

§ 1.802-5

Example 4. For the taxable year 1961, Z, a life insurance company, has taxable investment income of \$100,000, a policyholders surplus account of \$50,000 as of the beginning of such taxable year, a loss from operations (as defined in section 809(b)(2)) of \$25,000, and subtractions from the policyholders surplus account in the amount of \$20,000. For the taxable year 1961, Z has life insurance company taxable income of \$20,000, as only the amount (\$20,000) subtracted from the policyholders surplus account is taken into account.

[T.D. 6513, 25 FR 12658, Dec. 10, 1960]

§ 1.802-5 Special rule for 1959 and 1960.

(a) *Transitional rule.* Section 802(a)(3) provides a transitional rule for the determination of the tax liability of a life insurance company for the taxable years 1959 and 1960 by reason of the operation of section 802(b)(3). Except as limited by section 802(a)(3) and paragraph (b) of this section, any increase in a life insurance company's tax that is attributable to the operation of section 802(b)(3) is taken into account only to the extent of one-third and two-thirds for the taxable years 1959 and 1960, respectively. To the extent there is an increase in a life insurance company's tax that is attributable to the operation of section 802(b)(3) which is not taken into account for the taxable years 1959 and 1960 because of the transitional rule provided by section 802(a)(3) and this paragraph, such amounts shall be included in "other accounts" under section 815(a)(3). For taxable years commencing after December 31, 1960, the full amount of any increase in tax due to the operation of section 802(b)(3) shall be imposed without any further transitional reduction.

(b) *Limitations.* The transitional rule provided by section 802(a)(3) is limited solely to an increase in tax under section 802(b)(3) that is occasioned by the operation of section 815(c)(3) (relating to subtractions from the policyholders surplus account by reason of distributions to shareholders). This rule is further limited to actual distributions that are made by life insurance companies in 1959 or 1960 and does not extend to other distributions that are treated under section 815(d)(2)(B) as made by life insurance companies in 1959 or 1960. Furthermore, section 802(a)(3) shall not

apply to any increase in tax under section 802(b)(3) that is attributable to other subtractions from the policyholders surplus account by reason of the operation of the special rules contained in section 815(d). However, the transitional rule provided by section 802(a)(3) does apply in the case of a distribution to which section 815(e)(1)(B)(ii) applies.

(c) *Illustration of principles.* The provisions of section 802(a)(3) and this section may be illustrated by the following example:

Example. For the taxable year 1960, X, a life insurance company, had taxable investment income of \$9,000, gain from operations of \$27,000, and subtractions from the policyholders surplus account of \$22,000. Based upon these figures, X had life insurance company taxable income of \$40,000 for 1960, of which \$18,000 was includible under section 802(b)(1) and (2) and \$22,000 under section 802(b)(3). Applying the tax imposed by section 802(a)(1) (at rates as in effect for 1960), without regard to the transitional rule of section 802(a)(3), X would have a tax liability of \$15,300 (\$40,000 multiplied by 52 percent, less \$5,500). However, applying the transitional rule of section 802(a)(3), the actual tax liability of X, for 1960, would be \$12,000, computed as follows:

(1) Total tax liability (without regard to sec. 802(a)(3))	\$15,300
(2) Life insurance company taxable income	\$40,000
(3) Amount subtracted from policyholders surplus account	22,000
(4) Item (2) less item (3)	18,000
(5) Tax on amount includible under sec. 802(b)(1) and (2) (30% of \$18,000)	5,400
(6) Tax attributable to sec. 802(b)(3) (item (1) less item (5))	9,900
(7) Less: 33 1/3 percent of tax attributable to sec. 802(b)(3) (1/3 of \$9,900)	3,300
(8) Tax liability for 1960 after application of sec. 802(a)(3) (item (1) less item (7))	12,000

[T.D. 6513, 25 FR 12659, Dec. 10, 1960]

§ 1.803-1 Life insurance reserves.

(a) The term "life insurance reserves" is defined in section 803(b). Generally, such reserves, as in the case of level premium life insurance, are held to supplement the future premium receipts when the latter, alone, are insufficient to cover the increased risk in the later years. In the case of cancellable health and accident policies and similar cancellable contracts, the unearned premiums held to cover

the risk for the unexpired period covered by the premiums are not included in life insurance reserves. Unpaid loss reserves for noncancellable health and accident policies are included in life insurance reserves if they are computed or estimated on the basis of recognized mortality or morbidity tables and assumed rates of interest.

(b) In the case of an assessment life insurance company or association, life insurance reserves include sums actually deposited by such company or association with State or Territorial officers pursuant to law as guaranty or reserve funds, and any funds maintained under the charter or articles of incorporation or association of such company or association, or bylaws (approved by the State insurance commissioner) of such company or association, exclusively for the payment of claims arising under certificates of membership or policies issued upon the assessment plan and not subject to any other use.

(c) Life insurance reserves, except as otherwise provided in section 803(b), must be required by law either by express statutory provisions or by rules and regulations of the insurance department of a State, Territory, or the District of Columbia when promulgated in the exercise of a power conferred by statute but such requirement, without more, is not conclusive; for example, life insurance reserves do not include reserves required to be maintained to provide for the ordinary running expenses of a business which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, and unpaid brokerage; nor do they include the net value of risks reinsured in other solvent companies; liability for premiums paid in advance; liability for annual and deferred dividends declared or apportioned; liability for dividends left on deposit at interest; liability for accrued but unsettled policy claims whether known or unreported; liability for supplementary contracts not involving, at the time with respect to which the liability is computed, life, health, or accident contingencies.

(d) In any case where reserves are claimed, sufficient information must be filed with the return to enable the

district director to determine the validity of the claim. Only reserves which are required by law or insurance department ruling, which are peculiar to insurance companies, and which are dependent upon interest earnings for their maintenance will, except as otherwise specifically provided in section 803(b), be considered as life insurance reserves. A company is permitted to make use of the highest aggregate reserve required by any State or Territory or the District of Columbia in which it transacts business, but the reserve must have been actually held.

(e) In the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, it is required that reserve funds thereon be based upon recognized mortality or morbidity tables covering disability benefits of the kind contained in policies issued by this particular class of companies but they need not be required by law.

§ 1.803-2 Adjusted reserves.

For the purpose of determining "required interest" for taxable years beginning after December 31, 1953, but before January 1, 1955, and ending after August 16, 1954, certain reserves computed on a preliminary term method are to be adjusted by increasing such reserves by 7 percent. The reserves to be thus adjusted are reserves computed on preliminary term methods, such as the Illinois Standard, or the Select and Ultimate methods. Only reserves on policies in the modification period are to be so adjusted. Where reserves under a preliminary term method are the same as on the level premium method, and in the case of reserves for extended or paid-up insurance, no adjustment is to be made. The reserves are thus adjusted, and the rate of interest on which they are computed, should be reported in Schedule A, Form 1120L.

§ 1.803-3 Interest paid or accrued.

Interest paid or accrued is one of the elements to be used in computing the amount of "required interest" for purposes of determining the reserve interest credit provided in section 805. See