

such amounts by the percentage selected for the taxable year under section 819(c)(1) and paragraph (c)(1) of this section; and

(2) The excess referred to in section 815(e)(2)(A)(i) (without the adjustment provided by section 815(e)(2)(B)), is whichever of the following is the greater:

(i) The minimum figure for 1958 determined under section 819(b)(2)(A); or

(ii) The surplus held in the United States (as defined in section 819(b)(2)(B)) determined as of December 31, 1958.

(e) *No United States insurance business.* Foreign life insurance companies not carrying on an insurance business within the United States shall not be taxable under part I, subchapter L, chapter 1 of the Code, but shall be taxable as other foreign corporations. See section 881 and the regulations thereunder.

[T.D. 6558, 26 FR 2791, Apr. 4, 1961; 26 FR 3276, Apr. 18, 1961, as amended by T.D. 6970, 33 FR 12044, Aug. 24, 1968]

EDITORIAL NOTE: For a determination with respect to the percentage to be used by foreign life insurance companies in computing income tax for the taxable year 1984 and the estimated tax for taxable year 1985, see 51 FR 883, Jan. 9, 1986.

MUTUAL INSURANCE COMPANIES (OTHER THAN LIFE AND CERTAIN MARINE INSURANCE COMPANIES AND OTHER THAN FIRE OR FLOOD INSURANCE COMPANIES WHICH OPERATE ON BASIS OF PERPETUAL POLICIES OR PREMIUM DEPOSITS)

§ 1.821-1 Tax on mutual insurance companies other than life or marine or fire insurance companies subject to the tax imposed by section 831.

(a) *In general.* (1) For taxable years beginning after December 31, 1953, but before January 1, 1955, and ending after August 16, 1954, all mutual insurance companies, including foreign insurance companies carrying on an insurance business within the United States, not taxable under section 801 or 831 and not specifically exempt under the provisions of section 501(c)(15), are subject to the tax imposed by section 821 on their investment income or on their gross income, whichever tax is the greater, except interinsurers and recip-

rocal underwriters which are taxed only on their investment income. For the alternative tax, in lieu of the tax imposed by section 821 (a) or (b), where the net long-term capital gain for any taxable year exceeds the net short-term capital loss, see section 1201(a) and the regulations thereunder.

(2) The taxable income of mutual insurance companies subject to the tax imposed by section 821 differs from the taxable income of other corporations. See section 821(a)(2) and section 822. Such companies are entitled, in computing mutual insurance company taxable income, to the deductions provided in part VIII (section 241 and following, except section 248), subchapter B, chapter 1 of the Code. The gross amount of income during the taxable year from interest, the deduction under section 822(c)(1) for wholly tax-exempt interest, and the deduction under section 242 for partially tax-exempt interest, are decreased by the appropriate amortization of premium and increased by the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures or other evidences of indebtedness held by a mutual insurance company subject to the tax imposed by section 821. See section 822(d)(2) and § 1.822-3.

(3) All provisions of the Code and of the regulations in this part not inconsistent with the specific provisions of section 821 are applicable to the assessment and collection of the tax imposed by section 821 (a) or (b) and mutual insurance companies subject to the tax imposed by section 821 are subject to the same penalties as are provided in the case of returns and payment of income tax by other corporations. The return shall be on Form 1120M.

(4) Foreign mutual insurance companies not carrying on an insurance business within the United States are not taxable under section 821 (a) or (b), but are taxable as other foreign corporations. See section 881.

(5) Mutual insurance companies subject to the tax imposed by section 821, except interinsurers or reciprocal underwriters, with mutual insurance company taxable income (computed without regard to the deduction provided in section 242 for partially tax-exempt interest) of over \$3,000 or with

gross amounts of income from interest, dividends, rents, and net premiums (minus dividends to policyholders and wholly tax-exempt interest) in excess of \$75,000, are subject to a tax computed under section 821(a)(1) or section 821(a)(2) whichever is the greater. Interinsurers and reciprocal underwriters with mutual insurance company taxable income (computed without regard to the deduction provided in section 242 for partially tax-exempt interest) of over \$50,000 are subject to a tax computed under section 821(b).

(b) *Rates of tax.* (1) The normal tax under section 821(a)(1)(A) and 821(b)(1), except as hereinafter indicated, is computed upon mutual insurance company taxable income for purposes of the normal tax at the rate of 30 percent.

(2) The surtax under section 821(a)(1)(B) and 821(b)(2), except as hereinafter indicated, is computed on that portion of the mutual insurance company taxable income for purposes of the surtax in excess of \$25,000 at the rate of 22 percent. The tax under section 821(a)(2), except as hereinafter indicated, is 1 percent of the gross amount of income from interest, dividends, rents, and net premiums, minus dividends to policyholders and minus wholly tax-exempt interest.

(3) Under section 821(a)(1)(A) companies with mutual insurance company taxable income for purposes of the normal tax of over \$3,000 and not over \$6,000 pay a normal tax, at a specified rate, on that portion of such income in excess of \$3,000. The rate applicable in computing the normal tax of such companies is 60 percent. Under section 821(a)(2) companies with gross amounts of income from interest dividends, rents, and net premiums, minus dividends to policyholders and minus wholly tax-exempt interest, of over \$75,000 and not over \$150,000 pay a tax equal to 2 percent of that portion in excess of \$75,000.

(4) Under section 821(b)(1) interinsurers and reciprocal underwriters with mutual insurance company taxable income for purposes of the normal tax of over \$50,000 and not over \$100,000 pay a normal tax computed on that portion of such income in excess of \$50,000 at the rate of 60 percent. Under section 821(b)(2) interinsurers and re-

ciprocal underwriters with mutual insurance company taxable income for purposes of the surtax of over \$50,000 and not over \$100,000 pay a surtax, at the rate of 33 percent, on that portion of such income in excess of \$50,000.

(5) Section 821(c) provides for an adjustment of the amount computed under section 821(a)(1), section 821(a)(2), and section 821(b) where the gross amount received during the taxable year from interest, dividends, rents, and premiums (including deposits and assessments) is over \$75,000 and less than \$125,000. The adjustment reduces the tax otherwise computed under those sections to an amount which bears the same proportion to such tax as the excess over \$75,000 bears to \$50,000.

(c) *Application.* The application of section 821 (a) to (c) inclusive, may be illustrated by the following examples:

Example 1. The W Company, a mutual casualty insurance company, for the calendar year 1954, has mutual insurance company taxable income for purposes of the surtax of \$5,500 and, due to partially tax-exempt interest of \$800, has income for purposes of the normal tax of \$4,700. The gross amount of income of the W Company from interest, dividends, rents and net premiums, minus dividends to policyholders and wholly tax-exempt interest, is \$150,000. Its normal tax under section 821(a)(1) for the calendar year 1954 is 60 percent of \$1,700 (\$4,700 minus \$3,000) or \$1,020, since its income subject to normal tax is not over \$6,000. It is not liable for surtax for the calendar year 1954 as its mutual insurance company taxable income for purposes of the surtax does not exceed \$25,000. It has no surtax and, therefore, its total tax under section 821(a)(1)(A) is the normal tax of \$1,020. The tax under section 821(a)(2) is 2 percent of \$75,000 (\$150,000 - \$75,000), or \$1,500. Since the tax under section 821(a)(2) exceeds the tax under section 821(a)(1), the tax under section 821 is \$1,500, namely, that imposed by section 821(a)(2).

Example 2. If in example 1 the income for purposes of the normal tax were not over \$3,000, the income for purposes of the surtax were not over \$25,000, the gross amount received from interest, dividends, rents, and premiums (including deposits and assessments) were \$90,000, and the gross amount of income from interest, dividends, rents, and net premiums, minus dividends to policyholders and wholly tax-exempt interest, were \$70,000, the W Company would be required to file an income tax return but due to section 821(a) no income tax would be imposed.

Example 3. The X Company, a mutual casualty insurance company, for the calendar year 1954 has mutual insurance company taxable income for surtax purposes of \$28,000 and, due to partially tax-exempt interest of \$5,000, has income for normal tax purposes of \$23,000. The gross amount of income of the X Company from interest, dividends, rents, and net premiums, minus dividends to policyholders and wholly tax-exempt interest, is \$1,200,000. Under section 821(a)(1) its normal tax for the calendar year 1954 is 30 percent of \$23,000, or \$6,900, and the surtax is 22 percent of \$3,000 (\$28,000 - \$25,000), or \$660. The combined tax under section 821(a)(1) is \$7,560 (\$6,900 plus \$660). The tax under section 821(a)(2) is 1 percent of \$1,200,000, or \$12,000. Since the tax under section 821(a)(2) exceeds the tax under section 821(a)(1), the tax under section 821(a) is \$12,000, namely, that imposed by section 821(a)(2).

Example 4. The Y Company, a mutual fire insurance company subject to the tax imposed by section 821 for the calendar year 1954, has mutual insurance company taxable income for purposes of the surtax of \$35,000 and, due to partially tax-exempt interest of \$5,000, has income for purposes of the normal tax of \$30,000. The gross amount received from interest, dividends, rents and premiums (including deposits and assessments) is \$120,000, and the gross amount of income from interest, dividends, rents, and net premiums, minus dividends to policyholders and wholly tax-exempt interest, is \$100,000. Under section 821(a)(1), without application of section 821(c), the normal tax would be 30 percent of \$30,000, or \$9,000, since this is less than \$16,200, 60 percent of \$27,000 (excess of \$30,000 over \$3,000); and the surtax would be 22 percent of \$10,000 (excess of \$35,000 over \$25,000), or \$2,200. The combined tax of \$11,200 (\$9,000 plus \$2,200) would then be reduced by applying section 821(c), since the gross receipts are between \$75,000 and \$125,000. The tax under section 821(a)(1), as thus adjusted, would be 90 percent of \$11,200, or \$10,080, since \$45,000 (excess of \$120,000 over \$75,000) is 90 percent of \$50,000. Under section 821(a)(2), without reference to section 821(c), the tax is 2 percent of \$25,000 (excess of \$100,000 over \$75,000), or \$500, since this is less than \$1,000, 1 percent of \$100,000. Applying section 821(c) reduces this to \$450, or 90 percent of \$500. Since \$10,080, the tax under section 821(a)(1), as adjusted, exceeds \$450, the tax under section 821(a)(2), as adjusted, the tax under section 821(a)(1), as adjusted, is applicable. The Y Company would accordingly pay a combined normal taxing and surtax of \$10,080.

Example 5. The Z Exchange, an interinsurer, for the calendar year 1954 has mutual insurance company taxable income for purposes of the surtax of \$60,000 and, due to partially tax-exempt interest of \$12,000, has income for purposes of the normal tax of \$48,000. The gross amount received from in-

terest, dividends, rents, and premiums (including deposits and assessments) is \$2,700,000. The Z Exchange is not liable for normal tax under section 821(b)(1) for the calendar year 1954 as its mutual insurance company taxable income for purposes of the normal tax does not exceed \$50,000. Its surtax is 33 percent of \$10,000 (\$60,000 minus \$50,000), or \$3,300, since that amount is less than \$7,700, 22 percent of \$35,000 (excess of \$60,000 over \$25,000). Since the Z Exchange has no normal tax, is not subject to the tax imposed by section 821(a)(2), and is not entitled to the adjustment provided in section 821(c), its total tax under section 821(a) is \$3,300.

§ 1.821-2 Taxable years affected.

Section 1.821-1 is 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. Section 1.821-3 is 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 1.821-4 and 1.821-5 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 sections of 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 11110, Oct. 17, 1963]

§ 1.821-3 Tax on mutual insurance companies other than life or marine or fire insurance companies subject to the tax imposed by section 831.

(a) *In general.* (1) For taxable years beginning after December 31, 1954, all mutual insurance companies, including foreign insurance companies carrying on an insurance business within the United States, not taxable under section 802 or 831 and not specifically exempt under the provisions of section 501(c)(15), are subject to the tax imposed by section 821 on their investment income or on their gross income, whichever tax is the greater, except interinsurers and reciprocal underwriters which are taxed only on their

investment income. For the alternative tax, in lieu of the tax imposed by section 821 (a) or (b), where the net long-term capital gain for any taxable year exceeds the net short-term capital loss, see section 1201(a) and the regulations thereunder.

(2) The taxable income of mutual insurance companies subject to the tax imposed by section 821 differs from the taxable income of other corporations. See section 821(a)(2) and section 822. Such companies are entitled, in computing mutual insurance company taxable income, to the deductions provided in part VIII (section 241 and following, except section 248), subchapter B, chapter 1 of the Code. The gross amount of income during the taxable year from interest, the deduction under section 822(c)(1) for wholly tax-exempt interest, and the deduction under section 242 for partially tax-exempt interest, are decreased by the appropriate amortization of premium and increased by the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures or other evidences of indebtedness held by a mutual insurance company subject to the tax imposed by section 821. See section 822(d)(2) and § 1.822-7. However, for taxable years beginning after May 31, 1960, only the accrual of discount relating to issue discount will increase the deduction for wholly tax-exempt interest. See section 103. In the case of any such evidence of indebtedness, adjustment shall be made to basis in the same manner as that made by life insurance companies under section 1016(a)(17) and the regulations thereunder.

(3) All provisions of the Internal Revenue Code and of the regulations in this part not inconsistent with the specific provisions of section 821 are applicable to the assessment and collection of the tax imposed by section 821 (a) or (b) and mutual insurance companies subject to the tax imposed by section 821 are subject to the same penalties as are provided in the case of returns and payment of income tax by other corporations. The return shall be on Form 1120M.

(4) Foreign mutual insurance companies not carrying on an insurance business within the United States are not taxable under section 821 (a) or (b), but

are taxable as other foreign corporations. See section 881.

(5) Mutual insurance companies subject to the tax imposed by section 821, except interinsurers or reciprocal underwriters, with mutual insurance company taxable income (computed without regard to the deduction provided in section 242 for partially tax-exempt interest) of over \$3,000 or with gross amounts of income during the taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof) and net premiums (minus dividends to policyholders and wholly tax-exempt interest) in excess of \$75,000, are subject to a tax computed under section 821(a)(1) or section 821(a)(2) whichever is the greater. Interinsurers and reciprocal underwriters with mutual insurance company taxable income (computed without regard to the deduction provided in section 242 for partially tax-exempt interest) of over \$50,000 are subject to a tax computed under section 821(b).

