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# INSURANCE COMPANY BAD DEBT

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The large investment losses that insurance companies suffered during the credit crisis are adding to the workload of their tax departments and the Internal Revenue Service (IRS). Many companies are involved in tax controversies with the IRS, and others are dealing with tax accounting issues arising from the losses. Because of the natural time lag involved in most tax examinations, the partial worthlessness deductions that companies reported in 2008 and 2009 are just now ripening into proposed adjustments from IRS examiners. Many insurance companies reported large partial worthlessness deductions that are now under scrutiny by IRS examiners. The examinations have created uncertainty and are beginning to result in resource demands on the part of the industry as IRS examiners attempt to verify compliance with bad debt deduction requirements. For this reason, the industry and the IRS have agreed to try to resolve the problem through the IRS's Industry Issue Resolution ("IIR") program.<sup>1</sup> We have addressed insurance company bad debts several times in prior *TAXING TIMES* articles,<sup>2</sup> but did not have the benefit of the IRS examiners' positions at the time those articles were written. This article summarizes some of the key issues the IRS and insurance companies are grappling with in the tax compliance and examination process that led to the IIR project.

## INCOME ACCRUALS

There are two major tax issues to think about when investments are impaired. The first is whether to continue to accrue interest or discount on the instruments. The second is whether a principal write-down is available, and if so, when. Related to the second issue is whether any write-down will be ordinary or capital in character. The income accrual issue has not drawn significant attention thus far from IRS examiners, but is worth reviewing because of its important tax compliance implications. Treasury Regulation § 1.451-1(a) applies the accrual method of accounting and requires an income inclusion when all events have occurred that fix the right to receive the income and the amount can be determined with reasonable accuracy. For interest, this standard is met when interest is economically earned, payment is due or payment is received. A common law exception to this requirement to accrue income applies when there is a "reasonable doubt as to collectability" at the time



the standard otherwise would be satisfied.<sup>3</sup> In the banking context, the IRS has taken the position in a revenue ruling that the doubt as to collectability must be "substantial" in order for the accrual exception to apply.<sup>4</sup>

There are additional issues regarding how the income accrual exception applies in the context of Original Issue Discount ("OID") and market discount, which are economic substitutes for stated interest.<sup>5</sup> OID is the discount at original issue and is equal to the excess of the stated redemption price at maturity over the issue price.<sup>6</sup> Taxpayers other than life insurance companies are required to follow detailed income recognition rules in I.R.C. § 1272 under which they recognize OID in income on a constant yield basis over the term of the instrument.<sup>7</sup> The income recognition rules are intended to replicate accrual accounting for OID. The IRS has taken the position in a widely criticized Technical Advice Memorandum ("TAM") that the common law exception to income accrual for doubt as to collectability does not apply at all to OID and that taxpayers must continue to accrue OID even after they know with certainty that they will never collect the discount.<sup>8</sup> The IRS based its conclusion primarily on the fact that the OID rules in I.R.C. § 1272 do not provide an explicit exception for doubtful collectability. This ignores the fact that the exception to income accrual is a common law exception based on the basic principle that a taxpayer "cannot be charged to have realized an income unless there exists reason for believing that the income is likely to be paid."<sup>9</sup> The IRS made other technical arguments in support of the conclusion, but there is a general consensus in the tax bar that the TAM is erroneous and that the same common law exception that applies to interest accruals also applies to OID.<sup>10</sup>

The market discount rules present other issues. These issues have not been addressed by the IRS in the context of statutory impairments, at least to our knowledge, but the answers appear to be reasonably clear. Market discount is equal to the excess of the stated redemption price at maturity over the holder's basis in the instrument acquired at purchase in the secondary market.<sup>11</sup> Taxpayers may elect not to recognize

