No. 13-849

In the Supreme Court of the United States

NEW YORK LIFE INSURANCE COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether, for tax purposes, petitioner's liability to pay annual dividends on insurance policies was fixed before the year of payment.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-30) is reported at 724 F.3d 256. The order of the district court (Pet. App. 31-40) is reported at 780 F. Supp. 2d 324.

JURISDICTION

The judgment of the court of appeals was entered on August 1, 2013. A petition for rehearing was denied on October 22, 2013 (Pet. App. 41). The petition for a writ of certiorari was filed on January 14, 2014. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The parties' dispute in this case concerns the years in which petitioner, a life-insurance company, was permitted to deduct annual dividends that it paid

to policyholders. Under Section 808(c) of the Internal Revenue Code, a life-insurance company may deduct from its gross income "an amount equal to the policyholder dividends paid or accrued during the taxable year." 26 U.S.C. 808(c). Under certain circumstances, a particular liability may "accrue" during a given taxable year even though it is not paid until a subsequent year. Internal Revenue Service (IRS) regulations prescribe the general rules for determining the year in which a particular liability accrues. Those regulations provide that "a liability * * * is incurred * * * in the taxable year in which [i] all the events have occurred that establish the fact of liability; [ii] the amount of the liability can be determined with reasonable accuracy; and [iii] economic performance has occurred with respect to the liability." 26 C.F.R. 1.461-1(a)(2)(i); see 26 U.S.C. 461(h)(4) (stating first and second requirements).[1]

Under petitioner's life-insurance policies, a policyholder was entitled to a share of petitioner's surplus earnings as a dividend each year on the policy's anniversary date. Pet. App. 6. A policyholder was entitled to receive the annual dividend, however, only if (i) she had fully paid the policy's premiums by the anniversary date; and (ii) the policy remained in force on the anniversary date. *Ibid.*

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[1] That standard originated in *United States* v. *Anderson*, 269 U.S. 422, 441 (1926). As stated in *Anderson*, the standard included only the first two requirements. In codifying the standard as part of the Deficit Reduction Act of 1984, Pub. L. No. 98-369, Div. A, Tit. I, § 91(a), 98 Stat. 732, Congress added the third requirement. See 26 U.S.C. 461(h)(1) and (2); see also 57 Fed. Reg. 12,411, 12,420 (Apr. 10, 1992) (promulgating regulations addressing third requirement).

According to petitioner, its practice during the relevant period was to credit a policyholder's account with the amount of the annual dividend up to 30 days before the anniversary date (although the polices themselves contained no provision to that effect). Pet. App. 6. For any policy with an anniversary date between February and December, the date that the policyholder received the credit thus necessarily occurred in the same year as the date the policyholder received the payment. *Id.* at 7. But for policies with January anniversary dates (the "January Policies"), the date of the credit typically occurred the year before the anniversary date—and thus in a different taxable year than the date of payment. *Ibid.*

Petitioner filed tax returns for the taxable years 1990 through 1995. Pet. App. 10 & n.7. On each of those returns, petitioner sought to deduct the annual dividends it would pay the following year on all January Policies for which premiums had been fully paid by December of the year of the return. *Id.* at 10. The IRS audited the returns and rejected those deductions, concluding that petitioner's liability for dividends accrued in the year in which they were paid. *Ibid.* Petitioner paid the deficiencies assessed by the IRS and filed administrative refund claims, which the IRS denied. *Ibid.*

2. Petitioner then filed a refund action in the United States District Court for the Southern District of New York. Pet. App. 10. The district court granted the government's motion to dismiss the complaint. *Id.* at 31-40. The court agreed with the government that petitioner's claimed deductions did not satisfy the first of the three requirements for the accrual of a liability, because "all the events" necessary to "establish the

fact of the liability" had not occurred in the relevant taxable years. *Id.* at 36 (quoting 26 C.F.R. 1.461-1(a)(2)(i)). Specifically, because petitioner was required to pay an annual dividend only if a policy remained in force through the January anniversary date, the court held that petitioner's "liability was merely 'contingent' prior to that date." *Id.* at 38. In light of that conclusion, the court did not reach the government's alternative arguments that petitioner had failed to satisfy the second and third requirements for accrual of a liability. *Id.* at 39-40.

