

Accountant/Tax Attorney Dialogue on Internal Revenue Code Deference to NAIC: Part III: Insurance Classification Tax Issues

By Peter H. Winslow (Moderator), John T. Adney, Sheryl Flum,¹ Susan Hotine and Mark Smith

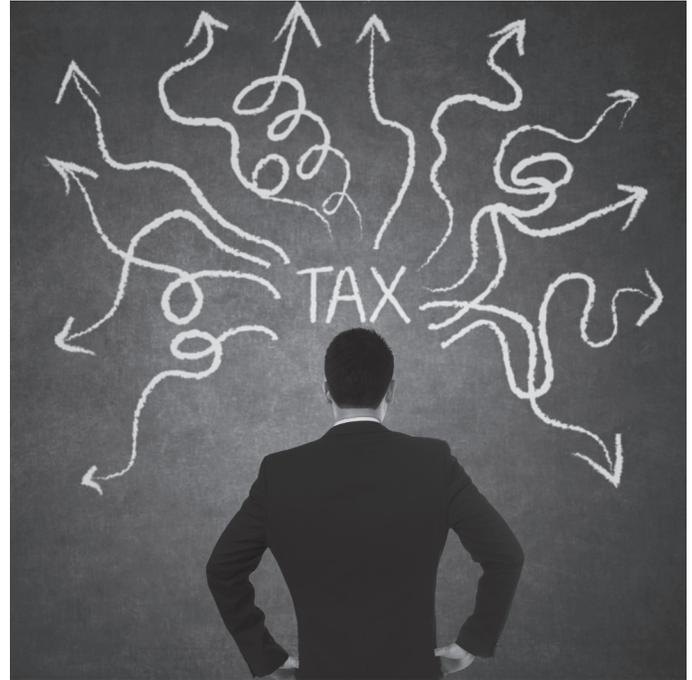
Note from the Editor:

Welcome again to our series of dialogues on the important and evolving topic of the extent to which federal tax law defers to the National Association of Insurance Commissioners (NAIC) in taxing life insurance companies and products. In the prior two issues of TAXING TIMES, our distinguished panelists explored many aspects of tax reserves including their deductibility, classification and computation,² as well as product tax considerations relating to life insurance, annuities, long-term care insurance and accelerated death benefits.³ In this Part III, the panelists will address legal and accounting questions relating to insurance classification and qualification under U.S. federal income tax law: examining the various characteristics required for a company to be treated as a life insurance company, for a transaction to be treated as insurance, for a reinsurance arrangement to be respected as such, and for a given insurance product to be placed in one of the several categories of contracts defined in the tax law.

We have made two adjustments to the series for the current edition: First, since the questions in this segment are focused on legal and accounting issues, our actuarial contributors have deferred to members of those professions, and the panel for Part III does not include an actuary. Second, due to the breadth of the topic of deference, we will expand the dialogue to a fourth installment, to appear in the next issue of TAXING TIMES, where we will wrap up our journey with an examination of deference to NAIC annual statement accounting in areas such as premiums, investment income, hedging and expenses.

I am eager to welcome back our panel of highly experienced tax professionals. Peter Winslow of Scribner, Hall & Thompson, LLP developed the concept for the dialogue and continues to serve skillfully as moderator. Peter is joined by Mark Smith of PricewaterhouseCoopers, LLP and Sheryl Flum of KPMG LLP (both of whom have previously headed the Internal Revenue Service (IRS) Chief Counsel's Insurance Branch), along with Susan Hotine of Scribner, Hall & Thompson, LLP and John T. Adney of Davis & Harman, LLP. Susan, John and Peter were all active in the legislative process "in the beginning"—during the enactment of the Tax Reform Act of 1984.

Enjoy the conversation!



Peter Winslow: This is the third installment of our extended dialogue on the issue of federal tax law's deference to insurance regulation rules. We have covered in some depth the deference issue as it relates to tax reserves and to policyholder tax issues. This installment will cover what I will call insurance classification issues, including the existential question—what is insurance? To what extent does guidance from the NAIC or state regulators matter in answering this question?

