

(2) *Safe harbor.* The requirements of paragraph (f)(1) of this section are deemed satisfied and the amount that the company reports as bona fide estimated salvage recoverable is not subject to adjustment by the district director, if—

(i) The company files with the insurance regulatory authority of the company's state of domicile, on or before September 16, 1991, a statement disclosing the extent to which losses incurred for each line of business reported on its 1989 annual statement were reduced by estimated salvage recoverable,

(ii) The company attaches a statement to its Federal income tax return filed for the first taxable year beginning after December 31, 1989, agreeing to apply the special rule for overestimates under section 11305(c)(4) of the 1990 Act to the amount of estimated salvage recoverable for which it has taken the special deduction, and

(iii) In the case of a company that is a member of a consolidated group, each insurance company subject to tax under section 831 that is included in the consolidated group complies with paragraph (f)(2)(ii) of this section with respect to its special deduction, if any.

(3) *Limitations on special deduction—*(i) The special deduction under section 11305(c)(3) of the 1990 Act is available only to an insurance company subject to tax under section 831.

(ii) An insurance company that claimed the benefit of the "fresh start" with respect to estimated salvage recoverable under section 1023(e) of the Tax Reform Act of 1986 may not claim the special deduction allowed by section 11305(c)(3) of the 1990 Act to the extent of the estimated salvage recoverable for which a fresh start benefit was previously claimed.

(iii) A company that claims the special deduction is precluded from also claiming the section 481 adjustment provided in paragraph (e)(2)(ii) of this section for pre-1990 accident years.

(g) *Effective date.* Paragraphs (b) through (f) of this section are effective

for taxable years beginning after December 31, 1989.

[T.D. 6681, 28 FR 11129, Oct. 17, 1963, as amended by T.D. 8171, 53 FR 118, Jan. 5, 1988; T.D. 8293, 55 FR 9425, Mar. 14, 1990. Redesignated and amended by T.D. 8390, 57 FR 3132, Jan. 28, 1992; 57 FR 6353, Feb. 24, 1992; T.D. 8857, 65 FR 706, Jan. 6, 2000]

§ 1.832-5 Deductions.

(a) The deductions allowable are specified in section 832(c) and by reason of the provisions of section 832(c)(10) and (12) include in addition certain deductions provided in sections 161, and 241 and following. The deductions, however, are subject to the limitation provided in section 265, relating to expenses and interest in respect of tax-exempt income. The net operating loss deduction is computed under section 172 and the regulations thereunder. For the purposes of section 172, relating to net operating loss deduction, "gross income" shall mean gross income as defined in section 832(b)(1) and the allowable deductions shall be those allowed by section 832(c) with the exceptions and limitations set forth in section 172(d). In addition to the deduction for capital losses provided in subchapter P (section 1201 and following), chapter 1 of the Code, insurance companies are allowed a deduction for losses from capital assets sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders. A special rule is provided for the application of the capital loss carryover provisions of section 1212. The deduction is the same as that allowed mutual insurance companies subject to the tax imposed by section 821; see section 822(c)(6) and the regulation thereunder. Insurance companies, other than mutual fire insurance companies described in section 831(a)(3)(A) and the regulations thereunder, are also allowed a deduction for dividends and similar distributions paid or declared to policyholders in their capacity as such. Similar distributions include such payments as the so-called unabsorbed premium deposits returned to policyholders by factory mutual insurance companies. The deduction is otherwise the same as

§ 1.832-6

that allowed mutual insurance companies subject to the tax imposed by section 821; see section 822(f)(2) and the regulations thereunder.

(b) Among the items which may not be deducted are income and profits taxes imposed by the United States, income and profits taxes imposed by any foreign country or possession of the United States (in cases where the company chooses to claim to any extent a credit for such taxes), taxes assessed against local benefits, decrease during the year due to adjustments in the book value of capital assets, decrease in liabilities during the year on account of reinsurance treaties, dividends paid to shareholders in their capacity as such, remittances to the home office of a foreign insurance company by the United States branch, and borrowed money repaid.

(c) In computing taxable income of insurance companies, losses sustained during the taxable year from the sale or other disposition of property are deductible subject to the limitation contained in section 1211. Insurance companies are entitled to the alternative taxes provided in section 1201.

[T.D. 6681, 28 FR 11130, Oct. 17, 1963, as amended by T.D. 6867, 30 FR 15094, Dec. 7, 1965]

§ 1.832-6 Policyholders of mutual fire or flood insurance companies operating on the basis of premium deposits.

For purposes of determining his taxable income for any taxable year, a taxpayer insured by a mutual fire or flood insurance company under a policy for which the premium deposit is the same regardless of the length of the term for which the policy is written, and who is entitled to have returned or credited to his on the cancellation or expiration of such policy the unabsorbed portion of the premium deposit not required for losses, expenses, or establishment of reserves, may, if such amount is otherwise deductible under this chapter, deduct so much of his premium deposit as was absorbed by the company during the taxpayer's taxable year. The amount of the premium deposit absorbed during the taxpayer's taxable year shall be determined in accordance with the schedule

of unabsorbed premium deposit returns in effect for the company during such taxable year. If the taxpayer is unable to determine the applicable rate of absorption in effect during his taxable year, he shall compute his deduction on the basis of the rate of absorption in effect at the end of the company's taxable year which next preceded the end of the taxpayer's taxable year. In such a case, an appropriate adjustment will be made upon the final determination of the rate of absorption applicable to the taxable year.

[T.D. 6681, 28 FR 11130, Oct. 17, 1963]

§ 1.832-7T Treatment of salvage and reinsurance in computing "losses incurred" deduction, taxable years beginning before January 1, 1990 (temporary).

(a) In computing "losses incurred" the determination of unpaid losses at the close of each year must represent actual unpaid losses as nearly as it is possible to ascertain them.

(b) Every insurance company to which this section applies must be prepared to establish to the satisfaction of the district director that the part of the deduction for "losses incurred" which represents unpaid losses at the close of the taxable year comprises only actual unpaid losses stated in amounts which, based upon the facts in each case and the company's experience with similar cases, can be said to represent a fair and reasonable estimate of the amount the company will be required to pay. Amounts included in, or added to, the estimates of such losses which in the opinion of the district director are in excess of the actual liability determined as provided in the preceding sentence will be disallowed as a deduction. The district director may require any such insurance company to submit such detailed information with respect to its actual experience as is deemed necessary to establish the reasonableness of the deduction for "losses incurred".

(c) That part of the deduction for "losses incurred" which represents an adjustment to losses paid for salvage and reinsurance recoverable shall, except as hereinafter provided, include all salvage in course of liquidation, and all reinsurance in process of collection