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amortization and accrual is the same as that provided for life insurance companies by section 803(i) and shall be determined in accordance with § 1.803–6, except that in determining the premium and discount of a mutual insurance company subject to the tax imposed by section 821 the basis provided in section 1012 shall be used in lieu of the acquisition value.

§ 1.822–4 Taxable years affected.

Sections 1.822–1 through 1.822–3 are applicable only to taxable years beginning after December 31, 1953, but before January 1, 1955, and ending after August 16, 1954, and all references to sections of part II, subchapter L, chapter 1 of the Code are to the Internal Revenue Code of 1954, before amendments. Sections 1.822–5 through 1.822–7 are applicable only to taxable years beginning after December 31, 1954, but before January 1, 1963, and all references to sections of part II, subchapter L, chapter 1 of the Code are to the Internal Revenue Code of 1954, as amended by the Life Insurance Company Tax Act for 1955 (70 Stat. 36). Sections 1.822–8 through 1.822–12 are applicable only to taxable years beginning after December 31, 1962, and all references to sections of parts II and III, subchapter L, chapter 1 of the Code are to the Internal Revenue Code of 1954 as amended by section 8 of the Revenue Act of 1962 (76 Stat. 989).

[T.D. 6681, 28 FR 11113, Oct. 17, 1963]

§ 1.822–5 Mutual insurance company taxable income.

(a) *Mutual insurance company taxable income defined.* Section 822(a) defines the term ''mutual insurance company taxable income'' for purposes of part II, subchapter L, chapter 1 of the Code. Mutual insurance company taxable income means gross investment income (as defined in section 822(b) and paragraph (b) of this section), less the deductions provided in section 822(c) and paragraph (c) of this section for wholly tax-exempt interest, investment expenses, real estate expenses, depreciation, interest paid or accrued, capital losses, special deductions, trade or business (other than in insurance business) expenses, and depletion. However, such expenses are deductible only to the extent that they relate to investment income and the deduction of such expenses is not disallowed by any other provision of subtitle A of the Code. For example, investment expenses are not allowable unless they are ordinary and necessary expenses within the meaning of section 162. In addition to the limitations on deductions relating to real estate owned and occupied by a mutual insurance company subject to the tax imposed by section 821 provided in section 822(d)(1), the adjustment for amortization of premium and accrual of discount provided in section 822(d)(2), and the limitation on the deduction for investment expenses where general expenses are allocated to investment income provided in section 822(c)(2), mutual insurance companies subject to the tax imposed by section 821 are subject to the limitation on deductions relating to wholly tax-exempt income provided in section 265. Such companies are not entitled to the net operating loss deduction provided in section 172, and a deduction shall not be permitted with respect to the same item more than once.

(b) *Gross investment income defined.* For purposes of part II, subchapter L, chapter 1 of the Code, section 822(b) defines the term ''gross investment income'' of a mutual insurance company subject to the tax imposed by section 821 as the sum of the following:

(1) The gross amount of income during the taxable year from:

(i) Interest (including tax-exempt interest and partially tax-exempt interest), as described in § 1.61–7. Interest shall be adjusted for amortization of premium and accrual of discount in accordance with the rules prescribed in section 822(d)(2) and § 1.822–7;

(ii) Dividends, as described in § 1.61–9;

(iii) Rents and royalties, as described in § 1.61–8;

(iv) The entering into of any lease, mortgage or other instrument or agreement from which the company may derive interest, rents, or royalties;

(v) The alteration or termination of any instrument or agreement described in subdivision (iv) of this subparagraph;

(vi) Gains from sales or exchanges of capital assets to the extent provided in

subchapter P (section 1201 and following, relating to capital gains and losses), chapter 1 of the Code.

(2) The gross income from any trade or business (other than an insurance business) carried on by a mutual insurance company subject to the tax imposed by section 821, or by a partnership of which the insurance company is a partner.

For example, gross investment income includes amounts received as commitment fees, or as a bonus for the entering into of a lease, or as a penalty for the early payment of a mortgage. In computing the gross income from any trade or business (other than an insurance business) carried on by the insurance company, or by a partnership of which the insurance company is a partner, any item described in section 822(b)(1) and paragraph (b)(1) of this section shall not be considered as gross income arising from the conduct of such trade or business, but shall be taken into account under section 822(b)(1) and paragraph (b)(1) of this section.

(c) *Deductions from gross investment income*—(1) *Wholly tax-exempt interest.* Interest which in the case of other taxpayers is excluded from gross income by section 103 but included in the gross investment income by section 822(b) is allowed as a deduction from gross investment income by section 822(c)(1).

