No. ______

In the

# Supreme Court of the United States

NEW YORK LIFE INSURANCE COMPANY,
*Petitioner,*

v.

UNITED STATES OF AMERICA,
*Respondent.*

**On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit**

## PETITION FOR WRIT OF CERTIORARI


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## QUESTION PRESENTED

In order for a taxpayer to accrue and deduct a liability for federal income tax purposes, "all events" that "establish the fact of the liability" must have occurred by the close of the taxable year. This case concerns whether the fact of liability has been established where a liability is payable on a future date unless there is an intervening change in the status quo.

The question presented is:

Whether the Second Circuit erred in holding, in conflict with this Court's decision in *United States v. Hughes Properties, Inc.*, 476 U.S. 593 (1986), that the continuation of the status quo is a required event, and thus a "condition precedent," needed to establish the fact of liability under the all-events test governing the accrual method of tax accounting.

## RULE 29.6 STATEMENT

New York Life Insurance Company ("New York Life") is organized as a mutual life insurance company and therefore has no shareholders. Since New York Life does not issue shares of stock, no publicly held company owns 10% or more of shares of stock in New York Life.

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## INTRODUCTION

The all-events test governing the accrual method of tax accounting is one of the most important tax accounting concepts in the tax law. This case concerns the first component of the all-events test—whether "all the events have occurred that establish the fact of the liability." *See* 26 C.F.R. § 1.461-1(a)(2)(i). Where on or before the end of the taxable year a taxpayer has an existing liability to make a payment in the following taxable year, it is well-settled that the all-events test can be satisfied in the year prior to the year of payment even if some event in the later year could defeat the taxpayer's payment obligation.

The specific question at issue in this case is whether the continuation of the status quo is an event, or condition precedent, needed to establish the fact of liability under the all-events test. In the proceedings below, the Second Circuit concluded that New York Life, a calendar-year taxpayer, may not deduct in one taxable year policyholder dividends that are payable on a life insurance policy's anniversary date in January of the next taxable year, even though the policyholder had paid all premiums necessary to keep the policy in force until that anniversary date. The court concluded that New York Life's liability to pay the policyholder dividends was not fixed because New York Life could not know at the close of the taxable year whether the policyholder would, "simply by failing to act," continue the policy in force until the anniversary date. App-18. The court reached this conclusion even though the policyholder had paid during the taxable year in which New York Life sought a

deduction all premiums necessary to keep the policy in force until the anniversary date, with the result that the continuation of the policy in force until its anniversary date merely required the continuation of the status quo.

The Second Circuit's approach conflicts with prior decisions of this Court and revives a multi-circuit conflict that should have been resolved by those decisions. Further, the decision creates considerable uncertainty for all accrual-basis taxpayers. The Court should grant certiorari to reverse the Second Circuit's departure from the long-standing fundamental principles articulated by this Court and provide much needed clarity regarding the application of the all-events test.

## OPINIONS BELOW

The Second Circuit's opinion is reported at 724 F.3d 256 and reproduced at App-1. The Southern District of New York's opinion is reported at 780 F.Supp.2d 324 and reproduced at App-31.

## JURISDICTION

The Second Circuit rendered its decision on August 1, 2013 and denied a timely petition for rehearing on October 22, 2013. This Court has jurisdiction under 28 U.S.C. § 1254(1).

## STATUTORY PROVISIONS INVOLVED

26 U.S.C. § 808, 26 U.S.C. § 811, 26 U.S.C. § 461, and 26 C.F.R. § 1.461-1 are reproduced at App-43.

## STATEMENT OF THE CASE

### A. Statutory and Regulatory Background

The tax code permits life insurance companies to deduct from gross income "an amount equal to the policyholder dividends paid or accrued during the taxable year." 26 U.S.C. § 808(c). Life insurance companies are generally required to use the accrual method of tax accounting. 26 U.S.C. § 811.

Unlike the cash method of accounting, which generally prevents the deduction of a liability until it is paid, a taxpayer using the accrual method may be permitted to deduct a liability before payment. Under the accrual method:

> [A] liability . . . is incurred, and generally is taken into account for Federal income tax purposes, in the taxable year in which [1] all the events have occurred that establish the fact of the liability, [2] the amount of the liability can be determined with reasonable accuracy, and [3] economic performance has occurred with respect to the liability.

26 C.F.R. § 1.461-1(a)(2)(i). The first two requirements together commonly are referred to as the all-events test. The third requirement commonly is referred to as the "economic performance" requirement.

The first prong of the all-events test considers whether all events have occurred during the taxable year that establish "the fact of the liability." 26 C.F.R. § 1.461-1(a)(2)(i). In applying the all-events

test, the critical question is whether at year end the taxpayer is subject to an existing liability or whether the existence of the taxpayer's liability remains contingent upon the occurrence of future events. In the latter instance, the future events are commonly referred to as "conditions *precedent*" that must occur in order for the taxpayer's liability to be considered fixed, and thus accruable. Where there is an existing liability but future events may act to terminate the obligation to pay the liability, such events are referred to as "conditions *subsequent*" that do not prevent accrual.

The distinction between conditions precedent and conditions subsequent is illustrated by two cases decided by this Court, *United States v. General Dynamics Corp.*, 481 U.S. 239, 245 (1987) and *United States v. Hughes Properties, Inc.*, 476 U.S. 593 (1986). In *General Dynamics*, this Court concluded that an employer's liability to reimburse employee medical expenses was contingent, and thus could not be accrued, where an employee had received medical services but had not filed a reimbursement claim form by the close of the taxable year. In that case, the submission of the claim form, not the receipt of medical services, was the "last link in the chain of events creating liability." *Gen. Dynamics*, 481 U.S. at 245. In other words, the filing of a claim form was a condition precedent because the liability did not arise until a claim form was filed. *Id.* at 244 n. 5 ("The filing of the claim form is thus a true condition precedent to liability on the part of the taxpayer.").

In *Hughes Properties*, this Court concluded that a casino's liability for the annual increase in a progressive slot machine jackpot satisfied the all-events test at year end where state law forbade the casino from reducing the jackpot. A progressive slot machine increases its jackpot each time patrons play the machine until the jackpot is won (or a maximum jackpot is reached). *Hughes Props.*, 476 U.S. at 595. This Court concluded that the liability was fixed at the close of the taxable year, even though there was a possibility that the casino's obligation to pay the liability would not be satisfied if the casino went out of business, surrendered or lost its gaming license, or went into bankruptcy. *See id.* at 606 (the "potential nonpayment of an incurred liability exists for every business that uses an accrual method, and it does not prevent accrual."). Thus, the existence of conditions subsequent that might reduce, or even eliminate, the taxpayer's liability did not prevent accrual.

The second prong of the all-events test requires that the amount of a liability be "determined with reasonable accuracy." 26 C.F.R. § 1.461-1(a)(2)(i). The amount of liability need not be known with absolute certainty; rather, the amount must be "susceptible of estimate with reasonable accuracy." *Harrold v. Comm'r*, 192 F.2d 1002, 1006 (4th Cir. 1951).

In the case of a taxpayer's liability to make a payment (a "payment liability"), the economic performance requirement is generally considered satisfied when the payment is made. 26 C.F.R. § 1.461-4(g). Under the statutory "recurring items"

exception to the economic performance requirement, however, a payment liability satisfying the all-events test can be deducted prior to the year of payment if certain statutory requirements are satisfied. 26 U.S.C. § 461(h)(3). Treasury regulations provide that "all rebates, refunds, and payments or transfers in the nature of a rebate or refund," are eligible for the recurring item exception. *See* 26 C.F.R. § 1.461-5; 26 C.F.R. § 1.461-4(g)(3).

### B. Premiums Payable on January Anniversary Policies Issued by New York Life

New York Life is a New York mutual life insurance company engaged in the business of writing various forms of individual and group life insurance and annuities. New York Life files a consolidated federal income tax return on a calendar year basis and uses the accrual method of tax accounting.

New York Life issues participating life insurance and annuity contracts that provide that each policy will be apportioned a share of New York Life's divisible surplus each year. These contracts require New York Life to pay an "annual dividend" on each policy that remains in force on its anniversary date if all premiums due have been "paid to such anniversary." Premiums are "paid to such anniversary" if the policyholder has paid the premiums required to keep the policy in force until that anniversary date, as, for example, when a policyholder has paid in full an annual premium.

Thirty days before a policy's anniversary date, New York Life credits the annual dividend amount to the policyholder's account if the policyholder has

paid all the premiums due to keep the policy in force until that anniversary (as would occur with a premium paid annually, semiannually, or quarterly). If the policyholder has not paid the full year's premiums at that time (as may occur with a policy with monthly premiums), the annual dividend amount is credited when all the premiums for that policy year are received. The dividend amounts so credited are paid in all cases no later than on the anniversary date.

This case involves the application of the all-events test to annual dividends payable on policies with an anniversary date arising in January ("January Anniversary Policies"). By the close of each of the taxable years at issue (1990 through 1995), New York Life credited annual dividends to the accounts of holders of January Anniversary Policies who had paid the premiums necessary to keep the policy in force until the policy's anniversary date in the following year. New York Life thus was able to calculate at the end of each taxable year the exact annual dividend amount that would be paid to holders of January Anniversary Policies in January of the next year. New York Life deducted this amount pursuant to 26 U.S.C. § 808(c) as policyholder dividends accrued in the taxable year prior to payment on the grounds that, by the close of each taxable year, its liability to pay annual dividends to those policyholders was fixed, the amount payable was determinable with reasonable accuracy, and the statutory and regulatory requirements for the "recurring item" exception to the economic performance requirement were satisfied.

### C. The Proceedings Below

The Internal Revenue Service ("IRS") disallowed New York Life's deduction in the 1990 through 1995 taxable years of annual dividends payable on January Anniversary Policies. New York Life filed a Complaint in the Southern District of New York challenging the IRS's disallowance of those deductions.[1] The district court had subject matter jurisdiction pursuant to 28 U.S.C. § 1346(a)(1) and 26 U.S.C. § 7422. Before filing an answer or engaging in any discovery, the United States of America moved to dismiss New York Life's Complaint. The district court granted the motion on the grounds that New York Life's liability to pay the policyholder dividends at issue did not satisfy the first prong of the all-events test. The district court did not reach the question of whether the other requirements for accrual were satisfied.

New York Life appealed the district court's decision to the Second Circuit, which affirmed. With respect to annual dividends payable on January Anniversary Policies, the Second Circuit concluded that New York Life's liability was not fixed in the

[1] The proceedings below also involved a second category of dividend deductions on policies (the "Eligible Policies") that entitle their holder to receive a "termination dividend" upon the termination of the policy by death, maturity, or surrender in addition to an annual dividend. With respect to the Eligible Policies, New York Life accrued a minimum dividend liability, calculated as the lesser of the annual or termination dividend amount payable in the next year. This petition does not raise this issue.

taxable year before payment because New York Life was obligated to pay only if the policyholder "maintained her policy in force through its anniversary date." App-17. The court stated that the policy terms required New York Life to pay an annual dividend only if (1) the policyholder had paid the last premium necessary to keep the policy in force through its anniversary date and (2) the policy was in force on the anniversary date. *Id.* The panel accepted New York Life's allegation that the first condition was satisfied but concluded that the second condition prevented accrual in the year before payment because New York Life could not know at the close of the taxable year whether the policyholder would, "simply by failing to act," continue the policy in force until its anniversary. App-18.

Rather than view the continuation of the policy in force until the policy's anniversary date as the continuation of the status quo subject to a potential condition subsequent that might defeat liability (*i.e.*, the policyholder's action to cancel the policy), an approach that would be consistent with this Court's decision in *Hughes Properties* and the Second Circuit's prior decision in *Burnham Corp. v. Commissioner*, 878 F.2d 86 (2d Cir. 1989), the court instead viewed the policy's continuation as conditioned on an affirmative act by the policyholder, *i.e.*, "failing to act." *See* App-18 ("[W]e see New York Life's liability for the Annual Dividend as depending upon an actual *choice* by the third-party policyholder: her decision not to redeem her policy for cash, for example, and invest her money elsewhere."). The court analogized New York Life's liability to pay annual dividends on January

Anniversary Policies to the situation in *General Dynamics*, where the taxpayer's liability for employee medical expenses became fixed only if proper claims forms were filed. In this case, however, New York Life's policyholder did not need to take any further action after year end in order to receive his or her annual dividend.[2]

The Second Circuit did not address whether New York Life satisfied the other requirements for an accrual deduction, specifically whether, as alleged by New York Life, the amount payable was determinable with reasonable accuracy and the statutory and regulatory requirements for the "recurring item" exception to the economic performance requirement were satisfied.

New York Life petitioned for panel rehearing and rehearing *en banc*, explaining that the Second

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[2] In contrast to the Second Circuit's decision below, the Court of Federal Claims has ruled, after a full trial and development of evidence, that the policyholder dividends at issue in that case satisfied the requirements for an accrual deduction in the year prior to payment. *Mass. Mut. Life Ins. Co. v. United States*, 103 Fed. Cl. 111 (2012). In analyzing the first prong of the all-events test, the court observed that certain policyholders had paid all premiums due under the policies and that, as a result, "no event but the passage of time would occur before those policyholders would receive their annual dividend and, thus, be eligible for the minimum guaranteed dividends." *Id.* at 136. The court concluded that "if the only event(s) still to occur are the passage of time and/or the payment, the liability is considered fixed." *Id.* The court also determined that policyholder dividends constitute "rebates, refunds, or similar payments" and are thus eligible for the recurring items exception to the economic performance requirement. *Id.* at 146.

Circuit's decision was inconsistent with the decisions of this Court and the Second Circuit's own prior precedent. The Second Circuit denied the petition.

## REASONS FOR GRANTING THE PETITION

The decision below is inconsistent with this Court's precedent regarding accrual accounting. The existence of a potential condition subsequent that could change the status quo, such as a casino's decision to cease its gambling business and thereby avoid the state law requirement to pay a jackpot, does not prevent accrual. *See Hughes Props.*, 476 U.S. 593. Although the all-events test is not satisfied where a liability is contingent upon the occurrence of a condition precedent, the continuation of the status quo is not an event, or condition precedent, necessary to fix a taxpayer's liability. *See id.*; *General Dynamics*, 481 U.S. 239.

Further, the decision below recreates a multi-circuit conflict resolved by this Court in *Hughes* Properties. Review is warranted to amplify the legal principle made clear in *Hughes Properties* and to avoid conflict between the circuits.

In addition, the all-events test at issue here is a foundational and pervasive concept in the tax law as evidenced by the government's filings in the Court in the *General Dynamics* and *Hughes Properties* cases. *See* Petition for Writ of Certiorari, *Gen. Dynamics*, 481 U.S. 239 (No. 85-554); Petition for Writ of Certiorari, *Hughes Props.*, 476 U.S. 593 (No. 85-1385). This Court should grant review to provide needed clarity.

## I. The Decision Below Disregards the Legal Principle this Court Established in *Hughes Properties*

The court below failed to apply properly this Court's long-standing precedent reflecting a clear distinction between conditions precedent and subsequent. The principles articulated in that precedent establish that the continuation of the status quo is not an event for purposes of the all events test. The continuation of the status quo is a non-event. The existence of a condition subsequent that could change the status quo does not prevent accrual.

In *Hughes Properties*, this Court upheld a casino operator's year-end deduction for the annual increase in the amount shown on a progressive slot machine. Under Nevada state law, the amount of the jackpot could not be decreased prior to ultimate payoff to a winning gambler. This Court concluded that, at year end, all events had occurred to fix the casino's liability for the amount by which the jackpot had increased in the year. This Court recognized the possibility "that a casino may go out of business, or surrender or lose its license, or go into bankruptcy, with the result that the amounts shown on the jackpot indicators would never be won by playing patrons" but determined that "this potential nonpayment of an incurred liability exists for every business that uses an accrual method, and it does not prevent accrual."[3] 476 U.S. at 605-606. This

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[3] In his dissent in *Hughes Properties*, Justice Stevens noted that the majority decision permitted the accrual of an (Continued …)

Court's conclusion that the liability was fixed is predicated on an assumption that the casino would continue to operate and retain its license, *i.e.*, that the status quo would continue and that the casino would be required to pay the jackpot.[4]

New York Life's liability to pay annual dividends on January Anniversary Policies was similarly fixed in the taxable year before payment because the policyholder had paid all premiums necessary to keep the policy in force until the anniversary date.

