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Department of the Treasury  
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December 10, 2020

Taxpayer =  
Parent =  
Retrocessionaire =  
Holding Company =  
Domicile =  
Contract =

Number A =  
Number B =  
Date =  
Year 1 =  
Year 2 =

Dear :

This letter responds to Taxpayer’s request for a letter ruling that the Contract between Taxpayer and Retrocessionaire is reinsurance for Federal income tax purposes.

**FACTS**

Taxpayer represents the following facts:

Taxpayer is domiciled in Domicile, where it is regulated as an insurance company. Taxpayer has determined that it would qualify under § 816 of the Internal Revenue Code (“Code”) as an insurance company other than a life insurance company. Taxpayer has elected under § 953(d) to be treated as a domestic corporation and computes its U.S. Federal income tax under § 831(a). Taxpayer is a subsidiary of Parent and is included in Parent’s consolidated Federal income tax return. Parent is in turn a subsidiary of Retrocessionaire, which is also domiciled in Domicile, where it is regulated as an insurance company. Retrocessionaire has not elected under § 953(d) to be treated as a domestic corporation. Retrocessionaire reinsures both affiliates and

third parties and is well capitalized to support its substantial business with unrelated third parties. Retrocessionaire is directly owned by Holding Company, a publicly traded insurance holding company domiciled in Domicile. Retrocessionaire and Taxpayer are part of the Holding Company Group, made up of Holding Company's direct and indirect subsidiaries.

Taxpayer is a reinsurance company. As part of its reinsurance business, Taxpayer through various modified co-insurance agreements ("Modco Agreements") assumes risks under deferred and immediate annuity contracts issued by, or in a few instances reinsured by, affiliates of Taxpayer (the "Annuity Contracts"). Taxpayer represents that the Annuity Contracts are issued by life insurance companies and satisfy the criteria for treatment as annuity contracts under § 72. The risks assumed by Taxpayer under the Modco Agreements (the "Reinsured Risks") with respect to some Annuity Contracts (specifically, deferred annuities that contain permanent purchase rate guarantees) include mortality, longevity, lapse, credit quality, reinvestment, and disintermediation risks and with respect to other Annuity Contracts (specifically, immediate annuities) include mortality, longevity, credit quality, and reinvestment risk.

Taxpayer has entered into the Contract with Retrocessionaire with regard to the obligations assumed by Taxpayer under specified Modco Agreements (the "Covered Modco Agreements"). The Contract is for a stated term of one year, beginning Date, and automatically renews annually for Number A years, unless Taxpayer provides timely written notice of non-renewal to Retrocessionaire. During that term, the Contract must be renewed if the total amount paid or payable by Retrocessionaire under the Contract from Date through the date Contract would be terminated exceeds the total amount paid or payable by Taxpayer under the Contract from Date through the date Contract would be terminated. Under the Contract, Retrocessionaire agreed to indemnify Taxpayer against loss from the Reinsured Risks under the Covered Modco Agreements (the "Covered Reinsured Risks") in excess of certain aggregate specified limits. The Covered Reinsured Risks relate to over Number B Annuity Contracts. Taxpayer entered the Contract to reduce or eliminate its exposure to such excess losses and to align Taxpayer's exposure to the Reinsured Risks with Taxpayer's available capital and the capital of the Holding Company Group.

The payments under the Contract are computed quarterly. For each quarter, a payment is computed taking into account the aggregate year-to-date business activity of Taxpayer related to the Covered Modco Agreements. If the result for the quarter is negative, indicating that losses under the Covered Modco Agreements exceeded the aggregate specified limits, an amount is owed by Retrocessionaire to Taxpayer, indemnifying Taxpayer for the adverse experience under the Covered Modco Agreements. If the result for the quarter is positive, a formula specified in the Contract is applied to different tranches of risk to determine the amount Taxpayer owes Retrocessionaire. Taxpayer has represented that the formula and risk tranches were determined by both an actuarial analysis and a third-party transfer pricing analysis. Taxpayer has also represented that there is a reasonable probability of a loss requiring

payment by Retrocessionaire occurring, and this probability was one of the factors considered in determining the formula and risk tranches. Each quarterly settlement payment takes into account the other quarterly settlement payments made during the calendar year. Hereinafter, if the quarterly payments made by Taxpayer to Retrocessionaire exceed those made by Retrocessionaire to Taxpayer in a taxable year, the net amount of the quarterly payments for the taxable year is referred to as the "Taxpayer Payment;" if the quarterly payments made by Retrocessionaire to Taxpayer exceed those made by Taxpayer to Retrocessionaire, the net amount of the quarterly payments is referred to as the "Retrocessionaire Payment." Taxpayer made Taxpayer Payments to Retrocessionaire for Year 1 and Year 2. Retrocessionaire has made a quarterly payment under the Contract, but there has been no Retrocessionaire Payment to date.

### REQUESTED RULING

The Contract is reinsurance for Federal income tax purposes.

