200044028	Reserves
832	200242005	Mutual Insurance Companies
832	200416006	Products
832	8817001	Reserves
832	8941032	Captives
832	9026002	Other
832	9029002	Reinsurance
832	9209029	Reserves
832	9233022	Reserves
832	9233023	Reserves
832	9409007	Reinsurance
832	9412002	Other
832	9416001	Products
832	9447006	Reserves
832	9504010	Reserves
832	9811055	Products
832	9836023	Other
832	9840046	Reserves
832, 834	9715013	Other
833	200201004	BCBS
833	8929023	BCBS
833	9125037	BCBS
833	9138039	BCBS
833	9833032	BCBS
835	8929004	Other
845	9335056	Reinsurance
846	9212009	Reserves
846	9216005	Reserves
846	9317043	Reserves

# Private Letter Rulings

Applicable Code Section	Private Letter Ruling Number	Monograph Chapter
846	9317045	Reserves
846	9811041	International, Mutual Insurance Companies
848	199905018	Reorganizations
848	199910016	Reorganizations
848	9507039	Reinsurance
848	9623031	Mutual Insurance Companies
848, 841	9528004	International, Products
882	8948003	International
894	9527022	International
904	8739001	International
953	199906016	International
953	9526008	International
954	200327052	International
954	200341019	International
1035	200342003	Products
1035	8604095	Products
1035	8806058	Products
1035	8810010	Products
1035	8816015	Products
1035	9017062	Products
1035	9044022	Products
1035	9141025	Products
1035	9319024	Products
1035	9330040	Products
1035	9335054	Products
1035	9452001	Reserves
1035	9820018	Products
1502	8650054	Consolidated Returns
1502	8744032	Consolidated Returns
1502	8833013	Consolidated Returns
1502	8838017	Consolidated Returns

Applicable Code Section	Private Letter Ruling Number	Monograph Chapter
1502	8840035	Consolidated Returns
1502	8842020	Consolidated Returns
1502	8948006	Consolidated Returns
1502	9009002	Consolidated Returns
1502	9132066	Consolidated Returns
1502	9133006	Consolidated Returns
1502	9210018	Consolidated Returns
1502	9211050	Consolidated Returns
1502	9234020	Consolidated Returns
1502	9246031	Consolidated Returns
1502	9314011	Consolidated Returns
1502	9327033	Consolidated Returns
1502	9441021	Consolidated Returns
1502	9530029	Mutual Insurance Companies
1502	9536004	Consolidated Returns
1502	9611014	Consolidated Returns
1503	9109012	Consolidated Returns
1504	8913029	BCBS, Consolidated Returns
1504	8923003	Consolidated Returns
1504	9115028	Consolidated Returns
1504	9140040	Consolidated Returns
1504	9206023	Consolidated Returns
1504	9240027	Consolidated Returns
1504	9314037	Consolidated Returns
1504	9419023	Consolidated Returns
1504	9420003	Consolidated Returns
1504	9605015	Consolidated Returns
2036	9037012	Products
2042	9026041	Other
2056A	9044072	Products
3121	8617094	Agent

# Private Letter Rulings

Applicable Code Section	Private Letter Ruling Number	Monograph Chapter
4371	200046034	International, Mutual Insurance Companies
4371	200321013	International
4371	200323016	International
4371	200327047	International
4371	200410012	International
4371	8723021	International
4371	8744012	International
4371	8802048	International
4371	8812027	International
4371	8820007	International
4371	8823003	International
4371	8823004	International
4371	8825045	International, Products
4371	8831001	International
4371	8831008	International
4371	8837080	International
4371	8842064	International
4371	8843006	International
4371	8848034	International
4371	8852040	International
4371	8908010	International
4371	8908018	International
4371	8913049	International
4371	8913058	International
4371	8913059	International
4371	8913060	International
4371	8913061	International
4371	8914047	International
4371	8914050	International
4371	8918020	International
4371	8918073	International
4371	8920064	International

Applicable Code Section	Private Letter Ruling Number	Monograph Chapter
4371	8928062	International
4371	8928063	International
4371	8928071	International
4371	8933035	International
4371	8936071	International
4371	8940049	International
4371	8942036	International
4371	9006029	International
4371	9104049	International
4371	9218020	International
4371	9218021	International
4371	9225018	International
4371	9229040	International
4371	9229041	International
4371	9229042	International
4371	9238022	International
4371	9245008	International
4371	9246021	International
4371	9246025	International
4371	9302011	International
4371	9302012	International
4371	9302013	International
4371	9308008	International
4371	9311017	International
4371	9314048	International
4371	9319037	International
4371	9320013	International
4371	9322040	International
4371	9325058	International
4371	9326029	International
4371	9326058	International
4371	9326060	International
4371	9336059	International

