

Internal Revenue Service

Department of the Treasury

PO Box 7604
Ben Franklin Station
Washington, DC 20044

Number: **201343003**

Release Date: 10/25/2013

Index Number: 162.00-00

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:ITA:B02
PLR-103735-13

In Re:

Date:
July 24, 2013

Legend:

Company =
Fund =
Insurer =
State X =
Court =
Plan =

Administrator =
Year 1 =
Year 2 =
Date u =
Date v =
Q =
R =
S =
\$a =
\$b =
\$c =

Dear _____ :

This is in response to the letter dated January 10, 2013, and subsequent correspondence, submitted on behalf of Company, requesting rulings that (1) its contributions to Fund are deductible under section 162 of the Internal Revenue Code, and (2) its contributions are deductible in the year paid.

FACTS

Company is a life insurance company that sells, among other things, life insurance and annuity products. Company is the common parent of a life-nonlife consolidated group of corporations that files a federal income tax return on a calendar year basis. Company maintains its books and records using an accrual method of accounting.

Insurer is a life insurance company domiciled in State X and, since Year 1, has been under the direction of Regulator as receiver, pursuant to Court's orders. Insurer's remaining assets are insufficient to continue paying full benefits as they become due. Accordingly, Regulator petitioned Court to adopt a liquidation plan ("Plan") and convert Insurer's rehabilitation proceeding into a liquidation proceeding, which Plan was approved by Court on Date v.

Despite the enhancements under the approved Plan, approximately Q individuals are expected to experience a significant shortfall in the total amount of benefits received relative to Insurer's obligations, resulting in financial and economic hardship for many of these individuals. If these individuals realize the anticipated shortfall resulting from Insurer's insolvency, then the insurance industry generally and Company specifically would be adversely affected from the public outcry because the individuals would be placed in a position of economic hardship. Company's business as well as its reputation in the community would suffer.

Fund was formed as a State X non-for-profit, non-stock corporation, in connection with the liquidation of Insurer. Fund intends to replace, in hardship situations, some of the benefits due to Insurer's payees, which benefits would otherwise be reduced due to Insurer's insolvency. Formation of Fund will likely promote reliability and confidence in the life insurance industry. The Company represents that the Fund qualifies as a business league under section 501(c)(6).

A consortium of approximately R life insurance companies, including Company (collectively, "Participating Companies"), intend to voluntarily contribute approximately \$b to Fund collectively. The majority of these proceeds will be used for payment to Insurer's payees whose policy benefits have been reduced and who otherwise qualify for Fund benefits ("Fund Beneficiaries"). Additionally, some of the

proceeds will be used to pay Fund operating expenses. Further, Fund agreed to indemnify Participating Companies for legal costs and damages, if any, related to and arising from their association with Fund.

In Year 2, Company contributed \$a to Fund. Company also intends to contribute \$c to Fund. The amount that Company has committed to contribute to Fund was determined based on Company's share of the nationwide annuity market. Company has represented that it reasonably expects a return commensurate with the amount of its contribution. No amounts contributed to Fund will revert to Company.

Payments from Fund to Fund Beneficiaries will be needs-based and administered by Administrator, an independent third-party, who will allocate Fund's assets among eligible Fund Beneficiaries based on certain objective criteria and guidelines developed by Administrator. After allocating Fund's assets, Administrator will make benefit payments to eligible Fund Beneficiaries.

LAW AND ANALYSIS

(1) Whether Company's contributions to Fund are deductible under section 162 of the Internal Revenue Code.

Section 162(a) provides for the allowance of a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 1.162-1(a) provides that "[b]usiness expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except items which are used as the basis for a deduction or credit under provisions of law other than section 162."

Section 1.162-15(b) provides that donations to organizations other than those described in section 170 of the Code, that bear a direct relationship to a taxpayer's business may be deductible business expenses if they are made with a reasonable expectation of a financial return commensurate with the amount of the donation.

Section 263(a) generally requires capitalization of amounts paid for permanent improvements or betterments made to increase the value of any property or estate.

Section 1.263(a)-4(d) provides that, except as provided in section 1.263(a)-4(f), a taxpayer must capitalize amounts paid to create an intangible, determined based on all the facts and circumstances.

Section 1.263(a)-4(f) provides a "12-month rule" under which a taxpayer is not

required to capitalize amounts paid to create (or to facilitate the creation of) any right or benefit for the taxpayer that does not extend beyond the earlier of (i) twelve months after the first date on which the taxpayer realizes the right or benefit; or (ii) the end of the taxable year following the taxable year in which the payment is made.

In Rev. Rul. 79-283, 1979-2 C.B. 80, the Service ruled that voluntary expenditures qualify as deductible ordinary and necessary business expenses when they are made either to prevent injury to the taxpayer's business, or to preserve and protect the goodwill of the business, if they do not result in acquisition of capital asset. Accordingly, members of a savings and loan association league who voluntarily contributed to a fund for distribution to victims of natural disasters (limited to victims who had damaged property mortgaged with members of the league) could deduct payments to the fund as ordinary and necessary business expenses. The rationale of the ruling is that the purpose of those payments was the protection of the goodwill and the capital of the contributors.

