Tax Accounting

By James E. Salles

In this month's issue:

- Revenue Ruling 2003-3[1] concludes that tax refunds accrue on approval of the taxpayer's claim.
- Revenue Ruling 2003-10[2] applies the "all events" test to customer disputes involving the sale of goods.
- Three new rulings[3] address captive insurance issues.
- Notice 2003-12[4] provides interim guidance under section 448(d)(5), which describes the "nonaccrual experience" method of accounting for service receivables.
- Finally, the section 446 regulations are amended to expressly provide that application of the post-1995 intercompany transaction rules is an accounting method.[5]

State Tax Refunds Accrue When Approved

In Revenue Ruling 2003-3,[6] the IRS addresses the complicated precedents involving the accrual of deductible taxes and backtracks from its former position that an accrual taxpayer may be required to report an expected refund before it is approved.

Background

In general, whether the "all events" test for income or a deduction is met is determined based upon the information that is "known or knowable" as of the end of the year.[7] This means, for example, that income from Medicaid billings[8] or a deduction for state income taxes[9] must be reported in the year in which the events that fix the calculation occur, even though it may not be practically possible to immediately compute the exact amount. While the regulations provide that taxpayers may deduct a "reasonably accurate" estimate of the liability and take the difference into account when the exact amount is determined,[10] the estimate must be based on the best information available as of the end of the year.[11] If the income or liability can be correctly computed based on available information in the year in which it accrues, then that figure must be used. If the calculation is later discovered to be wrong, any correction will "relate back" to the year that the item was originally taken into account.

Neither income nor deductions, however, will accrue to the extent that their computation depends on a factor not fixed by year end[12] or is otherwise affected by later events.[13] Likewise, rights to income[14] or liabilities[15] will not accrue to the extent they are contested.

Tax Deficiencies and Interest

These principles apply to deductible taxes as to other types of liabilities. A series of court cases held that undisputed adjustments to state taxes on audit "related back" to the year of the original deduction.[16] Revenue Ruling 75-562[17] applied the same principles to various scenarios involving Customs duties.

Since taxes that are contested at the end of the year will not "relate back," it is important to determine whether (and when[18]) a contest has arisen. Two revenue rulings under the accumulated earnings tax, which allows a deduction for "regular" federal taxes,[19] concluded that the question of whether there was a contest depended on whether the taxpayer filed an administrative protest. If the increased taxes were agreed to at the examination level, the "relation back" principle would apply and the additional deduction would be allowed for the year in which the liability arose.[20] However, if the taxpayer filed a protest, the deduction would only become allowable when the contest was resolved.[21] The same principles apply to state income taxes and

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other taxes that are deducted in computing the "regular" federal tax, although in many cases the economic performance rules now make "relation back" irrelevent because economic performance does not take place until the taxes are paid.

The IRS's published position on deficiency interest has not been entirely consistent with its position on deductible taxes. A staccato sentence in a 1970 ruling,[22] restating a 1931 ruling that was explicitly based on administrative convenience,[23] states that interest on federal tax deficiencies that arise on audit may be deducted when the audit is over, if the taxpayer does not further contest liability. Taxpayers have argued that if the tax principal is related back to the year of the initial accrual, then the associated interest should be deducted over the intervening period as it accrues.[24]

Moreover, as a taxpayer may deduct part of a liability while contesting the rest,[25] taxpayers have argued that if the taxpayer concedes that at least *some* additional tax is due following an audit, then the interest on the portion of the tax that is not protested should "relate back" and be deducted in the years in which it accrued.

