

**REVENUE RULING 78-338**

1978-2 C.B. 107, modified in Rev. Rul. 2001-31

**[IRS Annotation]****Business expenses; premiums paid to foreign insurance company by shareholder.**

Amounts paid by a domestic petroleum corporation to a foreign insurance company that provides insurance against certain risks incurred in the petroleum business only to its 31 unrelated shareholders and their subsidiaries and affiliates, none of which owns a controlling interest and among which the economic risk of loss can be shifted and distributed, are premiums deductible under section 162 of the Code, provided they are reasonable in amount for the coverage obtained and are based on sound actuarial principles. The tax imposed by section 4371 applies to each such policy. Rev. Rul. 77-316 distinguished.

**Rev. Rul. 78-338**

Advice has been requested whether, under the circumstances set forth below, amounts paid by a domestic corporation to a foreign insurance company are deductible as ordinary expenses under section 162 of the Internal Revenue Code of 1954.

The taxpayer is a domestic corporation that conducts its petroleum operations in various countries and areas of the world. A foreign insurance company was organized by the taxpayer under the laws of Country X. This corporation has one class of common voting stock which is owned by the taxpayer and 30 other unrelated corporations. No shareholder owns a controlling interest in the insurance company. The insurance company provides insurance only to its shareholders and their subsidiaries and affiliates for direct physical loss or damage to on-shore and off-shore property, personal injury and property damage claims resulting from pollution, and costs of controlling wild oil or gas wells or extinguishing oil or gas well fires, and certain related risks. The insurance coverage extends to risks located throughout the world. The insurance company is not engaged in trade or business in the United States nor is it [108] authorized to do business in the United States. Pursuant to the by-laws of the insurance company, no shareholder's individual risk coverage may exceed 5 percent of the total risks insured by the company.

Premium rates are established according to customary industry rating formulas. The insurance company's plan for rating insureds permits the company to measure hazard and expense differences among the insureds within a classification of various risks insured against and, on this basis, to provide for prospective premium adjustments.

In general, ownership of stock in the insurance company is open to any petroleum corporation in the world (except one in which more than 50 percent of the stock is owned by a government) that is determined to be financially sound and otherwise acceptable to the insurance company's board of directors.

The question presented is whether the amounts paid by the taxpayer to the insurance company are deductible as ordinary and necessary business expenses under section 162 of the Code.

Section 162(a) of the Code provides 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.

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, storm, theft, accident, or other similar losses in the case of a business.

Requisite to the concept of insurance under the Code is a shifting and distribution of the risk of loss from the insured to other insureds. See *Helvering v. Le [Gierse]*, 312 U.S. 531 (1941), 1941 -1 C.B. 430 and Rev. Rul. 60-275, 1960-2 C.B. 43. Also, Rev. Rul. 77-316, 1977-2 C.B. 53, presents three situations in which asserted insurance premiums are not deductible under section

162 of the Code because there is no economic shifting or distributing of risks of loss if the alleged insureds are all economically interrelated and the risks are carried or retained by a foreign corporation that is wholly owned by one of the alleged insureds.

Here, because the taxpayer and the other insureds-shareholders are not economically related, the economic risk of loss can be shifted and distributed among the shareholders who comprise the insured group.

Accordingly, in the instant situation, because the requisite risk-shifting and risk-distribution necessary to constitute insurance are present, it is held that the amount paid by the taxpayer for this insurance are premiums deductible as ordinary and necessary business expenses under section 162 of the Code, provided they are reasonable in amount for the insurance coverage obtained and provided they are based on sound actuarial principles.

It is further held that the contract of insurance between the foreign insurance company and the taxpayer is subject to the excise tax imposed by section 4371 of the Code which imposes a tax on each policy of insurance, indemnity bond, annuity contract, or policy of reinsurance issued by any foreign insurer or reinsurer if, in the case of casualty insurance under section 4371(1), issued to or for, or in the name of, an insured as defined in section 4372(d).

Rev. Rul. 77-316 is distinguished.