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market discount currently as it accrues but instead recognize it as ordinary income on sale or maturity.<sup>12</sup> However, taxpayers that have elected to defer current recognition that receive payments must recognize such payments as ordinary income to the extent of previously accrued market discount that has not been recognized.<sup>13</sup> Because market discount, like OID, is simply a substitute for stated interest, the common-law exception to interest income accruals should also apply to market discount and a taxpayer should not be required to continue accruing market discount if there is no reasonable expectation that the taxpayer will ever collect the discount. There may be an issue, however, with respect to pay-downs. Take, for example, a principal pay-down on a structured debt instrument that is severely distressed. Is a taxpayer required to recognize the previously accrued market discount when the partial pay-down occurs even though the payment is a return of principal and the taxpayer has no reasonable expectation of collecting the previously accrued market discount? The answer to this question may be yes because the recognition rule in I.R.C. § 1276(a)(3) requires payments to be treated as market discount to the extent it has been accrued.

For life insurance companies, all of these income accrual matters should be considered in light of I.R.C. § 811(b). That provision permits life insurance companies to accrue OID and market discount under their statutory accounting method if the method clearly reflects income. Therefore, if the company stops recognizing either OID or market discount under its statutory accounting method it should not be required to do so for tax purposes if it is using statutory accounting for its taxable income recognition.<sup>14</sup>

### PRINCIPAL WRITE-DOWNS

The second set of tax issues to think about when an instrument is impaired concerns the rules that apply to the timing and character of the write-downs. A corporate taxpayer that holds a business debt that is not a “security” under I.R.C. § 165(g) has the discretion to take ordinary partial worthlessness deductions as the debt becomes worthless in part or to wait until the debt is sold or becomes wholly worthless to take the loss.<sup>15</sup> The application of the rules can be significant both in terms of the timing of the loss and its character. The time value of reporting an ordinary deduction for a partial worthlessness deduction versus waiting for an exchange or a determination of complete worthlessness can be significant depending on the amount of the impairment and the term of the instrument. The character also can be important because a loss on exchange or sale would be capital in nature and the IRS may argue that a loss on termination may also be capital.<sup>16</sup> Capital losses can be

offset only against capital gains and are subject to a five-year limitation on carryover to subsequent years.

This is the area in which most of the recent IRS activity has occurred and the scrutiny is intensifying as the 2008 and 2009 tax years come under audit. Many insurance companies have claimed partial worthlessness deductions consistent with their statutory impairments on structured debt instruments of various types and on commercial mortgages that are not securities. Most of the controversy so far has centered on the application of the partial worthlessness rules to impairments of regular interests in Real Estate Mortgage Investment Conduits (REMIC regular interests). Under a REMIC structure, a pool of mortgages is securitized and divided into various tranches for sale to investors. The REMIC trust issues regular interests that represent the obligations of the REMIC trust and are treated as debt instruments to the investor for all tax purposes.<sup>17</sup> REMIC regular interests are sold in registered form and generally have the characteristics of a security; however, they do not meet the definition of a security under I.R.C. § 165(g) because they are issued by a trust. The definition of a security in I.R.C. § 165(g) covers only instruments that are issued by a corporation, government, or subdivision thereof. This is an important distinction because it opens the door for partial worthlessness deductions under I.R.C. § 166.

The IRS examiners for the most part appear to agree that REMIC regular interests are non-securities and that they qualify for some level of partial worthlessness deductions under I.R.C. § 166 and the regulations thereunder.<sup>18</sup> However, the qualification for the deduction is only the threshold question. The next issue is whether the actual amount claimed is worthless under the tax standard. The IRS and insurance company taxpayers have not had much success in resolving the amounts of the deductions largely because they are pursuing different avenues for substantiation of the deductions. The IRS for the most part is examining the details of substantiation under the general standard for worthlessness, whereas insurance company taxpayers for the most part are relying on the conclusive presumption in Treas. Reg. § 1.166-2(d) for regulated industries that the worthlessness standard has been met.

