

actual gas sales for 2000 and the payment received from L, that is, relating to a total of 460 mmcf of gas (M's sales of 40 mmcf for 2000, plus L's payment for 420 mmcf of gas). Under paragraph (d)(3)(ii)(B) of this section, L's deduction for making its payment to M for 420 mmcf of gas is allowable only for 2000. Under paragraph (d)(3)(iii)(B) of this section, L must reduce its deduction by the amount of any percentage depletion deductions allowed on its sales of M's gas, that is, relating to 360 mmcf of gas (300 mmcf for 1997 and 60 mmcf for 1998). In addition, under paragraph (d)(3)(iii)(C) of this section, L must increase its tax for 2000 by the amount of any section 29 credit L claimed on its sales of M's gas, but only to the extent that the credit claimed actually reduced L's tax in any earlier year.

Example 3. Non-abusive altering of the taking of production for a taxable year. (i) C and D enter into a JOA and a GBA on December 1, 1994, for gas production from a reservoir. The JOA allocates production at 50 percent to C and 50 percent to D. C and D agree in writing to use the cumulative method to account for gas sales. Additionally, C and D elect under section 761(a) and this section to exclude their organization from the application of subchapter K. C and D arrange to sell all their production under annually renewable contracts. In 1995, C and D each sell 480 mmcf of gas from the reservoir.

(ii) In November 1995, D is notified that its contract with its purchaser will not be renewed for 1996. D is unable to find a new purchaser for its gas for 1996. In December 1995, D notifies C that it will not be taking production from the reservoir in 1996. Pursuant to the GBA, C then contracts with its current gas purchaser to sell an additional 20 mmcf per month in 1996. Accordingly, C sells 720 mmcf in 1996 (60 mmcf per month \times 12 months). Under the facts described in this example, a principal purpose of altering the taking of production is not to avoid tax. Accordingly, the co-producers' election under section 761(a) will not be revoked by reason of altering the taking of production.

Example 4. Abusive altering of the taking of production for a taxable year. The facts are the same as in *Example 3*(i). For 1996, C anticipates that C's regular tax (reduced by the credits allowable under sections 27 and 28) will not exceed C's tentative minimum tax. Accordingly, under section 29(b)(6), C's credit allowed under section 29(a) for sales of its gas will be zero. For 1997, C anticipates that its credit allowed under section 29(a) will not be limited by section 29(b)(6). On the other hand, D anticipates that any credit it may claim under section 29(a) for 1996, even including a credit based on sales of C's share of current production under the JOA, will not be limited by section 29(b)(6). However, for 1997, D anticipates that its credit under section 29(a) will be limited by section 29(b)(6).

On January 1, 1996, C and D agree that D will contract with its purchaser to sell the entire 960 mmcf produced from the reservoir in 1996 and that C will contract with its purchaser to sell the entire 960 mmcf produced from the reservoir in 1997. Under these facts, a principal purpose of altering the taking of production is to avoid tax. Accordingly, the co-producers' election under section 761(a) will be revoked for 1996 and for subsequent years.

(7) *Effective date.* Except in the case of a part-year change to the annual method or the cessation of a JOA, both of which are described in paragraph (d)(2)(ii)(C) of this section, the provisions of this paragraph (d) apply to all taxable years beginning after December 31, 1994, of any producer that is a member of an unincorporated organization that produces natural gas under a JOA in effect on or after the start of the producer's first taxable year beginning after December 31, 1994. In the case of a part-year change, the provisions of this paragraph (d) apply on and after January 1, 1996. In the case of the cessation of a JOA, the co-producers use their current method of accounting with respect to that JOA until the JOA ceases to be in effect.

(e) *Cross reference.* For requirements with respect to the filing of a return on Form 1065 by a partnership, see § 1.6031-1.

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EFFECTIVE DATE FOR SUBCHAPTER K,
CHAPTER 1 OF THE CODE

§ 1.771-1 Effective date.

(a) *General rule.* Except as provided in paragraph (b) or (c) of this section, the provisions of subchapter K, chapter 1 of the Code, shall apply to any taxable year of a partnership beginning after December 31, 1954, and to any part of a partner's taxable year falling within such partnership taxable year. The provisions of the Internal Revenue Code of 1939 relating to partnerships shall apply to any taxable year of a partnership beginning before January 1, 1955, and to any part of a partner's taxable year falling within such partnership taxable year. If a partnership and the partners are on different taxable years, subchapter K shall become effective at

the same time both for the partnership and for the partners.

(b) *Special rules.* Certain provisions of section 771 apply after specific dates in 1954, as follows:

(1) *Adoption of taxable year.* Section 706(b) (relating to the adoption of taxable years by partners and partnerships), shall apply to any partnership which adopts or changes to, and any partner who changes to, a taxable year beginning on or after April 2, 1954. For the purpose of applying this subparagraph, the rules of section 708 (relating to the continuation of partnerships) shall apply. For example, if two or more partnerships merge after April 1, 1954, and the new partnership uses the taxable year of the partnership of which it is deemed to be the successor under section 708(b)(2)(A), it will not need prior approval to continue to use such taxable year even though such year may be different from the taxable years of the partners. Such a partnership is not "adopting" or "changing" its taxable year.