In two recent cases,[26] the Tax Court seemed to acknowledge the principle behind the taxpayers' argument[27] but found for the government on the facts. Both involved complex, multi-year audits that made it difficult to isolate a portion of the liability that was "conceded" before the whole case was settled. The Service has taken a similar tack in letter rulings, relying on the taxpayer's failure to demonstrate that any particular portion of its liability was uncontested in denying deductions before final settlement.[28]

Tax Refunds

Similar questions have also arisen about whether or how the "relation back" principle should apply when a taxpayer has overpaid a deductible tax and then files for a refund. If a refund is ultimately paid, should the taxpayer have to reduce its original deduction (and presumably accrue refund interest during the period over which it was earned)? There is an additional element in the analysis because while whether a taxpayer contests an assertion of additional tax liability is up to the taxpayer, once the tax is paid, allowance of a refund depends on the actions of government officials. Normally, rights to income (including, for this purpose, the return of amounts paid) do not accrue while they remain dependent on the actions of third parties.

Early cases held that interest on federal tax overpayments did not "relate back," because approval of the refund was a statutory prerequisite to the allowance of interest.[29] The IRS eventually agreed, and in Revenue Ruling 62-160,[30] concluded that refund interest accrued only when the government allowed the taxpayer's claim.

In Revenue Ruling 65-190,[31] however, the IRS ruled that a state refund attributable to a loss carryback accrued in the year of the loss, rather than in the following year when the taxpayer applied for and obtained the refund. Revenue Ruling 69-372[32] reached the same conclusion as to a "tentative" refund of state tax similar to those under section 6411. The IRS's reasoning in both instances was that "all events" determining the right to a refund became fixed when the taxpayer incurred the loss, and that the state's later allowance of the claim was "ministerial." Similarly, Revenue Ruling 73-385[33] held that a refund of state sales taxes accrued when the state first "took affirmative action to process" similar refunds, because the later processing of each taxpayer's individual claim was "ministerial."

The Tax Court has not agreed that the processing of a refund claim (at least one filed under normal procedures) is ministerial. In *Doyle, Dane, Bernbach, Inc. v. Commissioner*,[34] the court held that the taxpayer's claimed refunds of New York State and City taxes from carrying back a loss did not accrue "until the year the right to these refunds [was] ultimately determined." The court acknowledged that a merely "ministerial" requirement would not stand in the way of an accrual of income. However, it found the IRS "arbitrary" in essentially assuming the outcome of any state or city investigation of the taxpayer's claim, in contrast to its treatment of the federal refund claims in Revenue Ruling 62-160. That the claims stemmed from loss carrybacks was unimportant under the court's analysis. Any refund claim would have to be approved by the tax authorities, and the taxpayer's rights would remain contingent until that happened.

The Tax Court later followed *Doyle, Dane* on similar facts in *Yapp Corporation v. Commissioner*,[35] and indeed held the IRS's contrary position not "substantially justified."[36] However, the IRS has stuck by its published non-acquiescence and continued to maintain that refunds attributable to carrybacks "relate back" to the loss year. It was uncertain whether the IRS might try to extend the same logic to argue that an uncontested refund that is not attributable to a carryback reduces the original deduction, similar to the rule for deficiencies. On the other hand, it was not wholly clear that the Tax Court's holding—that the taxpayers' rights remained contingent until the tax authorities approved—would necessarily extend to accelerated "tentative" refunds subject only to a limited review before payment.

Revenue Ruling 2003-3

The IRS has now reversed course. Revenue Ruling 2003-3 involves a corporation that filed for refund of New York state franchise taxes based on a loss carryback from 2001. The claim was filed in 2002 and allowed in 2003. The IRS concluded that the tax refund does not accrue until 2003, when the taxpayer received notice of approval of its claim. An IRS "action on decision" released a few days later formally acquiesces in the Tax Court's holding in *Doyle, Dane*.[37]

The drafters seem to have intended to resolve the whole issue about refunds. Revenue Ruling 2003-3 expressly revokes not only Revenue Ruling 65-190 but also Revenue Ruling 69-372, which involved "tentative" refund claims. Revenue Ruling 73-385 survived, but probably because, as a recent private ruling noted, that ruling "expressly states that the furnishing of the evidence required by the Virginia tax authority was merely an administrative procedure so that the claims [which the state had already decided to allow] could be processed."[38] The case law, and the IRS' new position, indicate that—outside of unusual circumstances like those present in Revenue Ruling 73-385—no refund claims will "relate back" to affect the original deduction or require the taxpayer to accrue refund interest as it is earned. The principal amount of the tax and any accumulated refund interest will accrue when the taxpayer receives notice of allowance, or equivalent settlement documents following an audit.