In the context of life company taxation, our discussion will cover issues such as whether the company will be taxed as an insurance company, whether an insurance company will be classified as a life or nonlife company, and, of course, captive issues. Whether a transaction qualifies as reinsurance or something else also comes within this broad "what is insurance?" inquiry.

As in the past, I want to begin the discussion with our "In the Beginning" panelists, Susan Hotine and John Adney, who were both instrumental in the development of the 1984 Act, which forms the basis of current law. Susan, can you please describe for us what Congress did in the 1984 Act on the basic issues of classification of a company as an insurance company and/or a life insurance company?

LIFE INSURANCE COMPANY QUALIFICATION

Susan Hotine: Prior to the 1984 Act, the term "insurance company" was defined in the regulations under section 801 of the 1954 Internal Revenue Code as meaning "a company whose primary and predominant business activity during the taxable year is the issuing of insurance or annuity contracts or the reinsuring

of risks underwritten by insurance companies.”⁴ The regulation goes on to say that, although the company’s name, charter powers and regulation as an insurance company under state laws are significant, it is the character of the business activity actually done in the taxable year that determines whether the company is taxable as an insurance company.

While an insurance company was defined under pre-1984 law in the regulations, the definition of a life insurance company was set forth in the Code. The 1984 Act retained the tax definition of a life insurance company that had been in the Code under prior law—“an insurance company which is engaged in the business of issuing life insurance and annuity contracts (either separately or combined with accident and health insurance), or noncancellable contracts of health and accident insurance, if (1) its life insurance reserves⁵... , plus (2) unearned premiums, and unpaid losses (whether or not ascertained), on noncancellable life, accident, or health policies not included in life insurance reserves, comprise more than 50 percent of its total reserves.” But the 1984 Act went further and defined in the Code itself the term “insurance company” for purposes of determining whether a company is a life insurance company. That Code definition is very much like the definition of an insurance company that is in the regulations developed under prior law except that, instead of looking to the primary and predominant business activity, it requires that more than half of the company’s business during the taxable year be the issuing of insurance and annuity contracts or the reinsuring of risks underwritten by insurance companies.

Peter: Do these Code and regulation definitions give any explicit deference to the NAIC or state regulators in defining an insurance company or life insurance company?

Susan: No. Looking at both prior law regulations and the current Code, neither gives deference to the NAIC or state insurance regulators for purposes of determining whether a company is a life insurance company for tax purposes.⁶ Like the definition of an insurance company under the regulations developed under prior law, the Code definition seems to present an activities

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test. The 1984 Act legislative history points out that whether more than half the business activity is related to the issuing of insurance and annuity contracts depends on the facts and circumstances, and that the relative distribution of the number of employees assigned to, the amount of space allocated to, and the net income derived from the various business activities are all factors to be considered.⁷ Again, there does not seem to be a deference shown to the NAIC or state insurance regulators.

Peter: How about the pre-1984 Act case law in interpreting these provisions? John, did the courts use the regulations’ definition of a life insurance company?

John Adney: Yes they did, Peter. By way of example, in deciding whether credit life insurance companies should be taxed as life insurers under part I of Subchapter L, the courts looked to a construction of the Code and the Treasury regulations rather than simply the companies’ status under state law. In *United States v. Consumer Life Insurance Co.*,⁸ the Supreme Court focused on the reserves and risks assumed by the taxpayer as reinsurer of credit life coverage. The Court conducted a detailed examination of the statutory rules and the regulations, leading it to reject the IRS contention that “reserves follow the risk” and to uphold the taxpayer’s treatment as a part I life insurance company.⁹ Part I treatment also was upheld in the oft-cited decision in *Alinco Life Insurance Co. v. United States*.¹⁰ In that case, the Court of Claims cited the regulations chapter and verse to turn aside a broad-based government attack on Alinco’s tax treatment, a contention premised on the point that under pre-1959 Act law, the insurer could operate largely tax-free. Yet another credit life decision in the taxpayer’s favor was *Central National Life Insurance Co. v. United States*.¹¹

