INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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CASE MIS No.: TAM-110198-99/CC:DOM:FI&P:B4

District Director:

Taxpayer:

Taxpayer's I.D. Number:

Years Involved:

Date of Conference:

Legend:

Taxpayer =

Issue:

Whether Taxpayer is required to increase its taxable income in 1992 by $6.5 million on account of changing its statutory method of accounting for anticipated salvage and subrogation on its auto physical damage line of business in that year. Alternatively, if Taxpayer is not required to so increase its taxable income in 1992 on account of changing that statutory method of accounting, do the rules contained in § 111 require it to do so.

Conclusion:

Taxpayer is not required to increase its taxable income in 1992 by $6.5 million on account of changing its statutory method of accounting for anticipated salvage and subrogation on its auto physical damage line of business in that year. Nothing in § 111 requires Taxpayer to increase its taxable income by $6.5 million in that year.

Facts:

Taxpayer is a multi-line property and casualty insurance company subject to tax under § 831 of the Code. Prior to 1990, with respect to all of its lines of business other than its auto physical damage line, Taxpayer calculated its unpaid losses for tax purposes, and reported its unpaid losses on its National Association of Insurance

Commissioners (NAIC) annual statements, after taking into account anticipated salvage and subrogation. With respect to its auto physical damage line of business, Taxpayer calculated its unpaid losses for tax purposes, and reported its unpaid losses on its NAIC annual statements, without taking into account anticipated salvage and subrogation. In 1990, and thereafter through the year in issue, in calculating its unpaid losses for tax purposes, Taxpayer took into account anticipated salvage and subrogation on all of its lines of business.

In calculating its unpaid losses on its auto physical damage line of business for NAIC annual statement purposes, i.e., for statutory purposes, in 1990 and 1991, Taxpayer did not take salvage and subrogation into account. In 1992, in calculating its unpaid losses on that line of business for statutory purposes, it took that salvage and subrogation into account. In doing so, on its 1992 NAIC annual statement Taxpayer reflected its unpaid losses on that line of business as of 12/31/91 net of salvage and subrogation, thus reducing the amount of such unpaid losses from the corresponding amount reflected on its 1991 annual statement by $6.5 million.

In 1990 Taxpayer claimed the special deduction provided in § 11305(c)(3) of P.L. 101-508, the Revenue Reconciliation Act of 1990 (the Act).

Law and Analysis:

The Act amended § 832(b)(5) to require all property and casualty insurance companies to reduce their deductions for losses incurred by the amount of salvage recoverable, computed on a discounted basis, for all relevant lines of business. Section 11305(c)(2)(A) of the Act provided that in the case of any taxpayer required by its provisions to change its method of computing losses incurred, such change was to be treated as a change in method of accounting initiated by the taxpayer and made with the consent of the Secretary. The Act did not require those companies to change their method of accounting for salvage for statutory purposes.

Taxpayer's change in its accounting method in 1990 for computing unpaid losses for tax purposes on its auto physical damage line created an inconsistency between the unpaid losses with respect to that line reflected on its tax return, and the corresponding unpaid losses reflected on its statutory statement. The difference was reflected on lines 5 and 6 of the schedules F and in the schedules M-1 on its 1990 and 1991 tax returns. In this regard, the 1990 and 1991 schedule M-1 adjustments for Taxpayer's auto physical damage line of business were computed by taking the statutory financial statement change in its salvage accrual, and reducing it appropriately to recognize the effect of the required tax discounting. In 1992, in view of Taxpayer's having changed its method of accounting for statutory purposes to take into account anticipated salvage in computing its unpaid losses on its auto physical damage line, Taxpayer's schedule M-1 adjustment for that line of business was computed by taking into account the change in the discount itself on the relevant anticipated salvage, and not, as had been the case in 1990 and 1991, by taking into account the change in the discounted balance of that

salvage.

The Internal Revenue Code does not govern changes in statutory methods of accounting. Taxpayer changed its method of accounting for the relevant salvage for tax purposes in 1990 and computed its income consistently under that new method of accounting during all of the years in issue. Taxpayer did not determine its taxable income under a new method of accounting in 1992, but instead eliminated the effect of the change to its statutory income through a modification of the manner in which the book-to-tax adjustment shown on its 1992 schedule M-1 was computed.

Since Taxpayer's method of accounting for tax purposes for the relevant salvage remained the same from 1990 through the relevant year, and since Taxpayer appropriately reflected the change in its statutory income through its change in the method of calculating its schedule M-1 adjustment on its 1992 return, Taxpayer is not required to include an additional $6.5 million in its taxable income for that year.

The tax benefit rule in § 111 excludes from gross income the recovery of an item during the taxable year of any amount deducted in a prior year to the extent such amount in that prior year did not reduce the amount of tax imposed by Subtitle A, Chapter 1 (§§ 1-385) of the Code. In Hillsboro National Bank v. Commissioner, 460 U.S. 370 (1983), the Supreme Court expanded that rule to require the converse, i.e., to require taxpayers to include in income amounts recovered from a previously deducted loss to the extent the previous deduction generated a tax benefit. Nothing in this case involves Taxpayer's recovering any amounts of previous deductions. Consequently, nothing in this case implicates the operation of § 111 to require Taxpayer to include an additional $6.5 million in income in 1992.

Nothing in the Request for Technical Advice addressed whether Taxpayer grossed up its reserves for unpaid losses to take into account pre-1990 salvage relating to its auto physical damage line of business. Thus we express no opinion regarding that issue with respect to Taxpayer. We note, however, that Rev. Proc. 92-77, 1992-2 C.B. 454 provides that taxpayers claiming a special deduction under § 11305(c)(3) of the Act are not entitled to gross up their reserves for pre-1990 salvage taken into account in their computation.

Pursuant to § 6110(c)(1), names, addresses, and taxpayer identification numbers are required to be deleted from the copy of this technical advice memorandum that will be open for public inspection.

Caveat(s)

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

/S/DONALD J. DREES JR.