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expense that "may be avoided entirely at the election of the taxpayer," thereby creating the "potential for tax avoidance." *Hughes Props.*, 476 U.S. at 609 (Stevens, J., dissenting). In New York Life's case, only a decision of the policyholder, not the taxpayer, could defeat New York Life's liability to pay the annual dividends on January Anniversary Policies.

[4] In New York Life's Brief *Amicus Curiae* filed with this Court in *Hughes Properties*, it stated that, consistent with its position here:

> In applying the all-events test, the crucial distinction is whether at year end the taxpayer is subject to an existing liability, or whether the taxpayer's liability does not yet exist but is contingent upon the occurrence of future events. In the latter instance, the future events are 'conditions precedent' which must occur before the taxpayer's liability can be accrued. Other future events, which may act to terminate an existing liability, are 'conditions subsequent' and do not prevent accrual.

Brief of New York Life Insurance Company as *Amicus Curiae* Supporting Respondent at 6, *United States v. Hughes Props.*, 476 U.S. 593 (1986) (No. 85-554).

No further action by either party needed to occur to require payment. Therefore, at the close of the year, New York Life had an unconditional obligation to pay the annual dividends. Yet, contrary to *Hughes Properties*, the Second Circuit concluded that New York Life's liability was not fixed because New York Life could not know whether the policyholder would, "simply by failing to act," continue the policy in force. App-18. Under the Second Circuit's reasoning, the casino's liability in *Hughes Properties* was not fixed because the casino could not know with certainty at year end whether it would subsequently go out of business, declare bankruptcy, or lose its gaming license. In concluding that the casino's liability was fixed despite the possibility that the casino's obligation to pay the liability would be terminated upon the occurrence of a condition subsequent, this Court rejected the theory embraced by the court below.

The Second Circuit also incorrectly determined that this Court's decision in *General Dynamics* prevents accrual in New York Life's case. *General Dynamics* reflects the well-settled principle that the all-events test is not satisfied where the existence of a liability is contingent upon the occurrence of a condition precedent. In that case, the taxpayer sought to deduct reimbursements for medical expenses incurred by employees who had not filed a reimbursement claim form by the close of the taxable year. This Court determined that the taxpayer's reimbursement liability did not satisfy the first prong of the all-events test because the "last link in the chain of events creating liability"—the employees' filing of claim forms—had not occurred

within the taxable year. *Gen. Dynamics,* 481 U.S. at 245. Similarly, this Court has held that, where an insurance agent would become obligated to pay back a sales commission if the customer cancelled its contract, the agent's liability to repay the commission only became fixed when the customer actually cancelled the contract. *Brown v. Helvering*, 291 U.S. 193 (1934). The customer's cancellation of the contract was the event that created the liability. "[N]o liability accrues during the taxable year on account of cancellations which it is expected may occur in future years, since the events necessary to create the liability do not occur during the taxable year." *Id.* at 200. New York Life's liability to pay annual dividends on January Anniversary Policies is not contingent upon the occurrence of a condition precedent. At the close of the taxable year, the policyholder has paid the premiums necessary to keep the policy in force until its anniversary date. New York Life's liability is therefore fixed. Only a future condition subsequent, such as a policyholder's action to cancel its policy, could terminate New York Life's liability, and the possibility that such a condition subsequent might occur does not prevent accrual.

Review is needed to correct the Second Circuit's misapplication of *Hughes Properties*, *General Dynamics*, and this Court's long-standing precedent governing the all-events test.

## II. The Decision Below Recreates a Multi-Circuit Conflict that This Court Resolved in *Hughes Properties*

The Second Circuit's conclusion (that a liability is not accrued if there is the possibility that a future event may occur to change the status quo and terminate a taxpayer's liability) resurrects a conflict among several circuits that should be resolved in light of this Court's decision in *Hughes Properties.*

The Sixth and Ninth Circuits have both held, consistent with this Court's subsequent decision in *Hughes Properties*, that the existence of a potential future event that could eliminate liability does not prevent accrual. In *Wien Consolidated Airlines, Inc. v. Commissioner*, 528 F.2d 735 (9th Cir. 1976), the taxpayer was liable under state law to make worker's compensation payments to surviving spouses and minor children of employees killed in the course of their employment. The taxpayer's liability to pay a surviving spouse would terminate if the spouse remarried or died. The taxpayer's liability to pay a minor child would terminate if the child died or reached his or her nineteenth birthday. Thus, the taxpayer's liability was certain to occur if the status quo continued, *i.e.*, a surviving spouse's remaining alive and single and a child's remaining alive until the age of nineteen.

The Ninth Circuit rejected the IRS's argument that the "continued survival" of the children and the "unmarriedness" of the surviving spouse were a "condition precedent to liability." *Wien*, 528 F.2d at 737. Rather, the court agreed with the taxpayer that the conditions were "conditions subsequent . . . [that]

do not preclude accrual." *Id.* The Ninth Circuit's decision was cited favorably by this Court in *Hughes Properties* for the proposition that "potential nonpayment of an incurred liability exists for every business that uses an accrual method, and it does not prevent accrual." *Hughes Props.*, 476 U.S. at 606.

In *Ohmer Register Co. v. Commissioner*, 131 F.2d 682 (6th Cir. 1942), the Sixth Circuit similarly concluded that the possibility that future potential events could eliminate liability did not prevent accrual. In that case, the taxpayer agreed to pay sales commissions to its agents. However, if certain events occurred, such as the purchaser's cancellation of an order, the commission previously credited to the agent's account would be reversed. The court stated that "the right to deduct an expense item accrues when the fixed obligation is incurred, even though the amount may be diminished by subsequent events." *Id.* at 686. The Sixth Circuit thus determined that the liability was fixed because only a condition subsequent—the cancellation of an order—would reduce or terminate the taxpayer's liability to pay the sales commission.

Prior to the decision below, the Second Circuit had concluded, consistent with this Court's decision in *Hughes Properties*, that an "event" for purposes of the all-events test "is ordinarily something which marks a change in the status quo." *Burnham Corp. v. Comm'r*, 878 F.2d 86, 88 (2d Cir. 1989). Thus, in *Burnham*, the Second Circuit had concluded that, where the taxpayer's obligation under a settlement agreement was conditioned on the payee remaining

alive, the liability was properly accrued in the year of the settlement because the payee's continued survival was "merely a continuation of the status quo" and not an "event" for purposes of the all-events test. *Id.* In so concluding, the Second Circuit "respectfully decline[d] to follow" certain pre-*Hughes Properties* cases in the Fifth and Eighth Circuits (discussed below) applying the all-events test to deny an accrual deduction where a future contingency might defeat actual payment. *Id.*

In *Bennett Paper Corp. v. Commissioner*, 699 F.2d 450 (8th Cir. 1983), the Eighth Circuit held that an employer's liability to make payments to a profit-sharing plan for its employees was not fixed in the year prior to payment because the employee was required to remain employed in order to share in the profits of the plan. The court reasoned that because the employee had to continue working until the payment was made to maintain profit-sharing eligibility, "[t]he events necessary to fix the liability would not occur until" the distribution was actually made in the subsequent year. *Id.* at 453. Thus, the Eighth Circuit viewed the employees' continued employment as a condition precedent necessary to fix liability for purposes of the all-events test rather than the continuation of the status quo.

In *Trinity Construction Co. v. United States*, 424 F.2d 302 (5th Cir. 1970), the Fifth Circuit similarly concluded that a future event that could defeat payment prevented accrual. In that case, the taxpayer was obligated to pay premiums on life insurance policies owned by two former employees. If an employee died, the taxpayer's obligation to pay

premiums with respect to that employee would end. The Fifth Circuit held that the taxpayer's liability to pay the premiums was not fixed because it was contingent on the continued survival of the former employees. However, in *Lawyers' Title Guaranty Fund v. United States*, 508 F.2d 1, 6 (5th Cir. 1975), the Fifth Circuit subsequently recognized that the all events test is "not failed merely because a 'condition subsequent' may interfere with actual payment." The court held that amounts payable by the taxpayer as commissions were fixed even though they were held on deposit with the taxpayer for seven years and were subject to offset in certain circumstances. The court stated that "a liability to pay commissions to a selling agent is not defeated by the right of the principal to defer actual payment. . . and to offset the commissions" in certain circumstances. *Id.* at 6.

After *Hughes Properties*, the Fifth Circuit reiterated in *Valero Energy Corp. v. Commissioner*, 78 F.3d 909 (5th Cir. 1996), that "[w]hen a liability is fixed, 'other uncertainties do not necessarily destroy that initial certainty.'" *Valero*, 78 F.3d at 915 (citing *Hughes Properties*, 476 U.S. at 600). In *Valero*, the taxpayer transferred shares to a trust in connection with a settlement plan. The taxpayer committed that the shares would realize at least $115 million from dividends and/or their sale or redemption. The taxpayer further committed to pay in cash the difference between $115 million and the actual proceeds generated by a certain date. The Fifth Circuit held that the taxpayer's liability to pay $115 million was fixed in the year in which the settlement and stock transfer were implemented, even though the fair market value of the stock transferred was

only $89.1 million and "it was uncertain whether Valero would ever have to make any payments pursuant to the assurance provision." *Id.* at 915.

This Court should grant certiorari to avoid renewed conflict between the circuits that should have been resolved by *Hughes Properties*.

### III. The Legal Issue Presented is Fundamental to Accrual Accounting and Significantly Affects Accrual Taxpayers

The question presented has important implications for all accrual-method taxpayers. The decision below, as a result of its conflict with this Court's precedent and the decisions of sister circuits, creates considerable uncertainty. As this Court recognized in *Hughes Properties*, the "potential nonpayment of an incurred liability exists for every business that uses an accrual method." *Hughes Props.*, 476 U.S. at 606. Review is needed to make clear that the continuation of the status quo is not an event for purposes of the all-events test.

The case law illustrates the breadth of accrual-method taxpayers affected by the question presented. Such taxpayers range from casinos with jackpot liabilities (*Hughes Props.*, 476 U.S. 593), companies settling injury claims (*Burnham*, 878 F.2d 86), companies making worker's compensation payments (*Wien*, 528 F.2d 735), companies paying sales commissions (*Ohmer*, 131 F.2d 682), companies paying premiums on employee life insurance (*Trinity*, 424 F.2d 302), and companies making contributions to profit-sharing plans (*Bennett*, 699 F.2d 450). Indeed, every properly accrued liability could be extinguished by the occurrence of some

future event. As this Court has noted, every accrual-method taxpayer could potentially "go out of business" or "go into bankruptcy." *Hughes Props.,* 476 U.S. at 605-606. The question presented thus concerns the most fundamental precept of accrual accounting and is of great concern to accrual-method taxpayers.

This case has the broad implications described above notwithstanding that the economic performance provisions, for some taxpayers, may prevent accrual of a liability until the date of payment. Many liabilities can be accrued prior to payment pursuant to the recurring item exception to the economic performance requirement. *See* 26 U.S.C. § 461(h)(3); 26 C.F.R. § 1.461-4(g)(3), (g)(4), (g)(5); 26 C.F.R. § 1.461-5. Policyholder dividends are eligible for the recurring item exception because they are "rebates, refunds, [or] payments or transfers in the nature of a rebate or refund." *See* 26 C.F.R. § 1.461-4(g)(3); *Mass. Mut. Life Ins. Co. v. United States*, 103 Fed. Cl. at 146-166.

## CONCLUSION

The Court should grant the petition.

Respectfully submitted,

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January 14, 2014

*Appendix A*

**UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT**

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August Term, 2012
(Argued: September 6, 2012
Decided: August 1, 2013)
Docket No. 11-2394-cv

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NEW YORK LIFE INSURANCE COMPANY,
Plaintiff-Appellant,

–v.–

UNITED STATES OF AMERICA,
Defendant-Appellee.

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Before:

JACOBS, Chief Judge, CARNEY, Circuit Judge, and GLEESON, District Judge.[*]

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[*]The Honorable John Gleeson, United States District Judge for the Eastern District of New York, sitting by designation.

New York Life Insurance Company appeals the District Court's dismissal of its complaint pursuant to Fed. R. Civ. P. 12(b)(6). In its complaint, New York Life alleged that the Internal Revenue Service wrongfully denied it certain federal income tax deductions taken pursuant to Code Section 808, which permits a deduction for policyholder dividends "paid or accrued during the taxable year." On its returns for tax years 1990 through 1995, New York Life claimed deductions for amounts it projected it would pay as policyholder dividends in the following calendar years, asserting that its liability for these dividends had accrued under the deduction-timing rules of Treasury Regulation § 1.461-1(a)(2)(i). After the IRS denied the deductions, New York Life paid the taxes in full, then sought to recover the corresponding tax payment of approximately $99.66 million, plus interest. The parties agree that the "all-events" test governs and that New York Life may claim the deductions in a particular tax year only if "all the events have occurred that establish the fact of the liability" in that tax year. We agree with the Service and the District Court that New York Life's complaint fails to state a plausible claim that the all-events test was satisfied as to the two types of dividend-related deductions at issue here.

AFFIRMED.

ARTHUR L. BAILEY (J. Walker Johnson, Shannen W. Coffin, Amanda J. P. Varma, on the brief), Steptoe & Johnson LLP, Washington, D.C., *for Plaintiff-Appellant New York Life Insurance Company*.

MICHAEL J. BYARS (Sarah S. Normand, on the brief), for Preet Bharara, United States Attorney for the Southern District of New York, New York, N.Y., *for Defendant-Appellee United States of America.*

SUSAN L. CARNEY, Circuit Judge:

This case concerns the timing of two deductions that New York Life Insurance Company ("New York Life" or the "Company"), a calendar-year, accrual-basis taxpayer, claimed on its federal income tax returns for tax years 1990 through 1995. In its returns for each of those years, the Company deducted the amounts of two types of policyholder dividends that it treated as accrued expenses in the tax years at issue, but which it did not pay until the following years. The Internal Revenue Service ("IRS" or the "Service") disallowed the deductions, ruling that the Company could not deduct these dividend amounts until the tax year of payment. In the Service's view, the deductions did not satisfy the "all-events" test, which governs the deductibility of accrued but unpaid expenses. *See* Treas. Reg. § 1.461-1(a)(2)(i).

New York Life contested the ruling, paid the taxes owed, and challenged the Service's determination by filing a refund claim for approximately $99.66 million (its calculation of the alleged overpayment) plus interest in the United States District Court for the Southern District of New York. The District Court (Marrero, Judge) granted the Service's motion to dismiss the complaint, concluding

that New York Life failed to (and could not) allege that for the tax years in which they were deducted, the liabilities satisfied the "all-events" test. *New York Life Ins. Co. v. United States*, 780 F. Supp. 2d 324 (S.D.N.Y. 2011).

For the reasons more fully discussed below, we agree with the District Court that, with respect to the two claimed deductions, "all events" had not yet occurred to fix the Company's liability in the tax years in which the Company took the deductions. Because the Company's liability for the dividends was contingent, it did not satisfy the regulatory requirements for deduction of an accrued expense. We therefore AFFIRM the judgment of the District Court.

## BACKGROUND

The following statement of facts is drawn primarily from the allegations of New York Life's complaint.[1]

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[1]We also refer on occasion to the terms of five New York Life insurance policies that the Company presented as samples during its refund proceeding before the Service, on which the Complaint relies, and which the Service submitted in connection with its motion to dismiss. *See Subaru Distribs. Corp. v. Subaru of Am., Inc.*, 425 F.3d 119, 122 (2d Cir. 2005) ("In determining the adequacy of the complaint, the court may consider any written instrument attached to the complaint as an exhibit or incorporated in the complaint by reference, as well as documents upon which the complaint relies and which are integral to the complaint."). The five sample policies are indistinguishable from each other in all ways bearing on our decision.