(2) *Investment expenses.* (i) The deduction for investment expenses under section 822(c)(2) includes only those expenses of the taxable year which are fairly chargeable against gross investment income. For example, investment expenses include salaries and expenses paid exclusively for work in looking after investments, and amounts expended for printing, stationery, postage, and stenographic work incident to the collection of interest. An itemized schedule of such expenses shall be attached to the return.

(ii) Any assignment of general expenses to the investment department of a mutual insurance company subject to the tax imposed by section 821 subjects the entire deduction for investment expenses to the limitation provided in section 822(c)(2) and subdivision (iii) of this subparagraph. As used in section 822(c)(2), the term ''general expenses'' means any expense paid or incurred for the benefit of more than one department of the company rather than for the benefit of a particular department thereof. For example, if an expense, such as a salary, is attributable to more than one department, including the investment department, such expense may be properly allocated among these departments. If such expense is allocated, the amount properly allocable to the investment department shall be deductible as general expenses assigned to or included in investment expenses and as such shall be subject to the limitation of section 822(c)(2) and subdivision (iii) of this subparagraph. However, a company subject to the tax imposed by section 821 shall not deduct under section 822(c)(2) its real estate taxes, depreciation, or other expenses with respect to any portion of the real estate which it owns, irrespective of whether such items are properly allocable to its investment department. For the rules relating to the deductibility of these items, see section 822(c) (3) and (4) and subparagraphs (3) and (4) of this paragraph. If general expenses are in part assigned to or included in investment expenses, the maximum allowance (as determined under section 822(c)(2) shall not be granted unless it is shown to the satisfaction of the district director that such allowance is justified by a reasonable assignment of actual expenses. The accounting procedure employed is not conclusive as to whether any assignment has in fact been made. Investment expenses do not include Federal income and excess profits taxes, if any.

(iii) If any general expenses are in part assigned to or included in investment expenses, the total deduction under section 822(c)(2) shall not exceed the sum of:

(*a*) One-fourth of 1 percent of the mean of the book value of the invested assets held at the beginning and end of the taxable year, plus.

(*b*) One-fourth of the amount by which mutual insurance company taxable income (computed without any deduction for investment expenses, tax-free interest, partially tax-exempt interest, or dividends received) exceeds 33/4 percent of the book value of the

mean of the invested assets held at the beginning and end of the taxable year.

For purposes of section 822(c)(2) and this paragraph, the term ''invested assets'' means only those assets which are owned and used, and to the extent used, for the purpose of producing the income specified in section 822(b). See paragraph (b) of this section. The term does not include real estate owned and occupied, and to the extent owned and occupied, by the company.

(3) *Real estate expenses and taxes.* The deduction for real estate expenses and taxes under section 822(c)(3) includes taxes (as defined in section 164) and other expenses for the taxable year exclusively on or with respect to real estate owned by the company. For example, no deduction shall be allowed under section 822(c)(3) for amounts allowed as a deduction under section 164(e) (relating to taxes of shareholders paid by a corporation). No deduction shall be allowed under section 822(c)(3) for any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property. An itemized schedule of such taxes and expenses shall be attached to the return. See § 1.822–6 for limitation of such deduction.

(4) *Depreciation.* The deduction allowed by section 822(c)(4) for depreciation is, except as provided in section 822(d)(1) and § 1.822–6, identical to that allowed other corporations by section 167. Such amount allowed as a deduction from gross investment income in determining mutual insurance company taxable income is limited to depreciation sustained on the property used, and to the extent used, for the purpose of producing the income specified in section 822(b).

(5) *Interest paid or accrued.* The deduction allowed by section 822(c)(5) for interest on indebtedness is the same as that allowed other corporations by section 163. See § 1.163–1.

(6) *Capital losses.* (i) The deduction for capital losses under section 822(c)(6) includes not only capital losses to the extent provided in subchapter P, chapter 1 of the Code but in addition thereto losses from capital assets sold or exchanged to provide funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders. Losses in the latter case may be deducted from ordinary income while the deduction for losses under subchapter P is limited to the gains. See section 1211.

(ii) Capital assets are considered as sold or exchanged to provide for the funds or payments specified in section 822(c)(6), to the extent that the gross receipts from the sale or exchange of such assets are not greater than the excess, if any, for the taxable year of the sum of dividends and similar distributions paid to policyholders, and losses and expenses paid over the sum of the items described in section 822(b) (other than paragraph (1)(D) thereof) and net premiums received. If, by reason of a particular sale or exchange of a capital asset, gross receipts are greater than such excess, the gross receipts and the resulting loss should be apportioned and the excess included in capital losses subject to the provisions of subchapter P. Capital losses actually used to reduce net income in any taxable year may not again be used in a succeeding taxable year as an offset against capital gains in that year and for that purpose a special rule is set forth for the application of section 1212.