"All Events" Test Applied to Sales of Goods

The burst of year-end administrative guidance included another ruling that applies the "all events" test to different scenarios involving the sale of goods; as discussed above, whether a taxpayer's income or deductions are "fixed," and their amounts are determined based upon the information "known or knowable" as of the end of the year. Rights to income, or liabilities, will not accrue to the extent that they are contested. A contest that first arises after the end of the year in which the income or deduction otherwise accrues, however, will not affect the accrual.[39] Revenue Ruling 2003-10[40] applies these principles in three different sets of facts.

In the first scenario, the taxpayer shipped the goods that its customer ordered but mistakenly invoiced them for $16,000 rather than $15,000. The mistake was not corrected until after the end of the year. The taxpayer properly accrued $15,000, which was the amount it was owed based upon the facts as they stood at the end of the year. That it had miscomputed the amount in issuing the initial invoice was irrelevant. However, the ruling notes, if the taxpayer followed a consistent practice of always accruing based upon the invoice amount, then it would be obliged to follow its established method of accounting and accrue $16,000 unless it applied for permission to change.

In the second scenario, the taxpayer shipped the wrong goods. The customer discovered the error and disputed the amount due before the end of the year. After the end of the year, the customer agreed to accept the goods shipped in error at half the invoice price. The ruling held that the taxpayer should not accrue any income during the year of shipment because the customer disputed the entire invoice. When the dispute settled, the taxpayer would accrue the amount that the customer agreed to pay.

In the final scenario, the taxpayer shipped the wrong quantities of goods, but (apparently) invoiced properly for the goods actually shipped. When the error was discovered the following year, the parties agreed that the customer would accept the goods shipped and that the quantities of a later shipment would be adjusted. The taxpayer would properly accrue the invoiced amount; that was what it had actually earned based on the goods shipped, and the customer ultimately agreed to pay.

The IRS also requested comments on other scenarios, including what would happen if the products shipped were defective but the defect was not actually discovered until after the end of the year. Would the taxpayer have to accrue the invoiced amount because the dispute did not arise until the following year? Or would the income not accrue because the taxpayer would never actually have had a right to be paid for defective goods (regardless of whether it thought it would have one)?

Captive Insurance: The Other Shoe Drops

Background

The "captive insurance" issue has a rather involved history, which is presented at length in an earlier column.[41] Since the Supreme Court observed in *Helvering v. LeGierse*[42] that "insurance involves risk-shifting and risk-distributing," courts have focused on these concepts in determining whether a contract is to be respected as "insurance" for tax purposes. The Supreme Court may not have meant to distinguish between the two concepts, and half a century or more of judicial gloss have left both rather slippery.

The modern authorities begin in the 1970s, when the IRS refined its views and emerged with the position that a contract of "insurance" must provide:

- "risk-shifting" to an unrelated party (an insurer outside the insured's "economic family"); and
- "risk-distribution," meaning a sufficient sharing of different risks among the insured that the arrangement constitutes insurance rather than just a funded reserve.[43]

The IRS ran into consistent trouble in the courts on both fronts. Somewhat simplified, one line of cases held that it was possible for a taxpayer to insure with its own corporate sibling, even if that sibling were a "captive" serving only its own affiliates, but left uncertain whether a corporate parent could ever insure with its own subsidiary.[44] The other major line of authorities, mostly developed in the Tax Court, held that a parent could insure with its own subsidiary if that subsidiary did substantial business outside the group, but left it doubtful whether insuring other affiliates could qualify, at least if they were also direct or remote subsidiaries of the insured.[45] In the end, the IRS formally threw in the towel in Revenue Ruling 2001-31.[46]