# Private Letter Rulings

Applicable Code Section	Private Letter Ruling Number	Monograph Chapter
4371	9337005	International
4371	9338031	International
4371	9406025	International
4371	9427019	International
4371	9526026	International
4371	9533022	International
4371	9731025	International
4373	8703046	International
6901	9340042	Reinsurance
7701	8845011	Mutual Insurance Companies
7702	200446001	Products
7702	200006030	Products
7702	200006032	Products
7702	200143008	Products
7702	200150014	Products
7702	200150018	Products
7702	200219022	Products
7702	200230037	Products
7702	200320020	Products
7702	200327037	Products
7702	200328027	Products
7702	200350001	Products
7702	200438005	Products
7702	8816047	Products
7702	8843008	Products
7702	8844043	Products
7702	8846018	Products
7702	9034014	Products
7702	9042039	Products
7702	9106050	Products
7702	9144009	Products
7702	9144020	Products

Applicable Code Section	Private Letter Ruling Number	Monograph Chapter
7702	9146011	Products
7702	9146016	Products
7702	9202008	Products
7702	9203049	Products
7702	9214039	Products
7702	9235013	Products
7702	9244010	Products
7702	9322023	Products
7702	9338023	Products
7702	9416017	Products
7702	9436037	Products
7702	9438015	Products
7702	9441022	Products
7702	9441023	Products
7702	9452023	Products
7702	9519023	Products
7702	9540047	Products
7702	9601039	Products
7702	9615037	Products
7702	9828016	Products
7702	9833033	Products
7702	9834020	Products
7702	9839005	Reorganizations
7702, 101	199929028	Products
7702, 264	9203009	Products
7702, 264	9412023	Products
7702, 264	9445013	Products
7872	8952001	Other

# Announcements & Legal Memorandums

## Continuing Developments in the Taxation of Insurance Companies: A History

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334	Ann. 86-47	Reorganizations
809	Ann. 89-89	Reinsurance
817	Ann. 88-68	Products
832	Ann. 88-99	Reserves
4371	Ann. 2001-98	International
6011	Ann. 2002-63	Other
6011, 6012	Ann. 2004-4	International
	Legal Memorandum Number	
162	ILM 200442031	Captives
162	20031501F	Products
	General Counsel Memorandum Number	
264	GCM 39728	Products
501	GCM 39655	Other
501	GCM 39864	Tax Exempt and Small Insurance Companies
809	GCM 39417	Reinsurance
832	GCM 39609	Reserves
1035	GCM 39588	Products
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807	IR 88-1	Reserves
	Notice Number	
1	Notice 2003-69	International
1	Notice 2003-71	International
1	Notice 2004-70	International

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1	Notice 2004-71	International
72, 1035	Notice 2003-51	Products
170, 501	Notice 99-36	Products
172	Notice 97-36	Other
501	Notice 2003-31	Captives
501	Notice 2003-35	Tax Exempt and Small Insurance Companies
501	Notice 2004-64	Tax Exempt and Small Insurance Companies
501	Notice 2004-65	Captives
501, 831	Notice 2002-70	Captives
801, 816	Notice 2003-34	Other
812	Notice 97-32	Reserves
813	Notice 87-48	International
813	Notice 88-60	International
817	Notice 87-47	Products
817	Notice 2000-9	Products
832	Notice 92-1	Reserves
833	Notice 2000-34	BCBS
842	Notice 88-52	International
842	Notice 89-96	International
842	Notice 90-67	International
846	Notice 88-100	Reserves
953	Notice 87-50	International
953	Notice 88-111	International
953	Notice 89-79	International
954	Notice 2002-69	International
1402	Notice 90-72	Agent
1441	Notice 2001-11	International
1502	Notice 88-107	Consolidated Returns, BCBS
4371	Notice 89-44	International
4371	Notice 89-89	International
4371	Notice 90-40	International

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4371	Notice 96-37	International
7605	Notice 2000-65	Other
7702	Notice 93-37	Products
7702	Notice 99-48	Products
7702	Notice 2004-61	Products
7872	Notice 2001-10	Products
7872	Notice 2002-59	Products
7872	Notice 2002-8	Products

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61	TAM 9604001	Products
61	TAM 199918060	Products
61, 451	TAM 9519002	Other
101	TAM 9117005	Products
115	TAM 9347001	Captives
115	TAM 199906036	Captives
118, 832	TAM 9707004	Other
119	TAM 9602001	Other
162	TAM 8637003	Captives
162	TAM 8638003	Captives
162	TAM 9627002	Other
162	TAM 199924001	Products
162	TAM 200323026	Captives
162	TAM 200405005	BCBS
162	TAM 200439042	BCBS
162, 263	TAM 9810001	Other
162, 831	TAM 200149003	Captives
163	TAM 199901005	Products
163, 264	TAM 9812005	Products
163, 264	TAM 200213010	Products
165	TAM 9538005	Other
165	TAM 9817002	Other
166, 832	TAM 9732004	Reinsurance
167	TAM 9608005	Reinsurance
167	TAM 9830001	Other
195	TAM 9825005	Other
263, 804	TAM 200334005	Other
338	TAM 9331002	Reorganizations
368, 833	TAM 200418009	BCBS

