

amount of premiums and other consideration. L2 reduces its specified policy acquisition expenses for the 1993 taxable year by \$138,600.

(j) *Ceding commissions with respect to reinsurance of contracts other than specified insurance contracts.* A ceding commission incurred with respect to the reinsurance of an insurance contract that is not a specified insurance contract is not subject to the provisions of section 848(g).

(k) *Effective dates—(1) In general.* Unless otherwise specified in this paragraph, the rules of this section are effective for the taxable years of an insurance company beginning after November 14, 1991.

(2) *Reduction in the amount of net negative consideration to ensure consistency of capitalization for reinsurance agreements.* Section 1.848-2(g) (which provides for an adjustment to ensure consistency) is effective for—

(i) All amounts arising under any reinsurance agreement entered into after November 14, 1991; and

(ii) All amounts arising under any reinsurance agreement for taxable years beginning after December 31, 1991, without regard to the date on which the reinsurance agreement was entered into.

(3) *Net consideration rules.* Section 1.848-2(f) (which provides rules for determining the net consideration for a reinsurance agreement) applies to—

(i) Amounts arising in taxable years beginning after December 31, 1991, under a reinsurance agreement entered into after November 14, 1991; and

(ii) Amounts arising in taxable years beginning after December 31, 1994, under a reinsurance agreement entered into before November 15, 1991.

(4) *Determination of the date on which a reinsurance agreement is entered into.* A reinsurance agreement is considered entered into at the earlier of—

(i) The date of the reinsurance agreement; or

(ii) The date of a binding written agreement to enter into a reinsurance transaction if the written agreement evidences the parties' agreement on substantially all material items relating to the reinsurance transaction.

(5) *Special rule for certain reinsurance agreements with parties not subject to*

U.S. taxation. The election and special rules in paragraph (h) of this section relating to the determination of amounts required to be capitalized on reinsurance agreements with parties not subject to United States taxation apply to taxable years ending on or after September 30, 1990.

(6) *Carryover of excess negative capitalization amount.* The provisions of paragraph (i) of this section, including the special rule for the treatment of excess negative capitalization amounts of insolvent insurance companies, are affected with respect to amounts arising in taxable years ending on or after September 30, 1990.

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§ 1.848-3 Interim rules for certain reinsurance agreements.

(a) *Scope and effective dates.* The rules of this section apply in determining net premiums for a reinsurance agreement with respect to—

(1) Amounts arising in taxable years beginning before January 1, 1992, under a reinsurance agreement entered into after November 14, 1991; and

(2) Amounts arising in taxable years beginning before January 1, 1995, under a reinsurance agreement entered into before November 15, 1991.

(b) *Interim rules.* In determining a company's gross amount of premiums and other consideration under section 848(d)(1)(A) and premiums and other consideration incurred for reinsurance under section 848(d)(1)(B), the general rules of subchapter L of the Internal Revenue Code apply with the adjustments and special rules set forth in paragraph (c) of this section. Except as provided in paragraph (c)(5) of this section (which applies to modified coinsurance transactions), the gross amount of premiums and other consideration is determined without any reduction for ceding commissions, annual allowances, reimbursements of claims and benefits, or other amounts incurred by a reinsurer with respect to reinsured contracts.

(c) *Adjustment and special rules.* This paragraph sets forth certain adjustments and special rules that apply for reinsurance agreements in determining the gross amount of premiums and

other consideration under section 848(d)(1)(A) and premiums and other considerations incurred for reinsurance under section 848(d)(1)(B).

(1) *Assumption reinsurance.* The ceding company must treat the gross amount of consideration incurred with respect to an assumption reinsurance agreement as premiums and other consideration incurred for reinsurance under section 848(d)(1)(B). The reinsurance must include the same amount in the gross amount of premiums and other consideration under section 848(d)(1)(A). For rules relating to the determination and treatment of ceding commissions, see paragraph (c)(3) of this section.

