

Notice of Proposed Rulemaking and Notice of Public Hearing

Recomputation of Life Insurance Reserves

REG-246018-96

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to the definition of life insurance reserves. The proposed regulations permit the taxpayer or the IRS to recompute certain reserves if those reserves were initially computed or estimated on other than an actuarial basis. The proposed regulations affect both life insurance companies and property and casualty insurance companies. This document also contains a notice of a public hearing on the proposed regulations.

DATES: Written comments must be received by April 2, 1997. Requests to speak and outlines of oral comments to be discussed at the public hearing scheduled for Thursday, April 17, 1997, at 10 a.m. must be received by Thursday, March 27, 1997.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-246018-96), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-246018-96), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html. The public hearing will be held in the Commissioner's conference room, room 3313, Internal Revenue Service Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Ann Cammack, (202) 622-3970; concerning submissions and the hearing, Evangelista Lee, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

To qualify as a life insurance reserve for purposes of Part I of subchapter L of the Internal Revenue Code, a reserve must satisfy various requirements, including the requirement in section 816(b)(1)(A) and § 1.801-4(a)(1) that it be "computed or estimated on the basis of recognized mortality or morbidity tables and assumed rates of interest." Qualifying as a life reserve under section 816(b) has various consequences. Life reserves are included in the numerator and denominator of the reserve ratio test of section 816(a), which is used to determine when an insurance company is taxed as a life insurance company under Part I of subchapter L. Increases in life reserves as defined in section 816(b) are taken into account under section 807(c)(1). In addition, life reserves as defined in section 816(b) are considered part of a nonlife company's unearned premiums under section 832(b)(4).

Two circuits have construed former section 801(b)(1)(A), which was recodified as section 816(b)(1)(A) in 1984, to prevent reserves held with respect to life, annuity or noncancellable accident and health policies but not computed or estimated using actuarial tables from qualifying as life reserves. The IRS also has held that life reserves must be computed or estimated using actuarial tables under former section 801(b)(1)(A). See e.g., Rev. Rul. 69-302 (1969-2 C.B. 186). The Claims Court, in contrast, has concluded that the statute and regulation do not necessarily require the insurance company to compute its life reserves using actuarial tables, when a different method results in reserves that "reasonably approximate" actuarial reserves.

Rev. Rul. 69-302 held that not only were life reserves required to be computed or estimated on the basis of recognized mortality or morbidity tables and assumed rates of interest, but that reserves for credit life insurance contracts could not be retroactively recomputed in a manner that would enable them to qualify as life reserves. Neither of the cases cited in Rev. Rul. 69-302, however, addressed the question of whether taxpayers or the Commissioner could recompute reserves based on information that was available at the end of the applicable taxable year. Two subsequent cases came to opposite conclusions on this issue.

The reserve ratio test of section 816(a) was intended to distinguish between life and nonlife insurance companies based on the nature of each company's business, as measured by its reserves. This purpose is not achieved, however, if a company that only issues life insurance, annuity or noncancellable accident and health contracts can elect to be taxed as a nonlife company by failing to use mortality and morbidity tables and assumed rates of interest in computing or estimating its reserves for some of those contracts.

Explanation of Provisions

Proposed § 1.801-4(g)(1) provides that if an insurance company does not compute or estimate its reserves for certain contracts on the basis of mortality or morbidity tables and assumed rates of interest, then the taxpayer or the Commissioner may recompute those reserves on the basis of mortality or morbidity tables and assumed rates of interest. This regulation will apply to reserves for contracts involving, at the

time with respect to which the reserves are computed, life, accident or health contingencies, if such reserves were not initially computed in accordance with the requirements of section 816(b)(1)(A).

Proposed § 1.801-4(g)(2) provides that if the taxpayer or the Commissioner recomputes reserves pursuant to § 1.801-4(g)(1), the reserves satisfy the section 816(b)(1)(A) requirement that a life reserve be computed or estimated using actuarial tables and assumed rates of interest. Assuming that these amounts satisfy the other requirements of section 816(b), the recomputed amounts will be considered life insurance reserves under section 816(b), and the recomputed reserves will be included in both the numerator and the denominator of the reserve ratio test under section 816(a). In addition, the reserves for such contracts will be taken into account under section 807(c)(1) and will be used to compute a nonlife company's unearned premiums under section 832(b)(4).

Proposed § 1.801-4(g)(3) provides that for purposes of section 816(b)(4) and § 1.801-3(i), which provide that the mean of the beginning and end of year reserves will be used for purposes of section 816(a), (b) and (c), the reserves on a life insurance, annuity or noncancellable accident and health contract must be recomputed for both the beginning and the end of the year.

Proposed § 1.801-4(g)(4) requires that no information acquired after the date as of which the beginning of year reserves were initially computed or estimated may be taken into account in recomputing those reserves under paragraph (g)(1). It also requires that no information acquired after the date as of which the end of year reserves were initially computed or estimated may be taken into account in recomputing those reserves under paragraph (g)(1).

The IRS is considering whether to issue guidance under section 816, including regulations regarding the definition of "total reserves" under section 816(c) as well as redesignating and revising the regulations issued under prior law section 801. The IRS invites comments on this matter.

Proposed Effective Date

Proposed § 1.801-4(g) would be effective with respect to returns filed for taxable years beginning after the publication of the final regulations.

Effect on Other Documents

The IRS will modify, clarify, or obsolete publications as necessary to conform with this regulation as of the date of publication in the **Federal Register** of the final regulations. See e.g., Rev. Rul. 69-302 (1969-2 C.B. 186). The IRS solicits comments as to whether other publications should be modified or obsoleted.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and 8 copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for Thursday, April 17, 1997 in the Commissioner's conference room, room 3313, Internal Revenue Service Building at 10:00 a.m. Because of access restrictions, visitors will not be admitted beyond the Internal Revenue Building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit written comments by March 27, 1997 and submit an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and 8 copies) by March 27, 1997.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the

deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of this regulation is Ann B. Cammack, Office of Assistant Chief Counsel (Financial Institutions and Products). However, other personnel from the IRS and Treasury Department participated in their development.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.801-4 is amended by adding a new paragraph (g) to read as follows:

§ 1.801-4 Life insurance reserves.

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(g) *Recomputation of life insurance reserves*—(1) *General*. If an insurance company does not compute or estimate its reserves for contracts involving, at the time with respect to which the reserves are computed, life, accident or health contingencies, on the basis of mortality or morbidity tables and assumed rates of interest, then the taxpayer or the Commissioner may recompute reserves for those contracts on the basis of mortality or morbidity tables and assumed rates of interest.

(2) *Effect of recomputation*. If reserves are recomputed pursuant to paragraph (g)(1) of this section, the recomputed reserves satisfy the requirements of section 816(b)(1)(A).

(3) *Mean reserve*. For purposes of section 816(b)(4) and § 1.801-3(i), if reserves are recomputed pursuant to paragraph (g)(1) of this section for a taxable year, the reserves must be recomputed for both the beginning and the end of the taxable year.

(4) *Subsequently acquired information*. No information acquired after the date as of which a reserve was initially computed or estimated may be taken into account in recomputing that reserve under paragraph (g)(1) of this section.

(5) *Effective date*. This section is applicable with respect to returns filed for taxable years beginning after the date

final regulations are filed with the Office of the Federal Register.

Michael P. Dolan,
Acting Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on December 31, 1996, 8:45 a.m., and published in the issue of the Federal Register for January 2, 1997, 62 FR. 71)