

§ 1.812-9

26 CFR Ch. I (4-1-10 Edition)

Offset for 1963 (the \$30,000 gain from operations for such year reduced by the carryover for such year of \$10,000 from 1960, the carryover from 1962 to 1963 not being taken into account) .....	20,000
Offset for 1964 (the \$35,000 gain from operations for such year reduced by the carryover to such year of \$0 from 1960, the carryover from 1962 to 1964 not being taken into account) ...	35,000
Offset for 1965 (the \$75,000 gain from operations for such year reduced by the carryover to such year of \$0 from 1960, the carryover from 1962 to 1965 not being taken into account) .....	75,000
Sum of offsets .....	\$130,000
Carryover .....	20,000

(8) *Carryover to 1967.* The carryover to this year is \$3,000 (the excess, if any, of the loss from 1962 over the sum of the offsets for 1959, 1960, 1961, 1963, 1964, 1965, and 1966), computed as follows:

Loss from operations .....	\$150,000
Less:	
Offset for 1959 (the \$30,000 gain from operations for such year reduced by the carryback to such year of \$60,000 from 1960, the carryback from 1962 to 1959 not being taken into account) .....	0
Offset for 1960 (a year in which a loss from operations was sustained) .....	0

Offset for 1961 (the \$20,000 gain from operations for such year reduced by the carryover to such year of \$30,000 from 1960, the carryback from 1962 to 1961 not being taken into account) .....	0
Offset for 1963 (the \$30,000 gain from operations for such year reduced by the carryover to such year of \$10,000 from 1960, the carryover from 1962 to 1963 not being taken into account) .....	20,000
Offset for 1964 (the \$35,000 gain from operations for such year reduced by the carryover to such year of \$0 from 1960, the carryover from 1962 to 1964 not being taken into account) ....	35,000
Offset for 1965 (the \$75,000 gain from operations for such year reduced by the carryover to such year of \$0 from 1960, the carryover from 1962 to 1965 not being taken into account) ...	75,000
Offset for 1966 (the \$17,000 gain from operations for such year computed without the deduction of the carryover from 1962) .....	17,000
Sum of offsets .....	147,000
Carryover .....	3,000

(d) *Determination of operations loss deduction for each year.* The carryovers and carrybacks computed under paragraphs (b) and (c) of this section are used as a basis for the computation of the operations loss deduction in the following manner:

Taxable year	Carryover		Carryback		Operations loss deductions
	From 1960	From 1962	From 1960	From 1962	
1958 .....			\$75,000		\$75,000
1959 .....			60,000	\$150,000	210,000
1961 .....	\$30,000			150,000	180,000
1963 .....	10,000	\$150,000			160,000
1964 .....		130,000			130,000
1965 .....		95,000			95,000
1966 .....		20,000			20,000
1967 .....		3,000			3,000

[T.D. 6535, 26 FR 539, Jan. 20, 1961]

§ 1.812-9 Cross-reference.

For special rules regarding the treatment of modified guaranteed contracts (as defined in section 817A and § 1.817A-1(a)(1)), see § 1.817A-1.

[T.D. 9058, 68 FR 24350, May 7, 2003]

DISTRIBUTIONS TO SHAREHOLDERS

§ 1.815-1 Taxable years affected.

Sections 1.815-2 through 1.815-6, except as otherwise provided therein, 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), the Act of October 10, 1962 (76 Stat. 808), and the Act of October 23, 1962 (76 Stat. 1134).

[T.D. 6886, 31 FR 8689, June 23, 1966]

**§ 1.815-2 Distributions to shareholders.**

(a) *In general.* Section 815 provides that every stock life insurance company subject to the tax imposed by section 802 shall establish and maintain two special surplus accounts for Federal income tax purposes. These special accounts are the shareholders surplus account (as defined in section 815(b) and § 1.815-3) and the policyholders surplus account (as defined in section 815(c) and § 1.815-4). To the extent that a distribution to shareholders (as defined in paragraph (c) of this section) is treated as being made out of the shareholders surplus account, no tax is imposed on the company with respect to such distribution. However, to the extent that a distribution to shareholders is treated as being made out of the policyholders surplus account, the amount subtracted from the policyholders surplus account by reason of such distribution shall be taken into account in determining life insurance company taxable income under section 802(b).

(b) *Priority system for distributions to shareholders.* (1) For purposes of section 815 (other than subsection (e) thereof relating to certain mutualizations) and section 802(b)(3) (relating to the determination of life insurance company taxable income), any distribution made to shareholders after December 31, 1958, shall be treated in the following manner:

(i) Distributions shall be treated as first being made out of the shareholders surplus account (as defined in section 815(b) and § 1.815-3);

(ii) Once the shareholders surplus account has been reduced to zero, distributions shall then be treated as being made out of the policyholders surplus account (as defined in section 815(c) and § 1.815-4) until that account has been reduced to zero; and

(iii) Finally, any distributions in excess of the amounts in the shareholders surplus account and the policyholders surplus account shall be treated as being made out of other accounts (as defined in § 1.815-5).

