Tax Accounting

BY JAMES E. SALLES

This month's column discusses Revenue Ruling 2001-31,[1] in which the IRS signaled a new approach to related insurance affiliates (so-called "captive" insurers), and abandoned the "economic family" doctrine that it had followed since the 1970s.

INTRODUCTION

The IRS has long contended that insurance contracts between closely related parties should not be respected for tax purposes because there is no real shifting of risk, but its success in enforcing this so-called "economic family" doctrine has been mixed. A subsidiary that "insures" its parent and no one else is essentially a sinking fund dressed up in corporate trappings and is treated accordingly. Courts will also follow substance over form if the parties enter into guarantees or side agreements that nullify the shifting of risk or if the purported insurer is inadequately capitalized. Otherwise, however, most courts respect "captive" insurers' dealings with affiliates outside their direct chain of ownership. Some decisions even respect parents' insurance of risks with their wholly-owned subsidiaries so long as the subsidiary is a "real" insurance company with "substantial" outside dealings.

There have been numerous signals for some time that the IRS was rethinking its position, and in Revenue Ruling 2001-31, released June 5, it formally abandoned the "economic family" doctrine. The ruling, however, provides little insight into the IRS' new position beyond a cryptic statement that "captive" insurance arrangements may still be challenged "based on the facts and circumstances of each case." Filling in the blanks requires familiarity both with the basic principles that govern when "insurance" exists for tax purposes and with the fairly extensive case law that has grown up in the past twenty years specifically concerning "captive" insurance affiliates.

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"Insurance" Defined

The Supreme Court taught us in *Commissioner v. Lincoln Savings & Loan* [2] that expenditures to "create or enhance" a "separate and distinct asset" are never deductible. A fund to pay the taxpayer's future expenses is a classic case of a "separate and distinct asset." Long before *Lincoln Savings*, courts held that taxpayers could not get around the prohibition on deducting contingent liabilities[3] by setting up a sinking fund or trust to provide for the liability.[4] One relatively recent case illustrating this principle is *Anesthesia Services Medical Group v. Commissioner*,[5] denying a medical practice deductions for payments to a trust to provide for members' malpractice liabilities (for which the taxpayer would have been secondarily liable). Insurance premiums, however, *can* be deducted, even though an insurance company basically operates a large common fund for its subscribers' benefit.

This contrast in treatment naturally puts the spotlight on the definition of "insurance." In *Helvering v. LeGierse*,[6] an ailing 80-year-old woman paid an insurance company approximately $23,000 for a life insurance policy providing a death benefit of $25,000, and a further $4,000 for a lifetime annuity. She was excused the usual medical underwriting requirements, but had she not agreed to buy the annuity policy, she could not have obtained life insurance at all. She died a few weeks afterwards, and the issue before the court was whether the $25,000 in proceeds qualified for an estate tax exclusion for "amount[s] receivable . . . as insurance."

The Supreme Court observed that while "insurance involves risk-shifting and risk-distributing," in this case the life insurance contract and the annuity contract had each "neutralize[d] the risk customarily inherent" in the other. The decedent basically had paid $27,000 for the insurance company's agreement to pay her $600 a year for her lifetime and $25,000 upon her death. The exclusion was not available because there was no "insurance risk" in the combined transaction. Later courts have applied similar analyses in determining whether "insurance" exists for various tax purposes.[7]

Retrospective Premiums and Separate Accounts

"Retrospective premium" arrangements, under which a subscriber may be rebated premiums based upon the claims history of a group, normally qualify as insurance because there is still risk-shifting among members of the group.[8] However, this rule does not apply to rebates that are individually calculated so that each subscriber essentially pays its own claims plus a service fee. There may be good business reasons to pay an insurance company to administer claims, but that is not insurance.