### 1. The Two Types of Policyholder Dividends at Issue

New York Life is a mutual life insurance company organized under the laws of the State of New York. Like many such entities, the Company issues some policies that entitle their holders to receive a "policyholder dividend"—a share of the Company's annual "divisible surplus." Compl. ¶ 18; *see* N.Y. Ins. Law § 4231(a). During the period from 1990 through 1995, the Company distributed such policyholder dividends both at set periods and upon the occurrence of certain events, such as the death of the insured. Because the Internal Revenue Code allows life insurance companies to deduct from gross income "an amount equal to the policyholder dividends paid or accrued during the taxable year," 26 U.S.C. § 808(c), the Company deducted the amount of these dividends.

At issue here is the timing of the Company's deductions related to two categories of policyholder dividends: (1) the Company's "Annual Dividend for January Policies"; and (2) its "Termination Dividend."

#### A. The Annual Dividend for January Policies

In compliance with New York law, *see* N.Y. Ins. Law § 4231, and the terms of its policies, the Company paid certain of its whole life policyholders an Annual

Dividend on the relevant policy's anniversary date.[2] This Annual Dividend comprised the policyholder's share of the Company's surplus.

The timing of the Company's distribution of the Annual Dividend to eligible policyholders depended on the policy's anniversary date and the schedule for the policyholder's premium payments. According to the terms of the policies at issue here, New York Life paid an Annual Dividend to a policyholder only if, as of the policy's anniversary date, "the policy [was] then in force and all premiums due ha[d] been paid to that anniversary." Compl. ¶ 34. For a policyholder paying monthly premiums, for instance, payment of the twelfth premium in any single twelve-month period would keep the policy in force through its anniversary date.

The Company's practice in the relevant period was to credit a policyholder's account with the amount of the Annual Dividend on a date (the "Credit Date") that was before, but not more than thirty days before, the policy's anniversary date. The credit would occur if, as of the Credit Date, the policyholder had paid all premiums necessary to keep the policy in force through its anniversary date. New York Life did not actually

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[2]Generally, a "whole life" (also called an "ordinary life" or straight life") insurance policy "remains in full force and effect for the life of the insured, with premium payments being made for the same period." Harvey W. Rubin, *Dictionary of Insurance Terms* 358 (4th ed. 2000). A "term life insurance" policy, by contrast, "stays in effect for only a specified, limited period." *Id.* at 517.

pay the dividend, however, until "the Credited Policy's anniversary date."[3]

For most policies—those with anniversary dates falling from February 1 through December 31—the Credit Date fell within the same calendar year as the anniversary date. For policies with January anniversary dates, however, the Credit Date and the anniversary date typically fell in different calendar (and thus tax) years.

The Company deducted from its gross income for tax year 1990 the cumulative Annual Dividends on policies that had Credit Dates in December 1990 and anniversary dates in January 1991. It did the same for tax years 1991 through 1995. We refer to this deduction as the deduction for the "Annual Dividend for January Policies."

### B. The Termination Dividend and the Minimum Dividend Liability Deduction

Certain policies eligible for the Annual Dividend were also eligible, under New York Life's practices, to receive an amount the Company called a "Termination

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[3]Thus, if a policyholder contracted to pay monthly premiums on a policy with a May 15 anniversary date, she would be obligated to pay her twelfth monthly premium on or before April 15 to keep the policy in force through its anniversary date. If the April payment was timely made, the Company would credit the policyholder's account with the Annual Dividend on April 15.

Dividend." This was a share of the Company's surplus that it paid the policyholder or beneficiary upon the policy's termination, whether the termination occurred because the policy matured, the policyholder died, or the policyholder surrendered the policy to obtain its cash value.[4] Although the Termination Dividend, like the Annual Dividend, was drawn from the Company's surplus, the two dividends were calculated on different bases.

In the complaint, New York Life alleged that, in every year from 1990 through 1995, it made one of three possible combinations of dividend payments to eligible policyholders: (1) an Annual Dividend, (2) a Termination Dividend, or (3) *both* an Annual Dividend and a Termination Dividend. It reasoned as follows: If the terminating event—the policy's maturity, or the policyholder's surrender of the policy or death—occurred *before* it credited the policy with the Annual Dividend, the Company would pay the Termination Dividend only. If the terminating event occurred *after* New York Life credited the policy with the Annual Dividend, the Company would pay *both* the Annual and the Termination Dividends. And, if no terminating event occurred in a given year, the policyholder would receive only the Annual Dividend. Therefore, New York Life alleged, under any scenario during these years, it paid at least the lesser of the Annual or Termination Dividend to these

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[4]Each of the sample policies recognizes a holder's right to surrender the policy for its cash value at any time.

policyholders.[5]

New York Life's accrual and payment methods for the Termination Dividend were as follows. In each December from 1990 through 1995, the Company calculated the Annual Dividends and Termination Dividends it expected to pay in the following year to eligible policyholders. The Company then determined, on a policy-by-policy basis, the lesser of the two amounts. It claimed the aggregate of those amounts on its returns for 1990 through 1995 as a deduction for an accrued dividend under Code Section 808. For present purposes, we will refer to this claimed deduction as the Company's deduction for the "Minimum Liability Dividend."[6]

### 2. Prior Proceedings

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[5]The complaint is silent as to whether New York Life paid a Termination Dividend when a policy lapsed for nonpayment of premiums.

[6]To avoid making a duplicate deduction, New York Life excluded from its calculation of the Minimum Liability Dividend deduction the amount it claimed as a deduction for the Annual Dividend for January Policies. Additionally, for reasons related to other tax concerns not at issue here, New York Life claimed the Minimum Liability Dividend deduction with respect only to payments on policies whose anniversary dates fell within the first eight and one-half months of the following taxable year. *See* Code § 461(h)(3)(A)(ii); Treas. Reg. § 1.461-5(b)(1)(ii). Because we conclude that neither the Annual Dividend for January Policies deduction nor the Minimum Liability deduction satisfied the "all-events" test, this practice does not affect our decision and we need not address it further.

New York Life timely filed tax returns for the years 1990 through 1995, claiming in each year a deduction for the Annual Dividend for January Policies and a deduction for the Minimum Dividend Liability. Upon audit, the IRS rejected both claimed deductions, ruling that the Company was entitled to deduct these policyholder dividends only in the years of actual payment. New York Life paid the resulting deficiency and then filed a claim for a refund, which the Service denied. The instant action in the United States District Court for the Southern District of New York ensued.

In its complaint, the Company sought principally a refund of $99.66 million plus interest, claiming that it was entitled to accrue and deduct the two dividend-related amounts in each of the six tax years at issue.[7] The District Court granted the Service's motion to dismiss under Fed. R. Civ. P. 12(b)(6). The court concluded that the deductions did not satisfy the "all-events" test, a requirement under Treasury Regulation § 1.1.461-1(a)(2)(i) for deduction of an accrued expense. *See New York Life*, 780 F. Supp. 2d at 329. In the court's view, New York Life failed to allege sufficient facts from which to infer that, in the tax year for which the deduction was claimed, all events had occurred to establish the fact of the liability. As to the Annual Dividend for January Policies, the Company's claim fell short because it "had

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[7]New York Life also claimed a related credit carryback to tax year 1988.

no obligation to pay [the policyholder] an Annual Dividend if he surrendered the Policy on the day before the Policy anniversary." *Id.* at 328. As to the Minimum Dividend Liability, the Company's claim fell short because "as of December 31 of each taxable year at issue, New York Life did not have an obligation to pay either an Annual Dividend or a Termination Dividend in the following taxable year because neither dividend was unconditionally due." *Id.* at 329.

## DISCUSSION

We review the grant of a motion to dismiss *de novo*, accepting as true the complaint's factual assertions and drawing all reasonable inferences in the plaintiff's favor. *Gatt Commc'ns, Inc. v. PMC Assocs., L.L.C.*, 711 F.3d 68, 74 (2d Cir. 2013). "To survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 556 U.S. 662, 678 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)).

### 1. The All-Events Test

Section 808(c) of the Internal Revenue Code permits life insurance companies to deduct from gross income "an amount equal to the policyholder dividends paid *or accrued* during the taxable year." Code § 808(c) (emphasis added). To determine whether liability for a policyholder dividend has "accrued" in a taxable year, we look to IRS regulations governing the timing of deductions for accrual basis taxpayers like New

York Life.[8] *See Ferguson v. Comm'r*, 29 F.3d 98, 102-03 (2d Cir. 1994). Treasury Regulation § 1.461-1(a)(2)(i) provides that, for such taxpayers, "a liability . . . is incurred, and generally is taken into account for Federal income tax purposes, in the taxable year in which [1] all the events have occurred that establish the fact of the liability, [2] the amount of the liability can be determined with reasonable accuracy, and [3] economic performance has occurred with respect to the liability."[9]

The Service and New York Life agree that this three-part inquiry governs the timing of a life insurance company's deduction of a policyholder dividend under Section 808. They disagree, however, about whether New York Life can satisfy the first prong of the inquiry, in which the taxpayer must show, before deducting a dividend, that "all the events have occurred that establish the fact of the liability."

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[8]Life insurance companies are generally required to operate on an accrual basis for federal income tax purposes. *See* Code § 811.

[9]This tripartite rule is echoed also in Treasury Regulation § 1.446-1, which provides in relevant part that "[u]nder an accrual method of accounting, a liability (as defined in § 1.446-1(c)(1)(ii)(B)) is incurred, and generally is taken into account for Federal income tax purposes, in the taxable year in which all the events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability." *Id.* § 1.446-1(c)(1)(ii)(A).

Together, this prong and the second prong—that the amount of the liability be determinable "with reasonable accuracy"—comprise the "all-events" test. *See United States v. Hughes Props., Inc.*, 476 U.S. 593, 600 (1986). The all-events test was first articulated in *United States v. Anderson*, 269 U.S. 422, 441 (1926), where the Supreme Court concluded that liability for a munitions tax accrued and became deductible in the taxable year in which "all the events . . . occur[ed] which fix[ed] the amount of the tax and determine[d] the liability of the taxpayer to pay it." That general rule appears to have prevailed until 1984, when Congress limited its application by imposing an additional "economic performance" requirement, further defining and restricting the circumstances in which a taxpayer could claim a deduction for an accrued but unpaid expense. *See* Deficit Reduction Act of 1984, Pub. L. 98-369, § 91(a), 98 Stat. 494, 600 (codified at 26 U.S.C. § 461(h)) (the "1984 Act"); *United States v. Gen. Dynamics Corp.*, 481 U.S. 239, 243 n.3 (1987). Because we find that New York Life's complaint fails to state a plausible claim that the deductions at issue satisfied the first prong of the all-events test, we consider neither the second prong of the test (the "fixed amount" element), nor the statutory economic performance requirement and its exceptions.

Two seminal Supreme Court cases guide our analysis of the first prong of the all-events test. In *United States v. Hughes Properties, Inc.*, 476 U.S. 593 (1986), a Nevada casino owner claimed a deduction related to its payout obligations on so-called

"progressive" slot machines—machines that, with each play, ratchet up the available jackpot amount, until some patron wins the jackpot. *Id.* at 595. Nevada law prohibited the casino from reducing the amount of the jackpot payable on such a machine until a winner appeared and collected his reward. *Id.* at 596. Accordingly, the casino owner claimed a deduction each year for the marginal amount by which his liability for the jackpot had increased. *Id.* at 597. In the face of the IRS's objection to the practice, the Court considered whether "all events" had occurred to establish the fact of the casino owner's enhanced liability.

The Court determined that all such events had occurred, and permitted the deduction. It reasoned that the effect of the state law forbidding a jackpot reduction until payout to a winner "was to fix [the casino's] liability." *Id.* at 601. Although the casino owner did not know when or to whom it would be required to pay the jackpot amount, the casino "had a fixed liability for the jackpot which it could not escape," and the liability satisfied the all-events test. *Id.* at 602.

The following year, in *United States v. General Dynamics Corp.*, 481 U.S. 239 (1987), the Court rejected an employer's attempt to deduct a purportedly accrued liability for medical expenses reimbursements. General Dynamics, which self-insured with respect to its employee's medical coverage, required its employees to submit a claim form before it would reimburse an employee's medical expenses. *Id.* at 241.

The company sought to deduct the cost of medical services that employees had received in the tax year at issue, but for which they had yet to submit claims forms. *Id.* at 241-41. The Court refused the deduction, explaining that, because filing the claim form was "crucial" to establishing the company's liability, the employee's receipt of medical services did not "constitute the last link in the chain of events creating liability for purposes of the 'all events' test." *Id.* at 244-45. "General Dynamics was . . . liable to pay for covered medical services only if properly documented claims forms were filed." *Id.* at 244. "It is fundamental to the 'all events' test," the Court instructed, "that, although expenses may be deductible before they have become due and payable, liability must first be firmly established. . . . [A taxpayer] may not deduct a liability that is contingent, [n]or . . . an estimate of an anticipated expense, no matter how statistically certain, if it is based on events that have not occurred by the close of the taxable year." *Id.* at 243-44.

These cases highlight that the all-events test is not satisfied, and a liability not established, by a statistical probability—however high—that the taxpayer will ultimately pay the expense. Instead, the test requires that nothing further be needed to create a "fixed liability . . . which [the taxpayer cannot] escape." *Hughes Props.*, 476 U.S. at 602; *see Gen. Dynamics*, 481 U.S. at 243-44. If the taxpayer's obligation remains in some way contingent—dependent on some discrete event that has not yet occurred—the deduction will not satisfy the all-events test and may be disallowed. *Gen.*

*Dynamics*, 481 U.S. at 243; *Hughes Props.*, 476 U.S. at 602.

### 2. Application to the Annual Dividend for January Policies

Applying these principles, we conclude first that the Service properly disallowed New York Life's deduction for the Annual Dividend for January Policies. The Company's allegations did not support an inference that, as of the Credit Date, all events had occurred that established "the fact of the liability" for that dividend.

New York Life asserts that the last "event" for purposes of the all-events test occurred when, in the taxable year, the January policyholders paid the final premium sufficient to keep their policies in force through their anniversary dates in January.[10] It is true that the Credit Date for these January policies fell in the taxable year. Further, in the relevant tax years, many—perhaps even most—of those January policyholders received an Annual Dividend in January, based on a premium payment in the previous year.

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[10]New York Life argued in the District Court that the final "event" fixing liability was the Company's crediting of the policyholder's account with the amount of the Annual Dividend, up to thirty days before the policy's anniversary date. The Company has abandoned this contention on appeal. *See* Appellant's Reply Br. at 9 ("New York Life's liability arises from the payment of premium under the contract, not the crediting practice.").

But New York Life's argument overlooks that "the last link in the chain of events creating liability"—the policyholder's decision to keep his or her policy in force through the policy's anniversary date—did not occur until January of the following year. *Gen. Dynamics*, 481 U.S. at 245. According to the complaint and the sample policies, New York Life was obligated to pay an Annual Dividend to a policyholder only if *two* conditions held: (1) the policyholder had paid the last premium necessary to keep the policy in force through its anniversary date, *and* (2) the policy was in force on the anniversary date. The Company has plausibly alleged, and therefore we take as true, that the first condition was satisfied—that is, that the Company deducted the Annual Dividend only with respect to those January policyholders who had already paid the premiums necessary to keep the policy in force through the policy anniversary date.

New York Life's liability also turned, however, on satisfaction of the second condition: the Company was obligated to pay the Annual Dividend *only* if the policyholder also maintained her policy in force through its anniversary date. The sample policies recognize a policyholder's right to surrender her policy for its cash value at any time. Nowhere do the policies provide that New York Life is obligated to pay an Annual Dividend if a policyholder chooses to cash in her policy before the anniversary date; instead, the policies condition payment of an Annual Dividend on the policy being "in force" on its anniversary date. *See* J.A. 35, 43, 62, 72, 82. New York Life could not know in December which course of action the policyholder

would choose the following month. In economic circumstances favorable to her, a policyholder might decide—before the policy's anniversary date—to forgo the Annual Dividend and obtain the policy's cash value, so as to put the cash to another use or pursue a more remunerative investment option. She was certainly free to do so.

