the guaranteed death benefit which must be considered in the overall context of the integrated CARVM reserve. In arguing that the asset drop assumption is really a reserve for an investment risk, the IRS is missing the point that it is the assets in the general account that fund the GMDB, not the separate account assets. Even more fundamental, the IRS may be confused by the reference to "assets" in AG 34. Perhaps a more accurate way to refer to the rate-of-return assumptions in AG 34 would have been to describe an immediate drop in "account values" followed by subsequent account value increases.

The IRS cannot be insisting that traditional life insurance reserve CRVM principles derived from the SVL be used because CRVM does not apply to annuities. But, it is unclear from the CIGNA Notice of Deficiency and court filings how the IRS believes CARVM reserves should be recomputed and how any such recomputation would comply with section 807(d)'s mandate that the NAIC-prescribed method be used for tax reserves. The IRS not only has asserted that the asset drop assumption is improper, but also has argued that AG 34 cannot apply at all to contracts issued prior to the adoption of that actuarial guideline. Perhaps the IRS is contending that AG 33 should apply to contracts issued before the effective date of AG 34, but how or why the IRS believes a reserve computed under AG 33 must differ from an AG 34 reserve has not been explained. In fact, since the adoption of the Variable Life Insurance Model Regulation in 1974, an asset drop assumption has been standard practice in determining reserves for variable products. Moreover, AG 33 and AG 34 are consistent in principle and both require an assumption as to future rates of return on assets. So, the IRS must be arguing something like: "AG 33 should be applied in a manner that avoids an asset drop assumption." But, how this can be done while still reflecting the risks inherent in all future guaranteed death benefits in the CARVM integrated reserve required by AG 33 is a mystery. Expert witnesses undoubtedly will have some difficulty supporting the IRS's position in the *CIGNA* case because both the logic and the result of the IRS's position seem obscure.

END NOTES

[1] Although AG 43 has retroactive statutory effect for contracts issued before its effective date, section 807(d) of the Internal Revenue Code requires the use of the NAIC's prescribed method in effect at the time the contract was issued, *i.e.,* AG 34 in the case of annuities with GMDB.

[2] The IRS is required to issue a Notice of Deficiency proposing additional tax liability prior to assessment of tax to give the taxpayer an opportunity to file a petition in the U.S. Tax Court to challenge the IRS's position prior to payment. CIGNA exercised its right to file a Tax Court petition and its case is currently pending in that court. *CIGNA Corp. and Consolidated Subs. v. Commissioner,* No. 013645-09 (Tax Court petition filed June 4, 2009).

[3] 2008-5 I.R.B. 363.

[4] TAM 200448046 (Aug. 30, 2004).

[5] TAM 8111079 (Dec. 17, 1980).

[6] Rev. Rul. 67-435, 1967-2 C.B. 232.

IRS FINDS RISK DISTRIBUTION IN TWO REINSURANCE ARRANGEMENTS

By Janel C. Frank and Gregory K. Oyler

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A recent Internal Revenue Service (IRS) revenue ruling confirms, for the first time in formal guidance, assumptions long-held by taxpayers about the proper analysis of risk distribution in the context of reinsurance. Revenue Ruling 2009-26 (2009 38 I.R.B. 366) analyzes risk shifting and risk distribution in the context of property casualty reinsurance, but its principles would apply equally to other types of arrangements, such as reinsurance of XXX life reserves, where a special purpose reinsurance company is used to assume risks from a single direct writer.

Revenue Ruling 2009-26 considers two fact patterns involving Insurance Company Y ("Insurance Co.") and Reinsurer Z and whether Reinsurer should be treated as an insurance company under I.R.C. § 831(c). In Situation 1, Insurance Co. entered into a 90 percent quota share reinsurance contract with the Reinsurer that covered 10,000 insurance policies issued by Insurance Co. in the commercial multiple peril line of business. This was the Reinsurer's only business during the year. The ruling found that the policies issued by Insurance Co. involved insurance risks, transferred those risks from 10,000 unrelated policyholders to Insurance Co., distributed those risks (in that a loss by one policyholder was not borne in substantial part by that policyholder's premiums), and were insurance in the commonly accepted sense. The ruling also found that the reinsurance contract between Insurance Co. and Reinsurer likewise transferred the risks to Reinsurer and constituted reinsurance in the commonly accepted sense. With respect to risk distribution, the ruling concluded that the reinsurance contract did nothing to disturb the distribution of the risks of the 10,000 policyholders that had been achieved by their policies with Insurance Co. Accordingly, the Reinsurer qualified as an insurance company for tax purposes. This analysis likewise suggests that reinsurance of the XXX life reserves of a single ceding company would meet the risk dis-

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tribution requirement for tax purposes even if that reinsurance constituted the entirety of the reinsurer's business.

