

exempt interest, is \$100,000. Under section 821(a)(1), without application of section 821(c), the normal tax would be 30 percent of \$30,000, or \$9,000, since this is less than \$16,200, 60 percent of \$27,000 (excess of \$30,000 over \$3,000); and the surtax would be 22 percent of \$10,000 (excess of \$35,000 over \$25,000), or \$2,200. The combined tax of \$11,200 (\$9,000 plus \$2,200) would then be reduced by applying section 821(c), since the gross receipts are between \$75,000 and \$125,000. The tax under section 821(a)(1), as thus adjusted, would be 90 percent of \$11,200, or \$10,080, since \$45,000 (excess of \$120,000 over \$75,000) is 90 percent of \$50,000. Under section 821(a)(2), without reference to section 821(c), the tax is 2 percent of \$25,000 (excess of \$100,000 over \$75,000), or \$500, since this is less than \$1,000, 1 percent of \$100,000. Applying section 821(c) reduces this to \$450, or 90 percent of \$500. Since \$10,080, the tax under section 821(a)(1), as adjusted, exceeds \$450, the tax under section 821(a)(2), as adjusted, the tax under section 821(a)(1), as adjusted, is applicable. The Y Company would accordingly pay a combined normal tax and surtax of \$10,080.

Example 5. The Z Exchange, an inter-insurer, for the calendar year 1958 has mutual insurance company taxable income for purposes of the surtax of \$60,000 and, due to partially tax-exempt interest of \$12,000, has income for purposes of the normal tax of \$48,000. 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 \$2,700,000. The Z Exchange is not liable for normal tax under section 821(b)(1) for the calendar year 1958 as its mutual insurance company taxable income for purposes of the normal tax does not exceed \$50,000. Its surtax is 33 percent of \$10,000 (\$60,000 minus \$50,000), or \$3,300, since that amount is less than \$7,700, 22 percent of \$35,000 (excess of \$60,000 over \$25,000). Since the Z Exchange has no normal tax, is not subject to the tax imposed by section 821(a)(2), and is not entitled to the adjustment provided in section 821(c), its total tax under section 821(b) is \$3,300.

[T.D. 6610, 27 FR 8718, Aug. 31, 1962]

§ 1.821-4 Tax on mutual insurance companies other than life insurance companies and other than fire, flood, or marine insurance companies, subject to tax imposed by section 831.

(a) *In general*—(1) *Tax imposed.* (i) For taxable years beginning after December 31, 1962, all mutual insurance companies, including foreign insurance companies carrying on an insurance business within the United States, not taxable under section 802 or 831, and

not specifically exempt under the provisions of section 501(c)(15), are subject either to the tax imposed by section 821(a) on mutual insurance company taxable income or, in the case of certain small companies, to the tax imposed by section 821(c) on taxable investment income. The determination of whether a mutual insurance company is taxable under section 821 (a) or (c) for the taxable year is dependent upon the gross amount received by the company during such taxable year from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments). If such gross amount received exceeds \$150,000, but does not exceed \$500,000 for the taxable year, the company is subject to the tax imposed by section 821(c) on taxable investment income, unless (a) the company elects under section 821(d) in the manner provided in paragraph (f) of this section to be subject to the tax imposed by section 821(a), or (b) there is a balance in its protection against loss account at the beginning of the taxable year. A company having a gross amount received in excess of \$500,000 is subject to the tax imposed by section 821(a). For exemption from income tax of companies having a gross amount received not in excess of \$150,000, see section 501(c)(15). For the alternative tax, in lieu of the tax imposed by section 821 (a) or (c), where the net long-term capital gain for any taxable year exceeds the net short-term capital loss, see section 1201(a) and the regulations thereunder. For the definition of an insurance company, see paragraph (a) of § 1.801-3.

(ii) The term “premiums” as used in section 821 and this section has the same meaning as in section 501(c)(15) and § 1.501(c)(15)-1, and means the total amount of the premiums and other consideration provided in the insurance contract without any deduction for commissions, return premiums, reinsurance, dividends to policyholders, dividends left on deposit with the company, discounts on premiums paid in advance, interest applied in reduction of premiums (whether or not required

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), but does not include amounts received from other insurance companies for losses paid under reinsurance contracts.

(2) *Tax base.* The taxable income of mutual insurance companies taxable under section 821 differs from the taxable income of other corporations. See sections 821(b) and 822. Mutual insurance companies have special items of income and special deductions not provided for other corporations. See, for example, sections 821(b)(1)(C), 822(d), 823(b), 824(a), and 825(a). Thus, the computation of mutual insurance company taxable income for a company taxable under section 821(a), and the computation of taxable investment income for a company taxable under section 821(c), must be made in strict accordance with the provisions of part II of subchapter L of the Code.

(3) *Applicability of other provisions.* All provisions of the Code and of the regulations in this part not inconsistent with the specific provisions of part II of subchapter L of the Code are applicable to the assessment and collection of the tax imposed by section 821 (a) or (c), and mutual insurance companies subject to the tax imposed by section 821 are subject to the same penalties as are provided in the case of returns and payment of income tax by other corporations. The return shall be on Form 1120M.

(4) *Certain foreign companies.* Foreign mutual insurance companies (other than a life insurance company and other than a fire, flood, or marine insurance company subject to the tax imposed by section 831) not carrying on an insurance business within the United States are not taxable under section 821 (a) or (c), but are taxable as other foreign corporations. See section 881.

(b) *Rates of tax imposed by section 821(a)*—(1) *Normal tax.* For taxable years beginning before January 1, 1964, the normal tax imposed under section 821(a) is the lesser of 30 percent of mutual insurance company taxable income, or 60 percent of the amount by which mutual insurance company taxable income exceeds \$6,000. In the case of taxable years beginning after December 31, 1963, the normal tax is imposed at the rate of 22 percent of mutual insurance company taxable income, or 44 percent of the amount by which mutual insurance company taxable income exceeds \$6,000, whichever is the lesser. For example, a company subject to tax under section 821(a) will file a return but will pay no normal tax if mutual insurance company taxable income does not exceed \$6,000. When mutual insurance company taxable income exceeds \$6,000 but does not exceed \$12,000, the company will pay a normal tax equal to 44 percent (60 percent in the case of taxable years beginning before Jan. 1, 1964), of the amount by which mutual insurance company taxable income exceeds \$6,000. When mutual insurance company taxable income exceeds \$12,000, the company will pay normal tax at the rate of 22 percent (30 percent in the case of taxable years beginning before Jan. 1, 1964), of such income.

(2) *Surtax*—(i) *Taxable years beginning before January 1, 1964.* For taxable years beginning before January 1, 1964, companies taxable under section 821(a) are subject to a surtax equal to 22 percent of so much of their mutual insurance company taxable income (computed without regard to the deduction provided in section 242 for partially tax-exempt interest) as exceeds \$25,000. In the case of an interinsurer or reciprocal underwriter electing to be subject to the limitation provided in section 826(b), the surtax applies to any increase in mutual insurance company taxable income attributable to such election, without regard to the \$25,000 surtax exemption otherwise provided by this subparagraph, and without regard to whether the company is liable for any normal tax under subparagraph (1) of this paragraph. See section 826(f) and § 1.826-2.

(ii) *Taxable years beginning after December 31, 1963.* For taxable years beginning after December 31, 1963, companies taxable under section 821(a) are subject to a surtax at the rates and with the exemptions provided in section 11(c) on their mutual insurance company taxable income. In the case of an inter-insurer or reciprocal underwriter electing to be subject to the limitation provided in section 826(b), the surtax applies to any increase in mutual insurance company taxable income attributable to such election, without regard to the surtax exemption otherwise provided by section 11(d), and without regard to whether the company is liable for any normal tax under section 821(a)(1) and subparagraph (1) of this paragraph. See section 826(f) and § 1.826-2.

(c) *Mutual insurance company taxable income defined.* The tax imposed by section 821(a) with respect to any taxable year is computed upon mutual insurance company taxable income for the taxable year. Section 821(b) provides that in the case of a mutual insurance company subject to the tax imposed by section 821(a), mutual insurance company taxable income means the amount by which:

(1) The sum of:

(i) The taxable investment income (as defined in section 822(a)(1) and paragraph (a)(1) of § 1.822-8).

(ii) The statutory underwriting income (as defined in section 823(a)(1) and paragraph (b)(1) of § 1.823-6), and

(iii) The amounts required by section 824(d) and paragraph (b)(3) of § 1.824-1 to be subtracted from the protection against loss account, exceeds.

(2) The sum of:

(i) The investment loss (as defined in section 822(a)(2) and paragraph (a)(2) of § 1.822-8),

(ii) The statutory underwriting loss (as defined in section 823(a)(2) and paragraph (b)(2) of § 1.823-6), and

(iii) The unused loss deduction provided by section 825(a) and paragraph (a) of § 1.825-1.

If for any taxable year the amount determined under subparagraph (2) of this paragraph equals or exceeds the amount determined under subparagraph (1) of this paragraph, the mutual

insurance company taxable income for such year shall be zero.

(d) *Examples.* The application of the tax imposed by section 821(a) may be illustrated by the following examples:

Example 1. (a) M, a mutual casualty insurance company, for the calendar year 1963 has gross receipts from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) in excess of \$500,000, and therefore is subject to the tax imposed by section 821(a). M's taxable investment income, computed under section 822, is \$30,000 and its statutory underwriting income, computed under section 823, is \$15,000. M subtracts \$3,000 from its protection against loss account in accordance with the computation made under section 824(d). M has no unused loss deduction. M received no partially tax exempt interest. If M is not subject to section 826, its mutual insurance company taxable income for the taxable year 1963 is \$48,000, computed as follows:

(1) Taxable investment income	\$30,000
(2) Statutory underwriting income	15,000
(3) Subtractions from protection against loss account	3,000
(4) Total income items	48,000
(5) Investment loss	0
(6) Statutory underwriting loss	0
(7) Unused loss deduction	0
(8) Total loss items	0
(9) Mutual insurance company taxable income (item (4) minus item (8))	48,000

(b) Since M's mutual insurance company taxable income is in excess of \$12,000, M will pay normal tax on its mutual insurance company taxable income at a rate of 30 percent. In addition, since M's mutual insurance company taxable income exceeds \$25,000, M will pay surtax on such excess at a rate of 22 percent. M's total tax liability for the taxable year 1963 is \$19,460, computed as follows:

(1) Mutual insurance company taxable income as computed in item (a)(9)	\$48,000
(2) Normal tax; 30 percent of mutual insurance company taxable income	14,400
(3) Surtax exemption	25,000
(4) Mutual insurance company taxable income subject to the surtax (item (1) minus item (3))	23,000
(5) Surtax: 22 percent of mutual insurance company taxable income subject to the surtax	5,060
(6) Total tax (item (2) plus item (5))	19,460

Example 2. If in example 1, M's mutual insurance company taxable income for 1963 had been in excess of \$6,000 but not in excess of \$12,000, M would pay normal tax in an

amount equal to 60 percent of the amount by which such income exceeded \$6,000. Thus, if M had mutual insurance company taxable income of \$11,000, M's total tax liability for the taxable year 1963 would be \$3,000, computed as follows:

(1) Mutual insurance company taxable income	\$11,000
(2) Mutual insurance company taxable income in excess of \$6,000 (\$11,000 minus \$6,000)	5,000
(3) 30 percent of item (1)	3,800
(4) 60 percent of item (2)	3,000
(5) Normal tax (lesser of items (3) or (4))	3,000
(6) Surtax exemption	25,000

Since the surtax exemption exceeds the mutual insurance company taxable income for purposes of the surtax, there is no surtax liability. Since the normal tax under section 821(a) is the lesser of 30 percent of mutual insurance company taxable income or 60 percent of the amount by which such income exceeds \$6,000, M's normal tax (and total income tax liability) is \$3,000. If M's mutual insurance company taxable income was not in excess of \$6,000, M would be required to file a return, but would not be liable for any normal tax, since, in such a case, 60 percent of M's mutual insurance company taxable income in excess of \$6,000 would be zero.

Example 3. Assume the same income as in example 1 in the 1965 calendar year and that M is not a corporation to which section 1561 (with respect to certain controlled corporations) applies. Since M's mutual insurance company taxable income is in excess of \$12,000, M will pay normal tax on its mutual insurance company taxable income at a rate of 22 percent. In addition, since M's mutual insurance company taxable income exceeds the surtax exemption provided in section 11(d) of \$25,000, M will pay a surtax on such excess at the rate provided in section 11(c), 26 percent. M's total liability for the taxable year 1964 is \$16,540, computed as follows:

(1) Mutual insurance company taxable income as computed in example (1)	\$48,000
(2) Normal tax: 22 percent of mutual insurance company taxable income for normal tax purposes	10,560
(3) Surtax exemption provided by section 11(d)	25,000
(4) Mutual insurance company taxable income subject to the surtax (item (1) minus item (3))	23,000
(5) Surtax: at rates provided in section 11(c): 26 percent of mutual insurance company taxable income subject to the surtax	5,980
(6) Total tax (item (2) plus item (5))	16,540

(e) *Alternative tax for certain small mutual insurance companies—(1) In general.*
 (i) Section 821(c) provides an alternative tax for certain small mutual in-

urance companies. This alternative tax, which is in lieu of the tax imposed by section 821(a), is imposed on taxable investment income (as defined in section 822(a)(1) and paragraph (a)(1) of § 1.822-8) and consists of a normal tax and a surtax. The tax provided by section 821(c) is imposed on every mutual insurance company (other than a life insurance company and other than a fire, flood, or marine insurance company subject to the tax imposed by section 831) which 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) a gross amount in excess of \$150,000 but not in excess of \$500,000, except a company which has properly elected under section 821(d) and paragraph (f) of this section to be subject to the tax imposed by section 821(a), or a company which has a balance in its protection against loss account at the beginning of the taxable year.