(2) For purposes of subparagraph (1) of this paragraph, in order to determine whether a distribution (or any portion thereof) shall be treated as being made out of the shareholders surplus account, policyholders surplus account, or other accounts, the amount in such accounts at the end of any taxable year shall be the cumulative balance in such accounts at the end of the taxable year, computed without diminution by reason of a distribution (or any portion thereof) during the taxable year which is treated as being made out of such accounts. For example, on January 1, 1960, S, a stock life insurance company, had \$1,000 in its shareholders surplus account and \$3,000 in its policyholders surplus account. On November 1, 1960, S distributed \$4,000 to its shareholders. Under the provisions of section 815(b)(2) and paragraph (b) of § 1.815-3, S added \$5,000 to its shareholders surplus account for the taxable year 1960. Since the distributions to shareholders during the taxable year 1960, \$4,000, does not exceed the cumulative balance in the shareholders surplus account at the end of the taxable year, computed without diminution by reason of distributions treated as made out of such account during the taxable year, \$6,000 (\$1,000 plus \$5,000), the entire distribution is treated as being made out of the shareholders surplus account.

(3) Except in the case of a distribution in cash and as otherwise provided herein, the amount to be charged to the special surplus accounts referred to in subparagraph (1) of this paragraph with respect to any distributions to shareholders (as defined in section 815(a) and paragraph (c) of this section) shall be the fair market value of the property distributed, determined as of the date of distribution. However, for the amount of the adjustment to earnings and profits reflecting such distributions, see section 312 and the regulations thereunder. For a special rule relating to the determination of the amount to be charged to such special

### § 1.815-3

### 26 CFR Ch. I (4-1-10 Edition)

surplus accounts in the case of a distribution by a foreign life insurance company carrying on a life insurance business within the United States, see section 819(c)(1) and the regulations thereunder.

(c) *Distributions to shareholders defined.* (1) Except as otherwise provided in section 815(f) and subparagraph (2) of this paragraph, the term *distribution*, as used in section 815(a) and paragraph (b) of this section, means any distribution of property made by a life insurance company to its shareholders. For purposes of the preceding sentence, the term *property* means any property (including money, securities, and indebtedness to the company) other than stock, or rights to acquire stock, in the company making the distribution. Thus, for example, the term includes a distribution which is considered a dividend under section 316, but is not limited to the extent that such distribution must be made out of the accumulated or current earnings and profits of the company making the distribution. For example, except as otherwise provided in section 815(f) and subparagraph (2) of this paragraph, there is a distribution within the meaning of this paragraph in any case in which a corporation acquires the stock of a shareholder in exchange for property in a redemption treated as a distribution in exchange for stock under section 302(a) or treated as a distribution of property under section 302(d). For special rules relating to distributions to shareholders in acquisition of stock pursuant to a plan of mutualization, see section 815(e) and paragraph (e) of § 1.815-6.

(2) The term *distribution*, as used in section 815(a) and paragraph (b) of this section, does not (except for purposes of section 815(a)(3) and (e)(2)(B)) include any distribution in redemption of stock issued prior to January 1, 1958, where such stock was at all times on and after the date of its issuance and on and before the date of its redemption limited as to the amount of dividends payable and was callable, at the option of the issuer, at a price not in excess of 105 percent of the sum of its issue price plus the amount of contribution to surplus (if any) made by

the original purchaser at the time of his purchase.

[T.D. 6535, 26 FR 542, Jan. 20, 1961, as amended by T.D. 7189, 37 FR 12793, June 29, 1972]

### § 1.815-3 Shareholders surplus account.

(a) *In general.* Every stock life insurance company subject to the tax imposed by section 802 shall establish and maintain a shareholders surplus account. This account shall be established as of January 1, 1958, and the beginning or opening balance of the shareholders surplus account on that date shall be zero.

(b) *Additions to shareholders surplus account.* (1) The amount added to the shareholders surplus account for any taxable year beginning after December 31, 1957, shall be the amount by which the sum of:

(i) The life insurance company taxable income (computed without regard to section 802(b)(3)),

(ii) In the case of a taxable year beginning after December 31, 1958, the amount (if any) by which the net long-term capital gain exceeds the net short-term capital loss, reduced (in the case of a taxable year beginning after December 31, 1961) by the amount referred to in subdivision (i) of this subparagraph,

(iii) The deduction for partially tax-exempt interest provided by section 242 (as modified by section 804(a)(3)), the deductions for dividends received provided by sections 243, 244, and 245 (as modified by section 809(d)(8)(B)), and the amount of interest excluded from gross income under section 103, and

(iv) The small business deduction provided by section 809(d)(10). Exceeds the taxes imposed for the taxable year by section 802(a), computed without regard to section 802(b)(3).

(c) *Subtractions from shareholders surplus account—*(1) *In general.* There shall be subtracted from the cumulative balance in the shareholders surplus account at the end of any taxable year, computed without diminution by reason of distributions made during the taxable year, the amount which is treated as being distributed out of such account under section 815(a) and paragraph (b) of § 1.815-2.

**Internal Revenue Service, Treasury**

**§ 1.815-4**

(2) *Special rule; distributions in 1958.* There shall be subtracted from the shareholders surplus account (to the extent thereof) for any taxable year beginning in 1958 the amount of the distributions to shareholders made by the company during 1958. For example, assume S, a stock life insurance company, had additions to its shareholders surplus account (as determined under section 815(b)(2) and paragraph (b) of this section) for the taxable year 1958 of \$10,000, and actually distributed as dividends to its shareholders \$8,000 during the year 1958. The balance in S's shareholders surplus account as of January 1, 1959, shall be \$2,000. If S had distributed \$12,000 as dividends in 1958, the balance in its shareholders surplus account as of January 1, 1959, would be zero and the other accounts referred to in section 815(a)(3) and paragraph (b)(1)(iii) of § 1.815-2 would be reduced by \$2,000.

