

September 17, 2012

Much Ado About Nothing: The Tax Court Declines To Rule in *Cigna Corp.*

On September 13, 2012, the United States Tax Court issued its much-anticipated opinion in *Cigna Corp. v. Commissioner*.¹ In deciding the case, the court declined to rule on the issue of whether a life insurance company may compute tax reserves under § 807² by retroactively applying National Association of Insurance Commissioners (NAIC) Actuarial Guideline XXXIV (AG 34) for minimum guaranteed death benefits (MGDB) in variable annuity contracts. The court's conclusion was based, in large part, on the concession by the Internal Revenue Service (IRS) that the taxpayer's tax reserves were calculated correctly for the relevant taxable year, and the IRS's representation that it will not challenge taxpayers that used AG 34 to compute tax reserves for MGDB.

Sutherland Observation: Because the IRS has disputed whether AG 34 may be applied retroactively for purposes of calculating the tax reserves for insurance products other than those at issue in *Cigna Corp.*, taxpayers may continue to face challenges in this area.

In *Cigna Corp.*, the taxpayer had entered into reinsurance treaties prior to 1998 in order to reinsure certain MGDB (the Reinsurance Treaties). At the times that the taxpayer entered into the Reinsurance Treaties, there was no universally accepted method for computing statutory reserves for MGDB, and, as a result, life insurance companies generally computed their statutory reserves for MGDB under various standards imposed by state insurance regulators. On December 31, 1998, the NAIC sought to standardize these statutory reserve computations by promulgating AG 34. From 1999 to 2008, the taxpayer computed all of its statutory reserves for MGDB in accordance with AG 34, including the statutory reserves attributable to the Reinsurance Treaties, notwithstanding the fact that the taxpayer had entered into the Reinsurance Treaties before the promulgation of AG 34.

The IRS issued a notice of deficiency for the taxpayer's 2004 taxable year, claiming that the taxpayer could not use AG 34 to compute the tax reserves attributable to the Reinsurance Treaties because the taxpayer had entered into those treaties before the promulgation of AG 34. However, before the case went to trial, the IRS conceded that the taxpayer's tax reserve computations were correct. At trial, the only remaining dispute was whether, as a matter of law, the taxpayer could use AG 34 to compute the tax reserves attributable to the Reinsurance Treaties. In light of its concession, the IRS asked the Tax Court to enter judgment in the taxpayer's favor. The taxpayer objected, arguing that the court should consider the remaining dispute based on the importance of the issue to the insurance industry.

Ultimately, the Tax Court declined to rule on the tax reserve issue because it concluded that its opinion would be advisory. In so concluding, the court reasoned that the "interests of justice" did not compel it to rule on the tax reserve issue because that issue was a discrete one involving a specific insurance product. The court also was not convinced that resolving the tax reserve issue would alleviate taxpayer uncertainty, especially considering that the IRS represented that it will not challenge taxpayers that used AG 34 to compute tax reserves for MGDB.

¹ T.C. Memo. 2012-266.

² Unless otherwise specified, all "§" references are to the Internal Revenue Code of 1986, as amended.

© 2012 Sutherland Asbill & Brennan LLP. All Rights Reserved.

This communication is for general informational purposes only and is not intended to constitute legal advice or a recommended course of action in any given situation. This communication is not intended to be, and should not be, relied upon by the recipient in making decisions of a legal nature with respect to the issues discussed herein. The recipient is encouraged to consult independent counsel before making any decisions or taking any action concerning the matters in this communication. This communication does not create an attorney-client relationship between Sutherland and the recipient.

Sutherland Observation: The IRS sometimes has conceded issues before the Tax Court when a case presents bad facts for the IRS, but the IRS still believes that it is correct regarding the law. This may have been the case in *Cigna Corp.* However, the Tax Court has ignored an IRS concession when it believes that the interests of justice requires it to do so. See, e.g., *North West Life Assurance Co. of Canada v. Commissioner*, 107 T.C. 363 (1996).

While observers may be disappointed that the Tax Court did not address whether AG 34 may be applied retroactively for purposes of computing tax reserves under § 807, two circuit courts of appeals have recently outlined the circumstances under which NAIC guidance can be applied retroactively for tax reserve computation purposes. Specifically, in *American Financial Group v. Commissioner*,³ the Sixth Circuit held that taxpayers may apply actuarial guidelines retroactively for purposes of computing tax reserves under § 807 when the guidelines constitute clarifications rather than changes.⁴ Similarly, in *State Farm Mutual Automobile Insurance Co. v. Commissioner*,⁵ the Seventh Circuit held that a clarifying interpretation regarding statutory accounting practices could be applied retroactively in computing loss reserves under § 832. Thus, notwithstanding the holding in *Cigna Corp.*, taxpayers can look to these other cases for guidance regarding the types of NAIC pronouncements that may be applied retroactively when computing tax reserves.



If you have any questions about this Legal Alert, please feel free to contact any of the attorneys listed below or the Sutherland attorney with whom you regularly work.

Dennis L. Allen	202.383.0906	dennis.allen@sutherland.com
Thomas A. Gick	202.383.0191	tom.gick@sutherland.com
Jerome B. Libin	202.383.0145	jerome.libin@sutherland.com
Jeffrey H. Mace	212.389.5049	jeffrey.mace@sutherland.com
Michael R. Miles	202.383.0204	michael.miles@sutherland.com
Mary E. Monahan	202.383.0641	mary.monahan@sutherland.com
M. Kristan Rizzolo	202.383.0908	kristan.rizzolo@sutherland.com
Linda A. Sciuto	212.389.5031	linda.sciuto@sutherland.com
William J. Walderman	202.383.0243	william.walderman@sutherland.com
P. Bruce Wright	212.389.5054	bruce.wright@sutherland.com
Saren R. Goldner	212.389.5063	saren.goldner@sutherland.com
William R. Pauls	202.383.0264	william.pauls@sutherland.com
Christopher W. Schoen	202.383.0934	christopher.schoen@sutherland.com
Dwaune L. Dupree	202.383.0206	dwaune.dupree@sutherland.com

³ 678 F.3d 422 (6th Cir. 2012).

⁴ The actuarial guideline at issue in *American Financial* was NAIC Actuarial Guideline XXXIII (AG33), which was promulgated in 1995 and generally describes how insurance companies should resolve accounting questions connected to annuities sold after 1980.

⁵ ___ F.3d ___ (7th Cir. 2012), available on Westlaw at 2012 WL 3764718.