# Technical Advice Memorandum

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446	TAM 9302003	Other
451	TAM 9218004	Products
481	TAM 9516001	Other
801	TAM 8624001	Reserves
801	TAM 8951001	Reinsurance
801	TAM 200339049	Products
805	TAM 8702002	Other
805	TAM 9128011	Reserves
805	TAM 9306004	Reinsurance
806	TAM 9104004	Tax Exempt and Small Insurance Companies
806	TAM 200420002	Other
807	TAM 8702007	Reserves
807	TAM 9251005	Reserves
807	TAM 9452001	Reserves, Mutual Insurance Companies
807	TAM 9620001	Reserves
807	TAM 200108002	Reserves
807	TAM 200325001	Reserves
807	TAM 200328006	Reserves
807	TAM 200416009	Reserves
807	TAM 200435015	Reserves
808	TAM 9224001	Other
809	TAM 9110002	Other
809	TAM 9130009	Other
809	TAM 9333001	Mutual Insurance Companies
809	TAM 9347004	Other
809	TAM 9347005	Other
809	TAM 199942005	Other
811	TAM 9141001	Reinsurance
811	TAM 9143001	Other
811	TAM 9208006	Reinsurance

Applicable Code Section	Technical Advice Memorandum Number	Monograph Chapter
811	TAM 9307002	Other
811, 818	TAM 9732003	Other
812	TAM 9246001	Reserves
812	TAM 9622004	Other
812	TAM 200038008	Products
812	TAM 200330002	Products
816	TAM 200427024	Reserves
817	TAM 9807001	Products
820	TAM 8906004	Reinsurance
820	TAM 9113002	Reinsurance
820	TAM 9147066	Reinsurance
831	TAM 9540001	Other
831	TAM 9601001	Products
832	TAM 8614003	Reserves
832	TAM 9124003	Reserves
832	TAM 9147006	Reinsurance
832	TAM 9225003	Products
832	TAM 9251007	Products
832	TAM 9327008	Reserves
832	TAM 9647002	Reserves
832	TAM 9648002	Reserves
832	TAM 9714003	Other
832	TAM 9717009	BCBS
832	TAM 9823004	Other
832	TAM 199913031	Other
832	TAM 200006007	Reserves
832	TAM 200115002	Reserves
832	TAM 200415004	Other
833	TAM 9330002	BCBS
833	TAM 9533003	BCBS
833	TAM 9537001	BCBS
833	TAM 9638003	BCBS

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Applicable Code Section	Technical Advice Memorandum Number	Monograph Chapter
833	TAM 9710002	BCBS
833	TAM 200453014	BCBS
834	TAM 9609003	Other
842	TAM 200147007	International
845	TAM 9308003	Reinsurance
845	TAM 9339001	Captives
845	TAM 9346004	Reinsurance, Consolidated Returns
846	TAM 9228003	Reserves
846	TAM 9715005	Reserves
848	TAM 9623005	Reserves
860E	TAM 200404034	Consolidated Returns
864	TAM 9209001	International
864, 7805	TAM 200210028	International
902, 959	TAM 9817001	International
906	TAM 9227005	International
953	TAM 200453012	International, Captives
953	TAM 200453013	International, Captives
1033	TAM 200322017	Other
1035	TAM 8905004	Products
1243A	TAM 200452033	Products
1248	TAM 8920001	International
1278	TAM 199928003	Other
1502	TAM 9207006	Consolidated Returns
1502	TAM 9637001	Consolidated Returns, International
1502	TAM 200323002	Consolidated Returns
3121	TAM 9518001	Agent
3121	TAM 9736002	Agent
4371	TAM 9215004	International
4371	TAM 9243009	International
4371	TAM 9621001	International

Applicable Code Section	Technical Advice Memorandum Number	Monograph Chapter
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7805	TAM 9206007	Other

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# Field Service Advice

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111	FSA 200145004	Mutuals
162	FSA 199945009	Captives
162	FSA 200009006	International
162	FSA 200023010	International
162	FSA 200029010	Captives
162	FSA 200043008	Captives
162	FSA 200043011	Captives
162	FSA 200043012	Captives
162	FSA 200047021	Captives
162	FSA 200105014	Captives
162	FSA 200125005	Captives
162	FSA 200125009	Captives
162, 263	FSA 199925007	Other
162, 461	FSA 200209017	Captives
163	FSA 200202028	Products
264	FSA 200210010	Products
301	FSA 200238032	Reorganizations
338	FSA 200018004	Reorganizations
338	FSA 200144028	Reinsurance
482, 845	FSA 200027008	Captives
831	FSA 200202002	Captives
832	FSA 199946004	Reserves
832	FSA 199952011	Reserves
832	FSA 200023008	Reserves
832	FSA 200203016	Other
833	FSA 199933008	BCBS
833	FSA 200001002	BCBS
833, 832	FSA 199947008	BCBS
834	FSA 200001005	BCBS
1311	FSA 200143003	Reserves
1502	FSA 200215002	Consolidated Returns

