

## Internal Revenue Service, Treasury

## § 1.801-2

### INSURANCE COMPANIES

#### LIFE INSURANCE COMPANIES

##### DEFINITION; TAX IMPOSED

#### § 1.801-1 Definitions.

(a) *Life insurance company.* The term *life insurance company* as used in subtitle A of the Code is defined in section 801. For the purpose of determining whether a company is a "life insurance company" within the meaning of that term as used in section 801, it must first be determined whether the company is taxable as an insurance company under the Code. For the definition of an "insurance company", see paragraph (b) of this section. In determining whether an insurance company is a life insurance company, the life insurance reserves (as defined in section 803(b)) plus any unearned premiums and unpaid losses on noncancellable life, health, or accident policies, not included in "life insurance reserves" must comprise more than 50 percent of its total reserves (as defined in section 801). An insurance company writing only noncancellable life, health, or accident policies and having no "life insurance reserves" may qualify as a life insurance company if its unearned premiums and unpaid losses on such policies comprise more than 50 percent of its total reserves. A noncancellable insurance policy means a contract which the insurance company is under an obligation to renew or continue at a specified premium and with respect to which a reserve in addition to the unearned premium must be carried to cover that obligation. For the purpose of the preceding sentence, the term "unearned premium" means the amount which will cover the cost of carrying the insurance risk for the period for which the premium has been paid in advance. A burial or funeral benefit insurance company qualifying as a life insurance company engaged directly in the manufacture of funeral supplies or the performance of funeral services will be taxable under section 821 or section 831 as an insurance company other than life.

(b) *Insurance companies.* (1) Insurance companies include both stock and mutual companies, as well as mutual benefit insurance companies. A voluntary

unincorporated association of employees formed for the purpose of relieving sick and aged members and the dependents of deceased members is an insurance company, whether the fund for such purpose is created wholly by membership dues or partly by contributions from the employer. A corporation which merely sets aside a fund for the insurance of its employees is not required to file a separate return for such fund, but the income therefrom shall be included in the return of the corporation.

(2) Though its name, charter powers, and subjection to State insurance laws are significant in determining the business which a corporation is authorized and intends to carry on, the character of the business actually done in the taxable year determines whether it is taxable as an insurance company under the Code. For example, during the year 1954 the M Corporation, incorporated under the insurance laws of the State of R, carried on the business of lending money in addition to guaranteeing the payment of principal and interest of mortgage loans. Of its total income for the year, one-third was derived from its insurance business of guaranteeing the payment of principal and interest of mortgage loans and two-thirds was derived from its noninsurance business of lending money. The M Corporation is not an insurance company for the year 1954 within the meaning of the Code and the regulations thereunder.

#### § 1.801-2 Taxable years affected.

Section 1.801-1 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 1.801-3 through 1.801-7 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). Section 1.801-8 is applicable only to taxable years beginning after December 31, 1961, 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) and section 3 of the Act of October 23, 1962 (76 Stat. 1134).

[T.D. 6886, 31 FR 8681, June 23, 1966]

**§ 1.801-3 Definitions.**

For purposes of part I, subchapter L, chapter 1 of the Code, this section defines the following terms, which are to be used in determining if a taxpayer is a life insurance company (as defined in section 801(a) and paragraph (b) of this section):

(a) *Insurance company.* (1) The term *insurance company* means a company whose primary and predominant business activity during the taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies. Thus, though its name, charter powers, and subjection to State insurance laws are significant in determining the business which a company is authorized and intends to carry on, it is the character of the business actually done in the taxable year which determines whether a company is taxable as an insurance company under the Internal Revenue Code.

(2) Insurance companies include both stock and mutual companies, as well as mutual benefit insurance companies. For taxable years beginning before January 1, 1970, a voluntary unincorporated association of employees, including an association fulfilling the requirements of section 801(b)(2)(B) (as in effect for such years), formed for the purpose of relieving sick and aged members and the dependents of deceased members, is an insurance company, whether the fund for such purpose is created wholly by membership dues or partly by contributions from the employer. A corporation which merely sets aside a fund for the insurance of its employees is not an insurance company, and the income from such fund shall be included in the return of the corporation.

(b) *Life insurance company.* (1) The term *life insurance company*, as used in subtitle A of the Code, is defined in section 801(a). For the purpose of determining whether a company is a "life insurance company" within the mean-

ing of that term as used in section 801(a), it must first be determined whether the company is taxable as an insurance company (as defined in paragraph (a) of this section). An insurance company shall be taxed as a life insurance company if it is engaged in the business of issuing life insurance and annuity contracts (either separately or combined with health and accident insurance), or noncancellable contracts of health and accident insurance, and its life insurance reserves (as defined in section 801(b) and § 1.801-4), plus unearned premiums, and unpaid losses (whether or not ascertained), on noncancellable life, health, or accident policies not included in life insurance reserves, comprise more than 50 percent of its total reserves (as defined in section 801(c) and § 1.801-5). For purposes of determining whether it satisfies the percentage requirements of the preceding sentence, a company shall first make any adjustments to life insurance reserves and total reserves required by section 806(a) (relating to adjustments for certain changes in reserves and assets) and then as required by section 801(d) (relating to adjustments in reserves for policy loans). For examples of the adjustments required under section 806(a), see paragraph (b)(4) of § 1.806-3. For an example of the adjustments required under section 801(d), see paragraph (c) of § 1.801-6. Furthermore, if an insurance company which computes its life insurance reserves on a preliminary term basis elects to revalue such reserves on a net level premium basis under section 818(c), such revalued basis shall be disregarded for purposes of section 801.

(2) An insurance company writing only noncancellable life, health, or accident policies and having no "life insurance reserves" may qualify as a life insurance company if its unearned premiums, and unpaid losses (whether or not ascertained), on such policies comprise more than 50 percent of its total reserves.

(3) Section 801(f) provides that a burial or funeral benefit insurance company engaged directly in the manufacture of funeral supplies or the performance of funeral services shall not be taxable under section 802 but shall be taxable under section 821 or section 831

as an insurance company other than life.

(c) *Noncancellable life, health, or accident insurance policy.* The term *noncancellable life, health, or accident insurance policy* means a health and accident contract, or a health and accident contract combined with a life insurance or annuity contract, which the insurance company is under an obligation to renew or continue at a specified premium and with respect to which a reserve in addition to the unearned premiums (as defined in paragraph (e) of this section) must be carried to cover that obligation. Such a health and accident contract shall be considered noncancellable even though it states a termination date at a stipulated age, if, with respect to the health and accident contract, such age termination date is 60 or over. Such a contract, however, shall not be considered to be noncancellable after the age termination date stipulated in the contract has passed. However, if the age termination date stipulated in the contract occurs during the period covered by a premium received by the life insurance company prior to such date, and the company cannot cancel or modify the contract during such period, the age termination date shall be deemed to occur at the expiration of the period for which the premium has been received.

(d) *Guaranteed renewable life, health, and accident insurance policy.* The term *guaranteed renewable life, health, and accident insurance policy* means a health and accident contract, or a health and accident contract combined with a life insurance or annuity contract, which is not cancellable by the company but under which the company reserves the right to adjust premium rates by classes in accordance with its experience under the type of policy involved, and with respect to which a reserve in addition to the unearned premiums (as defined in paragraph (e) of this section) must be carried to cover that obligation. Section 801(e) provides that such policies shall be treated in the same manner as noncancellable life, health, and accident insurance policies. For example, the age termination date requirements applicable to noncancellable health and accident in-

surance policies shall also apply to guaranteed renewable life, health, and accident insurance policies. See paragraph (c) of this section.

