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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

TD 9258

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Guidance under Section 1502; Amendment of Tacking Rule Requirements of Life-Nonlife Consolidated Regulations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulation.

SUMMARY: This document contains temporary regulations concerning the requirements for including insurance companies in a life-nonlife consolidated return. These regulations affect corporations filing life-nonlife consolidated returns. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section in this issue of the **Federal Register**.

DATES: Effective Date: These regulations are effective April 25, 2006.

Applicability Date: For dates of applicability, see §1.1502-47T(b)(2).

FOR FURTHER INFORMATION CONTACT: Drafting Attorney, Ross Poulsen, (202) 622-7770 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

In 1983, the IRS issued §1.1502-47 of the Income Tax Regulations governing

life-nonlife consolidated returns. Section 1.1502-47 provides rules for determining whether a life insurance company meets the five-year affiliation requirement of section 1504(c) of the Internal Revenue Code of 1986. As a general rule, a newly-formed life insurance company must be affiliated with the group for a period of five taxable years before it joins in the filing of a consolidated return. However, §1.1502-47 sets forth an exception to the five-year affiliation requirement (the tacking rule). The tacking rule provides that, where an existing member of the group (the old corporation) transfers property to a new member of the group (the new corporation), the period during which the old corporation is affiliated with the group can be tacked onto the period for the new corporation if five conditions are met.

Of the five conditions, the third condition of the tacking rule requires, where both the old corporation and new corporation are life insurance companies, that the transfer from the old corporation to the new corporation not be reasonably expected to result in the separation of profitable activities from loss activities (the separation condition). The preamble to §1.1502-47 expressed concern that, under the so-called bottom-line method, life insurance companies could separate profitable activities from loss activities in order to reduce consolidated life insurance company taxable income. The bottom-line method required life insurance companies in a consolidated group to determine their treatment under the three-phase system, then applicable to life insurance companies, on a separate entity basis. To address the concern, the separation condition was included as a condition of the tacking rule.

In the Tax Reform Act of 1984, Public Law 98-369 (1984-3 C.B. 1), Congress

substantially revised the rules for taxing life insurance companies, largely eliminating the three-phase system. Under current section 801, a life company is taxed at the generally applicable corporate rate on its life insurance company taxable income.

In the American Jobs Creation Act of 2004, Public Law 108-357 (118 Stat. 1418), Congress suspended, during 2005 and 2006, the rules that impose a tax on direct or indirect distributions from a pre-1984 policyholders surplus account, the last significant remaining vestige of the former three-phase system.

In light of the changes to the taxation of life insurance companies, the IRS and Treasury Department believe that the separation condition should be eliminated because the rationale for adopting the separation condition is no longer relevant under current law.

Accordingly, these temporary regulations eliminate the separation condition of the tacking rule in §1.1502-47(d)(12). These regulations apply to taxable years for which the due date (without extensions) for filing returns is after April 25, 2006.

In addition, this document amends §1.1502-76 to reflect amendments to section 843.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has been determined under 5 U.S.C. 553(b)(B) that notice and public procedure are unnecessary because this Treasury decision merely conforms the regulations to current law. In addition, it has been determined under 5 U.S.C. 553(d)(1)

that a delayed effective date is not required because these regulations relieve affected taxpayers of regulatory restrictions. Accordingly, good cause is found for dispensing with notice and public comment pursuant to 5 U.S.C. 553(b) and with a delayed effective date pursuant to 5 U.S.C. 553(d). For the applicability of the Regulatory Flexibility Act refer to the Special Analyses section of the preamble to the cross-reference notice of proposed rulemaking published in the Proposed Rules section in this issue of the **Federal Register**. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Ross Poulsen, Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.1502-47T also issued under 26 U.S.C. 1502, 1503(c) and 1504(c). * * *
Section 1.1502-76T also issued under 26 U.S.C. 1502. * * *

Par. 2. Section 1.1502-47 is amended by:

1. Revising paragraph (b).
2. Revising paragraph (d)(12)(v).
3. Removing paragraph (d)(14) Example (10) and Example (11).
4. Redesignating paragraph (d)(14) Example (12) through Example (16) as paragraph (d)(14) Example (10) through Example (14).
5. Revising paragraph (d)(14) newly-designated Example (11), Example (13), and Example (14).

The revisions and additions read as follows:

§1.1502-47 Consolidated returns by life-nonlife groups.

* * * * *

(b) Effective dates--(1) General rule. This section is effective for taxable years for which the due date (without extensions) for filing returns is after March 14, 1983, except as provided in paragraph (b)(2) of this section.

(2) [Reserved]. For further guidance, see §1.1502-47T(b)(2).

* * * * *

(d) * * *

(12) * * *

(v) [Reserved]. For further guidance, see §1.1502-47T(d)(12)(v).

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(14) * * *

Example (11). The facts are the same as in Example (10) except that X owns all

of the stock of S₁, L₁, and S₂. In addition, on January 1, 1982, X transfers the stock of S₁ and S₂ to L₁. L₁ is eligible in 1982 under paragraph (d)(12)(iv) of this section. L₁ would still be eligible even if it owned a subsidiary during the base period but sold the subsidiary prior to January 1, 1982. S₁ and S₂ are ineligible in 1982.