(2) *Reimbursable dividends.* The reinsurer must treat the amount of policyholder dividends reimbursable to the ceding company (other than under a modified coinsurance agreement covered by paragraph (c)(5) of this section) as a return premium under section 848(d)(1)(B). The ceding company must include the same amount in the gross amount of premiums and other consideration under section 848(d)(1)(A). The amount of any experience-related refund due the ceding company is treated as a policyholder dividend reimbursable to the ceding company.

(3) *Ceding commissions—(i) In general.* The reinsurer must treat ceding commissions as a general deduction. The ceding company must treat ceding commissions as non-premium related income under section 803(a)(3). The ceding company may not reduce its general deductions by the amount of the ceding commission.

(ii) *Amount of ceding commission.* For purposes of this section, the amount of a ceding commission equals the excess, if any, of—

(A) The increase in the reinsurer's tax reserves resulting from the reinsurance agreement (computed in accordance with section 807(d)); over

(B) The gross consideration incurred by the ceding company for the reinsurance agreement, less any amount incurred by the reinsurer as part of the reinsurance agreement.

(4) *Termination payments.* The reinsurer must treat the gross amount of premiums and other consideration payable as a termination payment to the

ceding company (including the tax reserves on the reinsured contracts) as premiums and other consideration incurred for reinsurance under section 848(d)(1)(B). The ceding company must include the same amount in the gross amount of premiums and other consideration under section 848(d)(1)(A). This paragraph does not apply to modified coinsurance agreements.

(5) *Modified coinsurance agreements.* In the case of a modified coinsurance agreement, the parties must determine their net premiums on a net consideration basis as described in § 1.848-2(f)(5).

(D) *Examples.* The principles of this section are illustrated by the following examples.

Example 1. On July 1, 1991, an insurance company (L1) transfers a block of individual life insurance contracts to an unrelated insurance company (L2) under an arrangement whereby L2 becomes solely liable to the policyholder under the contracts reinsured. The tax reserves on the reinsured contracts are \$100,000. Under the assumption reinsurance agreement, L1 pays L2 \$83,000 for assuming the life insurance contracts. Under paragraph (c)(3) of this section, since the increase in L2's tax reserves (\$100,000) exceeds the net consideration transferred by L1 (\$83,000), the reinsurance agreement provides for a ceding commission. The ceding commission equals \$17,000 (\$100,000-\$83,000). Under paragraph (c)(3) of this section, L1 reduces its gross amount of premiums and other consideration for the 1991 taxable year under section 848(d)(1)(B) by the \$100,000 premium incurred for reinsurance, and L2 includes the \$100,000 premium for reinsurance in its gross amount of premiums and other consideration under section 848(d)(1)(A). L1 treats the \$17,000 ceding commission as non-premium related income and section 803 (a)(3).

Example 2. On July 1, 1991, a life insurance company (L1) transfers a block of individual life insurance contracts to an unrelated insurance company (L2) under an arrangement whereby L2 becomes solely liable to the policyholder under the contracts reinsured. The tax reserves on the reinsured contracts are \$100,000. Under the assumption reinsurance agreement, L1 pays L2 \$100,000 for assuming the contracts, and L2 pays L1 a \$17,000 ceding commission. Under paragraph (c)(1) of this section, L1 reduces its gross amount of premiums and other consideration under section 848(d)(1)(B) by \$100,000. L2 includes \$100,000 in its gross amount of premiums and other consideration under section 848(d)(1)(A). Under paragraph (c)(3) of this section, since the increase in L2's tax reserves (\$100,000) exceeds the net consideration transferred by L1, the reinsurance agreement provides for a ceding

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commission. The ceding commission equals \$17,000 (\$100,000 increase in L2's tax reserves less \$83,000 net consideration transferred by L1). L1 treats the \$17,000 ceding commission as non-premium related income under section 803(a)(3).