(e) *Unearned premiums.* The term *unearned premiums* means those amounts which shall cover the cost of carrying the insurance risk for the period for which the premiums have been paid in advance. Such term includes all unearned premiums, whether or not required by law.

(f) *Life insurance reserves.* For the definition of the term "life insurance reserves", see section 801(b) and § 1.801-4.

(g) *Unpaid losses (whether or not ascertained).* The term *unpaid losses (whether or not ascertained)* means a reasonable estimate of the amount of the losses (based upon the facts in each case and the company's experience with similar cases):

(1) Reported and ascertained by the end of the taxable year but where the amount of the loss has not been paid by the end of the taxable year.

(2) Reported by the end of the taxable year but where the amount thereof has not been either ascertained or paid by the end of the taxable year, or

(3) Which have occurred by the end of the taxable year but which have not been reported or paid by the end of the taxable year.

(h) *Total reserves.* For the definition of the term *total reserves*, see section 801(c) and § 1.801-5.

(i) *Amount of reserves.* For purposes of subsections (a), (b), and (c) of section 801 and this section, section 801(b)(5) provides that the amount of any reserve (or portion thereof) for any taxable year shall be the mean of such reserve (or portion thereof) at the beginning and end of the taxable year.

[T.D. 6513, 25 FR 12655, Dec. 10, 1960, as amended by T.D. 7172, 37 FR 5619, Mar. 17, 1972]

#### § 1.801-4 Life insurance reserves.

(a) *Life insurance reserves defined.* For purposes of part I, subchapter L, chapter 1 of the Code, the term *life insurance reserves* (as defined in section 801(b)) means those amounts:

(1) Which are computed or estimated on the basis of recognized mortality or morbidity tables and assumed rates of interest;

(2) Which are set aside to mature or liquidate, either by payment or reinsurance, future unaccrued claims arising from life insurance, annuity, and noncancellable health and accident insurance contracts (including life insurance or annuity contracts combined with noncancellable health and accident insurance) involving, at the time with respect to which the reserve is computed, life, health, or accident contingencies; and

(3) Which, except as otherwise provided by section 801(b)(2) and paragraphs (b) and (c) of this section, are required by law. For the meaning of the term "reserves required by law", see paragraph (b) of § 1.801-5.

For purposes of determining life insurance reserves, only those amounts shall be taken into account which must be reserved either by express statutory provisions or by rules and regulations of the insurance department of a State, Territory, or the District of Columbia when promulgated in the exercise of a power conferred by statute. Moreover, such amounts must actually be held by the company during the taxable year for which the reserve is claimed. However, reserves held by the company with respect to the net value of risks reinsured in other solvent companies (whether or not authorized) shall be deducted from the company's life insurance reserves. For example, if an ordinary life policy with a reserve of \$100 is reinsured in another solvent company on a yearly renewable term basis, and the reserve on such yearly renewable term policy is \$10, the reinsured company shall include \$90 (\$100 minus \$10) in determining its life insurance reserves. Generally, life insurance reserves, as in the case of level premium life insurance, are held to supplement the future premium receipts when the latter, alone, are insufficient to cover the increased risk in the later years. For examples of reserves which qualify as life insurance reserves, see paragraph (d) of this section. For examples of reserves which do not qualify as life insurance reserves, see paragraph (e) of this section.

(b) *Certain reserves which need not be required by law.* Section 801(b)(2) sets forth certain reserves which, though not required by law, may still qualify

as life insurance reserves, provided, however, that they first satisfy the requirements of section 801(b)(1) (A) and (B) and paragraph (a) (1) and (2) of this section. Thus, reserves need not be required by law:

(1) In the case of policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, and

(2) For taxable years beginning before January 1, 1970, in the case of policies issued by an organization which met the requirements of section 501(c)(9) (as it existed prior to amendment by the Tax Reform Act of 1969) other than the requirement of subparagraph (B) thereof.

(c) *Assessment companies.* Section 801(b)(3) provides that in the case of an assessment life insurance company or association, the term *life insurance reserves* includes:

(1) Sums actually deposited by such company or association with officers of a State or Territory pursuant to law as guaranty or reserve funds, and

(2) Any funds maintained, under the charter or articles of incorporation or association of such company or association (or bylaws approved by the State insurance commissioner) of such company or association, exclusively for the payment of claims arising under certificates of membership or policies issued upon the assessment plan and not subject to any other use.

For purposes of part I, subchapter L, chapter 1 of the Code, the reserves described in this paragraph shall be included as life insurance reserves even though such reserves do not meet the requirements of section 801(b) and paragraph (a) of this section. However, for such reserves to be included as life insurance reserves, they must be deposited or maintained to liquidate future unaccrued claims arising from life insurance, annuity, or noncancellable health and accident insurance contracts (including life insurance or annuity contracts combined with noncancellable health and accident insurance) involving, at the time with respect to which the reserve is deposited or maintained, life, health, or accident

contingencies. The rate of interest assumed in calculating the reserves described in this paragraph shall be 3 percent, regardless of the rate of interest (if any) specified in the contract in respect of such reserves.

(d) *Reserves which qualify as life insurance reserves.* The following reserves, provided they meet the requirements of section 801(b) and paragraph (a) of this section, are illustrative of reserves which shall be included as life insurance reserves:

(1) Reserves held under life insurance contracts.

(2) Reserves held under annuity contracts (including reserves held under variable annuity contracts as described in section 801(g)(1)).

(3) Reserves held under noncancellable health and accident insurance contracts (as defined in paragraph (c) of §1.801-3) and reserves held under guaranteed renewable health and accident insurance contracts (as defined in paragraph (d) of §1.801-3).

(4) Reserves held either separately or combined under contracts described in subparagraphs (1), (2), or (3) of this paragraph.

(5) Reserves held under deposit administration contracts. Generally, the reserves held by a life insurance company on both the active and retired lives under deposit administration contracts will meet the requirements of section 801(b) and paragraph (a) of this section.

However, reserves held by the company with respect to the net value of risks reinsured in other solvent companies (whether or not authorized) shall be deducted from the company's life insurance reserves. See paragraph (a) of this section.

(e) *Reserves and liabilities which do not qualify as life insurance reserves.* The following are illustrative of reserves and liabilities which do not meet the requirements of section 801(b) and paragraph (a) of this section and, accordingly, shall not be included as life insurance reserves:

(1) Liability for supplementary contracts not involving at the time with respect to which the liability is computed, life, health, or accident contingencies.

(2) In the case of cancellable health and accident policies and similar cancellable contracts, the unearned premiums and unpaid losses (whether or not ascertained).

(3) The unearned premiums, and unpaid losses (whether or not ascertained), on noncancellable life, health, or accident policies (and guaranteed renewable life, health, and accident policies) not included in life insurance reserves. (However, such amounts shall be taken into account under section 801(a)(2) for purposes of determining whether an insurance company is a life insurance company.)