The New Rulings

Revenue Ruling 2001-31 marked the death of the "economic family" theory but left vague what would supplant it. By this time, private rulings were consistently conceding "sibling" cases, including some in which the insurance affiliate's activities apparently were confined to members of its corporate group. However, the new IRS position concerning parent-subsidiary insurance in particular remained uncertain. Revenue Ruling 2001-31 left two basic options. One would have been to continue to argue that a parent could never insure with its own subsidiaries, accepting the first line of cases but continuing to resist the second. Alternatively, the IRS could accept that parents could sometimes insure with their own subsidiaries, but adopt the Tax Court's requirement that the corporation do "substantial" business outside the group. The latter would leave it with the task of defining what constituted "substantial" outside business and what activities would qualify as such.

The IRS has chosen the second course, establishing what amounts to a "safe harbor" for dealing with an insurance subsidiary. The new rulings also confirm that the IRS will not challenge taxpayers' deductions in the ordinary "sibling" case merely because of the parties' relationship and liberalize an existing ruling involving unrelated insureds that club together to establish a captive to insure common risks.

• Revenue Ruling 2002-89[47] addresses two fact patterns involving a parent insuring with its subsidiary. The subsidiary also insures similar risks for other parties. In the first fact pattern, the relationship accounts for 90 percent of the subsidiary's premiums paid and risks insured. In the second, the corresponding percentage is less than 50 percent. The ruling concludes that the first arrangement lacks the necessary risk shifting and risk distribution to be recognized as insurance for tax purposes. However, the second arrangement meets the standard for "insurance in the commonly accepted sense."

• In Revenue Ruling 2002-90[48] 12 corporate siblings insure with another subsidiary of the same parent. The ruling specifies that each subsidiary accounts for no less than 5 percent and no more than 15 percent of the subsidiary's risks. The ruling stated that the arrangements provided substantial risk shifting and risk distribution because each subsidiary's covered loss would be "borne, in substantial part, by the premiums paid by others," and that the insurer and insureds' common ownership did not affect the status of the arrangements as insurance.

• Finally, Revenue Ruling 2002-91[49] involves a "group captive" formed by a small group of unrelated businesses involved in a highly concentrated industry. Again, it is specified that no one participant owns more than 15 percent of the group captive or accounts for more than 15 percent of its insured risks. The ruling concludes that the contracts are insurance and the captive an insurance company. Revenue Ruling 2002-91 represents a liberalization of Revenue Ruling 78-338,[50] which involved a similar fact pattern except that there were 31 insureds and each one was limited to 5 percent of the risks.

Outlook

These rulings represent a significant step forward, although more insight into the IRS's reasoning would have been helpful. For example, given that Revenue Ruling 2002-89 allows a parent to account for up to 50 percent of its subsidiary's earned premiums (and the case law suggests even higher percentages[51]), why are the corporate siblings in Revenue Ruling 2002-90 and even the unrelated parties in Revenue Ruling 2002-91 limited to 15 percent? Nor does Revenue Ruling 2002-89 specify how many unrelated parties must make up the "other" 50 percent, although the reader is left with the impression of a broad customer base.

One way the IRS might approach designing a common safe harbor might be to require, as to any particular insured, a minimum 50 percent threshold of "outside" business. The insured's direct or remote subsidiaries would not count (although its siblings would). Finally, a minimum number of such outside participants (a dozen?) would be required. The IRS's thinking may not have yet reached that stage. The new rulings should, however, put to bed most of the conceptual disputes of the past.

Remaining "Pressure Points"

Assuming that a captive insurance arrangement passes muster under the rulings, what points of contention are likely to remain in any audit? The rulings suggest some answers, some obvious, and some less so.