Like the District Court, we see this dividend liability as most closely analogous to the liability for medical expenses that the taxpayer attempted to deduct as an accrued liability in *General Dynamics*. Just as the taxpayer there was "liable to pay for covered medical services *only* if properly documented claims forms were filed," 481 U.S. at 244, so too was New York Life liable to pay the Annual Dividend *only* if a policyholder kept her policy in force through its anniversary date. That many policyholders may have done so—in effect, "deciding" to maintain the policy in force simply by failing to act—does not change our analysis. That policyholders who pay their last premium might even be "statistically certain" to keep their policies in force through the anniversary date also does not matter: the relevant inquiry is whether the liability was based on any "events that ha[d] not occurred by the close of the taxable year." *Id.* at 243-44. New York Life's policies obligated it to pay an Annual Dividend only if the policy remained in force on the policyholder's anniversary date. Having adopted this structure, New York Life cannot at the same time disavow it simply to accelerate its use of the related income tax deduction.

The Company responds that Code Section 808(c) provides a deduction for policyholder dividends "paid or accrued during the taxable year," and argues that if it must wait until the tax year of payment to deduct the Annual Dividend for January Policies, Section 808(c)'s phrase "or accrued" becomes superfluous.

To see why this argument is unpersuasive, we need look no further than our decision in *National Life Insurance Co. v. Commissioner*, 103 F.3d 5 (2d Cir. 1996), a case also addressing a life insurance company's deduction of policyholder dividends. There, National Life "guaranteed dividends on a pro rata, monthly basis." *Id.* at 6. Under this arrangement, a policyholder who terminated her policy before its anniversary date was nonetheless guaranteed and entitled to receive a pro rata monthly share of the annual dividend. *Id.* For example, a policyholder who terminated her policy three months before its anniversary date would receive seventy-five percent (nine-twelfths) of the year's annual dividend, provided that her premium payments were current at the date of termination. *Id.*

In *National Life*, we noted that "[u]nder the accrual method, most insurance companies, because they do not guarantee the payment of policyholder dividends, may not deduct those dividends until the time that such dividends are actually paid." *Id.* National Life could deduct its dividends in advance of payment, however, because under its "guaranteed dividend policy," it became "obligated to pay one-twelfth of the dividend each month." *Id.* (emphasis

added).

To be sure, our decision in National Life ultimately turned on a different section of the Code,[11] and the language we have quoted is not binding on us here. Nonetheless, the case presents a useful factual comparison between liabilities for dividends "guaranteed . . . on a pro rata, monthly basis," id., and liabilities for dividends (like those paid by New York Life) guaranteed only for policies that remained in force for the entire year. National Life thus demonstrates how a liability for policyholder dividends may "accrue" under Section 808(c) and be deductible in advance of payment, under Treasury Regulation § 1.461-1(a)(2)(i), without running afoul of the all-events test.[12]

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[11]*National Life* addressed primarily the tax implications for companies of a transition from a "reserve" method of accounting to an accrual method under the 1984 Act, which disallowed the reserve method.

[12]For similar reasons, we see New York Life's case as distinguishable—if perhaps at the margins—from that considered in *Massachusetts Mutual Life Insurance Co. v. United States*, 103 Fed. Cl. 111 (2012) ("Mass. Mutual"), a recent decision of interest but not binding on us. In Mass. Mutual, the Court of Claims permitted deduction of a policyholder dividend in advance of payment where the taxpayer insurance company also required that a policy be "in force as of the anniversary date" to entitle the policyholder to a dividend payment. *Id.* at 114. There, however, the policy was considered "in force" simply "if the premiums for the policy [had been] paid through its anniversary date." *Id.* Here, by contrast, New York Life has defined eligibility for an Annual Dividend differently, requiring both that the policyholder have

New York Life also argues that a policyholder's decision to keep her policy in force does not constitute an "event" for purposes of the all-events test. In this regard, the Company relies for support on our decision in *Burnham v. Commissioner*, 878 F.2d 86 (2d Cir. 1989), a decision concerning accrual practices but unrelated to the payment of policyholder dividends. In *Burnham*, the taxpayer corporation entered into a one-time settlement agreement on a patent infringement claim. *Id.* at 87. That agreement required the company to make forty-eight monthly payments to the individual claimant totalling $60,000, whether or not she survived until the end of the period; if she did, the payments were to continue until her death. *Id.* Using mortality tables to estimate how long the payee was likely to survive and what the amount of its ultimate liability was likely to be, the company, in a single tax year, claimed a deduction for the entire sum it expected to pay over the payee's life. The Tax Court allowed the deduction, and we affirmed.

With respect to the first prong of the test, we reasoned "that the event necessary to fix the *fact* of [the company's] liability to [the payee]—namely, the settlement agreement—had occurred" by the taxable year in which the company claimed the deduction. *Id.* at 88 (emphasis added). And the Commissioner "d[id]

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paid all premiums and that she not have surrendered her policy for cash prior to the policy's anniversary date. *See* Compl. ¶ 34. To the extent that the reasoning of the *Mass. Mutual* court is at odds with ours, however, we respectfully disagree with that court's approach.

not dispute that" the company's liability "satisfied the second prong of the all events test[,] . . . in effect conced[ing] that the amount of the liability could be determined with reasonable accuracy." *Id.* at 87-88. The company was therefore entitled to the deduction.

In addressing the argument that the payee's continued survival each year was an "event" that precluded satisfaction of the all-events test, we also stated that an "event" is "ordinarily something which marks a change in the status quo." *Id.* at 88. New York Life seizes upon this language and argues that, with respect to its dividend accrual for January policyholders, once a policyholder paid her final premium, mere continuation of the status quo would result in the company's liability for the Annual Dividend. Therefore, as in *Burnham*, nothing more was required and the deduction should be allowed.

We are not persuaded. First, in *Burnham*, the parties established the fact of the liability when they executed the settlement agreement. *Id.* at 88. Only the ultimate amount of that obligation was uncertain, and the Commissioner "in effect conceded that the amount of liability could be determined with reasonable accuracy." *Id.* Here, the amount was perhaps more certain, but the fact of liability was still tentative. Second, we see New York Life's liability for the Annual Dividend as depending upon an actual *choice* by the third-party policyholder: her decision not to redeem her policy for cash, for example, and invest her money elsewhere. In *Burnham*, by contrast, no third-party choice was at issue; the payee's survival was hardly a

result of a choice, at least not in any ordinary sense. Even acknowledging that many New York Life policyholders might not daily or monthly reevaluate whether to surrender their policy, a significant decision is committed to them. Thus, the mere "continuation of the status quo" at issue in *Burnham* is unlike continuation of the status quo for New York Life.

Finally, a reading of *Burnham* that permits deduction in a taxable year of a liability that is dependent on a third party's investment decision in the following year would run afoul of the rule of *General Dynamics*, 481 U.S. at 243, the far closer analogue to the facts presented here. And surely a one-time litigation settlement payment and an insurer's annual dividend payment practice offer different contexts for assessing what it means to "continue the status quo" in the context of applying the all-events test.[13]

Accordingly, we conclude that New York Life failed to allege facts sufficient to support an inference that its deductions for the Annual Dividend for

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[13]We also note that *Burnham* relied on several out-of-circuit cases that permitted similar lump-sum deductions for companies obligated to make lifetime payments as a result of tort settlements or workers' compensation laws. *See* 878 F.2d at 88. In the 1984 Act, Congress brought an end to this practice, requiring companies to wait to deduct the amount of settlement or workers' compensation awards until payment is made. *See* Pub. L. 98-369, § 91(a), 98 Stat. 494, 598-99 (codified at 26 U.S.C. § 461(h)(2)(C)).

January Policyholders satisfied the all-events test.

### 3. Application to the Minimum Dividend Liability

New York Life's practice of comparing the size of the Annual and Termination Dividends and then deducting the lesser amount in the tax year before payment also fails to satisfy the requirement that "all the events have occurred that establish the fact of the liability." Treas. Reg. § 1.461-1(a)(2)(i). New York Life was under no contractual, statutory, or other obligation to pay a Termination Dividend when the policyholder surrendered her policy. Without such an obligation, we conclude, the Company was not entitled to deduct the Minimum Liability Dividend in advance of payment.

As an initial matter, it appears that New York Life bore no contractual obligation to pay a Termination Dividend when the policyholder surrendered her policy. With respect to the Termination Dividend, the Company alleged only that it "distributes a portion of its divisible surplus to owners of participating life insurance policies (if they meet certain criteria) upon the termination of the policy by death, maturity, or surrender." Compl. ¶ 48; *see id.* ¶ 49 ("New York Life pays termination dividend amounts on the date of termination of the Eligible Policies."); *see also* Appellant's Reply Br. at 13 ("For some of New York Life's policies (e.g., the Eligible Policies), this divisible surplus may be distributed through a termination dividend."). Review of the

sample policies confirms that no such contractual obligation existed: the policies state only that the Company will pay an Annual Dividend if the policy is in force on the anniversary date, and a "post-mortem dividend" of an uncertain amount to the beneficiary upon the death of the insured. *See* J.A. 43, 72, 82; *see also* J.A. 35, 62. Nowhere do the provisions discussing the Company's dividend obligations mention a dividend payable in addition to the cash value otherwise due the policyholder upon surrender of the policy.[14]

Perhaps recognizing that it lacked a contractual obligation to pay a Termination Dividend upon surrender, New York Life also implies that New York Insurance Law required it to do so. As relevant here, New York law provides that "every domestic life insurance company *shall ascertain and distribute annually, and not otherwise*, the proportion of any surplus accruing upon every participating insurance policy and annuity or pure endowment contract entitled as hereinafter provided to share therein." N.Y. Ins. Law § 4231(a)(1) (emphasis added). The law also provides that a life insurance company that distributes its divisible surplus on an annual basis "*may* apportion and distribute all or any part of its accumulated

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[14]And nowhere does the complaint allege that New York Life paid policyholders a dividend when they let their policy "lapse" by failing to pay premiums. *See, e,g.*, J.A. 33 ("Nonpayment of Premium"). In this scenario, too, it seems the Company was not obligated to pay either an Annual or Termination Dividend.

surplus . . . at reasonable intervals with respect to any policy or contract or on its termination by death, maturity or surrender, as additional or extra dividends." *Id.* § 4231(a)(4) (emphasis added). Nothing in these provisions requires New York Life to pay a Termination Dividend upon surrender.

The Company has pointed to no source from which we may reasonably infer that its payment of the Termination Dividend upon surrender was anything other than a voluntary practice. Absent an obligation to pay a dividend when a holder surrendered her policy, we cannot say that the fact of the Minimum Dividend Liability was "firmly established" at the time of deduction. *Gen. Dynamics*, 481 U.S. at 243.

New York Life responds that, under Treasury Regulation § 1.446-1(c)(1)(ii)(B), the term "liability" is "not limited to items for which a legal obligation to pay exists at the time of payment." But of course, we are not examining the deductibility of the Minimum Dividend Liability at the time of *payment*: we are examining whether New York Life's claim that this amount, related to a Termination Dividend paid in the following year, was deductible as accrued in the year before payment. Moreover, that the Supreme Court uses the term "liability" in connection with the all-events test for accrued expenses implies very directly that, to satisfy the test, the taxpayer must be under *some* obligation to pay if it is claiming a deduction for an accrued but unpaid expense. *See, e.g., Gen. Dynamics*, 481 U.S. at 242-43; *Hughes Props.*, 476 U.S. at 600; *see also Hallmark Cards, Inc. v. Comm'r*, 90

T.C. 26, 34 (1988) ("The all events test is based on the existence or nonexistence of legal rights or obligations at the close of a particular accounting period, not on the probability—or even absolute certainty—that such right or obligation will arise at some point in the future."); 2 *Mertens Law of Federal Income Taxation* § 12A:118 (Kathleen Bicek Bezdichek ed., 2013) ("[T]he taxpayer must be under some actual or apparent obligation for the payment at the time the liability is accrued for it to be deductible as an expense.").

State law might provide the source of this obligation, as it did in *Hughes Properties* by precluding the casino from reducing the amount of the jackpot for which the casino would ultimately be liable. *See* 476 U.S. at 602. Alternatively, the obligation might stem from the terms of an express or implied contract; in *General Dynamics*, for instance, the terms of the employee medical care plan provided the source of the taxpayer's liability. *See* 481 U.S. at 244. Here, as we have explained, there was no such source.

That New York Life's Board of Directors met annually in November and "approved the payment during the following year" of a Termination Dividend does not cure this defect. Compl. ¶ 25. Without some preexisting obligation, a board's resolution cannot convert a voluntary expense into an accrued liability for federal income tax purposes. We addressed this issue in *Commissioner v. H.B. Ives Co.*, 297 F.2d 229 (2d Cir. 1961), where a board of directors passed a resolution setting aside a sum for the purchase of annuity contracts for employees, which the company

duly purchased the following year. The corporation claimed a deduction for the purchase price of the contracts in the taxable year in which the board passed the resolution. *Id.* at 229-30. We determined that the Commissioner properly denied the deduction, concluding that "neither the resolution of respondent's board of directors, nor the entry on its books, in themselves establish the proper accrual of the claimed liability." *Id.* at 230. The obligation became fixed for tax deductibility purposes only when the company actually purchased the contracts. *Id.*

New York Life argues that *Ives* does not control, and that an "irrevocable" board resolution may fix a liability so as to satisfy the all-events test. The Company cites several authorities in support of this proposition, including *Willoughby Camera Stores, Inc. v. Commissioner*, 125 F.2d 607 (2d Cir. 1942). These cases are inapposite. In *Willoughby*, for example, we upheld a company's deduction in one taxable year of an amount its Board set aside to pay employee bonuses in the following year. *Id.* at 608. Our conclusion that the deduction was permissible rested on a finding that the company was under an "implied contract" to pay the bonus, because employees were told upon hiring that they would receive the bonus. *Id.; see also Champion Spark Plug Co. v. Comm'r*, 30 T.C. 295, 296-98 (1958), *aff'd*, 266 F.2d 347 (6th Cir. 1959) (finding that a board resolution to pay an employee post-employment compensation satisfied the all-events test where the employee had been informed upon hiring that he would be eligible for a pension plan and life insurance). Unlike the employer-employee context we considered

in *Willoughby*, we see no basis for finding an implied contractual obligation binding New York Life to pay a Termination Dividend upon surrender.

New York Life has thus failed to allege that it had a contractual, statutory, or other obligation to pay a Termination Dividend upon surrender, and we find unpersuasive its argument that no such obligation was necessary. Without establishing "the fact of the liability," the Company has not met the all-events test for its Minimum Dividend Liability. Contrary to the Company's contention, whether the Company in fact paid a Termination Dividend upon surrender in the relevant years is of no import.[15] For purposes of the all-events test, the relevant inquiry is whether, for the taxable years in question, New York Life was obligated to pay the Termination Dividend to certain policyholders—and therefore, whether it bore a fixed

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[15]New York Life also argues that, in *National Life*, the IRS permitted and we affirmed "deductions relating to [the insurer's] non-contractual '*practice*[ ]'" of guaranteeing prorated dividends. Appellant's Reply Br. at 14 (quoting *National Life*, 103 F.3d at 6) (emphasis added). But in *National Life*, the government stipulated that the insurer's practice made the prorated dividend payments "guaranteed"; our Court, having no occasion to consider that issue, treated the practice as sufficient to fix the liability for federal tax accrual purposes. *See, e.g.*, 103 F.3d at 6 ("National Life followed a practice whereby it *guaranteed* dividends on a pro rata, monthly basis." (emphasis added)); *id.* ("[U]nder National Life's guaranteed dividend policy, National Life becomes *obligated* to pay one-twelfth of the dividend each month." (emphasis added)); *id.* ("[I]f a policy terminated three months before the anniversary date . . . the policyholder would be *entitled* to seventy-five percent . . . of the dividend for that policy year." (emphasis added)).

liability for a Minimum Dividend for the years in which the deduction was claimed. We conclude that, given the allegations in the complaint, the answer is no.

## CONCLUSION

For the reasons set forth above, we **AFFIRM** the judgment of the District Court dismissing New York Life's complaint.

*Appendix B*

**UNITED STATES DISTRICT COURT**
**SOUTHERN DISTRICT OF NEW YORK**

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NEW YORK LIFE INSURANCE COMPANY,
Plaintiff,

- against - 10 Civ. 4701 (VM)

UNITED STATES OF AMERICA,
Defendant.