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Example (13). The facts are the same as in Example (12) except that S₂ (the first corporation in §1.1502-75(d)(3)) acquires the stock of S₁ in exchange for the stock of S₂. The result is that only S₂, S₁, and L₁ are eligible in 1982.

Example (14). Since 1974, S had owned all of the stock of L₁. L₁ is a large life company. On January 1, 1982, L₁ incorporates L₂ and transfers \$ 40 million in cash and securities to L₂ in a transaction described in section 351(a). On March 1, 1982, L₂ purchases the assets of L₃, an unrelated life company. The purchased assets have a fair market value (without liabilities) of \$ 30 million on March 1, 1982. L₂ is ineligible for 1982 because the tacking rule in §1.1502-47T(d)(12)(v) does not apply. L₂ experienced a disproportionate asset acquisition in 1982. See §1.1502-47T(d)(12)(v)(C).

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Par. 3. Section 1.1502-47T is added to read as follows:

§1.1502-47T Consolidated returns by life-nonlife groups (temporary).

(a) through (b)(1) [Reserved]. For further guidance, see §1.1502-47(a) through (b)(1).

(2) Tacking rule effective dates. (i) In general. The provisions of paragraph (d)(12)(v) of this section apply to taxable years for which the due date (without extensions) for filing returns is after April 25, 2006.

(ii) Prior law. For taxable years for which the due date (without extensions) for filing returns is on or before April 25, 2006, see §1.1502-47 as contained in the 26 CFR part 1 edition revised as of April 1, 2006.

(c) through (d)(12)(iv) [Reserved]. For further guidance, see §1.1502-47(c) through (d)(12)(iv).

(v) Tacking rule. The period during which an old corporation is in existence and a member of the group engaged in active business is included in (or tacks onto) the period for the new corporation if the following four conditions listed in this paragraph (d)(12)(v) are met. For purposes of this paragraph (d)(12)(v) and §1.1502-47(d)(12), a new corporation is a corporation (whether or not newly organized) during the period its eligibility depends upon the tacking rule. The four conditions are as follows:

(A) The first condition is that, at any time, 80 percent or more of the new corporation's assets it acquired (other than in the ordinary course of its trade or business) were acquired from the old corporation in one or more transactions described in section 351(a) or 381(a). This asset test is applied by using the fair market values of assets on the date they were acquired and without regard to liabilities. Assets acquired in the ordinary course of business will be excluded from total assets only if they were acquired after the new corporation became a member of the group (determined without section 1504(b)(2)). In addition, assets that the old corporation acquired from outside the group in transactions not conducted in the ordinary course of its trade or business are not included in the 80 percent (but are included in total assets) if the old corporation acquired those assets within five calendar years before the date of their transfer to the new corporation.

(B) The second condition is that at the end of the taxable year during which the first condition is first met, the old corporation and the new corporation must both have the same tax character. For purposes of this paragraph (d)(12), a corporation's tax character is the section under which it would be taxed (i.e., sections 11, 802, 821, or

831) if it filed a separate return. If the old corporation is not in existence (or adopts a plan of complete liquidation) at the end of that taxable year, this paragraph (d)(12)(v)(B) will apply to the old corporation's taxable year immediately preceding the beginning of the taxable year during which the first condition is first met.

(C) The third condition is that, at the end of the taxable year during which the first condition is first met, the new corporation does not undergo a disproportionate asset acquisition under §1.1502-47(d)(12)(viii).

(D) The fourth condition is that, if there is more than one old corporation, the first two conditions apply to all of the corporations. Thus, the second condition (tax character) must be met by all of the old corporations transferring assets taken into account in meeting the test in paragraph (d)(12)(v)(A) of this section.

(vi) through (s) [Reserved]. For further guidance, see §1.1502-47(d)(12)(vi) through (s).

Par. 4. Section 1.1502-76 is amended by revising paragraph (a) to read as follows:

§1.1502-76 Taxable year of members of group.

(a) [Reserved]. For further guidance, see §1.1502-76T(a).

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Par. 5. Section 1.1502-76T is added to read as follows:

§1.1502-76T Taxable year of members of group (temporary).

(a) Taxable year of members of group. The consolidated return of a group must be filed on the basis of the common parent's taxable year, and each subsidiary must

adopt the common parent's annual accounting period for the first consolidated return year for which the subsidiary's income is includible in the consolidated return. If any member is on a 52-53-week taxable year, the rule of the preceding sentence shall, with the advance consent of the Commissioner, be deemed satisfied if the taxable years of all members of the group end within the same 7-day period. Any request for such consent shall be filed with the Commissioner of Internal Revenue, Washington, DC 20224, not later than the 30th day before the due date (not including extensions of time) for the filing of the consolidated return.

(b) through (c)(3) [Reserved]. For further guidance, see §1.1502-76(b) through (c)(3).

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

Approved: April 12, 2006

Eric Solomon,
Acting Deputy Assistant Secretary of the Treasury (Tax Policy).