The classic case of this sort is *Steere Tank Lines v. United States*.[9] The taxpayer in *Steere Tank* agreed to reimburse its insurance company for all claims made against it. The insurer thus risked a loss only if the taxpayer became insolvent. The court held that the arrangement was, in effect, a surety bond rather than insurance, and allowed a current deduction only for a nonrefundable "minimum premium" that was the equivalent of an administration fee.[10] Controversy continues about when various kinds of rebate and separate account arrangements cross the line.[11] An arrangement may also be partially insurance and partially not, if, for example, the insured bears the full risk of loss up to a coverage limitation but has "excess" or "stop-loss" coverage beyond that threshold.[12]

"Captive" Affiliates

"Captive" insurance affiliates, frequently incorporated offshore, present a specialized case of the "self-insurance" problem. The issues are frequently referred to as "risk distribution" and "risk shifting." This terminology can be confusing, and it is misleading to read the early authorities in particular too technically. The terms trace back to the Supreme Court's observation in *LeGierse* that "[h]istorically and commonly insurance involves risk-shifting and risk-distributing,"[13] but *LeGierse* did not distinguish between the two concepts. Indeed, both *Steere Tank* and an early IRS ruling described *LeGierse* as holding that insurance required "risk shifting *or* risk distributing,"[14] in context strongly suggesting that the two terms were viewed as interchangeable. The IRS clearly differentiated the two concepts in Revenue Ruling 77-316, discussed below, and the ruling's terminology has been generally, although not universally, followed since.

"Risk shifting" refers to the general requirement that, in contrast to *Steere Tank* and similar cases, the arrangement must transfer risk from insured to insurer. As discussed below, in the captive situation it has been argued to mean that there must also be a differentiation of *ownership* between insured and insurer, or at least that one of them not own the other. "Risk distribution," on the other hand, refers to the spreading of risk among *insureds*. (Sometimes, however, both parts of the analysis are lumped together as "risk shifting.")

Revenue Ruling 77-316

In Revenue Ruling 77-316,[15] the IRS ruled that there was neither "risk shifting" nor "risk distribution," and therefore no insurance, to the extent the risk was ultimately borne by a member of the same "economic family" as the insured. Premiums paid on such policies would not be deductible and the captive, if it did no other business, would not qualify as an insurance company. Excise taxes on foreign insurance would not apply either.[16]

While adding captive insurance to the list of issues on which it ordinarily would not rule privately,[17] the IRS continued to refine its published position. Revenue Ruling 77-316 had addressed the "vanilla" case of a parent and its subsidiaries paying commercially reasonable premiums to an offshore subsidiary of the parent that did no unrelated business. In Revenue Ruling 88-72,[18] the IRS, which had previously been inconsistent on the issue,[19] made explicit its view that insurance required *both* "risk shifting" and "risk distribution," so that premiums that a taxpayer paid its captive affiliate could not be deducted no matter how much business the captive might do with persons outside the group. On the other hand, Revenue Ruling 92-93[20] respected life insurance policies that a captive wrote on its parent's employees because the risks being insured were not those of the parent. Appeals settlement guidelines and a related Industry Specialization Program position paper, although now somewhat dated, provide some further insight into the IRS' thinking.[21]

"Vanilla" Parent-Subsidiary Cases

Revenue Ruling 77-316 passed its first court test with flying colors in *Carnation Co. v. Commissioner*.[22] Both the Tax Court and the Ninth Circuit denied the taxpayer's deduction for premiums that it paid to an unrelated insurance company to the extent that the risk was reinsured with the taxpayer's Bermuda subsidiary. The thrust of both courts' opinions was that insuring with a subsidiary did not shift risk and was therefore not "insurance" under *LeGierse*. The captive in *Carnation* was relatively thinly capitalized and the parent guaranteed that it would make additional capital contributions in the event of claims. However, this factor was not critical, as both courts later made clear in reaching the same result in *Clougherty Packing Co. v. Commissioner*,[23] which involved virtually identical facts apart from the guarantee.[24]

Several other early cases reached the same result on similar fact patterns, including *Beech Aircraft Corp. v. United States*[25] and *Stearns-Roger Corp., Inc. v. United States*[26] in the Tenth Circuit and *Mobil Oil Corp. v. United States*[27] in the Court of Federal Claims. Although *Beech* and *Stearns-Roger*, like *Carnation*, involved thinly capitalized captives and/or guarantees that cast doubt on risk shifting even apart from the question of the captive's ownership, the courts in these cases essentially adopted the IRS' reasoning in Revenue Ruling 77-316, at least as to payments from parents to subsidiaries.

