

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

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CC:FIP:4-PLR-161694-01

Date:

March 12, 2002

Taxpayer =

State =

Date 1 =

Year 1 =

Target =

Company X =

Dear :

This is in response to your representative's letter dated November 1, 2001, requesting consent to Taxpayer's revocation of its election under section 831(b)(2)(A)(ii) of the Internal Revenue Code, effective tax year 2002. Additional information was submitted in letters dated January 10, 2002 and February 27, 2002.

FACTS

Taxpayer is a State corporation, and its principal business activity is the sale of fire, wind, and inland marine insurance. Taxpayer uses an accrual method of accounting and files returns on a calendar year basis.

Company X was formed as a corporation under the laws of State on Date 1. Company X's principal business activity was the sale of fire, wind, and inland marine insurance. In Year 1, Target merged into company X pursuant to what Taxpayer represents was a type A reorganization. Immediately following this merger, company X changed its name to Taxpayer pursuant to a type F reorganization. At least ten years prior to the merger, company X elected to be taxed only on its taxable investment income pursuant to section 831(b)(2)(A) of the Code.

The merger resulted in an increase in the geographical territory in which Taxpayer operates and in the number of policyholders it covers. Soon after the merger, many of Taxpayer's policies were changed to replacement policies and/or rewritten to

provide broader coverage.

Since the merger, Taxpayer has incurred significant underwriting losses due to numerous storms and fires that have occurred in the geographical area in which Taxpayer operates. These losses have been exacerbated by an increase in the cost of repairs due to the increased demand for repairs in the areas affected by the storms and fires. Because of these losses, Taxpayer's tax liability since the merger has been greater than it would have been had its section 831(b) election not been in effect.

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 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).

As indicated above, since its merger with Target, the character of Taxpayer's business has changed significantly in: (1) the geographic area covered by its policies, (2) the nature of its policies, and (3) the costs it must incur to meet its obligations under its policies. In view of the foregoing, Taxpayer requests that consent be granted to revoke its section 831 election. Taxpayer represents that it will not make an election under section 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.

CONCLUSION

Consent is hereby granted to Taxpayer to revoke its section 831(b) election, effective tax year 2002.

CAVEATS

No opinion is expressed under other sections of the Code and income tax regulations that may also be applicable.

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.

Section 6110(k)(3) of the Internal Revenue Code provides that this ruling may not be used or cited 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,
DONALD J. DREES, JR.
Senior Technician Reviewer
Branch 4
Office of Associate Chief Counsel
(Financial Institutions & Products)