**DECISION AND ORDER**

**VICTOR MARRERO, United States District Judge.**

Plaintiff New York Life Insurance Company ("New York Life") brought this action against defendant United States of America ("Government") seeking a refund of certain Federal income taxes that New York Life paid for the taxable years 1988 and 1990 through 1995. The Government now moves

pursuant to Rule 12 (b) (6) of the Federal Rules of Civil Procedure ("Rule 12 (b) (6) ") to dismiss the complaint. For the reasons listed below, the Court GRANTS the Government's motion.

## I. MOTION TO DISMISS STANDARD

In assessing a motion to dismiss under Rule 12 (b) (6), dismissal of a complaint is appropriate if the plaintiff has failed to offer factual allegations sufficient to render the asserted claim plausible on its face. *See Ashcroft v. Iqbal,* 129 S. Ct. 1937, 1949 (2009) (*quoting Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 570 (2007)). To state a facially-plausible claim, a plaintiff must plead enough "factual content that allows court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.*

## II. DISCUSSION[1]

Under New York law, New York Life must distribute annually a portion of its surplus earnings ("Annual Dividend") to the owners of "participating

[1]The facts below are taken from the complaint ("Complaint" or "Compl."), documents attached to the Complaint as exhibits and documents incorporated into the Complaint by reference. The Court accepts these facts as true for the purposes of ruling on a motion to dismiss. *See Spool v. World Child Int'l Adoption Agency*, 520 F.3d 178, 180 (2d Cir. 2008). However, allegations that are no more than legal conclusions "are not entitled to the assumption of truth." *Iqbal*, 129 S. Ct. at 1950. Except where specifically referenced, no further citation to these sources will be made.

insurance polic[ies] and annuity contract[s]" ("Policies"). N.Y. Ins. Law. § 4231(a). Each individual Policy provides that the Annual Dividend becomes payable on the anniversary of the Policy "if the Policy is then in force and all premiums due have been paid [prior] to such anniversary." (Compl. ¶ 19.) In each of the years 1990 through 1995, New York Life credited a policyholder's account with the Annual Dividend on the later of (1) thirty days before the anniversary of the Policy; or (2) the date on which all premiums due had been received.

Although New York Life credited a policyholder's account up to thirty days before the Policy anniversary, in most cases, New York Life did not pay the Annual Dividend until the policy anniversary. As a result, for Policies with anniversaries in February through December, the date New York Life credited the policyholder account and the date the company actual paid the Annual Dividend fell within the same taxable year. In contrast, for Policies with anniversaries in January ("January Anniversary Policies"), New York Life credited the policyholder account in December of one year but did not pay until January of the following year ("January Annual Dividend"). In other words, the January Annual Dividends were credited and paid in different taxable years.

In addition to requiring New York Life to pay an Annual Dividend, New York law allows New York Life to distribute a portion of its surplus earnings as a one-time dividend to policyholders when a Policy

terminates by death, maturity or surrender ("Termination Dividend"). *See* N. Y. Ins . Law § 4231 (a) (4). If a Policy terminated after New York Life credited the policyholder's account with the Annual Dividend (*i.e.*, the later of thirty days before the anniversary of the Policy or the date on which all premiums due had been received), the policyholder received both an Annual Dividend and a Termination Dividend in the year in which the Policy terminated. Alternatively if a Policy terminated before New York Life credited the policyholder's account with the Annual Dividend, the policyholder received only a Termination Dividend in that year. Finally, if a Policy did not terminate in a given year, the policyholder received only an Annual Dividend. In sum, New York Life expected to pay in any given year either an Annual Dividend or a Termination Dividend, or both, on each Policy. Each December, New York Life estimated the minimum amount, consisting of the smaller of the two dividends, to be paid on each Policy in the following year.

Under the Internal Revenue Code ("Code" or "I.R.C.") , a life insurance company may deduct from its Federal income tax return "policyholder dividends paid or accrued during the taxable year." 26 U.S.C. (I.R.C.) § 808 (c). Accordingly, in each of the taxable years 1990 through 1995, New York Life deducted from its Federal income tax return (1) January Annual Dividends that New York Life credited to its policyholders in December of 1990 through 1995 but did not pay until January of 1991 through 1996; and (2) the smaller of the Annual Dividend and the

Termination Dividend that New York Life expected to pay on each Policy in the first 8 1/2 months of the taxable years 1991 through 1996.[2] The Internal Revenue Service ("IRS") audited New York Life's returns for 1990 through 1995 and disallowed the deductions described above, limiting New York Life's deductions to policyholder dividends actually paid during the taxable year. New York Life paid assessed tax deficiencies and interest.

On April 18, 2000, New York Life filed a claim for a refund of Federal income tax it paid for 1990 through 1993. New York Life also claimed a credit carryback to 1988. On November 13, 2002, New York Life filed a second refund claim for 1994 and 1995. Both refund claims related, in part, to the disallowed deductions for policyholder dividends. After the IRS denied all of the claims described above, New York Life filed this action on seeking a refund of $99,664,009 in assessed taxes and interest.

It is undisputed that New York Li may deduct from its Federal income tax returns "policyholder dividends id or accrued during the taxable year." I.R.C. § 808(c). The parties disagree only as to when January Annual Dividends and Termination Dividends accrue under the Code. Under an accrual method of accounting, which life insurance companies such as

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[2]New York Life deducted only those dividends it expected to pay in the first 8 1/2 months of the following year to conform to Section 461 (h) (3) (A) (ii) (II) of the Code.

New York Life must employ, *see* I.R.C. § 811(a) (1), a liability becomes deductible when each of three conditions has been satisfied: (1) "all the events have occurred that establish the fact of the liability"; (2) "the amount of the liability can be determined with reasonable accuracy"; and (3) "economic performance has occurred." 26 C.F.R. ("Treas. Reg.") § 1.461-l(a) (2); *see also* I.R.C. § 4 61 (h) . Consequently, the deductions described above were proper only if New York Life has offered factual allegations sufficient to support a plausible inference that all three conditions were met.

The first condition, known as the "all events test," requires that the liability be "fixed and absolute," "'unconditional'" rather than "contingent." *United States v. Hughes Props., Inc.* 476 U.S. 593, 600 (1986). "[A]lthough expenses may be deductible before they have become due and payable, liability must first be firmly established." *United States v. Gen. Dynamics Corp.*, 481 U.S. 239, 243 (1987).

Two leading Supreme Court cases illustrate the difference between fixed and contingent liabilities for purposes of the all events test. First, in *Hughes Properties*, the Court held that a liability fixed in amount by state law accrued under the Code even though payment would not occur until an indefinite time in the future. 476 U.S. at 601-06. The taxpayer in that case was a casino located in Nevada, which operated a slot machine known as "progressive" because jackpot increased as money was gambled on it. *Id.* at 595. A Nevada regulation prevented casino from reducing the jackpot. Stated differently, the law

guaranteed that the casino would pay the jackpot that had accumulated on the progressive machine. The Court held that the Code permitted the casino to deduct the increase in the progressive jackpot from one taxable year to the next as an accrued liability, even though the jackpot had not yet been distributed to a winner. 601-06. *Id.* at 601-06.

Second, in *General Dynamics*, the Court held that an employer's liability to reimburse its employees for medical care was contingent even though the medical services had already been provided. 481 U.S. at 244-45. General Dynamics Corporation had deducted from its Federal income tax return its liability to reimburse employees medical care received during the final quarter of the taxable year, but for which the employees had not yet submitted claims. *Id.* at 240. The Court found that the liability did not accrue until claims were actually submitted, furnishing "the last link in chain of events creating liability for purposes of 'all events test.'" *Id.* at 245.

This Court finds the case at hand to be more akin to *General Dynamics* than to *Hughes Properties*. The Policies provide that "*on each policy anniversary* any share of divisible surplus apportioned to [the Policy] will be payable as a dividend *if* the Policy is then in force and all premiums due have been paid [prior] to such anniversary." (Compl. ¶ 19 (emphasis added).) Thus, under the terms of the Policies, even if a policyholder had paid all premiums due, New York Life had no obligation to pay him an Annual Dividend if he surrendered the Policy on the day before the

Policy anniversary. Unlike in *Hughes Properties*, where each play of the slot machine guaranteed an increased jackpot, here liability was not fixed until a sequence of events had been completed. The "last link in the chain of events creating liability" did not occur until the anniversary date of the Policy. *Gen. Dynamics*, 481 U.S. at 245. Because New York Life's obligation to pay arose only if the Policy remained in force on its anniversary, i.e., policy had not been terminated, its liability was merely "contingent" prior to that date.

New York Life does not argue that the contract terms require otherwise. Rather, it contends that its liability to pay an Annual Dividend on a January Anniversary Policy became unconditionally fixed when it credited the policyholder's account with the dividend. The Court disagrees. While New York Life has alleged facts that could establish that it paid all dividends that had been credited to an account as a matter of practice it has not alleged facts that could support a plausible inference that it was *required* to do so. The Second Circuit has firmly rejected the position that a company's internal recordkeeping practices can fix liability for purposes of the all events test. *See Comm'r of Internal Revenue v. H.B. Ives*, 297 F.2d 229, 230 (2d Cir. 1961) ("[N]either the resolution of respondent's board of directors, nor the entry on its books, in themselves establish the proper accrual of the claimed liability . Deduction could be claimed only when the liability to pay became certain."). Rather, the all events test looks to the date that liability is "firmly established." *Gen. Dynamics*, 481 U.S. at 243. In this

case, liability was not firmly established until the date fixed by the contract, *i.e.*, the anniversary date. That New York Life recorded the liability on its books up to thirty days prior does not alter the result. Its choice to post the entry when it did, for whatever accounting convenience or other reasons, was entirely voluntary. As long as New York Life was under no legal obligation to so record the liability, it could just as easily have reversed the practice at any time prior to the anniversary date. To that extent, the liability was contingent upon the continuation of an internal recordkeeping practice that was not required by law.

New York Life's claim that it was entitled to deduct the smaller of the Annual Dividend or the Termination dividend similarly fails. As explained above, an Annual Dividend was a contingent liability until the anniversary of the Policy. New York Life does not dispute that a Termination Dividend was a contingent liability because the Policy could remain in force for the entire taxable year. As a result, as of December 31 of each taxable year at issue, New York Life did not have an obligation to pay either an Annual Dividend or a Termination Dividend in the following taxable year because neither dividend was unconditionally due. It follows that the all events test was not satisfied in this case, and consequently that the Termination Dividends were not deductible under the Code.

Because the Court concludes that the all events test was not satisfied, the Court does not need to reach the other two of the conditions that must be satisfied

to qualify for deductibility, namely, whether "the amount of the liability can be determined with reasonable accuracy," see Treas. Reg. § 1.461-l(a) (2), or whether the "recurring item" exception to the economic performance requirement applies, see Treas. Reg. § 1.461-5.

**III. ORDER**

For the reasons stated above, is hereby

**ORDERED** that the motion (Docket No. 12) of defendant United States of America to dismiss the complaint of plaintiff New York Life Insurance Company is GRANTED.

The Clerk of Court is directed to terminate any pending motions and to close this case.

**SO ORDERED.**

Dated: New York, New York
19 April 2011

/s/
VICTOR MARRERO
U.S.D.J.

*Appendix C*

**UNITED STATES COURT OF APPEALS**
**FOR THE**
**SECOND CIRCUIT**

At a stated term of the United States Court of Appeals for the Second Circuit, held at the Thurgood Marshall United States Courthouse, 40 Foley Square, in the City of New York, on the 22nd day of October, two thousand thirteen,

New York Life Insurance Company,
Plaintiff - Appellant,

v. Docket No: 11-2394

United States of America,
Defendant - Appellee.

**ORDER**

Appellant New York Life Insurance Company filed a petition for panel rehearing, or, in the alternative, for rehearing *en banc*. The panel that determined the appeal has considered the request for panel rehearing, and the active members of the Court have considered the request for rehearing *en banc*.

IT IS HEREBY ORDERED that the petition is denied.

FOR THE COURT:
Catherine O'Hagan Wolfe, Clerk

/s/
[Seal]

*Appendix D*

**26 U.S.C. § 808**

**Policyholder dividends deduction**.

(a) Policyholder dividend defined.

For purposes of this part, the term "policyholder dividend" means any dividend or similar distribution to policyholders in their capacity as such.

(b) Certain amounts included.

For purposes of this part, the term "policyholder dividend" includes-

(1) any amount paid or credited (including as an increase in benefits) where the amount is not fixed in the contract but depends on the experience of the company or the discretion of the management,

(2) excess interest,

(3) premium adjustments, and

(4) experience-rated refunds.

(c) Amount of deduction.

The deduction for policyholder dividends for any taxable year shall be an amount equal to the policyholder dividends paid or accrued during the taxable year.

(d) Definitions.

For purposes of this section-

(1) Excess interest.

The term "excess interest" means any amount in the nature of interest-

(A) paid or credited to a policyholder in his capacity as such, and

(B) in excess of interest determined at the prevailing State assumed rate for such contract.

(2) Premium adjustment.

The term "premium adjustment" means any reduction in the premium under an insurance or annuity contract which (but for the reduction) would have been required to be paid under the contract.

(3) Experience-rated refund.

The term "experience-rated refund" means any refund or credit based on the experience of the contract or group involved.

(e) Treatment of policyholder dividends.

For purposes of this part, any policyholder dividend which-

(1) increases the cash surrender value of the contract or other benefits payable under the contract, or

(2) reduces the premium otherwise required to be paid,

shall be treated as paid to the policyholder and returned by the policyholder to the company as a premium.

(f) Coordination of 1984 fresh-start adjustment with acceleration of policyholder dividends deduction through change in business practice.

(1) In general.

The amount determined under paragraph (1) of subsection (c) for the year of change shall (before any reduction under paragraph (2) of subsection (c)) be reduced by so much of the accelerated policyholder dividends deduction for such year as does not exceed the 1984 fresh-start adjustment for policyholder dividends (to the extent such adjustment was not previously taken into account under this subsection).

(2) Year of change.

For purposes of this subsection, the term "year of change" means the taxable year in which the change in business practices which results in the accelerated policyholder dividends deduction takes effect.

(3) Accelerated policyholder dividends deduction defined.

For purposes of this subsection, the term "accelerated policyholder dividends deduction" means the amount which (but for this subsection) would be determined for the taxable year under paragraph (1) of subsection (c) but which would have been determined (under such paragraph) for a later taxable year under the business practices of the taxpayer as in effect at the close of the preceding taxable year.

(4) 1984 fresh-start adjustment for policyholder dividends.

For purposes of this subsection, the term "1984 fresh-start adjustment for policyholder dividends" means the amounts held as of December 31, 1983, by the taxpayer as reserves for dividends to policyholders under section 811(b) (as in effect on the day before the date of the enactment of the Tax Reform Act of 1984) other than for dividends which accrued before January 1, 1984. Such amounts shall be properly reduced to reflect the amount of previously nondeductible policyholder dividends (as determined under section 809(f) as in effect on the day before the date of the enactment of the Tax Reform Act of 1984).

(5) Separate application with respect to lines of business.

This subsection shall be applied separately with respect to each line of business of the taxpayer.

(6) Subsection not to apply to mere change in dividend amount.

This subsection shall not apply to a mere change in the amount of policyholder dividends.

(7) Subsection not to apply to policies issued after December 31, 1983.

(A) In general. This subsection shall not apply to any policyholder dividend paid or accrued with respect to a policy issued after December 31, 1983.

(B) Exchanges of substantially similar policies. For purposes of subparagraph (A), any policy issued after December 31, 1983, in exchange for a substantially similar policy issued on or before such date shall be treated as issued before January 1, 1984. A similar rule shall apply in the case of a series of exchanges.

(8) Subsection to apply to policies provided under employee benefit plans.

This subsection shall not apply to any policyholder dividend paid or accrued with respect to a group policy issued in connection with a plan to provide welfare benefits to employees (within the meaning of section 419(e)(2)).

**26 U.S.C. § 811**

**Accounting provisions.**

(a) Method of accounting.

