paid loss reserves into account for tax purposes under Treasury Regulation section 1.832-4-(b), which are discounted under section 846.

The industry and insurance regulators may have to recognize the tradeoff between a theoretically pure statutory principle-based reserving approach that is not easily applied in practice and an approach that is not theoretically pure but can be applied to value reserves by insurance companies and administered by insurance regulators. One benefit of the latter, practical, approach is that it can address important tax policy goals. It can include a discrete component that qualifies as a life insurance reserve under section 816(b) that (1) addresses the underlying intent of Congress, (2) can be applied by insurance companies and (3) can be administered by the Service. The NAIC demonstrated that it was sensitive to Treasury Department concerns regarding the impact of statutory accounting rules in the late 1940s and can do so again by issuing principle-based reserving rules that address related Treasury Department concerns.

New Whistleblower Law Generating Very Large Claims

by Samuel A. Mitchell

For many years the IRS has had the legal authority to award money to whistleblowers who provide information resulting in the collection of underpaid taxes. However, in the past, the IRS had complete discretion over the awards and did not effectively administer the process.[1] As a result, the old program—if one could call it a program—generally did not result in significant awards and did not draw much attention from taxpayers or practitioners. All of that changed on Dec. 20, 2006, with the passage of the Tax Relief and Health Care Act of 2006.[2] The Act creates a special Whistleblower Office within the IRS to administer claims and requires the IRS to make a whistleblower award—under certain circumstances—of at least 15 percent and up to 30 percent of the underpaid taxes, penalties and interest the IRS ultimately collects through administrative or judicial action it takes based on information provided by a whistleblower.

Significantly, the Notice also clarifies that the awards are available even if an audit of the taxpayer is already underway.

The required awards apply only in cases where the taxes, penalties and interest in dispute exceed $2,000,000, and, in an action against an individual taxpayer, where the offending taxpayer's gross income exceeds $200,000. The amount of the award (15 to 30 percent of the taxes, penalties and interest collected) depends on the extent to which the Whistleblower Office determines that the whistleblower "substantially contributed" to action against the offending taxpayer, and the Whistleblower Office's determination is subject to an appeal to the Tax Court.[3] The Act requires the IRS to issue regulatory guidance regarding the process and the standards the Office of Whistleblower will use in administering the new program. Recently the IRS issued interim guidance in the form of Notice 2008-4. The Notice restates the provisions in the Act, provides specific guidance on what information a whistleblower is required to file, and clarifies that the IRS will attempt to keep the whistleblower's identity confidential but cannot promise to do so in all cases.

Significantly, the Notice also clarifies that the awards are available even if an audit of the taxpayer is already underway. As an example, the Notice explains that the Whistleblower Office may approve an award if the information results in a new issue on the audit plan of a large-case taxpayer under audit or if the information results in a change in the way information about an existing issue is collected or analyzed that would not otherwise have occurred absent the information. In this context, it is important to note that even people who initiated or planned the actions that led to the underpayment of tax are eligible for the award. It is clear that such people are eligible for the award because the Act allows the Whistleblower Office to reduce the award paid to any such person.[4] Thus, tax managers, tax employees, investment

Samuel A. Mitchell is a partner with the Washington, D.C. law firm of Scribner, Hall & Thompson, LLP and may be reached at *smitchell@scribnerhall.com*.

[1] *See* former I.R.C. § 7623, providing for an award at the discretion of the Secretary, and Procedural Regulation § 301.7623-1, providing that an IRS district or service center director has the authority to "approve a reward, in a suitable amount . . . ."

[2] Pub. L. No. 109-432.

[3] Awards are available for lesser amounts under the old system of complete discretion. *See* Notice 2008-4, 2008-2 I.R.B. 253 (Dec.19, 2007). Moreover, similar discretionary awards are available under the new provision for less than a "substantial contribution," but not in excess of 10 percent of the unpaid taxes, interest and penalties. *Id.*

[4] If the person is convicted of a crime arising from the role in initiating or planning the action, the Whistleblower Office is required to deny the award.

continued ▸▸36

from pg. 35

bankers, accountants and others could conceivably collect awards (albeit reduced awards) under the program even if they participated in the planning or initiation of actions that led to the underpayment.