Another good example would be the decision of the Court of Appeals for the Fifth Circuit in *Group Life & Health Insurance Co. v. U.S.*¹² At issue there was whether the taxpayer (the Blue Cross/Blue Shield company in Texas) could claim life insurance reserve treatment for its guaranteed renewable health insurance contracts, and thus be taxed under part I, even though it did not maintain an “additional reserve” as the regulations required.¹³ The taxpayer argued that because the Texas State Board of Insurance did not require it to post the additional reserve, that trumped the regulation, but the court sided with the regulation and the taxpayer lost. As regards deference to state law, the Fifth Circuit made this quotable observation: “While Congress has occasionally enacted Federal tax provisions which depend on underlying state definitions and thus result in varying treatment between taxpayers of the several states, the life insurance company provisions of the Code evidence an intent that insurance companies are taxed uniformly.” This prompted the court to adhere closely to the text of the regulations defining noncancellable and guaranteed renewable contracts.¹⁴



Peter: What you are saying, I think, is that the courts (and the IRS) looked to the Code and the Treasury regulations in determining life insurance company qualification, quite apart from a company's treatment under state regulation and even in contravention of it. But don't the Code's rules contain an embedded element of deference to state regulation where they depend to some degree on statutory reserve classifications and accounting?

John: I believe they do. Much of Subchapter L, for both part I life companies and part II nonlife companies, is premised on state law rules and concepts generally and on the NAIC annual statement treatment in particular. As used in the elements of the section 816 qualification fraction carried over from prior law, life insurance reserves, with a few exceptions, must be "required by law," and "total reserves" include "all other reserves required by law."¹⁵ The law Congress referred to is state law, showing at least some degree of deference to state law rules in the company tax definition. In sum, one can view the deference to state law as "necessary but not sufficient" to define what an insurance company or a life insurance company is for federal income tax purposes.

On the other hand, perhaps a striking example of non-deference to state law in the life insurance company definition is found in section 816(f), a provision new in the 1984 law. According to that rule, solely for purposes of determining whether an insurance company is to be taxed under part I, reserves for contracts not containing permanent guarantees with respect to life, accident, or health contingencies are excluded from both the numerator and the denominator of the qualification fraction. This was intended to keep state-chartered life insurers subject to taxation under part I despite their issuance of large amounts of pension business that lacked permanent annuity purchase rate guarantees.

Peter: I love your characterization of the deference issue for life insurance company classification for tax as "necessary but not sufficient." I agree. Sheryl, is that the way the IRS National Office has viewed the deference issue in this context?

Sheryl Flum: I would say "helpful but not sufficient." The IRS National Office has taken the position that state qualification as an insurance company is but one factor to be considered in determining if an entity is an insurance company (life or non-life) for federal tax purposes, but is not necessarily the deciding factor. Notwithstanding that a company is regulated as an insurance company under state laws and regulations, the IRS has more than once asserted that such company is not an insurance company for tax purposes.

In *R.V.I. Guaranty Co. Ltd. v. Commissioner*,¹⁶ the government argued that the nonlife company taxpayer was not an insurance company for tax purposes notwithstanding that its state of domicile regulated it as an insurance company. In rejecting the government's argument, the Tax Court emphasized the importance of state insurance regulation in the determination of whether the company should be considered an insurance company for tax purposes. The court in *R.V.I.* found that R.V.I.'s policies were insurance within the "commonly accepted" sense, satisfying one prong of the common law test for "insurance," because R.V.I.'s policies were treated as insurance for nontax purposes and R.V.I. was organized, operated and regulated as an insurance company. Since the opinion is recent, and the IRS has not publicly responded since the opinion was issued, it is unclear whether this decision will impact the IRS' view.

On the "necessary" point, I don't think the IRS views state characterization as an insurance company as a requirement for federal qualification **if** the activities of the company otherwise meet the "insurance company" tests. For example, some obligor companies that are not insurance companies for state regulatory purposes may qualify as insurance companies for federal income tax purposes.

Peter: So, for insurance company status for tax purposes, the IRS National Office's position is that state regulation as an insurance company is helpful, but, depending on the circumstances, neither necessary nor sufficient. But, my guess is that the not-necessary conclusion generally applies to companies issuing property/casualty-type products, like warranty insurers. I cannot think off the top of my head of any instance where the IRS has said that a company qualifies as an insurance company where it issues life insurance-type products, but is not regulated as an insurance company. On the other hand, there are many instances where the IRS has ruled that a company regulated as a life insurance company does not qualify as an insurance company for tax purposes either because it is dormant or because its investment or non-insurance activity is disproportionate to its insurance activity—the not-sufficient part of the IRS' position.

Mark Smith: I think we're all saying the same thing, but want to be sure. First we analyze whether a company is an insurance

company. For this purpose, state regulation is “helpful but not sufficient.” Second, if the company is an insurance company, we analyze whether or not it is a life insurance company. For this purpose, state regulation is “necessary but not sufficient,” at least as a practical matter. This is because an insurance company is a life insurance company if more than half its reserves are life insurance reserves, and there are at least indirect requirements that can only be met by a company that is regulated as an insurer. For example, a company qualifies as a life insurance company only if more than half its reserves are life insurance reserves. And as John points out, only reserves “required by law” are life insurance reserves. One might think of this as an indirect deference to state law as to life insurance company characterization, but not as to insurance company characterization more generally.

In Part II of our dialogue we talked about limited situations in which the IRS has treated non-state regulated life insurance contracts as life insurance contracts.¹⁷ Might there be circumstances where the issuer of such contracts is eligible for taxation as an insurance company, but not as a life insurance company, under this framework? The question is rhetorical and reserved for another day or a real-life fact pattern.

It’s hard to talk about deference in this context without asking whether the rules we’ve described make sense. There is a classic tension between certainty, on the one hand, and other principles, such as horizontal equity and clear reflection of income, on the other. Here, a rule that automatically follows a company’s state law characterization would provide certainty, but not necessarily the best answer in all cases. A company chartered and regulated as an insurance company might not conduct its business as an insurance company. Or vice versa—a company that is not chartered and regulated as an insurance company might nevertheless issue products that are so similar to insurance or life insurance contracts that the best answer would be to use the same accounting methods as issuers of insurance or life insurance contracts.

The IRS’ practice of treating some corporate taxpayers as nonlife insurance companies even if they are not regulated as insurance companies seems correct, even obvious, in situations such as the extended warranty situations that Sheryl mentioned. And in any event, the IRS is understandably reluctant to cede authority to a nontax regulator to make what are basically tax determinations. As to life insurance company status, however, practical considerations weigh in favor of the indirect deference that generally prevents a nonregulated company from being taxed as a life insurer. For example, it may be difficult to apply section 807(d) to reserves of a company that is not otherwise subject to CRVM or CARVM, or that otherwise does not file an annual statement or have even a starting point for applying the statutory reserve cap.

All this could get quite messy in practice. Fortunately, the issue doesn’t come up all that often for most of us.

John: Peter, let me interject a comment. In saying “necessary but not sufficient,” I was thinking of the introductory regulation under the 1959 law, which defined the term “insurance company.” (I was raised on the 1959 law.) That regulation intones that “though its name, charter powers, and subjection to State insurance laws are significant in determining the business which a company is authorized and intends to carry on, it is the character of the business actually done” that determines its tax treatment.¹⁸ So, I will agree with you, Sheryl and Mark, by changing my answer to say “significant but not sufficient.” And as Susan mentioned earlier, in 1984 Congress altered the standard articulated at the beginning of that regulation, so that instead of looking to the primary and predominant business activity of a company to determine its status as an insurance company (or not), the law now requires that more than half of the company’s business during the taxable year consist of issuing or reinsuring insurance and annuity contracts.

WHAT IS INSURANCE?

Peter: So far, our discussion has focused on the company’s tax status as, first, an insurance company, and then a life insurance company. I want to now touch on the more fundamental question, “what is insurance?” to see what role deference plays in answering that question. Several things occur to me when thinking about this issue from a state insurance regulatory standpoint. First, there is a body of law dealing with the McCarran-Ferguson Act and the scope of the “business of insurance” subject to state regulation. Also, related to this is the case law dealing with claim priority statutes that apply when an insolvent insurer is liquidated. Those claim priority statutes give preference to the claims of policyholders over other general creditors, so it matters who is considered an insurance policyholder. There are not many situations where this case law dealing with these insurance regulatory issues has had much influence on tax cases. But, recently, the Tax Court in the *R.V.I.* case did cite the McCarran-Ferguson Act. On the other hand, I know that a significant factor in deciding whether a captive qualifies as an insurance company is whether the risk covered is insurance as that term is commonly understood. Mark, can you help sort this out?

