

TAXATION OF INSURANCE COMPANY INCOME

FEBRUARY 23 (legislative day, FEBRUARY 22), 1956.—Ordered to be printed

Mr. BYRD, from the Committee on Finance, submitted the following

R E P O R T

[To accompany H. R. 7201]

The Committee on Finance, to whom was referred the bill (H. R. 7201) relating to the taxation of income of insurance companies, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

(1) The House bill rewrites section 804 of the Internal Revenue Code of 1954 which provides a reserve and other policy liability deduction against the investment income of a life insurance company. Under the House bill for 1955 this deduction would be determined as 92½ percent of the net investment income allocable to pension plan reserves plus 90 percent of such income allocable to reserves for annuity contracts and deposits plus 85 percent of so much of the balance of the investment income as is not allocable to non-life-insurance reserves. Your committee has amended this provision to delete all special deductions with reference to pension, annuity, and deposit business, and to provide a larger deduction primarily affecting certain small life insurance companies. Under your committee's bill the deduction will be 87½ percent of the first \$1 million of net investment income allocable to life insurance reserves and 85 percent of the balance allocable to such reserves.

(2) Under section 804, as provided in the House bill, a maximum limitation is imposed upon the reserve and other policy liability deduction of a life insurance company. In general, this limitation is equal to two times the reserve interest requirements shown on the company's own books on reserves in connection with policies involving life contingencies, plus the amount of certain other interest obligations and dividends to policyholders. Your committee has amended this provision to allow a statutory presumption of reserve interest in the case of certain mutual assessment life insurance companies which do not have a formal reserve interest obligation.

(3) The House bill would add a new section 818 to the Internal Revenue Code which allows an alternative tax base related to total income for the first 5 years of operation in the case of a life insurance company first authorized to do life insurance business before July 1, 1955. Your committee has amended this provision to make it applicable to the first 5 years of operation of a company whenever organized.

(4) Life insurance companies were in doubt about the applicable tax law at the time when the estimated tax for 1955 was payable, September 15 and December 15 of 1955. Under general authority provided by the Internal Revenue Code, the Commissioner of Internal Revenue extended the time for filing the declaration of estimated tax for these corporations until March 15, 1956. However, these companies were not released from the additions to tax provided under section 6655 of the Internal Revenue Code for failure to pay the estimated tax. Your committee has added a section 7 to the House bill to provide that no additions to tax shall be made in this situation.

(5) Several clarifying amendments have been made in the House bill. These amendments are discussed below.

PURPOSE OF THE BILL

This bill, as amended by your committee, has two principal purposes. Basically the bill provides a tax on life insurance companies for the year 1955. To this extent it is a stopgap bill. Under the terms of the bill for 1956 and later years, the tax formula provided under present law for life insurance companies will be in operation. This is, basically, the same formula that was first enacted in the Revenue Act of 1942. The committee expects that additional legislation will be initiated in the House during this year relating to the taxing of life insurance companies for the future. In this connection the Secretary of the Treasury has stated:

* * * I suggest that an attempt be made to develop a method of taxing life insurance companies like other business, on the basis of their entire income from all sources, with appropriate deductions for their expenses and additions to their reserves against policy contracts * * *. It should now be possible to develop a fairer basis for taxation which will include all of the income and deduction items which properly reflect the earnings position of a life insurance company.

Apart from the 1-year provisions of this bill, certain basic reforms are made in the detailed procedures for taxing life insurance companies that may be applicable in the future under any investment income formula. Under the House bill, as with the bill as amended by your committee, these reforms are incorporated in the basic (1942) provisions so they will become operative in 1956 if those provisions become effective after 1955.

SUMMARY OF THE BILL

The bill continues to disregard underwriting gains and losses in the determination of taxable income, because of the difficulties of taxing insurance companies on the regular corporate basis. The methods of dealing with investment income and the taxation of income from non-life insurance business, however, are somewhat changed. The formula in effect in 1954 in effect taxed life insurance companies at regular corporate rates after deducting 87½ percent of the portion

deemed allocable to life insurance business. This deduction ratio is retained for the first \$1 million of such income and a deduction ratio of 85 percent is provided for the balance.

With respect to non-life-insurance business, primarily accident and health insurance, the bill moves in the direction of equalizing the tax treatment of life and casualty insurance companies. It is provided that both stock and mutual life insurance companies will pay tax on the income from this business as if it were the income of a mutual casualty insurance company.