Thus, by the close of the 1980s it was fairly well established that in the classic "captive" case, where a parent insures with its direct or remote subsidiary that does no other business, the arrangement will not be respected as insurance for tax purposes. If some of the payments came from affiliates other than the captive's parent, or if the captive does business entirely outside the group, the analysis became much more complicated.

"Group Captive" Arrangements

One tactic taxpayers used to get around Revenue Ruling 77-316 involved setting up captive insurance companies with multiple unrelated owners. The goal in such "group captive" arrangements was to demonstrate both risk shifting (to fellow shareholders) and risk distribution (to fellow insureds), who both happened to be the same people.

The model was *United States v. Weber Paper Co.*[28] *Weber* involved a "reciprocal flood insurance" arrangement between local merchants. While each participant was committed to pay, over time, an amount equal to the total coverage limitation, in the short run a claimant could receive more than it had paid in. The court held that the arrangement involved "risk shifting" and the premiums were deductible. The crucial factor appears to have been the court's finding that one subscriber's premium could be used to pay others' recoveries.[29]

The IRS does not agree that there was risk distribution in *Weber*,[30] but does not dispute that an arrangement qualifies as insurance if there is risk distribution and the insured is only one of many shareholders. In Revenue Ruling 78-338,[31] an offshore captive had more than thirty unrelated shareholders. The captive limited its business to its shareholders and their affiliates, but no more than 5 percent of insured risks could relate to any one shareholder. The IRS ruled that the premiums were deductible, and that the excise tax on foreign insurance applied.[32] Theoretically, for example, a 4 percent owner might lose 4 percent of the deduction, but the IRS has not pressed the point as to minority shareholders.[33]

"Risk Distribution" in Other Cases

The IRS acceptance of "group captives" left questions about how far the facts could depart from those in the rulings and still produce "risk distribution." A subtle definitional issue bears mention at the outset. In determining whether there has been "risk distribution," the IRS concentrates on whether the *risks* being insured are "unrelated" (that is, independent) of one another.[34] Thus, the IRS does not agree that there was risk distribution in *Weber Paper*, where there were numerous unrelated participants but only one real risk — a local flood. Courts, on the other hand, commonly restate the issue as what proportion of the captive's receipts come from unrelated or non-owner *insureds*.[35] The Tax Court has noted, however, that there may be risk distribution even among relatively few and/or related participants if they insure numerous independent risks.[36]

How much "outside" business suffices? The Tax Court in *Gulf Oil* found that 2 percent was *not* enough, but observed that "if at least 50 percent [of premiums] are unrelated, we cannot believe that sufficient risk transfer would not be present."[37] In *Harper Group v. Commissioner*,[38] the court held that it was unnecessary to consider whether siblings' premiums qualified as outside business, because the captive's 30 percent of receipts from outside the group sufficed.[39] In *Ocean Drilling & Exploration Co. v. United States*,[40] the Court of Federal Claims found risk distribution — and was upheld on appeal — when the captive did 44 percent to 66 percent of its business with unrelated parties. In short, 50 percent, or probably somewhat less, of unrelated premiums should suffice to establish "risk distribution." As discussed below, however, that is not necessarily enough to qualify the arrangement as insurance.

Is Risk Distribution Enough? The Tax Court "Trilogy"

Harper Group was one of three reviewed cases in which the Tax Court refined its approach to captive insurance. One important aspect of the Tax Court view is that insurance normally shifts risks to the pool of insureds, so if a related insurer does enough outside business, then risk has been shifted to outsiders. In other words, "risk distribution" automatically means "risk shifting," which in turn — unless there is some other problem — means that the arrangement will qualify as "insurance."