Mark: Well, that’s a good question and one worth developing. Rather than defer to the statutory accounting characterization as insurance, the tax law definition of insurance is generally thought to require that three elements be satisfied: (1) the risk involved must be an insurance risk; (2) the risk must be shifted to the insurer and distributed along the lines of the law of large numbers; and (3) the arrangement must constitute insurance in the commonly accepted sense, or some variation of that phrase.¹⁹ Statutory accounting has a role to play separately in each element of this tax definition, even though there is no deference as to the bottom-line characterization.

As for the first and third elements—presence of an insurance risk, and insurance in the commonly accepted sense—the case that Sheryl and you mentioned, *R.V.I. Guaranty Co. Ltd.*, is a perfect example of a court giving careful consideration to a regulator’s treatment of an arrangement to decide whether the risks are insurance risks, and whether the arrangement can be considered insurance in the commonly accepted sense. Of course, the interests of a regulator are sometimes different from the interests of the IRS in this regard. A regulator’s incentive may sometimes favor insurance characterization in order to retain jurisdiction to regulate, whereas the IRS’ incentive may sometimes be to disqualify an arrangement from the accounting that is afforded insurance under Subchapter L. Still, it’s hard to imagine any court, or the IRS for that matter, disregarding the regulatory treatment of an arrangement as insurance when deciding whether the risks are insurance risks, or the arrangement is insurance in the commonly accepted sense.

Peter: What about the second element of the definition—risk shifting and risk distribution?

Mark: That is more interesting. It would be easy to label a regulatory conclusion that there is risk shifting the way we earlier labeled other issues, that is, “helpful but not sufficient” or “necessary but not sufficient” for tax purposes. Risk shifting in particular is different, and these labels would not do the issue justice. Let’s unbundle that.

One reason why an arrangement might not involve risk shifting is based on the rights and responsibilities under a purported insurance contract itself. The risks at issue under the contract might themselves be remote, such as the proverbial hurricane insurance in Kansas, or kidnapping insurance in North Dakota. Or, the risks at issue might be so certain to happen that in substance there is no uncertainty at all, but rather, in substance, a financing. Or, the attachment points and policy limits might be set in a way that the expected cash flows are all but certain. With the important assistance of the actuarial profession, statutory accounting is well-equipped to analyze whether there is risk shifting based on the insured risks and the terms of a particular contract. Tax might or might not follow, depending on the IRS’ view of the substance of the arrangement and the application of general tax principles in a particular case.

Another factor that might prevent risk shifting for tax purposes might be the relationship between the parties. Despite the rule of *Moline Properties*,²⁰ which gives effect to the separate existence of a corporation, the IRS’ long-held view was that an arrangement between corporate members of the same “economic family” could not qualify as insurance.²¹ The IRS wisely abandoned that theory after the loss of several important court cases,²² but still applies a so-called “balance sheet test” to disqualify direct insurance arrangements between a parent and its wholly owned insurance



company if there is insufficient unrelated business. The theory underlying this test is that the payment of a parent’s claim by a wholly owned insurer reduces the value of the insurer on the parent’s balance sheet, such that there is no shifting of risk from the parent to the subsidiary. This is not to say that the relationship of the parties is wholly irrelevant for statutory accounting purposes. In the case of retroactive insurance, for example, the accounting treatment may sometimes depend on whether the ceding company and assuming company are related or unrelated.²³ But, for tax, this factor has in the past taken on special importance.

Yet another reason why an arrangement might flunk risk transfer may involve the capitalization of the company, or the responsibilities of other parties with regard to the same risks. For example, the IRS sometimes analyzes whether risk has shifted according to the insurer’s wherewithal to satisfy claims, or according to the existence of side arrangements and guarantees. There is not necessarily a direct correspondence between the IRS’ approach and the rules that might apply for statutory accounting purposes. Based on the *Malome & Hyde case*,²⁴ the IRS has historically attached more importance to the existence of a guaranty, for example, than has statutory accounting.

