

New York State Department of Taxation and Finance
Taxpayer Services Division
Technical Services Bureau

TSB-A-92 (13) C
Corporation Tax
October 2, 1992

STATE OF NEW YORK
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. C920520B

On May 20, 1992, a Petition for Advisory Opinion was received from American International Group, Inc., 70 Pine Street, 24th Floor, New York, New York 10270.

The issue raised by Petitioner, American International Group, Inc., is whether the special deduction pursuant to section 847 of the Internal Revenue Code for insurance companies which discount their unpaid loss reserves is also allowed for purposes of computing entire net income under section 1503 of Article 33 of the Tax Law.

Petitioner is a holding company which, through its subsidiaries, is primarily engaged in the insurance and financial services business worldwide. Several of Petitioner's insurance subsidiaries (hereinafter collectively referred to as "Taxpayer") underwrite risks in New York and file franchise tax returns as required pursuant to Article 33 of the New York Tax Law. The names of these subsidiaries are as follows: American Home Assurance Company, AIU Insurance Company, National Union Fire Insurance Company, Insurance Company of the State of PA, Commerce and Industry Insurance Company, Birmingham Fire Insurance Company, New Hampshire Insurance Company, United Guaranty Residential Insurance Company, American International Insurance Company, and American International Life Assurance Company of New York.

In computing federal taxable income, an insurance company is required to discount its unpaid loss reserves under section 846 of the Internal Revenue Code (hereinafter "IRC") and is specifically allowed an additional deduction under section 847 of the IRC that is not to exceed the excess of (1) the amount of undiscounted unpaid losses over (2) the amount of discounted unpaid losses. This deduction is available only if the insurance company makes a special estimated tax payment (hereinafter "SETP") corresponding to the tax benefit attributable to the deduction claimed under section 847 of the IRC.

Section 847 was added to the IRC by the Technical and Miscellaneous Revenue Act of 1988 (P.L. 100-647). The mechanics of section 847 operate as follows. When an insurance company claims a section 847 deduction on its return, the deduction reduces the company's federal taxable income before net operating losses and the special deduction allowed for dividends received. Section 847(3) provides that when a deduction is allowed, the insurance company must establish and maintain a special loss discount account. The insurance company must complete Form 8816, Special Estimated Tax Payments, which effectively creates a tax payment (the SETP) equal to the tax benefit associated with the deduction. Section 847(2) provides that these SETPs are not initially treated as estimated tax payments under section 6655 of the IRC, but will become estimated payments under section 6655 if not offset by additional tax due during the 15 taxable years after the SETPs were initially made. Section 847(5) provides that for any taxable year losses are paid and the unpaid loss reserves are taken down, the special loss discount account is reduced and the amount is

included in gross income. The additional tax due is offset by applying the SETP. The SETP becomes refundable to the insurance company in the 16th year if not otherwise used to discharge the company's additional tax liability.

The section 847 deduction was designed to remedy a financial accounting and reporting concern of insurers who must discount their unpaid loss reserves. The tax liability of each insurer and the cash flow to the Department of Treasury is the same whether or not the deduction is claimed, except for the possibility of a non-interest bearing refund in the 16th year after payment. This intent is shown in the Conference Agreement for P.L. 100-647 (H. Conf. Rep. No. 1104, 100th Cong. 2d Sess. 173; 1988 U.S. Code Cong. & Ad. News, 5233). The Conference Agreement, with respect to section 847 of the IRC, states that:

The conference agreement imposes a requirement that the taxpayer make special estimated tax payments in an amount equal to the tax benefit attributable to the additional deduction allowed under the provision. If amounts are included in gross income due to a reduction in the taxpayer's special loss discount account or due to the liquidation or termination of the taxpayer's insurance business, and an additional tax is due for any year as a result of the inclusion, then an amount of the special estimated tax payments equal to such additional tax is applied against such additional tax

Section 1501 of Article 33 imposes a tax on insurance companies measured by entire net income or other applicable basis. Under section 1503, entire net income is defined as a taxpayer's total net income from all sources, including life insurance company taxable income, which the taxpayer is required to report to the United States Treasury Department. This is generally understood to mean an insurance company's federal taxable income as reported on either Form 1120PC for property and casualty insurers or Form 1120L for life insurers.

In computing entire net income, the adjustments or modifications to federal taxable income are contained in section 1503(b). Insurance companies^s are permitted to exclude the discount on unpaid loss reserves from federal taxable income for purposes of computing entire net income as set forth in sections 1503(b)(1)(N) and 1503(b)(2)(R). However, there is no modification contained in section 1503(b) that makes reference to the additional deduction provided for under section 847 of the IRC.

However, section 1503(c) provides that the Commissioner of Taxation and Finance may, whenever necessary in order to properly reflect the entire net income of a taxpayer, determine the year or period in which any item of income or deduction shall be included in entire net income regardless of the method of accounting used by the taxpayer.

Herein, it is clear that the provisions of section 847 of the IRC were not designed to create a tax benefit. Therefore, the Commissioner of Taxation and Finance in accordance with the authority granted to him by section 1503(c) hereby determines that it is necessary, in order to properly reflect entire net income, to disallow the special deduction set forth in section 847 of the IRC in the year or period such deduction is claimed for federal income tax purposes. It is also necessary, in order to properly reflect entire net income, to exclude from such

income the amount of reduction to the special loss discount account which is included in gross income for federal income tax purposes.

Accordingly, for the taxable year that the Taxpayer, when computing federal taxable income, takes an additional deduction pursuant to section 847 of the IRC, such Taxpayer, when computing entire net income, must make an adjustment pursuant to section 1503(c) of the Tax Law to addback to such federal taxable income the amount of such additional deduction. In addition, for the taxable year that the Taxpayer for federal income tax purposes must include in gross income, pursuant to section 847 of the IRC, the amount of the reduction to the special loss discount account, the Taxpayer must make an adjustment pursuant to section 1503(c) of the Tax Law to reduce federal taxable income by such amount when computing entire net income for that taxable year.

DATED: October 2, 1992

s/PAUL B. COBURN
Deputy Director
Taxpayer Services Division

NOTE: The opinions expressed in Advisory Opinions
are limited to the facts set forth therein.