(4) The deficiency reserve (as defined in section 801(b)(4)) for each individual contract, that is, that portion of the reserve for such contract equal to the amount (if any) by which:

(i) The present value of the future net premiums required for such contract, exceeds

(ii) The present value of the future actual premiums and consideration charged for such contract.

(5) Reserves required to be maintained to provide for the ordinary operating expenses of a business which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, and unpaid brokerage.

(6) Liability for premiums received in advance.

(7) Liability for premium deposit funds.

(8) Liability for annual and deferred dividends declared or apportioned.

(9) Liability for dividends left on deposit at interest.

(10) Liability for accrued but unsettled policy claims whether known or unreported.

(11) A mandatory securities valuation reserve.

(f) *Adjustments to life insurance reserves.* In the event it is determined on the basis of the facts of a particular case that premiums deferred and uncollected and premiums due and unpaid are not properly accruable for the taxable year under section 809 and, accordingly, are not properly includible under assets (as defined in section 805(b)(4)) for the taxable year, appropriate reduction shall be made in the life insurance reserves. This reduction shall be made

## § 1.801-5

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

when the insurance company has calculated life insurance reserves on the assumption that the premiums on all policies are paid annually or that all premiums due on or prior to the date of the annual statement have been paid.

[T.D. 6513, 25 FR 12656, Dec. 10, 1960, as amended by T.D. 7172, 37 FR 5619, Mar. 17, 1972]

### § 1.801-5 Total reserves.

(a) *Total reserves defined.* For purposes of section 801(a) and § 1.801-3, the term “total reserves” is defined in section 801(c) as the sum of:

(1) Life insurance reserves (as defined in section 801(b) and § 1.801-4),

(2) Unearned premiums (as defined in paragraph (e) of § 1.801-3), and unpaid losses (whether or not ascertained) (as defined in paragraph (g) of § 1.801-3), not included in life insurance reserves, and

(3) All other insurance reserves required by law.

The term “total reserves” does not, however, include deficiency reserves (within the meaning of section 801(b)(4), and paragraph (e)(4) of § 1.801-4), even though such deficiency reserves are required by State law. In determining total reserves, a company is permitted to make use of the highest aggregate reserve required by any State or Territory or the District of Columbia in which it transacts business, but the reserve must have been actually held during the taxable year for which the reserve is claimed. For example, during the taxable year 1958 a life insurance company sells life insurance and annuity contracts in States A and B. State A requires reserves of 10 against the life and 5 against the annuity business. State B requires reserves of 9 against the life and 7 against the annuity business. Assuming the company actually holds these reserves during the taxable year 1958, its highest aggregate reserve for such taxable year is the 16 required by State B. Thus, the company is not permitted to compute its highest aggregate reserve by taking State A's requirement of 10 against its life insurance business and adding it to State B's requirement of 7 against its annuity business.

(b) *Reserves required by law defined.* For purposes of part I, subchapter L,

chapter 1 of the Code, the term *reserves required by law* means reserves which are required either by express statutory provisions or by rules and regulations of the insurance department of a State, Territory, or the District of Columbia when promulgated in the exercise of a power conferred by statute, and which are reported in the annual statement of the company and accepted by state regulatory authorities as held for the fulfillment of the claims of policyholders or beneficiaries.

(c) *Information to be filed.* In any case where reserves are claimed, sufficient information must be filed with the return to enable the district director to determine the validity of the claim. See section 6012 and paragraph (c) of § 1.6012-2. If the basis (for Federal income tax purposes) for determining the amount of any of the life insurance reserves as of the close of the taxable year differs from the basis for such determination as of the beginning of the taxable year then the following information must be filed with respect to all such changes in basis:

(1) The nature of the life insurance reserve (i.e., life, annuity, etc.);

(2) The mortality or morbidity table, assumed rate of interest, method used in computing or estimating such reserve on the old basis, and the amount of such reserve at the beginning and close of the taxable year computed on the old basis;

(3) The mortality or morbidity table, assumed rate of interest, method used in computing or estimating such reserve on the new basis, and the amount of such reserve at the close of the taxable year computed on the new basis;

(4) The deviation, if any, from recognized mortality or morbidity tables, or recognized methods of computation;

(5) The reasons for the change in basis of such reserve; and

(6) Whether such change in the reserve has been approved or accepted by the regulatory authorities of the State of domicile, and if so, a copy of the letter, certificate, or other evidence of such approval or acceptance.

(d) *Illustration of principles.* The provisions of section 801 relating to the percentage requirements for qualification as a life insurance company may be illustrated by the following example:

**Internal Revenue Service, Treasury**

**§ 1.801-7**

*Example.* The books of Y, an insurance company, selling life insurance, noncancellable health and accident insurance, and cancellable accident and health insurance, reflect (after adjustment under sections 806(a) and 801(d)) the following facts for the taxable year 1958:

	Jan. 1	Dec. 31	Mean of year
1. Life insurance reserves .....	\$3,000	\$5,000	\$4,000
2. Unearned premiums, and unpaid losses (whether or not ascertained), on noncancellable accident and health insurance not included in life insurance reserves .....	400	600	500
3. Unearned premiums, and unpaid losses (whether or not ascertained), on cancellable accident and health insurance	1,800	2,200	2,000
4. All other insurance reserves required by law .....	900	1,100	1,000
5. Total reserves .....	.....	.....	7,500

The rules provided by section 801 require that the sum of the mean of the year figures in items 1 and 2 comprise more than 50 percent of the mean of the year figure in item 5 for an insurance company to qualify as a life insurance company. Thus, Y would qualify as a life insurance company for the taxable year 1958 as the sum of the mean of the year figures in items 1 and 2 (\$4,500) comprise 60 percent of the mean of the year figure in item 5 (\$7,500).

[T.D. 6513, 25 FR 12657, Dec. 10, 1960]

**§ 1.801-6 Adjustments in reserves for policy loans.**

(a) *In general.* Section 801(d) provides that for purposes only of determining whether or not an insurance company is a life insurance company (as defined in section 801(a) and paragraph (b) of § 1.801-3), the life insurance reserves (as defined in section 801(b) and § 1.801-4), and the total reserves (as defined in section 801(c) and paragraph (a) of § 1.801-5), shall each be reduced by an amount equal to the mean of the aggregates, at the beginning and end of the taxable year, of the policy loans outstanding with respect to contracts for which life insurance reserves are maintained. Such reduction shall be made after any adjustments required under section 806(a) and § 1.806-3 have been made.

(b) *Policy loans defined.* The term *policy loans* includes loans made by the insurance company, by whatever name

called, for which the reserve on a contract is the collateral.

(c) *Illustration of principles.* The provisions of section 801(d) and this section may be illustrated by the following example:

*Example.* The books of T, an insurance company, selling only life insurance and cancellable accident and health insurance, reflect (after adjustment under section 806 (a)) the following facts for the taxable year 1958:

	Jan. 1	Dec. 31	Mean of year
1. Life insurance reserves .....	\$1,000	\$2,000	\$1,500
2. Policy loans .....	50	850	450
3. Life insurance reserves less policy loans .....	.....	.....	1,050
4. Unearned premiums, and unpaid losses (whether or not ascertained), on cancellable accident and health insurance	900	1,600	1,250
5. Total reserves adjusted for policy loans (item 3 plus item 4) .....	.....	.....	2,300

As the rules provided by section 801 (a) and (d) require that the figure in item 3 (\$1,050) be more than 50 percent of the mean of the year figure in item 5 (\$2,300) for an insurance company to qualify as a life insurance company, T would not qualify as a life insurance company for the taxable year 1958.

[T.D. 6513, 25 FR 12657, Dec. 10, 1960]

**§ 1.801-7 Variable annuities.**

(a) *In general.* (1) Section 801(g)(1) provides that for purposes of part I, subchapter L, chapter 1 of the Code, an annuity contract includes a contract which provides for the payment of a variable annuity computed on the basis of recognized mortality tables and the investment experience of the company issuing such a contract. A variable annuity differs from the ordinary or fixed dollar annuity in that the annuity benefits payable under a variable annuity contract vary with the insurance company's investment experience with respect to such contracts while the annuity benefits paid under a fixed dollar annuity contract are guaranteed irrespective of the company's actual investment earnings.

(2) The reserves held with respect to the annuity contracts described in section 801(g)(1) and subparagraph (1) of this paragraph shall qualify as life insurance reserves within the meaning of

section 801(b)(1) and paragraph (a) of § 1.801-4 provided such reserves are required by law (as defined in paragraph (b) of § 1.801-5) and are set aside to mature or liquidate, either by payment or reinsurance, future unaccrued claims arising from such contracts involving, at the time with respect to which the reserve is computed, life, health, or accident contingencies. Accordingly, a company issuing variable annuity contracts shall qualify as a life insurance company for Federal income tax purposes if it satisfies the requirements of section 801(a) (relating to the definition of a life insurance company) and paragraph (b) of § 1.801-3.

(b) *Special rules for variable annuities—*  
 (1) *Adjusted reserves rate; assumed rate.* The adjusted reserves rate for any taxable year with respect to the annuity contracts described in section 801(g)(1) and paragraph (a)(1) of this section, and the rate of interest assumed by the taxpayer for any taxable year in calculating the reserve on any such contract, shall be a rate equal to the current earnings rate determined under section 801(g)(3) and subparagraph (2) of this paragraph. However, any change in the rate of interest assumed by the taxpayer in calculating the reserve on a variable annuity contract for any taxable year which is attributable to an increase or decrease in the current earnings rate, shall not be treated as a change of basis in computing reserves for purposes of section 806(b) (relating to certain changes in reserves) or section 810 (d)(1) (relating to adjustment for change in computing reserves).

(2) *Current earnings rate.* (i) The current earnings rate for any taxable year with respect to the annuity contracts described in section 801(g)(1) and paragraph (a)(1) of this section shall be the current earnings rate determined under section 805(b)(2) and paragraph (a)(2) of § 1.805-5 with respect to such contracts, reduced by the percentage obtained by dividing (a) the amount of the actuarial margin charge on all such variable annuity contracts issued by the taxpayer, by (b) the mean of the reserves for such contracts.

(ii) For purposes of section 801(g)(3) and subdivision (i) of this subparagraph, the term *actuarial margin charge* means any amount retained by the

company from gross investment income pursuant to the terms of the variable annuity contract in excess of any portion of the investment expenses which is attributable to such contract and which is deductible under section 804(c) and paragraph (b) of § 1.804-4.

(3) *Increases and decreases in reserves.* (i) Section 801(g)(4) provides that for purposes of section 810 (a) and (b) (relating to adjustments for increases or decreases in certain reserves), the sum of the items described in section 810(c) and paragraph (b) of § 1.810-2 taken into account as of the close of the taxable year shall be adjusted:

(a) By subtracting therefrom the sum of any amounts added from time to time (for the taxable year) to the reserves for variable annuity contracts described in section 801(g)(1) and paragraph (a)(1) of this section by reason of realized or unrealized appreciation in the value of the assets held in relation thereto, and

(b) By adding thereto the sum of any amounts subtracted from time to time (for the taxable year) from such reserves by reason of realized or unrealized depreciation in the value of such assets.

(ii) The application of section 801(g)(4) and subdivision (i) of this subparagraph may be illustrated by the following example:

*Example.* Company M, a life insurance company issuing only variable annuity contracts of the type described in section 801(g)(1) and paragraph (a)(1) of this section, increased its life insurance reserves held with respect to such contracts during the taxable year 1959 by \$275,000. Of the total increase in the reserves, \$100,000 was attributable to premium receipts, \$50,000 to dividends and interest, \$100,000 to unrealized appreciation in the value of the assets held in relation to such reserves, and \$25,000 to realized capital gains on the sale of such assets. As of the close of the taxable year 1959, the reserves held by company M with respect to all variable annuity contracts amounted to \$1,275,000. However, under section 801(g)(4) and subdivision (i) of this subparagraph, this amount must be reduced by the \$100,000 unrealized asset value appreciation and the \$25,000 of realized capital gains. Accordingly, for purposes of section 810 (a) and (b), the amount of these reserves which is to be taken into account as of the close of the taxable year 1959 under section 810(c) is \$1,150,000 (\$1,275,000 less \$125,000).

(c) *Companies issuing variable annuities and other contracts.* (1) In the case of a life insurance company which issues both annuity contracts described in section 801(g)(1) and paragraph (a)(1) of this section and other contracts, the policy and other contract liability requirements (as defined in section 805(a) and paragraph (b) of §1.805-4) of such a company for any taxable year shall be considered to be the sum of:

(i) The policy and other contract liability requirements computed with respect to the items which relate to such variable annuity contracts, and

(ii) The policy and other contract liability requirements computed by excluding the items taken into account under subdivision (i) of this subparagraph.

(2) [Reserved for regulations to be issued under section 801(g)(5)(B).]

(d) *Termination.* Paragraphs (1), (2), (3), (4), and (5) of section 801(g) and paragraphs (a), (b), (c), and (d) of this section shall not apply with respect to any taxable year beginning after December 31, 1962.

[T.D. 6610, 27 FR 8717, Aug. 31, 1962]

**§ 1.801-8 Contracts with reserves based on segregated asset accounts.**

(a) *Definitions*—(1) *Annuity contracts include variable annuity contracts.* Section 801(g)(1)(A) provides that for purposes of part I, subchapter L, chapter 1 of the Code, an annuity contract includes a contract which provides for the payment of a variable annuity computed on the basis of recognized mortality tables and the investment experience of the company issuing such a contract. A variable annuity differs from the ordinary or fixed dollar annuity in that the annuity benefits payable under a variable annuity contract vary with the insurance company's investment experience with respect to such contracts while the annuity benefits paid under a fixed dollar annuity contract are guaranteed irrespective of the company's actual investment earnings.

(2) *Contracts with reserves based on a segregated asset account.* (i) For purposes of part I, section 801(g)(1)(B) defines the term *contract with reserves based on a segregated asset account* as a contract (individual or group):

(a) Which provides for the allocation of all or part of the amounts received under the contract to an account which, pursuant to State law or regulation, is segregated from the general asset accounts of the company,

(b) Which provides for the payment of annuities, and

(c) Under which the amounts paid in, or the amount paid as annuities, reflect the investment return and the market value of the segregated asset account.