The Tax Court in *Clougherty Packing* had expressly reserved the question of what would have happened if the captive had written policies for unrelated insureds.[41] The captive in *Gulf Oil* had done exactly that, albeit only to a minor extent in the years before the court. The court began its analysis by observing:

> When a sufficient proportion of premiums paid by unrelated parties is added, [related insureds] must necessarily anticipate relying on the premiums of the unrelated insureds. Thus, when the aggregate premiums paid by the captive's affiliated group is insufficient in a substantial amount to pay the aggregate anticipated losses . . . [premiums from related parties] should no longer be characterized as payments to a reserve. . . . Risk distribution and risk transfer would be present, and the arrangement is no longer in substance equated with self-insurance.[42]

In *Gulf Oil*, the Tax Court found that the outside business fell short of the necessary threshold for risk distribution, and the Third Circuit did not reach the issue. However, the issue recurred in *Harper Group* and its companion cases, which involved unquestionably *bona fide* insurance companies with substantial outside dealings. (In one of the other two cases, *Sears, Roebuck & Co. v. Commissioner*,[43] over 99 percent of the "captive's" business was with unrelated parties.) The Tax Court held that "substantial" outside business was enough to produce both "risk shifting" and "risk distribution," and that the contracts at issue in each case (including those with the captive's parent) therefore involved insurance.

The Tax Court organized the relevant factors under three general headings. To be insurance, the contract had to involve "insurance risk"; provide for risk shifting and risk distributing; and conform to "commonly accepted notions of insurance."[44] The first requirement rules out, for example, agreements to "compartmentalize" risk as in *Steere Tank,* as well as more subtle forms of self-insurance. The last requirement goes to both the captive itself (is it adequately capitalized? subject to regulation?) and its practices (are its premiums and reserves commercially reasonable?). "Risk shifting" and "risk distribution" are collapsed into the second prong, which the Tax Court holds can be met by showing that the captive does enough business with unrelated parties.

By contrast, the IRS maintained that "risk shifting" and "risk distribution" are independent requirements, and that "risk shifting" related to ownership, not to premium income. The IRS thus refused to allow a deduction for premiums paid to a related captive, no matter how much outside business the captive did,[45] because the party paying the premium did not thereby "divorce itself from the adverse financial implications that would be caused by the occurrence of the insured-against event."[46] The disagreement appears to have reflected different assumptions about the source of funds to pay claims. The Tax Court regards claims as paid from current premiums while the IRS assumed they fell on the insurer's shareholders.

The Tax Court's abandonment of a separate test for "risk shifting" was argued to be contrary to the Court of Federal Claims' decision in *Mobil Oil*, which disallowed deductions for all premiums even though one captive did some business with unrelated parties.[47] The Sixth Circuit also later expressed disapproval of the Tax Court's single-step approach.[48] However, the Tax Court's reasoning was expressly approved by the Ninth and Seventh Circuits on appeal in the trilogy cases.[49] Moreover, the Court of Federal Claims later concluded that *Mobil Oil* had *not* addressed the issue and adopted the Tax Court's analysis itself, and the Federal Circuit affirmed on appeal.[50] Thus, the Tax Court and three circuits will respect a captive's dealings with any affiliate so long as the captive does enough "outside" business.

Corporate "Siblings"

Another contentious issue involves the IRS' application of its "economic family" theory to disregard the captive's dealings with affiliates outside its direct chain of ownership ("corporate siblings"). The Appeals settlement guidelines claimed that *Stearns-Roger* and *Mobil Oil* at least "implicitly" adopted the government's position on this "sibling" issue,[51] but this misread both cases. The insurance contracts in *Stearns-Roger* covered the liabilities of the whole group, but it was the parent that paid the premiums, received all the payouts, and sought the deduction. *Mobil Oil* did involve some non-owner affiliates, but the Court of Claims did not address the sibling issue. (When it eventually did, it came out the other way.[52]) Both cases analyzed the issue exclusively from a parent-subsidiary perspective, focusing on the fact that neither premiums paid nor proceeds received had any effect on the parent's balance sheet.[53]

