

the reserve to an unrelated reinsurer. Z added \$250,000 to the 1985 year end reserve to take into account workers' compensation risks for the 1984 accident year that Z assumed in a reinsurance transaction on September 1, 1986. Z had \$230,000 of 1986 loss payments related to the 1984 accident year of its workers' compensation line, \$60,000 of which was attributable to the reinsurance assumed by Z. At the end of 1986, Z's reserve for the workers' compensation line for the 1984 accident year was \$1,100,000.

(ii) If only paragraph (c)(3)(i) of this section were applied, Z would have a \$460,000 reserve strengthening (\$1,100,000 - (\$1,000,000 - \$230,000 - \$130,000)).

Under paragraph (c)(3)(ii)(B) of this section, however, reserve strengthening does not include the \$250,000 that Z added to the reserve to take into account the reinsurance assumed. Also, none of the \$60,000 of loss payments attributable to the reinsurance assumed in 1986 are taken into account. Accordingly, Z has \$150,000 of reserve strengthening (\$460,000 - \$250,000 - \$60,000). If this is Z's only reserve strengthening or weakening, then the amount that Z must include in income for 1987 under paragraph (e) of this section is \$40,771.05 (\$150,000 × (100% - 72.8193%)). The factor of 72.8193% is the AY+2 factor from the workers' compensation series of discount factors published in Rev. Rul. 87-34.

*Example 6.* (i) X was a calendar year taxpayer before July 1, 1986, the date on which X became a member of an affiliated group of corporations that files a consolidated return with a June 30 year end. Thus, X had two taxable years beginning in 1986: a short taxable year ending June 30, 1986, and a fiscal taxable year ending June 30, 1987.

(ii) As of the end of 1985, X had undiscounted unpaid losses of \$800,000 in the automobile liability line of business for the 1983 accident year. At the end of the short taxable year, X had reserves of \$700,000 of undiscounted unpaid losses, and on June 30, 1987, had reserves of \$600,000 of undiscounted unpaid losses. During the short taxable year, ending June 30, 1986, X's loss payments for this reserve were \$120,000. During the taxable year ending June 30, 1987, X's loss payments for this reserve were \$180,000. Under paragraph (c)(3)(i) of this section, X has a \$100,000 reserve strengthening: of which \$20,000 (\$700,000 - (\$800,000 - \$120,000)) is attributable to the short taxable year ending June 30, 1986 and \$80,000 (\$600,000 - (\$700,000 - \$180,000)) is attributable to the taxable year ending June 30, 1987.

(iii) The amount of reserve strengthening for this line of business is determined pursuant to the principles of paragraph (c)(2) of this section.

[T.D. 8433, 57 FR 40845, Sept. 8, 1992; 57 FR 48563, Oct. 27, 1992; 57 FR 57531, Dec. 4, 1992]

**§ 1.846-4 Effective/applicability date.**

(a) *In general.* Sections 1.846-1 through 1.846-3 apply to taxable years beginning after December 31, 1986.

(b) *Section 338 election.* Section 1.846-2(d) applies to section 846(e) elections made with regard to a qualified stock purchase made on or after April 10, 2006.

[T.D. 9257, 71 FR 18006, Apr. 10, 2006, as amended by T.D. 9377, 73 FR 3873, Jan. 23, 2008]

**§ 1.846-4T Effective dates (temporary).**

(a) [Reserved]. For further guidance, see § 1.846-2(a).

(b) *Section 338 election.* Section 1.846-2(d) applies to section 846(e) elections made with regard to a qualified stock purchase made on or after April 10, 2006.

[T.D. 9257, 71 FR 18006, Apr. 10, 2006]

**§ 1.848-0 Outline of regulations under section 848.**

This section lists the paragraphs in §§ 1.848-1 through 1.848-3.

