

§ 1.806-1

attributable to any trade or business (other than an insurance business) carried on by the life insurance company, or by a partnership of which the life insurance company is a partner are, subject to the limitations in subdivisions (ii), (iii), and (iv) of this subparagraph, allowable as deductions from the gross investment income of a life insurance company in determining its investment yield. Such deductions are allowable, however, only to the extent that they are attributable to the production of income which is included in the life insurance company's gross investment income by reason of section 804(b)(3). However, since any interest, dividends, rents, and royalties received by any trade or business (other than an insurance business) carried on by the life insurance company, or by a partnership of which the life insurance company is a partner, is included in the life insurance company's gross investment income by reason of section 804(b)(1) and paragraph (b) of § 1.804-3, any expenses fairly chargeable against the production of such income may be deductible under section 804(c) (1), (2), (3), or (4). The allowable deductions may exceed the gross income from such business.

(ii) In computing the deductions under section 804(c)(5), there shall be excluded losses:

(a) From (or considered as from) sales or exchanges of capital assets,

(b) From sales or exchanges of property used in the trade or business (as defined in section 1231(b)), and

(c) From the compulsory or involuntary conversion (as a result of destruction, in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business (as so defined).

(iii) Any item, to the extent attributable to the carrying on of the insurance business, shall not be taken into account. For example, if a life insurance company operates a radio station primarily to advertise its own insurance services, a portion of the expenses of the radio station shall not be allowed as a deduction. The portion disallowed shall be an amount which bears the same ratio to the total expenses of the station as the value of advertising furnished to the insurance

26 CFR Ch. I (4-1-08 Edition)

company bears to the total value of services rendered by the station.

(iv) The deduction for net operating losses provided in section 172, and the special deductions for corporations provided in part VIII, subchapter B, chapter 1 of the Code, shall not be allowed.

[T.D. 6513, 25 FR 12662, Dec. 10, 1960]

§ 1.806-1 Adjustment for certain reserves.

(a) For taxable years beginning after December 31, 1953, but before January 1, 1955, and ending after August 16, 1954, a life insurance company writing contracts other than life insurance or annuity contracts (either separately or combined with noncancellable health and accident insurance contracts) must add to its life insurance company taxable income (as a factor in determining 1954 adjusted taxable income) an amount equal to eight times the amount of the adjustment for certain reserves provided in paragraph (b) of this section.

(b) The adjustment for certain reserves referred to in paragraph (a) of this section shall be an amount equal to 3 1/4 percent of the mean of the unearned premiums and unpaid losses at the beginning and end of the taxable year on such other contracts as are not included in life insurance reserves. If such unearned premiums, however, are less than 25 percent of the net premiums written during the taxable year on such other contracts, then the adjustment shall be 3 1/4 percent of 25 percent of the net premiums written during the taxable year on such other contracts plus 3 1/4 percent of the mean of the unpaid losses at the beginning and end of the taxable year on such other contracts. As used in this section, the term "unearned premiums" has the same meaning as in section 832(b)(4) and § 1.832-1.

§ 1.806-2 Taxable years affected.

Section 1.806-1 is applicable only to taxable years beginning after December 31, 1953, and before January 1, 1955, and all references to sections of part I, subchapter L, chapter 1 of the Code are to the Internal Revenue Code of 1954, before amendments. Sections 1.806-3

and 1.806-4 are applicable only to taxable years beginning after December 31, 1957, and all references to sections of part I, subchapter L, chapter 1 of the Code are to the Internal Revenue Code of 1954, as amended by the Life Insurance Company Income Tax Act of 1959 (73 Stat. 112).

[T.D. 6513, 25 FR 12668, Dec. 10, 1960]

§ 1.806-3 Certain changes in reserves and assets.