Sheryl: Another factor the IRS has traditionally considered in determining whether there is risk shifting and distribution is



identifying the person (or entity) that has the economic risk of loss. In its published guidance, the IRS has rejected risk distribution when a large number of units are covered if all of the units have the same owner. Under this theory, if a company issued a policy to the owner of a fleet of vehicles, and that was the only policy issued by the company, a state may regulate the company as an insurance company, but the IRS would not deem that company to be an insurance company for federal tax purposes. It should be noted that the Tax Court, in *Securitas* and *Rent-A-Center*, rejected the IRS' position. However, the IRS has not officially rejected this theory. Also, this risk of economic loss theory is difficult to apply in a life insurance arrangement.

Peter: How do your observations on the IRS' risk shifting analysis relate to the risk distribution requirement of the test?

Mark: Sometimes, the risk shifting issue may be conflated by the IRS with the issue of risk distribution for an arrangement to qualify as insurance. *TAXING TIMES* readers are likely more familiar than anyone with the operation of the "law of large numbers," which at its core explains the requirement of risk distribution. I've been told that an actuary would look at a large pool of similar but statistically independent risks and conclude quite easily whether the law of large numbers applies, without even asking which risks belong to whom. The IRS, in contrast, has historically been quite conservative in this area. This is because for tax purposes, tax-deductible reserves are a departure from the all-events test and economic performance requirement that ordinarily apply to a single accrual basis taxpayer. There are certainly limits to deference on risk distribution under current guidance,²⁸ but litigation losses by the IRS could cause both the government and companies to rethink this area.

IS IT REINSURANCE?

Peter: Sometimes it is unclear, at least to me, on a related "what is insurance?" issue: What role does NAIC accounting play on

the question of what qualifies as reinsurance for tax purposes? For example, if a transaction has transferred enough insurance risk to be treated as reinsurance under SSAP No. 61R, does that mean it will qualify as reinsurance for tax purposes?

Mark: That's a good question. Nothing is automatic. The IRS would rightfully give close scrutiny to a reinsurance arrangement that does not qualify as such under SSAP No. 61R but is treated as reinsurance for federal income tax purposes. In 2005, the IRS requested comments on "finite risk transactions,"³⁰ partly in response to press reports about reinsurance arrangements that transferred a limited amount of risk and were accounted for as reinsurance by one party and as a financing by the other. No guidance resulted from that request for comments. At a minimum, it illustrates that the IRS is aware of the issues that may come up in close cases. One would ordinarily expect qualification as reinsurance under SSAP No. 61R to be a prerequisite—"necessary but not sufficient"—to reinsurance characterization for tax purposes, but even that might not always be the case. For example, if two parties to a transaction account for a transaction inconsistently, one would expect the IRS to assert that it could depart from annual statement accounting on at least one side of the transaction to correct the inconsistency or to tax the arrangement according to its substance.

Reinsurance is analyzed similarly to direct insurance for many purposes in Subchapter L, and as with direct insurance, it is important that reinsurance entail sufficient risk shifting to be accounted for as such under Subchapter L. I would point out an important distinction, though. A few minutes ago we were talking about risk shifting in the context of direct insurance and unbundling some of the reasons why there might not be risk shifting in a particular case. One category of issues—the relationships of the parties—is significantly less important to reinsurance characterization for one important reason. The IRS and courts have both made clear that for reinsurance, the analysis of risk shifting and risk distribution looks through to the underlying policyholders.³¹ This is a factor that can cut either favorably for insurance (there are few or no issues as to arrangements between a parent and subsidiary) or unfavorably (in the captive insurance context, a direct policyholder cannot route its risks through a fronting company in order to avoid disqualification as direct insurance). These distinctions have their roots in tax and may or may not even be relevant to statutory accounting in some cases. Hence, the caution that nothing is automatic.