• The rulings all assume that the insurance company is adequately capitalized. Revenue Rulings 2002-89 and 2002-90 specify that there are no guarantees by or loans to related insureds or their affiliates, and it may also be significant that both insurers are described as domestic entities. Finally, Revenue Ruling 2002-90, like Revenue Ruling 2001-31, pointedly cites *Malone & Hyde, Inc. v. Commissioner*,[52] which held an insurance scheme lacked substance when the purported insurer was an offshore shell. The IRS is clearly reserving the right to raise challenges on "economic substance" grounds in appropriate cases.

• Another potential ground for challenge may be hinted at by the reference in both Revenue Ruling 2002-89 and Revenue Ruling 2002-90 to "homogeneous" risks.[53] The drafters may be thinking of situations in which unrelated lines of insurance business are arbitrarily combined in one entity so as to apparently meet the rulings' thresholds.

• Historically, "retrospective" premium arrangements, under which the insured's premiums are adjusted to reflect claims history over the covered period, have been respected as insurance.[54] However, some such arrangements border on "self-insurance," in which the insured is really paying for administrative services and (if the scheme works) an accelerated deduction.[55] Revenue Ruling 2002-90 observes that "[r]isk distribution necessarily entails a pooling of premiums, so that a potential insured is not in significant part paying for its own risks," and Revenue Ruling 2002-91 specifies that no member has to pay additional premiums, or be entitled to a refund, based on claims history. These may be signals that the IRS is shifting focus from the relationship among the parties to the terms of the arrangement.

• Finally, both of the rulings involving related parties specify that the parties are dealing at arm's length and according to "customary industry rating formulas."[56] As the IRS recently explicitly cautioned in a similar context,[57] section 482 and other remedies remain available to ensure that income is attributed properly among related taxpayers.

Interim Rules Under "Nonaccrual Experience" Method

On January 22, the IRS released Notice 2003-12,[58] providing interim guidance under the "nonaccrual experience method" of accounting under section 448(d)(5), as amended in 2002.[59] Pending final regulations, the Notice is effective for taxable years ending after March 9, 2002.

Background

As discussed in an earlier column,[60] the nonaccrual experience method allows eligible taxpayers to avoid accruing income which, based on experience, will not be collected. Before the 2002 amendments, the excludable percentage of a taxpayer's receivables was determined under temporary regulations dating from 1988.[61] These regulations determined the percentage by comparing bad debts to total receipts, rather than to year-end receivables, as under the "*Black Motor* formula"[62] traditionally used in computing bad-debt reserves before the Tax Reform Act of 1986. Taxpayers argued that the regulations substantially underestimated nonperforming receivables, but the Tax Court upheld their validity in *Hospital Corporation of America v. Commissioner*.[63]

The 2002 amendments were both pro- and anti-taxpayer. On the one hand, taxpayers will no longer be able to use the "nonaccrual experience method" unless they provide "qualified" (generally meaning professional) personal services or have gross receipts of $5 million or less. Taxpayers required to use full-fledged accrual accounting under section 448 will generally no longer be eligible to use the nonaccrual experience method.[64] Even subchapter "S" corporations and partnerships, which are mostly outside the scope of section 448, will not be allowed to use the method unless they meet one of these exceptions.

On the other hand, new section 448(d)(5)(C) provides that "[t]he Secretary shall prescribe regulations to permit taxpayers to determine [excludable amounts] using computations or formulas which, based on experience, accurately reflect the amount of income that will not be collected." The drafters seem to have contemplated something close to the *Black Motor* formula for which the taxpayer unsuccessfully argued in *Hospital Corporation of America*.[65]

New Methods Provided

The Notice allows taxpayers using the "nonaccrual experience method" three basic choices in calculating excludable receivables.

• Taxpayers may follow the 1988 temporary regulations.