In *Clougherty Packing*, the Ninth Circuit found it unnecessary to reach the "economic family" issue, and based its holding instead on a "balance sheet" analysis that recalled *Stearns-Roger* and *Mobil Oil*:

> As indirect owner of every share of [the captive's] stock, Clougherty suffers a loss in the value of one of its assets equal to the full amount of the claim paid. . . . *LeGierse* requires that an insurance agreement negate any effect of a covered loss on the insured party's assets . . . . Because a covered claim still affects Clougherty's assets, its captive insurance arrangement does not succeed in shifting its risk of loss.[54]

Again, the court's reasoning is confined to the "classic" parent-subsidiary case (and the much less common situation where an entity insures with its shareholder[55]).

In the first case to explicitly address the "sibling" issue, a district court *declined* to apply Revenue Ruling 77-316; however, the facts were unusual because the overlap in ownership was incomplete and the common shareholders were individuals.[56] However, in *Humana, Inc. v. Commissioner*,[57] when the full Tax Court found that there had been no risk distribution, it threw out the deductions of parent and subsidiaries alike — and then did it again in *Gulf Oil*. Thus, while the Tax Court did not adopt the IRS' separate analysis of "risk shifting," it did agree with the IRS that all affiliates' dealings should stand or fall together.

Gulf Oil was affirmed on independent grounds, but in *Humana* the "sibling deduction" issue was front and center on appeal. The Sixth Circuit invoked *Clougherty's* "balance sheet" approach and concluded that Humana's subsidiaries had really shifted risk to their captive sibling, although Humana itself had not. Under the same logic, the court concluded that each subsidiary insuring with the captive "distributed" its risk to its fellow subsidiaries, although, again, the same reasoning could not apply to their parent. Therefore, even though the captive did no business outside the group, the court allowed its siblings — although not its parent — to deduct premiums.

There followed something of a lull, apart from a couple of memorandum cases in which the Tax Court followed *Humana* because appeal was to the Sixth Circuit.[58] Finally, the Court of Federal Claims considered the issue in *Kidde Industries v. United States*.[59]Like the Sixth Circuit in *Humana*, the court applied a balance sheet approach, and concluded that siblings successfully shifted risk by contracting with the captive, although its parent did not. Thus, again, the siblings' deductions were allowed, even though the captive did not do material business outside the group.

The IRS Trims Its Sails

To sum up, all courts require that the captive have substance and that the parties not negate the transfer of risk through side agreements, guarantees, or the like. That threshold met, the Tax Court, the Seventh and Ninth Circuits, and the Court of Federal Claims (but not the Sixth Circuit) will respect even contracts with the captive's parent as insurance if the captive does enough "outside" business. The Sixth Circuit and the Court of Federal Claims (but not the Tax Court) will respect dealings with affiliates outside the captive's direct chain of ownership even without outside business, at least if such dealings are themselves "substantial" and involve a variety of risks.

No court has accepted the rulings' position that a captive's contracts with *all* members of its "economic family" should be disregarded even if it does substantial outside business. As early as 1993, it was noted in field service advice that the IRS was "reexamining" captive insurance issues,[60] and it has gradually modulated its approach to reflect the court decisions.

The IRS saw the "sibling" issue as a weak point, especially after *Humana*. A 1993 memorandum noted that "the expert usually retained by the government in captive insurance cases . . . has informally advised counsel" that the fact that the captive's parent's deductions were not at issue "makes his 'firm' or 'economic family' approach difficult to advance."[61] The expert's name was redacted, but was almost certainly Dr. Irving Plotkin, who testified for the government in most of the major captive insurance cases. Although described as an advocate of the "economic family" theory, Dr. Plotkin appears to have carefully confined his testimony to the parent-subsidiary situation, even where there were also payments from other affiliates.[62] After losing again in *Kidde*, the IRS seems to have started generally conceding "sibling" cases.[63]

Revenue Procedure 2001-31

Although it does not expressly say so, Revenue Ruling 2001-31 apparently formalizes the IRS' concession on the "sibling" issue. However, the arrangement must still be *bona fide* insurance, apart from the parties' ownership, and there is no indication that the IRS has adopted the Tax Court's position that enough "outside" business will establish "risk shifting" as well as "risk distribution." The ruling concludes by noting that the IRS:

> [m]ay however, continue to challenge certain captive insurance transactions based on the facts and circumstances of each case. See Malone & Hyde v. Commissioner, 62 F.3d 835 (6th Cir. 1995) (concluding that brother-sister transactions were not insurance because the taxpayer guaranteed the captive's performance and the captive was thinly capitalized and loosely regulated); Clougherty Packing Co. v. Commissioner (concluding that a transaction between parent and subsidiarywas not insurance).

