dividends to its shareholders $8,000 during the year 1958. The balance in S's shareholders surplus account as of January 1, 1959, shall be $2,000. If S had distributed $12,000 as dividends in 1958, the balance in its shareholders surplus account as of January 1, 1959, would be zero and the other accounts referred to in section 815(a)(3) and paragraph (b)(1)(iii) of § 1.815–2 would be reduced by $2,000.

(d) *Illustration of principles.* The application of section 815(b) and this section may be illustrated by the following example:

Example. The books of S, a stock life insurance company, reflect the following items for the taxable year 1960.

Balance in shareholders surplus account as of 1–1–60	$5,000
Life insurance company taxable income computed without regard to sec. 802(b)(3)	4,000
Excess of net long-term capital gain over net short-term capital loss	1,700
Tax-exempt interest included in gross investment income under sec. 804(b)	100
Small business deduction (determined under sec. 809(d)(10))	200
Tax liability under sec. 802(a) (1) and (2) computed without regard to sec. 802(b)(3)	1,625
Amount distributed to shareholders	9,000

For purposes of determining the amount to be subtracted from its shareholders surplus account for the taxable year, S would first make up the following schedule in order to determine the cumulative balance in the shareholders surplus account at the end of the taxable year, computed without diminution by reason of distributions made during the taxable year:

(1) Balance in shareholders surplus account as of 1–1–60		$5,000
(2) Additions to account:		
(a) Life insurance company taxable income computed without regard to sec. 802(b)(3)	$4,000	
(b) Excess of net long-term capital gain over net short-term capital loss	1,700	
(c) Tax-exempt interest included in gross investment income under sec. 804(b)	100	
(d) Small business deduction (determined under sec. 809(d)(10))	200	
Total	6,000	
Less:		
Tax liability under sec. 802(a) (1) and (2) computed without regard to sec. 802(b)(3)	1,625	
		4,375
(3) Cumulative balance in shareholders surplus account as of 12–31–60 (item (1) plus item (2))		9,375

Since the amount distributed to shareholders during the taxable year, $9,000, does not exceed the cumulative balance in the shareholders surplus account at the end of the taxable year, computed without diminution by reason of distributions made during the taxable year, $9,375, under the provisions of section 815(a), the entire distribution shall be treated as being made out of the shareholders surplus account. Thus, $9,000 shall be subtracted from the shareholders surplus account (leaving a balance of $375 in such account at the end of the taxable year) and S shall incur no additional tax liability by reason of the distribution to its shareholders during the taxable year 1960.

[T.D. 6535, 26 FR 542, Jan. 20, 1961, as amended by T.D. 7189, 37 FR 12793, June 29, 1972]

§ 1.815–4 Policyholders surplus account.

(a) *In general.* Every stock life insurance company subject to the tax imposed by section 802 shall establish and maintain a policyholders surplus account. This account shall be established as of January 1, 1959, and the beginning or opening balance of the policyholders surplus account on that date shall be zero.

(b) *Additions to policyholders surplus account.* The amount added to the policyholders surplus account for any taxable year beginning after December 31, 1958, shall be the sum of:

(1) An amount equal to 50 percent of the amount by which the gain from operations for the taxable year exceeds the taxable investment income,

(2) The deduction allowed or allowable under section 809(d)(5) (as limited by section 809(f)) for certain nonparticipating contracts, and

(3) The deduction allowed or allowable under section 809(d)(6) (as limited by section 809(f)) for taxable years beginning before January 1, 1963, for group life and group accident and health insurance contracts, and for taxable years beginning after December 31, 1962, for accident and health insurance and group life insurance contracts.

(c) *Subtractions from policyholders surplus account*—(1) *In general.* There shall be subtracted from the cumulative balance in the policyholders surplus account at the end of any taxable year, computed without diminution by reason of distributions made during the taxable year, an amount equal to the sum of:

(i) The amount which (without regard to subdivision (ii) of this subparagraph) is treated under section 815(a) as distributed out of the policyholders surplus account for the taxable year, plus

(ii) The amount (determined without regard to section 802(a)(3)) by which the tax imposed for taxable years beginning before January 1, 1962, by section 802(a)(1), and for taxable years beginning after December 31, 1961, by section 802(a), is increased by reason of section 802(b)(3).

In addition, there shall be subtracted from the policyholders surplus account for the taxable year those amounts which, at the close of the taxable year, are subtracted or treated as subtracted from the policyholders surplus account under section 815(d) (1) and (4) and paragraphs (a) and (d) of §1.815–6. For purposes of this paragraph, the subtractions from the policyholders surplus account shall be treated as made in the following order:

(a) First the amount determined under section 815(c)(3) by reason of distributions to shareholders during the taxable year which are treated as being made out of the policyholders surplus account;

(b) Next the amount elected to be subtracted from the policyholders surplus account for the taxable year under section 815(d)(1);

(c) Then the amount which is treated as a subtraction from the policyholders surplus account for the taxable year by reason of the limitation provided in section 815(d)(4); and

(d) Finally the amount taken into account upon termination as a life insurance company as provided in section 815(d)(2).

(2) *Method of computing amount subtracted from policyholders surplus account*—(i) *Where life insurance company taxable income, computed without regard to section 802(b)(3), exceeds $25,000.* If the life insurance company taxable income for any taxable year computed under section 802(b), computed without regard to section 802(b)(3), exceeds $25,000, the amount subtracted from the policyholders surplus account shall be determined by multiplying the amount treated as distributed out of such account by a ratio, the numerator of which is 100 percent and the denominator of which is 100 percent minus the sum of the normal tax rate and the surtax rate for the taxable year.

(ii) *Where life insurance company taxable income does not exceed $25,000.* If the life insurance company taxable income for any taxable year, computed under section 802(b), does not exceed $25,000, the amount subtracted from the policyholders surplus account shall be determined by multiplying the amount treated as distributed out of such account by a ratio, the numerator of which is 100 percent and the denominator of which is 100 percent minus the normal tax rate for the taxable year.

(iii) *Where life insurance company taxable income, computed without regard to section 802(b)(3) does not exceed $25,000, but computed with regard to section 802(b)(3) does exceed $25,000.* If the life insurance company taxable income for any taxable year, computed without regard to section 802(b)(3) does not exceed $25,000, but computed with regard to section 802(b)(3) does exceed $25,000, the amount subtracted from the policyholders surplus account shall be determined in the following manner:

(a) First, determine the amount by which $25,000 exceeds the amount determined under section 802(b) (1) and (2);

(b) Then, multiply the amount determined under *(a)* by a ratio, the numerator of which is 100 percent minus the normal tax rate and the denominator of which is 100 percent;

(c) Next, determine the amount by which the amount treated as distributed out of the policyholders surplus account exceeds the amount determined under *(b)* and multiply such excess by a ratio, the numerator of which is 100 percent and the denominator of which is 100 percent minus the sum of the normal tax rate and the surtax rate; and

(d) Finally, add the amounts determined under *(a)* and *(c)*.

(3) *Illustration of principles.* The application of section 815(c)(3) and subparagraph (2) of this paragraph may be illustrated by the following examples:

Example 1. The life insurance company taxable income of S, a stock life insurance company, computed without regard to section 802(b)(3), exceeds $25,000 for the taxable year 1959. Assume that of the amount distributed by S to its shareholders during the taxable year, $9,600 (as determined under section 815(a) and without regard to section 815(c)(3)(B)) is treated as distributed out of the policyholders surplus account. Since the sum of the normal tax rate (30%) and the surtax rate (22%) in effect for 1959 is 52 percent. S shall subtract $20,000 from its policyholders surplus account for the taxable year 1959, computed as follows:

$9,600×100/(100−52)=$9,600×100/48=$20,000

Of this amount, $9,600 is due to the application of section 815(c)(3)(A) and $10,400 to the application of section 815(c)(3)(B).

Example 2. Assume that for the taxable year 1960, S, a stock life insurance company, has taxable investment income of $1,000 and a gain from operations of $2,000. Assume further that of the amount distributed by S to its shareholders during the taxable year, $3,500 (as determined under section 815(a) and without regard to section 815(c)(3)(B)) is treated as distributed out of the policyholders surplus account. Since S's life insurance company taxable income does not exceed $25,000 for the taxable year and the normal tax rate in effect for 1960 is 30 percent, S shall subtract $5,000 from its policyholders surplus account for the taxable year 1960, computed as follows:

$3,500×100/(100−30)=$3,500×100/70=$5,000

Of this amount, $3,500 is due to the application of section 815(c)(3)(A), and $1,500 to the application of section 815(c)(3)(B).

Example 3. For the taxable year 1960, the life insurance company taxable income of S, a stock life insurance company, computed without regard to section 802(b)(3), is $10,000. Assume that of the amount distributed by S to its shareholders during the taxable year, $12,000 (as determined under section 815(a) and without regard to section 815(c)(3)(B)) is treated as distributed out of the policyholders surplus account. Since the life insurance company taxable income of S, computed with regard to section 802(b)(3), exceeds $25,000, in order to determine the amount to be subtracted from its policyholders surplus account, S would make up the following schedule:

(1) $25,000 minus life insurance company taxable income, computed without regard to sec. 802(b)(3) ($25,000 minus $10,000	$15,000
(2) Item (1) multiplied by 100 percent minus the normal tax rate as in effect for 1960, over 100 percent ($15,000×(100−30)÷100)	10,500
(3) Amount by which the amount treated as distributed out of policyholders surplus account ($12,000) exceeds item (2) ($10,500), multiplied by 100 percent over 100 percent minus the sum of the normal tax rate and the surtax rate as in effect for 1960 ($1,500×100÷(100−52))	3,125
(4) Item (1) plus item (3) ($15,000 plus $3,125)	18,125

For the taxable year 1960, S shall subtract $18,125 from its policyholders surplus account. Of this amount, $10,500 represents the distribution from the policyholders surplus account which is taxed at a 30 percent tax rate and $1,500 the distribution from the policyholders surplus account which is taxed at a 52 percent tax rate. Thus, of the amount subtracted from the policyholders surplus account for the taxable year 1960, $12,000 is due to the application of section 815(c)(3) (A), and $6,125 to the application of section 815(c)(3)(B).

(d) *Illustration of principles.* The application of section 815(c) and this section may be illustrated by the following example:

Example. The books of S, a stock life insurance company, reflect the following items for the taxable year 1960:

Taxable investment income	$25,000
Gain from operations	30,000
Tax base (sec. 802(b)(1) and (2))	27,500
Deduction for certain nonparticipating policies provided by sec. 809(d)(5) (as limited by sec. 809(f))	600
Deduction for group policies provided by sec. 809(d)(6) (as limited by sec. 809(f))	400
Amount distributed to shareholders	60,000
Cumulative balance in shareholders surplus account as of 12–31–60	36,000
Balance in policyholders surplus account as of 1–1–60	48,000

For purposes of determining the amount to be subtracted from its policyholders surplus account for the taxable year, S would first make up the following schedule in order to determine the cumulative balance in the policyholders surplus account at the end of the taxable year, computed without diminution by reason of distributions made during the taxable year:

(1) Balance in policyholders surplus account as of 1–1–60		$48,000
(2) Additions to account:		
(a) 50 percent of the amount by which the gain from operations ($30,000) exceeds the taxable investment income ($25,000) (1/2 ×$5,000)	$2,500	
(b) The deduction for certain nonparticipating contracts provided by sec. 809(d)(5) (as limited by sec. 809(f))	600	
(c) The deduction for group contracts provided by sec. 809(d)(6) (as limited by sec. 809(f))	400	

	3,500
(3) Cumulative balance in policyholders account as of 12–31–60 (item (1) plus item (2))	51,500

Under the provisions of section 815(a), since the amount distributed to shareholders during the taxable year, $60,000, exceeds the cumulative balance in the shareholders surplus at the end of the taxable year, computed without diminution by reason of distributions during the taxable year, $36,000, the shareholders surplus account shall first be reduced to zero. The remaining $24,000 ($60,000 minus $36,000) of the distribution shall then be treated as made out of the policyholders surplus account. Thus, since the tax base under section 802(b)(1) and (2) is in excess of $25,000, the total amount to be subtracted from the policyholders surplus account at the end of the taxable year would be $50,000 ($24,000×100÷(100−52)). Of this amount $26,000 ($50,000 minus $24,000) represents the tax on the portion of the distribution to shareholders which is treated as being out of the policyholders surplus account.

(e) *Special rule for 1959 and 1960.* For a special transitional rule applicable to any increase in tax liability under section 802(b)(3) for the taxable years 1959 and 1960 which is due solely to the operation of section 815(c)(3) and this section, see section 802(a)(3) and § 1.802–5.

[T.D. 6535, 26 FR 543, Jan. 20, 1961, as amended by T.D. 6886, 31 FR 8689, June 23, 1966]

§ 1.815–5 Other accounts defined.

The term *other accounts*, as used in section 815(a)(3) and paragraph (b) of § 1.815–2, means all amounts which are not specifically included in the shareholders surplus account under section 815(b) and paragraph (b) of § 1.815–3, or in the policyholders surplus account under section 815(c) and paragraph (b) of § 1.815–4. Thus, for example, other accounts includes amounts representing the increase in tax due to the operation of section 802(b)(3) which is not taken into account for the taxable years 1959 and 1960 because of the special transitional rule provided in section 802(a)(3) and § 1.802–5, earnings and profits accumulated prior to January 1, 1958, paid-in surplus, capital, etc. To the extent that a distribution (or any portion thereof) is treated as being made out of other accounts, no tax is imposed on the company with respect to such distribution.

[T.D. 6535, 26 FR 544, Jan. 20, 1961]

§ 1.815–6 Special rules.

(a) *Election to transfer amounts from policyholders surplus account to shareholders surplus account*—(1) *In general.* Section 815(d)(1) permits a life insurance company to elect, after the close of any taxable year for which it is a life insurance company, to subtract any amount (or any portion thereof) in its policyholders surplus account as of the close of the taxable year. The effect of such election is to subject the company to tax on the amounts elected to be subtracted for the taxable year for which the election applies. The amount so subtracted, less the amount of tax imposed with respect to such amount by reason of section 802(b)(3), shall be added to the shareholders surplus account as of the beginning of the taxable year following the taxable year for which the election applies and no further tax shall be imposed upon the company if the amount elected to be transferred to the shareholders surplus account is subsequently distributed to shareholders.

(2) *Manner and effect of election.* (i) The election provided by section 815(d)(1) and this section shall be made in a statement attached to the life insurance company's income tax return for any taxable year for which the company desires the election to apply. The statement shall include the name and address of the taxpayer, shall be signed by the taxpayer (or his duly authorized representative), and shall be filed not later than the date prescribed by law (including extensions thereof) for filing the return for such taxable year. In addition, the statement shall indicate that the company has made the election provided under section 815(d)(1) for the taxable year and the amount elected to be subtracted from the policyholders surplus account.

(ii) An election made under section 815(d)(1)(B) and subdivision (i) of this subparagraph shall be effective only with respect to the taxable year for which the election is made. Thus, the company must make a new election for each taxable year for which it desires the election to apply. Once such an election has been made for any taxable year it may not be revoked.