(d) *Illustration of principles.* The application of section 815(b) and this section may be illustrated by the following example:

*Example.* The books of S, a stock life insurance company, reflect the following items for the taxable year 1960.

Balance in shareholders surplus account as of 1-1-60 .....	\$5,000
Life insurance company taxable income computed without regard to sec. 802(b)(3) .....	4,000
Excess of net long-term capital gain over net short-term capital loss .....	1,700
Tax-exempt interest included in gross investment income under sec. 804(b) .....	100
Small business deduction (determined under sec. 809(d)(10)) .....	200
Tax liability under sec. 802(a) (1) and (2) computed without regard to sec. 802(b)(3) .....	1,625
Amount distributed to shareholders .....	9,000

For purposes of determining the amount to be subtracted from its shareholders surplus account for the taxable year, S would first make up the following schedule in order to determine the cumulative balance in the shareholders surplus account at the end of the taxable year, computed without diminution by reason of distributions made during the taxable year:

(1) Balance in shareholders surplus account as of 1-1-60 .....	\$5,000
(2) Additions to account:	
(a) Life insurance company taxable income computed without regard to sec. 802(b)(3) .....	\$4,000
(b) Excess of net long-term capital gain over net short-term capital loss .....	1,700

(c) Tax-exempt interest included in gross investment income under sec. 804(b) ...	100	
(d) Small business deduction (determined under sec. 809(d)(10)) .....	200	
<b>Total .....</b>	<b>6,000</b>	
Less:		
Tax liability under sec. 802(a) (1) and (2) computed without regard to sec. 802(b)(3) .....	1,625	4,375
(3) Cumulative balance in shareholders surplus account as of 12-31-60 (item (1) plus item (2)) .....		9,375

Since the amount distributed to shareholders during the taxable year, \$9,000, does not exceed the cumulative balance in the shareholders surplus account at the end of the taxable year, computed without diminution by reason of distributions made during the taxable year, \$9,375, under the provisions of section 815(a), the entire distribution shall be treated as being made out of the shareholders surplus account. Thus, \$9,000 shall be subtracted from the shareholders surplus account (leaving a balance of \$375 in such account at the end of the taxable year) and S shall incur no additional tax liability by reason of the distribution to its shareholders during the taxable year 1960.

[T.D. 6535, 26 FR 542, Jan. 20, 1961, as amended by T.D. 7189, 37 FR 12793, June 29, 1972]

**§ 1.815-4 Policyholders surplus account.**

(a) *In general.* Every stock life insurance company subject to the tax imposed by section 802 shall establish and maintain a policyholders surplus account. This account shall be established as of January 1, 1959, and the beginning or opening balance of the policyholders surplus account on that date shall be zero.

(b) *Additions to policyholders surplus account.* The amount added to the policyholders surplus account for any taxable year beginning after December 31, 1958, shall be the sum of:

- (1) An amount equal to 50 percent of the amount by which the gain from operations for the taxable year exceeds the taxable investment income,
- (2) The deduction allowed or allowable under section 809(d)(5) (as limited by section 809(f)) for certain non-participating contracts, and
- (3) The deduction allowed or allowable under section 809(d)(6) (as limited by section 809(f)) for taxable years beginning before January 1, 1963, for

group life and group accident and health insurance contracts, and for taxable years beginning after December 31, 1962, for accident and health insurance and group life insurance contracts.

(c) *Subtractions from policyholders surplus account*—(1) *In general.* There shall be subtracted from the cumulative balance in the policyholders surplus account at the end of any taxable year, computed without diminution by reason of distributions made during the taxable year, an amount equal to the sum of:

(i) The amount which (without regard to subdivision (ii) of this subparagraph) is treated under section 815(a) as distributed out of the policyholders surplus account for the taxable year, plus

(ii) The amount (determined without regard to section 802(a)(3)) by which the tax imposed for taxable years beginning before January 1, 1962, by section 802(a)(1), and for taxable years beginning after December 31, 1961, by section 802(a), is increased by reason of section 802(b)(3).

In addition, there shall be subtracted from the policyholders surplus account for the taxable year those amounts which, at the close of the taxable year, are subtracted or treated as subtracted from the policyholders surplus account under section 815(d) (1) and (4) and paragraphs (a) and (d) of § 1.815-6. For purposes of this paragraph, the subtractions from the policyholders surplus account shall be treated as made in the following order:

(a) First the amount determined under section 815(c)(3) by reason of distributions to shareholders during the taxable year which are treated as being made out of the policyholders surplus account;

(b) Next the amount elected to be subtracted from the policyholders surplus account for the taxable year under section 815(d)(1);

(c) Then the amount which is treated as a subtraction from the policyholders surplus account for the taxable year by reason of the limitation provided in section 815(d)(4); and

(d) Finally the amount taken into account upon termination as a life insur-

ance company as provided in section 815(d)(2).