The first citation is pretty easy to interpret; *Malone & Hyde* was basically a substance-over-form case. The IRS has explained its position in field service advice:

> In determining that the captive insurance company was a sham corporation, the court in *Malone* noted that the parent "propped up" the captive by guaranteeing its performance, that the captive was thinly capitalized, and that the captive was loosely regulated . . . . In addition to the factors set forth in *Malone*, other possible factors to consider in determining whether a captive insurance transaction is a sham include: whether the parties that insured with the captive truly faced hazards; whether premiums charged by the captives were based on commercial rates; whether the validity of claims was established before payments were made on them; and whether the captive's business operations and assets were kept separate from its parent's.[64]

The significance of the citation to *Clougherty Packing* is less clear. *Clougherty* was a vanilla parent-subsidiary case where the captive did no outside business. Plenty of precedent supports disregarding such arrangements. Moreover, the IRS seems to have thrown in the towel, even if the Tax Court has not, on insurance between corporate siblings. The real question is, in what circumstances will the IRS seek to apply whatever is left of the "economic family" doctrine to disregard transactions in the parent-subsidiary setting? Two potential arguments spring to mind:

1. If most of the captive's other business is with other affiliates, the IRS might argue, based upon the Sixth Circuit's opinion in *Humana*, and the Tax Court's holdings in *Humana* and *Gulf Oil*, that the parent's risk is not distributed to the extent that other insured parties are its direct or remote subsidiaries.
2. Even if the captive does "substantial" business completely outside the ownership group, the IRS might also argue, based again upon the Sixth Circuit's opinion in *Humana* (but contrary to the Tax Court "trilogy" cases and *Ocean Drilling*) that a parent can never insure with its own subsidiary because there is no risk shifting.

The IRS may also turn to other tools to police abuses. Among options IRS officials discussed at a recent seminar were enforcing arm's length terms under Code Section 482, and possible "economic substance" arguments, if the transaction would make no sense if the insurer were not an affiliate.[65] In short, more litigation battles can be expected, if on slightly different terrain.

1. 2001-26 I.R.B. 1348.
2. 403 U.S. 345 (1971).
3. *E.g., Brown v. Helvering*, 291 U.S. 193 (1934).
4. *E.g., Spring Canyon Coal Co. v. Commissioner*, 43 F.2d 78 (10th Cir. 1930), *cert. denied*, 284 U.S. 654 (1931) (self-insurance trust under workers' compensation law).

5. 85 T.C. 1031 (1985), *aff'd*, 825 F.2d 241 (9th Cir. 1987).

6. 312 U.S. 531 (1941).

7. *See, e.g.*, *Commissioner v. Treganowan*, 183 F.2d 288 (2d Cir.), *cert. denied sub nom. Estate of Strauss v. Commissioner*, 340 U.S. 853 (1950) (New York Stock Exchange members' death benefits were proceeds of "insurance" for estate tax purposes based on risk distribution among members).

8. Rev. Rul. 83-66, 1983-1 C.B. 43.

9. 577 F.2d 279 (5th Cir. 1978), *aff'g* 76-2 U.S.T.C. ¶ 9526 (N.D. Tex. 1976).

10. *Accord, e.g.*, *Wright v. Commissioner*, 66 T.C.M. (CCH) 214, 227-29 (1993), *aff'd in unpublished opinion*, 96-1 U.S.T.C. ¶ 50,086 (9th Cir., Dec. 20, 1995) (claims payments funded by individual annuity contracts subject to later refund); LTR 8638003 (6/11/86); LTR 8637003 (5/23/86) (involving arrangements similar to *Steere Tank*).