All computations entering into the determination of the taxes imposed by this part shall be made-

(1) under an accrual method of accounting, or

(2) to the extent permitted under regulations prescribed by the Secretary, under a combination of an accrual method of accounting with any other method permitted by this chapter (other than the cash receipts and disbursements method).

To the extent not inconsistent with the preceding sentence or any other provision of this part, all such computations shall be made in a manner consistent with the manner required for purposes of the annual statement approved by the National Association of Insurance Commissioners.

(b) Amortization of premium and accrual of discount.

(1) In general.

The appropriate items of income, deductions, and adjustments under this part shall be adjusted to reflect the appropriate amortization of premium and the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures, or other evidences of indebtedness held by a life insurance company. Such amortization and accrual shall be determined-

(A) in accordance with the method regularly employed by such company, if such method is reasonable, and

(B) in all other cases, in accordance with regulations prescribed by the Secretary.

(2) Special rules.

(A) Amortization of bond premium. In the case of any bond (as defined in section 171(d)), the amount of bond premium, and the amortizable bond premium for the taxable year, shall be determined under section 171(b) as if the election set forth in section 171(c) had been made.

(B) Convertible evidence of indebtedness. In no case shall the amount of premium on a convertible evidence of indebtedness include any amount attributable to the conversion features of the evidence of indebtedness.

(3) Exception.

No accrual of discount shall be required under paragraph (1) on any bond (as defined in section 171(d)), except in the case of discount which is-

(A) interest to which section 103 applies, or

(B) original issue discount (as defined in section 1273).

(c) No double counting.

Nothing in this part shall permit-

(1) a reserve to be established for any item

unless the gross amount of premiums and other consideration attributable to such item are required to be included in life insurance gross income,

(2) the same item to be counted more than once for reserve purposes, or

(3) any item to be deducted (either directly or as an increase in reserves) more than once.

(d) Method of computing reserves on contract where interest is guaranteed beyond end of taxable year.

For purposes of this part (other than section 816), amounts in the nature of interest to be paid or credited under any contract for any period which is computed at a rate which-

(1) exceeds the greater of the prevailing State assumed interest rate or applicable Federal interest rate in effect under section 807 for the contract for such period, and

(2) is guaranteed beyond the end of the taxable year on which the reserves are being computed,

shall be taken into account in computing the reserves with respect to such contract as if such interest were guaranteed only up to the end of the taxable year.

(e) Short taxable years.

If any return of a corporation made under this part is for a period of less than the entire calendar year (referred to in this subsection as "short period"), then section 443 shall not apply in respect to such period, but life insurance company taxable income shall be

determined, under regulations prescribed by the Secretary, on an annual basis by a ratable daily projection of the appropriate figures for the short period.

**26 U.S.C. § 461**

**General rule for taxable year of deduction.**

(a) General rule.

The amount of any deduction or credit allowed by this subtitle shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income.

(b) Special rule in case of death.

In the case of the death of a taxpayer whose taxable income is computed under an accrual method of accounting, any amount accrued as a deduction or credit only by reason of the death of the taxpayer shall not be allowed in computing taxable income for the period in which falls the date of the taxpayer's death.

(c) Accrual of real property taxes.

(1) In general.

If the taxable income is computed under an accrual method of accounting, then, at the election of the taxpayer, any real property tax which is related to a definite period of time shall be accrued ratably over that period.

(2) When election may be made.

(A) Without consent. A taxpayer may, without the consent of the Secretary, make an election under this subsection for his first taxable year in which he incurs real property taxes. Such an election shall be made not later than the time prescribed by law for

filing the return for such year (including extensions thereof).

(B) With consent. A taxpayer may, with the consent of the Secretary, make an election under this subsection at any time.

(d) Limitation on acceleration of accrual of taxes.

(1) General rule.

In the case of a taxpayer whose taxable income is computed under an accrual method of accounting, to the extent that the time for accruing taxes is earlier than it would be but for any action of any taxing jurisdiction taken after December 31, 1960, then, under regulations prescribed by the Secretary, such taxes shall be treated as accruing at the time they would have accrued but for such action by such taxing jurisdiction.

(2) Limitation.

Under regulations prescribed by the Secretary, paragraph (1) shall be inapplicable to any item of tax to the extent that its application would (but for this paragraph) prevent all persons (including successors in interest) from ever taking such item into account.

(e) Dividends or interest paid on certain deposits or withdrawable accounts.

Except as provided in regulations prescribed by the Secretary, amounts paid to, or credited to the accounts of, depositors or holders of accounts as dividends or interest on their deposits or withdrawable accounts (if such amounts paid or

credited are withdrawable on demand subject only to customary notice to withdraw) by a mutual savings bank not having capital stock represented by shares, a domestic building and loan association, or a cooperative bank shall not be allowed as a deduction for the taxable year to the extent such amounts are paid or credited for periods representing more than 12 months. Any such amount not allowed as a deduction as the result of the application of the preceding sentence shall be allowed as a deduction for such other taxable year as the Secretary determines to be consistent with the preceding sentence.

(f) Contested liabilities.

If-

(1) the taxpayer contests an asserted liability,

(2) the taxpayer transfers money or other property to provide for the satisfaction of the asserted liability,

(3) the contest with respect to the asserted liability exists after the time of the transfer, and

(4) but for the fact that the asserted liability is contested, a deduction would be allowed for the taxable year of the transfer (or for an earlier taxable year) determined after application of subsection (h),

then the deduction shall be allowed for the taxable year of the transfer. This subsection shall not apply in respect of the deduction for income, war profits, and excess profits taxes imposed by the authority of

any foreign country or possession of the United States.

(g) Prepaid interest.

(1) In general.

If the taxable income of the taxpayer is computed under the cash receipts and disbursements method of accounting, interest paid by the taxpayer which, under regulations prescribed by the Secretary, is properly allocable to any period-

(A) with respect to which the interest represents a charge for the use or forbearance of money, and

(B) which is after the close of the taxable year in which paid,

shall be charged to capital account and shall be treated as paid in the period to which so allocable.

(2) Exception.

This subsection shall not apply to points paid in respect of any indebtedness incurred in connection with the purchase or improvement of, and secured by, the principal residence of the taxpayer to the extent that, under regulations prescribed by the Secretary, such payment of points is an established business practice in the area in which such indebtedness is incurred, and the amount of such payment does not exceed the amount generally charged in such area.

(h) Certain liabilities not incurred before economic

performance.

(1) In general.

For purposes of this title, in determining whether an amount has been incurred with respect to any item during any taxable year, the all events test shall not be treated as met any earlier than when economic performance with respect to such item occurs.

(2) Time when economic performance occurs.

Except as provided in regulations prescribed by the Secretary, the time when economic performance occurs shall be determined under the following principles:

(A) Services and property provided to the taxpayer. If the liability of the taxpayer arises out of-

(i) the providing of services to the taxpayer by another person, economic performance occurs as such person provides such services,

(ii) the providing of property to the taxpayer by another person, economic performance occurs as the person provides such property, or

(iii) the use of property by the taxpayer, economic performance occurs as the taxpayer uses such property.

(B) Services and property provided by the taxpayer. If the liability of the taxpayer

requires the taxpayer to provide property or services, economic performance occurs as the taxpayer provides such property or services.

(C) Workers compensation and tort liabilities of the taxpayer. If the liability of the taxpayer requires a payment to another person and-

(i) arises under any workers compensation act, or

(ii) arises out of any tort,

economic performance occurs as the payments to such person are made. Subparagraphs (A) and (B) shall not apply to any liability described in the preceding sentence.

(D) Other items. In the case of any other liability of the taxpayer, economic performance occurs at the time determined under regulations prescribed by the Secretary.

(3) Exception for certain recurring items.

(A) In general. Notwithstanding paragraph (1) an item shall be treated as incurred during any taxable year if-

(i) the all events test with respect to such item is met during such taxable year (determined without regard to paragraph (1)),

(ii) economic performance with respect to such item occurs within the shorter of-

(I) a reasonable period after the close

of such taxable year, or

(II) 8 1/2 months after the close of such taxable year,

(iii) such item is recurring in nature and the taxpayer consistently treats items of such kind as incurred in the taxable year in which the requirements of clause (i) are met, and

(iv) either-

(I) such item is not a material item, or

(II) the accrual of such item in the taxable year in which the requirements of clause (i) are met results in a more proper match against income than accruing such item in the taxable year in which economic performance occurs.

(B) Financial statements considered under subparagraph (A)(iv). In making a determination under subparagraph (A)(iv), the treatment of such item on financial statements shall be taken into account.

(C) Paragraph not to apply to workers compensation and tort liabilities. This paragraph shall not apply to any item described in subparagraph (C) of paragraph (2).

(4) All events test.

For purposes of this subsection, the all events

test is met with respect to any item if all events have occurred which determine the fact of liability and the amount of such liability can be determined with reasonable accuracy.

(5) Subsection not to apply to certain items.

This subsection shall not apply to any item for which a deduction is allowable under a provision of this title which specifically provides for a deduction for a reserve for estimated expenses.

(i) Special rules for tax shelters.

(1) Recurring item exception not to apply.

In the case of a tax shelter, economic performance shall be determined without regard to paragraph (3) of subsection (h).

(2) Special rule for spudding of oil or gas wells.

(A) In general. In the case of a tax shelter, economic performance with respect to amounts paid during the taxable year for drilling an oil or gas well shall be treated as having occurred within a taxable year if drilling of the well commences before the close of the 90th day after the close of the taxable year.

(B) Deduction limited to cash basis.

(i) Tax shelter partnerships. In the case of a tax shelter which is a partnership, in applying section 704(d) to a deduction or loss for any taxable year attributable to an item which is deductible by reason of

subparagraph (A), the term “cash basis” shall be substituted for the term “adjusted basis”.

(ii) Other tax shelters. Under regulations prescribed by the Secretary, in the case of a tax shelter other than a partnership, the aggregate amount of the deductions allowable by reason of subparagraph (A) for any taxable year shall be limited in a manner similar to the limitation under clause (i).

(C) Cash basis defined. For purposes of subparagraph (B), a partner's cash basis in a partnership shall be equal to the adjusted basis of such partner's interest in the partnership, determined without regard to-

(i) any liability of the partnership, and

(ii) any amount borrowed by the partner with respect to such partnership which-

(I) was arranged by the partnership or by any person who participated in the organization, sale, or management of the partnership (or any person related to such person within the meaning of section 465(b)(3)(C)), or

(II) was secured by any asset of the partnership.

(3) Tax shelter defined.

For purposes of this subsection, the term “tax shelter” means-

(A) any enterprise (other than a C corporation) if at any time interests in such enterprise have been offered for sale in any offering required to be registered with any Federal or State agency having the authority to regulate the offering of securities for sale,

(B) any syndicate (within the meaning of section 1256(e)(3)(B)), and

(C) any tax shelter (as defined in section 6662(d)(2)(C)(ii)).

(4) Special rules for farming.

In the case of the trade or business of farming (as defined in section 464(e)), in determining whether an entity is a tax shelter, the definition of farming syndicate in section 464(c) shall be substituted for subparagraphs (A) and (B) of paragraph (3).

(5) Economic performance.

For purposes of this subsection, the term "economic performance" has the meaning given such term by subsection (h).

(j) Limitation on excess farm losses of certain taxpayers.

(1) Limitation.

If a taxpayer other than a C corporation receives any applicable subsidy for any taxable year, any excess farm loss of the taxpayer for the taxable year shall not be allowed.

(2) Disallowed loss carried to next taxable year.

Any loss which is disallowed under paragraph (1) shall be treated as a deduction of the taxpayer attributable to farming businesses in the next taxable year.

(3) Applicable subsidy.

For purposes of this subsection, the term "applicable subsidy" means-

> (A) any direct or counter-cyclical payment under title I of the Food, Conservation, and Energy Act of 2008, or any payment elected to be received in lieu of any such payment, or
>
> (B) any Commodity Credit Corporation loan.

(4) Excess farm loss.

For purposes of this subsection-

> (A) In general. The term "excess farm loss" means the excess of-
>
> > (i) the aggregate deductions of the taxpayer for the taxable year which are attributable to farming businesses of such taxpayer (determined without regard to whether or not such deductions are disallowed for such taxable year under paragraph (1)), over
> >
> > (ii) the sum of-
> >
> > > (I) the aggregate gross income or gain of such taxpayer for the taxable year which is attributable to such farming businesses, plus

(II) the threshold amount for the taxable year.

(B) Threshold amount.

(i) In general. The term "threshold amount" means, with respect to any taxable year, the greater of-

(I) $300,000 ($150,000 in the case of married individuals filing separately), or

(II) the excess (if any) of the aggregate amounts described in subparagraph (A)(ii)(I) for the 5-consecutive taxable year period preceding the taxable year over the aggregate amounts described in subparagraph (A)(i) for such period.

(ii) Special rules for determining aggregate amounts. For purposes of clause (i)(II)-

(I) notwithstanding the disregard in subparagraph (A)(i) of any disallowance under paragraph (1), in the case of any loss which is carried forward under paragraph (2) from any taxable year, such loss (or any portion thereof) shall be taken into account for the first taxable year in which a deduction for such loss (or portion) is not disallowed by reason of this subsection, and

(II) the Secretary shall prescribe rules

for the computation of the aggregate amounts described in such clause in cases where the filing status of the taxpayer is not the same for the taxable year and each of the taxable years in the period described in such clause.

(C) Farming business.

(i) In general. The term "farming business" has the meaning given such term in section 263A(e)(4).

(ii) Certain trades and businesses included. If, without regard to this clause, a taxpayer is engaged in a farming business with respect to any agricultural or horticultural commodity-

(I) the term "farming business" shall include any trade or business of the taxpayer of the processing of such commodity (without regard to whether the processing is incidental to the growing, raising, or harvesting of such commodity), and

(II) if the taxpayer is a member of a cooperative to which subchapter T applies, any trade or business of the cooperative described in subclause (I) shall be treated as the trade or business of the taxpayer.

(D) Certain losses disregarded. For purposes

of subparagraph (A)(i), there shall not be taken into account any deduction for any loss arising by reason of fire, storm, or other casualty, or by reason of disease or drought, involving any farming business.

(5) Application of subsection in case of partnerships and S corporations.

In the case of a partnership or S corporation-

(A) this subsection shall be applied at the partner or shareholder level, and

(B) each partner's or shareholder's proportionate share of the items of income, gain, or deduction of the partnership or S corporation for any taxable year from farming businesses attributable to the partnership or S corporation, and of any applicable subsidies received by the partnership or S corporation during the taxable year, shall be taken into account by the partner or shareholder in applying this subsection to the taxable year of such partner or shareholder with or within which the taxable year of the partnership or S corporation ends.

The Secretary may provide rules for the application of this paragraph to any other pass-thru entity to the extent necessary to carry out the provisions of this subsection.

(6) Additional reporting.

The Secretary may prescribe such additional reporting requirements as the Secretary

determines appropriate to carry out the purposes of this subsection.

(7) Coordination with section 469.

This subsection shall be applied before the application of section 469.

**26 C.F.R. § 1.461-1**

**General rules for taxable year of deduction.**

(a) General rule.

(1) Taxpayer using cash receipts and disbursements method. Under the cash receipts and disbursements method of accounting, amounts representing allowable deductions shall, as a general rule, be taken into account for the taxable year in which paid. Further, a taxpayer using this method may also be entitled to certain deductions in the computation of taxable income which do not involve cash disbursements during the taxable year, such as the deductions for depreciation, depletion, and losses under sections 167, 611, and 165, respectively. If an expenditure results in the creation of an asset having a useful life which extends substantially beyond the close of the taxable year, such an expenditure may not be deductible, or may be deductible only in part, for the taxable year in which made. An example is an expenditure for the construction of improvements by the lessee on leased property where the estimated life of the improvements is in excess of the remaining period of the lease. In such a case, in lieu of the allowance for depreciation provided by section 167, the basis shall be amortized ratably over the remaining period of the lease. See section 178 and the regulations thereunder for rules governing the effect to be given renewal options in determining whether the useful life of the improvements exceeds the remaining term of the lease where a

lessee begins improvements on leased property after July 28, 1958, other than improvements which on such date and at all times thereafter, the lessee was under a binding legal obligation to make. See section 263 and the regulations thereunder for rules relating to capital expenditures. See section 467 and the regulations thereunder for rules under which a liability arising out of the use of property pursuant to a section 467 rental agreement is taken into account.

