

**Office of Chief Counsel
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Memorandum**

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subject: Application of Section 847 in Closed Years

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUES

1. Can Taxpayer amend its tax return to reduce its taxable income by the aggregate amount of the special loss discount account (SLDA) that was incorrectly taken into income over its tax years?
2. How should the Service correct the errors that occurred in accounting for the § 847 election in closed years?

CONCLUSIONS

1. Taxpayer is barred by § 6511 from amending its tax return to reduce its taxable income by the aggregate amount of the SLDA, which includes amounts from closed years, that was incorrectly taken into income over its tax years.
2. The Service can make adjustments in an open year to address errors that occurred in accounting for § 847 in closed years.

FACTS

Taxpayer is a property and casualty insurance company taxable under § 831. Taxpayer is required to discount its reserves for unpaid losses under § 846. Taxpayer elected to

deduct additional loss deductions under § 847. Taxpayer added the § 847 deductions to a SLDA and made corresponding special estimated tax payments (SETPs) equal to the tax benefits attributable to the § 847 deductions. In subsequent years, as Taxpayer paid losses and the related § 846 discount declines, corresponding amounts were subtracted from the SLDA and included in Taxpayer's gross income. Any additional tax liability resulting from the inclusion of the previously deducted § 847 amounts was covered through Taxpayer's previously made SETP. Taxpayer kept track of SLDA and SETP accounts for each accident year separately on Forms 8816, Special Loss Discount Account and Special Estimated Tax Payments for Insurance Companies.

During examination of Taxpayer's deposits made into the SETP, it was discovered that there are numerous discrepancies between the SETP yearly deposits/withdrawals per the § 847 control card and the SETP yearly deposits/withdrawals per Taxpayer's Forms 8816. The discrepancy is partially due to the effect of a net operating loss (NOL) carryback. In , Taxpayer had a NOL that it elected to carry back five years. As a result of the NOL carryback, Taxpayer was refunded both the tax that it paid for and the SETP account as of . However, Taxpayer did not adjust its Forms 8816 to take this refund into consideration and as a result Taxpayer continued to take back into income over the years the § 847 deductions that were initially deducted on the filed tax returns for . As Taxpayer took into income the reductions from the SLDA, the corresponding increase in tax was paid through reductions of the SETP. Therefore, the SETP was refunded to Taxpayer twice, first when Taxpayer filed amended returns as a result of the NOL carryback and a second time over the years as it took into income the amounts previously deducted under § 847.

Taxpayer agrees that there is a shortage in the SETP. However, Taxpayer argues that the shortage in the SETP was caused by Taxpayer incorrectly taking into income the SLDA from over the tax years. Taxpayer argues it should be allowed to amend its tax return to reduce its taxable income by the aggregate amount of the SLDA that was incorrectly taken into income, and the resulting refund should be deposited back into the SETP. However, the statute of limitations is expired for most of the years in which Taxpayer took the amount (SLDA) back into income. Taxpayer argues that because § 847 is supposed to be revenue neutral, if the Service does not allow Taxpayer to reduce its income by the SLDA amount that were incorrectly taken into income, Taxpayer would have a permanent adjustment to its taxes.

LAW AND ANALYSIS

Section 832 requires that property and casualty insurance companies discount their deductions for insurance loss reserves in order to take into account the time value of money. Section 846 provides the methodology for computing the discount and determining the amount of the discounted loss deduction.

Section 847(1) permits an insurance company an additional deduction for the amount of the discount computed under § 846. Thus, by claiming a deduction for discounted

losses in accordance with § 846, and the additional deduction for the amount of the discount in accordance with § 847(1), a taxpayer may essentially deduct its full, undiscounted reserve for losses.