The bill makes several changes in the taxation of life insurance income designed to improve the definition of income and to prevent abuse of the life insurance treatment by companies which are not entirely life insurance companies. Several improvements in the income definition have been applied to casualty insurance companies as well as to life insurance companies. The reserve interest credit, a relief device provided in the Revenue Act of 1951 for certain companies with low earnings relative to their reserve and other policy requirements, is retained in substance.

The bill imposes a tax under the new system only for the year 1955 and provides that a tax similar to that imposed by the Revenue Act of 1942 will come into operation thereafter. By this action the committee does not intend any expression of approval of the tax formula provided in the 1942 act, but has provided for the application of that formula to 1956 because it is the method of taxing life insurance companies under the law as of the present time. The so-called stopgap formula in use since 1950 has not been extended beyond 1954.

It is estimated that the tax imposed on life insurance companies for the calendar year 1955, under this bill, will be \$248 million. This differs from the tax that would be imposed by the House bill, which was \$220 million. If the life insurance companies had continued to pay tax under the formula in effect in 1954, the tax on 1955 income would have been \$197 million.

DISCUSSION OF SUBSTANTIVE COMMITTEE AMENDMENTS

The principal amendment made by your committee removes from the House bill the provisions for special treatment of the business of a life insurance company connected with qualified pension plans and with annuities and deposits. Various companies objected to these provisions in the House bill. Your committee thought that it could not enact into law the principle of special treatment of pension and annuity business without hearings and further study. Since time did not permit such a study, the provisions have been removed from this bill with the understanding that this question will be further examined by the Congress in connection with legislation for 1956.

The special treatment of the first \$1 million of investment income in the hands of a life insurance company is designed to provide that relatively small life insurance companies would pay approximately the same tax as they would have paid under the law in effect in 1954.

It was felt that a tax increase on these companies might hinder the growth of competition in this field. The small business relief has been designed in such a manner that it will relate only to the life insurance portion of the company's income and will not involve a notch area subject to a high marginal rate of tax.

The extension of the application of section 818 of the House bill is designed to deal with the problem with respect to certain new life insurance companies which was created by a loophole closing provision inserted in the House bill. Under present law an insurance company may be able to have a relatively large life insurance deduction, proportionate to a relatively large investment income, even though its life insurance obligations may require only a small amount of investment income. In the extreme this might permit a company to be operated primarily as an investment company with very little life insurance business. H. R. 7201 deals with this problem by limiting the deduction against investment income to twice the amount actually needed according to the company's books for reserve interest requirements plus the amount needed for other interest commitments and policy dividends. Thus, excess investment income would be taxed at full corporate rates. Any new company must, however, have an initial capital before it can sell any insurance and have reserves. Thus, for a while it is bound to have excess investment income. The House bill provided relief in this situation for a new company first authorized to do business before the approximate announcement date of the House bill. Such company would be permitted to use as an alternative tax base its total income before tax as reported on the annual statement to the National Convention of Insurance Commissioners. This relief device would permit the company to take into account any excess of its insurance expenses over its premiums. It would automatically relieve a new, expanding life insurance company because excess investment income would be taxable only to the extent that it was not used to cover deficits incurred in establishing the life insurance business. Your committee approves of the intention of this provision and has extended it to new companies whenever authorized to commence business.

The maximum limitation of the reserve and other policy liability deduction provided in the House bill would work an unintended hardship in the case of certain mutual assessment life insurance companies which must keep a deposit with State insurance departments. These companies have reserves recognized as life insurance reserves under present law and they earn interest, but the policy contract does not specify a required interest on such reserves. Under the House bill, therefore, the entire interest earned would be deemed to be excess interest. Your committee has amended the House bill to allow a statutory presumption of required interest up to 3 percent in this case. This will put such companies in substantially the same position as other mutual insurance companies.

The bill was received from the House by your committee in July of 1955. At the same time certain other pressing legislation was received. Your committee did not feel able to give adequate consideration to the problems involved in the short time before adjournment. This left life insurance companies apparently subject to tax on 1955 income under the terms of the 1942 formula, which would involve a higher tax than was imposed under the House bill. Since your committee did not intend that this formula should come into operation, the Commissioner of Internal Revenue used the general authority provided under the Internal Revenue Code to postpone for life insurance companies the time for filing the declaration of estimated tax. This declaration was required under the Internal Revenue Code of 1954,

which provided that in 1955 corporations (with probable tax liabilities over \$100,000) would be required to estimate the tax payable on the income of that year, and pay 5 percent of such estimate by September 15 and 5 percent by December 15. While the Commissioner postponed the date for filing the declaration the companies involved were not relieved of the obligation for additions to tax for failure to pay appropriate amounts on September 15 and December 15. This addition to tax is computed at the rate of 6 percent per annum on the underpayment. It was indicated at that time that it was the intention of your committee to propose that these companies be relieved of the addition to tax, which the amendment adding section 7 to the bill does.