In Rev. Rul. 73-113, 1973-1 C.B. 65, the Service ruled that contributions to a city's oil pollution control fund, used to fund various cleanup costs associated with improving the city's tourist business lost due to an oil spill, were deductible under section 162 because the taxpayer suffered a considerable loss of business as a result of the spillage, the payments were reasonably calculated to improve the taxpayer's future business, and the payments were commensurate with the amount of financial return expected.

In Rev. Rul. 76-203; 1976-1 C.B. 45, the Service ruled that amounts expended by a taxpayer for uninsured customers of taxpayer's warehouse were ordinary and necessary business expenses under section 162 of the code because such payments operated to preserve taxpayer's goodwill and protect taxpayer's business reputation. The Service ruled that because the sole purpose of the payments was to preserve taxpayer's goodwill among its customers and to protect its business reputation, the amounts expended were ordinary and necessary business expenses deductible under section 162(a).

Expenditures that do not result in the acquisition of a capital asset and are made to protect a taxpayer's business may be deductible under section 162, even though the transaction giving rise to the expense originated with another taxpayer. See e.g., *Scruggs-Vandervoort-Barney, Inc. v. Commissioner*, 7 T.C. 779 (1946), acq., 1946-2 C.B. 5; *Miller v. Commissioner*, 37 B.T.A. 830 (1938), acq., 1955-1 C.B. 5.

In the present case, several factors favor a section 162 deduction for amounts Company contributes to Fund. First, it is reasonable to assume that Company would suffer economic injury if the Insurer's payees received less benefits under their policies with Insurer as a result of Insurer's insolvency. Next, Company's

contributions to Fund are designed to prevent injury by minimizing the shortfall Insurer's payees will realize. Company is making contributions to Fund for the purpose of preventing economic injury and protecting Company's goodwill and reputation. Finally, Company can reasonably expect a financial return commensurate with the amount of its contributions because the amount of Company's contributions are determined based on Company's national market share. Accordingly, based solely upon the information submitted it is concluded that taxpayer's contributions to Fund are generally deductible as a business expense under section 162(a) because the contributions protect Company's goodwill and business reputation and the expected return is commensurate with the amount of the contribution.

To the extent any portion of the contribution is attributable to the indemnity for legal cost and damages provided by Fund, Company must apply regulation section 1.263(a)-4 to determine whether to amortize or deduct such amount.

(2) Whether Company's contributions are deductible in the year paid.

Section 461(a) provides, in part, that a deduction shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income.

Section 1.461-1(a)(2) provides, in part, that under an accrual method of accounting, a liability is incurred, and generally is taken into account for federal income tax purposes, in the taxable year in which all the events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability.

Section 461(h) provides, in part, that in determining whether an amount has been incurred with respect to any item during the taxable year, the all events test shall not be treated as met any earlier than when economic performance with respect to such item has occurred.

Section 461(h)(2)(A)(i) and (ii) provide that if the liability of the taxpayer arises out of the providing of services or property to the taxpayer by another person, economic performance occurs as services or property is provided.

Section 461(h)(2)(A)(iii) provides that if the liability of the taxpayer arises out of the use of property by the taxpayer, economic performance occurs as the taxpayer uses such property.

Section 461(h)(2)(D) provides that if the liability in question does not arise out of one of the situations enumerated in § 461(h) and the regulations thereunder, then economic performance occurs as payment is made to the person to whom the

liability is owed.

Section 1.461-4(d)(2)(i) provides that if the liability of a taxpayer arises out of the providing of services or property to the taxpayer by another person, economic performance occurs as the services or property are provided.

Section 1.461-4(g) identifies 6 types of liabilities, in addition to liabilities arising out of workers' compensation or out of any tort, for which payment constitutes economic performance: (1) liabilities arising out of a breach of contract; (2) liabilities arising from a violation of law; (3) rebates and refunds; (4) awards, prizes and jackpots; (5) amounts paid for insurance, warranty and service contracts; and (6) taxes other than creditable foreign taxes.

Section 1.461-4(g)(7) provides that in the case of a taxpayer's liability for which specific economic performance rules are not provided elsewhere in the section or in any other regulation, revenue ruling or revenue procedure, economic performance occurs as the taxpayer makes payments in satisfaction of the liability to the person to which the liability is owed. Section 1.461-4(g)(7) further provides that its only application is if the liability in question is not covered by rules provided elsewhere under section 461.

On the date payments are made to Fund, Company's liability is fixed and the amount of such liability could be determined with reasonable accuracy under section 1.461-1(a)(2). Also, Company's payment to Fund constitutes a liability for which economic performance rules are not provided elsewhere in section 1.461-4 of the regulations, in any other regulation, revenue ruling, or revenue procedure. Thus, pursuant to section 1.461-4(g)(7), economic performance occurred when Company made the payments to Fund. Accordingly, Company may deduct payments to Fund in the year of the payments to Fund because at such time the amount of the payments could be determined with reasonable accuracy and economic performance is deemed to have occurred.

CONCLUSION

Based solely on the information submitted and representations made, we conclude that Company's contributions to Fund are generally deductible as an ordinary and necessary trade or business expense. If any portion of the contribution is attributable to the indemnity, the Company must apply regulation section 1.263(a)-4 to determine whether to amortize or deduct such amount.

Company's liability for each contribution is incurred in the taxable year of each respective contribution.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or

referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Thomas Moffitt
Branch Chief, Branch 2
Office of Associate Chief Counsel
(Income Tax & Accounting)

Enclosures:
Copy of Letter
Copy for section 6110 purposes