Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:
July 19, 2001

Taxpayer =

State =

Date 1 =

Date 2 =

Year 1 =

Target =

Company X =

x =

y =

z =

Dear :

This is in response to your representative's letter dated January 29, 2001, requesting consent to Taxpayer's revocation of its election under section 831(b)(2)(A)(ii) of the Internal Revenue Code. Additional information was submitted in letters dated May 21, 2001 and July 2, 2001.

FACTS

Taxpayer was formed as a corporation under the laws of State on or around Date 1. The principal business activity of Taxpayer is the sale of fire, wind, and inland marine insurance. Taxpayer uses the cash receipts and disbursements method of accounting and files returns on a calendar year basis. Taxpayer has elected to be taxed only on its taxable investment income pursuant to section 831(b)(2)(A) of the Code.

On Date 2, 2000, Target merged into company X pursuant to what Taxpayer

represents was a type A reorganization. Target was a non-life insurance company with net operating losses. Target used an accrual method of accounting and filed returns on a calendar year basis. Immediately following this merger, company X changed its name to Taxpayer pursuant to a type F reorganization.[1]

Taxpayer represents that the typical annual written premiums for Target were approximately x dollars. In 2000, Taxpayer received written premiums of less than $1,200,000 (including premiums earned on Target's business after the merger). Taxpayer anticipates that in tax years subsequent to 2000, its annual written premiums will exceed $1,200,000. Taxpayer requests consent to revoke its election under section 831(b)(2)(A)(ii) of the Code effective for the tax year 2000. Taxpayer represents that a revocation for the 2000 tax year will save the Taxpayer an estimated y hours of professional time and z dollars of fees for the year 2000.

LAW AND ANALYSIS

Section 831(a) of the Code imposes a tax for each taxable year on the taxable income of every insurance company other than a life insurance company.

Section 831(b) of the Code provides an alternative tax to the tax imposed by section 831(a) for certain insurance companies. The alternative tax for these companies is a tax computed for each year by multiplying the "taxable investment income" (defined in section 834(a)) of the company for the taxable year by the rates in section 11(b).

Section 831(b)(2)(A) of the Code provides that the alternative tax applies to every insurance company other than a life insurance company if (i) the company's net written premiums (or, if greater, direct written premiums) for the taxable year exceed $350,000, but do not exceed $1,200,000, and (ii) the company elects the application of section 831(b) (the alternative tax) for the taxable year.

Section 831(b)(3) of the Code provides that, for purposes of Part II of Subchapter L (Insurance Companies), except as provided in section 844, a net operating loss (as defined in section 172) shall not be carried (A) to or from any taxable year for which the insurance company is not subject to the tax imposed by section 831(a) of the Code, or (B) to any taxable year if, between the taxable year from which such loss is being carried and such taxable year, there is an intervening taxable year for which the insurance company was not subject to the tax imposed by section 831(a) of the Code.

Section 831(b)(2)(A) of the Code further provides regarding the effect of making

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[1] Because the type F reorganization has no effect on the substance of this ruling request, in the interest of simplicity, both company X and Taxpayer are hereinafter referred to as Taxpayer.

an election to have section 831(b) apply:

> The election under clause (ii) shall apply to the taxable year for which made and for all subsequent taxable 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.

The two sentences quoted above from section 831(b)(2)(A) of the Code were not in section 831(b), as originally added to the Code by section 1024(a)(4) of the Tax Reform Act of 1986, Pub. L. No. 99-514. These sentences were added to the Code by section 1010(f)(1) of the Technical and Miscellaneous Revenue Act of 1988 (TAMRA), Pub. L. No. 100-647. The change to section 831(b)(2) of the Code was retroactively effective for tax years beginning after December 31, 1986 (the same effective date as applicable to the rest of section 831(b)). See section 1019(a) of TAMRA and section 1024(e) of the Tax Reform Act of 1986.

The Senate Finance Committee offered the following explanation for the two sentences added to section 831(b) by section 1010(f)(1) of TAMRA:

> The bill clarifies that the election to be taxed only on investment income, once made and so long as the requirements for the election are met, may be revoked only with the consent of the Secretary. This clarification reflects Congress' intent 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 does not have net operating losses), but rather as a simplification for small companies.

S. Rep. No. 445, 100th Cong., 2d Sess. 127 (1988).

Taxpayer anticipates that its election under 831(b)(2)(A) will terminate automatically in 2001 because the combining of Target and Taxpayer's business activities will produce annual written premiums exceeding $1,200,000. However, because the merger occurred toward the end of 2000, the addition of Target's business activities to Taxpayer did not produce written premiums to Taxpayer in 2000 exceeding $1,200,000. Thus, absent a revocation of its election, in 2000 Taxpayer will be taxed only on its taxable investment income pursuant to section 831(b) of the Code.

One effect to Taxpayer of its being taxed pursuant to section 831(b) of the Code in Year 1 is its inability to utilize Target's net operating losses. Because the merger of Target into Taxpayer occurred in 2000, Target's net operating losses carryover to Taxpayer in 2000. However, if Taxpayer is taxed under section 831(b) of the Code in 2000, section 831(b)(3) prohibits Taxpayer from utilizing those net operating losses subsequent to 2000.

Taxpayer's January 29, 2001 submission stated that a "main reason" for its request to revoke its election under section 831(b)(2)(A)(ii) of the Code was its desire to

utilize Target's net operating losses. Despite Taxpayer's claims that the revocation is sought to ease administrative burdens that will arise if revocation is not granted, we are concerned that a primary motivation in seeking the revocation is as a means of eliminating tax liability through the use of Target's net operating losses. Taxpayer's elaboration of the professional time and fees that would be avoided for the year 2000 by a revocation does not alleviate this concern. We note that even without the requested revocation for the 2000 tax year, Taxpayer's election under section 831(b) of the Code will terminate for the 2001 tax year by reason of the $1,200,000 premium limitation of section 831(b)(2)(A)(i) of the Code.

Accordingly, based on the information submitted and the representations made, consent is not granted to Taxpayer's revocation of its election under section 831(b)(2)(A)(ii) of the Code to be taxed only on its taxable investment income.

CAVEATS

1. Except as expressly provided herein, no opinion is expressed concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

2. No ruling has been requested, and no opinion is expressed, concerning the application of section 844 of the Code to the facts presented in this ruling request.

The rulings contained in this letter are based upon information and representations submitted by the Taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Internal Revenue Code provides that it may not be used or cited as precedent.

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