

**Office of Chief Counsel  
Internal Revenue Service  
Memorandum**

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subject: GLAM-Special Deduction under Section 833(b)

This Generic Legal Advice Memorandum (GLAM) responds to your request for assistance dated October 21, 2013. This advice may not be used or cited as precedent.

**ISSUES**

Whether more than one Blue Cross and Blue Shield (BCBS) organization may include in the computation of its special deduction under § 833(b) of the Internal Revenue Code the cost of eligible medical services provided to a single BCBS policyholder through a national coordination program, and if not more than one, which organization may include it in the computation?

**CONCLUSION**

Only one BCBS organization, the Home Plan, may include in the computation of its special deduction under § 833(b) the cost of eligible medical services provided to a single BCBS policyholder through a national coordination program.

**GENERIC FACT PATTERN**

Two health insurance companies, the Home Plan and the Host Plan, are BCBS organizations that meet the requirements of § 833(c). The Home Plan and the Host Plan have contracts with service providers. As a condition of their license agreements

with the BCBS Association, the Home Plan and the Host Plan participate in a national coordination program that facilitates nationwide coverage for their subscribers (policyholders).

The Home Plan issues a health insurance policy and card to Subscriber X, an individual. Subscriber X visits a territory covered by the Host Plan and receives medical care from a service provider. The service provider submits its claim to the Host Plan. The Host Plan enters the data into the national coordination program system and the system forwards the data to the Home Plan. The Host plan does not make any determination regarding the scope of coverage or Subscriber X's eligibility for coverage. The Home Plan evaluates the data submitted by the Host Plan, determines whether or how much of the claim is allowable under the Home Plan's policy, and advises the Host Plan of its determination. The Host Plan then pays the service provider the approved amount and submits a claim to the Home Plan for reimbursement.

All of the financial transactions between the Home Plan and the Host Plan are carried out through a BCBS Association entity that nets and automatically settles financial obligations arising from claims handled through the national coordination program. These net settlements are made by direct access to each Plan's bank account.

Under the applicable accounting procedures, the Host Plan accounts for the payment to the service provider and reimbursement from the Home Plan through accounts payable and accounts receivable. The Host Plan recognizes no expense. The Host Plan recognizes revenue only for the administrative expense reimbursement and retained discount or access fee components of the amount received from the Home Plan. In contrast, the Home Plan records an unpaid claim liability and recognizes the related expense.

### LAW AND ANALYSIS

Section 833(a)(2) allows any organization that meets the requirements of § 833(c) to take a special deduction determined under § 833(b). Section 833(b)(1) provides that the special deduction for any taxable year is the excess (if any) of—

- (A) 25 percent of the sum of—
  - (i) the claims incurred during the taxable year and liabilities incurred during the taxable year under cost-plus contracts, and
  - (ii) the expenses incurred during the taxable year in connection with the administration, adjustment, or settlement of claims or in connection with the administration of cost-plus contracts, over
- (B) the adjusted surplus as of the beginning of the taxable year.

The special deduction is limited to the organization's health-related business. Section 833(b)(4). In addition, the special deduction cannot exceed taxable income attributable

to health-related business of the organization for the taxable year (determined without regard to such deduction). Section 833(b)(2).

A technical correction to § 833(b) was enacted in 1997 to clarify retroactively that liabilities and administrative expenses incurred in connection with cost-plus contracts were included in the special deduction calculation. Taxpayer Relief Act of 1997, Pub. L. 105-334, § 1604 (August 5, 1997).

Both the Home Plan and the Host Plan are “existing Blue Cross or Blue Shield organization[s]” within the meaning of § 833(c)(2). Accordingly, both the Home Plan and the Host Plan are entitled under § 833(b) to a special deduction against their regular taxable income if their qualifying claims, liabilities, and expenses incurred exceed an adjusted surplus threshold.

The Home Plan may include the cost of the medical services provided to Subscriber X in its computation of the special deduction as part of its claims incurred during the taxable year under § 833(b)(1)(A)(i). Thus, the question is whether the Host Plan may include the cost of the medical services provided to Subscriber X through the national coordination program as part of its liabilities or expenses incurred in connection with cost-plus contracts, or its expenses incurred during the taxable year in connection with the administration, adjustment, or settlement of claims.

The Home Plan/Host Plan arrangement is not an arrangement under a cost-plus contract, but a networking arrangement that allows BCBS organizations to ensure nationwide coverage for their BCBS subscribers. Cost-plus contracts are a class of self-insurance arrangement offered by BCBS organizations under which a BCBS organization will pay all of a self-insured plan’s covered claims from its own bank account and the self-insured plan will, in turn, pay the BCBS organization for the claims plus a negotiated amount to cover the BCBS organization’s administrative expenses and profit. Under the Home Plan/Host Plan, Subscriber X is not self-insured, but is covered by the health insurance policy underwritten by the Home Plan. The Home Plan bears the insurance risk. Even if Subscriber X were instead a participant in a self-insured group plan, the only cost-plus contract would be between the Home Plan and the sponsor of Subscriber X’s plan. As a result, only the Home Plan would incur a liability under a cost-plus contract.