• Alternatively, taxpayers may use an "actual experience method" based on comparing charge-offs to receivables outstanding at the beginning of each year over a test period (normally three years). This new method is likely to be popular, although the recordkeeping burden may be substantial for some, because taxpayers do not merely compare bad-debt expense with receivables balances, but must trace the particular outstanding receivables that have been written off.

• Finally, taxpayers may use any "alternative NAE method," provided that the amount excluded does not exceed the amount excludable under the "actual experience method." The cumulative amounts excluded are tested in the first year and over successive three-year periods.[66]

Automatic consent procedures are provided both for taxpayers that no longer qualify for the nonaccrual experience method under the new law, and for taxpayers changing to, or between, the methods outlined in the Notice.[67]

Intercompany Transactions Establish Accounting Method

Treasury and the IRS have tied up another loose end by amending the regulations under section 446 to provide that the special timing rules for transactions among members of a consolidated group ("intercompany transactions") are a method of accounting.[68] These amendments, which follow proposed regulations released in November, 2001,[69] are intended to drive the last nail in the coffin of the Tax Court's 1999 decision in *General Motors v. Commissioner*,[70] which held that an earlier version of the consolidated return regulations governing intercompany transactions did not establish an accounting method. The relevant consolidated return regulations were substantially rewritten in 1995, after the years at issue in *General Motors*,[71] and now expressly state that the prescribed treatment represents an accounting method.[72] However, for further support, the new amendment adds a similar statement under section 446 as well.[73]

1. 2003-2 I.R.B. 252.

2. 2003-3 I.R.B. 288.

3. Rev. Rul. 2002-89, 2002-52 I.R.B. 984; Rev. Rul. 2002-90, 2003-2 I.R.B. 985; Rev. Rul. 2002-91, 2003-2 I.R.B. 991.

4. 2003-6 I.R.B. 422.

5. T.D. 9025, 67 Fed. Reg. 76985 (Dec. 16, 2002), 2003-5 I.R.B. 362, amending Reg. § 1.446-1(c)(2)(iii).

6. 2003-2 I.R.B. 252.

7. *E.g., H.L.S. Excavating v. Commissioner*, 44 T.C.M. (CCH) 732, 734 (1982).

8. Rev. Rul. 81-176, 1981-2 C.B. 112.

9. *E.g., Uncasville Manufacturing Co. v. Commissioner*, 55 F.2d 893, 895 (2d Cir.), *cert. denied*, 286 U.S. 545 (1932) (liability "unknown, [but] not unknowable" at year end).

10. Reg. § 1.461-1(a)(2).

11. *Chicago, Burlington & Quincy Railroad Co. v. United States*, 455 F.2d 993, 1018-19 (Ct. Cl. 1972), *rev'd and rem'd on another issue*, 412 U.S. 401 (1973); *see also, e.g.*, Gen. Couns. Mem. 36365 (Aug. 8, 1975).

12. *E.g.*, Rev. Rul. 82-174, 1982-2 C.B. 99; Gen. Couns. Mem. 38901 (Feb. 12, 1982) at n.2 (deductible windfall profit tax).

13. *E.g., United States v. Delta Air Lines*, 255 F.2d 501 (5th Cir. 1958); *cf. Lucas v. Ox Fibre Brush Co.*, 281 U.S. 115, 120 (1930) (resolution authorizing bonus for past performance cannot create "retroactive" deduction).

14. *E.g., Swastika Oil & Gas Co. v. Commissioner*, 123 F.2d 382 (6th Cir. 1941), *cert. denied*, 317 U.S. 639 (1942); *Brutsche v. Commissioner*, 65 T.C. 1034, 1059-61 (1976), *rem'd on another issue*, 585 F.2d 436 (10th Cir. 1978).

15. *E.g., Dixie Pine Products Co. v. Commissioner*, 320 U.S. 516 (1944); *see* Reg. § 1.461-2.