In Situation 2 of the ruling, the facts were the same, except that the reinsurance contract with Insurance Co. covered the risks of only one policyholder (X, unrelated to Reinsurer), and Reinsurer also entered into reinsurance contracts with other insurance companies to assume additional policies in the same line of business. In this situation, although the risks of the single policyholder (X) assumed from Insurance Co. may not have been "distributed" when viewed in isolation, risk distribution was achieved by Reinsurer's assumption of similar risks of unrelated policyholders from other insurance companies, so that the risks of each original policyholder (including X) were distributed in that a loss by one policyholder was not borne in substantial part by that policyholder's premiums. Therefore, the ruling concluded, Reinsurer was treated as an insurance company under I.R.C. § 831(c) in Situation 2 as well.

LIFE NOL CARRYBACK

By Craig L. Pichette, Charles J. Auer and Michael E. Bauer

On Nov. 6, 2009, President Obama signed H.R. 3548, *the Worker, Homeownership, and Business Assistance Act of 2009* (the Act) into law. Among other changes, Code sections 172 and 810 were amended to provide an extended carryback period for net operating losses and the loss from operations of a life insurance company, respectively.

Section 810 contains rules similar to the net operating loss (NOL) rules found in section 172, and is specifically applicable to the loss from operations of a life insurance company. Prior to amendment, the rules permitted such losses to be carried back three years and forward 15 years from the year in which the loss was incurred. The section 172 rules, in contrast, generally permit taxpayers to carry NOLs back two years and forward 20 years.

Section 13(c) of the Act adds new paragraph (b)(4), entitled "Carryback for 2008 or 2009 Losses," to section 810. New section 810(b)(4) provides an elective five-year carryback for the loss from operations of a life insurance company for tax years ending after Dec. 31, 2007, and beginning before Jan. 1, 2010 (*i.e.,* tax years 2008 and 2009).

A taxpayer may elect to use the entire five-year carryback period or may instead elect a four-year carryback. The election may only be made with respect to one tax year. An election must be made by the due date of the taxpayer's 2009 tax return, including extensions, and is irrevocable once made.

A special rule applies to losses carried back to the fifth tax year preceding the year in which the loss was incurred. The rule limits the amount of loss that may be carried back to such year to 50 percent of the taxpayer's life insurance company taxable income for such year. Life insurance company taxable income is computed without regard to the loss from operations for the loss year or any tax year thereafter. Appropriate adjustments are to be made in calculating the carryover to a future year from the fifth preceding year to take the 50 percent limitation into account.

The Act also suspends the 90 percent limitation on the use of any alternative minimum tax (AMT) NOL deduction attributable to carrybacks of the applicable NOL for which an extended carryback period is elected. Although not specifically mentioned, presumably this suspension would apply to AMT operations loss deductions as well.

The Act indicates that the manner in which the election must be made will be prescribed by the Secretary. Revenue Procedure 2009-52 was issued shortly after enactment of the Act and provides guidance on making the election. Under the Revenue Procedure, a corporate taxpayer (including a life insurance company) may make an election on their federal income tax return for the year of the applicable NOL by attaching a statement to their return. A taxpayer that has previously filed its income tax return for the taxable year of the NOL may attach an election to an amended income tax return, Form 1120X. The election must be made by the due date, including extensions, for the filing the taxpayer's 2009 tax return.

Corporate taxpayers may also make the election on Form 1139 by attaching a statement thereto. The due date for filing Form 1139 to make an election is extended to the due date of their 2009 return, including extensions. Taxpayers who previously filed a Form 1139 or an amended return must state on their election that the current election amends a previous application or claim. The election statement must indicate that they are making the election under section 810(b)(4), as provided for in Revenue Procedure 2009-52, the number of years that they wish to carry the loss back, and that they are