Section 847 was not intended to give the taxpayer an additional tax benefit. The purpose of § 847 is to offset the negative effects on financial accounting reporting caused by the discounting requirement of § 846. Thus, the legislative history indicates that Congress intended § 847 to be revenue neutral. See H.R. Conf. Rep. No. 1104, 100th Cong. 2nd Sess. 173 (1988). While § 847(1) allows the taxpayer an additional deduction, § 847(2) offsets the tax benefit of that deduction by requiring that the taxpayer make a SETP in an amount equal to the tax benefit derived from the § 847(1) deduction.

Taxpayers who are allowed a deduction under § 847(1) are required by § 847(3) to establish and maintain a SLDA to keep track of the unreversed discount for each year for which a § 847(1) deduction was claimed. The amount of the discount claimed as a deduction for any taxable year is added to the account. Pursuant to § 847(5), amounts are subtracted from the account, and simultaneously included in the taxpayer's gross income, as time passes and the unreversed discount decreases. Assuming this inclusion in income gives rise to an additional tax liability, § 847(2) provides that the special estimated tax payments previously made are used to pay the additional tax liability.

Section 847(8) provides that the tax benefit attributable to the § 847 deduction shall be determined by taking into account tax benefits that would arise from the carryback of any net operating loss for the year, as well as current year tax benefits.

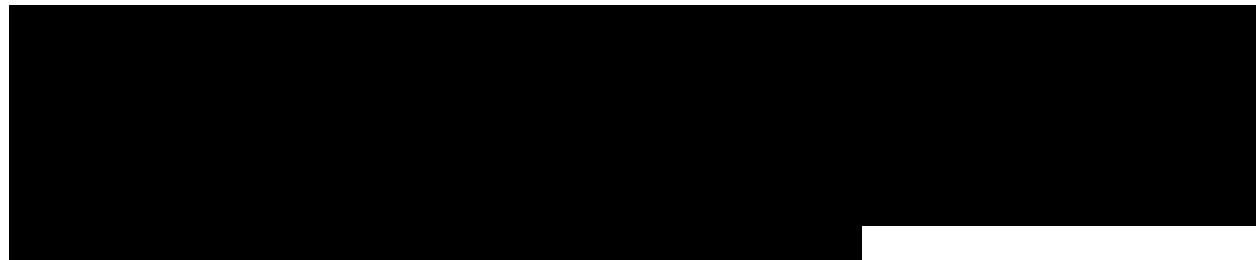
Section 6511(a) provides that a claim for refund of an overpayment of any tax shall be filed within three years from the time the return was filed or two years from the time the tax was paid, whichever of those periods expires the later. Section (b)(1) provides that no refund shall be allowed or made after the expiration of the period prescribed in § 6511(a). The period prescribed in § 6511(a) for most of the years in which Taxpayer took the SLDA back into income has expired. Section 847 does not extend any of the normal rules under § 6511. Therefore, Taxpayer may not amend its return to reduce its taxable income by the aggregate amount of the SLDA, which includes amounts from closed years, that was incorrectly taken into income over its tax years.

Nor can the Service carryback any additional net operating losses from [redacted] to offset income from [redacted] and give an additional refund for those years. Such a refund would also be precluded by § 6511. Section 6511(b) states that no refund can be paid if the taxpayer failed to file a claim within three years from the time the return was filed or two years from the time the tax was paid, whichever is later. Those periods have long passed for the [redacted] taxable years. There is an exception for net operating loss carrybacks under § 6511(d)(2), but that only extends the period that a claim can be made until 3 years after the due date of the return for the year of the NOL. In this case

that would be _____, and therefore, that period too has long passed. Therefore, there can be no refund based on the carryback from the _____ year to the _____ taxable years.

Although a refund may be barred under § 6511, and similarly assessment of an underpayment may be barred by § 6501, neither provision bars the actual adjustment to Taxpayer's return. There is no statute of limitation that bars the adjustment to the return. See Rev. Rul. 56-286, 1956 C.B. 134; Hill v. Commissioner, 95 T.C. 437 (1990). Therefore, if it is determined that the closed years were not calculated correctly, the Service may make adjustments to those years. Those adjustments could affect accounting for the § 847 election in open years.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS



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