DISCUSSION OF CLARIFYING COMMITTEE AMENDMENTS

Several clarifying amendments have been made in the House bill. The first of these corrects an erroneous reference contained in the last sentence of section 802 (f). The second of these amendments is made to the last sentence of paragraph (2) of section 804 (b). This amendment makes it clear that in computing the average rate of interest for purposes of the adjustment for policy loans, there shall be taken into account 7 percent of that portion of the life insurance reserves which are computed on a preliminary term basis. The third of these clarifying amendments is made to subsection (c) of section 811. This subsection provides the manner for computing the special interest deduction under the 1942 life insurance formula which the bill provides shall come into effect in 1956. The amendment is designed to make the special interest deduction operate in the same manner as it did from 1951 to 1954. The last of the clarifying amendments changes section 818 of the House bill. Subsection (c) of this section provides that a certain part of the dividends received credit shall be allowed in the case of new companies taxed on the basis of total income. The amendment is designed to insure that the deduction will in fact be allowed.

DETAILED EXPLANATION OF THE BILL

A. REGULAR LIFE INSURANCE BUSINESS

Except for special treatment of the first \$1 million, the bill provides a deduction of 85 percent of the net investment income allocable to the regular life insurance business. On the basis of reserves presently stated on the company books, the industry currently needs less than 85 percent of its net investment income to fulfill policy obligations, although the committee was told that 85 percent is an average deduction ratio over the last 5 years. This smaller current interest requirement is due in part to the fact that in recent years the companies have transferred considerable amounts of surplus to reserves in a process known as reserve strengthening. While this does reduce the current need for interest additions to reserves, it does not appear desirable that tax liability should depend on pure bookkeeping changes. Moreover, the ratio of interest requirements to current interest earnings will vary considerably over time because of the slow adjustment of reserve interest patterns to changing interest rates. It also does not appear desirable that tax liability should depend on these year-to-year variations in the reserve interest picture.

B. NONLIFE INSURANCE BUSINESS

The bill provides for 1955 that stock and mutual life insurance companies will pay tax on the income from nonlife insurance business as if it were the income of a mutual casualty company. This means that they will pay the higher of (1) a tax at regular corporate rates on their net investment income from that business or (2) a tax of 1 percent on the gross investment income from that business plus premiums (less dividends) on those policies. For this purpose the investment income is required to be determined in the same manner as for a mutual casualty company. This involves taking into account a proportionate part of the net capital gain (to which the alternative capital gains tax is applicable) and a proportionate part of the dividends received credit.

For many years the investment income attributable to the non-life insurance business has been viewed as $3\frac{1}{4}$ percent of the unearned premiums and unpaid losses on that business. Under this bill for 1955 the income attributable to the nonlife insurance business is that part of the total net investment income which corresponds to the ratio of these nonlife reserves to the total reserves.

In the casualty insurance field, where stock companies predominate, the stock companies are subjected to a different tax computation from mutuals, one that usually results in a higher tax. It is feared that if this were applied to the accident and health field of the life insurance industry, where mutuals predominate, the competitive consequences could be quite serious.

C. THE DEFINITION OF INCOME

The gross income of a life insurance company under present law is defined as interest, dividends, and rents. This definition has been changed by expressly including (1) royalties; (2) certain amounts received in connection with entering into, altering, or terminating agreements such as leases and mortgages; and (3) income derived from the operation of a noninsurance business. Royalties are considered to be similar to rents. Similarly, the receipts in connection with certain agreements are considered similar to the income received under the agreements. These amounts would include, for example, a bonus on entering into a lease and a penalty for early repayment of a mortgage. Normally a life insurance company will only have income from a noninsurance business where it acquires a going business in foreclosing a mortgage. Income earned in this situation is considered to be similar to mortgage interest. In some cases there is uncertainty as to the status of these items under present law.

The deductions corresponding to these types of income are allowed. Thus, the bill provides a deduction for depletion and a deduction for the ordinary expenses of any noninsurance business. As has always been the case, capital gains are not included in life insurance income.

The deduction for dividends received on corporate stock held for the life insurance business is denied on the grounds that the life insurance company already gets at least an 85 percent deduction on this income.

Where appropriate, these modifications of the definition of investment income have also been applied to casualty insurance companies. For mutual casualty companies there are expressly added to the pres-

ent definition of income royalties, payments in connection with agreements, and income from a noninsurance business. The corresponding deductions are allowed. Under present law all of these types of income are includible in the case of a stock casualty company, but the bill allows a deduction for depletion which is not allowed in the 1954 Code.

D. ABUSES OF THE LIFE INSURANCE PROVISIONS

The bill makes several changes in present law designed to prevent abuses of the special tax treatment permitted in the case of life insurance companies. One of these new provisions is an overall ceiling imposed upon the reserve and other policy liability deduction. That deduction, in general, is determined by means of specified percentages of net investment income and serves in lieu of a deduction for the actual commitment of each company to pay and accrue interest. But if, on the basis of its actual commitments, the investment income is far greater than what is necessary, instead of deducting the normal percentage, 87½ or 85 percent, of this large investment income, a ceiling for the deduction is imposed. The ceiling is roughly 200 percent of the interest requirements on life insurance reserves plus the actual interest commitments on contracts not involving life contingencies, plus dividends to policyholders. A dividends received deduction is allowed for the portion of dividends included in the part of income taxable at full rates. In some cases there is uncertainty as to the status of these items under present law.

In the computation of the ceiling on the reserve and other policy liability deduction it is provided that the interest on life insurance reserves to the extent that those reserves are matched by policy loans may be taken at only 100 percent and not 200 percent. This is designed to prevent the abuse of creating more or less fictitious life insurance reserves by selling insurance policies where a policy loan is extended immediately for almost the full amount of the premium.

Another new provision deals with the definition of a life insurance company. Under present law, an insurance company is denominated a life insurance company if more than 50 percent of its reserves are life insurance reserves. This rule is continued, but a modification is provided. Under present law a company finding its reserves other than life (generally accident and health insurance reserves) rising over the 50 percent can avoid taxation as a casualty insurance company by "manufacturing" life insurance reserves through the device of selling insurance policies and extending policy loans to the amount of the reserves set up on these policies. This is a paper transaction to disguise the true character of the company. The bill would remove the amount of policy loans from both life reserves and total reserves and apply the 50 percent test as though these transactions had never occurred.

The inclusion in the bill of a definite formula is not intended to affect the general principles of law under which sham transactions may be disregarded. Furthermore, it should be pointed out that the formula is not confined to situations similar to that described above, since its application is generalized to all policy loans whether or not they arise in the normal course of operations. It is considered that to the extent a life insurance company lends money to a policyholder it is creating a position similar to that which would have existed if it had initially sold him a policy involving a lower net reserve.

There is a potential abuse situation in the case of the so-called captive insurance companies. It may be possible for a finance company, for example, to establish a subsidiary life insurance company that will issue life insurance policies in connection with the business of the parent. If the subsidiary charges excessive premium on this business, a portion of the income of the parent company can be diverted to the life insurance company. It is believed that section 482 of the Internal Revenue Code of 1954 (relating to allocation of income and deductions among related taxpayers) provides the Secretary of the Treasury ample regulative authority to deal with this problem.

E. NEW INSURANCE COMPANIES

An alternative tax base is provided for the first 5 years during which a company is authorized to do business as an insurance company. Basically this section provides that if the investment income exceeds two times the interest requirements, so that the ceiling on the reserve and other policy liability deduction would come into effect, then the tax base cannot exceed the net gain from operations, after dividends to policyholders but before Federal income tax, as shown by the annual statement approved by the National Convention of Insurance Commissioners. In no case can this provision make the tax less than it would have been if there was no ceiling on the reserve and other policy liability deduction. Thus the company will be taxable at least on 12½ percent of its first \$1 million of investment income on life insurance business and on 15 percent of the balance.

SECTION-BY-SECTION ANALYSIS OF THE BILL

FIRST SECTION

The first section of the bill contains a short title for the bill, namely, the "Life Insurance Tax Act for 1955".

SECTION 2

Section 2 of the bill amends part I of subchapter L of chapter 1 of the Internal Revenue Code of 1954 (relating to the taxation of the income of life insurance companies) by substituting for the existing sections 801 to 807, inclusive, a new text which is divided into three subparts:

1. Subpart A (secs. 801 through 805), which deals with the new formula for the taxation of the income of life insurance companies for the taxable year 1955;
2. Subpart B (secs. 811 through 813) which deals with the 1942 formula (with certain revisions) for the taxation of that income, which formula will become effective in 1956 if other legislation is not enacted; and
3. Subpart C (secs. 816, 817, and 818), which deals with foreign life insurance companies, the denial of double deductions, and an alternate treatment for certain new life insurance companies.

SUBPART A

Section 801. Definition of life insurance companies

The new section 801 embodies, with a few minor changes, the definition of a life insurance company which is contained in section 801 of the Internal Revenue Code of 1954.

