

## Internal Revenue Service

Department of the Treasury

Number: **200308034**

Washington, DC 20224

Release Date: 2/21/2003

Index Number: U.I.L. 831.02-00

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Telephone Number:

Refer Reply To:

CC:FIP:4- PLR-144081-02

Date:

November 12, 2002

## LEGEND

Taxpayer:

State A :

Date A:

Year A:

Dear :

This is in reply to your letters dated July 31, 2002 and September 16, 2002, requesting consent to Taxpayer's revocation of its election under section 831(b) of the Internal Revenue Code to be taxed on only its investment income.

Taxpayer is a small mutual insurance company organized under the laws of State A on or around Date A. The principal activity of the Taxpayer is that of a small mutual insurance company selling fire, wind, and inland marine insurance. Taxpayer is subject to federal income tax as an insurance company under section 831. Taxpayer made the section 831(b) election in the first year it was allowed.

Taxpayer's business has changed significantly since Year A. First, State A has been plagued with very unusual weather in the past five or six years. The amount of wind and other weather related claims has dramatically increased. Second, contractors have raised their fees with the increase in properties in need of repair. Third, reinsurers have significantly increased their premiums for Taxpayer, based on past experience. Although the costs of the underwriting business are increasing, the premiums Taxpayer charges its policyholders have remained relatively level due to the highly competitive market.

Section 831(a) of the Code imposes a tax for each taxable year on the taxable income of every insurance company other than a life insurance company.

Section 831(b) provides an alternative tax that applies to an insurance company other than a life insurance company if (i) the company's net written premiums (or, if greater, direct written premiums) for the taxable year exceed \$350,000, but do not exceed \$1,200,000, and (ii) the company elects the application of section 831(b) (the alternative tax) for the taxable year.

Section 831(b)(3) provides that, for purposes of Part II of Subchapter L, except as provided in section 844, a net operating loss (as defined in section 172) shall not be carried (A) to or from any taxable year for which the insurance company is not subject to the tax imposed by section 831(a), or (B) to any taxable year if, between the taxable year from which such loss is being carried and such taxable year, there is an intervening taxable year for which the insurance company was not subject to the tax imposed by section 831(a).

Section 831(b)(2)(A) further provides the following regarding the effect of making the election:

The election ... shall apply to the taxable year for which made and for all subsequent taxable years for which the requirements ... are met. Such an election, once made, may be revoked only with the consent of the Secretary.

The two sentences quoted above from section 831(b)(2)(A) were not in section 831(b), as originally added to the Code by section 1024(a)(4) of the Tax Reform Act of 1986, Pub. L. No. 99-514. These sentences were added to the Code by section 1010(f)(1) of the Technical and Miscellaneous Revenue Act of 1988 (TAMRA), Pub. L. No. 100-647. The change to section 831(b)(2) of the Code was retroactively effective for tax years beginning after December 31, 1986 (the same effective date as applicable to the rest of section 831(b)). See section 1019(a) of TAMRA and section 1024(e) of the Tax Reform Act of 1986.

The Senate Finance Committee offered the following explanation for the two sentences added to section 831(b) by section 1010(f)(1) of TAMRA:

The bill clarifies that the election to be taxed only on investment income, once made and so long as the requirements for the election are met, may be revoked only with the consent of the Secretary. This clarification reflects Congress' intent that the election not be used as a means of eliminating tax liability (e.g., by making the election only for years when the taxpayer does not have net operating losses), but rather as a simplification for small companies.

S. Rep. No. 445, 100<sup>th</sup> Cong., 2d Sess. 127 (1988).

As indicated above, the character of Taxpayer's business has changed significantly in several ways: (1) weather related claims have dramatically increased; (2) repair costs now likewise increased; (3) reinsurance premiums have increased; and (4) due to competition, premiums have necessarily remained level. In view of the foregoing, Taxpayer requests that consent be granted to revoke its section 831(b) election. Taxpayer represents that it will not make an election under section 831(b) to be taxed only on its investment income for any of the first five taxable years following the year to which the consent relates. Taxpayer also represents that it will not claim a net operating loss relating to the years it was subject to section 831(b).

Accordingly, consent is hereby granted to Taxpayer to revoke its section 831(b) election, effective for its 2002 tax year.

No opinion is expressed under other sections of the Code and Income Tax Regulations.

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 the 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 and examination.

A copy of this letter should be attached to the federal income tax returns to be filed by Taxpayer with respect to the taxable year with respect to which consent is granted, and the next succeeding five taxable years.

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

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

Sincerely yours,

/S/

MARK S. SMITH  
Chief, Branch 4  
Office of Associate Chief Counsel  
(Financial Institutions & Products)