Example 3. On July 1, 1991, a life insurance company (L1) transfers a block of individual life insurance contracts to an unrelated insurance company (L2) under an arrangement whereby L2 becomes solely liable to the policyholder under the contracts reinsured. Under the assumption reinsurance agreement, L1 transfers assets of \$105,000 to L2. The tax reserves on the reinsured contracts are \$100,000. Under paragraph (c)(1) of this section, L1 reduces its gross amount of premiums and other consideration under section 848(d)(1)(B) by \$105,000, and L2 increases its gross amount of premiums and other consideration under section 848(d)(1)(A) by \$105,000. Since the net consideration transferred by L1 exceeds the increase in L2's tax reserves, there is no ceding commission under paragraph (c)(3) of this section.

Example 4. (i) On June 30, 1991, a life insurance company (L1) reinsures 40% of certain individual life insurance contracts to be issued after that date with an unrelated insurance company (L2) under an agreement whereby L1 remains directly liable to the policyholders with respect to the contracts reinsured. The agreement provides that L2 is credited with 40% of any premiums received with respect to the reinsured contracts, but must indemnify L1 for 40% of any claims, expenses, and policyholder dividends. During the period from July 1 through December 31, 1991, L1 has the following income and expense items with respect to the reinsured policies:

Item	Income	Expense
Premiums	\$8,000	.....
Benefits paid .....	.....	\$1,000
Commissions .....	.....	6,000
Policyholder dividends .....	.....	500
Total		7,500

(ii) Under paragraphs (b) and (c)(2) of this section, L1 includes \$8,200 in its gross amount of premiums and other consideration under section 848(d)(1)(A) (\$8,000 gross premiums on the reinsured contracts plus \$200 of policyholder dividends reimbursed by L2 (\$500×40%). L1 reduces its gross amount of premiums and other consideration by \$3,200 (40%×\$8,000) as premiums and other consideration incurred for reinsurance under section 848(d)(1)(B). The benefits and commissions incurred by L1 with respect to the reinsured

contracts do not reduce L1's gross amount of premiums and other consideration under section 848(d)(1)(B). L2 includes \$3,200 in its gross amount of premiums and other consideration (40%×\$8,000) and is treated as having paid return premiums of \$200 (the amount of reimbursable dividends paid to L1). L2 is also treated as having incurred the following expenses with respect to the reinsured contracts: \$400 as benefits paid (40%×\$1,000) and \$2,400 as commissions expense (40%×\$6,000). Under paragraph (b) of this section, these expenses do not reduce L2's gross amount of premiums and other consideration under section 848(d)(1)(A).

Example 5. On December 31, 1991, an insurance company (L1) terminates a reinsurance agreement with an unrelated insurance company (L2). The termination applies to a reinsurance agreement under which L1 had ceded 40% of its liability on a block of individual life insurance contracts to L2. Upon termination of the reinsurance agreement, L2 makes a final payment of \$116,000 to L1 for assuming full liability under the contracts. The tax reserves attributable to L2's portion of the reinsured contracts are \$120,000. Under paragraph (c)(4) of this section, L2 reduces its gross amount of premiums and other consideration under section 848(d)(1)(B) by \$120,000. L1 includes \$120,000 in its gross amount of premiums and other consideration under section 848(d)(1)(A).

Example 6. (i) On June 30, 1991, an insurance company (L1) reinsures 40% of its existing life insurance contracts with an unrelated life insurance company (L2) under a modified coinsurance agreement. For the period July 1, 1991 through December 31, 1991, L1 reports the following income and expense items with respect to L2's 40% share of the reinsured contracts:

Item	Income	Expense
Premiums	\$10,000	.....
Benefits paid .....	.....	\$4,000
Policyholder dividends .....	.....	500
Reserve adjustment .....	.....	1,500
Total		6,000

(ii) Pursuant to paragraph (c)(5) of this section, L1 reduces its gross amount of premiums and other consideration under section 848(d)(1)(B) by the \$4,000 net consideration for the modified coinsurance agreement (\$10,000-\$6,000). L2 includes the \$4,000 net consideration in its gross amount of premiums and other consideration under section 848(d)(1)(A).

[T.D. 8456, 57 FR 61829, Dec. 29, 1992]