

to be credited in reduction of premiums under the terms of the contract), or any other item of similar nature. Such term includes advance premiums, premiums deferred and uncollected and premiums due and unpaid, deposits, fees, assessments, and consideration in respect of assuming liabilities under contracts not issued by the taxpayer (such as a payment or transfer of property in an assumption reinsurance transaction as defined in paragraph (a)(7)(ii) of § 1.809-5). The term also includes amounts a life insurance company charges itself representing premiums with respect to liability for insurance and annuity benefits for its employees (including full-time life insurance salesmen within the meaning of section 7701(a)(20)).

(ii) The term *return premiums* means amounts returned or credited which are fixed by contract and do not depend on the experience of the company or the discretion of the management. Thus, such term includes amounts refunded due to policy cancellations or erroneously computed premiums. Furthermore, amounts of premiums or other consideration returned to another life insurance company in respect of reinsurance ceded shall be included in return premiums. For the treatment of amounts which do not meet the requirements of return premiums, see section 811 (relating to dividends to policyholders).

(iii) For purposes of section 809(c)(1) and this subparagraph, the term *reinsurance ceded* means an arrangement whereby the taxpayer (the reinsured) remains solely liable to the policyholder, whether all or only a portion of the risk has been transferred to the reinsurer. Such term includes indemnity reinsurance transactions but does not include assumption reinsurance transactions. See paragraph (a)(7)(ii) of § 1.809-5 for the definition of assumption reinsurance.

(2) *Decreases in certain reserves.* Each net decrease in reserves which is required by section 810 (a) and (d)(1) or 811(b)(2) to be taken into account for the taxable year as a net decrease for purposes of section 809(c)(2).

(3) *Other amounts.* All amounts, not included in computing investment yield and not otherwise taken into ac-

count under section 809(c) (1) or (2), shall be taken into account under section 809(c)(3) to the extent that such amounts are includible in gross income under subtitle A of the Code. See section 61 (relating to gross income defined) and the regulations thereunder.

(b) *Treatment of net long-term capital gains.* For taxable years beginning before January 1, 1962, any net long-term capital gains (as defined in section 1222(7)) from the sale or exchange of a capital asset (or any gain considered to be from the sale or exchange of a capital asset under applicable law) shall be excluded from the determination of gain or loss from operations of a life insurance company. On the other hand, with respect to taxable years beginning after December 31, 1961, the amount (if any) by which the net long-term capital gain exceeds the net short-term capital loss (as defined in section 1222(6)) shall be taken into account in determining gain or loss from operations under section 809. However, for any taxable year beginning after December 31, 1958, the excess of net short-term capital gain (as defined in section 1222(5)) over net long-term capital loss (as defined in section 1222(8)) is included in computing investment yield (as defined in section 804(c)) and, to that extent, is taken into account in determining gain or loss from operations under section 809.

[T.D. 6535, 26 FR 527, Jan. 20, 1961, as amended by T.D. 6610, 27 FR 8718, Aug. 31, 1962, T.D. 6886, 31 FR 8687, June 23, 1966]

§ 1.809-5 Deductions.

(a) *Deductions allowed.* Section 809(d) provides the following deductions for purposes of determining gain or loss from operations under section 809(b) (1) and (2), respectively:

(1) *Death benefits, etc.* All claims and benefits accrued (less reinsurance recoverable), and all losses incurred (whether or not ascertained), during the taxable year on insurance and annuity contracts (including contracts supplementary thereto). The term *all claims and benefits accrued* includes, for example, matured endowments and amounts allowed on surrender. The term *losses incurred (whether or not ascertained)* includes a reasonable estimate of the amount of the losses (based

upon the facts in each case and the company's experience with similar cases) incurred but not reported by the end of the taxable year as well as losses reported but where the amount thereof cannot be ascertained by the end of the taxable year.

(2) *Increases in certain reserves.* The net increase in reserves which is required by section 810 (b) and (d)(1) to be taken into account for the taxable year as a net increase for purposes of section 809(d)(2).

(3) *Dividends to policyholders.* The deduction for dividends to policyholders as determined under section 811(b) and §1.811-2. Except as provided in section 809(d)(3) and this subparagraph, no amount shall be allowed as a deduction in respect of dividends to policyholders under section 809(d). See section 809(f) and §1.809-7 for limitation of such deduction.

(4) *Operations loss deduction.* The operations loss deduction as determined under section 812.

(5) *Certain nonparticipating contracts.*

(i) An amount equal to the greater of:

(a) 10 percent of the increase for the taxable year in certain life insurance reserves for nonparticipating contracts (other than group contracts); or

(b) 3 percent of the premiums for the taxable year attributable to nonparticipating contracts (other than group contracts) which are issued or renewed for periods of 5 years or more.

(ii) For purposes of section 809(d)(5) and this subparagraph, the term *nonparticipating contracts* means those contracts which during the taxable year contain no right to participate in the divisible surplus of the company. For example, if at any time during the taxable year for which the deduction allowed under section 809(d)(5) and this subparagraph is claimed such contracts have rights to dividends or similar distributions (as defined in section 811(a) and paragraph (a) of §1.811-2), such contracts shall no longer be deemed nonparticipating contracts and, therefore, no deduction shall be allowed. Thus, if a class of contracts having no right to participate in the divisible surplus of the company is in force for nine years and on March 10, 1958, it is announced that such contracts shall be accorded dividend rights as of August 1, 1958, no

deduction shall be allowed under section 809(d)(5) and this subparagraph for the taxable year 1958 or any succeeding taxable year, whether or not dividends are actually paid on such contracts. However, if the announcement of March 10, 1958, states that such contracts shall be accorded dividend rights as of January 1, 1959, a deduction under section 809(d)(5) and this subparagraph shall be allowed for the taxable year 1958 but not for any succeeding taxable year.

(iii) For purposes of section 809(d)(5) and this subparagraph, the term *reserves for nonparticipating contracts* means such part of the life insurance reserves (as defined in section 801(b) and §1.801-4), other than that portion of such reserves which is allocable to annuity features, as relates to nonparticipating contracts (as defined in subdivision (ii) of this subparagraph). The amount of life insurance reserves taken into account shall be adjusted first as required by section 818(c) (relating to an election with respect to life insurance reserves computed on a preliminary term basis) and then as required by section 806(a) (relating to adjustments for certain changes in reserves and assets). In the case of the adjustments required by section 810(d) (relating to adjustment for change in computing reserves), the increase in life insurance reserves attributable to reserve strengthening shall be taken into account in accordance with the rules prescribed in section 810(d) and §1.810-3.

(iv) For purposes of section 809(d)(5) and this subparagraph, the term *premiums* means the net amount of the premiums and other consideration attributable to nonparticipating contracts (as defined in subdivision (ii) of this subparagraph) which are taken into account under section 809(c)(1). For this purpose, premiums include only such amounts attributable to such contracts which are issued or renewed for periods of 5 years or more, but does not include that portion of the premiums which is allocable to annuity features. No portion shall be deemed allocable to annuity features solely because a contract, such as an endowment contract, provides that at maturity the insured shall have an

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option to take an annuity. The determination of whether a contract meets the 5-year requirement shall be made as of the date the contract is issued, or as of the date it is renewed, whichever is applicable. Thus, a 20-year nonparticipating endowment policy shall qualify for the deduction under section 809(d)(5), even though the insured subsequently dies at the end of the second year, since the policy is issued for a period of 5 years or more. However, a 1-year renewable term contract shall not qualify, since as of the date it is issued (or of any renewal date) it is not issued (or renewed) for a period of 5 years or more. In like manner, a policy originally issued for a 3-year period and subsequently renewed for an additional 3-year period shall not qualify. However, if this policy is renewed for a period of 5 years or more, the policy shall qualify for the deduction under section 809(d)(5) from the date it is renewed.

(v) The provisions of section 809(d)(5) and this subparagraph may be illustrated by the following example:

Example. Assume the following facts with respect to X, a life insurance company, for the taxable year 1958:

Life insurance reserves on nonparticipating contracts without annuity features (other than group contracts) at 1-1-58	\$150,000
Life insurance reserves on nonparticipating contracts without annuity features (other than group contracts) at 12-31-58	225,000
Annuity reserves on nonparticipating contracts (other than group contracts) at 1-1-58	48,000
Annuity reserves on nonparticipating contracts (other than group contracts) at 12-31-58	57,000
Premiums on nonparticipating contracts without annuity features (other than group contracts) issued or renewed for 5 years or more	85,000
Premiums on nonparticipating contracts allocable to annuity features (other than group contracts) issued or renewed for 5 years or more	14,000
Return premiums on nonparticipating contracts without annuity features (other than group contracts)	5,000

In order to determine the deduction under section 809(d)(5) (without regard to the limitation of section 809(f)), X would make up the following schedule:

(1) Life insurance reserves on nonparticipating contracts without annuity features (other than group contracts) at 12-31-58	\$225,000
(2) Life insurance reserves on nonparticipating contracts without annuity features (other than group contracts) at 1-1-58	150,000
(3) Excess of item (1) over item (2) (\$225,000 minus \$150,000)	75,000

(4) 10 percent of item (3) (10%×\$75,000)	7,500
(5) Net premiums on nonparticipating contracts without annuity features issued or renewed for 5 years or more (other than group contracts) (gross premiums on such contracts (\$85,000) minus return premiums (\$5,000) on such contracts)	80,000
(6) 3 percent of item (5) (3%×\$80,000)	2,400
(7) The greater of item (4) or item (6)	7,500
(8) Tentative deduction under sec. 809(d)(5) (computed without regard to the limitation of sec. 809(f))	7,500

(vi) See section 809(f) and § 1.809-7 for limitation of the deduction provided by this subparagraph.

(6) *Certain accident and health insurance and group life insurance.* (i) For taxable years beginning before January 1, 1963, an amount equal to two percent of the premiums for the taxable year attributable to group life insurance contracts, group accident and health insurance contracts, or group accident and health insurance contracts with a life feature. For taxable years beginning after December 31, 1962, the deduction shall be an amount equal to two percent of the premiums for the taxable year attributable to group life insurance contracts, accident and health insurance contracts (other than those to which section 809(d)(5) applies), or accident and health insurance contracts with a life feature (other than those to which section 809(d)(5) applies). For purposes of section 809(d)(6) and this subparagraph, the term "premiums" means the net amount of the premiums and other consideration attributable to such contracts taken into account under section 809(c)(1). The deduction allowed by section 809(d)(6) and this subparagraph for the taxable year and all preceding taxable years shall not exceed 50 percent of the net amount of the premiums attributable to such contracts for the taxable year. For example, assume that premiums attributable to group life insurance and group accident and health insurance contracts are \$103,000 for the taxable year 1962. Assume further that there are \$3,000 of return premiums attributable to such contracts for the taxable year. Under the provisions of

section 809(d)(6) and this subparagraph, a deduction (determined without regard to section 809(f) of \$2,000 (2 percent of \$100,000 (\$103,000 - \$3,000)) is allowed. Assuming that the company continues to receive net premiums of \$100,000 attributable to such contracts for 15 years, the cumulative amount of these deductions is \$30,000 (\$2,000 for 15 years). If, in the sixteenth year, net premiums attributable to such contracts amount to \$60,000, no deduction shall be allowed under section 809(d)(6) and this subparagraph since the cumulative amount of these deductions (\$30,000) equals 50 percent of the current year's premiums (\$60,000) from such contracts.

(ii) In computing the deduction under section 809(d)(6), the determination as to when the 50 percent limitation on such deduction has been reached shall be based upon the amount allowed as a deduction for the taxable year and all preceding taxable years after the application of the limitation provided in section 809(f) and § 1.809-7. Thus, if in the example set forth in paragraph (c) of § 1.809-7 the application of the limitation provided by section 809(f) limited the deduction allowed for the taxable year under section 809(d)(6) to \$3,250,000, then for purposes of determining the 50 percent limitation on such deduction, only \$3,250,000 (the amount allowed) shall be taken into account.

(iii) For purposes of determining whether the 50 percent limitation applies to any taxable year, the deduction provided by section 809(d)(6) for all preceding taxable years shall be taken into account, irrespective of whether or not the life insurance company claimed a deduction for these amounts for such preceding taxable years.

(iv) See section 809(f) and § 1.809-7 for limitation of the deduction provided by this subparagraph.

(7) *Assumption by another person of liabilities under insurance, etc., contracts.*

(i) The consideration (other than consideration arising out of reinsurance ceded as defined in paragraph (a)(1)(iii) of § 1.809-4) in respect of the assumption by another person of liabilities under insurance and annuity contracts (including contracts supplementary thereto) of the taxpayer.

(ii) For purposes of section 809(d)(7) and this subparagraph, the term *assumption reinsurance* means an arrangement whereby another person (the reinsurer) becomes solely liable to the policyholders on the contracts transferred by the taxpayer. Such term does not include indemnity reinsurance or reinsurance ceded (as defined in paragraph (a)(1)(iii) of § 1.809-4).