(2) *Method of computing amount subtracted from policyholders surplus account*—(i) *Where life insurance company taxable income, computed without regard to section 802(b)(3), exceeds \$25,000.* If the life insurance company taxable income for any taxable year computed under section 802(b), computed without regard to section 802(b)(3), exceeds \$25,000, the amount subtracted from the policyholders surplus account shall be determined by multiplying the amount treated as distributed out of such account by a ratio, the numerator of which is 100 percent and the denominator of which is 100 percent minus the sum of the normal tax rate and the surtax rate for the taxable year.

(ii) *Where life insurance company taxable income does not exceed \$25,000.* If the life insurance company taxable income for any taxable year, computed under section 802(b), does not exceed \$25,000, the amount subtracted from the policyholders surplus account shall be determined by multiplying the amount treated as distributed out of such account by a ratio, the numerator of which is 100 percent and the denominator of which is 100 percent minus the normal tax rate for the taxable year.

(iii) *Where life insurance company taxable income, computed without regard to section 802(b)(3) does not exceed \$25,000, but computed with regard to section 802(b)(3) does exceed \$25,000.* If the life insurance company taxable income for any taxable year, computed without regard to section 802(b)(3) does not exceed \$25,000, but computed with regard to section 802(b)(3) does exceed \$25,000, the amount subtracted from the policyholders surplus account shall be determined in the following manner:

(a) First, determine the amount by which \$25,000 exceeds the amount determined under section 802(b) (1) and (2);

(b) Then, multiply the amount determined under (a) by a ratio, the numerator of which is 100 percent minus the normal tax rate and the denominator of which is 100 percent;

(c) Next, determine the amount by which the amount treated as distributed out of the policyholders surplus

account exceeds the amount determined under (b) and multiply such excess by a ratio, the numerator of which is 100 percent and the denominator of which is 100 percent minus the sum of the normal tax rate and the surtax rate; and

(d) Finally, add the amounts determined under (a) and (c).

(3) *Illustration of principles.* The application of section 815(c)(3) and subparagraph (2) of this paragraph may be illustrated by the following examples:

*Example 1.* The life insurance company taxable income of S, a stock life insurance company, computed without regard to section 802(b)(3), exceeds \$25,000 for the taxable year 1959. Assume that of the amount distributed by S to its shareholders during the taxable year, \$9,600 (as determined under section 815(a) and without regard to section 815(c)(3)(B)) is treated as distributed out of the policyholders surplus account. Since the sum of the normal tax rate (30%) and the surtax rate (22%) in effect for 1959 is 52 percent, S shall subtract \$20,000 from its policyholders surplus account for the taxable year 1959, computed as follows:

$$\$9,600 \times 100 / (100 - 52) = \$9,600 \times 100 / 48 = \$20,000$$

Of this amount, \$9,600 is due to the application of section 815(c)(3)(A) and \$10,400 to the application of section 815(c)(3)(B).

*Example 2.* Assume that for the taxable year 1960, S, a stock life insurance company, has taxable investment income of \$1,000 and a gain from operations of \$2,000. Assume further that of the amount distributed by S to its shareholders during the taxable year, \$3,500 (as determined under section 815(a) and without regard to section 815(c)(3)(B)) is treated as distributed out of the policyholders surplus account. Since S's life insurance company taxable income does not exceed \$25,000 for the taxable year and the normal tax rate in effect for 1960 is 30 percent, S shall subtract \$5,000 from its policyholders surplus account for the taxable year 1960, computed as follows:

$$\$3,500 \times 100 / (100 - 30) = \$3,500 \times 100 / 70 = \$5,000$$

Of this amount, \$3,500 is due to the application of section 815(c)(3)(A), and \$1,500 to the application of section 815(c)(3)(B).

*Example 3.* For the taxable year 1960, the life insurance company taxable income of S, a stock life insurance company, computed without regard to section 802(b)(3), is \$10,000. Assume that of the amount distributed by S to its shareholders during the taxable year, \$12,000 (as determined under section 815(a) and without regard to section 815(c)(3)(B)) is treated as distributed out of the policyholders surplus account. Since the life insur-

ance company taxable income of S, computed with regard to section 802(b)(3), exceeds \$25,000, in order to determine the amount to be subtracted from its policyholders surplus account, S would make up the following schedule:

(1) \$25,000 minus life insurance company taxable income, computed without regard to sec. 802(b)(3) (\$25,000 minus \$10,000 .....	\$15,000
(2) Item (1) multiplied by 100 percent minus the normal tax rate as in effect for 1960, over 100 percent (\$15,000 × (100 - 30) ÷ 100) .....	10,500
(3) Amount by which the amount treated as distributed out of policyholders surplus account (\$12,000) exceeds item (2) (\$10,500), multiplied by 100 percent over 100 percent minus the sum of the normal tax rate and the surtax rate as in effect for 1960 (\$1,500 × 100 ÷ (100 - 52)) .....	3,125
(4) Item (1) plus item (3) (\$15,000 plus \$3,125) ...	18,125

For the taxable year 1960, S shall subtract \$18,125 from its policyholders surplus account. Of this amount, \$10,500 represents the distribution from the policyholders surplus account which is taxed at a 30 percent tax rate and \$1,500 the distribution from the policyholders surplus account which is taxed at a 52 percent tax rate. Thus, of the amount subtracted from the policyholders surplus account for the taxable year 1960, \$12,000 is due to the application of section 815(c)(3) (A), and \$6,125 to the application of section 815(c)(3)(B).