3. The court of appeals affirmed. Pet. App. 1-30. The court explained that, under this Court's decisions in *United States* v. *Hughes Properties, Inc.*, 476 U.S. 593 (1986), and *United States* v. *General Dynamics Corp.*, 481 U.S. 239 (1987), "[i]f 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." Pet. App. 15. The court further explained that the all-events test "is not satisfied, and a liability is not established, by a statistical probability—however high—that the taxpayer will ultimately pay the expense." *Ibid.*

Applying that principle, the court of appeals rejected petitioner's argument that it could deduct dividends for January Policies for which the premiums were paid in full in December of the taxable year. The court explained 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." Pet. App. 17 (citation omitted). The court further explained that the terms of the policies did not require petitioner "to pay an Annual Dividend if a policyholder cho[se] to cash in her policy before the anniversary date; instead, the policies condition[ed] payment of an Annual Dividend on the policy being 'in force' on its anniversary date." *Ibid.*

The court of appeals contrasted petitioner's policies with the policies at issue in *National Life Insurance Co.* v. *Commissioner*, 103 F.3d 5 (2d Cir. 1996). Under the terms of the *National Life Insurance* policies, "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." Pet. App. 19. Petitioner's policies, by contrast, did not guarantee a policyholder any payment at all if she terminated the policy before the anniversary date. The court of appeals therefore determined that no liability accrued for tax purposes until the anniversary date. See *id.* at 19-20.

Like the district court, the court of appeals did not reach the government's alternative arguments that the second and third requirements for accrual of a liability were not met. See Pet. App. 13.

ARGUMENT

The court of appeals correctly applied settled accrual principles to the insurance-policy dividends issued by petitioner. The court's decision does not conflict with any decision of this Court or another court of appeals. Further review is not warranted.

1. The court of appeals correctly held that petitioner's liability for annual dividends on the January Policies did not accrue until the policies' anniversary dates, because until that point in time "all events" necessary to fix the liability had not yet occurred. Petitioner does not dispute that, under the policies, it

was required to pay an annual dividend to a policyholder only if two conditions were met: (i) the premiums had been fully paid by the anniversary date; and (ii) the policy remained in force on the anniversary date. Pet. App. 6; see Pet. 6. Petitioner also does not dispute that, for any policyholder who cashed in her policy before its anniversary date, the second condition was not satisfied and petitioner was not required to pay that policyholder an annual dividend, even if she had paid all premiums. See Pet. 9.

Those features of petitioner's insurance policies resolve this case. Even when the holder of a January Policy had paid all premiums in December of the prior year, petitioner's liability was not fixed because there was no guarantee that the policy would remain in force through the January anniversary date. The policyholder might have cashed in the policy (or died) before the January anniversary date, ensuring that petitioner would not bear any liability for the annual dividend. As the court of appeals explained, petitioner "could not know in December which course of action the policyholder would choose the following month," because "[i]n 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." Pet. App. 17-18.

Accordingly, it was not true in December of the taxable years in which petitioner claimed the relevant deductions that "all the events ha[d] occurred that establish the fact of liability." 26 C.F.R. 1.461-1(a)(2)(i). Only if the policy remained in force on the January anniversary date was the liability fixed—in contrast to the situation where the policyholder is guaranteed a pro rata share of the dividend even if she cashes in the policy before the anniversary date. See Pet. App. 19-20.

2. a. Petitioner argues (Pet. 12-15) that the court of appeals misinterpreted this Court's decisions in *United States* v. *Hughes Properties, Inc.*, 476 U.S. 593 (1986), and *United States* v. *General Dynamics Corp.*, 481 U.S. 239 (1987), which applied the "all events" test to casino jackpot payments and medical-services reimbursements respectively. That contention lacks merit.

At issue in *Hughes Properties* was whether a casino could deduct amounts that Nevada law required to be paid as part of a slot-machine jackpot. 476 U.S. at 595-596. This Court concluded that each year's increase in the guaranteed jackpot amount was deductible at the end of that taxable year, even if actual payment of the jackpot had not yet occurred. The Court explained that the liability was fixed because "[a] part of the machine's intake was to be paid out, that amount was known, and only the exact time of payment and the identity of the winner remained for the future." *Id.* at 604.

In contrast, in *General Dynamics*, this Court determined that a self-insuring employer could not deduct its estimated future reimbursements to employees for medical services they had received in the last quarter of the year, because the employer's obligation to pay any particular reimbursement remained contingent until the employee submitted a claim the following year. 481 U.S. at 244-245. The Court held that the submission of the claim was "the last link in the chain of events creating liability for purposes of the 'all events' test." *Id.* at 245.