Subsections (a), (c), and (e) of section 801 are in substance the same as section 801 of the 1954 code, while subsection (b), with a minor exception, is in substance the same as section 803 (b) of the 1954 code. Under these subsections the total reserves and the life insurance reserves of an insurance company are defined. The company is treated as a life insurance company if more than 50 percent of its total reserves are life insurance reserves or certain reserves on noncancelable accident and health insurance. Paragraph (4) of subsection (b) specifies that the amount of these reserves shall be the mean of these reserves at the beginning and end of the taxable year. This corresponds to the present practice of the Internal Revenue Service in applying this definitional test.

Subsection (d) of section 801 introduces a new element in the definition of a life insurance company. An insurance company, in computing its life insurance reserves to determine whether it qualifies as a life insurance company under section 801 (a), must under the provisions of subsection (d) reduce its life insurance reserves and its total reserves 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. The term "policy loans" is intended to include loans made by the insurance company, by whatever name called, for which the reserve on a policy is the collateral.

The effect of this subsection may be illustrated by the following example based on hypothetical data for the A insurance company selling only life insurance and cancelable accident and health insurance:

	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 reserves less policy loans.....			1,050
4. Unearned premiums and unpaid losses on cancelable accident and health insurance.....	900	1,600	1,250
5. Total reserves under the bill (item 3 plus item 4).....			2,300
6. Total reserves under present law (item 1 plus item 4).....			2,750

The rule provided in the bill requires that the mean of the year figure in item 3 (1,050) be more than 50 percent of the mean of the year figure in item 5 (2,300). Thus under the bill the A company would not qualify as a life insurance company. The present law rule requires that the mean of the year figure in item 1 (1,500) be more than 50 percent of the mean of the year figure in item 6 (2,750). This company would be regarded as a life insurance company under present law.

Section 802. Tax imposed for 1955

The new section 802 imposes the tax on life insurance companies for the year 1955. In the case of a company having no non-life

insurance reserves (as defined in sec. 804 (d) (2)) the tax provided by subsection (a) applies only on its life insurance taxable income. In the case of a company having non-life insurance reserves the tax is either (1) the tax imposed by section 802 (a), or (2) the tax computed under section 802 (c) (2), whichever is the higher.

Subsection (a) imposes a tax consisting of a normal tax and a surtax (computed under secs. 11 (b) and 11 (c) of the 1954 Code, respectively) on the sum of the "life insurance taxable income" plus the "non-life insurance taxable income."

Subsection (b) defines "life insurance taxable income" as the "net investment income" minus the sum of the net investment income allocable to non-life insurance reserves, the reserve and other policy liability deduction, and the special interest deduction (if applicable). The term "net investment income" is explained in section 803; "net investment income allocable to non-life insurance reserves" in section 804 (d); "reserve and other policy liability deduction" in section 804; and "special interest deduction" in section 805.

Subsection (c) provides an alternative method of computing the tax in the case of life insurance companies having non-life insurance reserves. In such cases, the taxpayer insurance company pays the greater of either the tax imposed under section 802 (a) or the alternative tax computed under section 802 (c) (2). If the operation of section 1201 (a) (providing an alternative tax on capital gains) reduces the tax computed under section 802 (a) to an amount less than that computed under section 802 (c) (2), then the latter tax would apply.

The alternative tax under section 802 (c) (2) consists of the sum of two partial taxes. The first partial tax is a normal tax and surtax (computed as under secs. 11 (b) and 11 (c), respectively) on the taxpayer's life insurance taxable income. The second partial tax consists of the sum of (i) 1 percent of that portion of the gross investment income which is allocable to the non-life insurance reserves and (ii) 1 percent of the excess of the net premiums on the non-life insurance contracts over the dividends due policyholders (in their capacity as such) on those contracts. Net premiums and dividends to policyholders are to be computed as provided in section 823. Paragraph (2) (B) (i) of subsection (c) provides that the portion of the gross investment income allocable to non-life insurance reserves is to be an amount which bears the same ratio to gross investment income (reduced by the deduction for wholly exempt interest allowed by sec. 803 (c) (1)) as the nonlife reserves bear to the "qualified reserves" (defined under sec. 804 (c)). The "excess" described in clause (ii) of subsection (c) (2) (B) could conceivably be a negative figure which would then reduce the amount to be determined under such subsection.

Subsection (d) of section 802 provides methods for computing the deduction for partially tax-exempt interest. Paragraph (1) of subsection (d) provides (for the purpose of the normal tax computed under sec. 802 (a)) a deduction for partially tax-exempt interest equal to an amount which bears the same ratio to the amount of the deduction provided by section 242 as the sum of the life insurance taxable income (determined under sec. 802 (b)) and the net investment income allocable to non-life insurance reserves (determined under sec. 804 (d)) bears to the net investment income. Since the net investment income is reduced by the reserve and other policy liability

deduction, the deduction for partially tax-exempt interest is correspondingly reduced. For the purpose of the normal tax in computing the first partial tax under section 802 (c) (2) (A), the deduction for partially tax-exempt interest is an amount which bears the same ratio to the amount of the deduction provided by section 242 as the life-insurance taxable income bears to the net investment income.

Subsection (e) of section 802 provides for a method of computing the alternative tax on capital gains in the case of a life insurance company which has non-life insurance reserves. Under section 1201 (a), if the net long-term capital gain of a corporation exceeds its net short-term capital loss, then the alternative capital gains tax is computed by reference to such excess. Under subsection (e), the excess to be taken into account is an amount which bears the same ratio to the excess described in section 1201 (a) as the non-life insurance reserves bear to the qualified reserves. In determining this excess, a net capital loss for any taxable year beginning before January 1, 1955, shall not be taken into consideration.

The "non-life insurance taxable income" of a life insurance company is defined in section 802 (f) as the net investment income allocable to non-life insurance reserves increased by a proportionate share of the net capital gain allocable to this non-life insurance income and decreased by the proportionate share of the deductions for dividends received provided in sections 243, 244, and 245. In computing the net capital gain for purposes of this subsection, a net capital loss for any taxable year beginning before January 1, 1955, shall not be taken into account.

Section 803. Income and deductions

Section 803 provides rules and definitions for the determination of income and deductions to be used only in the case of life insurance companies.

Subsection (b) of section 803 defines "gross investment income." It starts with the definition of gross income, as provided by section 803 (a) (2) of the Internal Revenue Code of 1954, and adds to that definition royalties and gross income from any trade or business (other than an insurance business) carried on by the life insurance company.

Subsection (b) (1) includes in the definition of "gross investment income" the gross amount of any income, received or accrued, during the taxable year, from interest, dividends, rents, and royalties. It is made clear that income includes the gross amount received in conjunction with the making of any lease, mortgage, or other instrument or agreement from which the life insurance company will derive interest, rents, or royalties, and the alteration or termination of any such lease, etc. Examples of such amounts would be a penalty for early payment of a mortgage and a bonus for entering into a lease. Any amount received in conjunction with an agreement which would be deemed a capital gain under other provisions of the Internal Revenue Code will not be included in gross investment income.

Under subsection (b) (2) of section 803, "gross investment income" also includes the gross income from any trade or business (other than an insurance business) carried on by the insurance company individually or in partnership. In determining the amount of income from such trade or business it is provided that any items described in section 803 (b) (1) be excluded. Gross investment income does not

include any gain from the sale or exchange of a capital asset. This exclusion applies also to any gain which is treated as a gain from the sale or exchange of a capital asset under other provisions of the Internal Revenue Code.

Section 803 (c) defines "net investment income" (a term comparable to "taxable income" as used in sec. 803 (g) of the Internal Revenue Code of 1954), as gross investment income (referred to in sec. 803 (b)) less a number of deductions.

The deductions for tax-free interest, investment expenses, and depreciation are in substance the same as provided in section 803 (g) of the 1954 Code. As under present law the insurance company is permitted to deduct taxes and other expenses (other than capital improvements) paid or accrued during the taxable year exclusively on or with respect to real estate owned by the company. The bill adds a reference to section 164 to bring into operation here certain changes in the deductibility of taxes adopted in 1954 which are not now applied to insurance companies. Paragraph (5) of section 803 (c) provides for a new deduction, that for depletion (and depreciation) allowed by section 611.

Paragraph (6) of this subsection allows the deductions attributable to any trade or business, the income from which is included in the life insurance company's gross investment income by reason of section 803 (b) (2), except losses from (a) sales or exchanges of capital assets, (b) sales or exchanges of property used in the trade or business (as defined in section 1231 (b)), and (c) losses from the compulsory or involuntary conversion of property used in the trade or business. The allowable deductions may exceed the gross income from this business. Any part of the deductions provided in paragraph (6) will be disallowed to the extent attributable to the carrying on of the insurance business. An example of this disallowance could be provided by a life insurance company that operated a radio station primarily to advertise its own insurance services. A portion of the expenses of the radio station (corresponding to the ratio of the value of advertising furnished to the insurance company to the total value of services rendered by the station) will not be allowed as deductions. Paragraph (6) also excludes the deduction for net operating losses provided in section 172.