(a) *In general.* For purposes of part I, subchapter L, chapter 1 of the Code, section 806(a) provides that if there is a change in life insurance reserves (as defined in section 801(b)), during the taxable year, which is attributable to the transfer between the taxpayer and another person of liabilities under contracts taken into account in computing such life insurance reserves, then the means of such reserves, and the mean of the assets, shall be appropriately adjusted to reflect the amounts involved in such transfer. For example, the adjustments required under section 806(a) are applicable to transfers in which one life insurance company purchases or acquires a part or all of the business of another life insurance company under an arrangement whereby the purchaser or transferee becomes solely liable on the contracts transferred. This provision shall apply in the case of assumption reinsurance but not in the case of indemnity reinsurance or reinsurance ceded. Thus, no adjustments shall be required under section 806(a) when, in the ordinary course of business, an indemnity reinsurance contract is entered into with another company (on a yearly renewable term basis, on a coinsurance basis, or otherwise) whereby there is a sharing of risks under one or more individual contracts. It will be necessary for each life insurance company participating in a transfer described in section 806(a) to make the adjustments required by such section. Such adjustments shall be made without regard to whether or not the transferor of the liabilities was the original insurer.

(b) *Manner in which adjustments shall be made—(1) Daily basis.* The means of the life insurance reserves, and the mean of the assets, shall be appropriately adjusted, on a daily basis, to

reflect the amounts involved in a transfer described in section 806(a) and paragraph (a) of this section. The transferor and the transferee shall be treated as having held such life insurance reserves and assets for a fraction of the year in which the transfer occurs.

(2) *Determination of period held.* In determining the fraction which represents the fractional year that such reserves and assets were held, the numerator shall be the number of days during the taxable year which such reserves and assets were actually held, and the denominator shall be the number of days in the calendar year of the transfer. In computing the period held for purposes of the numerator, the day on which such reserves and assets are transferred is included by the transferor and excluded by the transferee.

(3) *Adjustments to the means of life insurance reserves and assets not transferred.* All life insurance reserves and assets transferred during the taxable year, within the meaning of section 806(a), shall be excluded from the beginning and end of the taxable year balances of the transferor and transferee, respectively. The amount of assets to be excluded from the beginning of the taxable year balance of the transferor shall be an amount equal to the value of such reserves at the beginning of the taxable year. The amount of assets to be excluded from the end of the taxable year balance of the transferee shall be an amount equal to the value of such reserves at the end of the taxable year. The means of the life insurance reserves and assets not so transferred shall be determined in the ordinary manner, that is, the arithmetic means. There shall be added to these means an amount to appropriately adjust them, on a daily basis, for the life insurance reserves and assets that were transferred during the taxable year. This adjustment shall be determined by multiplying (i) the mean of the transferred life insurance reserves (or assets, as the case may be) at the beginning of the taxable year (or, if acquired later, at the beginning of the period held as defined in subparagraph (2) of this paragraph) and the end of the period held as defined in subparagraph (2) of this paragraph (or

§ 1.806-3

26 CFR Ch. I (4-1-08 Edition)

at the end of the taxable year, if held at such time) by (ii) the fraction determined under subparagraph (2) of this paragraph.

(4) *Examples.* The application of this paragraph may be illustrated by the following examples:

Example 1. On March 14, 1958, the M Company, a life insurance company, transferred to the N Company, a life insurance company, pursuant to an assumption reinsurance agreement, all of its life insurance reserves, and related assets, on one block of policies. The reserves (and assets) for this block were held by the M Company on January 1, 1958, and totaled \$60,000; on March 14, the reserves (and assets) totaled \$64,000. The M Company had life insurance reserves of \$1,000,000 at the beginning of 1958 (including those subsequently transferred) and \$1,040,000 at the end of 1958. The M Company had assets of \$1,300,000 at the beginning of 1958 (including those subsequently transferred) and \$1,380,000 at the end of 1958. The mean of M's life insurance reserves for the taxable year 1958 is computed as follows:

| | | |
|---|-------------|--|
| Reserves at 1-1-58 | \$1,000,000 | |
| Exclude reserves (at beginning of year) on contracts transferred to N | 60,000 | |
| Recomputed amount at 1-1-58 | \$940,000 | |
| Reserves at 12-31-58 | 1,040,000 | |
| Sum | 1,980,000 | |
| Mean | 990,000 | |
| Adjustment for reserves transferred on 8-14-58: | | |
| Reserves at 1-1-58 on contracts transferred to N | \$60,000 | |
| Reserves at 3-14-58 on such contracts | 64,000 | |
| Sum | 124,000 | |
| Mean | 62,000 | |
| Fraction taken into account | 73/365 | |
| Adjustment (73/365×\$62,000) | \$12,400 | |
| Mean of M's life insurance reserves after section 806(a) adjustment | 1,002,400 | |