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1502, 833	FSA 200149009	BCBS
4371	FSA 199952018	International
4371, 6402	FSA 200032002	International
7872	FSA 200040001	Products

## Cases

Applicable Code Section	Case Name	Monograph Chapter
41	Nicholas E. Eustace, et al. v. Commissioner, T.C. Memo 2001-66 (March 20, 2001)	Other
41	Tax and Accounting Software Corp. v. U.S., 111 F. Supp. 2d 1153 (N.D. Oklahoma, 2000)	Other
41	United Stationers, Inc. v. U.S., 982 F.Supp. 1279, (N.D. Illinois, 1997)	Other
41	United Stationers, Inc. v. United States, 163 F.3d 440 (7th Cir., 1998)	Other
56	State Farm Mutual Automobile Insurance Co., et al. v. Commissioner, 119 T.C. No. 21 (2002)	Consolidated Returns
61	Wentz v. Commissioner, 105 T.C. No. 1 (1995)	Agent
61, 162	United Parcel Service of America v. Commissioner, T.C. Memo 1999-268 (1999)	Captives
61, 162	United Parcel Service of America v. Commissioner, 254 F.3d 1014 (11th Cir., 2001)	International
67	Butts v. Commissioner and Smithwick v. Commissioner, 49 F.3d 713 (11th Cir., 1995)	Agent
111	American Mutual Life Insurance Co. v. United States, 46 Fed. Cl. 445 (2000)	Mutual Insurance Companies
111	American Mutual Life Insurance Co. v. United States, 267 F.3d 1344 (Fed. Cir., 2001)	Mutual Insurance Companies
111	Equitable Life Assurance Society of the Untied States v. United States, 89 A.F.T.R. 2d, (unpublished) (S.D.N.Y., 2002)	Reserves
162	Addis v. Commissioner, 374 F.3d 881 (9th Cir. 2004)	Products
162	AMERCO and Subsidiaries and Republic Western Insurance Co. v. Commissioner, 96 T.C. No. 3 (1991)	Reserves
162	AMERCO Inc. v. Commissioner, 979 F.2d 162 (9th Cir., 1992)	Captives
162	Anesthesia Service Medical Group Employee Protective Trust v. Commissioner, 85 T.C. 1031 (1985)	Captives
162	Beech Aircraft Corp. v. United States, 797 F. 2d 920 (10th Cir., 1986)	Captives

Applicable Code Section	Case Name	Monograph Chapter
162	Black Hills Corp. v. Commissioner, 101 T.C. No. 11 (1993)	Captives
162	Black Hills Corp. v. Comm'r, 73 F. 3d 799 (8th Cir., 1996)	Captives
162	Clougherty Packing Company v. Commissioner, 811 F.2d 1297 (9th Cir., 1987)	Captives
162	Connecticut Mutual Life Ins. Co. v. Comm'r, 106 T.C. No. 27 (1996)	Other
162	General Dynamics Corp. v. United States, 773 F. 2d 1224 (Fed. Cir., 1985)	Captives
162	General Dynamics Corp. v. United States, 107 S.Ct. 1732 (1987)	Captives
162	Gulf Oil Corporation v. U.S. 89 T.C. No. 70 (1987)	Captives
162	Gulf Oil Corp. v. Commissioner, 914 F.2d 396 (3rd Cir., 1990)	Captives
162	Humana Inc. and Subsidiaries v. Commissioner, 88 T.C. No. 13 (1987)	Captives
162	Humana Inc. v. Commissioner, 881 F.2d 247 (6th Cir., 1989)	Captives
162	INDOPCO, Inc. v. Commissioner, 112 S. Ct. 1039 (1992)	Reorganizations
162	Kidde Industries, Inc. v. U.S., 40 Fed. Cl. 42 (1997)	Captives
162	Kurt Orban Company, Inc. v. Commissioner T.C. Memo. 1987-518 (1987)	Captives
162	Malone & Hyde Inc., et al v. Commissioner, T.C. Memo. 1993-585 (1993)	Captives
162	Malone & Hyde Inc. v. Commissioner, 62 F.3d 835 (6th Cir., 1995)	Captives
162	Ocean Drilling and Exploration Co. v. United States, 24 Cl. Ct. 714 (1991)	Captives
162	Ocean Drilling & Exploration Co. v. United States, 988 F.2d 1135 (Fed. Cir., 1993)	Captives
162	PNC Bancorp v. Commissioner, 110 T.C. No. 27 (1998)	Other
162	PNC Bancorp Inc. v. Commissioner, 212 F. 3d 822 (3rd Cir., 2000)	Other

