***North Cent. Life Ins. Co. v. Commissioner, 92 T. C. 254 (1989)***

A life insurance company can fully deduct retroactive rate credits as commissions under IRC § 809(d)(11) if they are payments for services rendered by accounts, not dividends or return premiums to policyholders.

**Summary**

North Central Life Insurance Co. sought to deduct retroactive rate credits paid to accounts as commissions. The Tax Court held that these credits were deductible as compensation for services under IRC § 809(d)(11), not as dividends to policyholders or return premiums. The court also ruled that the company could not deduct changes in its reserve for these credits because the reserve did not meet the all-events test for accrual accounting. Finally, the disallowance of the reserve was considered a change in accounting method under IRC § 481, requiring an adjustment to the company's income.

**Facts**

North Central Life Insurance Co. sold credit life and accident/health insurance through financial institutions and auto dealerships (accounts). It paid these accounts commissions and retroactive rate credits based on the volume of insurance sold. The credits were calculated after subtracting claims and reserves from net premiums earned. The company also maintained a reserve for these credits, which it used to adjust its commission deductions on its tax returns.

**Procedural History**

The Commissioner determined deficiencies in the company's taxes for 1972-1976, disallowing the deduction of retroactive rate credits as dividends to policyholders and rejecting the reserve. The company petitioned the U. S. Tax Court, which assigned the case to a Special Trial Judge. After a trial in 1987, the court issued its opinion in 1989.

**Issue(s)**

1. Whether retroactive rate credits paid by the company are deductible as dividends to policyholders, return premiums, or commissions.
2. Whether the company may take into account changes in its reserve for retroactive rate credits in computing the amount of the deduction.
3. If not, whether the disallowance of the reserve constitutes a change in method of accounting under IRC § 481.

**Holding**

1. No, because the retroactive rate credits are not dividends to policyholders or return premiums, as the accounts were not policyholders. Yes, the credits are

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deductible as commissions under IRC § 809(d)(11) because they were payments for services rendered by the accounts.
2. No, because the reserve did not meet the all-events test for accrual accounting, as the liability for the credits was contingent and not fixed by the end of the tax year.
3. Yes, because the disallowance of the reserve affected the timing of the deduction, constituting a change in accounting method under IRC § 481.

**Court's Reasoning**

The court determined that the accounts were not policyholders under IRC §§ 809(c)(1) and 811(a) because the insureds controlled the insurance policies and paid the premiums. The retroactive rate credits were found to be compensation for the accounts' services in selling and servicing the insurance, meeting the requirements for deductibility under IRC § 162(a) and § 809(d)(11). The court rejected the company's reserve for the credits, as it failed the all-events test due to contingencies related to minimum production levels, future claims, and the distribution of claims among accounts. The disallowance of the reserve was considered a change in accounting method under IRC § 481, requiring an adjustment to the company's income to prevent duplication or omission of amounts.

**Practical Implications**

This decision clarifies that life insurance companies can deduct retroactive rate credits as commissions if they are payments for services rendered by accounts, not dividends or return premiums to policyholders. It also emphasizes the importance of meeting the all-events test for accrual accounting when establishing reserves for contingent liabilities. The ruling may impact how life insurance companies structure their compensation arrangements with accounts and report these payments for tax purposes. Subsequent cases, such as Modern American Life Insurance Co. v. Commissioner (1987), have further explored the deductibility of payments between insurance companies under similar provisions.

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