

Part I

Section 809.—Reduction in Certain Deductions of Mutual Life Insurance Companies

Rev. Rul. 99-3

ISSUE

Whether a life insurance subsidiary of a mutual holding company is a mutual life insurance company for which the deduction for policyholder dividends is reduced pursuant to sections 808(c)(2) and 809 of the Internal Revenue Code?

FACTS

For valid business reasons, MLIC, a mutual life insurance company, restructures under the law of State X into three separate entities -- a mutual holding company (MHC), a stock holding company (SHC), and a stock life insurance company (SLIC). MHC initially owns all of the stock of SHC, which owns all the stock of SLIC. MLIC and SLIC are life insurance companies as defined in section 816(a) of the Code. Neither MHC nor SHC is an insurance company for federal income tax purposes.

In connection with the restructuring, the policyholders' interests as members of MLIC are replaced by memberships in MHC. The policyholders' contractual rights as customers of MLIC remain with the reorganized life insurance company (SLIC).

SHC or SLIC may issue stock to unrelated persons. However, MHC must at all times

own at least a majority of the voting shares of SHC, which must at all times own at least a majority of the voting shares of SLIC. Throughout SLIC's first taxable year following the reorganization, MHC continues to own all the stock of SHC, which owns all the stock of SLIC.

The restructuring is entered into for valid business reasons, such as providing the resulting entities with flexibility to raise capital in subsequent years through the issuance of stock by SHC or SLIC.

ANALYSIS

Sections 801 through 818 of the Code (Subchapter L, Part I) provide rules that govern the taxation of life insurance companies. Section 801(a)(1) imposes a tax “on the life insurance company taxable income of every life insurance company.” Section 801(b) defines “life insurance taxable income” as “life insurance gross income, reduced by life insurance deductions.” “Life insurance gross income” is comprised of (1) premiums, (2) decreases in certain reserves, and (3) other amounts. Section 803(a). “Life insurance deductions” include “the general deductions provided in section 805.” Section 804. Among the general deductions allowed by section 805 is “the deduction for policyholder dividends (determined under section 808(c)).” Section 805(a)(3).

Section 808(c) provides as follows:

(c) Amount of deduction.--

(1) In general.-- Except as limited by paragraph (2), the deduction for policyholder dividends for any taxable year shall be an amount equal to the policyholder dividends paid or accrued during the taxable year.

(2) Reduction in case of mutual companies.-- In the case of a mutual life insurance company, the deduction for policyholder dividends for any taxable year shall be reduced

by the amount determined under section 809.

See also section 809(a)(1).

Section 809 identifies the nondeductible portion of policyholder dividends issued by mutual companies to their policyholders as the owners of the company. In American Mutual Life Ins. Co. v. United States, 43 F.3d 1172, 1173 (8th Cir. 1994), cert. denied, 516 U.S. 930 (1995), the court explained the provision as follows:

Section 809 is an attempt to isolate the taxable component of dividends that mutual life insurance companies ... make to their policyholders. Mutual life insurance companies make dividends to their policyholders that contain both taxable and untaxable components. The taxable component is the distribution of earnings to owners; the untaxable component consists of price rebates to customers. The dividend that mutual life insurance policyholders receive is not easily broken into its components because mutual life insurance companies do not have separate groups of stockholder owners and policyholding customers. The customers own the company. By contrast, stock life insurance companies pay earnings to stockholders as nondeductible dividends, and refunds to their insurance policyholders as deductible price rebates.

Similar explanations of section 809 can be found in Indianapolis Life Ins. Co. v. United States, 115 F.3d 430, 431 (7th Cir. 1997); CUNA Mutual Life Ins. Co. v. United States, 39 Fed. Cl. 660, 661 (1997); and Pan American Life Ins. Co. v. United States, Civil No. 96-343 (E.D. La. 1997).

Except as otherwise provided in section 809(h) (relating to stock life insurance subsidiaries of mutual life insurance companies), section 809 by its terms applies only to mutual life insurance companies. Subsidiaries of mutual life insurance companies are generally treated as

stock life insurance companies in computing the subsidiaries' entity level income tax liability.

H.R. Rep. No. 432 (Pt.2), 98th Cong., 2d Sess., 1425-26 (1984); S. Prt. No. 169 (Vol. 1), 98th Cong., 2d Sess., 553 (1984) .

Neither the Code nor the Income Tax Regulations define the term “mutual life insurance company.” In Pan American Life Ins. Co., the only case interpreting “mutual life insurance company” for purposes of section 809, the court determined that the critical feature distinguishing stock and mutual life insurance companies is that “mutual companies do not have stockholders.”

In the present case, throughout SLIC's first taxable year following the reorganization, MHC owns all the stock of SHC, which owns all the stock of SLIC. As ownership of SLIC is evidenced not by membership interests on the part of its policyholders, but by stock owned by SHC, SLIC is not a mutual life insurance company for purposes of section 809.

CONCLUSION

In determining its life insurance company taxable income for the first taxable year following the reorganization, SLIC is not a mutual life insurance company for which the deduction for policyholder dividends is reduced pursuant to sections 808(c)(2) and 809 of the Code. This conclusion would apply to subsequent taxable years if SLIC continues to be a subsidiary of a mutual holding company or other corporation. This conclusion also would apply if MHC, not SHC, owned all of the stock of SLIC.

CONTACT INFORMATION

For information regarding this revenue ruling, contact Branch 4 of the Office of Assistant Chief Counsel (Financial Institutions & Products) at (202) 622-3970 (not a toll-free call).