DEFERRED ACQUISITION COST (DAC) CLASSIFICATION OF THE CONTRACT

Peter: Sometimes classification of the type of insurance coverage can make a difference in company taxation. For example, whether an accident and health insurance contract qualifies as guaranteed renewable or cancellable can make a difference on which tax reserve rules apply and on whether the contract is sub-

ject to being “DACed.” John, does the tax law defer to NAIC definitions to classify the type of insurance for purposes of life insurance company tax?

John: There is a deference of sorts to the state law definitions of these terms, in that the tax law contains its own definitions of “noncancellable” and “guaranteed renewable,” but these are modeled on the state law concepts. The regulations under former section 801, in addressing the terms used in the life insurance company qualification ratio now contained in section 816, define a noncancellable contract as one “which the insurance company is under an obligation to renew or continue at a specified premium and with respect to which a reserve in addition to the unearned premiums ... must be carried to cover that obligation.”³² Thus, the contract must be renewable by the policyholder at a stated premium—the regulation says renewable at least to age 60—and there must be an additional reserve related to the renewal obligation.³³ A guaranteed renewable contract is defined similarly in the regulations, except that the renewal premiums may be adjusted “by classes in accordance with [the insurer’s] experience under the type of policy involved.”³⁴ Hence, to be considered guaranteed renewable under the tax law, an additional reserve must be maintained in respect of the obligation to renew, a reserve which together with the unearned premiums is often called the active lives reserve. The need for this additional reserve was the very issue in the *Group Life & Health* case I discussed earlier. Recall that in that case, the insurer’s state regulator did not require the additional reserve, but the court followed the former section 801 regulations and said the additional reserve must be held in order for the contract to be considered guaranteed renewable, to allow the insurer to claim life insurance reserve treatment for its health insurance contracts.

Peter: So, to see whether we have a guaranteed renewable contract, we first start with a test similar to the NAIC definition, but then add another requirement that there be an additional reserve to reflect a risk beyond the current contract year. I believe the IRS also issued a ruling some time ago that says that, if the insurer retains the right to cancel all coverage in a state, the contract is not guaranteed renewable.³⁵ This seems a departure from the regulatory definition of guaranteed renewable, and may not be right.

John: This classification issue may have a big tax impact. Today, the qualification of a contract as guaranteed renewable is significant not only for reserve classification (which can affect life insurance company status) and for application of the section 848 DAC tax, but also in the case of a long-term care insurance contract. The ability of such a contract to be “qualified” under section 7702B depends in part on whether it is guaranteed renewable. So, the regulations’ definitions of noncancellable and guaranteed renewable remain important. That said, those defi-

nitions appear to be close to the related state law concepts, with the exception that state law varies from the regulations’ notion that contract renewability can cease at age 60, and the possible exception you mentioned, Peter.

Peter: I think that winds up this segment of our dialogue. As with our first two dialogues dealing with tax reserves and policyholder taxation, the degree of deference to the NAIC and state regulation on the insurance classification tax issues seemed to be a mixed bag. It depends on the Code section we are interpreting and on whether it is the IRS or the courts talking.

The next, and final, installment of our dialogue will be a catch-all discussion that will cover the deference question as it relates to NAIC annual statement accounting. Until then, on behalf of our *TAXING TIMES* readers, I want to once again thank our panelists for their participation in this interesting dialogue.

Note: The views expressed herein are those of the authors and do not necessarily reflect the views of their current or former employers. ■

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END NOTES

¹ **Disclaimer:** The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the author only, and does not necessarily represent the views or professional advice of KPMG LLP.

² Peter Winslow et al., "Actuary/Accountant/Tax Attorney Dialogue on Internal Revenue Code Deference to the NAIC Part I: Tax Reserves," *TAXING TIMES*, Vol. 11, Issue 2, at 22 (June 2015).

³ Peter Winslow et al., "Actuary/Accountant/Tax Attorney Dialogue on Internal Revenue Code Deference to NAIC: Part II: Policyholder Issues," *TAXING TIMES*, Vol. 11, Issue 3, at 13 (October 2015).

⁴ Treas. Reg. § 1.801-3(a).

⁵ Section 816(a).

⁶ Note that as of 2004, the definition of an insurance company applicable for life insurance companies also applies to nonlife insurance companies. Section 831(c).