11. *See, e.g.*, *Hinshaw's, Inc. v. Commissioner*, 68 T.C.M. (CCH) 108, 111-13. (1994); LTR 199924001 (Feb. 9, 1999), both resolving the issue in the taxpayer's favor.

12. *See, e.g.*, LTR 8638003 (6/11/86); *see also, e.g.*, Rev. Rul. 60-275, 1960-2 C.B. 43, 46 (allowing deduction for 1 percent nonrefundable override for catastrophic losses).

13. 312 U.S. at 539.

14. *Steere Tank*, 577 F.2d at 280; Rev. Rul. 60-275, 1960-2 C.B. 43, 45 (emphasis added).

15. 1977-2 C.B. 53.

16. Rev. Rul. 78-277, 1978-2 C.B. 268.

17. Rev. Proc. 82-41, 1982-2 C.B. 761, *ultimately superseded by* Rev. Proc. 2001-3, § 4.01(11), 2001-1 C.B. 111, 116.

18. 1988-2 C.B. 31, *clarified in* Rev. Rul. 89-61, 1989-1 C.B. 75.

19. *See* Gen. Couns. Mem. 38136 (Oct. 12, 1979), *revoked by* Gen. Couns. Mem. 39247 (June 27, 1984).

20. 1992-2 C.B. 45.

21. "Appeals Settlement Guidelines for Captive Insurance Companies" (June 7, 1991), 1999-2000 *IRS Positions Reports* (CCH) ¶ 181,335 [hereinafter "Guidelines"]; Industry Specialization Program Coordinated Issue Paper, "Captive Insurance" (Oct. 31, 1991), 1991-1995 *IRS Positions Reports* (CCH) ¶ 150,105.

22. 71 T.C. 400 (1978), *aff'd*, 640 F.2d 1010 (9th Cir.), *cert. denied*, 454 U.S. 965 (1981).

23. 84 T.C. 948, 956-57 (1985), *aff'd*, 811 F.2d 1297, 1303 (9th Cir. 1987).

24. *Accord, e.g., Kurt Orban Co. v. Commissioner*, 54 T.C.M. (CCH) 861, 86 (1987) (another parent-subsidiary case).

25. 797 F.2d 920 (10th Cir. 1986).

26. 577 F. Supp. 833 (D. Colo. 1984), *aff'd*, 774 F.2d 414 (10th Cir. 1985).

27. 8 Cl. Ct. 555 (1985).

28. 320 F.2d 199 (8th Cir. 1963).

29. *See, e.g., Steere Tank*, 577 F.2d at 280, distinguishing *Weber Paper* on that basis, and the discussion of the *Gulf Oil* case below.

30. Rev. Rul. 64-72, 1964-1 C.B. (pt. 1) 85; Rev. Rul. 60-275, 1960-2 C.B. 43; PLR 8002007 (9/24/79).

31. 1978-2 C.B. 107.

32. *See also, e.g.*, Rev. Rul. 80-120, 1980-1 C.B. 41 (mutual insurance company providing physicians' malpractice insurance); PLRs 200121019 (2/15/01) and 9624028 (3/20/96) (mutual insurance among money market funds).

33. Guidelines at 81,363.

34. Guidelines at 81,358, citing *Clougherty Packing Co. v. Commissioner*, 811 F.2d 1297, 1300 (9th Cir. 1987).

35. *See, e.g., Gulf Oil Corp. v. Commissioner*, 89 T.C. 1010, 1027 (1987) (reviewed), *aff'd on the captive insurance issue on other grounds, aff'd, rev'd, and rem'd on unrelated issues*, 914 F.2d 396, 411-12 (3d Cir. 1990).

36. *See, e.g., Gulf Oil*, 89 T.C. at 1026 & n.10; *Malone & Hyde, Inc.*, 66 T.C.M. (CCH) 1551, 1562 (1993), *rev'd on other grounds*, 62 F.3d 835 (6th Cir. 1995).