(b) *Rates of tax.* (1) For taxable years beginning before July 1, 1963, the normal tax under section 821(a)(1)(A) and 821(b)(1), except as hereinafter indicated, is computed upon mutual insurance company taxable income for purposes of the normal tax at the rate of 30 percent.

(2) The surtax under section 821(a)(1)(B) and 821(b)(2), except as hereinafter indicated, is computed on that portion of the mutual insurance company taxable income for the purposes of the surtax in excess of \$25,000 at the rate of 22 percent. The tax under section 821(a)(2), except as hereinafter indicated, is 1 percent of the gross amount of income during the taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof) and net premiums, minus dividends to policyholders and minus wholly tax-exempt interest.

(3) For taxable years beginning before July 1, 1963, under section 821(a)(1)(A) companies with mutual insurance company taxable income for purposes of the normal tax of over \$3,000 and not over \$6,000 pay a normal tax, at a specified rate, on that portion of such income in excess of \$3,000. The

rate applicable in computing the normal tax of such companies is 60 percent. Under section 821(a)(2) companies with gross amounts of income during the taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof) and net premiums, minus dividends to policyholders and minus wholly tax-exempt interest, of over \$75,000 and not over \$150,000 pay a tax equal to 2 percent of that portion in excess of \$75,000.

(4) For taxable years beginning before July 1, 1963, under section 821(b)(1) interinsurers and reciprocal underwriters with mutual insurance company taxable income for purposes of the normal tax of over \$50,000 and not over \$100,000 pay a normal tax computed on that portion of such income in excess of \$50,000 at the rate of 60 percent. Under section 821(b)(2) interinsurers and reciprocal underwriters with mutual insurance company taxable income for purposes of the surtax of over \$50,000 and not over \$100,000 pay a surtax, at the rate of 33 percent, on that portion of such income in excess of \$50,000.

(5) Section 821(c) provides for an adjustment of the amount computed under section 821(a)(1), section 821(a)(2), and section 821(b) where the gross amount received during the taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) is over \$75,000 and less than \$125,000. The adjustment reduces the tax otherwise computed under those sections to an amount which bears the same proportion to such tax as the excess over \$75,000 bears to \$50,000.

(c) *Application.* The application of section 821 (a) to (c) inclusive, may be illustrated by the following examples:

Example 1. The W Company, a mutual casualty insurance company, for the calendar year 1958, has mutual insurance company taxable income for purposes of the surtax of \$5,500 and, due to partially tax-exempt interest of \$800, has income for purposes of the normal tax of \$4,700. The gross amount of income of the W Company from the items described in section 822(b) (other than paragraph (1)(D) thereof) and net premiums, minus dividends to policyholders and wholly tax-exempt interest, is \$150,000. Its normal tax under section 821(a)(1) for the calendar

year 1958 is 60 percent of \$1,700 (\$4,700 minus \$3,000) or \$1,020, since its income subject to normal tax is not over \$6,000. It is not liable for surtax for the calendar year 1958 as its mutual insurance company taxable income for purposes of the surtax does not exceed \$25,000. It has no surtax and, therefore, its total tax under section 821(a)(1)(A) is the normal tax of \$1,020. The tax under section 821(a)(2) is 2 percent of \$75,000 (\$150,000 - \$75,000), or \$1,500. Since the tax under section 821(a)(2) exceeds the tax under section 821(a)(1), the tax under section 821 is \$1,500, namely, that imposed by section 821(a)(2).

Example 2. If in the above example the income for purposes of the normal tax were not over \$3,000, the income for purposes of the surtax were not over \$25,000, the gross amount received from interest, dividends, rents, and premiums (including deposits and assessments) were \$90,000, and the gross amount of income from the items described in section 822(b) (other than paragraph (1)(D) thereof) and net premiums, minus dividends to policyholders and wholly tax-exempt interest were \$70,000, the W Company would be required to file an income tax return but due to section 821(a) no income tax would be imposed.

Example 3. The X Company, a mutual casualty insurance company, for the calendar year 1958, has mutual insurance company taxable income for surtax purposes of \$28,000 and, due to partially tax-exempt interest of \$5,000, has income for normal tax purposes of \$23,000. The gross amount of income of the X Company received during the taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof) and net premiums, minus dividends to policyholders and wholly tax-exempt interest, is \$1,200,000. Under section 821(a)(1) its normal tax for the calendar year 1958 is 30 percent of \$23,000, or \$6,900, and the surtax is 22 percent of \$3,000 (\$28,000 - \$25,000), or \$660. The combined tax under section 821(a)(1) is \$7,560 (\$6,900 plus \$660). The tax under section 821(a)(2) is 1 percent of \$1,200,000, or \$12,000. Since the tax under section 821(a)(2) exceeds the tax under section 821(a)(1), the tax under section 821(a) is \$12,000, namely, that imposed by section 821(a)(2).

Example 4. The Y Company, a mutual fire insurance company subject to the tax imposed by section 821 for the calendar year 1958, has mutual insurance company taxable income for purposes of the surtax of \$35,000 and, due to partially tax-exempt interest of \$5,000, has income for purposes of the normal tax of \$30,000. The gross amount received during the taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) is \$120,000, and the gross amount of income from interest, dividends, rents, and net premiums, minus dividends to policyholders and wholly tax-

exempt interest, is \$100,000. Under section 821(a)(1), without application of section 821(c), the normal tax would be 30 percent of \$30,000, or \$9,000, since this is less than \$16,200, 60 percent of \$27,000 (excess of \$30,000 over \$3,000); and the surtax would be 22 percent of \$10,000 (excess of \$35,000 over \$25,000), or \$2,200. The combined tax of \$11,200 (\$9,000 plus \$2,200) would then be reduced by applying section 821(c), since the gross receipts are between \$75,000 and \$125,000. The tax under section 821(a)(1), as thus adjusted, would be 90 percent of \$11,200, or \$10,080, since \$45,000 (excess of \$120,000 over \$75,000) is 90 percent of \$50,000. Under section 821(a)(2), without reference to section 821(c), the tax is 2 percent of \$25,000 (excess of \$100,000 over \$75,000), or \$500, since this is less than \$1,000, 1 percent of \$100,000. Applying section 821(c) reduces this to \$450, or 90 percent of \$500. Since \$10,080, the tax under section 821(a)(1), as adjusted, exceeds \$450, the tax under section 821(a)(2), as adjusted, the tax under section 821(a)(1), as adjusted, is applicable. The Y Company would accordingly pay a combined normal tax and surtax of \$10,080.

Example 5. The Z Exchange, an inter-insurer, for the calendar year 1958 has mutual insurance company taxable income for purposes of the surtax of \$60,000 and, due to partially tax-exempt interest of \$12,000, has income for purposes of the normal tax of \$48,000. The gross amount received during the taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) is \$2,700,000. The Z Exchange is not liable for normal tax under section 821(b)(1) for the calendar year 1958 as its mutual insurance company taxable income for purposes of the normal tax does not exceed \$50,000. Its surtax is 33 percent of \$10,000 (\$60,000 minus \$50,000), or \$3,300, since that amount is less than \$7,700, 22 percent of \$35,000 (excess of \$60,000 over \$25,000). Since the Z Exchange has no normal tax, is not subject to the tax imposed by section 821(a)(2), and is not entitled to the adjustment provided in section 821(c), its total tax under section 821(b) is \$3,300.

[T.D. 6610, 27 FR 8718, Aug. 31, 1962]

§ 1.821-4 Tax on mutual insurance companies other than life insurance companies and other than fire, flood, or marine insurance companies, subject to tax imposed by section 831.

(a) *In general*—(1) *Tax imposed.* (i) For taxable years beginning after December 31, 1962, all mutual insurance companies, including foreign insurance companies carrying on an insurance business within the United States, not taxable under section 802 or 831, and

not specifically exempt under the provisions of section 501(c)(15), are subject either to the tax imposed by section 821(a) on mutual insurance company taxable income or, in the case of certain small companies, to the tax imposed by section 821(c) on taxable investment income. The determination of whether a mutual insurance company is taxable under section 821 (a) or (c) for the taxable year is dependent upon the gross amount received by the company during such taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments). If such gross amount received exceeds \$150,000, but does not exceed \$500,000 for the taxable year, the company is subject to the tax imposed by section 821(c) on taxable investment income, unless (a) the company elects under section 821(d) in the manner provided in paragraph (f) of this section to be subject to the tax imposed by section 821(a), or (b) there is a balance in its protection against loss account at the beginning of the taxable year. A company having a gross amount received in excess of \$500,000 is subject to the tax imposed by section 821(a). For exemption from income tax of companies having a gross amount received not in excess of \$150,000, see section 501(c)(15). For the alternative tax, in lieu of the tax imposed by section 821 (a) or (c), where the net long-term capital gain for any taxable year exceeds the net short-term capital loss, see section 1201(a) and the regulations thereunder. For the definition of an insurance company, see paragraph (a) of § 1.801-3.;

(ii) The term “premiums” as used in section 821 and this section has the same meaning as in section 501(c)(15) and § 1.501(c)(15)-1, and means the total amount of the premiums and other consideration provided in the insurance contract without any deduction for commissions, return premiums, reinsurance, dividends to policyholders, dividends left on deposit with the company, discounts on premiums paid in advance, interest applied in reduction of premiums (whether or not required

to be credited in reduction of premiums under the terms of the contract), or any other item of similar nature. Such term includes advance premiums, premiums deferred and uncollected and premiums due and unpaid, deposits, fees, assessments, and consideration in respect of assuming liabilities under contracts not issued by the taxpayer (such as a payment or transfer of property in an assumption reinsurance transaction), but does not include amounts received from other insurance companies for losses paid under reinsurance contracts.

(2) *Tax base.* The taxable income of mutual insurance companies taxable under section 821 differs from the taxable income of other corporations. See sections 821(b) and 822. Mutual insurance companies have special items of income and special deductions not provided for other corporations. See, for example, sections 821(b)(1)(C), 822(d), 823(b), 824(a), and 825(a). Thus, the computation of mutual insurance company taxable income for a company taxable under section 821(a), and the computation of taxable investment income for a company taxable under section 821(c), must be made in strict accordance with the provisions of part II of subchapter L of the Code.

(3) *Applicability of other provisions.* All provisions of the Code and of the regulations in this part not inconsistent with the specific provisions of part II of subchapter L of the Code are applicable to the assessment and collection of the tax imposed by section 821 (a) or (c), and mutual insurance companies subject to the tax imposed by section 821 are subject to the same penalties as are provided in the case of returns and payment of income tax by other corporations. The return shall be on Form 1120M.

(4) *Certain foreign companies.* Foreign mutual insurance companies (other than a life insurance company and other than a fire, flood, or marine insurance company subject to the tax imposed by section 831) not carrying on an insurance business within the United States are not taxable under section 821 (a) or (c), but are taxable as other foreign corporations. See section 881.

(b) *Rates of tax imposed by section 821(a)*—(1) *Normal tax.* For taxable years beginning before January 1, 1964, the normal tax imposed under section 821(a) is the lesser of 30 percent of mutual insurance company taxable income, or 60 percent of the amount by which mutual insurance company taxable income exceeds \$6,000. In the case of taxable years beginning after December 31, 1963, the normal tax is imposed at the rate of 22 percent of mutual insurance company taxable income, or 44 percent of the amount by which mutual insurance company taxable income exceeds \$6,000, whichever is the lesser. For example, a company subject to tax under section 821(a) will file a return but will pay no normal tax if mutual insurance company taxable income does not exceed \$6,000. When mutual insurance company taxable income exceeds \$6,000 but does not exceed \$12,000, the company will pay a normal tax equal to 44 percent (60 percent in the case of taxable years beginning before Jan. 1, 1964), of the amount by which mutual insurance company taxable income exceeds \$6,000. When mutual insurance company taxable income exceeds \$12,000, the company will pay normal tax at the rate of 22 percent (30 percent in the case of taxable years beginning before Jan. 1, 1964), of such income.

(2) *Surtax*—(i) *Taxable years beginning before January 1, 1964.* For taxable years beginning before January 1, 1964, companies taxable under section 821(a) are subject to a surtax equal to 22 percent of so much of their mutual insurance company taxable income (computed without regard to the deduction provided in section 242 for partially tax-exempt interest) as exceeds \$25,000. In the case of an interinsurer or reciprocal underwriter electing to be subject to the limitation provided in section 826(b), the surtax applies to any increase in mutual insurance company taxable income attributable to such election, without regard to the \$25,000 surtax exemption otherwise provided by this subparagraph, and without regard to whether the company is liable for any normal tax under subparagraph (1) of this paragraph. See section 826(f) and § 1.826-2.

(ii) *Taxable years beginning after December 31, 1963.* For taxable years beginning after December 31, 1963, companies taxable under section 821(a) are subject to a surtax at the rates and with the exemptions provided in section 11(c) on their mutual insurance company taxable income. In the case of an inter-insurer or reciprocal underwriter electing to be subject to the limitation provided in section 826(b), the surtax applies to any increase in mutual insurance company taxable income attributable to such election, without regard to the surtax exemption otherwise provided by section 11(d), and without regard to whether the company is liable for any normal tax under section 821(a)(1) and subparagraph (1) of this paragraph. See section 826(f) and § 1.826-2.

(c) *Mutual insurance company taxable income defined.* The tax imposed by section 821(a) with respect to any taxable year is computed upon mutual insurance company taxable income for the taxable year. Section 821(b) provides that in the case of a mutual insurance company subject to the tax imposed by section 821(a), mutual insurance company taxable income means the amount by which:

(1) The sum of:

(i) The taxable investment income (as defined in section 822(a)(1) and paragraph (a)(1) of § 1.822-8).

(ii) The statutory underwriting income (as defined in section 823(a)(1) and paragraph (b)(1) of § 1.823-6), and

(iii) The amounts required by section 824(d) and paragraph (b)(3) of § 1.824-1 to be subtracted from the protection against loss account, exceeds.