Some background discussion of the two approaches will help explain this problem. The IRS has the discretion to allow a partial worthlessness deduction (1) to the extent the taxpayer charges the amount off on its financial books and records in the same year it seeks the partial write-down,<sup>19</sup> and (2) to the extent the taxpayer can prove that the portion it wrote down

on its books actually was worthless under the tax standard.<sup>20</sup> Under the general tax standard for determining worthlessness, a debt is worthless to the extent collection appears to the reasonable business person exercising sound business judgment to be hopeless.<sup>21</sup> Although the Commissioner is limited in his or her authority to challenge the reasonable exercise of sound business judgment,<sup>22</sup> the examination of whether the standard has been met requires a detailed evaluation of the underlying facts. The conclusive presumption in Treas. Reg. § 1.166-2(d), on the other hand, does not require a detailed examination of the facts underlying the deduction. Under that provision, a regulated company's book charge-off is presumed to be correct in the year of the charge-off if it is made under established policies and procedures of the regulator and if the regulator confirms this fact upon its first examination of the company's books and records for the year of the charge-off.

#### IRS EXAMINATION APPROACH

In examining REMIC regular interests under the general standard in the regulations, the IRS has attempted to dig deep into the background of each regular interest and the taxpayers' investment and accounting determinations of worthlessness under statutory accounting standards. The investment and accounting evaluations are complex and difficult to present to IRS examiners in auditable form. Moreover, many insurance company taxpayers have been reluctant to devote the resources to provide detailed explanations because the conclusive presumption obviates the need to do so. IRS examiners generally have taken the position that charge-offs based on estimates of future cash flows do not satisfy the tax standard of worthlessness because they consider anticipated future defaults that have not yet occurred and because non-credit-related factors, such as prepayment assumptions, are considered. Insurance companies disagree with the IRS audit position and have been unwilling to recalculate future cash flow projections based on the IRS's more restrictive view of worthlessness in the REMIC context. As a result, the IRS examiners appear to have focused their efforts on remittance advices received from REMIC trustees to propose deduction disallowances. The monthly remittance advices typically present delinquency and default information for the various tranches and show allocations of the loss of principal for each tranche. REMICs, like other structured securities, typically have a capital structure in which higher-ranked tranches are protected by credit support in the form of subordination of lower-ranking tranches. The lower-ranking tranches typically absorb losses on the underlying mortgages first. Another typical form of credit support is excess collateral.<sup>23</sup> The remittance

advices show allocations of principal losses to particular tranches when enough mortgages have defaulted and the collateral has been liquidated to exhaust the credit support underlying the tranche. The losses typically are not allocated and reported in the remittance advice until the collateral has been liquidated. Therefore, the remittance advice approach that many IRS examiners have taken is, in essence, a liquidation approach to valuation of the partial worthlessness. This approach in most cases has resulted in only a few current-year deductions in the years under examination so far, even though it is abundantly clear that the companies have had large losses charged against book earnings under statutory accounting standards.

#### INSURANCE COMPANY RELIANCE ON THE CONCLUSIVE PRESUMPTION

In contrast to the liquidation approach of IRS examiners, taxpayers' conclusive presumption approach conforms the tax partial worthlessness deductions to the statutory accounting impairments the companies are required to record under Statements of Statutory Accounting Principles. Application of the statutory accounting standards has resulted in impairments that are made in advance of the loss allocations flowing through the remittance advices the IRS has examined. For REMIC regular interests and other structured securities, the statutory accounting rules require an analysis of whether a decline in fair value is attributable to an other-than-temporary impairment. This is done in part through the projection of cash flows. In projecting the cash flows, the companies are required to consider a variety of credit-related factors such as the payment terms, the financial condition of the issuer, expected defaults, the value of the collateral, industry analyst reports, sector credit ratings and other market data pertaining to collectability and the ability of subordinated interests to absorb losses.<sup>24</sup> If the company does not intend to sell the instrument and has the ability to hold it to recovery, it is required to write the instrument down to the present value of the projected cash flows discounted at the pricing yield.<sup>25</sup> This type of write-down is intended to capture the credit-related portion of a decline in fair value.<sup>26</sup> If the company has the intent to sell the instrument or if it does not have the ability to hold it to recovery, the company is required to write the instrument

Application of the statutory accounting standards has resulted in impairments that are made in advance of the loss allocations flowing through the remittance advices the IRS has examined.