*§ 1.848-1 Definitions and special provisions.*

- (a) Scope and effective date.
- (b) Specified insurance contract.
  - (1) In general.
  - (2) Exceptions.
    - (i) In general.
    - (ii) Reinsurance of qualified foreign contracts.
    - (c) Life insurance contract.
    - (d) Annuity contract.
    - (e) Noncancellable accident and health insurance contract.
    - (f) Guaranteed renewable accident and health insurance contract.
    - (g) Combination contract.
      - (1) Definition.
      - (2) Treatment of premiums on a combination contract.
        - (i) In general.
        - (ii) De minimis premiums.
        - (3) Example.
        - (h) Group life insurance contract.
          - (1) In general.
          - (2) Group affiliation requirement.
            - (i) In general.
            - (ii) Employee group.
            - (iii) Debtor group.
            - (iv) Labor union group.
            - (v) Association group.
            - (vi) Credit union group.
            - (vii) Multiple group.
            - (viii) Certain discretionary groups.
            - (ix) Employees treated as members.

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(x) Class or classes of a group determined without regard to individual health characteristics.

- (A) In general.
- (B) Limitation of coverage based on certain work and age requirements permissible.
- (3) Premiums determined on a group basis.
  - (i) In general.
  - (ii) Exception for substandard premium rates for certain high risk insureds.
  - (iii) Flexible premium contracts.
  - (iv) Determination of actual age.
  - (4) Underwriting practices used by company. [Reserved]
  - (5) Disqualification of group.
    - (i) In general.
    - (ii) Exception for de minimis failures.
  - (6) Supplemental life insurance coverage.
  - (7) Special rules relating to the payment of proceeds.
    - (i) Contracts issued to a welfare benefit fund.
    - (ii) Credit life insurance contracts.
    - (iii) "Organization or association" limited to the sponsor of the contract or the group policyholder.
      - (i) General deductions.

*§ 1.848-2 Determination of net premiums.*

- (a) Net premiums.
  - (1) In general.
  - (2) Separate determination of net premiums for certain reinsurance agreements.
- (b) Gross amount of premiums and other consideration.
  - (1) General rule.
  - (2) Items included.
  - (3) Treatment of premium deposits.
    - (i) In general.
    - (ii) Amounts irrevocably committed to the payment of premiums.
    - (iii) Retired lives reserves.
  - (4) Deferred and uncollected premiums.
- (c) Policy exchanges.
  - (2) External exchanges.
  - (3) Internal exchanges resulting in fundamentally different contracts.
    - (i) In general.
    - (ii) Certain modifications treated as not changing the mortality, morbidity, interest, or expense guarantees.
    - (iii) Exception for contracts restructured by a court supervised rehabilitation or similar proceeding.
    - (4) Value of the contract.
      - (i) In general.
      - (ii) Special rule for group term life insurance contracts.
      - (iii) Special rule for certain policy enhancement and update programs.
        - (A) In general.
        - (B) Policy enhancement or update program defined.
    - (5) Example.

(d) Amounts excluded from the gross amount of premiums and other consideration.

- (1) In general.
- (2) Amounts received or accrued from a guaranty association.
- (3) Exclusion not to apply to dividend accumulations.
- (e) Return premiums.
- (f) Net consideration for a reinsurance agreement.
  - (1) In general.
  - (2) Net consideration determined by a ceding company.
    - (i) In general.
    - (ii) Net negative and net positive consideration.
  - (3) Net consideration determined by the reinsurer.
    - (i) In general.
    - (ii) Net negative and net positive consideration.
  - (4) Timing consistency required.
  - (5) Modified coinsurance and funds-withheld reinsurance agreements.
    - (i) In general.
    - (ii) Special rule for certain funds-withheld reinsurance agreements.
  - (6) Treatment of retrocessions.
  - (7) Mixed reinsurance agreements.
  - (8) Treatment of policyholder loans.
  - (9) Examples.
  - (g) Reduction in the amount of net negative consideration to ensure consistency of capitalization for reinsurance agreements.
    - (1) In general.
    - (2) Application to reinsurance agreements subject to the interim rules.
    - (3) Amount of reduction.
    - (4) Capitalization shortfall.
    - (5) Required capitalization amount.
      - (i) In general.
      - (ii) Special rule with respect to net negative consideration.
    - (6) General deductions allocable to reinsurance agreements.
    - (7) Allocation of capitalization shortfall among reinsurance agreements.
    - (8) Election to determine specified policy acquisition expenses for an agreement without regard to general deductions limitation.
      - (i) In general.
      - (ii) Manner of making election.
      - (iii) Election statement.
      - (iv) Effect of election.
    - (9) Examples.
    - (h) Treatment of reinsurance agreements with parties not subject to U.S. taxation.
      - (1) In general.
      - (2) Agreements to which this paragraph (h) applies.
        - (i) In general.
        - (ii) Parties subject to U.S. taxation.
          - (A) In general.
          - (B) Effect of a closing agreement.