(2) The sum of:

(i) The investment loss (as defined in section 822(a)(2) and paragraph (a)(2) of § 1.822-8),

(ii) The statutory underwriting loss (as defined in section 823(a)(2) and paragraph (b)(2) of § 1.823-6), and

(iii) The unused loss deduction provided by section 825(a) and paragraph (a) of § 1.825-1.

If for any taxable year the amount determined under subparagraph (2) of this paragraph equals or exceeds the amount determined under subparagraph (1) of this paragraph, the mutual

insurance company taxable income for such year shall be zero.

(d) *Examples.* The application of the tax imposed by section 821(a) may be illustrated by the following examples:

Example 1. (a) M, a mutual casualty insurance company, for the calendar year 1963 has gross receipts from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) in excess of \$500,000, and therefore is subject to the tax imposed by section 821(a). M's taxable investment income, computed under section 822, is \$30,000 and its statutory underwriting income, computed under section 823, is \$15,000. M subtracts \$3,000 from its protection against loss account in accordance with the computation made under section 824(d). M has no unused loss deduction. M received no partially tax exempt interest. If M is not subject to section 826, its mutual insurance company taxable income for the taxable year 1963 is \$48,000, computed as follows:

(1) Taxable investment income	\$30,000
(2) Statutory underwriting income	15,000
(3) Subtractions from protection against loss account	3,000
(4) Total income items	48,000
(5) Investment loss	0
(6) Statutory underwriting loss	0
(7) Unused loss deduction	0
(8) Total loss items	0
(9) Mutual insurance company taxable income (item (4) minus item (8))	48,000

(b) Since M's mutual insurance company taxable income is in excess of \$12,000, M will pay normal tax on its mutual insurance company taxable income at a rate of 30 percent. In addition, since M's mutual insurance company taxable income exceeds \$25,000, M will pay surtax on such excess at a rate of 22 percent. M's total tax liability for the taxable year 1963 is \$19,460, computed as follows:

(1) Mutual insurance company taxable income as computed in item (a)(9)	\$48,000
(2) Normal tax; 30 percent of mutual insurance company taxable income	14,400
(3) Surtax exemption	25,000
(4) Mutual insurance company taxable income subject to the surtax (item (1) minus item (3))	23,000
(5) Surtax: 22 percent of mutual insurance company taxable income subject to the surtax	5,060
(6) Total tax (item (2) plus item (5))	19,460

Example 2. If in example 1, M's mutual insurance company taxable income for 1963 had been in excess of \$6,000 but not in excess of \$12,000, M would pay normal tax in an amount equal to 60 percent of the amount by which such income exceeded \$6,000. Thus, if M had mutual insurance company taxable income of \$11,000, M's total tax liability for the

taxable year 1963 would be \$3,000, computed as follows:

(1) Mutual insurance company taxable income	\$11,000
(2) Mutual insurance company taxable income in excess of \$6,000 (\$11,000 minus \$6,000)	5,000
(3) 30 percent of item (1)	3,800
(4) 60 percent of item (2)	3,000
(5) Normal tax (lesser of items (3) or (4))	3,000
(6) Surtax exemption	25,000

Since the surtax exemption exceeds the mutual insurance company taxable income for purposes of the surtax, there is no surtax liability. Since the normal tax under section 821(a) is the lesser of 30 percent of mutual insurance company taxable income or 60 percent of the amount by which such income exceeds \$6,000, M's normal tax (and total income tax liability) is \$3,000. If M's mutual insurance company taxable income was not in excess of \$6,000, M would be required to file a return, but would not be liable for any normal tax, since, in such a case, 60 percent of M's mutual insurance company taxable income in excess of \$6,000 would be zero.

Example 3. Assume the same income as in example 1 in the 1965 calendar year and that M is not a corporation to which section 1561 (with respect to certain controlled corporations) applies. Since M's mutual insurance company taxable income is in excess of \$12,000, M will pay normal tax on its mutual insurance company taxable income at a rate of 22 percent. In addition, since M's mutual insurance company taxable income exceeds the surtax exemption provided in section 11(d) of \$25,000, M will pay a surtax on such excess at the rate provided in section 11(c), 26 percent. M's total liability for the taxable year 1964 is \$16,540, computed as follows:

(1) Mutual insurance company taxable income as computed in example (1)	\$48,000
(2) Normal tax: 22 percent of mutual insurance company taxable income for normal tax purposes	10,560
(3) Surtax exemption provided by section 11(d)	25,000
(4) Mutual insurance company taxable income subject to the surtax (item (1) minus item (3))	23,000
(5) Surtax: at rates provided in section 11(c): 26 percent of mutual insurance company taxable income subject to the surtax	5,980
(6) Total tax (item (2) plus item (5))	16,540

(e) *Alternative tax for certain small mutual insurance companies—(1) In general.*

(i) Section 821(c) provides an alternative tax for certain small mutual insurance companies. This alternative tax, which is in lieu of the tax imposed by section 821(a), is imposed on taxable investment income (as defined in section 822(a)(1) and paragraph (a)(1) of § 1.822-8) and consists of a normal tax and a surtax. The tax provided by section 821(c) is imposed on every mutual insurance company (other than a life insurance company and other than a fire, flood, or marine insurance com-

pany subject to the tax imposed by section 831) which received during the taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) a gross amount in excess of \$150,000 but not in excess of \$500,000, except a company which has properly elected under section 821(d) and paragraph (f) of this section to be subject to the tax imposed by section 821(a), or a company which has a balance in its protection against loss account at the beginning of the taxable year.

(ii) Any company which would be taxable under section 821(c) but for the presence of an amount in its protection against loss account at the beginning of the taxable year may elect to subtract the balance from such account. See section 824(d)(5) and § 1.824-3. If such an election is made in such a case, the company shall not be subject to the tax imposed by section 821(a), but shall be subject to the tax imposed by section 821(c).

(2) *Rates of tax imposed by section 821(c)—(i) Normal tax.* The normal tax for taxable years beginning before January 1, 1964, is the lesser of 30 percent of taxable investment income or 60 percent of the amount by which taxable investment income exceeds \$3,000. For taxable years beginning after December 31, 1963, the normal tax is imposed at the rate of 22 percent of taxable investment income, or 44 percent of the amount by which taxable investment income exceeds \$3,000, whichever is the lesser. Thus, a company subject to tax under section 821(c) will file a return but will pay no tax if for the taxable year its taxable investment income does not exceed \$3,000; or will pay a normal tax equal to 44 percent (60 percent in the case of taxable years beginning before Jan. 1, 1964), of taxable investment income in excess of \$3,000 when such income exceeds \$3,000 but does not exceed \$6,000. When taxable investment income exceeds \$6,000, the normal tax is imposed at the rate of 22 percent (30 percent in the case of taxable years beginning before Jan. 1, 1964) of such income.

(ii) *Surtax.* For taxable years beginning before January 1, 1964, a surtax is imposed at the rate of 22 percent of

taxable investment income (computed without regard to the deduction provided in section 242 for partially tax-exempt interest) in excess of \$25,000. For taxable years beginning after December 31, 1963, a surtax is imposed at the rate provided in section 11(c) on taxable investment income in excess of the surtax exemption provided in section 11(d).

(f) *Election to be taxed under section 821(a)*—(1) *In general.* Section 821(d) provides that any mutual insurance company taxable under section 821(c) may elect, in the manner provided by subparagraph (3) of this paragraph, to be taxed under section 821(a).

(2) *Scope of election.* Except as otherwise provided herein, an election made under section 821(d) and this paragraph to be taxable under section 821(a) shall be binding for the taxable year for which made and for all succeeding taxable years unless the Commissioner consents to a revocation of such election. If for any taxable year the gross amount received from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) does not exceed \$150,000, a company's prior election made under section 821(d) to be taxable under section 821(a) will automatically terminate and any balance in the protection against loss account will be taken into account for the preceding taxable year. (See section 824(d)(4) and § 1.824-2 for automatic termination of protection against loss account if company is not subject to the tax imposed by section 821(a).) If for any taxable year thereafter the gross amount received exceeds \$150,000 but does not exceed \$500,000, the company shall be taxable under section 821(c) unless it makes a new election to be taxable under section 821(a). If a company subject to tax under section 821(c) for a taxable year elects under section 821(d) and this section to be taxed under section 821(a) and, in a subsequent taxable year, the gross receipts of such company exceed \$500,000, the election made for such earlier taxable year shall be considered as continuing in effect. Thus, such a company will continue to be taxable under section 821(a) notwithstanding that its gross receipts subsequently fall below

\$500,000 (so long as they do not fall below \$150,000) unless the Commissioner consents to a revocation of the prior election. Whether revocation is permissible in any case will depend on the facts and circumstances of the particular case, but in no case will revocation be granted in the absence of a showing that the election creates an undue burden or material hardship on the company due to a substantial change in the character of its operations.

(3) *Time and manner of making election.* The election provided by section 821(d) shall be made in a statement attached to the company's income tax return for the first taxable year for which the election is to apply. The statement shall include the name and address of the taxpayer, shall be signed by the taxpayer (or its duly authorized representative), and shall be filed not later than the date prescribed by law (including extensions thereof) for filing the return for such taxable year.

(g) *Examples.* The application of the tax imposed by section 821(c) may be illustrated by the following examples:

Example 1. M, a mutual casualty insurance company, for the calendar year 1963 has a gross amount received from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) of \$400,000. Since M's gross amount received exceeds \$150,000, but does not exceed \$500,000, M is subject to the tax imposed by section 821(c) on taxable investment income unless it elects to be subject to the tax imposed on mutual insurance company taxable income by section 821(a). M computes its taxable investment income under section 822 to be \$35,000. In computing taxable investment income, M deducted \$2,000 of partially tax-exempt interest under section 242. If M does not make an election to be taxed under section 821(a), its total tax liability for the taxable year 1963 is \$13,140 computed as follows:

(1) Taxable investment income as computed under section 822	\$35,000
(2) 30 percent of taxable investment income	10,500
(3) 60 percent of taxable investment income in excess of \$3,000	19,200
(4) Normal tax (lesser of items (2) or (3))	10,500
(5) Partially tax-exempt interest deducted in computing taxable investment income	2,000
(6) Taxable investment income for purposes of the surtax (item (1) plus item (5))	37,000
(7) Surtax exemption	25,000
(8) Taxable investment income subject to surtax (item (6) minus item (7))	12,000
(9) Surtax (22 percent of item (8))	2,640
(10) Total tax liability (item (4) plus item (9))	13,140

Example 2. N, a mutual casualty insurance company, for the taxable year 1963 has a gross amount received from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) of \$210,000. Since N's gross amount received exceeds \$150,000 but does not exceed \$500,000, N is subject to the tax imposed by section 821(c) on taxable investment income unless it elects to be subject to the tax imposed by section 821(a). Furthermore, since the gross amount received by N does not exceed \$250,000, N is entitled to the special tax reduction provided by section 821(c)(2). N computes its taxable investment income under section 822 to be \$24,000. In computing taxable investment income, N deducted \$2,000 of partially tax-exempt interest under section 242. If N does not make an election to be taxed under section 821(a), its total tax liability for the taxable year 1963 is \$4,452 computed as follows:

(1) Taxable investment income as computed under section 822	\$24,000
(2) 30 percent of taxable investment income	7,200
(3) 60 percent of taxable investment income in excess of \$3,000	12,600
(4) Normal tax (lesser of items (2) or (3))	7,200
(5) Partially tax-exempt interest deducted in computing taxable investment income	2,000
(6) Taxable investment income for purposes of the surtax (item (1) plus item (5))	26,000
(7) Surtax exemption	25,000
(8) Taxable investment income subject to surtax (item (6) minus item (7))	1,000
(9) Surtax 22 percent of item (8)	220
(10) Tax liability computed without regard to special reduction (item (4) plus item (9))	7,420
(11) Amount by which gross receipts exceed \$150,000 (\$210,000 gross receipts minus \$150,000)	60,000
(12) Percentage which item (1) bears to \$100,000 (\$60,000 over \$100,000)	0.60
(13) Tax as adjusted (percentage determined in item (12) applied to item (10))	4,452

If N's taxable investment income for purposes of the surtax did not exceed \$3,000, N would file a return but would pay no tax. Had N elected (under section 821(d)) to be subject to tax under section 821(a), N would not be entitled to the special reduction afforded by section 821(c)(2), since that provision applies only to companies taxable under section 821(c).

[T.D. 6681, 28 FR 11110, Oct. 17, 1963, as amended by T.D. 7100, 36 FR 5333, Mar. 20, 1971; 36 FR 5846, Mar. 30, 1971]

§ 1.821-5 Special transitional underwriting loss.

(a) *In general.* Section 821(f) provides a special reduction in the statutory underwriting income (as defined by section 823(a)(1) and paragraph (b)(1) of § 1.823-6) of any company taxable under section 821(a) which was taxable under

section 821 for the five taxable years immediately preceding January 1, 1962, and which incurred an underwriting loss (as defined in section 821(f)(3) and paragraph (c) of this section) for each of such five taxable years.

(b) *Amount of reduction.* In the case of a company described in section 821(f)(1) and paragraph (a) of this section the statutory underwriting income for the taxable year (determined without regard to this paragraph) shall be reduced by an amount equal to the amount by which:

(1) The sum of the underwriting losses of such company for the five taxable years immediately preceding January 1, 1962, exceeds

(2) The total amount by which the company's statutory underwriting income was reduced by reason of section 821(f) and this section for prior taxable years.

(c) *Underwriting loss defined.* For purposes of computing the amount of the reduction available under section 821(f) and paragraph (a) of this section, the term underwriting loss means statutory underwriting loss (as defined by section 823(a)(2) and paragraph (b)(2) of § 1.823-6) computed without any deduction under section 824(a) and paragraph (a) of § 1.824-1 (relating to deduction to provide protection against losses) and without any deduction under section 832(c)(11) (relating to dividends and similar distributions paid or declared to policyholders). For rules relating to the definition of dividends and similar distributions paid or declared to policyholders, see paragraph (a) of § 1.832-5.

(d) *Years of applicability.* Section 821(f)(4) provides that the special reduction of statutory underwriting income allowed by section 821(f)(2) and paragraph (b) of this section shall apply to any taxable year beginning after December 31, 1962, and before January 1, 1968, for which the taxpayer is subject to the tax imposed by section 821(a).

