Blue Cross & Blue Shield of Texas, Inc. v. Commissioner, 115 T. C. 148 (2000)

Only amounts actually paid and then recovered by an insurer can be considered 'estimated salvage recoverable' for the purpose of special tax deductions under OBRA 1990.

Summary

Blue Cross & Blue Shield of Texas sought to claim 'special' deductions under the Omnibus Budget Reconciliation Act of 1990 (OBRA 1990) for Coordination of Benefits (COB) savings, arguing that these savings constituted 'estimated salvage recoverable'. The Tax Court held that only amounts actually paid and then recovered could be considered salvage recoverable. The court rejected Blue Cross's claim, determining that COB savings, where Blue Cross used a 'wait-and-pay' approach and did not actually pay the claims, did not qualify. The court also found Blue Cross ineligible for safe harbor relief due to inadequate disclosure to state regulators.

Facts

Blue Cross & Blue Shield of Texas, Inc. , a health insurance provider, calculated 'special' deductions under OBRA 1990's transition rule for 1992 and 1993 based on Coordination of Benefits (COB) savings from 1989. These savings arose when Blue Cross was a secondary insurer and did not have to pay the full claim amount due to the primary insurer's responsibility. Blue Cross used a 'wait-and-pay' approach for COB claims, meaning it did not pay the full claim amount upfront and seek reimbursement. Approximately 94% of the claimed salvage recoverable was COB savings, with 85% of that being Medicare-related. The IRS disallowed these deductions, leading to the dispute.

Procedural History

The IRS determined deficiencies in Blue Cross's federal income taxes for 1992 and 1993, disallowing the special deductions claimed under OBRA 1990. Blue Cross appealed to the U. S. Tax Court. The court heard arguments on whether COB savings qualified as 'estimated salvage recoverable' and whether Blue Cross was eligible for safe harbor relief under the regulations.

Issue(s)

1. Whether Coordination of Benefits (COB) savings, where Blue Cross used a 'wait-and-pay' approach, qualify as 'estimated salvage recoverable' under the special deduction rule of OBRA 1990, section 11305(c)(3).
2. Whether Blue Cross is eligible for safe harbor relief under section 1. 832-4(f)(2) of the Income Tax Regulations for its claimed salvage recoverable deductions.

Holding

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1. No, because COB savings under a ‘wait-and-pay’ approach do not represent genuine salvage recoverable, as Blue Cross did not expect to pay these amounts and therefore did not have a right of recovery or salvage.
2. No, because Blue Cross did not satisfy the disclosure requirements for safe harbor relief and its COB savings were not considered bona fide salvage recoverable.

Court’s Reasoning

The court applied the statutory and regulatory framework of OBRA 1990 and section 832 of the Internal Revenue Code to determine that ‘estimated salvage recoverable’ must reflect an expectation of actual payment followed by recovery. The court found that Blue Cross’s COB savings did not meet this standard because Blue Cross used a ‘wait-and-pay’ approach and did not expect to pay the full claim amount. The court emphasized that without actual payment, there could be no salvage recoverable. The court also rejected Blue Cross’s argument that potential payment under a different approach (pay-and-pursue) could qualify as salvage recoverable. For the safe harbor issue, the court found that Blue Cross’s disclosure to state regulators was inadequate and that its COB savings were not bona fide salvage recoverable, thus disqualifying it from safe harbor relief. The court referenced section 1. 832-4 of the Income Tax Regulations and case law to support its interpretation of ‘salvage recoverable’.

Practical Implications

This decision clarifies that only amounts actually paid and then recovered can be considered ‘estimated salvage recoverable’ for special deductions under OBRA 1990. Insurance companies must carefully evaluate their claims handling practices to determine eligibility for such deductions. The ruling also underscores the importance of precise disclosure to state regulators to qualify for safe harbor relief. Legal practitioners advising insurance clients should ensure that any claims for salvage recoverable deductions are supported by actual payments and recoveries, not just theoretical or potential liabilities. This case may influence how insurance companies structure their claims handling processes and report their financials to regulators and the IRS, potentially affecting their tax planning strategies.

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