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162	Raymond Davis v. Commissioner of Internal Revenue, T.C. Summ.Op. 2004-64 (2004)	Agent
162	Security Associates Agency Insurance Corporation v. Commissioner, T.C. Memo. 1987-317 (1987)	Other
162	Stearns-Roger Corp. v. United States, 774 F. 2d 414 (10th Cir., 1985)	Captives
162	Stevedoring Services of America, Inc. v. C.I.R., T.C. Memo 1997-160 (1997)	Captives
162	Stevedoring Services of America v. Commissioner, (unpublished opinion), 166 F.3d 1218 (9th Cir., 1999)	International
162	The Harper Group and Includible Subsidiaries v. Commissioner, 96 T.C. No. 4 (1991)	Captives
162	The Harper Group v. Commissioner, 979 F.2d 1341 (9th Cir., 1992)	Captives
162, 163	U. S. Freightways Corp., et al. v. Commissioner, 113 T.C. No. 23 (1999)	Other
162, 163	U.S. Freightways Corp., et al. v. Commissioner, 270 F.3d 1137 (7th Cir., 2001)	Other
163	American Electric Power v. United States, 136 F. Supp 2d 762 (S.D. Ohio, 2001)	Products
163	American Electric Power v. U.S., 326 F.3d 737 (6th Cir., 2003)	Products
163	Campbell v. Cen-Tex, 377 F. 2d 688 (5th Cir., 1967)	Products
163	Dow Chemical Co. and Subsidiaries v. U.S. 250, F.Supp.2d 748 (E.D.Mich., 2003)	Products
163	In re CM Holdings Inc. Internal Revenue Service v. CM Holdings, Inc. 254 B.R. 578 (D. Delaware, 2000)	Products
163	In re CM Holdings, Inc., Camelot Music, Inc., G.M.G. Advertising and Grapevine Records and Tapes, Inc. Internal Revenue Service v. CM Holdings, Inc. 301 F.3d 96 (3rd Cir., 2002)	Products
163	Winn-Dixie Stores, Inc. v. Commissioner, 113 T.C. No. 21 (1999)	Products
163	Winn-Dixie Stores, Inc. v. Commissioner, 254 F.3d 1313 (11th Cir., 2001)	Products
163	Winn-Dixie Stores Inc. v. Commissioner, U.S., 122 S.Ct. 1537 (Mem), cert. Denied (2002)	Products

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165	Capital Blue Cross vs. Commissioner, 122 T.C. No. 11 (2004)	BCBS
165	Lychuk v. Commissioner, 116 T.C. 374 (2000)	Other
166	Credit Life Insurance Co. v. United States, 948 F.2d 723 (F. Cir., 1991)	Other
167	Decker v. Commissioner, 864 F.2d 51 (7th Cir. 1988)	Reorganizations
167	Globe Life and Accident Insurance Company v. United States, 54 Fed. Cl. 132 (2002)	Other
167	Toyota Town, Inc. v. Commissioner, T.C. Memo 2000-40 (2000)	Products
170, 1502	George Nichols III, in his capacity as Liquidator of Kentucky Central Life Insurance Company v. United States 260 F. 3d 637 (6th Cir., 2001)	Consolidated Returns
172	Sealy Corporation v. Comm'r, 107 T.C. 177 (1996)	Other
172	Sealy Corp. v. Commissioner, 107 T.C. 177 (1996), aften, 171 F. 3d 655 (9th Cir., 1999)	Other
264	Cecil H. Shirar, et ux. v. Commissioner, 916 F.2d 1414 (9th Cir., 1990)	Products
338	GE Life and Annuity Co. v. United States, 127 F.Supp.2d 794 (E.D. Va., 2000)	Reorganizations, Other
338	GE Life and Annuity Co. v. United States, 89 A.F.T.R. 2d 2002-1815 (E.D. Va., 2002)	Reorganizations, Other
451	Gerling International Insurance Co. v. Commissioner, 98 T.C. No. 44 (1992)	Reinsurance
453, 1001	ACM Partnership v. Commissioner, 157 F. 3d 231 (3rd Cir., 1998)	Other
501	Florida Hospital Trust Fund, et al. v. Commissioner, 103 T.C. No. 10 (1994)	Other
501	Nonprofits' Insurance Alliance of California v. United States, 32 Fed.Cl. 277 (1994)	Other
501	Paratransit Insurance Corp. v. Commissioner, 102 T.C. No. 34, June 14,1994	Other
501	Roark v. Commissioner, T.C. Memo 2004-271 (2004)	Products
801	Aetna Life Insurance Company v. United States, 16 Cl.Ct. 364 (1989)	Reserves