(ii) The term *contract with reserves based on a segregated asset account* includes a contract such as a variable annuity contract, which reflects the investment return and the market value of the segregated asset account, even though such contract provides for the payment of an annuity computed on the basis of recognized mortality tables, but the term includes such contract only for the period during which it satisfies the requirements of section 801(g)(1)(B) and subdivision (i) of this subparagraph. However, such term does not include a pension contract written on the basis of the so-called new-money concept. Thus, for example, such term does not include a pension contract whereby reserves are credited on the basis of the company's new high yield investments. Furthermore, such term does not include a contract which during the taxable year contains a right to participate in the divisible surplus of the company where such right merely reflects the company's investment return. Nevertheless, the term does include a contract which meets the requirements of section 801(g)(1)(B) and of this subparagraph even if part of the amounts received are, for example, allocated to reserves under provisions of the contract which are written on the basis of the new-money concept. However, such reserves do not qualify as a segregated asset account referred to in section 801(g) and this section.

(iii) If at any time during the taxable year a contract otherwise satisfying the requirements of section 801(g)(1)(B) and subdivision (i) of this subparagraph ceases to reflect current investment return and current market value, such contract shall not be considered as meeting the requirements of section 801(g)(1)(B)(iii) and subdivision (i)(c) of

this subparagraph after such cessation. Thus, a contract with reserves based on a segregated asset account includes a contract under which the reflection of investment return and market value terminates at the beginning of the annuity payments, but only for the period prior to such termination. For example, if the purchaser of a variable annuity contract which meets such requirements elects an option which provides for the payment of a fixed dollar annuity, then such contract shall be considered as satisfying such requirements only for the period prior to the time such contract ceases to reflect current investment return and current market value. Furthermore, a group annuity contract which satisfies the requirements of section 801(g)(1)(B) and subdivision (i) of this subparagraph shall be considered as continuing to meet such requirements even though a certificate holder under the group contract elects an option which provides for the payment of a fixed dollar annuity. However, the annuity attributable to such certificate holder shall not be considered as satisfying such requirements as of the time such annuity ceases to reflect current investment return and current market value. On the other hand, a group annuity contract which does not reflect current market value shall not be considered as satisfying such requirements even though a certificate holder under the group contract elects an option which provides for the payment of a variable annuity. However, the variable annuity attributable to such certificate holder shall be considered as satisfying such requirements as of the time such variable annuity commences to reflect current investment return and current market value.

(b) *Life insurance reserves.* Section 801(g)(2) provides that for purposes of section 801(b)(1)(A), the reflection of the investment return and the market value of the segregated asset account shall be considered an assumed rate of interest. Thus, the reserves held with respect to contracts described in section 801(g)(1) and paragraph (a) of this section shall qualify as life insurance reserves within the meaning of section 801(b)(1) and paragraph (a) of § 1.801-4 provided such reserves are required by

law (as defined in paragraph (b) of § 1.801-5) and are set aside to mature or liquidate, either by payment or reinsurance, future unaccrued claims arising from such contracts with reserves based on segregated asset accounts involving, at the time with respect to which the reserve is computed, life, health, or accident contingencies. Accordingly, a company issuing contracts with reserves based on segregated asset accounts shall qualify as a life insurance company for Federal income tax purposes if it satisfies the requirements of section 801(a) (relating to the definition of a life insurance company) and paragraph (b) of § 1.801-3.

(c) *Separate accounting.* (1) For purposes of part I, section 801(g)(3) provides that a life insurance company (as defined in section 801(a) and paragraph (b) of § 1.801-3) which issues contracts with reserves based on segregated asset accounts (as defined in section 801(g)(1)(B) and paragraph (a)(2) of this section) shall separately account for each and every income, exclusion, deduction, asset, reserve, and other liability item which is properly attributable to such segregated asset accounts. In those cases where such items are not directly accounted for, separate accounting shall be made:

(i) According to the method regularly employed by the company, if such method is reasonable, and

(ii) In all other cases in a manner which, in the opinion of the district director, is reasonable.

A method of separate accounting for such items as are not accounted for directly will be deemed "regularly employed" by a life insurance company if the method was consistently followed in prior taxable years, or if, in the case of a company which has never before issued contracts with reserves based on segregated asset accounts, the company initiates in the first taxable year for which it issues such contracts a reasonable method of separate accounting for such items and consistently follows such method thereafter. Ordinarily, a company regularly employs a method of accounting in accordance with the statute of the State, Territory, or the District of Columbia, in which it operates.

(2) Every life insurance company issuing contracts with reserves based on segregated asset accounts shall keep such permanent records and other data relating to such contracts as is necessary to enable the district director to determine the correctness of the application of the rules prescribed in section 301(g) and this section and to ascertain the accuracy of the computations involved.

(d) *Investment yield.* (1) For purposes of part I, section 801(g)(4)(A) provides that the policy and other contract liability requirements (as determined under section 805), and the life insurance company's share of investment yield (as determined under sections 804(a) or 809(b)), shall be separately computed:

(i) With respect to the items separately accounted for in accordance with section 801(g)(3) and paragraph (c) of this section, and

(ii) Excluding the items taken into account under subdivision (i) of this subparagraph.

Thus, for purposes of determining both taxable investment income and gain or loss from operations, a life insurance company shall separately compute the life insurance company's share of the investment yield on the assets in its segregated asset account without regard to the policy and other contract liability requirements of, and the investment income attributable to, contracts with reserves that are not based on the segregated asset account. Such separate computations shall be made after any allocation required under section 801(g)(4)(B) and subparagraph (2) of this paragraph.

(2)(i) Section 801(g)(4)(B) provides that if the net short-term capital gain (as defined in section 1222(5)) exceeds the net long-term capital loss (as defined in section 1222(8)), determined without regard to any separate computations under section 801(g)(4)(A) and subparagraph (1) of this paragraph, then such excess shall be allocated between section 801(g)(4)(A) (i) and (ii) and subparagraph (1) (i) and (ii) of this paragraph. Such allocation shall be in proportion to the respective contributions to such excess of the items taken into account under each such section and subparagraph. The allocation

under this subparagraph shall be made before the separate computations prescribed by section 801(g)(4)(A) and subparagraph (1) of this paragraph.

(ii) The operation of the allocation required under section 801(g)(4)(B) and subdivision (i) of this subparagraph may be illustrated by the following examples:

*Example 1.* For the taxable year 1962, T, a life insurance company which issues regular life insurance and annuity contracts and contracts with reserves based on segregated asset accounts, had (without regard to section 801(g)(4)(A)) realized short-term capital gains of \$10,000 and short-term capital losses of \$10,000 attributable to its general asset accounts and realized short-term capital gains of \$12,000 attributable to its segregated asset accounts. For the taxable year 1962, the excess of the net short-term capital gain ( $\$10,000 + \$12,000 - \$10,000$ , or \$12,000) over the net long-term capital loss (0) was \$12,000. Of the excess of \$12,000, 100 percent was contributed by the segregated asset accounts. Applying the provisions of section 801(g)(4)(B), T would allocate the entire \$12,000 to its segregated asset accounts for such taxable year.

*Example 2.* The facts are the same as in example 1 except that for the taxable year 1962, T had (without regard to section 801(g)(4)(A)) realized short-term capital losses of \$8,000 attributable to its general asset accounts and realized long-term capital gains of \$1,000 and long-term capital losses of \$5,000 attributable to its segregated asset accounts. For the taxable year 1962, the excess of the net short-term capital gain ( $\$10,000 + \$12,000 - \$8,000$ , or \$14,000) over the net long-term capital loss ( $\$5,000 - \$1,000$ , or \$4,000) was \$10,000. Of the excess of \$10,000, the general asset accounts contributed 20 percent (\$2,000 ( $\$10,000 - \$8,000$ ) ÷ \$10,000) and the segregated asset accounts contributed 80 percent (\$8,000 ( $\$12,000 - \$4,000$ ) ÷ \$10,000). Applying the provisions of section 801(g)(4)(B), T would allocate \$2,000 ( $\$10,000 \times 20$  percent) to its general asset accounts and \$8,000 ( $\$10,000 \times 80$  percent) to its segregated asset accounts for such taxable year.

*Example 3.* W is a life insurance company which issues regular life insurance and annuity contracts and contracts with reserves based on either of two segregated asset accounts, Separate Account C or Separate Account D. For the taxable year 1962, W had (without regard to section 801(g)(4)(A)) realized short-term capital gains of \$16,000 and long-term capital losses of \$15,000 attributable to its general asset accounts, long-term capital gains of \$12,000 and short-term capital losses of \$6,000 attributable to Separate Account C and long-term capital gains of \$7,000 and short-term capital losses of \$5,000 attributable to Separate Account D.

**§ 1.801-8**

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

For the taxable year 1962, the excess of the net short-term capital gain (\$16,000 - \$6,000 - \$5,000) over the net long-term capital loss (0) was \$5,000. Of the \$5,000 excess, 20 percent (\$16,000 - \$15,000 + \$5,000) was contributed by the general asset accounts, leaving 80 percent as the amount contributed by the segregated asset accounts. Applying the provisions of section 801(g)(4)(B) W would allocate \$1,000 (20 percent of \$5,000) to the general asset accounts, leaving \$4,000 (80 percent of \$5,000) to be allocated among the segregated asset accounts, Separate Account C and Separate Account D. W would allocate \$3,000 of the \$4,000 to Separate Account C computed as follows:

$$\$3,000 = \frac{(\$4,000) \times (\$12,000 - \$6,000)}{(\$12,000 - \$6,000) + (\$7,000 - \$5,000)}$$

W would allocate \$1,000 of the \$4,000 to Separate Account D computed as follows:

$$\$1,000 = \frac{(\$4,000) \times (\$7,000 - \$5,000)}{(\$12,000 - \$6,000) + (\$7,000 - \$5,000)}$$

(e) *Policy and other contract liability requirements.* (1) For purposes of part I, section 801(g)(5)(A) provides that with respect to life insurance reserves based on segregated asset accounts (as defined in section 801(g)(1)(B) and paragraph (a)(2) of this section), the adjusted reserves rate and the current earnings rate for purposes of section 805(b), and the rate of interest assumed by the taxpayer for purposes of sections 805(c) and 809(a)(2), shall be a rate equal to the current earnings rate determined under section 805(b)(2) and paragraph (a)(2) of § 1.805-5 with respect to the items separately accounted for in accordance with section 801(g)(3), reduced by the percentage obtained by dividing:

(i) Any amount retained with respect to all of the reserves based on a segregated asset account by the life insurance company from gross investment income (as defined in section 804(b) and paragraph (a) of § 1.804-3) on segregated assets, to the extent such retained amount exceeds the deductions allowable under section 804(c) which are attributable to such reserves, by

(ii) The means of such reserves.  
 (2) For purposes of part I, section 801(g)(5)(B) provides that with respect to reserves based on segregated asset accounts other than life insurance reserves, there shall be included as interest paid within the meaning of section

805(e)(1) and paragraph (b)(1) of § 1.805-8, an amount equal to the product of the means of such reserves multiplied by the rate of interest assumed as defined in section 801(g)(5)(A) and subparagraph (1) of this paragraph.

(3) For purposes of this paragraph, any change in the rate of interest assumed by the taxpayer in calculating the reserve on a contract with reserves based on a segregated asset account for any taxable year beginning after December 31, 1961, which is attributable to an increase or decrease in the current earnings rate, shall not be treated as a change of basis in computing reserves for purposes of section 806(b) (relating to certain changes in reserves) or section 810 (d)(1) (relating to adjustment for change in computing reserves).

(4) The provisions of section 801(g) (3) through (5) may be illustrated by the following example. For purposes of this example, it is assumed that all computations have been carried out to a sufficient number of decimal places to insure substantial accuracy and to eliminate any significant error in the resulting tax liability.

*Example.* The books of R, a life insurance company, discloses the following facts with respect to items of investment yield, deductions, assets, and reserves for the taxable year 1962:

(a) *Excerpts from Company Financial Statements.*

	Company regular account	Separate account A	Separate account B
(1) Investment yield			
Interest wholly tax-exempt .....	\$100,000	\$3,000	\$1,000
Interest—other .....	10,000,000	8,000	15,000
Dividends received	200,000	25,000	27,000
Other items of investment yield ....	100,000	2,000	1,000
Gross investment income .....	10,400,000	38,000	44,000
Less deductions (sec. 804(c)) .....	1,000,000	4,000	4,400
Investment yield ....	9,400,000	34,000	39,600
(2) Assets and reserves:			
(i) Assets:			
Jan. 1, 1962 ...	190,000,000	.....	.....
Dec. 31, 1962	210,000,000	1,600,000	1,800,000
Mean .....	200,000,000	800,000	900,000
(ii) Life insurance reserves:			
Jan. 1, 1962 ...	152,000,000	.....	.....
Dec. 31, 1962	168,000,000	1,600,000	1,640,000

(1) Investment yield	Company regular account	Separate account A	Separate account B
Mean .....	160,000,000	800,000	820,000
(iii) Reserves based on segregated asset accounts other than life insurance reserves:			
Jan. 1, 1962 ...	.....	.....	120,000
Dec. 31, 1962 ...	.....	.....	60,000
Mean .....	.....	.....	60,000

(b) *Additional facts.* In addition to the facts assumed in (a) above, assume the following: The company retained with respect to reserves based upon segregated asset accounts a total of \$4,720 from gross investment income on Separate Account A and \$5,720 from gross investment income on Separate Account B. With respect to the Company Regular Account computed without regard to the items in either of the separate accounts, the policy and other contract liability requirement is \$6,580,000 and the required interest is \$5,640,000. There are no items of interest paid with respect to the separate accounts other than those computed under section 801(g)(5)(B). Based on these facts, the current earnings rate (sec. 805(b)); adjusted reserves rate (sec. 805 (b)); and rate of interest assumed (secs. 805(c) and 809(a)(2)); and the policy and other contract liability requirements are determined for each of the Separate Accounts A and B (and the policy and other contract liability requirements for the Company Regular Account) as set forth in items (c) through (1) below.