The court below correctly held that petitioner's "dividend liability [is] most closely analogous to the liability for medical expenses that the taxpayer attempted to deduct as an accrued liability in *General Dynamics*." Pet. App. 18. "Just as the taxpayer there was 'liable to pay for covered medical services *only* if properly documented claims forms were filed,' so too was [petitioner] liable to pay the Annual Dividend *only* if a policyholder kept her policy in force through its anniversary date." *Ibid.* (quoting *General Dynamics*, 481 U.S. at 244) (internal citation omitted). And just as it was irrelevant in *General Dynamics* whether it was extremely likely (even "statistically certain") that the claims forms would be filed, 481 U.S. at 243-244, it is irrelevant here whether it was very likely that any individual policyholder would keep her policy in force through the January anniversary date. See Pet. App. 18.

Petitioner contends (Pet. 13-14) that this case is more like *Hughes Properties* because the final condition to fix petitioner's liability for the annual dividend—that the policy remain in force through the January anniversary date—is not an affirmative action but rather a "continuation of the status quo." Pet. 11. But the Court's decision in *Hughes Properties* did not turn on whether the final "event" was best characterized as an affirmative action rather than as a decision not to take some action. Nor did this Court suggest that any omission necessary for liability must be deemed, in petitioner's terminology, a "condition subsequent" rather than a "condition precedent" (terms that do not appear in the opinion).[2] Instead, the Court concluded that, because all events had occurred that would "fix[] the jackpot amount irrevocably" under Nevada law, the liability had accrued in the relevant taxable year, even if the casino had the "ability to control the timing of payouts." 476 U.S. at 602-604. Here, by contrast, petitioner's liability to pay an annual dividend was not fixed "irrevocably" by the fact that a policyholder had paid all premiums in December of the taxable year, because petitioner would not have been required to pay the annual dividend if the policyholder had cashed in the policy before the January anniversary date or the policy was no longer in force for some other reason.

Petitioner relies (Pet. 12) on this Court's conclusion in *Hughes Properties* that the jackpot amounts did not become contingent liabilities merely because there existed "the possibility 'that a casino may go out of business, or surrender or lose its license, or go into bankruptcy'"—a possibility that "exists for every business that uses an accrual method," 476 U.S. at 605-606. Petitioner analogizes the possibility that a policyholder will cash in her policy before the anniversary date to the possibility that the taxpayer will go into bankruptcy. Pet. 13-14. But that analogy ignores the distinction between a contingent liability and an inability to satisfy a fixed liability. As this Court explained in *Hughes Properties*, under the accrual method, "'[t]he existence of an absolute liability is necessary; absolute certainty that it will be discharged by payment is not.'" 476 U.S. at 606 (quoting

[2] The Court in *General Dynamics* characterized the filing of the claims form as a "condition precedent," 481 U.S. at 244 n.5, but it did not draw the rigid distinction that petitioner proposes.

Helvering v. *Russian Fin. & Constr. Corp.*, 77 F.2d 324, 327 (2d Cir. 1935)). That a taxpayer may become unable to pay a fixed liability due to insolvency does not render the liability contingent. Here, however, the insurance contracts governing petitioner's payment obligation did not require petitioner to pay an annual dividend to a policyholder who had fully paid her premiums unless the policy was in force on its anniversary date. Pet. App. 17.

b. Citing five cases decided by other circuits between 1942 and 1983, petitioner argues (Pet. 16-19) that the court of appeals' decision "recreates a multi-circuit conflict that this Court resolved in *Hughes Properties*." Pet. 16 (capitalization altered). That argument reflects petitioner's view that the court of appeals misapplied *Hughes Properties* and *General Dynamics* in holding that petitioner's dividend liabilities did not accrue until the policies' anniversary dates. For the reasons discussed above, that argument lacks merit.

In any event, no conflict exists between the decisions petitioner cites and the ruling below. None of those decisions embraced petitioner's view that a person's failure to take some action can never be an "event" for purposes of the all-events test. Nor did any of those decisions address insurance-policy dividends or other contractual liabilities analogous to the obligations at issue here. Rather, the court in each of those cases reached a fact-specific conclusion that the subsequent event was not an event necessary to fix the relevant liability.

