Certain Reinsurance Arrangements

Notice 2004–65

This notice modifies Notice 2002–70, 2002–2 C.B. 765, and Notice 2003–76, 2003–49 I.R.B. 1181, by removing the identification of transactions that are the same as, or substantially similar to, transactions described in Notice 2002–70 as "listed transactions" for purposes of § 1.6011–4(b)(2) of the Income Tax Regulations and §§ 301.6111–2(b)(2) and 301.6112–1(b)(2) of the Procedure and Administration Regulations. The Service will, however, continue to scrutinize transactions described in Notice 2002–70 that are being used to shift income from taxpayers to related companies purported to be insurance companies that are subject to little or no U.S federal income tax.

BACKGROUND

Notice 2002–70 describes a reinsurance arrangement involving a taxpayer ("Taxpayer") (typically a service provider, automobile dealer, lender, or retailer) that offers its customers the opportunity to purchase an insurance contract through Taxpayer in connection with the products or services being sold. The insurance provides coverage for repair or replacement costs if the product breaks down or is lost, stolen, or damaged, or coverage for the customer's payment obligations in case the customer dies, or becomes disabled or unemployed. Taxpayer offers the insurance to its customers by acting as an insurance agent for an unrelated insurance company ("Company X"). Taxpayer receives a sales commission from Company X equal to a percentage of the premiums paid by Taxpayer's customers. Taxpayer forms a wholly owned corporation ("Company Y"), typically in a foreign country, to reinsure the policies sold by Taxpayer. Promoters sometimes refer to these companies as producer owned reinsurance companies or "PORCs." If Company Y is a foreign corporation, it typically elects to be treated as a domestic insurance company under § 953(d) of the Internal Revenue Code. Company Y takes the position that it is entitled to the benefits of § 501(c)(15) (providing that certain small non-life insurance companies are tax exempt), § 806 (providing a deduction for certain life insurance companies with life insurance company taxable income not in excess of $15,000,000), or § 831(b) (allowing qualifying non-life insurance companies whose net written premiums do not exceed $1,200,000 to elect to be taxed solely on investment income). Taxpayer receives premiums from its customers and remits those premiums (typically net of its sales commission) to Company X. Company X pays any claims and state premium taxes due and retains an amount from the premiums received from Taxpayer. Under Company Y's reinsurance agreement with Company X, Company Y reinsures all insurance policies that Taxpayer sells to its customers. Company X transfers the remainder of the premiums to Company Y as reinsurance premiums.

Notice 2002–70 alerts taxpayers that, in appropriate cases, the Service intends to challenge the purported tax benefits from these transactions on a number of grounds. Notice 2002–70 also identifies transactions that are the same as, or substantially similar to, the transaction described in the Notice 2002–70 as "listed transactions" for purposes of § 1.6011–4T(b)(2) of the temporary Income Tax Regulations (now § 1.6011–4(b)(2) of the Income Tax Regulations) and §§ 301.6111–2T(b)(2) of the temporary Procedure and Administration Regulations (now §§ 301.6111–2(b)(2) of the Procedure and Administration Regulations).

Section 206 of the Pension Funding Equity Act, P.L. 108–218, amended § 501(c)(15) effective for taxable years beginning after December 31, 2003. Notice 2004–64, 2004–41 I.R.B. 598 (October 12, 2004), describes the amendments and notifies taxpayers that the Service will continue to scrutinize the tax-exempt status of entities claiming to be described in § 501(c)(15).

DISCUSSION

The Treasury Department and the Service have concluded that these transactions no longer should be identified as "listed transactions" for purposes of the disclosure, registration, and list maintenance requirements. Since issuing Notice 2002–70, the Service has examined various types of these arrangements. These examinations have revealed fewer abusive transactions than anticipated. Further, the Treasury Department and the Service anticipate that the recent amendments to § 501(c)(15) will curtail the use of this provision by a number of these arrangements. Accordingly, transactions will no longer be identified as "listed transactions" for purposes of §§ 1.6011–4(b)(2), 301.6111–2(b)(2) and 301.6112–1(b)(2) solely because they are the same as, or substantially similar to, the transaction described in Notice 2002–70. However, the Service will continue to scrutinize transactions described in Notice 2002–70 that are being used to shift income from taxpayers to related companies purported to be insurance companies that are subject to little or no U.S federal income tax. Although a transaction is no longer a "listed transaction" solely because the transaction is described in Notice 2002–70, the transaction may still otherwise be subject to the disclosure requirement of § 6011, the registration requirement of § 6111, or the list maintenance requirement of § 6112.

EFFECT ON OTHER DOCUMENTS

Notice 2002–70 and Notice 2003–76 are modified by removing the identification of transactions that are the same as, or substantially similar to, transactions described in Notice 2002–70 as "listed transactions" effective for taxable years for which the due date of the return (including extensions, whether or not actually requested) is after September 24, 2004.

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