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<u>Legend</u>

Taxpayer =

Foreign Parent =

Insurance Subsidiary =

Insurance Manager =

Jurisdiction F =

Foreign Country G =

H =

I =

J =

K =

L =

Reinsurer M =

Jurisdiction N	=
Insurance Subsidiary O	=
Foreign Country P	=
Subsidiary 1	=
Subsidiary 2	=
Subsidiary 3	=
Subsidiary 4	=
Subsidiary 5	=
Subsidiary 6	=
Subsidiary 7	=
Subsidiary 8	=
Subsidiary 9	=
Subsidiary 10	=
Subsidiary 11	=
Subsidiary 12	=
Subsidiary 13	=
Subsidiary 14	=

Subsidiary 15	=
Subsidiary 16	=
Subsidiary 17	=
Subsidiary 18	=
Subsidiary 19	=
Subsidiary 20	=
Subsidiary 21	=
Subsidiary 22	=
Number w	=
Number x	=
Number y	=
Amount z	=
Year 1	=
Year 2	=
Year 4	=
Year 5	=

Dear

This is in reply to a letter dated January 19, 2006 submitted on behalf of Taxpayer and certain of its subsidiaries requesting a ruling that for purposes of determining the deduction for business expenses under § 162 of the Internal Revenue Code, the amounts paid for product liability and other coverages by Taxpayer (and its subsidiaries) to an affiliate are treated as "insurance premiums." Additional information was submitted in letters dated March 24 and May 10, 2006.

Taxpayer is a wholly owned subsidiary of Foreign Parent. Foreign Parent, which is incorporated in Foreign Country G, is a world leader of H products. Foreign Parent has diverse business operations that may be categorized into three broad areas. The first area involves the creation, development, manufacture, and marketing of a wide range of products that restore, maintain and improve H. The second involves the discovery, development, manufacture, and marketing of I products such as J. The third area involves the development, manufacture, and marketing of K. Foreign Parent operates through Number w affiliates in Number x countries. Within the United States, Foreign Parent's operations are conducted by Taxpayer. Taxpayer operates through 22 corporate operating subsidiaries (Subsidiary 1 through 22) which join in the filing of Taxpayer's consolidated return.

As a result of a significant loss event in Year 1 impacting the insurance industry, a wave of asbestos claims, and high profile I litigation losses, insurers increased the premiums for excess liability insurance and drastically reduced the coverage they were willing to provide. The increasing difficulty of obtaining insurance relating to I risks was commonly reported in insurance publications. Foreign Parent suffered from the effects of this changing insurance market when, at the end of Year 1, Foreign Parent's insurers cancelled Foreign Parent's insurance program. As a result Foreign Parent was forced to secure insurance on significantly less favorable terms. Confronted with continually escalating expenses and risk exposure, Foreign Parent began to explore alternatives to the increasing risk-adverse insurance markets for its worldwide insurance needs, including the creation of an insurance subsidiary.

In late Year 2, Insurance Subsidiary, a Jurisdiction F insurance company, was formed as an indirect wholly owned subsidiary of Foreign Parent to insure its worldwide operations. Insurance Subsidiary is subject to L insurance regulation in Jurisdiction F and is adequately capitalized under L law.[1] Principally, the risks covered are product liability and other commercial risks of Foreign Parent's diverse group of subsidiaries and affiliates including Foreign Parent's United States operations conducted by Taxpayer and its subsidiaries. Neither Taxpayer nor its subsidiaries has an ownership interest in Insurance Subsidiary. Subsequent to its initial formation, Insurance Subsidiary is funded solely through the receipt of premiums and the return on its investments.

Typically, Insurance Subsidiary issues a minimum of four "claims-made" policies annually, each providing insurance for losses in excess of a specified threshold. The policies cover product liability and other common commercial risks of the insureds, including property damage and business interruption. The risks covered by the Insurance Subsidiary's policies are similar to the risks covered by other commercial insurance companies underwriting the Foreign Parent's group; however, the coverage is in different layers. Of the policies issued annually, one typically is issued to Foreign Parent (as the named insured) and covers the losses of Foreign Parent and all its subsidiaries and affiliates worldwide, including those in the United States. The other policies issued by Insurance Subsidiary provide that Taxpayer is a named insured. The policies explicitly state that all the subsidiaries of named insureds are insureds under the policies. The limits on the policies were chosen to reflect the level of insurance that was in place through Year 1. That is, Foreign Parent wanted to be restored to its Year 1 position of having (on average) Number y dollars of insurance coverage for each $100 in sales. Insurance Subsidiary's underwriting operations are managed by Insurance Manager. Insurance Manager is an independent, third party which is a leading provider of risk management services, insurance and reinsurance brokerage and other services. The risks inherent in Insurance Subsidiary's policies were found to be reasonable taking into consideration the balanced spread of risk of geographic exposure and product diversity. Insurance Subsidiary has also entered into reinsurance agreements with Reinsurer M, a Jurisdiction N insurance company, which is also a wholly owned indirect subsidiary of Foreign Parent. Neither Taxpayer nor Subsidiaries 1 through 22 has an ownership interest in Reinsurer M.

