§ 1.817–3

Gains and losses from the sale of the stocks, bonds, housing development, and radio station shall be treated as gains and losses from the sale of capital assets since such items are capital assets within the meaning of section 1221 (as modified by section 817(a)(2)). Accordingly, the provisions of section 1231 shall not apply to the sale of such capital assets. However, the provisions of section 1231 (as modified by section 817(a)(1)) shall apply to the sale of the branch office building and the furniture and equipment, and the apartment building involuntarily converted. Since the aggregate of the recognized losses ($115,000) exceeds the aggregate of the recognized gains ($37,000), the gains and losses are treated as ordinary gains and losses.

Example 2. Y, a life insurance company, owns a twenty-story home office building, having an adjusted basis of $15,000,000, ten floors of which it rents to various tenants, one floor of which is utilized by it in operating its investment department, and the remaining nine floors of which are occupied by it in carrying on its insurance business. If in 1960, Y sells the building for $10,000,000, Y must first apportion its basis between that portion of the building (one-half) used in carrying on an insurance business, and that portion of the building (one-half) classified as an “investment asset”, before it can determine the character of the loss attributable to each portion of the building. For such purpose, the one floor utilized by Y in operating its investment department is treated as used in carrying on an insurance business. Assuming that each portion of the building bears an equal (one-half) relation to the basis of the entire building, Y (without regard to section 817(b)) would have a $2,500,000 ordinary loss on that portion used in carrying on an insurance business (assuming that Y had no gains subject to section 1231), and a $2,500,000 capital loss on that portion of the building classified as an investment asset.


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(a) Limitation on gain recognized on property held on December 31, 1958. (1) Section 817(b)(1) limits the amount of gain that shall be recognized on the sale or other disposition of property other than insurance and annuity contracts (and contracts supplementary thereto) and property described in section 1221(1) (relating to stock in trade or inventory-type property) if:

(i) The property was held (or treated as held within the meaning of paragraph (c)(1) of this section) by a life insurance company on December 31, 1958;

(ii) The taxpayer has been a life insurance company at all times on and after December 31, 1958, including the date of the sale or other disposition of the property; and

(iii) The fair market value of the property on December 31, 1958, exceeds the adjusted basis for determining gain as of such date.

The gain on the sale or other disposition of such property shall be limited to an amount (but not less than zero) equal to the amount by which the gain (determined without regard to section 817(b)(1)) exceeds the difference between fair market value of such property on December 31, 1958, and the adjusted basis for determining gain as of such date. Accordingly, the tax imposed under section 862(a) shall apply with respect to the amount of gain so limited. In addition, in the case of a stock life insurance company, the amount of such gain shall be taken into account under section 815(b)(2)(A)(i) for purposes of determining the amount to be added to the shareholders surplus account (as defined in section 815(b) and §1.815–3) for the taxable year. Furthermore, the amount of the gain (determined without regard to section 817(b)(1) and this paragraph) which is not taken into account under section 802(a) and under paragraph (f) of §1.802–3 by reason of the application of section 817(b)(1) shall be included in other accounts (as defined in §1.815–5) by such a company for the taxable year.

(2) Section 817(b)(1) and subparagraph (1) of this paragraph shall not apply for
purposes of determining loss with respect to property held on December 31, 1958.

(b) Illustration of principles. The application of section 817(b)(1) and paragraph (a) of this section may be illustrated by the following examples:

Example 1. On December 31, 1958, J, a stock life insurance company, owned stock of Z Corporation and on such date the stock had an adjusted basis for determining gain of $5,000 and a fair market value of $6,000. On August 1, 1959, the company sells such stock for $8,000. Assuming J qualifies as a life insurance company for the taxable year 1959, and applying the provisions of section 817(b)(1) and paragraph (a) of this section, the gain recognized (assuming no adjustment to basis for the period since December 31, 1958) on the sale shall be limited to $2,000 (the amount by which the gain realized, $3,000, exceeds the difference, $1,000, between the fair market value, $6,000, and the adjusted basis, $5,000, for determining gain on December 31, 1958). Thus, J shall take into account $2,000 under section 815(b)(2)(A)(ii) for purposes of determining the amount to be added to its shareholders surplus account for the taxable year and shall include $1,000 in other accounts for the taxable year.

Example 2. The facts are the same as in example 1, except that the selling price is $5,500. In such case, no gain shall be recognized even though there is a realized gain of $800 since such realized gain does not exceed the difference ($1,000) between the fair market value ($6,000) and the adjusted basis ($5,000) for determining gain on December 31, 1958. Furthermore, no loss shall be realized or recognized as a result of this transaction. Thus, J shall include $800 in other accounts for the taxable year and shall not take into account any amount under section 815(b)(2)(A)(ii).

Example 3. The facts are the same as in example 1, except that the adjusted basis for determining loss is $5,000 and the selling price is $4,500. In such case, since J has sustained a loss, section 817(b)(1) does not apply.