(d) *Illustration of principles.* The application of section 815(c) and this section may be illustrated by the following example:

*Example.* The books of S, a stock life insurance company, reflect the following items for the taxable year 1960:

Taxable investment income .....	\$25,000
Gain from operations .....	30,000
Tax base (sec. 802(b)(1) and (2)) .....	27,500
Deduction for certain nonparticipating policies provided by sec. 809(d)(5) (as limited by sec. 809(f)) .....	600
Deduction for group policies provided by sec. 809(d)(6) (as limited by sec. 809(f)) .....	400
Amount distributed to shareholders .....	60,000
Cumulative balance in shareholders surplus account as of 12-31-60 .....	36,000
Balance in policyholders surplus account as of 1-1-60 .....	48,000

For purposes of determining the amount to be subtracted from its policyholders surplus account for the taxable year, S would first make up the following schedule in order to determine the cumulative balance in the policyholders surplus account at the end of the taxable year, computed without diminution by reason of distributions made during the taxable year:

(1) Balance in policyholders surplus account as of 1-1-60 .....	\$48,000
---	----------

**§ 1.815-5**

(2) Additions to account:		
(a) 50 percent of the amount by which the gain from operations (\$30,000) exceeds the taxable investment income (\$25,000) (1/2 × \$5,000) .....	\$2,500	
(b) The deduction for certain nonparticipating contracts provided by sec. 809(d)(5) (as limited by sec. 809(f)) .....	600	
(c) The deduction for group contracts provided by sec. 809(d)(6) (as limited by sec. 809(f)) .....	400	
	3,500	
(3) Cumulative balance in policyholders account as of 12-31-60 (item (1) plus item (2)) .....		51,500

Under the provisions of section 815(a), since the amount distributed to shareholders during the taxable year, \$60,000, exceeds the cumulative balance in the shareholders surplus at the end of the taxable year, computed without diminution by reason of distributions during the taxable year, \$36,000, the shareholders surplus account shall first be reduced to zero. The remaining \$24,000 (\$60,000 minus \$36,000) of the distribution shall then be treated as made out of the policyholders surplus account. Thus, since the tax base under section 802(b)(1) and (2) is in excess of \$25,000, the total amount to be subtracted from the policyholders surplus account at the end of the taxable year would be \$50,000 (\$24,000×100+(100-52)). Of this amount \$26,000 (\$50,000 minus \$24,000) represents the tax on the portion of the distribution to shareholders which is treated as being out of the policyholders surplus account.

(e) *Special rule for 1959 and 1960.* For a special transitional rule applicable to any increase in tax liability under section 802(b)(3) for the taxable years 1959 and 1960 which is due solely to the operation of section 815(c)(3) and this section, see section 802(a)(3) and § 1.802-5.

[T.D. 6535, 26 FR 543, Jan. 20, 1961, as amended by T.D. 6886, 31 FR 8689, June 23, 1966]

**§ 1.815-5 Other accounts defined.**

The term *other accounts*, as used in section 815(a)(3) and paragraph (b) of § 1.815-2, means all amounts which are not specifically included in the shareholders surplus account under section 815(b) and paragraph (b) of § 1.815-3, or in the policyholders surplus account under section 815(c) and paragraph (b) of § 1.815-4. Thus, for example, other accounts includes amounts representing the increase in tax due to the operation of section 802(b)(3) which is not taken into account for the taxable years 1959 and 1960 because of the special transi-

tional rule provided in section 802(a)(3) and § 1.802-5, earnings and profits accumulated prior to January 1, 1958, paid in surplus, capital, etc. To the extent that a distribution (or any portion thereof) is treated as being made out of other accounts, no tax is imposed on the company with respect to such distribution.

[T.D. 6535, 26 FR 544, Jan. 20, 1961]

**§ 1.815-6 Special rules.**

(a) *Election to transfer amounts from policyholders surplus account to shareholders surplus account—(1) In general.* Section 815(d)(1) permits a life insurance company to elect, after the close of any taxable year for which it is a life insurance company, to subtract any amount (or any portion thereof) in its policyholders surplus account as of the close of the taxable year. The effect of such election is to subject the company to tax on the amounts elected to be subtracted for the taxable year for which the election applies. The amount so subtracted, less the amount of tax imposed with respect to such amount by reason of section 802(b)(3), shall be added to the shareholders surplus account as of the beginning of the taxable year following the taxable year for which the election applies and no further tax shall be imposed upon the company if the amount elected to be transferred to the shareholders surplus account is subsequently distributed to shareholders.

(2) *Manner and effect of election.* (i) The election provided by section 815(d)(1) and this section shall be made in a statement attached to the life insurance company's income tax return for any taxable year for which the company desires the election to apply. The statement shall include the name and address of the taxpayer, shall be signed by the taxpayer (or his duly authorized representative), and shall be filed not later than the date prescribed by law (including extensions thereof) for filing the return for such taxable year. In addition, the statement shall indicate that the company has made the election provided under section 815(d)(1) for the taxable year and the amount elected to be subtracted from the policyholders surplus account.