### LAW AND ANALYSIS

#### *Law*

Neither the Code nor the Income Tax Regulations defines the terms "insurance" or "insurance contract" for Federal income tax purposes. In the seminal case addressing this subject, the United States Supreme Court described "insurance" as an arrangement that is insurance "in its commonly accepted sense," involving "insurance risk," "risk-shifting," and "risk-distributing." *Helvering v. Le Gierse*, 312 U.S. 531, 539 (1941). Subsequent cases have also considered whether an arrangement involves insurance risk, risk shifting, and risk distribution and have considered additional factors in determining whether an arrangement is insurance "in its commonly accepted sense." See, e.g., *AMERCO, Inc. v. Commissioner*, 979 F.2d 162, 165 (9th Cir. 1992), aff'd 96 T.C. 18 (1991); *Avrahami v. Commissioner*, 149 T.C. 144, 177 (2017).

Insurance includes the issuing of annuity contracts. See § 816(a) ("[I]nsurance company' means any company more than half of the business of which during the taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies."); S. Prt. 98-169 (Vol. 1) at 525-527 (1984); see also *Perano v. Commissioner*, 130 T.C. 93, 101 (2008) ("The issuance of insurance, to include annuities, requires risk shifting and risk distribution.").

Risk shifting occurs when a person facing the possibility of an economic loss transfers some or all of the financial consequences of the potential loss to the insurer. See Rev. Rul. 2005-40, 2005-2 C.B. 4, 7. If the insured has shifted its risk to the insurer, then a loss by the insured does not affect the insured because the loss is offset by the insurance payment. See *Clougherty Packing Co. v. Commissioner*, 811 F.2d 1297, 1300 (9th Cir. 1987).

Risk distribution occurs if the insurer pools a large enough collection of unrelated risks. See, e.g., Avrahami, 149 T.C. at 181; see also Perano, 130 T.C. at 101-102 (the pooling of possible annuity termination dates is risk distribution). Rev. Rul. 2009-26, 2009-38 I.R.B. 366, concludes that an entity, Z, the only business of which was to assume 90% of the risk borne by IC Y under 10,000 insurance contracts, qualified as an insurance company because, among other things, the risks Z assumed from IC Y remained distributed.

The commonly accepted sense of insurance signifies, among other things, an arrangement with an entity organized, operated, and regulated as an insurance company. See Avrahami, 149 T.C. at 191; *R.V.I. Guaranty Co., Ltd. v. Commissioner*, 145 T.C. 209, 231 (2015). Other factors considered include whether the insurer was adequately capitalized; whether the contracts were valid and binding; whether the premiums were reasonable and the result of an arm's length transaction; whether claims were paid; whether the policies covered typical insurance risks; and whether there was a legitimate business purpose for the transaction. See Avrahami, 149 T.C. at 191.

### *Analysis*

The Covered Reinsured Risks are underwritten by the life insurance companies issuing the Annuity Contracts and are risks commonly assumed in issuing annuity contracts. The Covered Reinsured Risks are therefore considered insurance risks.

If Taxpayer's experience with regard to the Covered Reinsured Risks under the Covered Modco Contracts is negative, as expressed by the Contract's formula, the Retrocessionaire Payment has the effect of mitigating Taxpayer's loss. The loss is borne by Retrocessionaire, as evidenced by the Retrocessionaire Payment made to Taxpayer. Accordingly, Taxpayer shifts a portion of the Covered Reinsured Risks to Retrocessionaire under the Contract.

Retrocessionaire's risk is distributed through the pooling of the Covered Reinsured Risks, which relate to over Number B Annuity Contracts.

The Contract is insurance in the commonly accepted sense of insurance: Retrocessionaire is organized, operated, and regulated as an insurance company and is adequately capitalized; the Contract is valid and binding; the payment formula and risk tranches used to calculate payments under the Contract were determined by both an actuarial analysis and a third-party transfer pricing analysis; payments have been made as provided in the Contract; the Annuity Contracts cover typical insurance risks of annuity contracts; and there was a legitimate business purpose for acquiring insurance from Retrocessionaire.

## RULING

Based solely on the information submitted and the representations made, the Contract is reinsurance for Federal income tax purposes.

## CAVEATS

The ruling contained in this letter is based upon information and representations Taxpayer submitted, accompanied by penalty of perjury statements executed by appropriate parties. This office has not verified any of the material submitted in support of the ruling request, and it is subject to verification on examination.

No opinion is expressed as to the tax treatment of the transaction under the provisions of any of the other sections of the Code and regulations that may also be applicable thereto or to the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered by the above ruling. Taxpayer has not requested any ruling, and no ruling is provided, regarding whether Taxpayer is an insurance company for Federal income tax purposes, whether the Annuity Contracts are annuity contracts within the meaning of § 72, or whether the Contract is priced at arm's length.

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) 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.

Pursuant to a power of attorney on file in this office, a copy of this ruling is being furnished to your authorized representatives.

Sincerely,

Kathryn J. Sneade  
Senior Technician Reviewer, Branch 4  
Associate Chief Counsel  
Financial Institutions and Products)

cc: