

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 ex-

ample, 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:

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]

§ 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 distrib-

uted 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 January 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