⁷ Staff of the J. Comm. on Tax'n, 98th Cong., *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984* ("1984 Blue Book"), at 582-583.

⁸ 430 U.S. 725 (1977).

⁹ Life insurance companies are taxed under Part I of Subchapter L of the Code. Nonlife insurance companies are taxed under Part II of Subchapter L.

¹⁰ 373 F.2d 336 (Ct. Cl. 1967).

¹¹ 574 F.2d 1067 (Ct. Cl. 1978).

¹² 434 F.2d 115 (5th Cir. 1970).

¹³ Treas. Reg. § 1.801-3(d).

¹⁴ 434 F.2d at 118-120.

¹⁵ Section 816(b)(2) and (c).

¹⁶ 145 T.C. No. 9 (Sept. 21, 2015).

¹⁷ The discussion appears at Peter Winslow et al., "Actuary/Accountant/Tax Attorney Dialogue on Internal Revenue Code Deference to NAIC: Part II: Policyholder Tax Issues," *TAXING TIMES*, Vol. 11, Issue 3, at 13 (October 2015). See also PLR 200002030 (Oct. 15, 1999) and PLR 199921036 (Feb. 26, 1999) (both treating death benefits paid under employee welfare benefits plans as life insurance proceeds); *Commissioner v. Treganowan*, 183 F.2d 288 (2d Cir. 1950) (amounts received from New York Stock Exchange Gratuity Fund treated as life insurance proceeds, before the 1984 enactment of section 7702).

¹⁸ Treas. Reg. § 1.801-3(a)(1).

¹⁹ *AMERCO v. Commissioner*, 96 T.C. 18 (1991), *aff'd*, 979 F.2d 162 (9th Cir. 1992).

²⁰ *Moline Props., Inc. v. Commissioner*, 319 U.S. 436 (1943).

²¹ See, e.g., Rev. Rul. 77-316, 1977-2 C.B. 53, *obsoleted* by Rev. Rul. 2001-31, 2001-1 C.B. 1348; Rev. Rul. 78-277, 1978-2 C.B. 268, *obsoleted* by Rev. Rul. 2001-31, 2001-1 C.B. 1348.

²² Rev. Rul. 2001-31, 2001-1 C.B. 1348.

²³ See, e.g., SSAP No. 62, paragraph 30.d, treating retroactive reinsurance as prospective reinsurance in the case of an intercompany reinsurance agreement among certain companies that are commonly controlled.

²⁴ *Malone & Hyde Inc. v. Commissioner*, 62 F.3d 835 (6th Cir. 1995).

²⁵ See Rev. Rul. 2005-40, 2005-2 C.B. 4.

²⁶ *Securitas Holdings, Inc. v. Commissioner*, T.C. Memo 2014-225.

²⁷ *Rent-A-Center, Inc. v. Commissioner*, 142 T.C. 1 (2014).

²⁸ For example, in Rev. Rul. 2005-40, 2005-2 C.B. 4, the IRS concluded that an arrangement with an insurer who insures only a single policyholder, or who insures a policyholder representing 90 percent of the business of the company, does not satisfy the insurance requirement of risk distribution. This conclusion was not based on any statutory accounting guidance.

²⁹ In *Rent-A-Center* and *Securitas*, the Tax Court concluded risk distribution was present in situations involving a large number of independent risk units and a concentration of risks in a small number of policyholders. The court's opinions did not elaborate on the relevance of the number of policyholders or concentration of risks.

³⁰ Notice 2005-49, 2005-2 C.B. 14.

³¹ See Rev. Rul. 2009-26, 2009-38 I.R.B. 366 (concluding that the issuer of a single reinsurance treaty with a single ceding company qualifies as an insurance company based on the policies underlying the reinsurance contract); *Gulf Oil Corp. v. Commissioner*, 914 F.2d 396 (3rd Cir. 1990) (denying deduction for premiums paid to commercial insurers where the risks were subsequently reinsured with a captive affiliate).

³² Treas. Reg. § 1.801-3(c).

³³ *Id.*

³⁴ Treas. Reg. § 1.801-3(d).

³⁵ PLR 8601013 (Sept. 30, 1985).