In addition, even though the Host Plan pays the service provider before receiving reimbursement from the Home Plan, the Host Plan only makes this payment after the Home Plan adjudicates the claim and informs the Host Plan of the approved amount. The Host Plan does not make any determination regarding the scope of coverage or Subscriber X’s eligibility for coverage. Because the Home Plan/Host Plan arrangement is not an arrangement under a cost-plus contract, the Host Plan cannot include the cost of the medical services provided to Subscriber X as part of its liabilities or expenses incurred in connection with cost-plus contracts.

Nor can the Host Plan include the cost of the medical services provided to Subscriber X as part of its expenses incurred during the taxable year in connection with the administration, adjustment, or settlement of claims. The Host Plan does not have an insurance risk in the Home Plan/Host Plan arrangement, nor is the Host Plan subject to a credit risk in regard to whether the Home Plan will reimburse the Host Plan for its payments to the service provider. All of the financial transactions between the Home Plan and the Host Plan are carried out through a BCBS Association entity that nets and automatically settles financial obligations arising from claims handled through the national coordination program. Most importantly, the Host Plan only pays the service provider the approved amount after receiving notification from the Home Plan of its claim determination and the Home Plan agrees to reimburse the Host Plan. Therefore, the Host Plan does not have an expense incurred and cannot include the cost of the claim that it paid for Subscriber X's medical care as part of its expenses incurred during the taxable year in connection with the administration, adjustment, or settlement of claims.

This conclusion is supported by the principle that a taxpayer is not allowed to deduct an otherwise deductible amount if the taxpayer is entitled to reimbursement, unless the reimbursement is included in gross income, is worthless, or is unlikely to be collected. Glendinning, McLeish & Co. v. Commissioner, 61 F.2d 950, 952 (2d Cir. 1932), aff'g 24 B.T.A 518 (1931); Addressograph-Multigraph Corp. v. Commissioner, 4 T.C.M. 147, 177 (1945); Findley v U.S., 28 F.Supp. 715, 719 (W.D. La. 1939); Standard Oil Co. of N.J. v. Commissioner, 11 T.C. 843, 848-49 (1948), supplementing 7 T.C. 1310 (1946); Pittsburgh Indus. Eng'g Co. v. Commissioner, 9 T.C.M. 1132, 1140 (1950). See Weihrauch v. Commissioner, 37 T.C.M. 28, 32 (1978); Rev. Rul. 75-46, 1975-1 C.B. 55.

The term "expenses incurred" means all expenses shown on the annual statement approved by the National Association of Insurance Commissioners, and is computed as follows: to all expenses paid during the taxable year, add expenses unpaid at the end of the taxable year and deduct expenses unpaid at the end of the preceding taxable year. Section 832(b)(6). Section 832(b)(6) also provides that for the purpose of computing the taxable income subject to the tax imposed by § 831, there shall be deducted from expenses incurred all expenses incurred which are not allowed as deductions by § 832(c). Section 832(c)(1) allows as a deduction all ordinary and necessary expenses incurred, as provided in § 162 (relating to trade or business expenses).

Section 162(a) provides a deduction for all ordinary and necessary business expenses paid or incurred during the taxable year in carrying on a trade or business. To properly claim the deduction requires an expense. Indopco, Inc. v. Commissioner, 503 U.S. 79 (1992). A deduction is not allowed for an amount for which there is a right or expectation of reimbursement. See Burnett v. Commissioner, 356 F. 2d 755 (5th Cir. 1966) cert. denied 385 U.S. 832, 87 S. Ct. 77, 17 L. Ed. 2d 68 (1966); Manocchio v. Commissioner, 78 T.C. 989 (1982).

Only one BCBS organization, the Home Plan, may include in the computation of its special deduction under § 833(b) the cost of eligible medical services provided to Subscriber X through the national coordination program. Although the Plans' accounting procedures are not controlling, those procedures are consistent with this conclusion. Specifically, the Host Plan only accounts for the payment and reimbursement through accounts payable and accounts receivable, recognizing no expense and revenue only for the administrative expense reimbursement and retained discount or access fee components of the amount received from the Home Plan. In contrast, the Home Plan records an unpaid claim liability and recognizes the related expense. Thus, only the Home Plan incurs expense under § 832(b)(6).

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