(ii) Any company which would be taxable under section 821(c) but for the presence of an amount in its protection against loss account at the beginning of the taxable year may elect to subtract the balance from such account. See section 824(d)(5) and § 1.824-3. If such an election is made in such a case, the company shall not be subject to the tax imposed by section 821(a), but shall be subject to the tax imposed by section 821(c).

(2) *Rates of tax imposed by section 821(c)—(i) Normal tax.* The normal tax for taxable years beginning before January 1, 1964, is the lesser of 30 percent of taxable investment income or 60 percent of the amount by which taxable investment income exceeds \$3,000. For taxable years beginning after December 31, 1963, the normal tax is imposed at the rate of 22 percent of taxable investment income, or 44 percent of the amount by which taxable investment income exceeds \$3,000, whichever is the lesser. Thus, a company subject to tax under section 821(c) will file a return but will pay no tax if for the taxable year its taxable investment income does not exceed \$3,000; or will pay a

normal tax equal to 44 percent (60 percent in the case of taxable years beginning before Jan. 1, 1964), of taxable investment income in excess of \$3,000 when such income exceeds \$3,000 but does not exceed \$6,000. When taxable investment income exceeds \$6,000, the normal tax is imposed at the rate of 22 percent (30 percent in the case of taxable years beginning before Jan. 1, 1964) of such income.

(ii) *Surtax.* For taxable years beginning before January 1, 1964, a surtax is imposed at the rate of 22 percent of taxable investment income (computed without regard to the deduction provided in section 242 for partially tax-exempt interest) in excess of \$25,000. For taxable years beginning after December 31, 1963, a surtax is imposed at the rate provided in section 11(c) on taxable investment income in excess of the surtax exemption provided in section 11(d).

(f) *Election to be taxed under section 821(a)*—(1) *In general.* Section 821(d) provides that any mutual insurance company taxable under section 821(c) may elect, in the manner provided by subparagraph (3) of this paragraph, to be taxed under section 821(a).

(2) *Scope of election.* Except as otherwise provided herein, an election made under section 821(d) and this paragraph to be taxable under section 821(a) shall be binding for the taxable year for which made and for all succeeding taxable years unless the Commissioner consents to a revocation of such election. If for any taxable year the gross amount received from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) does not exceed \$150,000, a company's prior election made under section 821(d) to be taxable under section 821(a) will automatically terminate and any balance in the protection against loss account will be taken into account for the preceding taxable year. (See section 824(d)(4) and § 1.824-2 for automatic termination of protection against loss account if company is not subject to the tax imposed by section 821(a).) If for any taxable year thereafter the gross amount received exceeds \$150,000 but does not exceed \$500,000, the company shall be taxable under section

821(c) unless it makes a new election to be taxable under section 821(a). If a company subject to tax under section 821(c) for a taxable year elects under section 821(d) and this section to be taxed under section 821(a) and, in a subsequent taxable year, the gross receipts of such company exceed \$500,000, the election made for such earlier taxable year shall be considered as continuing in effect. Thus, such a company will continue to be taxable under section 821(a) notwithstanding that its gross receipts subsequently fall below \$500,000 (so long as they do not fall below \$150,000) unless the Commissioner consents to a revocation of the prior election. Whether revocation is permissible in any case will depend on the facts and circumstances of the particular case, but in no case will revocation be granted in the absence of a showing that the election creates an undue burden or material hardship on the company due to a substantial change in the character of its operations.

(3) *Time and manner of making election.* The election provided by section 821(d) shall be made in a statement attached to the company's income tax return for the first taxable year for which the election is to apply. The statement shall include the name and address of the taxpayer, shall be signed by the taxpayer (or its 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.

