

INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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Index (UIL) No.: 860E.01-01
CASE-MIS No.: TAM-156749-02, CC: FIP: B01

Chief, Appeals Office

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No.
Years Involved:
Date of Conference:

LEGEND:

Taxpayer =
Year 1 =
Year 2 =
\$a =
\$b =
\$c =
\$d =
Date 1 =

ISSUE:

If a consolidated group of corporations includes both life and non-life members, are the excess inclusion rules of § 860E(a)(1) of the Internal Revenue Code applied at the subgroup level or the consolidated group level.

CONCLUSION:

If a consolidated group of corporations includes both life and non-life members, the excess inclusion rules of § 860E(a)(1) are applied at the consolidated group level.

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FACTS:

Taxpayer is the common parent of an affiliated group of corporations that files a consolidated federal income tax return (consolidated group). The affiliated group includes a life insurance company subgroup (Life Group) and a non-life insurance company subgroup (Non-Life Group).

In Year 1 and Year 2, at least one member of both the Life Group and the Non-Life Group held residual interests (as defined in § 860G(a)(2)) in a real estate mortgage investment conduit (REMIC). In Year 1, the Non-Life Group's total excess inclusions under § 860E(c) were \$a. For Year 1, Taxpayer reported zero taxable income for the Non-Life Group under § 1.1502-47(h) of the Income Tax Regulations and a net operating loss for the Non-Life Group, as defined in § 1.1502-47(h)(2). Also in Year 1, the Life Group's total excess inclusions under § 860E(c) were \$b. For Year 1, the Life Group reported partial life insurance consolidated taxable income under § 1.1502-47(a)(2), without consideration of excess inclusions, in an amount that was greater than the total excess inclusions for both subgroups (\$a + \$b). On Taxpayer's Year 1 consolidated Federal income tax return, Taxpayer increased its consolidated taxable income by \$a, the amount of the Non-Life Group's total excess inclusions.

In Year 2, the Non-Life Group's excess inclusions under § 860E(c) were \$c. Taxpayer reported zero taxable income for the Non-Life Group for Year 2 under § 1.1502-47(h) resulting from a carry forward of the Non-Life Group's net operating loss in Year 1. Also in Year 2, the Life Group's total excess inclusions under § 860E(c) were \$d. For Year 2, the Life Group reported partial life insurance consolidated taxable income under § 1.1502-47(a)(2), without consideration of excess inclusions, in an amount that was greater than the total excess inclusions for both subgroups (\$c + \$d). On Taxpayer's Year 2 consolidated Federal income tax return, Taxpayer increased its consolidated taxable income by \$c, the amount of the Non-Life Group's total excess inclusions.

On Date 1, Taxpayer filed a claim for refund and reduced its income by \$a for Year 1 and \$c for Year 2. Taxpayer argued that the total aggregate excess inclusions for both its life and non-life subgroups must only be exceeded by the consolidated taxable income at the consolidated group level. The agent denied the claim for refund in full.

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LAW AND ANALYSIS:

Section 860G(a)(2) defines residual interest as an interest in a REMIC which is issued on the startup day, which is not a regular interest, and which is designated as a residual interest.

Section 860E(c)(1) defines excess inclusion as, with respect to any residual interest in a REMIC for any calendar quarter, the excess (if any) of the amount taken into account with respect to such interest by the holder under § 860C(a) over the sum of the daily accruals with respect to that interest for days during the calendar quarter while held by the holder.

Section 860E(a)(1) states that the taxable income of any holder of a residual interest in a REMIC for any taxable year may not be less than the excess inclusion for such taxable year. With respect to affiliated groups, § 860E(a)(2) provides that the members of an affiliated group filing a consolidated return are treated as one taxpayer for purposes of the excess inclusion rules of § 860E.

Section 1.860E-1(a)(1) provides, in part, that the taxable income of any holder of a residual interest for any taxable year is in no event less than the sum of the excess inclusions attributable to that holder's residual interests for the taxable year.

Furthermore, § 1.860E-1(a)(2) provides that if a holder of a REMIC residual interest is a member of an affiliated group filing a consolidated income tax return, the taxable income of the affiliated group cannot be less than the sum of the excess inclusions attributable to all residual interests held by members of the affiliated group. Thus, for purposes of § 860E, in the case of an affiliated group of corporations filing a consolidated income tax return, the comparison of taxable income to excess inclusions is made at the consolidated group level rather than at the separate member level.

However, in the case of a life-nonlife group filing a consolidated income tax return, the issue is whether the subgroup approach of § 1.1502-47 requires that the comparison of taxable income with excess inclusions mandated by § 860E(a)(1) be made at the subgroup level. Section 1.1502-47(a) provides that the regulations adopt a subgroup method to determine consolidated taxable income for a life-nonlife consolidated group. Under the subgroup approach of § 1.1502-47, each subgroup first calculates subgroup income or loss by treating each subgroup as the group under § 1.1502-11. At that point, § 1.1502-47(g) provides that the consolidated group's consolidated taxable income is computed on a group basis as the sum of each subgroup's income as offset by losses of the other subgroup (as allowable under § 1503(c) and § 1.1502-47). Section 1.1502-47(f)(7) provides that the consolidated group's tax is the tax imposed under § 11 on the consolidated taxable income and the tax imposed by § 1201 on the group's consolidated net capital gain.

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The requirement that life-nonlife groups calculate their taxable income initially on a subgroup basis does not require the comparison of excess inclusions to taxable income to be made on a subgroup basis. The comparison of excess inclusions to taxable income under § 860E(a) is not part of the calculation of consolidated taxable income but a requirement that once consolidated taxable income is calculated, consolidated taxable income may not be less than the aggregate excess inclusions of the members. Because this comparison is not part of the calculation in arriving at subgroup taxable income, the subgroup rules do not literally apply.

In a consolidated return (without the combination of both life and nonlife companies), § 860E(a)(2) requires the comparison be made with consolidated taxable income. Section 1.1502-47(q) generally provides that the rules of this section (calculating the income or loss of each subgroup) preempt any inconsistent rules in other consolidated return sections. However, § 860E(a)(1), and not the consolidated return provisions, provides that the excess inclusion rules be applied at the consolidated group level (affiliated group of corporations filing a consolidated return). In the instant case, pursuant to § 1.1502-47(r), the life-nonlife regulations do not preempt the normal consolidated return rules, and thus the normal consolidated return rules apply.

CAVEAT(S):

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(k)(3) provides that it may not be used or cited as precedent.