(c) Certain substituted property acquired after December 31, 1958. Section 817(b)(2) provides that if a life insurance company acquires property after December 31, 1958, in exchange for property actually held by the company on December 31, 1958, and the property acquired has a substituted basis within the meaning of section 1016(b) and §1.1016–10, the following rules shall apply:

(1) For purposes of section 817(b)(1), such acquired property shall be deemed as having been held continuously by the taxpayer since the beginning of the holding period thereof as determined under section 1223;

(2) The fair market value and adjusted basis referred to in section 817(b)(1) shall be that of that property for which the holding period taken into account includes December 31, 1958;

(3) Section 817(b)(1) shall apply only if the property or properties, the holding periods of which are taken into account, were held only by life insurance companies after December 31, 1958, during the holding periods so taken into account;

(4) The difference between the fair market value and adjusted basis referred to in section 817(b)(1) shall be reduced (but not below zero) by the excess of (i) the gain that would have been recognized but for section 817(b) on all prior sales or other dispositions after December 31, 1958, of properties referred to in section 817(b)(2)(C) over (ii) the gain that was recognized on such sales or other dispositions; and

(5) The basis of such acquired property shall be determined as if the gain which would have been recognized but for section 817(b) were recognized gain. For purposes of section 817(b)(2) and this paragraph, the term property does not include insurance and annuity contracts (and contracts supplementary thereto) and property described in section 1221(1) (relating to stock in trade or inventory-type property). Furthermore, the provisions of section 817(b)(1) and paragraph (a)(1) of this section shall not apply for purposes of determining loss with respect to property described in section 817(b)(2) and this paragraph.

(d) Illustration of principles. The application of section 817(b)(2) and paragraph (c) of this section may be illustrated by the following example:

Example. Assume that W, a life insurance company, owns property B on December 31, 1958, at which time its adjusted basis was $1,000 and its fair market value was $1,000. On January 31, 1960, in a transaction to which section 1031 (relating to exchange of property held for productive use or investment) applies, W receives property H having a fair market value of $1,700 plus $300 in cash in exchange for property B. The gain realized on the transaction, without regard to section 817(b) is $1,000 (assuming no adjustments to basis for the period since December 31, 1958).
Under the provisions of section 817(b)(1) the gain is limited to $200. The entire $200 shall be recognized since such amount is less than the amount of gain ($300) which would be recognized under section 1031. Applying the provisions of section 817(b)(2) and paragraph (c) of this section, the basis of property H shall be determined as if the entire $300 of cash received is recognized gain. Thus, the basis of property H under section 1031 is $1,000 ($1,000 (the basis of property H) minus $300 (the amount of money received) plus $300 (the recognized gain of $200 plus $100 which would have been recognized but for section 817(b))). If W later sells property H for $2,200 cash, and assuming no further adjustments to its basis of $1,000, the gain realized is $1,200, but due to the application of section 817(b)(2) the amount of gain recognized is $500, computed as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Selling price</td>
<td>$2,200</td>
</tr>
<tr>
<td>Less: Adjusted basis as of date of sale</td>
<td>$1,000</td>
</tr>
<tr>
<td>Gain realized</td>
<td>$1,200</td>
</tr>
<tr>
<td>Fair market value as of 12–31–58</td>
<td>$1,800</td>
</tr>
<tr>
<td>Adjusted basis as of 12–31–58</td>
<td>$1,000</td>
</tr>
<tr>
<td>Excess of fair market value over adjusted basis</td>
<td>$800</td>
</tr>
<tr>
<td>Less: Excess of gain which would have been recognized on all prior dispositions (section 817(b))</td>
<td>$100</td>
</tr>
<tr>
<td>Minus: Gain recognized</td>
<td>$500</td>
</tr>
</tbody>
</table>


§ 1.817–4 Special rules.

(a) Limitation on capital loss carryovers. Section 817(c) provides that a net capital loss (as defined in section 1222(10)) for any taxable year beginning before January 1, 1959, shall not be taken into account. For any taxable year beginning after December 31, 1958, the provisions of part II, subchapter P, chapter 1 of the Code (relating to the treatment of capital losses) shall be applicable to life insurance companies for purposes of determining the tax imposed by section 802(a) and § 1.802–3 (relating to the imposition of tax in case of capital gains).

(b) Gain on transactions occurring prior to January 1, 1959. For purposes of part I, subchapter L, chapter 1 of the Code, section 817(d) provides that:

(1) There shall be excluded from tax any gain from the sale or exchange of a capital asset, which results from sales or other dispositions of property prior to January 1, 1959; and

(2) Any gain after December 31, 1958, resulting from the sale or other disposition of property prior to January 1, 1959, which, but for this subparagraph would be taken into account under section 1231, shall not be taken into account under section 1231.

For example, if a life insurance company makes an installment sale of a capital asset prior to January 1, 1959, and payments are received after such date, any capital gain attributable to such sale shall not be taken into account for purposes of section 802(a). Furthermore, any gain referred to in subparagraphs (1) and (2) and the preceding sentence shall not be taken into account in determining the excess of the net short-term capital gain over the net long-term capital loss (and for taxable years beginning after December 31, 1961, the excess of the net long-term capital gain over the net short-term capital loss) for purposes of computing taxable investment income under section 804(a)(2) or gain or loss from operations under section 809(b).

(c) Certain reinsurance transactions in 1958. For purposes of part I, section 817(e) provides that where a life insurance company reinsures (or sells) all of its insurance contracts of a particular type, such as an entire industrial department, in either a single transaction, or in a series of related transactions, all of which occurred during 1958, and the reinsuring (or purchasing) company or companies assume all liabilities under such contracts, such reinsurance (or sale) shall be treated as the sale of a capital asset. However, such transaction shall be subject to the provisions of section 806(a) and § 1.806–3 (relating to adjustments for certain changes in reserves and assets).

(d) Certain other reinsurance transactions. (1) For any taxable year beginning after December 31, 1958, the reinsurer of all or a part of the insurance contracts of a particular type by a life insurance company, in either a single transaction, or in a series of related transactions, occurring in any such taxable year, whereby the reinsuring company or companies assume all liabilities under such contracts, shall