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down to fair value and charge the write-down against current earnings.<sup>27</sup>

#### APPLICATION OF THE CONCLUSIVE PRESUMPTION TO INSURANCE COMPANIES

The threshold issue the IRS has had to consider in examining taxpayers' partial impairment write-downs based on the statutory accounting standards is whether the conclusive presumption in Treas. Reg. § 1.166-2(d) applies to the insurance industry. The regulation subsection, which is titled "Banks and other regulated corporations," applies to "a bank or other corporation which is subject to supervision by Federal authorities, or by State authorities maintaining substantially equivalent standards."<sup>28</sup> IRS examiners generally have accepted that insurance companies are an "other regulated corporation" within the meaning of the regulation because of the strict regulatory environment in which they operate. However, IRS examiners have questioned whether the State insurance regulatory standards are "substantially equivalent" to Federal bank standards as the regulation requires. Some examiners have taken the position that in order for the presumption to apply, the actual statutory accounting standards for the insurance company write-downs must be substantially the same as the standards for bank write-downs of bad loans. This interpretation of the regulation is inconsistent with the historical background of the presumption. The conclusive presumption entered the regulations in 1922,<sup>29</sup> at a time when there were no specific controlling standards for bank write-downs. Thus, it is reasonable to conclude that the reference to "substantially similar" standards refers to the standards of "supervision" of the industry in general, and not to specific standards for write-downs.

There is one court decision regarding whether the conclusive presumption applies to insurance companies as "other regulated corporations" and whether the standards of regulation are "substantially similar." The Court of Claims in *Credit Life Insurance Company v. United States* held that the insurance supervisory authority in the state of Ohio was substantially similar to the authority of Federal banking regulators and that the conclusive presumption applied to a life insurer domiciled in that State.<sup>30</sup> The court considered the general supervisory authority of the state regulators as compared to the underlying policy of the banking regulators under the Office of the Comptroller of the Currency ("OCC"). In comparing the two regulatory regimes, the court considered Rev. Rul. 79-214, 1979-2 C.B. 90, which identifies the critical criteria for coverage under the regulations as whether the regulator has an established authority to compel the charge-off on the financial statements of the company. The court also considered the underlying policy rationale for the conclusive presumption, which is to ensure that taxpayers subject to banking and similar supervisory regulation receive fair and consistent treatment as between the taxing authorities and their supervisory regulators.<sup>31</sup> These considerations led the court to a holding that the insurance company taxpayer was in a substantially similar position to a bank, that the underlying policy rationale for the presumption applied equally to the insurance company and that the conclusive presumption applied.

#### ADDITIONAL ISSUES ARISING UNDER THE CONCLUSIVE PRESUMPTION

In addition to questions over the threshold issues of whether insurance regulations are "substantially similar" to banks, IRS examiners have raised several other questions and issues concerning the write-downs under the statutory standards, particularly with respect to REMIC regular interests. First, several IRS examiners have been reluctant to accept the statutory write-downs on REMIC regular interests even if the conclusive presumption were to apply, based on a conclusion that the cash flow projections under the OTTI standard result in deductions for "future anticipated worthlessness." This concern stems from a mistaken view of the instruments. The examiners appear to be looking through the REMIC trust to the underlying mortgagors as the debtors for tax purposes. In their view, it is inappropriate to take a worthlessness deduction for future defaults (*i.e.*, "future anticipated worthlessness") on underlying mortgages. In reality, however, the REMIC trust is the debtor and the cash flows from underlying mortgages are the collateral supporting the trust's obligation. The regulations under the general worthlessness regulations provide that it is appropriate to consider the condition of the debtor

and the value of the collateral in determining worthlessness.<sup>32</sup> Considering future defaults on underlying mortgages in this context simply involves an analysis of the condition of the debtor and its ability to pay based on the collateral supporting the debt. Additionally, even if it were appropriate to look through the REMIC trust and consider the mortgagors as the debtors for worthlessness purposes, the regulations provide that it is not necessary to wait until there is a default before taking a worthlessness deduction.<sup>33</sup>

