APPEALS

Industry Specialization Program
Coordinated Issue

Settlement Position

Industry:	Life Insurance
Issue:	Loss Utilization in a Life-Nonlife Consolidated Return Separate v. Single Entity Approach
Coordinator:	James T. Izbicki
Telephone Number:	(973) 645-2623
UIL No.:	1503.05-00
Factual/Legal Issue:	Legal

Approved:

/s/ Richard R. Guevara — 5/17/2001
Director, Appeals LMSB Area 1 — Date

/s/ Thomas R. Roley — SEP 28 2001
Director, Appeals LMSB Operating Unit — Date

Effective Date: SEP 28 2001

SETTLEMENT POSITION

Loss Utilization in a Life-Nonlife Consolidated Return
Separate v. Single Entity Approach

STATEMENT OF ISSUE

Whether the income and losses of newly acquired nonlife members of a consolidated group can be aggregated when determining the amount of nonlife losses which may be used to offset the taxable income of life insurance companies in a life-nonlife consolidated return.

COMPLIANCE'S POSITION

The loss of a nonlife member of a recently acquired group may not be aggregated with the income of another such member when determining the amount of nonlife loss which may offset life income. Each newly acquired nonlife member's individual loss must be subtracted in its entirety from the nonlife subgroup's net loss before the nonlife subgroup loss may be used to offset life members' income. See CIGNA Corporation v. Commissioner, 109 T.C. 100 (1997), aff'd, 177 F.3d 136 (3rd Cir. 1999), cert. denied, 120 S.Ct. 496 (1999).

This is characterized as the separate entity approach.

INDUSTRY POSITION

The Coordinated Issue Paper states: "A common method used by taxpayers treats the former members of the acquired consolidated group as a single economic entity after they become members of the acquiring group (i.e., as a subgroup of the acquiring group). This is accomplished by aggregating the income and losses of the former acquired group before applying Treas. Reg. section 1.1502-47(m)(3)." Restated, the loss of an ineligible acquired member was used to offset the income of other ineligible acquired members, before being offset by losses of eligible members. This maximized the amount of eligible nonlife losses that the subgroup used to offset life income. This is known as the single entity approach.

This was the taxpayer's position in CIGNA . CIGNA maintained its single entity treatment of nonlife losses was sanctioned by three factors:

- An extensive dialog with Treasury officials on the separate v. single entity approach after the proposed regulations were issued in June 1982 and before the promulgation of the final section 1.1502-47 regulations in March 1983.
- The comment in the Preamble to the final section 1.1502-47 regulations that "[Finally,] the Treasury will study further whether it is appropriate to aggregate the income and losses of ineligible members in certain cases."
- The "reserved" heading of subparagraph (4) of section 1.1502-47(m), in the absence of a explicit prohibition, permitted the adoption of a subgroup approach to net losses of ineligible nonlife companies against income of other nonlife companies of the subgroup.

DISCUSSION

The central issues are the deference to be accorded to legislative regulations and the agency's interpretation of its own regulations.

Prior to the enactment of the Tax Reform Act of 1976, Pub.L. 94-455, 90 Stat. 1525 ("the Act"), nonlife insurance companies were not permitted to file consolidated returns with their affiliated life companies. The Act amended the Internal Revenue Code of 1954 to allow life companies to elect to file consolidated returns for taxable years beginning after December 31, 1980. However, the legislative history shows that Congress was concerned that the historically profitable life companies would acquire nonlife companies with tax losses merely in order to offset their taxable income. To prevent this from occurring, several restrictions were also added to the 1954 Code in sections 1503 and 1504.

Section 1503(c)(1) limits the amount of nonlife losses that may offset life insurance company taxable income to the lesser of 35 percent of the life insurance company taxable income or 35 percent of the nonlife company losses. Section 1503(c)(2) requires nonlife companies to be members of an affiliated group for five years before their losses may be used to offset life insurance company taxable income. Section 1504(c)(2) requires life insurance companies to be members of an affiliated group for five years before they may file a consolidated return with such group.