(ii) An election made under section 815(d)(1)(B) and subdivision (i) of this subparagraph shall be effective only with respect to the taxable year for which the election is made. Thus, the company must make a new election for each taxable year for which it desires the election to apply. Once such an election has been made for any taxable year it may not be revoked.

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

*Example.* For the taxable year 1960, the life insurance company taxable income of S, a stock life insurance company, computed without regard to section 802(b)(3), exceeds \$25,000. Assume that S elects to subtract \$20,000 from its policyholders surplus account under section 815(d)(1) for the taxable year. Since S is subject to a 52 percent tax rate, the tax on the amount elected to be subtracted from the policyholders surplus account (as of the close of the taxable year 1960) is \$10,400 ( $\$20,000 \times 52$  percent). Thus, the amount to be added to the shareholders surplus account as of January 1, 1961, is \$9,600 (the amount subtracted from the policyholders surplus account by virtue of the section 815(d)(1) election, less the tax imposed upon such amount by reason of section 802(b)(3), or \$20,000 minus \$10,400).

(b) *Termination as life insurance company—(1) Effect of termination.* Except as provided in section 381(c)(22) (relating to carryovers in certain corporate readjustments), section 815(d)(2)(A) provides that if for any taxable year the taxpayer is not an insurance company (as defined in paragraph (a) of § 1.801-3), or if for any two successive taxable years the taxpayer is not a life insurance company (as defined in section 801(a) and paragraph (b) of § 1.801-3), the amount taken into account under section 802(b)(3) for the last preceding year for which the company was a life insurance company shall be increased (after the application of section 815(d)(2)(B)) by the entire balance in the policyholders surplus account at the close of such last preceding taxable year.

(2) *Effect of certain distributions.* If for any taxable year the taxpayer is an insurance company (as defined in paragraph (a) of § 1.801-3) but is not a life insurance company (as defined in section 801(a) and paragraph (b) of § 1.801-3), section 815(d)(2)(B) provides that

any distribution to shareholders during such taxable year shall be treated as having been made on the last day of the last preceding taxable year for which the company was a life insurance company.

(3) *Examples.* The application of section 815(d)(2) and this paragraph may be illustrated by the following examples:

*Example 1.* At the end of the taxable year 1959, the balance in the policyholders surplus account of S, a life insurance company within the meaning of section 801(a) and paragraph (b) of § 1.801-3, is \$12,000. If S fails to qualify as an insurance company (as defined in paragraph (a) of § 1.801-3) for the taxable year 1960, and section 381(c)(22) does not apply, under the provisions of section 815(d)(2)(A), the entire balance of \$12,000 in the policyholders surplus account at the end of 1959, the last year S was a life insurance company, shall be taken into account under section 802(b)(3) for purposes of determining S's tax liability for the taxable year 1959.

*Example 2.* Assume the facts are the same as in example 1, except that for the taxable years 1960 and 1961, S qualifies as an insurance company (as defined in paragraph (a) of § 1.801-3) but does not qualify as a life insurance company within the meaning of section 801(a) and paragraph (b) of § 1.801-3. Assume further that as a result of a distribution by S to its shareholders in 1960, \$4,800 (as determined under section 815(a) and without regard to section 815(c)(3)(B)) is treated as distributed out of the policyholders surplus account. Under the provisions of section 815(d)(2)(B), if section 381(c)(22) does not apply, any distribution to shareholders during the taxable years 1960 and 1961 shall be treated as having been made on December 31, 1959 (the last day of the last preceding taxable year for which S was a life insurance company). Thus, assuming S is subject to a 52 percent tax rate on additions to life insurance company taxable income, \$10,000 (\$4,800 plus \$5,200, the tax on the portion of the distribution treated as made out of the policyholders surplus account) shall be treated as being subtracted from the policyholders surplus account at the end of 1959 and shall be taken into account under section 802(b)(3) for purposes of determining S's tax liability for the taxable year 1959. Under the provisions of section 815(d)(2)(A), the entire balance of \$2,000 ( $\$12,000$  minus  $\$10,000$ ) in the policyholders surplus account at the end of 1959 (after the application of section 815(d)(2)(B)), shall also be taken into account under section 802(b)(3) for purposes of determining S's tax liability for the taxable year 1959.

(c) *Treatment of certain indebtedness.* Section 815(d)(3) provides that if a taxpayer makes any payment in discharge of its indebtedness and such indebtedness is attributable to a distribution by the taxpayer to its shareholders after February 9, 1959, the amount of such payment shall be treated as a distribution in cash to shareholders both for purposes of section 802(b)(3) and section 815. However, this paragraph shall only apply to the extent that the distribution of such indebtedness to shareholders was treated as being out of accounts other than the shareholders and policyholders surplus accounts at the time of distribution.