[T.D. 6681, 28 FR 11112, Oct. 17, 1963]

§ 1.822-1 Taxable income and deductions.

(a) *In general.* For taxable years beginning after December 31, 1953, but before January 1, 1955, and ending after

August 16, 1954, the taxable income of a mutual insurance company subject to the tax imposed by section 821 is its gross investment income, namely, the gross amount of income during the taxable year from interest, dividends, rents, and gains from sales or exchanges of capital assets, less the deductions provided in section 822(c) for wholly tax-exempt interest, investment expenses, real estate expenses, depreciation, interest paid or accrued, capital losses to the extent provided in subchapter P (sec. 1201 and following), chapter 1 of the Code, and the special deductions provided in part VIII (section 241 and following), except section 248, subchapter B, chapter 1 of the Code. 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.

(b) *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).

(c) *Investment expenses.* The deduction allowed by section 822(c)(2) for investment expenses is the same as that allowed life insurance companies by section 803(g)(2). See paragraph (c) of § 1.803-4.

(d) *Taxes and expenses with respect to real estate.* The deduction allowed by section 822(c)(3) for taxes and expenses with respect to real estate owned by the company is the same as that allowed life insurance companies by section 803(g)(3). See paragraph (d) of § 1.803-4.

(e) *Depreciation.* The deduction allowed by section 822(c)(4) for depreciation is the same as that allowed life insurance companies by section 803(g)(4). See paragraph (e) of § 1.803-4.

(f) *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.

(g) *Capital losses.* (1) The deduction for capital losses under section 822(c)(6) includes not only capital losses to the extent provided in subchapter P 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.

(2) 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 interest, dividends, rents, 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.

(3) 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 1954 sells capital assets in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and

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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, rents 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 interest, dividends, rents, 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 interest, dividends, rents, 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, had capital losses of \$18,000 and capital gains of \$10,000, the net capital loss for the taxable year 1954, 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).

(h) *Special deductions.* Section 822(c)(7) allows a mutual insurance company the special deductions pro-

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vided 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.

§ 1.822-2 Real estate owned and occupied.

The limitation in section 822(d)(1) on the amount allowable as a deduction for taxes, expenses, and depreciation upon 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 is the same as that provided in the case of life insurance companies by section 803(h). See § 1.803-5.

§ 1.822-3 Amortization of premium and accrual of discount.

Section 822(d)(2) makes provision for the appropriate amortization of premium and the appropriate accrual of discount, attributable to the taxable year, on bonds, notes, debentures or other evidences of indebtedness held by a mutual insurance company subject to the tax imposed by section 821. Such 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 $\frac{3}{4}$ 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

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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 occupied by the company is equal to one-half of the rental value of the entire property, the deduction for taxes, expenses, and depreciation is one-half of the taxes, expenses, and depreciation on account of the entire property. Where a deduction is claimed as provided in this section, the parts of the property occupied and the parts not occupied by the company, together with the respective rental values thereof, must be shown in a statement accompanying the return.

[T.D. 6610, 27 FR 8722, Aug. 31, 1962]

§ 1.822-7 Amortization of premium and accrual of discount.

Section 822(d)(2) makes provision for the appropriate amortization of premium and the appropriate accrual of discount, attributable to the taxable year, on bonds, notes, debentures, or other evidences of indebtedness held by a mutual insurance company subject to the tax imposed by section 821. Such amortization and accrual is the same as that provided for life insurance companies by section 818(b)(1), as amended

by the Life Insurance Company Income Tax Act of 1959 (73 Stat. 133), and shall be determined in accordance with paragraphs (a) and (b) of §1.818-3, except in the case of a mutual insurance company subject to the tax imposed by section 821, paragraph (b) of §1.818-3 shall apply without regard to the date of acquisition and the basis provided in section 1012 shall be used in lieu of the acquisition value.

[T.D. 6610, 27 FR 8722, Aug. 31, 1962]

§ 1.822-8 Determination of taxable investment income.

(a) *In general*—(1) *Taxable investment income defined.* Section 822(a)(1) defines the term “taxable investment income” for purposes of part II, subchapter L, chapter 1 of the Code as the 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 an 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 (a) or (c) 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. See, however, sec-

tion 825 and paragraph (a) of §1.825-1 for unused loss deduction allowed companies taxable under section 821(a). A deduction shall not be permitted with respect to the same item more than once.

(2) *Investment loss defined.* The term “investment loss” is defined by section 822(a)(2) as the amount by which the deductions allowable under section 822(c) and paragraph (c) of this section exceed the gross investment income (as defined in section 822(b) and paragraph (b) of this section).

(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 (a) or (c) 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 §1.822-10;

(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 (a) or (c), 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 (a) or (c) 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 (a) or (c) 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 taxable investment 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 § 1.822-9 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 § 1.822-9, identical to that allowed other corporations by section 167. Such amount allowed as a deduction from gross investment income in determining taxable investment 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 distribu-

tions 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 tax under section 821, in the taxable year 1963 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. Since 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 in computing taxable investment income under section 822.

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 taxable investment 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 1963, 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 investment 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 investment 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. In applying section 246(b) (relating to limitation on aggregate amount of deductions for dividends received) for purposes of this subparagraph, the reference in such section to "taxable income" shall be treated as a reference to "taxable investment income".

(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 taxable investment 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. 6681, 28 FR 11113, Oct. 17, 1963]

§ 1.822-9 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 (a) or (c) 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 occupied by the company is equal to one-half of the rental value of the entire property, the deduction for taxes, expenses, and depreciation is one-half of the taxes, expenses, and depreciation on account of the entire property.

Where a deduction is claimed as provided in this section, the parts of the property occupied and the parts not occupied by the company, together with the respective rental values thereof, must be shown in a statement accompanying the return.

[T.D. 6681, 28 FR 11115, Oct. 17, 1963]

§ 1.822-10 Amortization of premium and accrual of discount.

(a) *In general.* In computing taxable investment income for the taxable year, the gross amount of income from interest, the deduction under section 822(c)(1) for wholly tax-exempt interest, and the deduction under section 242 for partially tax-exempt interest, are, under the provisions of section 822(d)(2), each to be decreased by the appropriate amortization of premium and increased by the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures, or other evidences of indebtedness held by a mutual insurance company subject to the tax imposed by section 821 (a) or (c). However, only the accrual of discount relating to issue discount will increase the deduction for wholly tax-exempt interest. See section 103. Such amortization and accrual is the same as that provided for life insurance companies by section 818(b)(1), as amended by the Life Insurance Company Income Tax Act of 1959 (73 Stat. 133), and shall be determined in accordance with paragraphs (a) and (b) of § 1.818-3, except as provided by paragraph (b) of this section.

(b) *Modifications.* (1) Paragraph (b) of § 1.818-3 shall apply to mutual casualty insurance companies subject to the tax imposed by section 821 (a) or (c) without regard to the date of acquisition of the particular securities to which the amortization of premium or accrual of discount is attributable.

(2) In computing the amount of premium or discount for purposes of section 822(d)(2) with respect to securities held by a company taxable under section 821, the basis provided by section 1012 shall be used in lieu of the acquisition value provided by paragraph (b) of § 1.818-3. In the case of a company subject to the tax imposed by section 821(c), adjustments to basis to reflect the accrual of discount and the amorti-

zation of premium shall be made in the manner provided by paragraphs (a) and (b) of § 1.818-3. However, for purposes of determining statutory underwriting income or loss for the taxable year under section 823, a company subject to the tax imposed by section 821(a) is not required to accrue discount or to amortize premium in computing its income under section 832 as if it were subject to the tax imposed by section 831. Thus, the accrual of discount and amortization of premium required in the computation of taxable investment income by a company subject to the tax imposed by section 821(a) neither increases nor decreases the mutual insurance company taxable income of such a company and, except to the extent such a company actually accrues discount or amortizes premium for purposes of making the section 832 computation, no adjustment shall be made to the basis of obligations held by it to reflect accrual of discount or amortization of premium.

[T.D. 6681, 28 FR 11115, Oct. 17, 1963]

§ 1.822-11 Net premiums.

The term “net premiums”, defined in section 822(f)(1), includes deposits and assessments, but excludes amounts returned to policyholders which are treated as dividends under section 822(f)(2). Net premiums are used in sections 822(c)(6) and 832(c)(5) in determining the limitation on certain capital losses and in the application of section 1212.

[T.D. 6681, 28 FR 11115, Oct. 17, 1963]

§ 1.822-12 Dividends to policyholders.

(a) Dividends to policyholders are used in determining the “underwriting loss” for purposes of the special transitional underwriting loss deduction provided by section 821(f), and the limitation on capital losses under section 822(c)(6); in computing statutory underwriting income or loss under section 823, and the subtractions from the protection against loss account under section 824(d). The term “dividends to policyholders” is defined in section 822(f)(2) as dividends and similar distributions paid or declared to policyholders. It includes amounts returned to policyholders where the amount is

not fixed in the insurance contract but depends upon the experience of the company or the discretion of the management. Such amounts are not to be treated as return premiums under section 822(f)(1). Savings credited to the individual accounts of the subscribers of a reciprocal underwriter or inter-insurer under section 823(b)(2) are not dividends paid or declared within the meaning of this paragraph. However, distributions in respect of such credits shall be considered as dividends paid. See section 823(b)(2) and paragraph (c)(2) of § 1.823-6. The term "paid or declared" is to be construed according to the method of accounting regularly employed in keeping the books of the insurance company, and such method shall be consistently followed with respect to all deductions (including dividends and similar distributions to policyholders) and all items of income.

(b) If the method of accounting so employed is the cash receipts and disbursements method, the deduction is limited to the dividends and similar distributions actually paid to policyholders in the taxable year. If, on the other hand, the method of accounting so employed is the accrual method, the deduction, or a reasonably accurate estimate thereof, for dividends and similar distributions declared to policyholders for any taxable year will, in general, be computed by adding the amount of dividends and similar distributions declared but unpaid at the end of the taxable year to dividends and similar distributions paid during the taxable year and deducting dividends and similar distributions declared but unpaid at the beginning of the taxable year. If an insurance company using the accrual method does not compute the deduction for dividends and similar distributions declared to policyholders in the manner stated, it must submit with its return a full and complete explanation of the manner in which the deduction is computed. For the rule as to when dividends are considered paid, see the regulations under section 561.

[T.D. 6681, 28 FR 11115, Oct. 17, 1963]

§ 1.823-1 Net premiums.

Net premiums are one of the items used, together with interest, dividends,

and rents, less dividends to policyholders and wholly tax-exempt interest, in determining tax liability under section 821(a)(2). They are also used in section 822(c)(6) in determining the limitation on certain capital losses and in the application of section 1212. The term "net premiums" is defined in section 823(1) and includes deposits and assessments, but excludes amounts returned to policyholders which are treated as dividends under section 823(2).

§ 1.823-2 Dividends to policyholders.

(a) Dividends to policyholders is one of the deductions used, together with wholly tax-exempt interest, in determining tax liability under section 821(a)(2). They are also used in section 822(c)(6) in determining the limitation on certain capital losses and in the application of section 1212. The term "dividends to policyholders" is defined in section 823(2) as dividends and similar distributions paid or declared to policyholders. It includes amounts returned to policyholders where the amount is not fixed in the insurance contract but depends upon the experience of the company or the discretion of the management. Such amounts are not to be treated as return premiums under section 823(1). Similar distributions include such payments as the so-called unabsorbed premium deposits returned to policyholders by factory mutual fire insurance companies. The term "paid or declared" is to be construed according to the method of accounting regularly employed in keeping the books of the insurance company, and such method shall be consistently followed with respect to all deductions (including dividends and similar distributions to policyholders) and all items of income.

(b) If the method of accounting so employed is the cash receipts and disbursements method, the deduction is limited to the dividends and similar distributions actually paid to policyholders in the taxable year. If, on the other hand, the method of accounting so employed is the accrual method, the

deduction, or a reasonably accurate estimate thereof, for dividends and similar distributions declared to policyholders for any taxable year will, in general, be computed as follows:

To dividends and similar distributions paid during the taxable year add the amount of dividends and similar distributions declared but unpaid at the end of the taxable year and deduct dividends and similar distributions declared but unpaid at the beginning of the taxable year.

If an insurance company using the accrual method does not compute the deduction for dividends and similar distributions declared to policyholders in the manner stated, it must submit with its return a full and complete explanation of the manner in which the deduction is computed. For the rule as to when dividends are considered paid, see the regulations under section 561.

§ 1.823-3 Taxable years affected.

Sections 1.823-1 and 1.823-2 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 1.823-4 and 1.823-5 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 1.823-6 through 1.823-8 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 11116, Oct. 17, 1963]

§ 1.823-4 Net premiums.

Net premiums are one of the items used, together with the gross amount of income during the taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof), less dividends to policyholders and wholly tax-exempt interest, in deter-

mining tax liability under section 821(a)(2). They are also used in section 822(c)(6) in determining the limitation on certain capital losses and in the application of section 1212. The term "net premiums" is defined in section 823(1) and includes deposits and assessments, but excludes amounts returned to policyholders which are treated as dividends under section 823(2).

[T.D. 6610, 27 FR 8722, Aug. 31, 1962]

§ 1.823-5 Dividends to policyholders.

(a) Dividends to policyholders is one of the deductions used, together with wholly tax-exempt interest, in determining tax liability under section 821(a)(2). They are also used in section 822(c)(6) in determining the limitation on certain capital losses and in the application of section 1212. The term "dividends to policyholders" is defined in section 823(2) as dividends and similar distributions paid or declared to policyholders. It includes amounts returned to policyholders where the amount is not fixed in the insurance contract but depends upon the experience of the company or the discretion of the management. Such amounts are not to be treated as return premiums under section 823(1). Similar distributions include such payments as the so-called unabsorbed premium deposits returned to policyholders by factory mutual fire insurance companies. The term "paid or declared" is to be construed according to the method of accounting regularly employed in keeping the books of the insurance company, and such method shall be consistently followed with respect to all deductions (including dividends and similar distributions to policyholders) and all items of income.