CIGNA was formed in March 1982 by the merger of Connecticut General and INA. Connecticut General ("CG") had been the common parent of over 40 affiliated subsidiaries, which had previously filed a consolidated return. INA had been the parent of over 160 affiliated nonlife companies and had also filed consolidated returns. CIGNA succeeded Connecticut General as the overall common parent, keeping the CG group intact but becoming the common parent of each of the former members of the INA group. In 1984, CIGNA also acquired Preferred Health Care ("PHC"), which had been the common parent of a group of nonlife companies that had filed consolidated returns. After that acquisition, CIGNA also became the common parent of each of the individual companies in the former PHC group.

Proposed regulations were issued in June 1982 that adopted a subgroup approach in computing life-nonlife consolidated taxable income. Life companies were treated as one subgroup and nonlife companies as the other subgroup. Each subgroup had to offset the gains and losses of member companies to determine whether there was a subgroup consolidated net operating loss (CNOL). Only the net nonlife subgroup consolidated loss could then be used to offset the life subgroup's consolidated income. The nonlife CNOL , however, was further restricted in that the CNOL had to be reduced by the separate loss of any nonlife member that was "ineligible" – had not been a member of the group for at least five years. Section 1.1502-47(m)(3)(vi)(A) of the proposed Income Tax Regulations.   The proposed regulations did not explicitly deal with the acquisition of existing groups of nonlife companies that had previously filled their own consolidated returns.

CIGNA urged Treasury that section 1.1502-47(m)(3)(vi)(A) of the proposed regulations should not be adopted with respect to companies that had been members of their own group and were acquired in a single transaction.

The final regulations issued in March 1984 were nearly identical, however, to the proposed regulations, keeping the separate entity approach. The accompanying Preamble stated " ... the Treasury will study further whether it is appropriate to aggregate the income and losses of ineligible members in certain cases." The final Treas. Reg. Section 1.1502-47(m)(3)(A) had language added to clarify that its definition of ineligible NOL was only " for purposes of … subparagraph (3)." A new subparagraph was added, § 1.1502-47(m)(4), reading in its entirety "Acquired groups. [Reserved]."

Connecticut General filed its 1980, and CIGNA its 1981 through 1985, consolidated returns reporting their taxable income by (1) netting the income and loss of all nonlife companies to obtain a nonlife consolidated net operating income or loss, (2) computing the net loss of the former INA and PHC companies as if they were still distinct subgroups, and then (3) subtracting the resulting ineligible net operating losses of the former INA and PHC groups from the income of all nonlife companies, before offsetting the net eligible nonlife losses against life income. This position contravened the separate entity approach of Treas. Reg. 1.1502-47(m)(3).

Upon audit, the examiners applied the separate entity method specified in the regulations, treating each of the former INA and PHC companies as a separate entity whose loss, if any, was considered ineligible under the five year restriction in section 1503(c)(2). CIGNA disagreed and petitioned the Tax Court for review of the notice of deficiency. The taxpayer and the Government stipulated the facts and filed cross-motions for summary judgment.

In granting summary judgment for the Government in <u>CIGNA</u> , the Tax Court specifically rejected the taxpayer's contentions that (1) any discussions with individual Government officials or material from the administrative files created during the deliberative process before issuance of the regulation; (2) the comments in the Preamble to the final regulations; or (3) the “reserved” heading of section 1.1502-47(m)(4), somehow limited or even negated the general rule for the separate entity treatment for ineligible nonlife companies stated in section 1503(c)(2) and Treas. Reg. 1.1502-47(m)(3)(vi).

The Third Circuit, in affirming the Tax Court, did a plenary review of each factor considered by the Tax Court in granting the summary judgment and found that the government’s interpretation of Treas. Reg. 1.1502-47(m)(3) and (4) was neither inconsistent with any prior interpretation nor incompatible with the plain text of the statute. Accordingly, the regulations mandating the separate entity approach to the utilization of nonlife companies losses were determined to be a permissible interpretation of the statute by the Commissioner.

SETTLEMENT POSITION

Appeals Officers should not concede any part of this issue. The taxpayer’s arguments were addressed and rejected by the U.S. Court of Appeals for the Third Circuit. The Supreme Court denied the taxpayers’ request for certiorari from the Third Circuit. Treas. Reg. section 1.1502-47(m)(3) applies to all ineligible nonlife companies, whether they are acquired individually or as part of a group. Each newly acquired nonlife member’s individual loss must be subtracted in its entirety from the nonlife subgroup’s net loss before the nonlife subgroup loss may be used to offset the life subgroup’s income.