[industry **comment**]

Phillip England and **Randall Beckie** of Anderson Kill & Olick discuss and attempt to dispel the confusion surrounding the tax treatment of cell captives that has been created in the wake of Revenue Ruling 2008-8

IN REVENUE Ruling 2008-8, the IRS validated a method of analysing the nature of a purported insurance arrangement involving a cell of a segregated cell company (SCC). The IRS' method is essentially to allow that the cell may be viewed as a separate insurance company for tax purposes if transactions with the cell give rise to risk shifting and risk distribution in keeping with definitional criteria per Revenue Rulings 2002-89, 2002-90 and 2005-40.

The IRS' method is the same approach that was available to taxpayers based on tax principles that have existed since long before the issuance of Revenue Ruling 2008-8. Indeed, some taxpayers independently had already come to the conclusion that a cell company was allowed to file a separate US insurance company tax return.

In the months since Revenue Ruling 2008-8 was issued, it has come to our attention that some captive insurance tax advisers have been saying that a segregated cell is not yet eligible to file a separate insurance company tax return. Disagreement among tax advisers about the present tax treatment of cell captives has led to confusion among captive managers and their clients. We would like to dispel such confusion here.

IRS Notice 2008-19 requested comments by 4 May 2008 about how to implement Revenue Ruling 2008-8. The Notice proposed guidance for cells on topics such as obtaining a US taxpayer identification number; filing an insurance company tax return; making tax elections, including the section 953(d) "domestic" election; and generally distinguishing the activities of the cell from the activities of the SCC.

The Notice also said – confusingly – that such proposed guidance, if adopted, may take the form of a regulation, revenue ruling, revenue procedure or other IRS publication, in any of which cases such proposed guidance would be effective for the first taxable year beginning no more than 12 months after the date the guidance is published in final form.

'A cell captive must make a current determination as to whether it qualifies as a separate insurance company or not for US tax purposes'

In other words, Notice 2008-19 outlines the procedural rules for a cell to treat itself as a separate insurance company for tax purposes but simultaneously appears to defer the effective date of such rules.

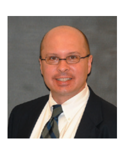
Appearances can be deceiving. We spoke with the drafter of Notice 2008-19, who confirmed that the apparent deferral of the effective date was intended merely to leave open the possibility that guidance about implementation may be subject to revision in forthcoming regulations. The drafter confirmed that, while final guidance remains pending, the fact remains that a cell captive must make a current determination as to whether it qualifies as a separate insurance company or not for US tax purposes and – to our point here – act accordingly.

Upon issuance, a revenue ruling has immediate effect as an interpretation of the IRS' position. Rev. Rul. 2008-8 rightly notes that the qualification of an arrangement as an insurance contract does not depend on the regulatory status of the issuer.

Per Revenue Rulings 83-132 and 83-172, which Revenue Ruling 2008-8 relies on, it is furthermore true that the qualification of a risk pool as an insurance company does not depend on the regulatory status of the issuer. On the basis of this authority, cell captives have always been eligible to be treated as separate insurance companies for US tax purposes, provided that they otherwise satisfy applicable definitional requirements.

For cell captives, IRS rulings since 1983 have meant: if it quacks like a duck, you can call it a duck, and Revenue Ruling 2008-8, rather than changing that interpretation, validates it.

Phillip England is an equity shareholder in the New York office of Anderson Kill & Olick, P.C.



Randall Beckie is executive director of Anderson Kill Insurance Services (AKIS), a subsidiary of Anderson Kill & Olick.