Currently, Insurance Subsidiary bills Subsidiaries 1 through 22 directly for their respective portions of the premiums. The billing is accomplished on the basis of a

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[1] L from time to time promulgates directives concerning various aspects of insurance company regulation. All member states are required to comply with these directives. The member states do so by passing local legislation and regulations which comply with the L directives. While there is some variation among the member states' interpretations they all comply with the directives. Under this regime Jurisdiction F legislation and regulation comply with all L insurance directives.

percentage of sales. Insurance Subsidiary receives payment of the amount of the premium billed via wire transfers, which is the equivalent of cash settlements. The premiums were calculated with the assistance of Insurance Manager and were also based upon the cost of insurance provided by unrelated commercial insurance companies determined from quotes Foreign Parent had been recently able to obtain from third party insurers.

Insurance Subsidiary has had claims activity on its policies. For example, in Year 4 it was notified of several claims by Subsidiary 6. In Year 5, it paid a substantial claim in the gross amount of Amount z to Subsidiary 16, however, 90 percent of that claim was reimbursed by Reinsurer M.

Insurance Subsidiary's operations are independent of the operations of Foreign Parent, Taxpayer and Subsidiaries 1 through 22. For example, Insurance Subsidiary manages its own investments, which are investment grade, fixed-income instruments

(e.g., those issued by the United States Treasury and other governmental entities) and other securities of issuers unrelated to Foreign Parent and its affiliates. Except for an investment in all of the stock of Insurance Subsidiary O, which is an insurance company licensed under the laws of Foreign County P, Insurance Subsidiary does not invest in affiliates.[2] Further, Insurance Subsidiary does not lend money to Foreign Parent or any of its subsidiaries.

In connection with this ruling request it is represented as follows:

(1) Insurance Subsidiary's obligations are not guaranteed in any form by Foreign Parent or any of its subsidiaries.

(2) Insurance Subsidiary is adequately capitalized considering its risk exposures and reinsurance coverage.

(3) No one company of the Number w insured companies has more than 15 percent of the total risks covered by Insurance Subsidiary.

(4) The amount of premiums paid by Taxpayer and its subsidiaries reflect commercial rates for the insurance involved.

Section 162(a) of the Code provides, in part, that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

[2] No portion of the value of the stock of Insurance Subsidiary O was, in fact, included by insurance Subsidiary for purposes of satisfying its Jurisdiction F insurance company solvency requirements.

Section 1.162-1(a) of the Income Tax Regulations provides, in part, that among the items included in business expenses are insurance premiums against fire, storms, theft, accident, or other similar losses in the case of a business.

Neither the Code nor the regulations define the term "insurance" or "insurance contract." In Helvering v. LeGierse, 312 U.S. 531 (1941), however, the United States Supreme Court explained that in order for an arrangement to constitute "insurance" for federal income tax purposes, both risk shifting and risk distribution must be present.

Risk shifting occurs if a person facing the possibility of an economic loss transfers some or all of the potential loss to the insurer. See Rev. Rul. 92-93, 1992-2 C.B. 45. If an insured has shifted its risk to the insurer, then a loss by or a claim against the insured does not affect the insured because that loss is offset by the proceeds of an insurance payment. Clougherty Packing Co. v. Commissioner, 811 F.2d 1297, 1300 (9th Cir. 1987).

Risk distribution allows the insurer to reduce the possibility that a single costly claim will exceed the amount taken in as premiums and set aside for the payment of such a claim. By assuming numerous relatively small, independent risks that occur randomly over time, the insurer smooths out losses to match more closely its receipt of premiums. Clougherty Packing Co. v. Commissioner, 811 F.2d 1297, 1300 (9th Cir. 1987). Risk distribution necessarily entails a pooling of premiums, so that a potential insured is not in significant part paying for its own risks. See Humana Inc. v. Commissioner, 881 F.2d 247, 257 (6th Cir. 1989). In Humana, the Sixth Circuit held that arrangements between the parent corporation and its insurance subsidiary did not constitute insurance for federal income tax purposes. The court also held that arrangements between the insurance subsidiary and several dozen other subsidiaries of the parent (operating an even greater number of hospitals) qualified as insurance for federal income tax purposes because the requisite risk shifting and risk distribution were present. Further, in Kidde Industries. Inc. v. United States, 40 Fed. Cl. 42 (1997), the Court of Federal Claims concluded that an arrangement between the captive insurance subsidiary and each of the 100 operating subsidiaries of the same parent constituted insurance for federal income tax purposes.

In the present case, Number w covered companies shifted to Insurance Subsidiary their product liability and other common commercial risks. These risks were insurance risks, and the arrangements were regulated as insurance and constituted insurance in the commonly accepted sense. Insurance Subsidiary distributed these risks by accepting premiums, determined at arms length, from those numerous insureds and agreeing to indemnify those insureds in the event of loss. Accordingly, the arrangements qualify as insurance contracts for federal income tax purposes. See Rev. Rul. 2002-90, 2002-2 C.B. 985.

Based solely on the information submitted and the representations made, we conclude that, for purposes of determining the deduction for ordinary and necessary business expenses under § 162, the amounts paid for product liability and other coverages by Taxpayer and its operating subsidiaries to Insurance Subsidiary are treated as "insurance premiums."

Except as expressly provided herein, no opinion is expressed under the provisions of any other section of the Code or Regulations. No opinion is expressed as to whether or not the amount of premiums charged by Insurance Subsidiary has been calculated correctly. No opinion is expressed as to whether Insurance Subsidiary or Reinsurer M is an insurance company for Federal income tax purposes. This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

A copy of this letter should be attached to any Federal income tax return to which it is relevant.

In accordance with the power of attorney on file in this office, we are sending a copy of this letter to your authorized representative.

Sincerely yours,

/S/

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