Unlike present law this bill omits the deduction for intercorporate dividends in computing the basic net investment income of a life insurance company. It is specified in paragraph (6) that none of the deductions allowed in part VIII of subchapter B shall be allowed as expenses of the noninsurance business.

Subsection (d), limiting the deductions related to real estate, and subsection (e), relating to amortization of premium and accrual of discount on bonds and other evidences of indebtedness are in substance the same as subsections (h) and (i), respectively, of section 803 of the Internal Revenue Code of 1954.

Section 804. Reserve and other policy liability deduction

Section 804 provides a new rule for determining the "reserve and other policy liability deduction" for the purpose of subpart A of part I of subchapter L of the 1954 Code. Subject to the limitations provided in subsection (b), subsection (a) defines the term "reserve and other policy liability deductions" (for the purposes of the subpart) as meaning the sum of the amounts determined by applying

the following percentages to the excess of the net investment income over the net investment income allocable to non-life insurance reserves (determined under subsection (d)):

(1) 87½ percent of so much of the excess as does not exceed \$1 million; and

(2) 85 percent of so much of the excess as exceeds \$1 million.

Subsection (b) provides that the deduction for reserve and other policy liabilities shall not exceed an amount which is equal to the sum of the following:

(A) Two times the required interest on life insurance reserves (determined under sec. 805 (c) (1));

(B) The required interest on reserves for deferred dividends (determined under sec. 805 (c) (2));

(C) The amount of interest paid (as defined in sec. 804 (d));

(D) The dividends to policyholders paid or declared (other than dividends on non-life insurance contracts referred to in subsection (d) (2) (A) of sec. 804; and

(E) In the case of a mutual assessment life insurance company or association such maximum is to be an amount equal to two times whichever of the following is the lesser:

(i) The amount of the net investment income on life insurance reserves described in subparagraph (A) or (B) of section 801 (b) (3); or

(ii) 3 percent of the life insurance reserves so described.

The above sum must be reduced by the amount of the adjustment for policy loans provided in paragraph (2) of subsection (b). For the purposes of (D) the dividends to policyholders shall be construed as those paid, or those declared, according to the method of accounting regularly employed in keeping the books of the insurance company.

Paragraph (2) of subsection (b) provides for the application of an adjustment which will reduce the amount computed under paragraph (1) by an amount equal to the mean of the aggregates (at the beginning and end of the taxable year) of the outstanding policy loans with respect to contracts for which life insurance reserves are maintained, multiplied by the average rate of interest applicable to life insurance reserves.

Paragraph (3) of subsection (b) permits an insurance company, whose reserve and other policy liability deduction has been limited by paragraph (1) of this subsection, to take as a deduction an amount corresponding to the dividends received deductions provided in sections 243, 244, and 245 of the 1954 Code. Specifically, subparagraph (A) of the paragraph provides that where paragraph (1) of subsection (b) reduces the reserve and other policy liability deduction allowed by section 804 or 812, an insurance company will be allowed, in computing life insurance taxable income under section 802 (b) or 811 (b), an additional deduction corresponding to the dividends received deduction computed under the provisions of subparagraph (B).

The deduction computed under subparagraph (B) is to be an amount which bears the same ratio to the total intercorporate dividends received deductions provided in sections 243, 244, and 245 as the net investment income reduced as provided in the next paragraph, bears to the total net investment income.

In the above-mentioned computation, the net investment income is reduced by the sum of the net investment income allocable to nonlife

insurance reserves (or for the purposes of sec. 811 (d), the amount of the adjustment for certain reserves provided in sec. 813), and 100/85 of the maximum limitation determined under paragraphs (1) and (2) of subsection (b).

The provisions of paragraph (3) may be illustrated by the following example:

Company A (a life insurance company organized in 1945) has investment income of \$300,000. In applying subsection (b) of section 804, the company has—

Required interest, \$42,000, times 2.....	\$84, 000
Interest paid.....	1, 000
	\$85, 000

Maximum reserve and other policy liability deduction.....