(iii) The provisions of section 809(d)(7) and this subparagraph may be illustrated by the following example:

Example. During the taxable year 1958, T, a life insurance company, transferred a block of insurance policies and made a payment of \$50,000 to R, a life insurance company, under an arrangement whereby R became solely liable to the policyholders on the policies transferred by T. Under the provisions of section 809(d)(7) and this subparagraph, T is allowed a deduction of \$50,000 for the taxable year 1958. For the treatment by R of this \$50,000 payment, see section 809(c)(1) and paragraph (a)(1)(i) of § 1.809-4. See section 806(a) and § 1.806-3 for the adjustments in reserves and assets to be made by T and R as a result of this transaction.

(8) *Tax-exempt interest, dividends, etc.*

(i) Each of the following items:

(a) The life insurance company's share of interest which under section 103 is excluded from gross income;

(b) The deduction for partially tax-exempt interest provided by section 242 (as modified by section 804(a)(3) and paragraph (d)(2)(i) of § 1.804-2) computed with respect to the life insurance company's share of such interest; and

(c) The deductions for dividends received provided by sections 243, 244, and 245 (as modified by section 809(d)(8)(B) and subdivision (i) of this subparagraph) computed with respect to the life insurance company's share of the dividends received.

(ii) The modification contained in section 809(d)(8)(B) provides the method for applying section 246(b) (relating to limitation on aggregate amount of deductions for dividends received) for purposes of section 809(d)(8)(A)(iii) and subdivision (i)(c) of this subparagraph. Under this method, the sum of the deductions allowed by sections 243(a)(1) (relating to dividends received by corporations), 244(a) (relating to dividends received on certain preferred stock), and 245 (relating to dividends received from certain foreign corporations)

shall be limited to 85 percent of the gain from operations computed without regard to:

(a) The deductions provided by section 809(d) (3), (5), and (6);

(b) The operations loss deductions provided by section 812; and

(c) The deductions allowed by sections 243(a)(1), 244(a), and 245.

If a life insurance company has a loss from operations (as determined under sec. 812) for the taxable year, the limitation provided in section 809(d)(8)(B) and this subdivision shall not be applicable for such taxable year. In that event, the deductions provided by sections 243(a)(1), 244(a), and 245 shall be allowable for all tax purposes to the life insurance company for such taxable year without regard to such limitation. If the life insurance company does not have a loss from operations for the taxable year, however, the limitation shall be applicable for all tax purposes for such taxable year. In determining whether a life insurance company has a loss from operations for the taxable year under section 812, the deductions allowed by sections 243(a)(1), 244(a), and 245 shall be computed without regard to the limitation provided in section 809(d)(8)(B) and this subdivision.

(9) *Investment expenses, etc.* (i) The amount of investment expenses to the extent not allowed as a deduction under section 804(c)(1) in computing investment yield. For example, if a deduction in the amount of \$100,000 is claimed for investment expenses, which amount includes general expenses assigned to or included in investment expenses, and due to the operation of the limitation provided by section 804(c)(1) only \$85,000 is allowed, then the excess (\$15,000) shall be allowed as a deduction under section 809(d)(9) and this subparagraph.

(ii) The amount (if any) by which the sum of the deductions allowable under section 804(c) exceeds the gross investment income. For example, if gross investment income under section 804(b) equals \$400,000, and the sum of the deductions allowable under section 804(c) equals \$425,000, then the excess (\$25,000) shall be allowed as a deduction under section 809(d)(9) and this subparagraph.

(iii) In determining the amount of the deductions allowed under subdivisions (i) and (ii) of this subparagraph, a life insurance company shall first take such deductions to the full extent allowable under section 804(c)(1), and any amount which is allowed as a deduction under section 804(c) shall not again be allowed as a deduction under section 809(d)(9).

(10) *Small business deduction.* The small business deduction as determined under section 804(a)(4).

(11) *Certain mutualization distributions.* The amount of distributions to shareholders actually made by the life insurance company in 1958, 1959, 1960, and 1961 in acquisition of stock pursuant to a plan of mutualization adopted by the company before January 1, 1958. If such deduction is claimed, there must be attached to the return of the company claiming such deduction a certified copy of the plan of mutualization and proof that such plan was adopted prior to January 1, 1958. See section 809(g) and § 1.809-8 for limitation of such deduction.

(12) *Other deductions.* Except as modified by section 809(e) and § 1.809-6, all other deductions allowed under subtitle A of the Code for purposes of computing taxable income to the extent not allowed as a deduction in computing investment yield. For example, a life insurance company shall be allowed a deduction under section 809(d)(12) and this subparagraph for amounts representing premiums charged itself with respect to liability for insurance and annuity benefits for its employees (including full-time life insurance salesmen within the meaning of section 7701(a)(20)) in accordance with the rules prescribed in sections 162 and 404 and the regulations thereunder, to the extent that a deduction for such amounts is not allowed under section 804(c)(1) and paragraph (b)(1) of § 1.804-4 or section 809(d)(9) and subparagraph (9) of this paragraph.

