

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 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 decrease 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

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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
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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
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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
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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.