(d) *Limitation on amount in policyholders surplus account—(1) In general.* Section 815(d)(4) provides a limitation on the amount that any life insurance company may accumulate in its policyholders surplus account. If the policyholders surplus account at the end of any taxable year (computed without regard to this paragraph) exceeds whichever of the following is the greatest:

- (i) 15 percent of life insurance reserves (as defined in section 801(b) and paragraph (a) of § 1.801-4) at the end of the taxable year.
- (ii) 25 percent of the amount by which the life insurance reserves at the end of the taxable year exceed the life insurance reserves at the end of 1958, or
- (iii) 50 percent of the net amount of the premiums and other consideration taken into account for the taxable year under section 809(c)(1),

then such excess shall be treated as a subtraction from the policyholders surplus account as of the end of such taxable year. The amount so treated as subtracted, less the amount of tax imposed with respect to such amount by reason of section 802(b)(3), shall be added to the shareholders surplus account at the beginning of the succeeding taxable year.

(2) *Example.* The application of the limitation contained in subparagraph (1) of this paragraph may be illustrated by the following example:

*Example.* The books of S, a stock life insurance company, reflect the following items for the taxable year 1960:

Balance in policyholders surplus account, computed without regard to sec. 815(d)(4), as of 12-31-60 .....	\$175
Life insurance reserves (as defined in sec. 801(b)) as of 12-31-60 .....	4,500
Life insurance reserves (as defined in sec. 801(b)) as of 12-31-58 .....	3,900
Premiums and other consideration taken into account for the taxable year under sec. 809(c)(1) .....	310

In order to determine the limitations on the amount that it may accumulate in its policyholders surplus account at the end of the taxable year under section 815(d)(4), S would make up the following schedule:

(1) 15 percent of life insurance reserves at the end of the taxable year (15%×\$4,500) .....	\$675
(2) 25 percent of amount by which life insurance reserves at the end of the taxable year (\$4,500) exceed life insurance reserves as of 12-31-58 (\$3,900) (25%×\$600) .....	150
(3) 50 percent of premiums and other consideration taken into account under sec. 809(c)(1) for the taxable year (50%×\$310) .....	155
(4) Limitation on policyholders surplus account (the greatest of items (1), (2), or (3)) .....	675

Since the balance in the policyholders surplus account at the end of the taxable year 1960, \$175, does not exceed the limitation provided by section 815(d)(4), \$675, S is not required to make any further adjustment to its policyholders surplus account at the end of the taxable year.

(e) *Special rule for certain mutualizations—(1) In general.* Section 815(e) provides a rule for determining priorities which shall operate in place of section 815(a) and paragraph (b) of § 1.815-2 where a life insurance company makes any distribution to its shareholders after December 31, 1958, in acquisition of stock pursuant to a plan of mutualization. Section 815(e)(1) provides that such a distribution shall first be treated as being made out of paid-in capital and paid-in surplus, and, to the extent thereof, no tax shall be imposed on the company with respect to such distribution. Thereafter, distributions made pursuant to such plan of mutualization shall be treated as made in two allocable parts. One part shall be treated as being made out of other accounts (as defined in § 1.815-5) and the company shall incur no tax with respect to such portion of the distribution. The other part shall be treated as a distribution to which section 815(a) and paragraph (b) of § 1.815-2 applies. Thus, such portion of the distribution shall be treated as first being made out of the shareholders surplus account (as defined in section 815(b) and § 1.815-3), to the extent thereof, and

then out of the policyholders surplus account (as defined in section 815(c) and §1.815-4), to the extent thereof. See paragraph (a) of §1.815-2. For purposes of this paragraph, a distribution shall be considered as being made pursuant to a plan of mutualization only if the requirements of applicable State law for the adoption of such plan (as, for example, approval by the requisite majority of the board of directors, shareholders, and policyholders) have been fulfilled.

(2) *Allocation ratio.* Section 815(e)(2)(A) provides an allocation ratio which when applied to the amount distributed under a plan of mutualization in excess of the balance in the paid-in capital and paid-in surplus accounts determines the portion of such excess to be treated as distributed out of the shareholders surplus account, policyholders surplus account, or other accounts. The numerator of this ratio is the excess of the assets of the company (as defined in section 805(b)(4) and paragraph (a)(4) of §1.805-5) over the total liabilities (including reserves), both determined as of December 31, 1958, and adjusted in the manner provided in subparagraph (3) of this paragraph. The denominator of this ratio is the amount included in the numerator plus the amounts in the shareholders surplus account and policyholders surplus account, all determined as of the beginning of the year of the distribution.

(3) *Adjustment for certain distributions.* Section 815(e)(2)(B) provides that if between 1958 and the year of distribution the taxpayer has been treated as having made a distribution (under a plan of mutualization or otherwise) which is treated as a return of paid-in capital and paid-in surplus or as out of other accounts (as defined in §1.815-5), the aggregate amount of any such prior distributions must be subtracted from the numerator and denominator in all cases where the allocation ratio provided by subparagraph (2) of this paragraph applies.

(f) *Recomputation required as a result of a subsequent loss from operations under section 812—(1) In general.* Any amounts added to or subtracted from the special surplus accounts referred to in section 815(a) and paragraph (b) of

§1.815-2 for any taxable year shall be adjusted to the extent necessary to properly reflect a subsequent loss from operations which under section 812 is carried back to the taxable year for which such additions or subtractions were made.

