Office of Chief Counsel
Internal Revenue Service
Memorandum

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Release Date: 12/13/2013

CC:FIP:B04:DRemus
PLR-132436-12

Third Party Communication: None
Date of Communication: Not Applicable

UILC: 831.07-00, 162.00-00

date: June 13, 2013

to: Mary Coleman
Examination Director, Central Area
(Small Business/Self-Employed)

from: Donald J. Drees, Jr.
Senior Technician Reviewer, Branch 4
(Financial Institutions & Products)

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subject: Notification of No-Rule Decision on Letter Ruling Request

LEGEND

Company =

Foreign Jurisdiction =

Date =

Address =

Insured Affiliate 1 =

Insured Affiliate 2 =

ISSUES

Pursuant to section 7.07(2)(a) of Rev. Proc. 2012-1, 2012-1 I.R.B. 1, 30, this is to notify you that we were unable to rule on a letter ruling request submitted by Company regarding section 831 of the Internal Revenue Code (the “Code”).

FACTS

Company was incorporated in Foreign Jurisdiction on Date and is licensed as an insurance company by the insurance regulators of Foreign Jurisdiction. Company made a permanent election under section 953(d) of the Code to be taxed as a domestic corporation for federal tax purposes and it annually files a Form 1120-PC tax return. Company's U.S. address is Address.

Company directly issued purported insurance contracts with a one year coverage period to Insured Affiliate 1 and Insured Affiliate 2 (collectively, the "Insured Affiliates"). Company joined a reinsurance pool (the "Pool") consisting of several other unrelated purported insurance companies. Under the reinsurance agreements Company ceded to the Pool a substantial portion of its direct written premiums and risks and assumed from the Pool a roughly equal amount of premiums and risks. The agreements contained language providing for experience refunds and experience loss carryforwards, which were to be paid back with interest.

Company sought two rulings:

1. That Company would be treated as an insurance company under section 831 of the Code for federal tax purposes.

2. That the purported insurance premiums paid to Company by Insured Affiliates would be deductible as "insurance premiums" under section 162 of the Code for federal tax purposes.

LAW AND ANALYSIS

Section 831(a) of the Code provides that taxes, computed as provided in section 11, are imposed for each taxable year on the taxable income of each insurance company other than a life insurance company. Section 831(c) provides that, for purposes of section 831, the term "insurance company" has the meaning given to such term by section 816(a). Under section 816(a), 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."

Neither the Code nor the Income Tax Regulations define the terms "insurance" or "insurance contract" in the context of property and casualty insurance. The Supreme Court of the United States has explained that in order for an arrangement to constitute insurance for federal tax purposes, both risk shifting and risk distribution must be present. Helvering v. Le Gierse, 312 U.S. 531 (1941). The risk transferred must be risk of economic loss. Allied Fidelity Corp. v. Commissioner, 572 F.2d 1190, 1193 (7th Cir. 1978). The risk must contemplate the fortuitous occurrence of a stated contingency,

Commissioner v. Treganowan, 183 F.2d 288, 290-291 (2d Cir. 1950), and must not be merely an investment or business risk. Rev. Rul. 2007-47, 2007-2 C.B. 127. In addition, the arrangement must constitute insurance in the commonly accepted sense. See, e.g., Ocean Drilling & Exploration Co. v. United States, 988 F.2d 1135, 1153 (Fed. Cir. 1993); AMERCO, Inc. v. Commissioner, 979 F.2d 162 (9th Cir. 1992).

Our review of the materials that Company submitted in connection with its letter ruling request led us to identify three areas of concern:

1. Whether the pooling arrangement actually provided risk shifting and risk distribution. In particular, we were concerned that the reinsurance agreements between Company and the Pool contained provisions whose net effect might be to negate risk shifting and risk distribution.

2. Whether some or all of the purported insurance contracts were insurance for federal tax purposes, as opposed to, for example, contracts covering investment or business risks.

3. Whether the premiums paid by Insured Affiliates to Company reflected an arms-length transaction between the parties.

The Company did not provide sufficient information for us to address these concerns. Accordingly, we are unable to rule pursuant to sections 10.06 and 15.10(1)(c) of Rev. Proc. 2012-1.

Had we been able to rule, the letter ruling would have been controlling for only the year specified in the letter ruling because section 831(c) imposes an annual test and the specific contracts involved covered risks for only a one year period.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 622-3970 if you have any further questions.

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