Examiners have also raised issues under Rev. Rul. 84-95, 1984-2 C.B. 53. In that ruling, the IRS held that the conclusive presumption did not apply to a write-down under rules promulgated by the OCC that required a bank to account for Other Real Estate Owned at the lesser of net book value or fair value. The process described in the ruling was “based solely on a mechanical comparison of net book value of real estate with its current appraised value.”<sup>34</sup> In the ruling the IRS compared the “mechanical” process to other OCC rules covering bad debts, which required the bank to evaluate the write-down in the context of credit-related factors such as “the delinquency or default of a debtor.”<sup>35</sup> It concluded that the conclusive presumption did not apply to the fair value write-down because the process did not involve consideration of traditional bad-debt credit-related factors.<sup>36</sup> Rev. Rul. 84-95 should not be an obstacle to the application of the conclusive presumption in the case of REMIC regular interests. The revenue ruling merely holds that the conclusive presumption does not apply unless the regulator treats the write-down as a bad debt (as opposed to a reduction in value of real estate as in the ruling). Moreover, as described above, the current statutory standards result in a write-down that is based on a number of credit-related factors such as the financial condition of the issuer, expected defaults, the value of collateral, industry analyst reports, sector ratings and other factors that bear on the likelihood of collectability.<sup>37</sup> In limited situations involving cases in which the insurance company either intends to sell the instrument or does not have the ability to hold it until recovery, the current statutory accounting standard requires that the instrument be written down to fair value.<sup>38</sup> However, the process for writing down to fair value in these limited circumstances takes place in the context of an OTTI determination. It is not the same type of mechanical mark-to-market approach that applied to the real estate at issue in Rev. Rul. 84-95. In any event, life insurance companies are required to bifurcate the write-down between credit component and non-credit components.<sup>39</sup>

Going beyond Rev. Rul. 84-95, some examiners have questioned whether the conclusive presumption applies only when

the regulator’s standards are the same standards as would be applied under the general worthlessness standard discussed above. The IRS National Office, however, has conceded in a technical advice that banking standards are binding in the context of the conclusive presumption and that it is not necessary for those standards strictly to adhere to the general standard of worthlessness that would otherwise apply in the context of I.R.C. § 166 and its regulations.<sup>40</sup> This is consistent with case law holding that write-down orders pursuant to regulator orders that are not consistent with general I.R.C. § 166 standards are nevertheless conclusive. For example, in *Citizens National Bank of Orange v. Commissioner*, the court held that a bank order requiring a bank to write down a bond based on a market fluctuation was conclusive.<sup>41</sup> This holding is inconsistent with Rev. Rul. 84-95 and casts doubt on the validity of that ruling. Putting that aside, however, the case at least makes it clear that the bank standards under the conclusive presumption do not have to be the same as the general worthlessness standard.

These issues are complex and ripe for resolution on a global basis under the IIR process. If all goes well, by the time this article is published, the IRS and the insurance industry should be well down the path of resolving these issues so that they do not result in an expensive prolonged dispute. ◀