(c) *Separate Account A.* The current earnings rate determined under section 805 (b)(2) with respect to the items separately accounted for under Separate Account A, prior to the reduction provided for under section 801(g)(5)(A), is 4.25 percent (the investment yield, \$34,000, divided by the mean of the assets, \$800,000). The company retained with respect to such reserves from gross investment income on Separate Account A a total of \$4,720. The company had deductions allowable under section 804(c) with respect to such account of \$4,000. Accordingly, for purposes of section 801(g)(5)(A)(i), the amount retained by the company was \$720 (the total amount retained of \$4,720 less the deductions allowable under section 804(c) of \$4,000). The reduction percentage for purposes of section 801(g)(5)(A) is 0.09 percent (the amount retained of \$720 divided by the mean of the life insurance reserves of \$800,000). Therefore, the adjusted reserves rate and the current earnings rate for purposes of section 805(b), and the rate of interest assumed for purposes of sections 805(c) and 809(a)(2) is equal to 4.16 percent (the current earnings rate of 4.25 percent less the reduction percentage of 0.09 percent).

The policy and other contract liability requirements with respect to Separate Account A is determined as follows: For purposes of section 805(a) (1) and (2), the amount is \$33,280 (the mean of the life insurance reserves, \$800,000, multiplied by the current earnings rate, as determined under section 801(g)(5)(A), 4.16 percent). Thus, the policy and other contract liability requirement for Separate Account A is \$33,280.

(d) *Separate Account B.* The current earnings rate determined under section 805 (b)(2) with respect to the items separately accounted for under Separate Account B, prior to the reduction provided for under section 801(g)(5)(A), is 4.40 percent (the investment yield, \$39,600 divided by the mean of the assets, \$900,000). The company retained with respect to such reserves from gross investment income on Separate Account B a total of \$5,720. The company had deductions allowable under section 804(c) with respect to such account of \$4,400. Accordingly, for purposes of section 801(g)(5)(A)(i) the amount retained by the company was \$1,320 (the total amount retained of \$5,720 less the deductions allowable under section 804(c) of \$4,400). The reduction percentage for purposes of section 801(g)(5)(A) is 0.15 percent (the amount retained of \$1,320 divided by the mean of the reserves based on Separate Account B of \$880,000 (\$820,000 plus \$60,000)). Therefore, the adjusted reserves rate and the current earnings rate for purposes of section 805(b), and the rate of interest assumed for purposes of section 805(c) and 809(a)(2) is equal to 4.25 percent (the current earnings rate of 4.40 percent less the reduction percentage of 0.15 percent).

With respect to reserves based on segregated asset accounts other than life insurance reserves, Separate Account B had such reserves at December 31, 1962, of \$120,000. The mean of such reserves was \$60,000. The rate of interest assumed with respect to such reserves is 4.25 percent, as computed above. Accordingly, there shall be included as interest paid within the meaning of section 805(e)(1) the amount of \$2,550 (the mean of such reserves, \$60,000 multiplied by the rate of interest assumed of 4.25 percent).

The policy and other contract liability requirements with respect to Separate Account B is determined as follows:

(1) For purposes of section 805(a)(1) and (2), the amount is \$34,850 (the mean of the life insurance reserves, \$820,000, multiplied by the current earnings rate, as determined under section 801(g)(5)(A), 4.25 percent).

(2) For purposes of section 805(a)(3), the amount is \$2,550 (the mean of the reserves based on Separate Account B other than life insurance reserves, \$60,000, multiplied by the rate of interest assumed, as determined under section 801(g)(5)(A), 4.25 percent). It has been assumed that there was no other interest paid on Separate Account B within

§ 1.801-8

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

the meaning of section 805(e). If there was other interest paid with respect to Separate Account B that met the requirements of section 805(e), however, then such interest would be included under section 805(a)(3). Thus, the policy and other contract liability requirement for Separate Account B is \$37,400 (\$34,850+\$2,550).

(e) *Company Regular Account.* The policy and other contract liability requirements with respect to the Company Regular Account is \$6,580,000 (this amount is determined by the company in the manner provided by section 805 (and the regulations thereunder) without regard to either Separate Account A or Separate Account B).

(f) *Policyholders' share and company's share of investment yield—section 804.* The policyholders' and company's share of investment yield and taxable investment income are computed as follows:

(1) *Company Regular Account*  
 Policyholders' share of investment yield. 70% (\$6,580,000÷\$9,400,000).  
 Company's share of investment yield (100% less 70%). 30%.

(2) *Separate Account A*  
 Policyholders' share of investment yield. 97.8824% (\$33,280 ÷\$34,000).  
 Company's share of investment yield (100% less 97.8824%). 2.1176%.

(3) *Separate Account B*  
 Policyholders' share of investment yield. 94.444% (\$37,400 ÷\$39,600).  
 Company's share of investment yield (100% less 94.444%). 5.556%.

(g) *The company's share of investment yield under section 804 is determined as follows:*

Investment yield (from item (a)(1))	Company regular account (30 percent times each amount in item (a)(1))	Separate account A (2.1176 percent times each amount in item (a)(1))	Separate account B (5.556 percent times each amount in item (a)(1))
Interest wholly tax-exempt .....	\$30,000	\$63.53	\$55.56
Interest—other .....	3,000,000	169.41	833.40
Dividends received .....	60,000	529.40	1,500.12
Other items of gross investment income. ....	30,000	42.35	55.56
	3,120,000	804.69	2,444.64
Less deductions .....	300,000	84.70	244.46
Investment yield .....	2,820,000	719.99	2,200.18

(h) *Taxable investment income.* The company's taxable investment income (without regard to any excess of net long-term capital

gain over net short-term capital loss) is determined as follows:

Life insurance company's share of investment yield (\$2,820,000+\$719.99÷ \$2,200.18) .....	\$2,822,920.17
Less:	
Company's share of interest wholly tax-exempt (\$30,000÷ \$63.53+\$55.56)=\$30,119.09	
85 percent of company's share of dividends received (but not to exceed 85% of taxable investment income computed without regard to this deduction) (85%×\$62,029.52) (\$60,000+\$529.40+\$1,500.12)=\$52,725.09	
Small business deduction (10% of investment yield, \$9,473,600, not to exceed \$25,000) = \$25,000.00	107,844.18
Taxable investment income .....	2,715,075.99

(i) *Required interest—section 809(a)(2)—(1) Separate Account A.* The rate of interest assumed by the company, with respect to Separate Account A is 4.16 percent (see (c) above). The required interest for purposes of section 809(a)(2) is determined as follows:

Life insurance reserves: 4.16% (rate assumed) times \$800,000 (mean of life insurance reserves) .....	\$33,280.00
---	-------------

(2) *Separate Account B.* The rate of interest assumed by the company with respect to Separate Account B is 4.25 percent (see (d) above). The required interest for purposes of section 809(a)(2) is determined as follows:

(i) Life insurance reserves: 4.25% (rate assumed) times \$820,000 (mean of life insurance reserves) .....	\$34,850.00
(ii) Other section 810(c) reserves: 4.25% (rate assumed) times \$60,000 (mean of reserves other than life insurance reserves) .....	\$2,550.00
	\$37,400.00

(3) *Company Regular Account.* The required interest with respect to the Company Regular Account is \$5,640,000 (this amount is assumed for purposes of this example, but it would be determined by the company in the

**Internal Revenue Service, Treasury**

**§ 1.801-8**

manner provided by section 809 without regard to either Separate Account A or Separate Account B).

holders' share and the company's share of investment yield for purposes of section 809 is determined as follows:

(j) *Policyholders' share and company's share of investment yield—section 809.* The policy-

(1) <i>Company Regular Account:</i>	
Policyholders' share of investment yield .....	60% (\$5,640,000+\$9,400,000).
Company's share of investment yield (100 percent—60%) .....	40%.
(2) <i>Separate Account A:</i>	
Policyholders' share of investment yield .....	97.8824% (\$33,280+\$34,000).
Company's share of investment yield (100%—97.8824 percent) .....	2.1176%.
(3) <i>Separate Account B:</i>	
Policyholders' share of investment yield .....	94.444% (\$37,400+\$39,600).
Company's share of investment yield (100%—94.444%) .....	5.556%.