(b) If the method of accounting so employed is the cash receipts and disbursements method, the deduction is limited to the dividends and similar distributions actually paid to policyholders in the taxable year. If, on the other hand, the method of accounting so employed is the accrual method, the deduction, or a reasonably accurate estimate thereof, for dividends and similar distributions declared to policyholders for any taxable year will, in general, be computed as follows: To dividends and similar distributions

paid during the taxable year add the amount of dividends and similar distributions declared but unpaid at the end of the taxable year and deduct dividends and similar distributions declared but unpaid at the beginning of the taxable year. If an insurance company using the accrual method does not compute the deduction for dividends and similar distributions declared to policyholders in the manner stated, it must submit with its return a full and complete explanation of the manner in which the deduction is computed. For the rule as to when dividends are considered paid, see the regulations under section 561.

[T.D. 6610, 27 FR 8722, Aug. 31, 1962]

§ 1.823-6 Determination of statutory underwriting income or loss.

(a) *In general.* Section 823(a) and this section provide that for purposes of determining statutory underwriting income or loss for the taxable year, a mutual insurance company subject to the tax imposed by section 821(a) must first take into account the same gross income and deduction items (except as modified by section 823(b) and paragraph (c) of this section) as a taxpayer subject to tax under section 831 would take into account for purposes of determining its taxable income under section 832. These items are then reduced to the extent that they include amounts which are included in determining taxable investment income or loss under section 822(a) and § 1.822-8. In addition, in computing its statutory underwriting income or loss for the taxable year, a company taxable under section 821(a) is allowed to deduct the amount determined under section 824(a) (relating to deduction to provide protection against losses) and, if its gross amount received is less than \$1,100,000, is allowed to deduct the amount determined under section 823(c) and paragraph (d) of this section (relating to special deduction for certain small companies), subject to the limitations provided therein.

(b) *Definitions*—(1) *Statutory underwriting income defined.* Section 823(a) (1) defines the term “statutory underwriting income” for purposes of part II of subchapter L of the Code. Subject to the modifications provided by section

823(b) and paragraph (c) of this section, statutory underwriting income is defined as the amount by which:

(i) The gross income which would be taken into account in computing taxable income under section 832 if the taxpayer were subject to the tax imposed by section 831, reduced by the gross investment income (as determined under section 822(b)), exceeds

(ii) The sum of:

(a) The deductions which would be taken into account in computing taxable income if the taxpayer were subject to the tax imposed by section 831, reduced by the deductions provided in section 822(c) (relating to deductions allowed in computing taxable investment income), plus

(b) The deductions provided in section 823(c) (relating to special deduction for small company having gross amount of less than \$1,100,000) and section 824(a) (relating to deduction to provide protection against losses).

For purposes of subdivision (ii)(a) of this subparagraph, the limitations on the amounts deductible under paragraphs (9) (relating to charitable, etc., contributions) and (12) (relating to partially tax-exempt interest and to dividends received) of section 832(c) shall be computed by reference to taxable income as defined by section 832(a), and as modified by section 823(b) and paragraph (c) of this section.

(2) *Statutory underwriting loss defined.* “Statutory underwriting loss” is defined in section 823(a)(2) as the amount by which the amount determined under section 823(a)(1)(B) and subparagraph (1)(ii) of this paragraph exceeds the amount determined under section 823(a)(1)(A) and subparagraph (1)(i) of this paragraph.

(c) *Modifications*—(1) *Net operating losses.* In applying section 832 for purposes of determining statutory underwriting income or loss under section 823(a) and paragraph (b) of this section, the deduction for net operating losses provided by section 172 is not allowed. However, see section 825(a) and § 1.825-1 for unused loss deduction allowed companies taxable under section 821(a) in computing mutual insurance company taxable income under section 821(b).

(2) *Interinsurers and reciprocal underwriters*—(i) *In general.* Section 823(b)(2) provides that in computing the statutory underwriting income or loss of a mutual insurance company which is an interinsurer or reciprocal underwriter, there shall be allowed as a deduction the increase for the taxable year in savings credited to subscriber accounts, or there shall be included as an item of gross income the decrease for the taxable year in savings credited to subscriber accounts. For purposes of this subparagraph, the term “savings credited to subscriber accounts” means such portion of the surplus for the taxable year as is credited to the individual accounts of subscribers before the 16th day of the third month following the close of the taxable year, but only if the company would be obligated to pay such amount promptly to such subscriber if he terminated his contract at the close of the company’s taxable year, and only if the company mails notification to such subscriber of the amount credited to his individual account in the manner provided by subdivision (v) of this subparagraph.

(ii) *Limitations.* Amounts representing return premiums (as defined in paragraph (a)(1)(ii) of §1.809-4) which the company would be obligated to pay to any subscriber terminating his contract at the close of the company’s taxable year are not savings credited to subscriber accounts within the meaning of section 823(b)(2) and subdivision (i) of this subparagraph. The deduction for savings credited to individual subscriber accounts is allowed only in the case of reciprocal underwriters or interinsurers where the subscriber or policyholder has not only a legally enforceable right to receive the amount so credited if he withdraws from the exchange, but where the amounts credited, as a matter of actual practice, are paid to subscribers or policyholders who terminate their contracts. Thus, no deduction shall be allowed for savings credited to subscriber accounts if such savings are not in fact promptly returned to subscribers when they terminate their contracts.

(iii) *Computation of increase or decrease in savings credited to subscriber accounts.* For purposes of determining the increase or decrease for the taxable

year in savings credited to subscriber accounts, every reciprocal underwriter or interinsurer claiming a deduction under section 823(b)(2) and this section shall establish and maintain an account for savings credited to subscriber accounts. The opening balance in such account for the first taxable year for which a deduction is claimed under section 823(b)(2) and this section shall be zero. In each taxable year there shall be added to such account the total amount of savings credited to subscriber accounts for the taxable year, and there shall be subtracted from such account the total amount of savings subtracted from subscriber accounts for the taxable year. However, in no case may the amount added to the account exceed the total amount of savings to subscribers for the taxable year, irrespective of the amount of savings credited to subscriber accounts for the taxable year. Credits made to subscriber accounts after the close of the taxable year and before the 16th day of the third month following the close of the taxable year will be taken into account as if such amounts had been credited on the last day of the taxable year to the extent such amounts would have become fixed and determinable legal obligations due subscribers if such subscribers had terminated their contracts on the last day of the company’s taxable year unless, at the time the amounts are credited, the company specifically designates such amounts as being from surplus for the taxable year in which the amounts were actually credited. Such a designation, once made, shall be irrevocable. However, if a company credited savings to subscriber accounts after December 31, 1962, and before March 16, 1963, and failed to designate such credits as being from surplus for the taxable year 1963, such company may designate such credits as being from surplus for the taxable year 1963 for purposes of determining the total amount of credits to subscriber accounts for such year. In determining the total amount of savings subtracted from subscriber accounts for the taxable year, only amounts subtracted from savings credited for taxable years beginning with the first taxable year for which a deduction was claimed under section

823(b)(2) and this subparagraph will be taken into account. The method of accounting regularly employed by the taxpayer in keeping its books of account will be used for purposes of determining whether the amounts subtracted from the subscriber accounts are from savings for taxable years beginning before the first taxable year for which a deduction is claimed under section 823(b)(2) and this subparagraph, or from savings for taxable years beginning with such first taxable year. Where the method of accounting regularly employed by the taxpayer in keeping its books of account does not clearly indicate whether an amount was subtracted from savings credited to subscriber accounts for taxable years beginning before the first taxable year for which a deduction is claimed under section 823(b)(2) and this subparagraph, or from savings credited for such first taxable year and subsequent taxable years, the amount subtracted will be deemed to have come from savings credited to subscriber accounts for all taxable years, on a pro rata basis. Where an amount is subtracted from a subscriber's account for record purposes, but such subtraction does not reflect the discharge of the company's legal obligation to pay the amount subtracted promptly to the subscriber if he terminates his contract, then such subtraction shall not be taken into account for purposes of section 823(b)(2) and this subparagraph. On the other hand, where the company ceases to be under a legal obligation to pay promptly to any subscriber the amount credited to his individual account, then such amount shall be considered as having been subtracted from such subscriber's account at the time such obligation ceased to exist. For purposes of section 823(b)(2) and this subparagraph, the increase (if any) for the taxable year in savings credited to subscriber accounts shall be the amount by which the balance in the account for savings credited to subscriber accounts as of the close of the taxable year exceeds the balance in such account as of the close of the preceding taxable year; and the decrease (if any) for the taxable year in savings credited to subscriber accounts shall be the amount by which the balance in the account for savings

credited to subscriber accounts as of the close of the preceding taxable year exceeds the balance in such account as of the close of the taxable year.

(iv) *Legal obligation.* For purposes of this subparagraph, the existence of a legal obligation on the part of the company to pay to the subscriber the savings credited to him will be determined under the insurance contract pursuant to which the credits are made. Where it appears that the company is otherwise legally obligated to pay amounts credited to its subscribers, the requisite legal obligation will not be considered absent merely because a subscriber's credits remain subject to absorption by future losses incurred if left on deposit with the company.

(v) *Notification to subscribers.* Every reciprocal underwriter or interinsurer claiming a deduction under section 823(b)(2) and this subparagraph for amounts credited to the individual accounts of its subscribers must mail to each such subscriber written notification of the amount credited to the subscriber's account for the taxable year, the date on which such amount was credited, and the date on which the subscriber's right to such amount first would have become fixed if such subscriber had terminated his contract at the close of the company's taxable year. As an alternative to providing each subscriber with specific information relating to the amount of savings credited to his individual account, the notification required by this subdivision may be provided in the form of a table or formula mailed to the subscribers. However, a table or formula may not be used in lieu of the specific notification required by this subdivision unless such table or formula has been approved by the Commissioner. Generally, a table or formula will be approved if it enables the subscriber to simply and readily ascertain the amount of savings credited to his individual account for the taxable year, the date on which such amount was credited, and the date on which his right to such amount first would have become fixed if he had terminated his contract at the close of the company's taxable year. A reciprocal underwriter or interinsurer which desires to use such a table or formula should direct a

written request for approval of such table or formula to the Commissioner of Internal Revenue, Attention: T:R, Washington, DC, 20224. Such request must set forth a copy of the table or formula proposed to be used, together with sufficient information to permit the Commissioner to determine the basis upon which such table or formula was prepared and the manner in which the subscribers will use such table or formula in determining the amounts credited to their individual accounts. Once a table or formula has been approved, the use of such table or formula with respect to savings credited for subsequent taxable years will not require further approval unless the basis upon which such table or formula was prepared, or the manner in which such table or formula is to be applied, is substantially changed. The table or formula method of notification may be used with respect to all or less than all of the company's subscribers. For example, the company might provide the notification required by this subdivision to one class of subscribers in the form of a table or formula mailed to the individual subscribers, while providing another class of subscribers with specific statements of the amounts credited to their individual accounts. The notification required by this subdivision must be mailed before the 16th day of the third month following the close of the reciprocal's taxable year for which the account was credited. Where for any taxable year a reciprocal underwriter or interinsurer claims a deduction under section 823(b) and this subparagraph and fails to give notice as required by this subdivision, such deduction shall not be allowed unless the reciprocal establishes to the satisfaction of the district director that the failure to mail such notice within the prescribed period was due to reasonable cause.

(d) *Special deduction for small company having gross amount of less than \$1,100,000*—(1) *In general.* In the case of a taxpayer subject to the tax imposed by section 821(a), section 823(c) provides that if the gross amount received during the taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) is

less than \$1,100,000, then, subject to the limitation provided in section 823(c)(2) and subparagraph (2) of this paragraph, there shall be allowed an additional deduction for purposes of determining statutory underwriting income or loss under section 823(a) for the taxable year. The amount of the additional deduction is \$6,000; except that if the gross amount received for the taxable year exceeds \$500,000, the additional deduction is limited to an amount equal to 1 percent of the amount by which \$1,100,000 exceeds such gross amount.

(2) *Limitation.* The amount of the deduction provided by section 823(c)(1) may not exceed the statutory underwriting income for the taxable year, computed without regard to the deduction allowed under section 823(c)(1) and subparagraph (1) of this paragraph, and the deduction allowed under section 824(a) (relating to deduction for protection against losses).

(3) *Example.* The application of section 823(c) and this paragraph may be illustrated by the following example:

M, a mutual insurance company subject to the tax imposed by section 821(a), has the following items for the taxable year 1963:

Gross amount for purposes of section 823(c)(1)	\$800,000
Gross investment income (including capital gains)	150,000
Capital gains	100,000
Gross income under section 832	900,000
Deductions under section 822(c)	22,000
Deductions under section 832 (as modified by section 823(b)(2))	746,000

Under the provisions of section 823(c), M's special small company deduction for the taxable year 1963 would be \$3,000, computed as follows:

(1) Gross amount for purposes of section 823(c)(1)	\$800,000
(2) Amount by which \$1,100,000 exceeds item (1) (\$1,100,000 minus \$800,000)	300,000
(3) 1 percent of item (2) (not to exceed \$6,000)	3,000
(4) Gross income under section 832, reduced by gross investment income (\$900,000 minus \$150,000)	750,000
(5) Deductions under section 832 (as modified by section 823(b)), reduced by deductions under section 822(c) (\$746,000 minus \$22,000)	724,000
(6) Limitation on deduction under section 823(c)(1) (excess, if any, of item (4) over item (5))	26,000
(7) Deduction under section 823(c)(1) (item (3) or item (6), whichever is the lesser)	3,000

[T.D. 6681, 28 FR 11116, Oct. 17, 1963]

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§ 1.823-7 Subscribers of reciprocal underwriters and interinsurers.