For example, in *Wien Consolidated Airlines, Inc.* v. *Commissioner*, 528 F.2d 735 (9th Cir. 1976), the Ninth Circuit held that an employer's liability for legally required workman's compensation benefits accrued at the time of injury, even though it was uncertain at that time what the full amount of the payments would be, given the possibility that survivors would die or remarry. See *id.* at 737-738. In that circumstance, the liability is arguably fixed as soon as the injury occurs because the employer must begin making payments immediately; the only open question is the total *amount* of the payments. In contrast, in this case, if a policyholder cashed in a January Policy before its anniversary date, petitioner would not have been obligated to pay her anything. Indeed, in a case petitioner cites (at 17-18), the Second Circuit reached the same conclusion as the Ninth Circuit in *Wien*, holding that "the all events test does not require that the amount of liability be known with certainty" so long as the *fact* of liability is certain, see *Burnham Corp.* v. *Commissioner*, 878 F.2d 86, 88 (1989), and the decision below reiterated that point, see Pet. App. 22.[3] *Wien* therefore does not conflict with the decision below. See also *Lawyers' Title Guar. Fund* v. *United States*, 508 F.2d 1, 6 (5th Cir. 1976) (cited at Pet. 19) (holding that "the tax accrual of a liability to pay commissions to a selling agent is not defeated by the right of the principal to defer actual payment to secure payment of liabilities the selling agent may incur

[3] The court below also distinguished *Burnham* on the ground that a policyholder's "decision not to redeem her policy for cash * * * and invest her money elsewhere" is "an actual *choice* by the third-party policyholder," unlike the fact of survival. Pet. App. 22-23. To the extent petitioner contends that the decision below conflicts with *Burnham*, this Court does not typically grant certiorari to resolve intra-circuit conflicts. See *Wisniewski* v. *United States*, 353 U.S. 901, 902 (1957).

to the principal in *unrelated* transactions") (emphasis added).

Petitioner cites only one decision by another circuit issued after *Hughes Properties* and *General Dynamics*. In *Valero Energy Corp.* v. *Commissioner*, 78 F.3d 909 (5th Cir. 1996), the taxpayer, as part of a settlement agreement, promised to provide a settlement trust with shares of stock. See *id.* at 910. The agreement entitled other settling parties to the proceeds from the disposition of the stock by a specified date, and it further guaranteed that the taxpayer would make up the difference in cash between the amount realized on the disposition and the remaining amount owed under the settlement agreement. See *id.* at 910-911. When the stock was sold in a subsequent year for less than the full amount owed, the taxpayer made up the difference in cash as required by the agreement. See *id.* at 911. Applying the all-events test, the Fifth Circuit agreed with the Commissioner that the taxpayer had properly taken a deduction in the first year for the entire amount owed under the agreement and therefore could not take a second deduction for the cash payment in the subsequent year. See *id.* at 914-915. The court found it "abundantly clear that [the taxpayer] had a contractual obligation to the settling customers in the [full] amount" set forth in the settlement agreement. *Id.* at 914. The court explained that, as in *Hughes Properties*, the liability was fixed in the first year "even if the amount or time of payments in support of that liability * * * was uncertain." *Id.* at 915.

There is no conflict between *Valero Energy* and the decision below, in which the court of appeals correctly found that, under the specific terms of petitioner's policies, liability for annual dividends is not fixed unless the policy remains in force through its anniversary date. Rather, the Second and Fifth Circuits simply applied the same settled accrual principles to different contractual arrangements.

Finally, the decision of the Court of Federal Claims (CFC) in *Massachusetts Mutual Life Insurance Co.* v. *United States*, 103 Fed. Cl. 111 (2012), which held that certain policyholder dividends paid by an insurance company satisfied the all-events test, see *id.* at 140, does not support petitioner's request for further review of the decision in this case. See Pet. 10 n.2. The United States has appealed the CFC's decision to the United States Court of Appeals for the Federal Circuit. See 07-648T Docket entry No. 183 (Ct. Fed. Cl. Nov. 14, 2013). Any potential conflict between the decision below and a decision of the CFC would not warrant this Court's review.

3. Petitioner contends (Pet. 20-21) that the court of appeals' decision has far-reaching implications for taxpayers using the accrual method of accounting. But because the court correctly applied settled accrual principles to the particular contracts at issue here, its decision does not change the preexisting state of the law. Petitioner's view of the practical implications of the decision below appears to rest in large part on the premise that, under the court of appeals' reasoning, the possibility that a taxpayer will go out of business or file for bankruptcy is sufficient to render an otherwise fixed liability contingent. See Pet. 21. The United States has not urged the adoption of such a rule, however, and the court of appeals did not cast doubt on this Court's contrary holding in *Hughes Properties*. Rather, so long as all events necessary to establish a

payment *obligation* have occurred, any uncertainty as to the taxpayer's ultimate *ability* to pay will not delay accrual of the relevant liability. See pp. 9-10, *supra*.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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