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801	Harco Holdings, Inc. v. United States, 754 F.Supp. 130, (D. Illinois, 1990)	Reserves
801	Harco Holdings v. United States, 977 F. 2d 1027 (7th Cir., 1992)	Reserves
801	Metropolitan Life Insurance Co. v. United States, 30 Fed.Cl. 195 ( 1993)	Reserves
801	Phoenix Mutual Life v. Commissioner, 96 TC 18 (1991)	Reserves, Mutual Insurance Companies
801	Principal Mutual Life Insurance Co. v. U.S., 26 Cl.Ct. 616 (1992)	Reserves, Mutual Insurance Companies
801	Principal Mutual Life Insurance Co. v. U.S., 50 F.3d 1021, (Fed. Cir., 1995)	Reserves, Mutual Insurance Companies
801, 804	Southwestern Life Insurance Co. v. United States 9 Cl.Ct. 102 (1985)	Other
804	Life Insurance Co. of Georgia v. United States, 16 Cl.Ct. 359 (1989)	Other
804	Lutheran Mutual Life Insurance Co. v. United States 816 F.2d 376 (8th Cir., 1987)	Other
804	Northwestern Mutual Life Insurance Co. v. United States, 795 F. 2d 74 (Fed. Cir., 1986)	Other
804	Phoenix Mutual Life v. Commissioner, 96 T.C. 17 (1991)	Other
804	Prudential Insurance Company of America v. Commissioner, 90 T.C. 36 (1988)	Other
804	Prudential Insurance Co. of America v. Commissioner, 882 F.2d 832 (3d Cir. 1989)	Other
804	Travelers Insurance Co. v. United States, 25 Cl.Ct. 141 (1992)	Other
805	UNUM Life Insurance Co. v. United States 897 F2d 599 (1st Cir., 1990)	Reserves
805	UNUM Life Insurance Co. v. United States, 709 F.Supp. 13 (D. Me. 1989)	Reserves
806	Trans City Life Insurance Co. v. Comm'r, 106 T.C. No. 15, (1996)	Small Insurance Companies

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807	Provident Life v. Commissioner, 334 F.Supp.2d 1029 (E.D. Tenn., 2004)	Other
808	National Life Insurance Co, et al. v. Commissioner, 103 F.3d 5 (2nd Cir., 1996)	Other
809	American Mutual Life Insurance Co. v. United States 73 A.F.T.R.2d 94-301 (unpublished) (S.D. Iowa, 1993)	Mutual Insurance Companies
809	American Mutual Life Insurance Co. v. U.S., 116 S.Ct. 335, rev denied (1995)	Mutual Insurance Companies
809	Anchor National Life Insurance Co. v. Commissioner, 93 T.C. 34 (1989)	Reinsurance
809	Colonial American Life Insurance Co. v. Commissioner, 843 F.2d 201, (5th Cir., 1988)	Reinsurance
809	Colonial American Life Insurance Co. v. Commissioner, 109 S. Ct. 2408 (1989)	Reinsurance
809	Commissioner v. Merit Life Insurance Co., 109 S. Ct. 3208 (1989)	Reinsurance
809	CUNA Mutual Life Insurance Company v. U.S., 39 Fed.Cl. 660 (1997)	Mutual Insurance Companies
809	Gulf Life Ins. Co. v. U.S., 35 Fed. Cl. 12 (1996)	Reinsurance
818	Gulf Life Ins. Co. v. U.S., 118 F.3d 1563 (Fed. Cir., 1997)	Reinsurance
809	Indianapolis Life Ins. Co. v. U.S., 940 F. Supp. 1370 (S.D. Ind. 1996)	Mutual Insurance Companies
809	Indianapolis Life Insurance Co. v. U.S., 115 F.3d 430 (7th Cir., 1997)	Mutual Insurance Companies
809	John Hancock Financial Services, Inc. v. U.S., 57 Fed.Cl. 643 (2003)	Mutual Insurance Companies
809	John Hancock Mutual Life Insurance Company v. Commissioner, 378 F.3d 1302 (Fed. Cir., 2004)	Mutual Insurance Companies
809	Modern American Life Insurance Co. v. Commissioner, 92 T.C. 80 (1989)	Other

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809	Modern American Life Insurance Company, Successor in Interest to Dynamic Security Life Insurance Company v. Commissioner of Internal Revenue Service, 830 F.2d 110 (8th Cir., 1987)	Reinsurance
809	North Central Life Insurance Co. v. Commissioner, 92 T.C. 15 (1989)	Reserves
809	Pan American Life Insurance Co. v. U.S., 79 A.F.T.R.2d 97-2414 (unpublished) (E.D. Louisiana, 1997)	Mutual Insurance Companies
809	Pan American Life Insurance Co. v. United States, 174 F.3d 694 (5th Cir., 1999)	Mutual Insurance Companies
809	Prairie States Life Insurance Co. v. United States 828 F.2d 1222 (8th Cir., 1987)	Other
809	UNUM Corp. v. U.S., 130 F.3d 501 (1st Cir., 1997)	Mutual Insurance Companies
809	UNUM Corporation v. U.S., 886 F.Supp. 150 (D.Maine, 1995)	Mutual Insurance Companies
809	UNUM Corp. v. US, 929 F. Supp. 15 (D. Maine, 1996)	Mutual Insurance Companies
809	UNUM Corp. v. U.S., 119 S.Ct. 42 (1998)	Mutual Insurance Companies
809	USAA Life Insurance Company v. Commissioner, T.C. Memo. 1993-12 (1993)	Reserves
809, 811	Principal Mutual Life Insurance Company and Subsidiaries v. United States, 295 F. 3d 1241 (Fed. Cir., 2002)	Reserves, Mutual Insurance Companies
809, 818	Time Insurance Co. v. Commissioner, 86 T.C. 298 (1986)	Reserves
815	Bankers Life & Casualty Co. v. U.S., 1996 WL 137646 (unpublished) (N.D. Illinois, 1996)	Other
815	Bankers Life and Casualty Co. v. U.S., 142 F.3d 973 (7th Cir., 1998), cert. den. 119 S. Ct. 403 (1998)	Other
815	Continental Bankers Life Insurance Co. of the South v. Commissioner, 93 T.C. 6 (1989)	Other