(2) *Example.* The application of subparagraph (1) of this paragraph may be illustrated by the following example:

*Example.* Assume that for the taxable years 1959 through 1961, the books of S, a stock life insurance company subject to a 30 percent tax rate for all taxable years involved, reflect the following items:

	1959	1960	1961
Taxable investment income .....	\$40.00	\$40.00	\$40.00
Gain from operations .....	60.00	60.00	60.00
Tax base (sec. 802(b)(1) and (2)) .....	50.00	50.00	50.00
Tax (sec. 802(b)(1) and (2) base) .....	15.00	15.00	15.00
Shareholders surplus account—			
At beginning of year ...	0	35.00	37.00
Added at beginning of year by reason of election under sec. 815(d)(1) .....	0	7.00	0
Added for year (without regard to election under sec. 815(d)(1)) .....	35.00	35.00	35.00
Subtracted (distributions) .....	0	40.00	40.00
Policyholders surplus account—			
At beginning of year ...	0	0	10.00
Added for year .....	10.00	10.00	10.00
Subtracted (distributions) .....	0	0	0
Subtracted (by reason of election under sec. 815(d)(1)) .....	10.00	0	0
Tax base (sec. 802(b)(3)) .....	10.00	0	0
Tax (sec. 802(b)(3) base) .....	3.00	0	0

Assume further that S has a loss from operations for the taxable year 1962 of \$25. Under the provisions of section 812, the \$25 loss from operations would be carried back to the taxable year 1959 and would reduce the 1959 tax base under section 802(b)(1) and (2) to \$35 (\$60 minus \$25). After adjustments reflecting the 1962 loss from operations, the results for the taxable years 1959 through the beginning of 1962 would be as follows:

	1959	1960	1961	1962
Taxable investment income .....	\$40.00	\$40.00	\$40.00	.....
Gain from operations .....	35.00	60.00	60.00	.....
Tax base (sec. 802(b)(1) and (2)) ...	35.00	50.00	50.00	.....

§ 1.817-1

	1959	1960	1961	1962
Tax (sec. 802(b)(1) and (2) base) .....	10.50	15.00	15.00	.....
Shareholders surplus account—				
At beginning of year	0	24.50	19.50	\$14.50
Added for year (without regard to election under sec. 815(d)(1)) ....	24.50	35.00	35.00	.....
Added by reason of election under sec. 815(d)(1) ....	0	0	0	.....
Subtracted (distributions) .....	0	40.00	40.00	.....
Policyholders surplus account—				
At beginning of year	0	0	10.00	20.00
Added for year .....	0	10.00	10.00	.....
Subtracted (distributions) .....	0	0	0	.....
Subtracted (by reason of election under sec. 815(d)(1)) .....	0	0	0	.....
Tax base (sec. 802(b)(3)) .....	0	0	0	.....
Tax (sec. 802(b)(3) base) .....	0	0	0	.....

As a result of the loss from operations for 1962, the election under section 815(d)(1) for the taxable year 1959 has become inapplicable in its entirety since the balance in the policyholders surplus account at the end of 1959, as recomputed, is zero. Thus, S would be entitled to a total refund of \$7.50 for the taxable year 1959. Of this amount, \$4.50 is due to the recomputation of the section 802(b)(1) and (2) tax base and \$3 to the amount of tax paid by reason of the election under section 815(d)(1).

[T.D. 6535, 26 FR 545, Jan. 20, 1961]

MISCELLANEOUS PROVISIONS

§ 1.817-1 Taxable years affected.

Except as otherwise provided therein, §§ 1.817-2 through 1.817-4 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) and section 3 of the Act of October 23, 1962 (76 Stat. 1134).

[T.D. 6886, 31 FR 8689, June 23, 1966]

§ 1.817-2 Treatment of capital gains and losses.

(a) *In general.* For taxable years beginning after December 31, 1958, and before January 1, 1962, if the net long-

term capital gain (as defined in section 1222(7)) of any life insurance company exceeds its net short-term capital loss (as defined in section 1222(6)), section 802(a)(2) prior to its amendment by section 3 of the Act of October 23, 1962 (76 Stat. 1134), imposes a separate tax equal to 25 percent of such excess. For taxable years beginning after December 31, 1961, if the net long-term capital gain of any life insurance company exceeds its net short-term capital loss, section 802(a)(2) imposes an alternative tax in lieu of the tax imposed by section 802(a)(1), if and only if such alternative tax is less than the tax imposed by section 802(a)(1). Except as modified by section 817 (rules relating to certain gains and losses), the general rules of the Code relating to gains and losses, such as subchapter O (relating to gain or loss on disposition of property), subchapter P (relating to capital gains and losses), etc., shall apply with respect to life insurance companies.

(b) *Modification of section 1221 and 1231.* (1) In the case of a life insurance company, section 817(a)(1) provides that for purposes of applying section 1231(a) (relating to property used in the trade or business and involuntary conversions), the term *property used in the trade or business* shall be treated as including only:

(i) Property used in carrying on an insurance business, of a character subject to the allowance for depreciation under section 167 (even though fully depreciated), held for more than 1 year (6 months for taxable years beginning before 1977; 9 months taxable years beginning in 1977), and real property used in carrying on an insurance business, held for more than 1 year (6 months for taxable years beginning before 1977; 9 months taxable years beginning in 1977), and which is not:

(a) Property of a kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year;

(b) Property held by the taxpayer primarily for sale to customers in the ordinary course of business; or

(c) A copyright, a literary, musical, or artistic composition, a letter or memorandum, or similar property held by a taxpayer described in section