**INTERNAL REVENUE SERVICE**

Number: **200133020**
Release Date: 8/17/2001
UIL Number(s): 0831.00-00: 0831.02-00

CC:FIP:4/PLR-102789-01
May 17, 2001

Legend

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|---|---|---|
| Taxpayer | = | |
| State A | = | |
| YEAR 1 | = | |
| YEAR 10 | = | |
| YEAR 11 | = | |
| YEAR 14 | = | |
| Date A | = | |
| Target | = | |
| Old Area | = | |
| New Area | = | |
| r | = | |
| s | = | |
| H | = | |
| x | = | |
| y | = | |

Dear

This is in response to letters dated December 27, 2000 and March 26, 2001 requesting consent to Taxpayer's revocation of its election under § 831(b) to be taxed only on its investment income effective for the calendar 2000 tax year.

Taxpayer is a small mutual insurance company incorporated in State A and is taxable under § 831. Taxpayer has been in the insurance business for many years and presently provides fire and allied lines insurance coverage to residents in a geographic area within State A under a variety of policies, including standard fire, homeowners, farm owners, and commercial multi-peril policies.

Section 831 provides generally that insurance companies, other than life insurance companies, are taxed on their taxable income. Section 831(b) allows certain small non-life companies to elect to be taxed on their taxable investment income only. This election is found under § 831(b)(2)(A)(ii), and a company is eligible to make the election if, as provided in § 831(b)(2)(A)(i), its net written premiums (or, if greater, direct written premiums) for the taxable year exceed $350,000, but do not exceed $1,200,000. Once the election is made, the company's "taxable investment income" is computed under § 834.

Taxpayer made the § 831(b) election for YEAR 1 with the filing of its U.S. Property and Casualty Insurance Company Income Tax Return. At that time, Taxpayer was a county mutual insurance company that was allowed to write its lines of business (primarily fire and allied lines) in a six adjacent county area within State A (the Old Area).

Prior to Taxpayer's acquisition of Target by statutory merger in YEAR 11 (described below), the bulk of the policies written by Taxpayer covered risks in the $0 to $200,000 range. At the end of YEAR 10, Taxpayer's direct written premium was only $x. Prior to the YEAR 11 merger, Taxpayer was heavily reliant upon the quota share reinsurance that it obtained from other insurance companies[1]

On Date A of YEAR 11, Taxpayer acquired all the assets of Target, another State A county mutual insurance association, in a statutory merger under State A law. Taxpayer, as the surviving company in the merger, decided to issue policies in a different six adjacent county area within State A (the New Area), which contained a large agricultural county in which it had not previously engaged in the insurance business. Also subsequent to the merger, Taxpayer raised its risk limits so that the bulk of its policies were in the $50,000 to $500,000 range. Further, after the merger, Taxpayer also shifted away from its reliance upon quota share reinsurance and assumed greater risks on its own and, generally, limited its use of reinsurance to excess of loss reinsurance.[2] This reduced the reinsurance premium amounts that it paid from amount $r in YEAR 11 to an average annual reinsurance premium of only $s per year over the next three years. In addition, as a result of some serious H natural disasters that had occurred in its area of operations, which were covered by Taxpayer's policies, Taxpayer's management has placed increased attention to the possibility of significant underwriting losses. In fact, Taxpayer has suffered underwriting losses in several years in the recent past and, thus, Taxpayer's tax liability was larger than those liabilities would have been had its § 831(b) election not been in effect.

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[1] Quota share reinsurance is automatic reinsurance which requires the insurer to transfer and the reinsurer to accept a given percentage of every risk within a defined category of business written by the insurer.

[2] Excess of loss reinsurance is a method whereby an insurer pays the amount of each claim for each risk up to a limit determined in advance and the reinsurer pays the amount of the claim above that limit up to a specific sum.

Finally, since the merger, Taxpayer's direct written premiums have increased significantly from $x in YEAR 10 to $y in YEAR 14.

Taxpayer represents that it will not make an election under § 831(b) to be taxed on only its investment income for any of the first five taxable years following the year to which the consent relates (2000).

Section 1010(f) of the Technical and Miscellaneous Revenue Act of 1988 added the flush paragraph following § 831(b)(2)(A)(ii), which states: "The election under clause (ii) shall apply to the taxable year for which made and for all subsequent years for which the requirements of clause (i) are met. Such an election, once made, may be revoked only with the consent of the Secretary."

In making that change, Congress indicated that in adopting the amendment it intended that the election not be used as a means of eliminating tax liability (e.g., by making the election only for years when the taxpayer did not have a net operating losses). Rather, it intended that the election be a simplification measure for small companies. H.R. Rep. No. 795, 100th Cong., 2d Sess. 121 (1988); S. Rep. No. 445, 100th Cong., 2d Sess. 127 (1988).

As indicated above, Taxpayer has shown that, since its merger with Target in YEAR 11 the character of its business has changed significantly in: (1) the geographic area covered by its policies, (2) the dollar limits of its coverage, and (3) its reinsurance strategy of retaining more of the risks that it writes. Further, since the merger the amount of premiums written by Taxpayer has increased significantly.

In view of the foregoing, Taxpayer requests that consent be granted to the revocation to its § 831 election.

Consent is hereby granted to the revocation of Taxpayer's § 831(b) election effective for the year 2000.

No opinion is expressed under other sections of the Code and income tax regulations that may also be applicable. The ruling is directed only to the taxpayer who requested it.

Section 6110(k)(3) of the Code provides that it may not be used or cites as precedent.

A copy of this letter should be attached to the federal income tax returns to be filed by Taxpayer with respect to the taxable year with respect to which this consent is granted, and the next succeeding five taxable years.

Pursuant to a power of attorney on file in this office, a copy of this letter is being sent to your authorized representative.

Sincerely yours,
Acting Associate Chief Counsel
(Financial Institutions & Products)
By:Mark Smith.
Chief, Branch 4