#### END NOTES

- 1 The Industry Issue Resolution (IIR) process is described in Revenue Procedure 2003-36, 2003-1 C.B. 859. In late March 2011, the IRS accepted the issue into the IIR program pursuant to an industry request that was supported by the American Council of Life Insurers.
- 2 See *Tax Aspects of Nonperforming Assets*, 4 *TAXING TIMES* 28 (Sept. 2008); *REMIC Impairments May Qualify as Worthless Bad Debts*, 5 *TAXING TIMES* 50 (May 2009); *SSAP 43R and Tax Standards for Partial Worthlessness Deductions*, 6 *TAXING TIMES* 27 (May 2010).
- 3 *Jones Lumber, Inc. v. Commissioner*, 404 F.2d 764, 766 (6th Cir. 1968). See also *Corn Exchange Bank v. United States*, 37 F.2d 34 (2d Cir. 1930); Rev. Rul. 80-361, 1980-2 C.B. 164.
- 4 Rev. Rul. 2007-32, 2007-1 C.B. 1278.
- 5 *United States v. Midland-Ross Corp.*, 381 U.S. 54 (1965).
- 6 I.R.C. § 1273(a).
- 7 See *infra*, discussion regarding life insurance rules under § 811(b).
- 8 TAM 9538007 (June 13, 1995).
- 9 *Corn Exchange Bank*, *supra*, 37 F.2d at 34.
- 10 The IRS’s points and the rebuttal arguments are discussed at length in comments submitted to Congress and the IRS on July 23, 2008, by the New York City Bar Committee on Taxation of Business Entities. See [http://www.nycbar.org/pdf/report/ABCNY%20CityBar\\_%20Distressed\\_debt.pdf](http://www.nycbar.org/pdf/report/ABCNY%20CityBar_%20Distressed_debt.pdf).
- 11 I.R.C. § 1278(a)(2).
- 12 I.R.C. § 1278(b).
- 13 I.R.C. § 1276(a).

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## END NOTES CONT.

