

**§ 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 para-

graph (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 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.

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#### § 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