A subscriber or policyholder of a reciprocal underwriter or interinsurer entitled to the deduction allowed by section 823(b)(2) and paragraph (c)(2) of § 1.823-6 shall treat amounts representing savings credit to his individual account for the taxable year as a dividend paid or declared for purposes of computing his taxable income. If a reciprocal credits savings to subscriber accounts after the close of its taxable year, but before the 16th day of the third month following the close of the taxable year, and the reciprocal takes such credits into account as if they had been made on the last day of its taxable year, the subscribers of such reciprocal must take such savings into account as if they had in fact been credited on the last day of the company's taxable year. The subscriber shall take savings credited to his account into account without regard to whether the amounts credited are actually distributed to him in cash. To the extent the insurance premium constituted a deductible expense when paid or accrued, the subscriber's taxable income for the taxable year will be increased and any loss for the taxable year will be decreased, by the amount credited to his account. Amounts credited to a subscriber's account which are taken into income by him and which subsequently are used to absorb losses of the reciprocal shall be treated by the subscriber as an additional insurance expense for the taxable year in which the amounts are absorbed. Such amounts may be deducted in computing taxable income to the extent insurance constitutes an otherwise properly deductible expense for such taxable year.

[T.D. 6681, 28 FR 11118, Oct. 17, 1963]

§ 1.823-8 Special transitional underwriting loss; cross reference.

With respect to taxable years beginning after December 31, 1962, and before January 1, 1968, section 821(f) provides, for any company subject to the tax imposed by section 821(a), a special reduction in the statutory underwriting income if such company was subject to tax under section 821 for the five taxable years immediately preceding Jan-

uary 1, 1962, and incurred an underwriting loss in each of such five taxable years. For rules relating to the determination of the amount of such reduction, see section 821(f) and § 1.821-5.

[T.D. 6681, 28 FR 11118, Oct. 17, 1963]

§ 1.825-1 Unused loss deduction; in general.

(a) *Amount of deduction.* Section 825(a) provides that the unused loss deduction of a mutual insurance company subject to the tax imposed by section 821(a) shall be an amount equal to the sum of the unused loss carryovers and carrybacks to the taxable year. The amount so determined is used in the computation of mutual insurance company taxable income for the taxable year. See section 821(b) and § 1.821-4.

(b) *Unused loss defined.* Section 825(b) defines the term "unused loss" as the amount (if any) by which:

(1) The sum of the statutory underwriting loss (as defined in section 823(a)(2)) and the investment loss (as defined in section 822(a)(2)) exceeds

(2) The sum of:

(i) The taxable investment income (as defined in section 822(a)(1)),

(ii) The statutory underwriting income (as defined in section 823(a)(1)), and

(iii) The amounts required to be subtracted from the protection against loss account under section 824(d).

(c) *Steps in computation of unused loss deduction.* The three steps to be taken in the ascertainment of the unused loss deduction for any taxable year are as follows:

(1) Compute the unused loss for any preceding or succeeding taxable year from which an unused loss may be carried over or carried back to the taxable year.

(2) Compute the unused loss carryovers to the taxable year from such preceding taxable years and the unused loss carrybacks to the taxable year from such succeeding taxable years.

(3) Add such unused loss carryovers and carrybacks in order to determine the unused loss deduction for the taxable year.

(d) *Statement with tax return.* Every mutual insurance company taxable

under section 821(a) claiming an unused loss deduction for any taxable year shall file with its return for such year a concise statement setting forth the amount of the unused loss deduction claimed and all material and pertinent facts relative thereto, including a detailed schedule showing the computation of the unused loss deduction.

(e) *Ascertainment of deduction dependent upon unused loss carryback.* If a mutual insurance company taxable under section 821(a) is entitled in computing its unused loss deduction to a carryback which it is not able to ascertain at the time its return is due, it shall compute the unused loss deduction on its return without regard to such unused loss carryback. When the company ascertains the unused loss carryback, it may within the applicable period of limitations file a claim for credit or refund of the overpayment, if any, resulting from the failure to compute the unused loss deduction for the taxable year with the inclusion of such carryback; or it may file an application under the provisions of section 6411 for a tentative carryback adjustment.

(f) *Law applicable to computations.* The following rules shall apply to taxable years for which the taxpayer is subject to the tax imposed by section 821(a):

(1) In determining the amount of any unused loss carryback or carryover to any taxable year, the necessary computations involving any other taxable year shall be made under the law applicable to such other taxable year.

(2) The unused loss for any taxable year shall be determined under the law applicable to that year without regard to the year to which it is to be carried and in which, in effect, it is to be deducted as part of the unused loss deduction.

(3) The amount of the unused loss deduction which shall be allowed for any taxable year shall be determined under the law applicable for that year.

[T.D. 6681, 28 FR 11122, Oct. 17, 1963]

§ 1.825-2 Unused loss carryovers and carrybacks.

(a) *Years to which loss may be carried—*(1) *In general.* In order to determine its unused loss deduction for any taxable year, a mutual insurance company tax-

able under section 821(a) must first determine the part of any unused losses for any preceding or succeeding taxable years which are carryovers or carrybacks to the taxable year in issue. An unused loss is to be an unused loss carryback to each of the 3 taxable years preceding the loss year, and an unused loss carryover to each of the 5 taxable years following the loss year, subject to the limitations provided in section 825(g) and subparagraph (2) of this paragraph.

(2) *Limitations.* An unused loss may not be carried:

(i) To or from any taxable year beginning before January 1, 1963,

(ii) To or from any taxable year for which the taxpayer is not subject to the tax imposed by section 821(a), nor

(iii) To any taxable year if, between the loss year and such taxable year, there is an intervening taxable year for which the taxpayer was not subject to the tax imposed by section 821(a).

(3) *Periods of less than 12 months.* A fractional part of a year which is a taxable year under sections 441(b) and 7701(a)(23) is a preceding or a succeeding taxable year for the purpose of determining under section 825 the first, second, etc., preceding or succeeding taxable year.

(b) *Loss year defined.* The term "loss year" as used in this section means any taxable year for which a company subject to the tax imposed by section 821(a) has an unused loss in excess of zero.

(c) *Amount of carrybacks and carryovers.* Section 825(e) provides that in the case of a loss year for a company taxable under section 821(a), the entire amount of the unused loss shall be carried to the earliest taxable year to which such loss may be carried under section 825(d) (subject to the limitations of section 825(g)). The amount of the unused loss carried to each of the other taxable years to which such loss may be carried under section 825(d) following such earliest taxable year shall be the excess (if any) of such loss over the sum of the offsets for each taxable year preceding the taxable year to which the unused loss is carried.

(d) *Offset defined—*(1) *In general.* Section 825(f) defines the term "offset" and provides that the taxable year to

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which an unused loss is carried shall be referred to as the "offset year". The definition of the term offset in the case of an unused loss carryback to an offset year, differs from the definition of such term in the case of an unused loss carryover to an offset year.

(2) *Offset in case of carryback.* In the case of an unused loss carryback from the loss year to the offset year, the offset is the mutual insurance company taxable income for the offset year, computed without regard to any unused loss carryback from the loss year or any taxable year thereafter.

(3) *Offset in case of carryover.* In the case of an unused loss carryover from the loss year to the offset year, the offset is equal to the sum of:

(i) The amount required to be subtracted from the protection against loss account under section 824(d)(1)(C) (relating to amounts equal to the unused loss carryovers to the offset year), plus

(ii) The mutual insurance company taxable income for the taxable year, computed without regard to any un-

used loss carryback or carryover from the loss year or any taxable year thereafter.

[T.D. 6681, 28 FR 11123, Oct. 17, 1963]

§ 1.825-3 Examples.

The application of section 825 may be illustrated by the following examples:

Example 1. For the taxable year 1967, F, a mutual insurance company subject to the tax imposed by section 821(a), has the following items:

Taxable investment income	1
Underwriting loss	59
Addition to protection against loss account	8
Statutory underwriting loss	67

The subtractions from the protection against loss account are as follows:

Amount subtracted from amounts in account with respect to taxable years 1963 through 1966	18
Amount subtracted from amounts in account with respect to taxable year 1967	8
Total subtractions from protection against loss account under section 824(d)	26

The application of section 825 in this case may be illustrated by the facts and results shown in the following table and explained below:

	TAXABLE YEAR					
	1963	1964	1965	1966	1967	1968
Protection against loss account:						
Addition to account during taxable year	6	2	3	7	8	7
Subtraction from account during taxable year	0	0	0	0	8	7
Protection against loss account (at end of year)	6	2	3	7	0	0
Protection against loss account (at end of taxable year 1968)	0	0	0	0	0	0
Unused loss	0	0	0	0	40	0
Unused loss carryback	0	40	35	25	0	0
Unused loss carryover	0	0	0	0	0	18
Unused loss deduction	0	40	35	25	0	18
Mutual insurance company taxable income (computed without regard to unused loss)	13	5	10	7	0	2
Mutual insurance company taxable income (computed with regard to unused loss)	13	0	0	0	0	0
Offset for year	0	5	10	7	0	9
Offset total	0	5	15	22	22	31

1967: Under the provisions of section 825(b), F's unused loss for 1967 is 40, the amount by which the sum of the statutory underwriting loss and the investment loss, 67 (67 plus 0), exceeds the sum of the taxable investment income, the statutory underwriting income, and the amounts required to be subtracted from the protection against loss account under section 824(d) for the taxable year, 27 (the sum of 1, 0, and 26, respectively).

1967 carryback to 1964: Under the provisions of section 825(e), the entire unused loss for 1967 of 40 is carried back to 1964, the earliest year to which the loss may be carried under

section 825(d). Since there are no other amounts carried to 1964, the unused loss deduction for 1964 is 40. Thus, after taking the unused loss deduction into account, the mutual insurance company taxable income for 1964 is zero, and the offset for 1964 is 5 (the mutual insurance company taxable income for 1964 determined without regard to the unused loss carryback from 1967 or any year thereafter).

1967 carryback to 1965: The portion of the unused loss for 1967 which is carried back to 1965 is 35 (40 minus 5, the offset for 1964). After taking the unused loss deduction into

account, the mutual insurance company taxable income for 1965 is zero. The offset for 1965 is 10, the mutual insurance company taxable income for 1965 determined without regard to any unused loss carryback from 1967 or any year thereafter.

1967 carryback to 1966: The portion of the unused loss for 1967 which is carried back to 1966 is 25. This amount is the excess of the unused loss for 1967 of 40 over the sum of the offset for 1964 (5) and the offset for 1965 (10). As a result of the unused loss deduction the mutual insurance company taxable income for 1966 is reduced to zero. The offset for 1966 is 7.

1967 carryover to 1968: Under the provisions of section 825(d), the portion of the unused loss for 1967 which is carried forward to 1968 is 18 (40 minus the sum of 5, 10, and 7, the offsets for 1964, 1965, and 1966, respectively). Under section 825(f)(2), this amount is first applied against any amounts in the protection against loss account at the end of 1968, and is then applied against the mutual insurance company taxable income for 1968 (computed without regard to any unused loss carryovers or carrybacks from 1967 or any taxable year thereafter). Thus, assuming that there are no other subtractions from its protection against loss account under section 824(d) for 1968, F's protection against loss account of 7 is reduced to zero by reason of the subtraction under section 824(d)(1)(C). The remaining portion of the unused loss for 1967 which is carried to 1968, 11 (18 minus 7, the amount of the unused loss carryover to 1968 which is subtracted from the protection against loss account under section 824(d)(1)(C)), is then applied against the mutual insurance company taxable income for 1968 computed without regard to any unused carryback or carryover from the loss year (1967) or any taxable year thereafter. After the application of the unused loss deduction for 1968, the mutual insurance company taxable income for 1968 is zero. The offset for 1968 is 9, the sum of the amount required to be subtracted from the protection against loss account under section 824(d)(1)(C) for 1968 (7), plus the mutual insurance company taxable income for 1968, determined without regard to any unused loss carryover or carryback from 1967 or any year thereafter (2). The remaining 9 of the unused loss for 1967 (40 minus the sum of 5, 10, 7, and 9, the offsets for 1964, 1965, 1966, and 1968, respectively), is carried forward to 1969, and to the extent not used in that year or any year thereafter, may be carried forward to 1970, 1971, and 1972, in that order.

Example 2. If in example 1 F had an unused loss in 1966 of 22, then, with respect to F's 1967 unused loss of 40, the offset for 1964 would be zero; the offset for 1965 would be 6—the 1965 mutual insurance company taxable income of 10 less an unused loss carryback of 4 from 1966 (the 1966 unused loss of 22 minus

the 1963 offset of 13 and the 1964 offset of 5); the offset for the loss year 1966 would be zero, and 34 (the 1967 unused loss of 40 minus the offset for 1965 of 6) would remain as an unused loss carryover to 1968, 1969, 1970, 1971, 1972, in that order. Thus, the unused loss carrybacks or carryovers to an offset year are applied against the mutual insurance company taxable income for such year in the order in which the losses occurred, with the earliest loss being offset first.

Example 3. For the taxable year 1963, M, a mutual insurance company subject to tax imposed by section 821(a), has an unused loss (as defined in section 825(b)) of \$65,000. Under section 825(g), the loss may not be carried back to any taxable year beginning before 1963. However, the loss may be carried forward to each of the 5 taxable years following 1963 provided that for each of such succeeding taxable years M is subject to the tax imposed by section 821(a).

Example 4. Assume the facts are the same as in example 3, except that for the taxable year 1964, the gross amount received by M from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) exceeds \$150,000 but does not exceed \$500,000. If M does not make the election under section 821(d) (relating to election to be taxed under section 821(a)) for 1964, M's 1963 unused loss of \$65,000 will not be allowed as an unused loss carryover or carryback since, by reason of section 825(g)(3), the unused loss may not be carried to any taxable year if, between the loss year and such taxable year, there is an intervening taxable year for which the insurance company was not subject to the tax imposed by section 821(a), and by reason of section 825(g)(1), the unused loss may not be carried to any taxable year beginning before 1963.

[T.D. 6681, 28 FR 11123, Oct. 17, 1963]

§ 1.826-1 Election by reciprocal underwriters and interinsurers.

(a) *In general.* Except as otherwise provided in section 826(c), any mutual insurance company which is an interinsurer or reciprocal underwriter taxable under section 821(a) may elect under section 826(a) to limit its deductions for amounts paid or incurred to its attorney-in-fact to the deductions of its attorney-in-fact which are allocable to income received by the attorney-in-fact from the reciprocal during the taxable year. See § 1.826-4 for rules relating to allocation of expenses. In no case may such an election increase the amount deductible by the reciprocal for amounts paid or due its attorney-in-fact for the taxable year. The

election allowed by section 826(a) and this section in effect increases the income of the reciprocal by the net income of the attorney-in-fact attributable to its business with the reciprocal. A reciprocal making the election is allowed a credit for the amount of tax paid by the attorney-in-fact for the taxable year which is attributable to income received by the attorney-in-fact from the reciprocal. See section 826(e) and § 1.826-5.