16. *E.g., H.E. Harman Coal Corp. v. Commissioner*, 16 T.C. 787, 803-04 (1951), *aff'd and rev'd on other issues*, 200 F.2d 415 (4th Cir. 1952); *Standard Paving Co. v. Commissioner*, 13 T.C. 425, 447-48 (1949), *aff'd on other issues*, 190 F.2d 330 (10th Cir.), *cert. denied*, 342 U.S. 860 (1951), and authorities cited.

17. 1975-2 C.B. 197.

18. *Compare* Rev. Rul. 75-562, situation (3), *with Japanese Trading Co. v. Commissioner*, 25 T.C.M. (CCH) 441 (1966).

19. The same "all events" principles apply as to other deductions. Reg. §§ 1.535-2(a)(1), 1.545-2(a)(1).

20. Rev. Rul. 68-632, 1968-2 C.B. 253.

21. Rev. Rul. 72-306, 1972-1 C.B. 165.

22. Rev. Rul. 70-560, 1970-2 C.B. 37.

23. G.C.M. 9575, X-1 C.B. 381 (1931).

24. *Cf. Clark v. Commissioner*, 266 F.2d 698, 714-15 (9th Cir. 1959); *Stark v. Commissioner*, 29 T.C. 122 (1957), *nonacq. on other grounds*, 1961-2 C.B. 6.

25. *See* Regs. § 1.461-1(a)(2)(ii), -2(a)(4) (Ex. (2)).

26. *Exxon Corp. v. Commissioner*, 78 T.C.M. (CCH) 165 (1999); *Phillips Petroleum Co. v. Commissioner*, 61 T.C.M. (CCH) 2836, 2843-45 (1991).

27. *See also H.E. Fletcher Co. v. Commissioner*, 10 T.C.M. (CCH) 1025, 1028 (1951).

28. *See* ILM 200236007 (May 23, 2002).

29. *Pacific Coast Biscuit Co. v. Commissioner*, 32 B.T.A. 39, 43-45 (1935) (reviewed), *acq. on this issue*, 1962-2 C.B. 5; *Household Products, Inc. v. Commissioner*, 24 B.T.A. 594 (1932), *nonacq.* XI-1 C.B. 9 (1932), *nonacq. withdrawn and acq. substituted*, 1962-2 C.B. 4; *see also American Enka Corp. v. Commissioner*, 30 T.C. 684, 695-97 (1958).

30. 1962-2 C.B. 139.

31. 1965-2 C.B. 150.

32. 1969-2 C.B. 104.

33. 1973-2 C.B. 151.

34. 79 T.C. 101, 105-07 (1982), *nonacq.* 1988-2 C.B. 1.

35. 63 T.C.M. (CCH) 3155 (1992).

36. *Yapp Corporation v. Commissioner*, 66 T.C.M. (CCH) 180 (1993).

37. AOD, CC-2003-01.

38. CCA 200211043 (Feb. 5, 2002).

39. *E.g., Globe Products Corp. v. Commissioner*, 72 T.C. 609 (1979), *acq.* 1980-2 C.B. 1 (deduction accrued when taxpayer settled case unaware of facts that established an ultimately successful statute of limitations defense); Rev. Rul. 2003-10, 2003-3 I.R.B. 288; Rev. Rul. 67-127, 1967-1 C.B. 113.

40. 2003-3 I.R.B. 288.

41. J. Salles, "Tax Accounting," 2(12) *Corp. Bus. Tax'n Monthly* 27 (Sept. 2001).

42. 312 U.S. 531, 539 (1941).

43. Rev. Rul. 77-316, 1977-2 C.B. 53.

44. *E.g., Humana, Inc. v. Commissioner*, 881 F.2d 247 (6th Cir. 1989); *Kidde Industries v. United States*, 40 Fed. Cl. 42 (1997).