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(3) Election to separately determine the amounts required to be capitalized for reinsurance agreements with parties not subject to U.S. taxation.

(i) In general.  
(ii) Manner of making the election.  
(4) Amount taken into account for purposes of determining specified policy acquisition expenses.

(5) Net foreign capitalization amount.  
(i) In general.  
(ii) Foreign capitalization amounts by category.

(6) Treatment of net negative foreign capitalization amount.

(i) Applies as a reduction to previously capitalized amounts.

(ii) Carryover of remaining net negative foreign capitalization amount.

(7) Reduction of net positive foreign capitalization amount by carryover amounts allowed.

(8) Examples.  
(i) Carryover of excess negative capitalization amount.

(1) In general.  
(2) Excess negative capitalization amount.  
(3) Treatment of excess negative capitalization amount.

(4) Special rule for the treatment of an excess negative capitalization amount of an insolvent company.

(i) When applicable.  
(ii) Election to forego carryover of excess negative capitalization amount.

(iii) Amount of reduction to the excess negative capitalization amount and specified policy acquisition expenses.

(iv) Manner of making election.  
(v) Presumptions relating to the insolvency of an insurance company undergoing a court supervised rehabilitation or similar state proceeding.

(vi) Example.  
(j) Ceding commissions with respect to reinsurance of contracts other than specified insurance contracts.

(k) Effective dates.  
(1) In general.  
(2) Reduction in the amount of net negative consideration to ensure consistency of capitalization for reinsurance agreements.

(3) Net consideration rules.  
(4) Determination of the date on which a reinsurance agreement is entered into.

(5) Special rule for certain reinsurance agreements with parties not subject to U.S. taxation.

(6) Carryover of excess negative capitalization amount.

*§ 1.848-3 Interim rules for certain reinsurance agreements.*

- (a) Scope and effective dates.
- (b) Interim rules.
- (c) Adjustments and special rules.
- (1) Assumption reinsurance.

(2) Reimbursable dividends.

(3) Ceding commissions.

(i) In general.

(ii) Amount of ceding commission.

(4) Termination payments.

(5) Modified coinsurance agreements.

(d) Examples.

[T.D. 8456, 57 FR 61818, Dec. 29, 1992]

**§ 1.848-1 Definitions and special provisions.**

(a) *Scope and effective date.* The definitions and special provisions in this section apply solely for purposes of determining specified policy acquisition expenses under section 848 of the Internal Revenue Code, this section, and §§ 1.848-2 and 1.848-3. Unless otherwise specified, the rules of this section are effective for the taxable years of an insurance company beginning after November 14, 1991.

(b) *Specified insurance contract*—(1) *In general.* A “specified insurance contract” is any life insurance contract, annuity contract, noncancellable or guaranteed renewable accident and health insurance contract, or combination contract. A reinsurance agreement that reinsures the risks under a specified insurance contract is treated in the same manner as the reinsured contract.

(2) *Exceptions*—(i) *In general.* A “specified insurance contract” does not include any pension plan contract (as defined in section 818(a)), flight insurance or similar contract, or qualified foreign contract (as defined in section 807(e)(4)).

(ii) *Reinsurance of qualified foreign contracts.* The exception for qualified foreign contracts does not apply to reinsurance agreements that reinsure qualified foreign contracts.

(c) *Life insurance contract.* A “life insurance contract” is any contract—

(1) Issued after December 31, 1984, that qualifies as a life insurance contract under section 7702(a) (including an endowment contract as defined in 7702(h)); or

(2) Issued prior to January 1, 1985, if the premiums on the contract are reported as life insurance premiums on the insurance company’s annual statement (or could be reported as life insurance premiums if the company were required to file the annual statement