(b) *Companies eligible to elect under section 826(a).* Any mutual insurance company which is a reciprocal underwriter or interinsurer subject to the tax imposed by section 821(a) may elect (in the manner prescribed by paragraph (c) of this section) to be subject to the limitation provided by section 826(b) and paragraph (a) of this section provided the attorney-in-fact of the electing reciprocal:

(1) Is subject to the taxes imposed by section 11 (b) and (c) and the regulations thereunder;

(2) Consents (in the manner provided by paragraph (a) of § 1.826-3) to provide the information required under paragraph (b) of § 1.826-3 during the period in which the election made under section 826(a) and this section is in effect;

(3) Reports the income received from the reciprocal and the deductions allocable thereto under the same method of accounting used by the reciprocal in reporting its deductions for amounts paid or due its attorney-in-fact; and

(4) Files its income tax return on a calendar year basis.

(c) *Manner of making election.* The election provided by section 826(a) and this section shall be made in a statement attached to the taxpayer's income tax return for the first taxable year for which such election is to apply. The statement shall include the name and address of the taxpayer, shall be signed by the taxpayer (or its duly authorized representative), and shall be filed not later than the time prescribed by law for filing the income tax return (including extensions thereof) for the first taxable year for which such election is to apply. For information required of an electing reciprocal, see paragraph (e) of this section.

(d) *Scope of election.* The election allowed by section 826(a) is binding for

the taxable year for which made and all succeeding taxable years unless the Commissioner consents to a revocation of such election. Whether revocation will be permitted will depend upon the facts and circumstances of each particular case.

(e) *Information required of an electing company.* Every reciprocal underwriter or interinsurer making the election provided by section 826(a) and this section shall, in the manner provided by paragraph (f) of this section, furnish the following information for each taxable year during which such election is in effect:

(1) The name and address of the attorney-in-fact with respect to which the election allowed by section 826(a) and this section is in effect; the district in which such attorney-in-fact filed its return for the taxable year; and a copy of the consent required by section 826 and § 1.826-3 and the date and district in which such consent was filed;

(2) The deductible amount paid or due to such attorney-in-fact from the reciprocal computed without regard to the limitation provided by section 826(b);

(3) The total amount claimed as a deduction by the reciprocal for amounts paid to its attorney-in-fact after giving effect to the limitation provided by section 826(b);

(4) The amount of the increase (if any) in underwriting gain (as defined in section 824(a)) attributable to the election allowed by section 826(a);

(5) The amount of the increase (if any) in the deduction allowed by section 824(a) (relating to deduction to provide protection against losses) attributable to the election allowed by section 826(a);

(6) The amount of any increase or decrease in the statutory underwriting income or loss for the taxable year (as computed under section 823) attributable to the election allowed by section 826(a);

(7) The amount of any increase or decrease in the mutual insurance company taxable income or unused loss for the taxable year attributable to the election allowed by section 826(a);

(8) The amount of the increase (if any) in the tax liability of the reciprocal for the taxable year attributable to the election allowed by section 826(a) before taking into account the credit provided by section 826(e);

(9) The amount of tax attributable to income received by the attorney-in-fact from the reciprocal during the taxable year (as determined under § 1.826-5) claimed (under section 826(e) and paragraph (a) of this section) by the reciprocal as a credit for the taxable year; and

(10) The information which the attorney-in-fact is required to submit to the reciprocal under paragraphs (b) and (c) of § 1.826-3.

(f) *Manner in which information is to be provided.* The information required by paragraph (e) of this section shall be set forth in a statement attached to the taxpayer's income tax return for each taxable year for which such information is required. Such statement shall include the name and address of the taxpayer; and shall be filed not later than the date prescribed by law (including extensions thereof) for filing the income tax return for the taxable year with respect to which such information is being provided.

[T.D. 6681, 28 FR 11124, Oct. 17, 1963]

§ 1.826-2 Special rules applicable to electing reciprocals.

(a) *Protection against loss account.* Section 826(d) provides that for purposes of determining the amount to be subtracted from the protection against loss account under section 824(d)(1)(D) and the regulations thereunder (relating to amounts added to the account for the fifth preceding taxable year) for any taxable year, any amount which was added to such account by reason of the election under section 826(a) and paragraph (a) of § 1.826-1 shall be treated as having been added by reason of section 824(a)(1)(A) and the regulations thereunder (relating to amounts equal to 1 percent of losses incurred during the taxable year). Thus, no amount added to the protection against loss account by reason of an election made under section 826(a) may remain in such account beyond the end of the fifth taxable year following the taxable year with respect to which such

amount was added. See section 824(d)(1)(D) and paragraph (b)(3) of § 1.824-1. The amount added to the protection against loss account by reason of an election under section 826(a) is that amount which is equal to 25 percent (plus, in the case of a reciprocal which qualifies as a concentrated risk company under section 824(a), so much of the concentrated wind-storm, etc., premium percentage as exceeds 40 percent) of the amount by which:

(1) The underwriting gain (as defined by section 824(a)(1)) computed after taking into account the limitation provided by section 826(b) and § 1.826-1, exceeds

(2) The underwriting gain computed without regard to the limitation provided by section 826(b) and § 1.826-1.

(b) *Denial of surtax exemption.* Section 826(f) provides that the tax imposed upon any increase in the mutual insurance company taxable income of a reciprocal which is attributable to the limitation provided by section 826(b) shall be computed without regard to the surtax exemption provided by section 821(a)(2) and the regulations thereunder. Thus, a company making the election provided under section 826(a) will be subject to surtax, as well as normal tax, on the increase in its mutual insurance company taxable income for the taxable year which is attributable to such election. Similarly, any amount which was added to the protection against loss account by reason of an election under section 826(a) and § 1.826-1, and which is subtracted from such account in accordance with section 826(d) and paragraph (a) of this section, will be subject to surtax, as well as normal tax, to the extent such amount increases mutual insurance company taxable income in the year in which the subtraction is made. Furthermore, the company will be subject to surtax on such increases notwithstanding the fact that it may have no normal tax liability for the taxable year, because its mutual insurance company taxable income (after giving effect to the election provided by section 826(a)) does not exceed \$6,000.

(c) *Adjustment for refunds.* Section 826(g) provides that if for any taxable year an attorney-in-fact is allowed a

credit or refund for taxes paid with respect to which credit or refund to the reciprocal resulted under section 826(e), the taxes of such reciprocal for such taxable year shall be properly adjusted. The reciprocal shall make the adjustment required by section 826(g) by increasing its income tax liability for its taxable year in which the credit or refund is allowed to the attorney-in-fact by the amount of such credit or refund which is attributable to taxes paid by the attorney-in-fact on income received from the reciprocal, as determined under § 1.826-6, but only to the extent that the payment of such amount by the attorney-in-fact resulted in a credit or refund to the reciprocal. However, if the refund or credit to the attorney-in-fact is the result of an error in determining its items of income or deduction for the taxable year with respect to which the refund or credit is allowed, and such error affects the amount of deductions allocable to its reciprocal for such taxable year, then, if the reciprocal's period for filing an amended return has not otherwise expired, the preceding sentence shall not apply and the reciprocal shall make the adjustment required by section 826(g) by filing an amended return for such taxable year and all subsequent taxable years for which an adjustment is required. The reciprocal's amended return or returns shall give effect to the change in the deductions of the attorney-in-fact allocable to income received from the reciprocal and the tax paid by the attorney-in-fact attributable to such income. The amount of any adjustment required by section 826(g) and this section and the computation thereof shall be set forth in a statement attached to and filed with the taxpayer's income tax return for the taxable year for which the adjustment is made. Such statement shall include the name and address of the taxpayer, and a copy of the notification received by the attorney-in-fact indicating that it has been allowed the credit or refund requiring adjustment of the reciprocal's taxes.

[T.D. 6681, 28 FR 11125, Oct. 17, 1963, as amended by T.D. 7100, 36 FR 5334, Mar. 20, 1971]

§ 1.826-3 Attorney-in-fact of electing reciprocals.

(a) *Manner of making consent.* Section 826(c)(2) provides that a reciprocal may not elect to be subject to the limitation provided by section 826(b) unless its attorney-in-fact consents to make certain information available. See paragraph (b) of this section. The attorney-in-fact of a reciprocal making the election provided by section 826(a) shall signify the consent required by section 826(c) in a statement attached to its income tax return for the first taxable year for which the reciprocal's election is to apply. Such statement shall include the name and address of the consenting taxpayer; the name and address of the reciprocal with respect to which such consent is to apply; shall be signed by the taxpayer (or its duly authorized representative); and shall be filed not later than the date prescribed by law (including extensions thereof) for filing the income tax return for the first taxable year for which such consent is to apply. In addition, such statement shall specify that the taxpayer is subject to the taxes imposed by section 11 (b) and (c); the method of accounting used in reporting income received from its reciprocal and the deductions allocable thereto; and that its return is filed on the calendar year basis. Consent, once given, shall be irrevocable for the period during which the election provided for the reciprocal by section 826(a) is in effect. See paragraph (e) of § 1.826-1.

(b) *Information required of consenting attorney-in-fact.* Every attorney-in-fact making the consent provided by section 826(c)(2) and paragraph (a) of this section shall, in the manner prescribed by paragraph (c) of this section, furnish the following information for each taxable year during which the consent provided by section 826(c)(2) and paragraph (a) of this section is in effect:

(1) The name and address of the reciprocal with respect to which the consent required by section 826(c)(2) and paragraph (a) of this section is to apply;

(2) Gross income in total and by sources, adjusted for returns and allowances;

(3) Deductions (itemized to the same extent as on taxpayer's income tax return and accompanying schedules) allocable to each source of gross income and in total (see § 1.826-4);

(4) Method of allocation used in subparagraph (3) of this paragraph;

(5) Taxable income (if any) in total and by sources, as in subparagraph (2) of this paragraph (income by sources from subparagraph (2) of this paragraph minus expenses allocable thereto under subparagraph (3) of this paragraph);

(6) Total income tax liability (if any) for the taxable year;

(7) Taxes paid attributable (under § 1.826-5) to income earned by the taxpayer in dealing with the reciprocal;

(8) Such other information as may be required by the district director.

(c) *Manner in which information is to be provided.* (1) The information required by paragraph (b) of this section shall be set forth in a statement attached to the taxpayer's income tax return for each taxable year for which the consent provided by section 826(c)(2) and paragraph (a) of this section is in effect. Such statement shall include the name and address of the taxpayer, and shall be filed not later than the date prescribed by law (including extensions thereof) for filing the income tax return for each taxable year for which such information is required.

(2) A copy of the statement containing the information required by paragraph (b) of this section shall be submitted to the board of advisors (or other comparable body) of the reciprocal on whose behalf the consent provided under section 826(c)(2) is given. The copy shall be executed in the same manner as the original and shall be delivered to such board not later than 10 days before the last date prescribed by law (including extensions thereof) for filing the reciprocal's income tax return for the taxable year for which the information is required unless the attorney-in-fact establishes to the satisfaction of the district director that the failure to furnish such copy or the failure to furnish such copy within the prescribed 10 day period was due to circumstances beyond its control. In addition, there shall be attached to and

made a part of such copy, a copy of the income tax return of the attorney-in-fact (including accompanying schedules) for each taxable year for which such statement is required.

[T.D. 6681, 28 FR 11125, Oct. 17, 1963]

§ 1.826-4 Allocation of expenses.

An attorney-in-fact allocating expenses as required by section 826(b) and paragraph (b) of § 1.826-3 shall allocate each expense itemized in its income tax return (and accompanying schedules) for the taxable year to each source of gross income (as set forth pursuant to paragraph (b)(2) of § 1.826-3). However, no portion of the net operating loss deduction allowed by section 172 shall be allocated to income received or due from the reciprocal, and no expenses, other than those directly related thereto, shall be allocated to capital gains. Where the method of allocation used by the taxpayer does not reasonably reflect the expenses of the taxpayer allocable to income received or due from the reciprocal, the district director may require the taxpayer to use such other method of allocation as is reasonable under the circumstances.

[T.D. 6681, 28 FR 11126, Oct. 17, 1963]

§ 1.826-5 Attribution of tax.

(a) *In general.* Section 826(e) provides that a reciprocal making the election allowed by section 826(a) shall be credited with so much of the tax paid by the attorney-in-fact as is attributable to the income received by the attorney-in-fact from the reciprocal in such taxable year.

(b) *Computation.* For purposes of section 826(e) and paragraph (a) of this section, the amount of tax attributable to income received by the attorney-in-fact from the reciprocal in the taxable year shall be computed in the following manner:

(1) First, compute the taxable income (if any) from each source of gross income set forth in paragraph (b)(2) of § 1.826-3 by deducting from each such amount the expenses allocable thereto under § 1.826-4;

(2) Second, compute the normal tax on each amount of taxable income computed in subparagraph (1) of this

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paragraph at the rate provided by section 11(b) of the Code;

(3) Third, deduct from each amount determined in subparagraph (1) of this paragraph an amount which bears the same proportion to the surtax exemption provided by section 11(c) of the Code as each amount computed under subparagraph (1) of this paragraph bears to the total of the amounts computed under subparagraph (1) of this paragraph;

(4) Fourth, compute the surtax on each remainder computed in subparagraph (3) of this paragraph at the rate provided by section 11(c) of the Code;

(5) Fifth, add the normal tax computed under subparagraph (2) of this paragraph to the surtax computed under subparagraph (4) of this paragraph for each amount computed under subparagraph (1) of this paragraph;

(6) Sixth, deduct from each amount of tax computed under subparagraph (5) of this paragraph any tax credits (other than those arising from payments made with respect to the tax liability for the taxable year or other taxable years) allocable (in the same manner as provided for expenses under §1.826-4) to such amount;

(7) Seventh, compute that amount which bears the same proportion to the tax actually paid with respect to the taxable year as each individual amount computed under subparagraph (6) of this paragraph bears to the total of the amounts computed under subparagraph (6) of this paragraph. The amount so determined with respect to each amount computed under subparagraph (6) of this paragraph is the tax paid which is attributable to the amount computed under subparagraph (1) of this paragraph.