Applicable Code Section	Case Name	Monograph Chapter
815	Monat Capital Corp. v. Commissioner 869 F.Supp. 1513 (D. Kansas, 1994)	Other
815	World Service Life Insurance Company, etc. v. Commissioner 89 T.C. No. 8 (1987)	Other
816	Best Life Assurance Co. of California v. Commissioner, 281 F.3d 828 (9th Cir. 2002)	Reserves
816	Best Life Assurance Company of California v. Commissioner, T.C. Memo 2000-134 (2000)	Reserves
817	Individual Life Assurance Co. v. Commissioner, T.C. Memo 1986-201 (1986)	Reinsurance
817	Merit Life Insurance Co. v. Commissioner, 853 F.2d 1435, (7th Cir., 1988)	Reinsurance
818	American General Life and Accident Insurance Co. v. U.S., No. 82-3817 (unpublished) (D. Tenn. Dec. 4, 1989)	Reserves
818	Liberty National Life Insurance Company v. United States 816 F.2d 1520 (11th Cir., 1987)	Other
818	Oxford Life Insurance Co. v. United States, 790 F.2d 1370 (1986)	Reinsurance
818	USAA Life Insurance Company v. Commissioner 94 T.C. 499 (1990)	Reserves
818	USAA Life Insurance Co. v. Commissioner, 937 F.2d 606 (5th Cir., 1991), rev'd and rem'd, 94 T.C. 499	Reserves
832	Allstate Insurance Company v. United States, 20 Cl.Ct 308 (1990)	Reserves
832	American International Group, Inc., et al v. U.S., 38 Fed.Cl. 274 (1997)	Reserves
832	Blue Cross & Blue Shield of Texas Inc. v. Commissioner of Internal Revenue, 115 T.C. No. 12 (August 18, 2000)	BCBS
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Applicable Code Section	Case Name	Monograph Chapter
832	Minnesota Lawyers Mutual Insurance Company and Subsidiaries v. Commissioner, T.C. Memo 2000-203 (2000)	Reserves, Mutual Insurance Companies
832	Minnesota Lawyers Mutual Insurance Company and Subsidiaries v. Commissioner of Internal Revenue, 285 F. 3d 1086 (8th Cir., 2002)	Reserves, Mutual Insurance Companies
832	Sears, Roebuck and Co. and Affiliated Corporations v. Commissioner, 96 T.C. No. 5 (1991) modified by, 96 T.C. No. 26 (1991)	Reserves
832	Sears v. Commissioner, 972 F.2d 858 (7th Cir., 1992)	Reserves
832	State Of Maryland Deposit Insurance Fund Corp. v. Commissioner, 88 T.C. No. 59 (1987)	Reserves
832	The Home Group, Inc. v. Commissioner, 875 F.2d 377 (2d Cir., 1989)	Agent
832	Utah Medical Insurance Association v. Commissioner, T.C. Memo 1998-458 (1998)	Reserves
833	Trigon Insurance Company (Formerly Blue Cross and Blue Shield of Virginia) v. United States of America, 215 F.Supp.2d 687 (E.D. Va., 2002)	BCBS
842	The North West Life Assurance Co. of Canada v. C.I.R., 107 T.C. No. 19 (1996)	International
846	Atlantic Mutual Ins. Co. v. Commissioner, T.C. Memo. 1996-75 (1996)	Reserves, Mutual Insurance Companies
846	Atlantic Mutual Insurance Co., et al. v. Commissioner, 111 F.3d 1056 (3d Cir., 1997)	Reserves, Mutual Insurance Companies
846	Atlantic Mutual Insurance Co. v. Commissioner, 118 S. Ct. 1413 (1998)	Reserves, Mutual Insurance Companies
846	Mutual Assurance Inc. v. U.S., 56 F.3d 1353 (11th Cir., 1995)	Reserves, Mutual Insurance Companies