(g) *Examples.* The application of the tax imposed by section 821(c) may be illustrated by the following examples:

Example 1. M, a mutual casualty insurance company, for the calendar year 1963 has a gross amount received from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) of \$400,000. Since M's gross amount received exceeds \$150,000, but does not exceed \$500,000, M is subject to the tax imposed by section 821(c) on taxable investment income unless it elects to be subject to the tax imposed on mutual insurance company taxable income by section 821(a). M computes its taxable investment income under section 822 to be \$35,000. In computing taxable investment income, M deducted \$2,000 of partially tax-exempt interest under section 242. If M does

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not make an election to be taxed under section 821(a), its total tax liability for the taxable year 1963 is \$13,140 computed as follows:

(1) Taxable investment income as computed under section 822	\$35,000
(2) 30 percent of taxable investment income	10,500
(3) 60 percent of taxable investment income in excess of \$3,000	19,200
(4) Normal tax (lesser of items (2) or (3))	10,500
(5) Partially tax-exempt interest deducted in computing taxable investment income	2,000
(6) Taxable investment income for purposes of the surtax (item (1) plus item (5))	37,000
(7) Surtax exemption	25,000
(8) Taxable investment income subject to surtax (item (6) minus item (7))	12,000
(9) Surtax (22 percent of item (8))	2,640
(10) Total tax liability (item (4) plus item (9))	13,140

Example 2. N, a mutual casualty insurance company, for the taxable year 1963 has a gross amount received from the items described in section 822(b) (other than paragraph (1)(D) thereof) and premiums (including deposits and assessments) of \$210,000. Since N's gross amount received exceeds \$150,000 but does not exceed \$500,000, N is subject to the tax imposed by section 821(c) on taxable investment income unless it elects to be subject to the tax imposed by section 821(a). Furthermore, since the gross amount received by N does not exceed \$250,000, N is entitled to the special tax reduction provided by section 821(c)(2). N computes its taxable investment income under section 822 to be \$24,000. In computing taxable investment income, N deducted \$2,000 of partially tax-exempt interest under section 242. If N does not make an election to be taxed under section 821(a), its total tax liability for the taxable year 1963 is \$4,452 computed as follows:

(1) Taxable investment income as computed under section 822	\$24,000
(2) 30 percent of taxable investment income	7,200
(3) 60 percent of taxable investment income in excess of \$3,000	12,600
(4) Normal tax (lesser of items (2) or (3))	7,200
(5) Partially tax-exempt interest deducted in computing taxable investment income	2,000
(6) Taxable investment income for purposes of the surtax (item (1) plus item (5))	26,000
(7) Surtax exemption	25,000
(8) Taxable investment income subject to surtax (item (6) minus item (7))	1,000
(9) Surtax 22 percent of item (8)	220
(10) Tax liability computed without regard to special reduction (item (4) plus item (9))	7,420
(11) Amount by which gross receipts exceed \$150,000 (\$210,000 gross receipts minus \$150,000)	60,000
(12) Percentage which item (1) bears to \$100,000 (\$60,000 over \$100,000)	0.60
(13) Tax as adjusted (percentage determined in item (12) applied to item (10))	4,452

If N's taxable investment income for purposes of the surtax did not exceed \$3,000, N would file a return but would pay no tax. Had N elected (under section 821(d)) to be subject to tax under section 821(a), N would not be entitled to the special reduction af-

forded by section 821(c)(2), since that provision applies only to companies taxable under section 821(c).

[T.D. 6681, 28 FR 11110, Oct. 17, 1963, as amended by T.D. 7100, 36 FR 5333, Mar. 20, 1971; 36 FR 5846, Mar. 30, 1971]

§ 1.821-5 Special transitional underwriting loss.

(a) *In general.* Section 821(f) provides a special reduction in the statutory underwriting income (as defined by section 823(a)(1) and paragraph (b)(1) of § 1.823-6) of any company taxable under section 821(a) which was taxable under section 821 for the five taxable years immediately preceding January 1, 1962, and which incurred an underwriting loss (as defined in section 821(f)(3) and paragraph (c) of this section) for each of such five taxable years.

(b) *Amount of reduction.* In the case of a company described in section 821(f)(1) and paragraph (a) of this section the statutory underwriting income for the taxable year (determined without regard to this paragraph) shall be reduced by an amount equal to the amount by which:

(1) The sum of the underwriting losses of such company for the five taxable years immediately preceding January 1, 1962, exceeds

(2) The total amount by which the company's statutory underwriting income was reduced by reason of section 821(f) and this section for prior taxable years.

(c) *Underwriting loss defined.* For purposes of computing the amount of the reduction available under section 821(f) and paragraph (a) of this section, the term underwriting loss means statutory underwriting loss (as defined by section 823(a)(2) and paragraph (b)(2) of § 1.823-6) computed without any deduction under section 824(a) and paragraph (a) of § 1.824-1 (relating to deduction to provide protection against losses) and without any deduction under section 832(c)(11) (relating to dividends and similar distributions paid or declared to policyholders). For rules relating to the definition of dividends and similar distributions paid or declared to policyholders, see paragraph (a) of § 1.832-5.