To the extent the amounts determined under subparagraph (1) of this paragraph are attributable to amounts received from the reciprocal for the taxable year, the tax attributable to such amounts (as determined under subparagraph (7) of this paragraph) shall be the amount of tax attributable to income received by the attorney-in-fact from the reciprocal during the taxable year.

(c) *Taxes of attorney-in-fact unaffected.* Nothing in section 826 or the regulations thereunder shall increase or de-

crease the taxes imposed on the income of the attorney-in-fact.

[T.D. 6681, 28 FR 11126, Oct. 17, 1963]

§ 1.826-6 Credit or refund.

(a) *Notification required.* In any case where a taxpayer applies for a credit or refund of taxes paid by it in respect of a taxable year for which the taxpayer was the consenting attorney-in-fact of a reciprocal making the election provided by section 826(a), such taxpayer shall give notice to its reciprocal for such taxable year, first, upon applying for the credit or refund; and again, within 10 days from the date on which a final determination is made that such credit or refund has been allowed or denied.

(b) *Notice form.* The notices required by this section shall include the name and address of the taxpayer and shall be signed by the taxpayer or its duly authorized representative. In addition, there shall be attached to and made a part of each first notice a concise statement of the claim upon which the application for refund or credit is based; and there shall be attached to and made a part of each second notice:

(1) A copy of the notification (if any) received by the taxpayer indicating that the credit or refund has been allowed; and

(2) A statement setting forth the amount of such credit or refund attributable to taxes paid by the taxpayer on income received from the reciprocal, and the computation by which such amount was determined.

(c) *Manner of apportioning refund or credit.* The taxpayer shall determine the amount of the refund or credit attributable to taxes paid on income received from its reciprocal by reallocating its income and expense items for the taxable year, with respect to which the refund or credit is allowed, in the manner provided by §§1.826-3 and 1.826-4 so as to reflect the adjustments (if any) in such items which resulted in the credit or refund of tax for the taxable year. The taxpayer shall then recompute the tax attributable to income received from its reciprocal for such taxable year in the manner provided by §1.826-5. The district director

may require such additional information as may be necessary in the circumstances to verify the computations required by this paragraph.

[T.D. 6681, 28 FR 11126, Oct. 17, 1963]

§ 1.826-7 Examples.

The application of section 826 may be illustrated by the following examples:

Example 1. For the taxable year 1963, R, a reciprocal underwriter subject to the taxes imposed by section 821(a), has the following items (determined before applying any election under section 826):

Gross income under sec. 832	\$578
Gross investment income	50
<hr/>	
Deductions under sec. 832 (as modified by sec. 823(b)):	
Deduction for amounts paid by R to attorney-in-fact A	\$100
All other deductions	500
<hr/>	
Total deductions under sec. 832	600
Deductions under sec. 822(c)	40
Incurring losses	400
Protection against loss deduction	4
Underwriting gain	0
Mutual insurance company taxable income	0
Unused loss	22
Credit or refund for taxes paid	0

Assume that the deductions of attorney-in-fact A allocable to the income received by A from R are 60 and the tax paid by A allocable to the income received from R is 16. If R elects to be subject to the limitation provided in section 826(b), the results for 1963 would be as follows:

Gross income under sec. 832	\$578
Gross investment income	50
<hr/>	
Deductions under sec. 832 (as modified by sec. 823(b)):	
Deduction for amounts paid by R to attorney-in-fact A	\$60
All other deductions	500
<hr/>	
Total deduction under sec. 832	560
Deductions under sec. 822(c)	40
Incurring losses	400
Underwriting gain	8
Protection against loss deduction	6
Mutual insurance company taxable income	12
Unused loss	0
Credit or refund for taxes paid	16

Under the provisions of section 826(b), R's deduction for amounts paid or incurred to the attorney-in-fact in the taxable year 1963 would be limited to the deductions of A allocable to the income received by A from R. Thus, R's deductions under section 832 (as modified by section 823(b)) for 1963 would be 60 (the deductions of A which are allocable to the income received by A from R). As a result of making the election under section

826(a) for the taxable year 1963, R's underwriting gain would be 8, and its statutory underwriting income would be 2 (the underwriting gain of 8 minus the protection against loss deduction of 6—of which 4 represents the amount determined under section 824(a)(1)(A)—and 2 represents the amount determined under section 824(a)(1)(B)—or 8 minus 6). R's mutual insurance company taxable income for 1963 would be 12, consisting of taxable investment income of 10 (gross investment income minus deductions under section 822(c), or 50 minus 40) plus statutory underwriting income of 2. Since all of R's mutual insurance company taxable income of 12 is attributable to the limitation under section 826(b), the entire amount is subject to the surtax under section 821(a)(2) without regard to the \$25,000 surtax exemption. The credit of 16, representing that part of the tax paid by A which is allocable to the income received by A from R, may be applied by R against its taxes with respect to its mutual insurance company taxable income of 12 for 1963, and R would be entitled to a refund of any excess of the amount of such credit over its tax liability for 1963.

Under the provisions of section 826(d), no portion of the amount added to the protection against loss account in 1963 by reason of the election under section 826(a), 2 (25 percent of the amount by which the consolidated underwriting gain exceeds 25 percent of the underwriting gain determined without regard to the election under section 826(a), or the amount by which 25 percent of 8 exceeds 25 percent of 0), may remain in such account beyond the taxable year 1968.

Example 2. For the taxable year 1963, F is a corporate attorney-in-fact subject to the taxes imposed by section 11(b) and (c) of the Code. F files its return on the calendar year basis and reports income received from its reciprocal and the deductions allocable thereto under the same method of accounting used by its reciprocal in reporting its deductions for amounts paid to R. F properly consents to provide the information required by paragraph (b) of § 1.826-3. In addition to its attorney-in-fact business, F owns real estate for investment purposes, and operates a real estate management service. For the taxable year 1963, F has gross income from these various sources as follows:

Attorney-in-fact fees	\$85,000
Real estate management fees.....	18,000
Rental income	25,000

F allocates its expenses for the taxable year on the basis of their direct relation to each source of income. During 1963, F acquired property for use in its attorney-in-fact operations which entitled F to an investment

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credit of \$800 under section 38. For 1963, F determines that the tax paid by it which is attributable to its reciprocal is \$21,863, computed as follows:

	Attorney-in-fact fees	Real estate management	Rental income	Total
Gross income	\$85,000	\$18,000	\$25,000	\$128,000
Allocable expenses	25,000	3,000	35,000	63,000
Taxable income (loss)	60,000	15,000	(10,000)	65,000
Normal tax (30 percent)	18,000	4,500	0	19,500
Surtax exemption ..	20,000	5,000	0	25,000
Income subject to surtax	40,000	10,000	0	40,000
Surtax (22 percent) ..	8,800	2,200	0	8,800
Total tax	26,800	6,700	0	28,300
Investment credit	800	0	0	800
1963 tax liability	26,000	6,700	0	27,500
1963 tax paid	27,500
Allocation of tax paid ..	21,863	5,637	0	27,500

Under paragraph (b)(1) of § 1.826-5, F computes its taxable income from its attorney-in-fact fees to be \$60,000 (\$85,000 minus \$25,000), and its taxable income from its real estate management to be \$15,000 (\$18,000 minus \$3,000). Since F's rental operations resulted in a \$10,000 loss for the taxable year (\$25,000 minus \$35,000), F's taxable income from its rental operations is zero. Using the 30 percent rate provided by section 11(b), F computes its normal tax to be \$18,000 on its attorney-in-fact fees and \$4,500 on its real estate management operations. F's normal tax on total income is \$19,500. The \$3,000 difference between the normal tax on F's total income and the normal taxes on F's profitable operations results from the loss on F's rental operations. Under paragraph (b)(3) of § 1.826-5, F allocates its surtax exemption as follows: \$20,000 (\$60,000/\$75,000×\$25,000) to its attorney-in-fact fees; and \$5,000 (\$15,000/\$75,000×\$25,000) to its real estate management operations. F computes its surtax on its profitable operations at the 22 percent rate provided by section 11(c) as follows: \$8,800 (22 percent of \$40,000) on attorney-in-fact fees; and \$2,200 (22 percent of \$10,000) on real estate management income. F adds its normal tax and surtax on its profitable operations and determines its total tax to be \$26,800 on its attorney-in-fact operations; \$6,700 on its real estate management operations; and \$28,300 on its total income. F must allocate its investment credit on the same basis as it used to allocate its expenses. Thus, F's en-

tire investment credit must be allocated to its attorney-in-fact operations. Accordingly, F's 1963 tax liability is \$26,000 on its attorney-in-fact fees; \$6,700 on its real estate management operations; \$0 on its rental operations; and \$27,500 on its total income. Under paragraph (b)(7) of § 1.826-5, F allocates \$21,863 (\$26,000/\$32,700×\$27,500) of its 1963 tax paid to its attorney-in-fact fees; and \$5,637 (\$6,700/\$32,700×\$27,500) of its 1963 tax paid to its real estate management business. F's reciprocal will be allowed a credit or refund of \$21,863 for taxes paid by F which are attributable to F's income received from its reciprocal.

Example 3. Assume the same facts as in example 2, and assume further that in 1966 F sustains a net operating loss on its overall operations of \$5,000. In carrying the loss back to 1963 as a net operating loss deduction under section 172, F must allocate the deduction under the same method it used in allocating its 1963 deductions. Thus, if the loss was entirely attributable to F's rental operations for the taxable year 1966, F would reduce its taxable income attributable to those operations by the entire amount of the loss and would recompute the tax attributable to those operations under paragraph (b) of § 1.826-5. As recomputed in the table below, F's 1963 tax liability from attorney-in-fact fees would be \$19,800 and F's total tax liability would be \$24,900.

	Attorney-in-fact fees	Real estate management	Rental income	Total
Gross income	\$85,000	\$18,000	\$25,000	\$128,000
Allocable expenses	25,000	3,000	35,000	63,000
Net operating loss deduction	0	0	5,000	5,000
Taxable income (loss)	60,000	15,000	(15,000)	60,000
Normal tax (30 percent)	18,000	4,500	0	18,000
Surtax exemption ..	20,000	5,000	0	25,000
Income subject to surtax	40,000	10,000	0	35,000
Surtax (22 percent) ..	8,800	2,200	0	7,700
Total tax	26,800	6,700	0	25,700
Investment credit	800	0	0	800
1963 tax liability	26,000	6,700	0	24,900
1963 tax paid	24,900
Allocation of tax paid ..	19,800	5,100	0	24,900

As a result of its 1966 net operating loss, F would be entitled to a refund of \$2,600 (1963 taxes paid of \$27,500 minus recomputed 1963

taxes of \$24,900). Under paragraph (a) of §1.826-6, F would be required to notify its reciprocal of its claim for refund and of the amount of the refund or credit attributable to taxes paid on income received from the reciprocal. Since the 1963 tax paid by F attributable to its reciprocal (as recomputed) is less than the amount claimed in 1963 by F's reciprocal as a credit, F's reciprocal would be required, under section 826(g), to add the difference—\$2,063 (\$21,863 minus \$19,800), to its tax liability for 1966. Thus, F's reciprocal would first compute its tax liability for 1966 without regard to section 826(g) and then would increase such liability by \$2,063.

[T.D. 6681, 28 FR 11126, Oct. 17, 1963]

OTHER INSURANCE COMPANIES

§ 1.831-1 Tax on insurance companies (other than life or mutual), mutual marine insurance companies, and mutual fire insurance companies issuing perpetual policies.

(a) All insurance companies, other than life or mutual or foreign insurance companies not carrying on an insurance business within the United States, and all mutual marine insurance companies and mutual fire insurance companies exclusively issuing either perpetual policies, or policies for which the sole premium charged is a single deposit which, except for such deduction of underwriting costs as may be provided, is refundable upon cancellation or expiration of the policy, are subject to the tax imposed by section 831. As used in this section and §§1.832-1 and 1.832-2, the term "insurance companies" means only those companies which qualify as insurance companies under the definition provided by paragraph (b) of §1.801-1 and which are subject to the tax imposed by section 831.

(b) All provisions of the Code and of the regulations in this part not inconsistent with the specific provisions of section 831 are applicable to the assessment and collection of the tax imposed by section 831(a), and insurance companies are subject to the same penalties as are provided in the case of returns and payment of income tax by other corporations.

(c) Since section 832 provides that the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners shall be the basis for com-

puting gross income and since the annual statement is rendered on the calendar year basis, the returns under section 831 shall be made on the basis of the calendar year and shall be on Form 1120. Insurance companies are entitled, in computing insurance company taxable income, to the deductions provided in part VIII (section 241 and following), subchapter B, chapter 1 of the Code.

(d) Foreign insurance companies not carrying on an insurance business within the United States are not taxable under section 831 but are taxable as other foreign corporations. See section 881.

(e) Insurance companies are subject to both normal tax and surtax. The normal tax shall be computed as provided in section 11(b) and the surtax shall be computed as provided in section 11(c). For the circumstances under which the \$25,000 exemption from surtax for certain taxable years may be disallowed in whole or in part, see section 1551. For alternative tax where the net long-term capital gain for any taxable year exceeds the net short-term capital loss, see section 1201(a) and the regulations thereunder.

§ 1.831-2 Taxable years affected.

Section 1.831-1 is applicable only to taxable years beginning after December 31, 1953, but before January 1, 1963, and ending after August 16, 1954, and all references therein to sections of the Code and regulations are to sections of the Internal Revenue Code of 1954 and the regulations thereunder before amendments. Section 1.831-3 is applicable only to taxable years beginning after December 31, 1962, and all references therein to sections of the Code and regulations are to sections of the Internal Revenue Code of 1954 as amended. Section 1.831-4 is applicable only with respect to the companies described therein, and only with respect to taxable years beginning after December 31, 1961.

[T.D. 6681, 28 FR 11128, Oct. 17, 1963]