- <sup>14</sup> Many life insurance companies do not follow statutory accounting for market discount accruals because the statutory rules generally require amortization of market discount whereas the tax rules allow it to be deferred to the extent payments have not been received. Statement of Statutory Accounting No. 34 requires discount to be included in earnings as investment income accrued. See NAIC, Accounting Practices & Procedures Manual, *Statement of Statutory Accounting Principles No. 34*, Investment Income Due and Accrued, para. 3 (Volume I, as of March 2011).
- <sup>15</sup> A "security" for this purpose is defined as a stock, subscription right or bond, debenture, note or certificate or evidence of indebtedness with interest coupons or in registered form issued by a corporation, government or political subdivision thereof. See I.R.C. § 165(g).
- <sup>16</sup> I.R.C. § 1271(a)(1) provides that amounts received by the holder on the retirement of a debt instrument are deemed to be received in an exchange. If this provision applies, the exchange gives rise to a capital gain or loss, not an ordinary loss.
- <sup>17</sup> See I.R.C. § 860B(a), which provides that "[i]n determining the tax under this chapter of any holder of a regular interest in a REMIC, such interest (if not otherwise a debt instrument) shall be treated as a debt instrument." REMICs also issue residual interests, which essentially represent the equity in the REMIC and are not taxed as debt instruments. See generally I.R.C. § 860C.
- <sup>18</sup> In a few cases, IRS examiners have asserted that regular interests that were issued with OID are not eligible for partial bad debt deductions under I.R.C. § 166 based on a theory that the deductions would be "negative OID," which is prohibited under the legislative history of the OID provisions. See *Glick v. United States*, 96 F. Supp. 2d 850, 871 (S.D. Ind. 2000) (citing H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess. (1986)). This issue is beyond the scope of this article. However, in our view the *Glick* case is limited to a narrow set of facts. It dealt with REMIC regular interests that gave the holder a right to a very small amount of principal associated with interest at a high coupon rate (sometimes exceeding 1,000 percent). The instruments essentially were Interest Only and therefore were especially vulnerable to prepayment risk. The taxpayers in the *Glick* case suffered losses because prepayments accelerated as a result of decreasing interest rates (i.e., the underlying mortgages were refinanced). The legislative history reflected the intent to prevent temporary losses that could result from the application of the OID income inclusion formula as a result of prepayments, and not to prevent taxpayers from taking permanent losses from credit-related events.
- <sup>19</sup> See Treas. Reg. § 1.166-3(a)(2)(ii).
- <sup>20</sup> See Treas. Reg. § 1.166-2.
- <sup>21</sup> See *PepsiAmericas, Inc. v. United States*, 52 Fed. Cl. 41, 47 (2002).
- <sup>22</sup> See *Portland Mfg. Co. v. Comm'r*, 56 T.C. 58 (1971); *Estate of Mann v. United States*, 731 F.2d 267 (5th Cir. 1984).
- <sup>23</sup> Excess collateral would mean, for example, that a tranche with \$100 million in principal may be supported by \$110 million in mortgages. Additional forms of credit support are excess interest-rate spreads and financial guaranty insurance from a monoline financial guaranty insurer. Excess interest rate refers to the spread between the underlying mortgages and the lower certificate rate on the regular interest.
- <sup>24</sup> See NAIC, *supra* SSAP 43R para. 40, listing these and other factors. This statement was effective beginning Sept. 30, 2009. The standard it replaces was SSAP 43, which was similar to SSAP 43R but did not require the cash flows to be discounted. An additional standard that never became required and eventually was withdrawn was SSAP 98. SSAP 98 essentially was a fair value standard.
- <sup>25</sup> See *id.* para. 33.
- <sup>26</sup> See *id.* para. 33, Fn 8.
- <sup>27</sup> See *id.* para. 30-31.
- <sup>28</sup> Treas. Reg. § 1.166-2(d)(1).
- <sup>29</sup> See T.D. 3262, C.B. I 1 (1922).
- <sup>30</sup> *Credit Life Ins. Co. v. United States*, No. 585-84T (Cl. Ct. 1990), *rev'd on other grounds*, 948 F.2d 723 (Fed. Cir. 1991). Unfortunately, the Claims Court gave this holding in a bench ruling which was not published. The case was reversed on appeal on other grounds.
- <sup>31</sup> This policy rationale is explained in Rev. Rul. 80-180, 1980-2 C.B. 66 and in several cases, including *United States v. Beckman*, 104 F.2d 260 (3d Cir. 1939) and *Citizens Nat'l Bank of Orange v. Comm'r*, 74 F.2d 604 (4th Cir. 1935). The *Citizens Nat'l Bank* court explained the rationale as follows:  
Here we have a case in which one branch of the government can compel the taxpayer to take an action with regard to its securities which, when taken, will not be recognized by another branch of the government. This is not fair to the taxpayer. There should be at least some semblance of coordination between the several branches of government in dealing with a taxpayer.  
74 F.2d at 605.
- <sup>32</sup> See Treas. Reg. § 1.166-2(a), which provides as follows: "In determining whether a debt is worthless in whole or in part the district director will consider all pertinent evidence, including the value of the collateral, if any, securing the debt and the financial condition of the debtor."
- <sup>33</sup> See Treas. Reg. § 1.166-1(c), which provides as follows: "The fact that a bad debt is not due at the time of deduction shall not of itself prevent its allowance under I.R.C. § 166."
- <sup>34</sup> Rev. Rul. 84-95.
- <sup>35</sup> *Id.*
- <sup>36</sup> The General Counsel Memorandum underlying the Revenue Ruling makes it clear that the primary reason the IRS held that the conclusive presumption did not apply was that the "mechanical" fair value write-down of the real estate did not involve any type of consideration of "bad debt criteria." GCM 39023 (Aug. 23, 1983).
- <sup>37</sup> NAIC, *supra* SSAP 43R, para. 40. Write-downs under the earlier applicable SSAP 43 were evaluated under credit standards as well. Additionally, fair value write-downs under SSAP 98 for companies that adopted it were evaluated in a similar context of OTTI determinations in which credit-factors were considered. The write-downs were not the simple, mechanical fair value write-downs described in Rev. Rul. 84-95.
- <sup>38</sup> NAIC *supra* SSAP 43R, para. 30-31.
- <sup>39</sup> SSAP 43R paragraph 36 requires life insurers to account for the credit component in the Asset Valuation Reserve and the non-credit component through the Interest Maintenance Reserve.
- <sup>40</sup> Technical Advice Memorandum 9122001 (Feb. 8, 1991).
- <sup>41</sup> *Citizens Nat'l Bank*, *supra*, 74 F.2d at 606-607. The IRS specifically noted and commented on this aspect of the case in General Counsel Memorandum 37875 (March 6, 1979).