(iii) The application of section 822(c)(6) may be illustrated by the following examples:

Example 1. The X Company, a mutual fire insurance company subject to the tax imposed by section 821, in the taxable year 1958 sells capital assets in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders. The gross receipts from the sale are $60,000, resulting in losses of $20,000. It pays dividends to policyholders of $150,000. It sustains losses of $25,000, and pays expenses of $25,000. It receives interest of $50,000, dividends of $5,000, royalties of $4,000, and net premiums of $66,000. The excess of the sum of dividends, losses, and expenses paid ($200,000) over the sum of the items described in section 822(b) (other than paragraph (1)(D) thereof) and net premiums received ($125,000) is $75,000. As the gross receipts from the sale of capital assets ($60,000) do not exceed such excess ($75,000), the losses of $20,000 are allowable as a deduction from gross investment income.

Example 2. If in example 1 the gross receipts were $76,000 and the last capital asset

sold, for the purpose therein specified, resulted in gross receipts of $2,000 and a loss of $500, the losses allowable as a deduction from gross investment income would be $19,750. The last sale made the gross receipts of $76,000 exceed by $1,000 the excess ($75,000) of the sum of dividends, losses, and expenses paid ($200,000) over the sum of the items described in section 822(b) (other than paragraph (1)(D) thereof) and net premiums received ($125,000). The gross receipts and the resulting loss from the last sale are apportioned on the basis of the ratio of the excess of $1,000 to the gross receipts of $2,000, or 50 percent. Fifty percent of the loss of $500 is deducted from the total loss of $20,000. The remaining gross receipts of $1,000 and the proportionate loss of $250 should be reported as capital losses under subchapter P.

Example 3. If in example 1 the X Company had mutual insurance company taxable income for purposes of the surtax of $9,750 and, under the provisions of subchapter P, chapter 1 of the Code, had capital losses of $18,000 and capital gains of $10,000, the net capital loss for the taxable year 1958, in applying section 1212 for the purposes of section 822(c)(6), would be $8,000. This is determined by subtracting from total losses of $38,000 ($18,000 capital losses under subchapter P plus $20,000 other capital losses under section 822(c)(6)) the sum of capital gains of $10,000 and losses from the sale or exchange of capital assets sold or exchanged to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders of $20,000. Such losses of $20,000 are added to capital gains of $10,000, since they are less than taxable income for purposes of the surtax, computed without regard to gains or losses from sales or exchanges of capital assets, of $29,750 ($9,750 taxable income for purposes of the surtax plus $20,000 other capital losses under section 822(c)(6) plus the portion of capital losses allowable under subchapter P of $10,000 minus capital gains under subchapter P of $10,000).

(7) *Special deductions.* Section 822(c)(7) allows a mutual insurance company the special deductions provided by part VIII (section 241 and following), except section 248, subchapter B, chapter 1 of the Code, relating to partially tax-exempt interest and to dividends received.

(8) *Trade or business deductions.* (i) Under section 822(c)(8), the deductions allowed by subtitle A of the Code (without regard to this part) which are attributable to any trade or business (other than an insurance business) carried on by the insurance company, or by a partnership of which the company is a partner are, subject to the limitations in subdivision (ii) of this subparagraph, allowable as deductions from gross investment income in computing mutual insurance company taxable income. Such deductions are allowable, however, only to the extent that they relate to income which is included in the company's gross investment income by reason of section 822(b) (2). Thus, a deduction shall not be allowed under section 822(c)(8) with respect to any item described in section 822(b)(1). The allowable deductions may exceed the gross income from such business.

(ii) In computing the deductions under section 822(c)(8):

(*a*) Any item, to the extent attributable to the carrying on of the insurance business, shall not be taken into account. For example, if the company operates a radio station primarily to advertise its own insurance services, a portion of the expenses of the radio station shall not be allowed as a deduction. The portion disallowed shall be an amount which bears the same ratio to the total expenses of the station as the value of advertising furnished to the insurance company bears to the total value of services rendered by the station.

(*b*) The deduction for net operating losses provided in section 172 shall not be allowed.

(9) *Depletion.* The deduction allowed by section 822(c)(9) for depletion is the same as that allowed life insurance companies under section 804(c)(4). See paragraph (b)(5) of § 1.804–4.

[T.D. 6610, 27 FR 8720, Aug. 31, 1962, as amended by T.D. 6631, 28 FR 219, Jan. 9, 1963]

§ 1.822–6 Real estate owned and occupied.

Section 822(d)(1) provides that the amount allowable as a deduction for taxes, expenses, and depreciation on or with respect to any real estate owned and occupied in whole or in part by a mutual insurance company subject to the tax imposed by section 821 shall be limited to an amount which bears the same ratio to such deduction (computed without regard to this limitation) as the rental value of the space not so occupied bears to the rental value of the entire property. For example, if the rental value of the space not