(2) *Property distributed by a partnership.* Section 735(a), relating to the character of gain or loss on disposition of property distributed by a partnership to a partner, shall apply only to property distributed after March 9, 1954. Although a partnership whose taxable year begins before January 1, 1955, generally will be subject to the provisions of the Internal Revenue Code of 1939, any unrealized receivables or inventory items distributed by any such partnership after March 9, 1954, will be subject to the provisions of section 735(a), and the gain or loss on the subsequent disposition of such property will be ordinary gain or loss rather than capital gain or loss. In the case of property distributed before March 10, 1954, section 735(a) will not apply, even though the property is disposed of by the distributee partner after that date, unless the partnership elects under paragraph (c) of this section to apply section 735.

(3) *Unrealized receivables and inventory items.* Section 751 (providing for the realization of ordinary income on certain transfers or distributions of unrealized receivables or substantially appreciated inventory items) shall be applicable to any such transfer or distribu-

tion occurring after March 9, 1954. For the purpose of applying section 751 in the case of a taxable year beginning before January 1, 1955, a partnership or partner may elect to treat as applicable any other section of subchapter K. See paragraph (f) of §1.751-1.

(4) *Partner receiving income in respect of a decedent.* Section 753, which provides that the amount includible in the gross income of a successor in interest of a deceased partner under section 736(a) shall be considered income in respect of a decedent under section 691, shall apply only in the case of payments made with respect to decedents whose death occurred after December 31, 1954.

(c) *Optional treatment of certain distributions.* (1) For a partnership taxable year beginning after December 31, 1953, and before January 1, 1955, a partnership may elect to apply the rules of certain sections of subchapter K with respect to current distributions made by the partnership in such year. These sections are 731, 732 (a), (c), and (e), 733, 735, and 751 (b), (c), and (d). If an election is made, it shall apply to the partnership and all its members for all current distributions made by the partnership during the taxable year. Such distributions shall also be subject to the rules of section 705 (relating to determination of basis of a partner's interest), 752 (relating to treatment of certain liabilities), and 761(d) (relating to the definition of liquidation of a partner's interest), to the extent that such sections apply to current distributions.

(2) An election under this paragraph shall be made by a statement filed with the partnership return for the taxable year to which such election applies, or before August 23, 1956, whichever date is later. The statement shall be signed by all members of the partnership and the election once made shall be binding on the partnership and on all of its members.

INSURANCE COMPANIES
LIFE INSURANCE COMPANIES
DEFINITION; TAX IMPOSED

§ 1.801-1 Definitions.

(a) *Life insurance company.* The term *life insurance company* as used in subtitle A of the Code is defined in section 801. For the purpose of determining whether a company is a “life insurance company” within the meaning of that term as used in section 801, it must first be determined whether the company is taxable as an insurance company under the Code. For the definition of an “insurance company”, see paragraph (b) of this section. In determining whether an insurance company is a life insurance company, the life insurance reserves (as defined in section 803(b)) plus any unearned premiums and unpaid losses on noncancellable life, health, or accident policies, not included in “life insurance reserves” must comprise more than 50 percent of its total reserves (as defined in section 801). An insurance company writing only noncancellable life, health, or accident policies and having no “life insurance reserves” may qualify as a life insurance company if its unearned premiums and unpaid losses on such policies comprise more than 50 percent of its total reserves. A noncancellable insurance policy means a contract which the insurance company is under an obligation to renew or continue at a specified premium and with respect to which a reserve in addition to the unearned premium must be carried to cover that obligation. For the purpose of the preceding sentence, the term “unearned premium” means the amount which will cover the cost of carrying the insurance risk for the period for which the premium has been paid in advance. A burial or funeral benefit insurance company qualifying as a life insurance company engaged directly in the manufacture of funeral supplies or the performance of funeral services will be taxable under section 821 or section 831 as an insurance company other than life.

(b) *Insurance companies.* (1) Insurance companies include both stock and mutual companies, as well as mutual benefit insurance companies. A voluntary

unincorporated association of employees formed for the purpose of relieving sick and aged members and the dependents of deceased members is an insurance company, whether the fund for such purpose is created wholly by membership dues or partly by contributions from the employer. A corporation which merely sets aside a fund for the insurance of its employees is not required to file a separate return for such fund, but the income therefrom shall be included in the return of the corporation.

(2) Though its name, charter powers, and subjection to State insurance laws are significant in determining the business which a corporation is authorized and intends to carry on, the character of the business actually done in the taxable year determines whether it is taxable as an insurance company under the Code. For example, during the year 1954 the M Corporation, incorporated under the insurance laws of the State of R, carried on the business of lending money in addition to guaranteeing the payment of principal and interest of mortgage loans. Of its total income for the year, one-third was derived from its insurance business of guaranteeing the payment of principal and interest of mortgage loans and two-thirds was derived from its noninsurance business of lending money. The M Corporation is not an insurance company for the year 1954 within the meaning of the Code and the regulations thereunder.

§ 1.801-2 Taxable years affected.

Section 1.801-1 is applicable only to taxable years beginning after December 31, 1953, and before January 1, 1955, and all references to sections of part I, subchapter L, chapter 1 of the Code are to the Internal Revenue Code of 1954, before amendments. Sections 1.801-3 through 1.801-7 are applicable only to taxable years beginning after December 31, 1957, and all references to sections of part I, subchapter L, chapter 1 of the Code are to the Internal Revenue Code of 1954, as amended by the Life Insurance Company Income Tax Act of 1959 (73 Stat. 112). Section 1.801-8 is applicable only to taxable years beginning after December 31, 1961, and all references to sections of part I, subchapter L, chapter 1 of the Code are to