(2) Taxpayer using an accrual method.

(i) In general. Under an accrual method of accounting, a liability (as defined in §1.446-1(c)(1)(ii)(B)) is incurred, and generally is taken into account for Federal income tax purposes, in the taxable year in which all the events have occurred that establish the fact of the liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability. (See paragraph (a)(2)(iii)(A) of this section for examples of liabilities that may not be taken into account until a taxable year subsequent to the taxable year incurred, and see §§1.461-4 through 1.461-6 for rules relating to economic performance.) Applicable provisions of the Code, the Income Tax Regulations, and other guidance published by the Secretary prescribe the manner in which a liability that has been incurred is taken into account. For example,

section 162 provides that the deductible liability generally is taken into account in the taxable year incurred through a deduction from gross income. As a further example, under section 263 or 263A, a liability that relates to the creation of an asset having a useful life extending substantially beyond the close of the taxable year is taken into account in the taxable year incurred through capitalization (within the meaning of § 1.263A-1(c)(3)), and may later affect the computation of taxable income through depreciation or otherwise over a period including subsequent taxable years, in accordance with applicable Internal Revenue Code sections and guidance published by the Secretary. The principles of this paragraph (a)(2) also apply in the calculation of earnings and profits and accumulated earnings and profits.

(ii) Uncertainty as to the amount of a liability. While no liability shall be taken into account before economic performance and all of the events that fix the liability have occurred, the fact that the exact amount of the liability cannot be determined does not prevent a taxpayer from taking into account that portion of the amount of the liability which can be computed with reasonable accuracy within the taxable year. For example, A renders services to B during the taxable year for which A charges $10,000. B admits a liability to A for $6,000 but contests

the remainder. B may take into account only $6,000 as an expense for the taxable year in which the services were rendered.

(iii) Alternative timing rules.

(A) If any provision of the Code requires a liability to be taken into account in a taxable year later than the taxable year provided in paragraph (a)(2)(i) of this section, the liability is taken into account as prescribed in that Code provision. See, for example, section 267 (transactions between related parties) and section 464 (farming syndicates).

(B) If the liability of a taxpayer is subject to section 170 (charitable contributions), section 192 (black lung benefit trusts), section 194A (employer liability trusts), section 468 (mining and solid waste disposal reclamation and closing costs), or section 468A (certain nuclear decommissioning costs), the liability is taken into account as determined under that section and not under section 461 or the regulations thereunder. For special rules relating to certain loss deductions, see sections 165(e), 165(i), and 165(l), relating to theft losses, disaster losses, and losses from certain deposits in qualified financial institutions.

(C) Section 461 and the regulations thereunder do not apply to any amount

allowable under a provision of the Code as a deduction for a reserve for estimated expenses.

(D) Except as otherwise provided in any Internal Revenue regulations, revenue procedure, or revenue ruling, the economic performance requirement of section 461(h) and the regulations thereunder is satisfied to the extent that any amount is otherwise deductible under section 404 (employer contributions to a plan of deferred compensation), section 404A (certain foreign deferred compensation plans), or section 419 (welfare benefit funds). See §1.461-4(d)(2)(iii).

(E) Except as otherwise provided by regulations or other published guidance issued by the Commissioner (See §601.601(b)(2) of this chapter), in the case of a liability arising out of the use of property pursuant to a section 467 rental agreement, the all events test (including economic performance) is considered met in the taxable year in which the liability is to be taken into account under section 467 and the regulations thereunder.

(3) Effect in current taxable year of improperly accounting for a liability in a prior taxable year. Each year's return should be complete in itself, and taxpayers shall ascertain the facts necessary to make a correct return. The expenses,

liabilities, or loss of one year generally cannot be used to reduce the income of a subsequent year. A taxpayer may not take into account in a return for a subsequent taxable year liabilities that, under the taxpayer's method of accounting, should have been taken into account in a prior taxable year. If a taxpayer ascertains that a liability should have been taken into account in a prior taxable year, the taxpayer should, if within the period of limitation, file a claim for credit or refund of any overpayment of tax arising therefrom. Similarly, if a taxpayer ascertains that a liability was improperly taken into account in a prior taxable year, the taxpayer should, if within the period of limitation, file an amended return and pay any additional tax due. However, except as provided in section 905(c) and the regulations thereunder, if a liability is properly taken into account in an amount based on a computation made with reasonable accuracy and the exact amount of the liability is subsequently determined in a later taxable year, the difference, if any, between such amounts shall be taken into account for the later taxable year.

(4) Deductions attributable to certain foreign income. In any case in which, owing to monetary, exchange, or other restrictions imposed by a foreign country, an amount otherwise constituting gross income for the taxable year from sources without the United States is not includible in gross income of the taxpayer for that year, the deductions and credits properly chargeable against the amount so restricted shall

not be deductible in such year but shall be deductible proportionately in any subsequent taxable year in which such amount or portion thereof is includible in gross income. See paragraph (b) of §1.905-1 for rules relating to credit for foreign income taxes when foreign income is subject to exchange controls.

(b) Special rule in case of death. A taxpayer's taxable year ends on the date of his death. See section 443(a)(2) and paragraph (a)(2) of §1.443-1. In computing taxable income for such year, there shall be deducted only amounts properly deductible under the method of accounting used by the taxpayer. However, if the taxpayer used an accrual method of accounting, no deduction shall be allowed for amounts accrued only by reason of his death. For rules relating to the inclusion of items of partnership deduction, loss, or credit in the return of a decedent partner, see subchapter K, chapter 1 of the Code, and the regulations thereunder.

(c) Accrual of real property taxes.

(1) In general. If the accrual of real property taxes is proper in connection with one of the methods of accounting described in section 446(c), any taxpayer using such a method of accounting may elect to accrue any real property tax, which is related to a definite period of time, ratably over that period in the manner described in this paragraph. For example, assume that such an election is made by a calendar-year taxpayer whose real property taxes, applicable to the period from July 1, 1955, to June 30, 1956,

amount to $1,200. Under section 461(c), $600 of such taxes accrue in the calendar year 1955, and the balance accrues in 1956. For special rule in the case of certain contested real property taxes in respect of which the taxpayer transfers money or other property to provide for the satisfaction of the contested tax, see §1.461-2. For general rules relating to deductions for taxes, see section 164 and the regulations thereunder.

(2) Special rules.

(i) Effective date. Section 461(c) and this paragraph do not apply to any real property tax allowable as a deduction under the Internal Revenue Code of 1939 for any taxable year beginning before January 1, 1954.

(ii) If real property taxes which relate to a period prior to the taxpayer's first taxable year beginning on or after January 1, 1954, would, but for section 461(c), be deductible in such first taxable year, the portion of such taxes which applies to the prior period is deductible in such first taxable year (in addition to the amount allowable under section 461(c)(1)).

(3) When election may be made.

(i) Without consent. A taxpayer may elect to accrue real property taxes ratably in accordance with section 461(c) and this paragraph without the consent of the Commissioner for his first taxable year

beginning after December 31, 1953, and ending after August 16, 1954, in which the taxpayer incurs real property taxes. Such election must be made not later than the time prescribed by law for filing the return for such year (including extensions thereof). An election may be made by the taxpayer for each separate trade or business (and for nonbusiness activities, if accounted for separately). Such an election shall apply to all real property taxes of the trade business, or nonbusiness activity for which the election is made. The election shall be made in a statement submitted with the taxpayer's return for the first taxable year to which the election is applicable. The statement should set forth:

(a) The trades or businesses, or nonbusiness activity, to which the election is to apply, and the method of accounting used therein;

(b) The period of time to which the taxes are related; and

(c) The computation of the deduction for real property taxes for the first year of the election (or a summary of such computation)

(ii) With consent. A taxpayer may elect with the consent of the Commissioner to accrue real property taxes ratably in accordance with section 461(c) and this paragraph. A written

request for permission to make such an election shall be submitted to the Commissioner of Internal Revenue, Washington 25, D. C., within 90 days after the beginning of the taxable year to which the election is first applicable, or before March 26, 1958, whichever date is later. The request for permission shall state:

(a) The name and address of the taxpayer;

(b) The trades or businesses, or nonbusiness activity, to which the election is to apply, and the method of accounting used therein;

(c) The taxable year to which the election first applies;

(d) The period to which the real property taxes relate;

(e) The computation of the deduction for real property taxes for the first year of election (or a summary of such computation); and

(f) An adequate description of the manner in which all real property taxes were deducted in the year prior to the year of election.

(4) Binding effect of election. An election to accrue real property taxes ratably under section 461(c) is binding upon the taxpayer unless the consent of the Commissioner is obtained under

section 446(e) and paragraph (e) of §1.446-1 to change such method of deducting real property taxes. If the last day prescribed by law for filing a return for any taxable year (including extensions thereof) to which section 461(c) is applicable falls before March 25, 1958, consent is hereby given for the taxpayer to revoke an election previously made to accrue real property taxes in the manner prescribed by section 461(c). If the taxpayer revokes his election under the preceding sentence, he must, on or before March 25, 1958, notify the district director for the district in which the return was filed of such revocation. For any taxable year for which such revocation is applicable, an amended return reflecting such revocation shall be filed on or before March 25, 1958.

(5) Apportionment of taxes on real property between seller and purchaser. For apportionment of taxes on real property between seller and purchaser, see section 164(d) and the regulations thereunder.

(6) Examples. The provisions of this paragraph are illustrated by the following examples:

Example (1). A taxpayer on an accrual method reports his taxable income for the taxable year ending June 30. He elects to accrue real property taxes ratably for the taxable year ending June 30, 1955 (which is his first taxable year beginning on or after January 1, 1954). In the absence of an election under section 461(c), such taxes would accrue on January 1 of the calendar

year to which they are related. The real property taxes are $1,200 for 1954; $1,600 for 1955; and $1,800 for 1956. Deductions for such taxes for the fiscal years ending June 30, 1955, and June 30, 1956, are computed as follows:

Fiscal year ending June 30, 1955

| | |
|---|---|
| July through December 1954 | None[1] |
| January through June 1955 (6/12 of $1,600) | $800 |
| Deduction for fiscal year ending June 30, 1955 | 800 |

[1] The taxes for 1954 were deductible in the fiscal year ending June 30, 1954, since such taxes accrued on January 1, 1954.

Fiscal year ending June 30, 1956

| | |
|---|---|
| July through December 1955 (6/12 of $1,600) | $800 |
| January through June (6/12 of $1,800) | 900 |
| Deduction for fiscal year ending June 30, 1956 | 1,700 |

Example (2). A calendar-year taxpayer on an accrual method elects to accrue real property taxes ratably for 1954. In the absence of an election under section 461(c), such taxes would accrue on July 1 and are assessed for the 12-month period beginning on that date. The real property taxes assessed for the year ending June

30, 1954, are $1,200; $1,600 for the year ending June 30, 1955; and $1,800 for the year ending June 30, 1956. Deductions for such taxes for the calendar years 1954 and 1955 are computed as follows:

Year ending December 31, 1954

| | |
|---|---|
| January through June 1954 | None[1] |
| July through December 1954 (6/12 of $1,600) | $800 |
| Deduction for year ending December 31, 1954 | 800 |

[1] The entire tax of $1,200 for the year ended June 30, 1954, was deductible in the return for 1953, since such tax accrued on July 1, 1953.

Year ending December 31, 1955

| | |
|---|---|
| January through June 1955 6/12 of $1,600) | $800 |
| July through December 1955 6/12 of $1,800) | 900 |
| Deduction for year ending December 31, 1955 | 1,700 |

Example (3). A calendar-year taxpayer on an accrual method elects to accrue real property taxes ratably for 1954. In the absence of an election under section 461(c), such taxes, which relate to the calendar year 1954, are accruable on December 1 of the preceding calendar year. No deduction for real property taxes is allowable for

the taxable year 1954 since such taxes accrued in the taxable year 1953 under section 23(c) of the Internal Revenue Code of 1939.

Example (4). A taxpayer on an accrual method reports his taxable income for the taxable year ending March 31. He elects to accrue real property taxes ratably for the taxable year ending March 31, 1955. In the absence of an election under section 461(c), such taxes are accruable on June 1 of the calendar year to which they relate. The real property taxes are $1,200 for 1954; $1,600 for 1955; and $1,800 for 1956. Deductions for such taxes for the taxable years ending March 31, 1955 and March 31, 1956, are computed as follows:

Fiscal year ending March 31, 1955

| | |
|---|---|
| April through December 1954 (9/12 of $1,200) | $900 |
| January through March 1955 (3/12 of $1,600) | 400 |
| Taxes accrued ratably in fiscal year ending March 31, 1955 | 1,300 |
| Tax relating to period January through March 1954, paid in June 1954, and not deductible in prior taxable years (3/12 of $1,200) | 300 |
| Deduction for fiscal year ending March 31, 1955 | 1,600 |

Fiscal year ending March 31, 1956

| | |
|---|---|
| April through December 1955 (9/12 of $1,600) | $1,200 |
| January through March 1956 (3/12 of $1,800) | 450 |
| Deduction for fiscal year ending March 31, 1956 | 1,650 |

Example (5). The facts are the same as in example (4) except that in June 1955, when the taxpayer pays his $1,600 real property taxes for 1955, he pays $400 of such amount under protest. Deductions for taxes for the taxable years ending March 31, 1955, and March 31, 1956, are computed as follows:

Fiscal year ending March 31, 1955

| | |
|---|---|
| April through December 1954 (9/12 of $1,200) | $900 |
| January through March 1955 (3/12 of $1,200, that is, $1,600 minus $400 (the contested portion which is not properly accruable)) | 300 |
| Taxes accrued ratably in fiscal year ending March 31, 1955 | 1,200 |
| Tax relating to period January through March 1954, paid in June 1954, and not deductible in prior taxable years (3/12 of | 300 |

| | |
|---|---|
| $1,200) | |
| Deduction for fiscal year ending March 31, 1955 | 1,500 |
| Fiscal year ending March 31, 1956 | |
| April through December 1955 (9/12 of $1,200) | $900 |
| January through March 1956 (3/12 of $1,800) | 450 |
| Taxes accrued ratably in fiscal year ending March 31, 1956 | 1,350 |
| Contested portion of tax relating to period January through December 1955, paid in June 1955, and deductible, under section 461(f), for taxpayer's fiscal year ending March 31, 1956 | 400 |
| Deduction for fiscal year ending March 31, 1956 | 1,750 |

(d) Limitation on acceleration of accrual of taxes.

(1) Section 461(d)(1) provides that, in the case of a taxpayer whose taxable income is computed under an accrual method of accounting, to the extent that the time for accruing taxes is earlier than it would be but for any action of any taxing jurisdiction taken after December 31, 1960, such taxes are to be treated as accruing at the time they would have accrued but for such action. Any such action which, but for the provisions of

section 461(d) and this paragraph, would accelerate the time for accruing a tax is to be disregarded in determining the time for accruing such tax for purposes of the deduction allowed for such tax. Such action is to be disregarded not only with respect to a taxpayer (whose taxable income is computed under an accrual method of accounting) upon whom the tax is imposed at the time of the action, but also with respect to such a taxpayer upon whom the tax is imposed at any time subsequent to such action. Thus, in the case of a tax imposed on property, the acceleration of the time for accruing taxes is to be disregarded not only with respect to the taxpayer who owned the property at the time of such acceleration, but also with respect to any subsequent owner of the property whose taxable income is computed under an accrual method of accounting. Similarly, such action is to be disregarded with respect to all property subject to such tax, even if such property is acquired after the action. Whenever the time for accruing taxes is to be disregarded in accordance with the provisions of this paragraph, the taxpayer shall accrue the tax at the time (original accrual date) the tax would have accrued but for such action, and shall, in the absence of any action of the taxing jurisdiction placing the time for accruing such tax at a time subsequent to the original accrual date, continue to accrue the tax as of the original accrual date for all future taxable years.