45. *Ocean Drilling & Exploration Co. v. United States*, 24 Cl. Ct. 714 (1991), *aff'd*, 988 F.2d 1135 (Fed. Cir. 1993); *AMERCO v. Commissioner*, 96 T.C. 18 (1991) (reviewed), *aff'd*, 979 F.2d 162 (9th Cir. 1992); *Harper Group v. Commissioner*, 96 T.C. 45 (1991), *aff'd*, 979 F.2d 1341 (9th Cir. 1992); *Sears, Roebuck & Co. v. Commissioner*, 96 T.C. 61 (1991), *aff'd on this issue, rev'd and rem'd on another*, 972 F.2d 858 (7th Cir. 1992); *see also* Raby & Raby, "Captive Insurance—Some Lights in the Fog," 97 Tax Notes 1711, 1712 (Dec. 30, 2002) (30 percent "likely sufficient").

46. 2001-1 C.B. 1348.

47. 2002-52 I.R.B. 984.

48. 2002-52 I.R.B. 985.

49. 2002-52 I.R.B. 991.

50. 1978-2 C.B. 107.

51. *See, e.g., Ocean Drilling & Exploration Co. v. United States*, 24 Cl. Ct. 714, 728 (1991), *aff'd per curiam*, 988 F.2d 1135 (Fed. Cir. 1993) (44 to 66 percent unrelated); *Harper Group v. Commissioner*, 96 T.C. 45, 60 n.10 (1991), *aff'd*, 979 F.2d 1341 (9th Cir. 1992) (30 percent of receipts from wholly outside the group sufficed).

52. 62 F.3d 835 (6th Cir. 1995).

53. Rev. Rul. 2002-89, 2002-52 I.R.B. at 984 ("The risks of unrelated entities and those of *P* are homogeneous"); Rev. Rul. 2002-90, 2002-52 I.R.B. at 985 ("Together, the 12 subsidiaries have asignificant volume of independent, homogeneous risks").

54. *See, e.g.*, Rev. Rul. 83-66, 1983-1 C.B. 43.

55. *Cf. Steere Tank Lines v. United States*, 577 F.2d 279 (5th Cir. 1978), *cert. denied*, 440 U.S. 946 (1979).

56. Rev. Rul. 2002-89, 2002-52 I.R.B. at 984; Rev. Rul. 2002-90, 2002-52 I.R.B. at 985.

57. Notice 2002-70, 2002-44 I.R.B. 765.

58. 2003-6 I.R.B. 422.

59. I.R.C. § 448(d)(5), *as amended by* Job Creation and Worker Protection Act of 2002, Pub. L. No. 107-127, § 403(a).

60. J. Salles, "Tax Accounting," 3(11) *Corp. Bus. Tax'n Monthly* 28 (Aug. 2002).

61. Reg. § 1.448-2T(e).

62. *See Black Motor Co. v. Commissioner*, 41 B.T.A. 300, 302 (1940), *aff'd on other issues*, 125 F.2d 977 (6th Cir. 1942).

63. 107 T.C. 116 (1996).

64. *Compare* I.R.C. § 448(d)(5)(A), *as amended by* Pub. L. No. 107-147, § 403(a), *with* I.R.C. § 448(b).

65. *See* Joint Committee Technical Explanation of the Job Creation and Worker Assistance Act of 2002 (JCS-12-02, March 6, 2002) at 30-31.

66. Notice 2003-13, § 3.02-.03.

67. Notice 2003-13, § 5.

68. T.D. 9025, 67 Fed. Reg. 76985 (Dec. 16, 2002), 2003-5 I.R.B. 362.

69. REG-125161-01, 2001-2 C.B. 538, discussed in J. Salles, "Tax Accounting," 3(4) Corp. Bus. Tax'n Monthly 34, 37-38 (January, 2002).

70. 112 T.C. 270 (1999).

71. Reg. § 1.1502-13, T.D. 8597, 1995-2 C.B. 147.

72. Reg. § 1.1502-13(a)(3)(i).

73. Reg. § 1.446-1(c)(2)(iii), *as added by* T.D. 9025.