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Office of Chief Counsel
Internal Revenue Service
Memorandum

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subject: Section 4375-77 Excise Tax on Certain Insurance Policies,

ISSUES

This memo addresses whether fees paid by issuers of certain health insurance policies and plan sponsors of certain self-insured health plans to fund the Patient-Centered Outcomes Research Trust Fund (PCOR) are ordinary and necessary business expenses, and, thus, deductible business expenses.

BACKGROUND

Sections 4375-77 of the Internal Revenue Code were added by § 6301 of the Affordable Care Act (ACA). The ACA provides for the establishment of the private, non-profit corporation, Patient-Centered Outcomes Research Institute, to assist the public in making informed health decisions. Sections 4375-77 provide a funding source for the PCOR that is to be financed, in part, by fees to be paid by issuers of specified health insurance policies and sponsors of applicable self-insured health plans. These fees are paid yearly.

LAW AND ANALYSIS

Section 162(a) allows a deduction for all ordinary and necessary business expenses. The PCOR fee is required to be paid by any issuer or sponsor of specified health insurance policies for each policy year ending after September 30, 2012, and before October 1, 2019. There are no exceptions to this rule.

Section 164(a) lists various taxes that are specifically deductible. The PCOR fee is not listed in that section. Section 1.164-2(f) provides that Federal excise taxes which are not deductible under § 164 of the Code may be deducted under § 162 of the Code if the taxes represent an ordinary and necessary business expense paid or incurred by the taxpayer. See, for example, Rev. Rul. 54-219, 1954-1 C.B. 51 (holding that payments for federal excise tax on wagers are deductible as an ordinary and necessary business expense of someone in the business of accepting wagers).

Another Code section may disallow, limit, or defer a deduction. For example, § 263(a) requires certain expenditures to be capitalized rather than immediately deducted. Whether an expense is deductible under § 162 or must be capitalized under § 263(a) is a factual determination. When an expense creates a separate and distinct asset, it usually must be capitalized. See Commissioner v. Lincoln Sav. & Loan Association, 403 U.S. 345, 91 S. Ct. 1893 (1971). If the expense does not create such an asset, the most critical factors to consider in passing on the question of deductibility are the period of time over which the taxpayer will derive a benefit from the expense and the significance of the benefit to the taxpayer. See Indopco v. Commissioner, 503 U.S. 79, 112 S. Ct. 1039 (1992). The PCOR fees are paid yearly, with no benefits extending beyond the end of the taxpayer's taxable year.

Some taxes imposed by the ACA, such as the employer shared responsibility tax and the excise tax on high cost employer-sponsored health coverage, are nondeductible under § 275(a)(6). See, for example, §§ 4980H(c)(7) and 4980I(f)(10). Additionally, certain fees imposed by the ACA are expressly treated as nondeductible taxes under § 275(a)(6), specifically the annual fee on branded prescription pharmaceutical manufacturers and importers, the annual fee on medical device manufacturers and importers, and the annual fee on health insurance providers. See §§ 9008(f)(2), 9009(e)(2) and 9010(f)(2) of the ACA. There is no provision specifically providing that fees paid under §§ 4375-77 are nondeductible.

Issuers of specified health insurance policies and sponsors of applicable self-insured health plans will be required to pay the PCOR fee yearly in connection with carrying on their trade or business. Section 162(a) allows a taxpayer to deduct all ordinary and necessary expenses incurred by the taxpayer in carrying on a trade or business. An expense is "ordinary" if it is "normal, usual or customary" in the taxpayer's trade or business. See Deputy v. Dupont, 308 U.S. 488, 495 (1940). An expense is "necessary" if it is "appropriate and helpful" in the taxpayer's business, but it need not be absolutely essential. Commissioner v. Tellier, 383 U.S. 687, 689 (1966) (citing Welch v. Helvering,

290 U.S. 111, 113 (1933)). Whether an expense is deductible under § 162 is a question of fact to be decided on the basis of all the relevant facts and circumstances. Cloud v. Commissioner, 97 T.C. 613, 618 (1991) (citing Commissioner v. Heininger, 302 U.S. 467, 473-5 (1943)). The required PCOR fee will be an ordinary and necessary business expense paid or incurred in carrying on a trade or business and, therefore, will be deductible under § 162.

This analysis does not take into account rules under Subchapters D or L of Chapter 1 of the Internal Revenue Code that may be relevant.

Please call Erika Reigle at 202-622-4950 if you have any further questions.