Example 2. Assuming the facts to be the same as in example 1, the mean of M's assets for the taxable year 1958 is computed as follows:

| | | |
|---|-------------|--|
| Assets at 1-1-58 | \$1,300,000 | |
| Exclude assets (at beginning of year) on contracts transferred to N | 60,000 | |
| Recomputed amount at 1-1-58 .. | \$1,240,000 | |
| Assets at 12-31-58 | 1,380,000 | |
| Sum | 2,620,000 | |
| Mean | 1,310,000 | |

| | | |
|--|-----------|--|
| Adjustments for assets transferred on 3-14-58: | | |
| Assets at 1-1-58 on contracts transferred to N | \$60,000 | |
| Assets at 3-14-58 on such contracts | 64,000 | |
| Sum | 124,000 | |
| Mean | 62,000 | |
| Fraction taken into account | 73/365 | |
| Adjustment (73/365×\$62,000) - .. | \$12,400 | |
| Mean of M's assets after section 806(a) adjustment | 1,322,400 | |

Example 3. Assume the facts are the same as in example 1. At the end of 1958, N Company had life insurance reserves (and assets) of \$80,000 on the contracts transferred on March 14, 1958. The N Company had life insurance reserves of \$6,000,000 at the beginning of 1958 and \$6,400,000 at the end of 1958 (including those transferred). The N Company had assets of \$6,800,000 at the beginning of 1958 and \$7,300,000 at the end of 1958 (including those on the contracts transferred). The mean of N's life insurance reserves for the taxable year 1958 is computed as follows:

| | | |
|---|-------------|--|
| Reserves at 1-1-58 | \$6,000,000 | |
| Reserves at 12-31-58 | \$6,400,000 | |
| Exclude reserves (at end of year) on contracts transferred from M | 80,000 | |
| Recomputed amount at 12-31-58 | 6,320,000 | |
| Sum | 12,320,000 | |
| Mean | 6,160,000 | |
| Adjustment for reserves transferred on 3-14-58: | | |
| Reserves at 3-14-58 on contracts transferred from M | \$64,000 | |
| Reserves at 12-31-58 on such contracts | 80,000 | |
| Sum | 144,000 | |
| Mean | 72,000 | |
| Fraction taken into account | 292/365 | |
| Adjustment (292/365×\$72,000) | 57,600 | |
| Mean of N's life insurance reserves after section 806(a) adjustment | 6,217,600 | |

Example 4. Assuming the facts to be the same as in example 3, the mean of N's assets for the taxable year 1958 is computed as follows:

| | | |
|---|-------------|--|
| Assets at 1-1-58 | \$6,800,000 | |
| Assets at 12-31-58 | \$7,300,000 | |
| Exclude assets (at end of year) on contracts transferred from M | 80,000 | |
| Recomputed amount at 12-31-58 | 7,220,000 | |
| Sum | 14,020,000 | |
| Mean | 7,010,000 | |

| | | |
|--|----------|-----------|
| Adjustments for assets transferred on 3-14-58: | | |
| Assets at 3-14-58 on contracts transferred from M | \$64,000 | |
| Assets at 12-31-58 on such contracts | 80,000 | |
| Sum | 144,000 | |
| Mean | 72,000 | |
| Fraction taken into account | 292/365 | |
| Adjustment (292/365×\$72,000) | | \$57,600 |
| Mean of N's assets after section 806(a) adjustment | | 7,067,600 |

Example 5. The facts are the same as in example 1, except that on October 19, 1958, company N transfers to company P, a life insurance company, all of the life insurance reserves, and related assets, on the block of policies it had received from company M on March 14, 1958. The reserves (and assets) for this block totaled \$76,000 on October 19, 1958. The means of company M's life insurance reserves and assets, as computed in examples 1 and (2), respectively, would be unchanged by the transfer of October 19, 1958. Since company N did not own this block of policies at either the beginning or end of the taxable year, it would not have to recompute its beginning or end of the taxable year reserves or assets. Company N will, however, have to adjust (or increase) the mean of its life insurance reserves and assets on account of the policies it received from company M. This adjustment will be \$42,000, which is determined by multiplying the means of the life insurance reserves (or assets) on these policies as of March 15, 1958, and October 19, 1958, \$70,000 $(\$64,000 + \$76,000 = \$140,000 \div 2)$ by the fraction 219/365 (the numerator of 219 is determined by excluding the day of the transfer to N, March 14, 1958, and including the day of the transfer from N to P, October 19, 1958). Company P will have to recompute its end of the year life insurance reserves and assets (in the same manner as illustrated in examples 3 and 4). Assuming the end of the year reserves (and assets) on this block of policies is \$80,000, company P will have an adjustment under section 806 (a) of \$15,600, which is determined by multiplying the means of the reserves on these policies as of October 20, 1958, and December 31, 1958, \$78,000 $(\$76,000 + \$80,000 = \$156,000 \div 2)$ by the fraction 73/365.

[T.D. 6513, 25 FR 12663, Dec. 10, 1960]

§ 1.806-4 Change of basis in computing reserves.

(a) *In general.* For purposes of subpart B, part I, subchapter L, chapter 1 of the Code, section 806(b) provides that if the basis for determining the amount of any item referred to in section 810(c) (relating to items taken into account)

as of the close of the taxable year differs from the basis for such determination as of the beginning of the taxable year, then in determining taxable investment income the amount of the item as of the close of the taxable year shall be the amount computed on the old basis, and the amount of the item as of the beginning of the next taxable year shall be the amount computed on the new basis. For purposes of the preceding sentence, an election under section 818(c) shall not be treated as a change in basis for determining the amount of an item referred to in section 810(c). A change of basis in computing any of the items referred to in section 810(c) is not a change of accounting method requiring the consent of the Secretary or his delegate under section 446(e).

(b) *Illustration of change of basis in computing reserves.* The application of section 806(b) and paragraph (a) of this section may be illustrated by the following examples:

Example 1. Assume that the life insurance reserves of Y, a life insurance company, at the beginning of the taxable year 1959 are \$100 and that during such taxable year a portion of the reserves is strengthened (by reason of a change in mortality or interest assumptions, or otherwise), so that at the end of the taxable year 1959 the reserves (computed on the new basis) are \$130 but computed on the old basis would be \$120. Assume further that at the close of the next taxable year, 1960, the reserves (computed on the new basis) are \$142. Under the provisions of section 806(b) and paragraph (a) of this section, the mean of such reserves for the taxable year of the reserve strengthening, namely 1959, is \$110 (the mean of \$100, the balance at the beginning of the taxable year 1959, and \$120, the balance at the end of the taxable year 1959 computed on the old basis). The mean of such reserves for the next taxable year, 1960, is \$136 (the mean of \$130, the balance at the beginning of the taxable year 1960 computed on the new basis, and \$142, the balance at the end of the taxable year 1960 computed on the new basis).

Example 2. The life insurance reserves of S, a life insurance company, computed with respect to contracts for which such reserves are determined on a recognized preliminary term basis amount to \$50 on January 1, 1959, and \$80 on December 31, 1959. For the taxable year 1959, S elects to revalue such reserves on a net level premium basis under section 818(c). Such reserves computed under section 818(c) amount to \$60 on January 1, 1959, and

§ 1.807-1

\$96 on December 31, 1959. Under the provisions of paragraph (a) of this section, the mean of such reserves for the taxable year 1959 is \$78 (the mean of \$60, the balance at the beginning of the taxable year 1959 computed under section 818(c), and \$96, the balance at the end of the taxable year 1959 computed under section 818(c).