FIN-48 and the IRS' war on tax shelters have resulted in renewed scrutiny on tax departments and on the positions large corporate taxpayers report on their returns. The whistleblower provision will only increase that scrutiny and create another, perhaps even more significant deterrent for corporations tempted to take aggressive tax positions on their returns. There is no doubt that the new law's generous provisions will result in very large claims against corporate taxpayers, and lawyers are lining up to represent claimants. Indeed, one whistleblower firm with offices in Washington D.C. has announced that it has filed claims involving $4 billion in taxes, penalties and interest in the year since the law was enacted. The firm's latest claim reportedly involved $600 million. Even after a substantial contingency fee, a possible 30-percent recovery on $600 million would be very tempting even to the most loyal employee.

Section 338 Insurance Company Regulations Finalized

by Lori J. Jones and Mark H. Kovey

Lori J. Jones is a partner with the Washington, D.C. law firm of Scribner, Hall & Thompson, LLP and may be reached at *ljones@scribnerhall.com.*

Mark H. Kovey is a partner with the Washington, D.C. law firm of Scribner, Hall & Thompson, LLP and may be reached at *mkovey@scribnerhall.com.*

The IRS has finalized the last package of regulations dealing with taxable acquisitions and dispositions of insurance businesses under section 1060 and pursuant to section 338 elections. The final regulations did not make any major changes to the proposed regulations, adopting an assumption reinsurance model for the transfer of an insurance business pursuant to a section 338 deemed asset sale. The final regulations also retain the distinction between acquisitions of insurance businesses which are subject to section 1060 (assumption reinsurance or indemnity reinsurance transactions) because they involve the acquisition of a significant business asset versus mere reinsurance which continues to be subject only to the principles under Treas. Reg. § 1.817-4(d).

Specifically, in T.D. 9377, published on Jan. 22, 2008, the IRS finalized proposed and temporary regulations under sections 197, 338, 381 and 846 primarily without change. All of the regulations apply to transactions that occur on or after April 10, 2006 when the rest of the related regulations were finalized. This new set of final regulations deals with situations where the proposed regulations (originally issued on March 8, 2002) were modified as a result of comments. Specifically, the newly finalized regulations include Treas. Reg. § 1.197-2(g)(5)(ii) which provides guidance on the interplay between section 197(f)(5) (generally requiring capitalization of a ceding commission in an assumption reinsurance transaction in excess of the section 848 amortization) and section 848 (requiring capitalization of specified policy acquisition expenses). Treas. Reg. § 1.338-11(d) deals with reserve increases by new target after the deemed asset sale pursuant to a section 338 election or the actual asset sale subject to section 1060. Treas. Reg. § 1.381(c)(22)-1 amends Example 3 by correcting a mathematical error. Finally, Treas. Reg. § 1.846-4 lists a section 338 election as an event pursuant to which a company can make a section 846(e) election (if the qualified stock purchase is made on or after April 10, 2006).

IRS Withdraws Proposed Captive Insurance Regulations

by Frederic J. (Rick) Gelfond and Yvonne S. Fujimoto

On Feb. 20, 2008, the IRS announced that it withdrew the portion of its Sept. 27, 2007, proposed regulations (REG 107592-00) that would have eliminated the ability of certain domestic captive insurance companies to currently deduct their loss reserves relating to insurance covering members of the captive's consolidated group. [*See* proposed regulations section 1.1502-13(e)(2)(ii)(C).] The proposed regulations were an unexpected development that was met with strong efforts by many states and captive insurance industry providers to have the proposed regulations withdrawn. Among the major concerns expressed to the IRS were:

- The approach of the insurance provisions contained in Subchapter L of the Internal Revenue Code, which the proposed regulations would have effectively negated, more clearly reflects income.
- The proposed regulations are contrary to a long history of case law and the IRS's own revenue rulings that respect the insurance tax treatment of transactions in a captive insurance scenario.
- Because the proposed regulations only applied to domestic consolidated groups, the practical impact of adoption would have been to cause many groups to move their captive insurance companies offshore. As a result, foreign domiciles for captives would have benefited to the detriment of many domestic state domiciles that depend on revenue from captives and the generation of jobs related to the captive industry.

Had the proposed regulations been adopted, it is likely that many taxpayers would have been required