37. 89 T.C. at 1027 n.14.

38. 96 T.C. 45, 60 n.10 (1991), *aff'd*, 979 F.2d 1341 (9th Cir. 1992).

39. *Accord, e.g., AMERCO v. Commissioner*, 96 T.C. 18 (1991) (reviewed), *aff'd*, 979 F.2d 162 (9th Cir. 1992) (52 percent to 74 percent "outside" business established risk distribution).

40. 24 Cl. Ct. 714 (1991), *aff'd per curiam*, 988 F.2d 1135 (Fed. Cir. 1993).

41. *Clougherty Packing*, 84 T.C. at 960.

42. 89 T.C. at 1027.

43. 96 T.C. 61 (1991), *aff'd on the captive insurance issue, rev'd and rem'd on another issue*, 972 F.2d 858 (7th Cir. 1992).

44. *Sears, Roebuck*, 96 T.C. at 100-02.

45. Rev. Rul. 88-72, 1988-2 C.B. 31, *clarified in* Rev. Rul. 89-61, 1989-1 C.B. 75.

46. Settlement Guidelines at 81,355.

47. *See* 8 Cl. Ct. at 562-63; *see also Beech Aircraft*, 797 F.2d at 922-23 n.1 (0.5 percent "outside" receipts ignored).

48. *Humana, Inc. v. Commissioner*, 881 F.2d 247, 257 n. 4 (6th Cir. 1989).

49. *See AMERCO*, 979 F.2d at 166-68; *Harper Group*, 979 F.2d at 1342; *Sears, Roebuck*, 972 F.2d at 860-64.

50. *Ocean Drilling & Exploration Co. v. United States*, 24 Cl. Ct. 714 (1991), *aff'd*, 988 F.2d 1135 (Fed. Cir. 1993).

51. Settlement Guidelines at 81,355-56.

52. *Kidde Industries, Inc. v. United States*, 40 Fed. Cl. 42 (1997).

53. *Stearns-Roger*, 774 F.2d at 415, 417; *Mobil Oil*, 8 Cl. Ct. at 567.

54. 811 F.2d at 1305.

55. *See, e.g., Pariseau v. Commissioner*, 49 T.C.M. (CCH) 984, 991-93 (1985) (no risk-shifting when corporations insured with sole shareholder's proprietorship).

56. *Crawford Fitting Co. v. United States*, 606 F. Supp. 136 (N.D. Oh. 1985).

57. 88 T.C. 197 (1987) (reviewed), *aff'd and rev'd*, 881 F.2d 247 (6th Cir. 1989).

58. *Hospital Corp. of America v. Commissioner*, 74 T.C.M. (CCH) 1020 (1997); *Malone & Hyde v. Commissioner*, 61 T.C.M. (CCH) 1551 (1993), *rev'd and rem'd on other grounds*, 62 F.3d 835 (6th Cir. 1995).

59. 40 Cl. Ct. 42, 50-59 (1997).

60. Unnumbered FSAs dated Nov. 12, 1993, 1993 WL 1468155 and 1993 WL 1470308.

61. Unnumbered FSA, 1993 WL 1469718.

62. *See, e.g., Mobil*, 8 Cl. Ct. at 563; *AMERCO*, 96 T.C. at 34-35; *Humana*, 88 T.C. at 209-12, *especially* 210 n.2.

63. *See, e.g.*, FSA 200125009 (3/12/01); FSA 200125005 (1/25/01); FSA 200105014 (10/26/00); FSA 200043012 (6/19/00); FSA 200043011 (6/12/00); FSA 200043008 (5/31/00); CCA 199932007 (4/12/99); unnumbered FSA (1/14/98), 1998 WL 1757780 (captive also insured unrelated parties).

64. FSA 200125009 (3/12/01); *see also, e.g.*, FSA 199915004 (11/5/98).

65. "'Economic Family,' Unpaid Loss Reserves Dominate P&C Discussion," *91 Tax Notes* 1968, 1969 (June 18, 2001).