[T.D. 6513, 25 FR 12669, Dec. 10, 1960]

§ 1.807-1 Mortality and morbidity tables.

(a) *Tables to be used.* If there are no commissioners' standard tables applicable to an insurance contract when the contract is issued, then the mortality and morbidity tables set forth in this subsection are used to compute reserves under section 807(d)(2) for the contract.

| Type of Contract | Table |
|---|---|
| 1. Group term life insurance (active life reserves). | 1960 Commissioners' Standard Group Mortality Table. |
| 2. Group life insurance (active life reserves); accidental death benefits. | 1959 Accidental Death Benefits Table. |
| 3. Permanent and paid-up group life insurance (active life reserves). | Same table as are applicable to males for ordinary life insurance. |
| 4a. Group life insurance disability income benefits (active life reserves). | The tables of period 2 disablement rates and the 1930 to 1950 termination rates of the 1952 Disability Study of the Society of Actuaries. |
| 4b. Group life insurance disability income benefits (disabled life reserves). | The 1930 to 1950 termination rates of the 1952 Disability study of the Society of Actuaries. |
| 5. Group life insurance; survivor income benefits insurance. | Same tables as are applicable to group annuities. |
| 6. Group life insurance; extended death benefits for disabled lives. | 1970 Intercompany Group life Disability Valuation Table. |
| 7. Credit life insurance | 1958 Commissions' Extended Term Table. |
| 8. Supplementary contracts involving life contingencies. | Same tables as are applicable to individual immediate annuities. |
| 9. Noncancellable accident and health insurance (active life reserves); benefits issued before 1984. | Tables used for NAIC annual statement reserves as of December 31, 1983. |
| 10a. Noncancellable accident and health insurance (active life reserves); group disability benefits issued after 1983 and individual disability benefits issued after 1983 and before 1989. | 1964 Commissioners' Disability Tables. |
| 10b. Noncancellable accident and health insurance (active life reserves); individual disability benefits issued after 1988. | 1985 Commissioners' Individual Disability Table A or Commissioners' Individual Disability Table B. |

| Type of Contract | Table |
|--|--|
| 11. Noncancellable accident and health insurance (active life reserves); accidental death benefits issued after 1983. | 1959 Accidental Death Benefits Tables. |
| 12. Noncancellable accident and health insurance (active life reserves); all benefits issued after 1983 other than disability and accidental death. | Tables used for NAIC annual statement reserves. |
| 13a. Noncancellable accident and health insurance (claim reserves); group disability benefits for all years of issue and individual disability benefits for years before 1989. | 1964 Commissioners' Disability Tables. |
| 13b. Noncancellable accident and health insurance (claim reserves); individual disability benefits for years after 1988. | 1985 Commissioners' Individual Disability Table A or Commissioners' Individual Disability Table B. |
| 14. Noncancellable accident and health insurance (claim reserves); all benefits other than disability for all years of issue. | Tables used for annual statement reserves. |

(b) *Adjustments.* An appropriate adjustment may be made to the tables in paragraph (a) of this section to reflect risks (such as substandard risks) incurred under the contract which are not otherwise taken into account.

(c) *Special rule where more than 1 table or option applicable.* If, with respect to any category of risks, there are 2 or more tables (or options under 1 or more tables) in paragraph (a) of this section, the table (and option thereunder) which generally yields the lowest reserves shall be used to compute reserves under section 807(d)(2) for the contract.

(d) *Effective date.* This section is effective for taxable years beginning after December 31, 1983, except that the 1985 Commissioners' Individual Disability Tables A and B shall be treated (for purposes of section 807(d)(5)(B) and for purposes of determining the issue dates of contracts for which they shall be used) as if the tables were new prevailing commissioners' standard tables adopted by the twenty-sixth State on December 26, 1989.

[T.D. 8278, 54 FR 52934, Dec. 26, 1989; 55 FR 1768, Jan. 18, 1990]

§ 1.807-2 Cross-reference.

For special rules regarding the treatment of modified guaranteed contracts