(b) *Denial of double deduction.* Nothing in section 809(d) shall permit the same item to be deducted more than once in determining gain or loss from operations. For example, if an item is allowed as a deduction for the taxable year by reason of its being a loss incurred within such taxable year

(whether or not ascertained) under section 809(d)(1), such item, or any portion thereof, shall not also be allowed as a deduction for such taxable year under section 809(d)(2).

[T.D. 6535, 26 FR 527, Jan. 20, 1961, as amended by T.D. 6610, 27 FR 8718, Aug. 31, 1962; T.D. 6886, 31 FR 8687, June 23, 1966; T.D. 6992, 34 FR 827, Jan. 18, 1969]

§ 1.809-6 Modifications.

Under section 809(e), the deductions allowed under section 809(d)(12) and paragraph (a)(12) of § 1.809-5 (relating to other deductions) are subject to the following modifications:

(a) *Interest.* No deduction shall be allowed under section 163 for interest in respect of items described in section 810(c) since such interest is taken into account in the determination of required interest under section 809.

(b) *Bad debts.* No deduction shall be allowed for an addition to reserves for bad debts under section 166(c). However, a deduction for specific bad debts shall be allowed to the extent that such deduction is allowed under section 166 and the regulations thereunder. In the case of a loss incurred on the sale of mortgaged or pledged property, see § 1.166-6 of this chapter.

(c) *Charitable, etc., contributions and gifts.* (1) The deduction by a life insurance company in any taxable year for a charitable contribution (as defined in section 170(c)) shall be limited to 5 percent of the gain from operations (as determined under section 809(b)(1)), computed without regard to any deductions for:

(i) Charitable contributions under section 170;

(ii) Dividends to policyholders under section 811(b);

(iii) Certain nonparticipating contracts under section 809(d)(5);

(iv) Group life insurance contracts and group accident and health insurance contracts under section 809(d)(6);

(v) Tax-exempt interest, dividends, etc., under section 809(d)(8); and

(vi) Any operations loss carryback to the taxable year under section 812.

(2) In applying the first sentence of section 170(b)(2) as contained in section 170 or, in the case of taxable years beginning after December 31, 1969, section 170(d)(2)(B) as contained in section

170A, any excess of the charitable contributions made by a life insurance company in a taxable year over the amount deductible in such year under the limitation contained in subparagraph (1) of this paragraph, shall be reduced to the extent that such excess:

(i) Reduces life insurance company taxable income (computed without regard to section 802(b)(3)) for the purpose of determining the offsets referred to in section 812(b)(2); and

(ii) Increases an operations loss carryover under section 812 for a succeeding taxable year.

(3) The application of the rules provided in section 809(e)(3) and this paragraph may be illustrated by the following example:

Example. Assume that life insurance company P is organized on January 1, 1958, and has a loss from operations for that year in the amount of \$100,000 which is an operations loss carryover to 1959. In 1959, company P has a gain from operations and tax base (computed without regard to section 802(b)(3)) of \$100,000 before the allowance of a deduction for a \$5,000 charitable contribution made in 1959 and before the application of the operations loss carryover from 1958. Under section 170(b)(2), the operations loss carryover from 1958 is first applied to eliminate the \$100,000 gain from operations and tax base in 1959 and the \$5,000 charitable contribution carryover would (except for the limitation contained in this paragraph) become a charitable contribution carryover to 1960. However, for the purpose of computing the offsets referred to in section 812(b)(2), the \$5,000 charitable contribution is applied to reduce the gain from operations and tax base for 1959 to \$95,000 before the application of the operations carryover from 1958. Since only \$95,000 of the \$100,000 loss from operations in 1958 is an offset for 1959, the remaining \$5,000 becomes an operations loss carryover to 1960. Accordingly, under the limitation contained in this paragraph, the charitable contributions carryover provided under the second sentence of section 170(b)(2) is eliminated.

(d) *Amortizable bond premium.* No deduction shall be allowed under section 171 for the amortization of bond premiums since a special deduction for such premiums is specifically taken into account under section 818(b).

(e) *Net operating loss deduction.* No deduction shall be allowed under section 172 since section 812 allows an "operations loss deduction".

(f) *Partially tax-exempt interest.* No deduction shall be allowed under section