(k) *The company's share of investment yield under section 809 is determined as follows:*

Investment yield (from item (a)(1))	Company regular account (40 percent times each amount in item (a)(1))	Separate account A (2.1176 percent times each amount in item (a)(1))	Separate account B (5.556 percent times each amount in item (a)(1))
Interest wholly tax-exempt .....	\$40,000	\$63.53	\$55.56
Interest—other .....	4,000,000	169.41	833.40
Dividends received .....	80,000	529.40	1,500.12
Other items of gross investment income .....	40,000	42.35	55.56
Less deductions .....	4,160,000	804.69	2,444.64
	400,000	84.70	244.46
Investment yield .....	3,760,000	719.99	2,200.18

(1) *Deductions under section 809(d)(8).* For purposes of section 809(d)(8), the life insurance company's share of each of such items is determined as follows:

(1) Wholly tax-exempt interest (\$40,000+\$63.53+\$55.56) .....	\$40,119.09
(2) Dividends received 85% (\$80,000+\$529.40+\$1,500.12) (it is assumed for purposes of this example that this amount does not exceed 85% of the gain from operations as computed under sec. 809(d)(8)(B)) .....	69,725.09

(ii) By adding thereto the sum of any amounts subtracted from time to time (for the taxable year) from such reserves by reason of realized or unrealized depreciation in the value of such assets.

(2) The provisions of subparagraph (1) of this paragraph may be illustrated by the following example:

*Example.* Company M, a life insurance company issuing only contracts with reserves based on segregated asset accounts as defined in section 801(g)(1)(B) and paragraph (a)(2) of this section (other than contracts described in section 805(d)(1) (A), (B), (C), or (D)), increased its life insurance reserves held with respect to such contracts during the taxable year 1962 by \$275,000. Of the total increase in the reserves, \$100,000 was attributable to premium receipts, \$50,000 to dividends and interest, \$100,000 to unrealized appreciation in the value of the assets held in relation to such reserves, and \$25,000 to realized capital gains on the sale of such assets. As of the close of the taxable year 1962, the reserves held by company M with respect to all such contracts amounted to \$1,275,000. However, under section 801(g)(6) and this subparagraph, this amount must be reduced by the \$100,000 unrealized asset value appreciation and the \$25,000 of realized capital gains.

(f) *Increases and decreases in reserves.* (1) Section 801(g)(6) provides that for purposes of section 810 (a) and (b) (relating to adjustments for increases or decreases in certain reserves), the sum of the items described in section 810(c) and paragraph (b) of § 1.810-2 taken into account as of the close of the taxable year shall be adjusted:

(i) By subtracting therefrom the sum of any amounts added from time to time (for the taxable year) to the reserves separately accounted for in accordance with section 801(g)(3) and paragraph (c) of this section by reason of realized or unrealized appreciation in value of the assets held in relation thereto, and

Accordingly, for purposes of section 810(a) and (b), the amount of these reserves which is to be taken into account as of the close of the taxable year 1962 under section 810(c) is \$1,150,000 (\$1,275,000 less \$125,000). However, for purposes of section 810 (a) and (b), the amount of these reserves which is to be taken into account as of the beginning of the taxable year 1963 under section 810(c) is \$1,275,000 (the amount as of the close of the taxable year 1962 before reduction of \$125,000 for unrealized appreciation and realized capital gains).

(3)(i) Under section 801(g)(6), the deduction allowable for items described in section 809(d) (1) and (7) (relating to death benefits and assumption reinsurance, respectively) with respect to segregated asset accounts shall be reduced to the extent that the amount of such items is increased for the taxable year by appreciation (or shall be increased to the extent that the amount of such items is decreased for the taxable year by depreciation) not reflected in adjustments required to be made under subparagraph (1) of this paragraph.

(ii) The provisions of this subparagraph may be illustrated by the following example:

*Example.* On June 30, 1962, X, a life insurance company, reinsured a portion of its insurance contracts with reserves based on segregated asset accounts with Y, a life insurance company, under an agreement whereby Y agreed to assume and become solely liable under the contracts reinsured. The reserves on the contracts reinsured by X were \$90,000, of which \$10,000 was attributable to unrealized appreciation in the value of the assets held in relation to such reserves. However, no amounts had been added to the reserves by reason of the unrealized appreciation of \$10,000 and consequently, the \$10,000 was not reflected in adjustments to reserves under section 809(g)(6) or subparagraph (1) of this paragraph. Under the reinsurance agreement, X made a payment of \$90,000 in cash to Y for assuming such contracts. Applying the provisions of section 809(d)(7), and assuming no other such reinsurance transactions by X during the taxable year, X would have an allowable deduction of \$90,000 as a result of this payment on June 30, 1962. However, applying the provisions of section 801(g)(6) and this subparagraph, the actual deduction allowed would be \$80,000 (\$90,000 less \$10,000). See section 806 (a) and § 1.806-3 for the adjustments in reserves and assets to be made by X and Y as a result of this transaction. For the treatment by Y of this \$90,000 payment, see section 809(c)(1) and paragraph (a)(1)(i) of § 1.809-4.

(g) *Basis of assets held for certain pension plan contracts.* Section 801(g)(7) provides that in the case of contracts described in section 805(d)(1) (A), (B), (C), (D), or (E) (relating to the definition of pension plan reserves), the basis of each asset in a segregated asset account shall (in addition to all other adjustments to basis) be (i) increased by the amount of any appreciation in value, and (ii) decreased by the amount of any depreciation in value; but only to the extent that such appreciation and depreciation are reflected in the increases and decreases in reserves, or other items described in section 801(g)(6), with respect to such contracts. Thus, there shall be no capital gains tax payable by a life insurance company on appreciation realized on assets in a segregated asset account to the extent such appreciation has been reflected in reserves, or other items described in section 801(g)(6), for contracts described in section 805(d)(1) (A), (B), (C), (D), or (E) based on segregated asset accounts.

(h) *Additional separate computation—*  
(1) *Assets and total insurance liabilities.* A life insurance company which issues contracts with reserves based on segregated asset accounts (as defined in section 801(g)(1)(B) and paragraph (a)(2) of this section) shall separately compute and report with its return the assets and total insurance liabilities which are properly attributable to all of such segregated asset accounts. Each foreign corporation carrying on a life insurance business which issues such contracts shall separately compute and report with its return assets held in the United States and total insurance liabilities on United States business which are properly attributable to all of such segregated asset accounts.

(2) *Foreign life insurance companies.* For adjustment under section 819 in the case of a foreign life insurance company which issues contracts based on segregated asset accounts under section 801(g), see § 1.819-2(b)(4).

[T.D. 6886, 31 FR 8681, June 23, 1966, as amended by T.D. 6970, 33 FR 12044, Aug. 24, 1968; T.D. 7501, 42 FR 42341, Aug. 23, 1977]