(2) For purposes of this paragraph-

(i) The term "a taxpayer whose taxable income is computed under an accrual method of accounting" means a taxpayer who, for Federal income tax purposes, accounts for any tax which is the subject of "any action" (as defined in subdivision (iii) of this subparagraph) under an accrual method of accounting. See section 446 and the regulations thereunder. If a taxpayer uses an accrual method as his overall method of accounting, it shall be presumed that he is "a taxpayer whose taxable income is computed under an accrual method of accounting." However, if the taxpayer establishes to the satisfaction of the district director that he has, for Federal income tax purposes, consistently accounted for such tax under the cash method of accounting, he shall be considered not to be "a taxpayer whose taxable income is computed under an accrual method of accounting."

(ii) The time for accruing taxes shall be determined under section 461 and the regulations in this section.

(iii) The term "any action" includes the enactment or reenactment of legislation, the adoption of an ordinance, the exercise of any taxing or administrative authority, or the taking of any other step, the result of which is an acceleration of the accrual event of any tax. The term also applies to the substitution of a substantially similar tax by either the

original taxing jurisdiction or a substitute jurisdiction. However, the term does not include either a judicial interpretation, or an administrative determination by the Internal Revenue Service, as to the event which fixes the accrual date for the tax.

(iv) The term "any taxing jurisdiction" includes the District of Columbia, any State, possession of the United States, city, county, municipality, school district, or other political subdivision or authority, other than the United States, which imposes, assesses, or collects a tax.

(3) The provisions of this paragraph may be illustrated by the following examples:

Example (1). State X imposes a tax on intangible and tangible personal property used in a trade or business conducted in the State. The tax is assessed as of July 1, and becomes a lien as of that date. As a result of administrative and judicial decisions, July 1 is recognized as the proper date on which accrual method taxpayers may accrue their personal property tax for Federal income tax purposes. In 1961 State X, by legislative action, changes the assessment and lien dates from July 1, 1962, to December 31, 1961, for the property tax year 1962. The action taken by State X is considered to be "any action" of a taxing jurisdiction which results in the time for accruing taxes being earlier than it would have been but for that action. Therefore, for purposes of the deduction allowed for such tax,

the personal property tax imposed by State X, for the property tax year 1962, shall be treated as though it accrued on July 1, 1962.

Example (2). Assume the same facts as in example (1) except that State X repeals the personal property tax and in lieu thereof enacts a franchise tax which is imposed on the privilege of conducting a trade or business within State X, and is based on the value of intangible and tangible personal property used in the trade or business. The franchise tax is to be assessed and will become a lien as of December 31, 1961, for the franchise tax year 1962, and on December 31 for all subsequent franchise tax years. Since the franchise tax is substantially similar to the former personal property tax and since the enactment of the franchise tax has the effect of accelerating the accrual date of the personal property tax from July 1, 1962, to December 31, 1961, the action taken by State X is considered to be "any action" of a taxing jurisdiction which results in the time for accruing taxes being earlier than it would have been but for that action. Therefore, for purposes of the deduction allowed for such tax, the franchise tax imposed by State X shall be treated as though it accrued on July 1, 1962, for the franchise tax year 1962, and on July 1 for all subsequent franchise tax years.

Example (3). Assume the same facts as in example (1) except that State X repealed the personal property tax and empowered the

counties within the State to impose a personal property tax. Assuming the counties in State X subsequently imposed a personal property tax and chose December 31 of the preceding year as the assessment and lien date, the action of each of the counties would be considered to be "any action" of a taxing jurisdiction which results in the time for accruing taxes being earlier than it would have been but for that action since it is immaterial whether the original taxing jurisdiction or a substitute jurisdiction took the action.

(4) Section 461(d)(1) shall not be applicable to the extent that it would prevent the taxpayer and all other persons, including successors in interest, from ever taking into account, for Federal income tax purposes, any tax to which that section would otherwise apply. For example, assume that State Y imposes a personal property tax on tangible personal property used in a trade or business conducted in the State during a calendar year. The tax is assessed as of February 1 of the year following the personal property tax year, and becomes a lien as of that date. As a result of administrative and judicial decisions, February 1 of the following year is recognized as the proper date on which accrual method taxpayers may accrue the personal property tax for Federal income tax purposes. In 1962 State Y, by legislative action, changes the assessment and lien dates for the personal property tax year 1962 from February 1, 1963, to December 1, 1962, and to December 1 of the personal property tax year

for all subsequent years. Corporation A, an accrual method taxpayer which uses the calendar year as its taxable year, pays the tax for 1962 on December 10, 1962. On December 15, 1962, the property which was taxed is completely destroyed and, on December 20, 1962, corporation A transfers all of its remaining assets to its shareholders, and is dissolved. Since corporation A is not in existence in 1963, and therefore could not take the personal property tax into account in computing its 1963 Federal income tax if February 1, 1963, is considered to be the time for accruing the tax, and no other person could ever take such tax into account in computing his Federal income tax, such tax shall be treated as accruing as of December 1, 1962. To the extent that any person other than the taxpayer may at any time take such tax into account in computing his taxable income, the provisions of section 461(d)(1) shall apply. Thus, upon the dissolution of a corporation or the termination of a partnership between the time which, but for the provisions of section 461(d)(1) and this paragraph, would be the time for accruing any tax which was the subject of "any action" (as defined in subdivision (iii) of subparagraph (2)), and the original accrual date, the corporation or the partnership would be entitled to a deduction for only that portion, if any, of such tax with respect to which it can establish, to the satisfaction of the district director, that no other taxpayer can properly take into account in computing his taxable income. However, to the

extent that the corporation or partnership cannot establish, at the time of its dissolution or termination, as the case may be, that no other taxpayer would be entitled to take such tax into account in computing his taxable income, and it is subsequently determined that no other taxpayer is entitled to take such tax into account in computing his taxable income, the corporation or partnership may file a claim for refund for the year of its dissolution or termination (subject to the limitations prescribed in section 6511) and claim as a deduction therein the portion of such tax determined to be not deductible by any other taxpayer.

(5) Section 461(d) and this paragraph shall apply to taxable years ending after December 31, 1960.

(e) Dividends or interest paid by certain savings institutions on certain deposits or withdrawable accounts.

(1) Deduction not allowable.

(i) In general. Except as otherwise provided in this paragraph, pursuant to section 461(e) amounts paid to, or credited to the accounts of, depositors or holders of accounts as dividends or interest on their deposits or withdrawable accounts (if such amounts paid or credited are withdrawable on demand subject only to customary notice to withdraw) by a mutual savings bank not having capital stock represented by shares, a domestic building and loan association, or a cooperative

bank shall not be allowed as a deduction for the taxable year to the extent such amounts are paid or credited for periods representing more than 12 months. The provisions of section 461(e) are applicable with respect to taxable years ending after December 31, 1962. Whether amounts are paid or credited for periods representing more than 12 months depends upon all the facts and circumstances in each case. For example, payments or credits which under all the facts and circumstances are in the nature of bona fide bonus interest or dividends paid or credited because a shareholder or depositor maintained a certain balance for more than 12 months, will not be considered made for more than 12 months, providing the regular payments or credits represent a period of 12 months or less. The nonallowance of a deduction to the taxpayer under section 461(e) and this subparagraph has no effect either on the proper time for reporting dividends or interest by a depositor or holder of a withdrawable account, or on the obligation of the taxpayer to make a return setting forth, among other (relating to returns regarding payments of interest) and the regulations thereunder. With respect to a short period (a taxable year consisting of a period of less than 12 months), amounts of dividends or interest paid or credited shall not be allowed as a deduction to the extent that such amounts are paid or credited for a

period representing more than the number of months in such short period. In such a case, the rules contained in section 461(e) and this paragraph apply to the short period in a manner consistent with the application of such rules to a 12-month taxable year. Subparagraph (2) of this paragraph provides rules for computing amounts not allowed in the taxable year and subparagraph (3) provides rules for determining when such amounts are allowed. See section 7701(a)(19) and (32) and the regulations thereunder for the definitions of domestic building and loan association and cooperative bank.

(ii) Exceptions. The rule of nonallowance set forth in subdivision (i) of this subparagraph is not applicable to a taxpayer in the year in which it liquidates (other than following, or as part of, an acquisition of its assets in which the acquiring corporation, pursuant to section 381(a), takes into account certain items of the taxpayer, which for purposes of this paragraph shall be referred to as an acquisition described in section 381(a)). In addition, such rule of nonallowance is not applicable to a taxpayer which pays or credits grace interest or dividends to terminating depositors or shareholders, provided the total amount of the grace interest or dividends paid or credited during the payment or crediting period (for example, a quarterly or semiannual period) does not exceed 10 percent of the total amount of the interest or

dividends paid or credited during such period, computed without regard to the grace interest or dividends. For example, providing the 10 percent limitation is met, the rule of nonallowance does not apply in a case in which a calendar year taxpayer, with regular interest payment dates of January 1, April 1, July 1, and October 1, pays grace interest for the period beginning October 1 to a depositor who terminates his account on December 10.

(2) Computation of amounts not allowed as a deduction.

(i) Method of computation. The amount of the dividends or interest to which subparagraph (1) of this paragraph applies, which is not allowed as a deduction, shall be computed under the rules of this subparagraph. The amount which is not allowed as a deduction is the difference between the total amount of dividends or interest paid or credited to that class of accounts with respect to which a deduction is not allowed under subparagraph (1) of this paragraph during the taxable year (or short period, if applicable) and an amount which bears the same ratio to such total as the number 12 (or number of months in the short period) bears to the number of months with respect to which such amounts of dividends or interest are paid or credited.

(ii) Examples. The provisions of subdivision (i) of this subparagraph may be illustrated by the following examples:

Example (1). X Association, a domestic building and loan association filing its return on the basis of a calendar year, regularly credits dividends on its withdrawable accounts quarterly on the first day of the quarter following the quarter with respect to which they are earned. X changes the time of crediting dividends commencing with the credit for the fourth quarter of 1964. Such credit and all subsequent credits are made on the last day of the quarter with respect to which they are earned. As a result of this change X's credits for the year 1964 are as follows:

| Period With Respect To Which Earned | Date Credited In 1964 | Amount |
|---|---|---|
| 4th quarter, 1963 | Jan. 1 | $250,000 |
| 1st quarter, 1964 | Apr. 1 | 300,000 |
| 2d quarter, 1964 | July 1 | 300,000 |
| 3d quarter, 1964 | Oct. 1 | 300,000 |
| 4th quarter, 1964 | Dec. 31 | 350,000 |
| Total dividends credited | | 1,500,000 |

Since the change in the time of crediting dividends results in the crediting in 1964 of amounts of dividends representing periods totalling 15 months (October 1963 through December 1964), amounts shall not be allowed as a deduction in 1964 which are in

excess of $1,200,000, which is the amount which bears the same ratio to the amounts of dividends credited during the year ($1,500,000) as the number 12 bears to the number of months (15) with respect to which such dividends are credited. Thus, $300,000 ($1,500,000 minus $1,200,000) is not allowed as a deduction in 1964.

Example (2). Y Association, a domestic building and loan association filing its return on the basis of a calendar year, regularly credits dividends on its withdrawable accounts on the basis of a semiannual period on March 31 and September 30 of each year. Y changes the period with respect to which credits are made from the semiannual period to the quarterly basis, commencing with the last quarter in 1964. The credit for this last quarter and all subsequent credits are made on the last day of the quarter with respect to which they are earned. As a result of this change, Y's credits for the year 1964 are as follows:

| Period With Respect To Which Earned | Date Credited In 1964 | Amount |
| --- | --- | --- |
| 6-month period ending Mar. 31, 1964 | Mar. 31 | $300,000 |
| 6-month period ending Sept. 30, | Sept. 30 | 400,000 |

| | | |
|---|---|---|
| 1964 | | |
| 4th quarter, 1964 | Dec. 31 | 200,000 |
| Total dividends credited | | 900,000 |

Since the change in the basis of crediting dividends results in a crediting in 1964 of dividends representing periods totaling 15 months (October 1963 through December 1964), amounts shall not be allowed as a deduction in 1964 which are in excess of $720,000, which is the amount which bears the same ratio to the amounts of dividends credited during the year ($900,000) as the number 12 bears to the number of months (15) with respect to which such dividends are credited. Thus, $180,000 ($900,000 minus $720,000) is not allowed as a deduction in 1964.

Example (3). Z Association, a domestic building and loan association regularly files its return on the basis of a fiscal year ending on the last day of February and regularly credits dividends on its withdrawable accounts quarterly on the last day of the quarter with respect to which they are earned. Z receives approval from the Commissioner of Internal Revenue to change its accounting period to a calendar year and effects the change by filing a return for a short period ending on December 31, 1964. Dividend credits for the short period

beginning on March 1 and ending on December 31, 1964, are as follows:

| Period With Respect To Which Earned | Date Credited In 1964 | Amount |
|---|---|---|
| January-March 1964 | Mar. 31 | $250,000 |
| April-June 1964 | June 30 | 300,000 |
| July-September 1964 | Sept. 30 | 300,000 |
| October-December 1964 | Dec. 31 | 350,000 |
| Total dividends credited | | 1,200,000 |

Since the change of accounting period results in amounts of dividends credited ($1,200,000) representing periods totaling 12 months (January through December 1964), and such periods represent more than the number of months (10) in the short period, an amount shall not be allowed as a deduction in such short period which is in excess of $1,000,000, which is the amount which bears the same ratio to the amount of dividends credited in the short period ($1,200,000) as the number of months (10) in the short period bears to the number of months (12) with respect to which such dividends are credited. Thus, $200,000 ($1,200,000 minus $1,000,000) is not allowed as a deduction in the short period.

(3) When amounts allowable. The amount of dividends or interest not allowed as a deduction under subparagraph (1) of this paragraph shall be allowed as follows (subject to the limitation that the total of the amounts so allowed shall not exceed the amount not allowed under subparagraph (1)):

(i) Such amount shall be allowed as a deduction in a later taxable year or years subject to the limitation that, when taken together with the deductions otherwise allowable in the later taxable year or years, it does not bring the deductions for any later taxable year to a total representing a period of more than 12 months (or number of months in the short period, if applicable). However, in any event, an amount otherwise allowable under subdivision (ii) of this subparagraph shall be allowed notwithstanding the fact that it may bring the deductions allowable to a total representing a period of more than 12 months (or number of months in the short period, if applicable).

(ii) In any case in which it is established to the satisfaction of the Commissioner that the taxpayer does not intend to avoid taxes, one-tenth of such amount shall be allowed as a deduction in each of the 10 succeeding taxable years-

(a) Commencing with the taxable year for which such amount is not allowed as a deduction under subparagraph (1), or

(b) In the case of such amount not allowed for a taxable year ending before July 1, 1964, commencing with either the first or second taxable year after the taxable year for which such amount is not allowed as a deduction under subparagraph (1) if the taxpayer has not taken a deduction on his return, or filed a claim for credit or refund, in respect of such amount under (a). Normally, if the deduction not allowed under subparagraph (1) is a result of a change, not requested by the taxpayer, in the taxpayer's annual accounting period or dividend or interest payment or crediting dates solely as a consequence of a requirement of a Federal or State regulatory authority, or if the deduction is not allowed solely as a result of the taxpayer being a party to an acquisition to which section 381(a) applies, the Commissioner will permit the allowance of the amount not allowed in the manner provided in this subdivision. Nothing set forth in this subdivision shall be construed as permitting the allowance of a credit or refund for any year which is barred by the limitations on credit or refund provided by section 6511.

(iii) If the total of the amounts, if any, allowed under subdivisions (i) and (ii) of this subparagraph before the taxable year in which the taxpayer liquidates or otherwise

ceases to engage in trade or business is less than the amount not allowed under subparagraph (1), there shall be allowed a deduction in such taxable year for the difference between the amount not allowed under subparagraph (1) and the amounts allowed, if any, as deductions under subdivisions (i) and (ii) unless the circumstances under which the taxpayer ceased to do business constitute an acquisition described in section 381(a) (relating to carryovers in certain corporate acquisitions). If the circumstances under which the taxpayer ceased to do business constitute an acquisition described in section 381(a), the acquiring corporation shall succeed to and take into account the balance of the amounts not allowed on the same basis as the taxpayer had it not ceased to engage in business.