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846	Western National Mutual Insurance Co. v. Commissioner, 65 F.3d 90 (8th Cir., 1995)	Reserves, Mutual Insurance Companies
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907	Travelers Insurance Company v. United States, 303 F.3d 1373 (Fed. Cir., 2002)	International
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1001	Warren L. Baker, Jr. and Dorris J. Baker v. Commissioner of Internal Revenue, 118 T.C. No. 28 (2002)	Agent
1012	Department of Treasury v. Fabe, 113 S.Ct. 2202 (1993)	Other, 1012 refers to U.S.C.A. 1012(b)
1017	Greene v. U.S., 62 Fed. Cl. 418, (fed. Cl., 2004)	Other
1035	Conway v. Commissioner, 111 T.C. No. 20 (1998)	Products
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1401	Orin F. Farnsworth and Mary L. Farnsworth v. Commissioner of Internal Revenue, T.C. Memo 2002-29 (2002)	Agent
1401	Robert Schelble, et ux. v. Commissioner, 130 F.3d 1388 (10th Cir., 1997)	Agent
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1401, 1402	Jackson v. Commissioner, 108 T.C. 130 (1997)	Agent
1402	Gump v. U.S., 86 F. 3d 1126 (Fed. Cir. 1996)	Agent
1402	Robert E. Milligan v. Commissioner, 38 F.3d 1094 (9th Cir., 1994)	Agent
1502	Connecticut General Life Insurance Company v. Commissioner, 177 F. 3d. 136 (3rd Cir., 1999), cert. den., 120 S.Ct. 496 (1999)	Consolidated Returns

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1502	Norwest Corporation and Subsidiaries v. Commissioner, 110 T.C. 454 (1998)	Consolidated Returns
1502	Rite Aid Corp. v. United States, 225 F.3d 1357 (Fed. Cir., 2001)	Consolidated Returns
1502	State Farm Mutual Automobile Insurance Company v. United States, 94 A.F.T.R.2d 2004-5155 (unpublished) (7th Cir., 2004)	Other
1502	United Dominion Industries v. Commissioner, 121 S.Ct. 1934 (2001)	Consolidated Returns
3121	Albert Ware, et ux. v. United States, 850 F.Supp. 602 (W.D. Michigan, 1994)	Agent
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4371	International Business Machines Corp. v. U.S., 59 F.3d 1234 (Fed. Cir., 1995)	International
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4371	Neptune Mutual Association, Ltd. Of Bermuda v. U.S., 862 F.2d 1546 (Fed. Cir., 1988)	International
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6501	Mickey L. Worden, et ux. v. Commissioner, T.C. Memo. 1994-193 (1994)	Agent
6521	Lozon v. C.I.R., T.C. Memo. 1997-250 (1997)	Agent
7443	Ben Cox v. Comm'r, T.C. Memo. 1996-241 (1996)	Agent





## appendix



Atlanta, Georgia

Sherrie Winokur 678-419-1172 sherrie.winokur@us.pwc.com

Bermuda

Richard E. Irvine 441-299-7136 richard.e.irvine@bm.pwc.com

Birmingham, Alabama

Kurt Hopper 205-250-8525 kurt.w.hopper@us.pwc.com

Boston, Massachusetts

John Farina 617-530-7391 john.farina@us.pwc.com

David Rudicel 617-530-7721 dave.rudicel@us.pwc.com

Chicago, Illinois

Craig Larsen 312-298-5524 craig.b.larsen@us.pwc.com

Fort Worth, Texas

Chuck Lambert 817-870-5521 chuck.lambert@us.pwc.com

Honolulu, Hawaii

Wendell Lee 808-531-3436 wendell.k.lee@us.pwc.com

Kent Tsukamoto 808-531-3462 kent.k.tsukamoto@us.pwc.com

Indianapolis, Indiana

Kevin Crowe 317-453-4117 kevin.p.crowe@us.pwc.com

Los Angeles, California

Susan Leonard 213-830-8248 susan.leonard@us.pwc.com

New York, New York

Joseph Foy	646-471-8628	joseph.foy@us.pwc.com
Timothy Kelly † ††	646-471-8184	timothy.kelly@us.pwc.com
Ad Shuster	646-471-3880	addison.shuster@us.pwc.com
Ewing Madole	646-471-7310	ewing.w.madole@us.pwc.com

Philadelphia, Pennsylvania

Richard Ashley	267-330-6040	richard.a.ashley@us.pwc.com
----------------	--------------	-----------------------------

St. Louis, Missouri

Dave Monday	314-206-8174	david.r.monday@us.pwc.com
Jeffrey Kohler	314-206-8159	jeffrey.j.kohler@us.pwc.com

Washington, D.C.

Elaine Church	202-414-1461	elaine.church@us.pwc.com
Tony DiGilio	202-414-1702	anthony.digilio@us.pwc.com

† Insurance Tax Leader, Americas  
†† U.S. Financial Services Industry Tax Leader

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