Assuming the investment income allocable to non-life insurance reserves was \$100,000 and the deduction under sections 243, 244, and 245 was \$6,000, the total deduction for dividends received would be \$4,000 determined in the following manner:

Deduction under 802 (f), \$6,000 $\left(\frac{100,000}{300,000}\right)$	\$2, 000
Under 804 (b) (3), \$6,000 $\left(\frac{300,000 - 100,000 - \frac{100}{85}(85,000)}{300,000}\right)$	2, 000
Total deduction.....	4, 000

The application of the preceding subsection may be illustrated by the following example:

The B life insurance company has net investment income of 300, of which 100 is allocable to non-life insurance reserves. The reserve and other policy liability deduction as computed under subsection (a) of section 804 is 87½ percent of 200 or 175. The company must then determine its maximum reserve and other policy liability deduction. The first element of this maximum relates to its interest on life insurance reserves which is computed as follows:

	Reserves, Jan. 1	Reserves, Dec. 31	Reserves, mean of year	Amount of required interest
Reserves at 2½ percent.....	900	1, 100	1, 000	25
Reserves at 3 percent.....	1, 050	950	1, 000	30
Total.....			2, 000	55

The calculation of the maximum will include twice the sum of 25 and 30 or 110. There is also added interest paid on borrowings and on contracts not involving contingencies, which is 20, and dividends paid to policyholders of 10.

From 140 (the sum of 110, 20, and 10) there must be subtracted the adjustment for loans on policies involving life insurance reserves. The amount of such policy loans is 150 at the beginning of the year and 250 at the end or 200 as the mean. The adjustment for policy loans is determined by first dividing the reserve interest required (55) by the sum of the means of the life insurance reserves (2,000). This average rate is thus 2.75 percent. This rate multiplied by the mean policy loans of 200 yields an adjustment of 5.5. Thus the reserve

and other policy liability deduction for the B company will be limited by subsection (b) and will be 140 less 5.5, or 134.5.

Section 804 (c) defines the term "qualified reserves" (as used in subpart A) as the sum of the following items:

(1) Life insurance reserves (as defined in sec. 801 (b)) plus 7 percent of that portion of such reserves as are computed on a preliminary term basis.

(2) The "nonlife insurance reserves" (defined in sec. 804 (d) (2)).

(3) The amounts (discounted at the rates assumed by the company) necessary to satisfy certain obligations under insurance and annuity contracts (including contracts supplementary thereto). Such amounts are to be included only if the above-mentioned obligations, when satisfied, will reflect an increment in the nature of interest, and such obligations do not involve life, health, or accident contingencies at the time with respect to which the computation is made under paragraph (3) of section 804 (c).

(4) The amounts held at the end of the taxable year as reserves for dividends to policyholders, the payment of which dividends is deferred for at least 5 years from the date of the policy contract. Such amount shall not be deemed to include dividends payable during the year following the taxable year for which such computation is made.

(5) The dividend accumulations, and other amounts, held at interest in connection with insurance or annuity contracts, including supplementary contracts.

(6) Premiums and annuity considerations received in advance, and liabilities for premium deposit funds and for annuity consideration deposit funds.

In applying subsection (c), the same item shall only be counted once. With the exception of paragraph (4) of section 804 (c), the amount of any reserves (or portion thereof) for any taxable year (as used in sec. 804) shall be the mean of such reserves (or portion thereof) at the beginning and end of the taxable year.

Subsection (d) of section 804 provides for the definition of non-life insurance reserves and for the method of determining the amount of the net investment income allocable to such reserves.

Paragraph (1) of subsection (d) provides for the determination of the net investment income allocable to non-life insurance reserves as that amount which bears the same ratio to the net investment income as such reserves bear to the qualified reserves. Paragraph (2) of the subsection defines non-life insurance reserves as the sum of the unearned premiums and the unpaid losses (whether or not ascertained) on contracts other than life insurance, annuity, and noncancelable health and accident insurance contracts, except any unearned premiums and unpaid losses which are included in the life insurance reserves as defined in section 801 (b). The parenthetical phrase "whether or not ascertained" is intended as continuation of the treatment accorded unpaid losses under present law. The unearned premiums shall not be considered to be less than 25 percent of the net premiums written during the taxable year on such contracts.

Paragraph (3) of subsection (d) provides for an adjustment (under regulations prescribed by the Secretary or his delegate) with respect to certain non-life insurance contracts that do have some life insurance reserves.

Section 805. Special interest deduction

Section 805 provides for a special interest deduction (comparable to the reserve interest credit provided in sec. 805 (b) of the Internal Revenue Code of 1954) to be used when computing the tax imposed by section 802. The deduction is provided for life insurance companies whose net investment incomes are insufficient or barely sufficient to meet their required interest commitments.

The deduction is determined as under present law, with some minor changes. Under present law if the ratio of adjusted taxable income to required interest is less than 1.00 the company receives an additional deduction of 50 percent of the income subject to the life insurance tax. To conform the numerator of this ratio to the current bill an adjusted net investment income is used described in subsection (b). To retain the effect of the provision under present law the ratio is multiplied by the net investment income reduced by the sum of net investment income allocable to non-life insurance reserves and the reserve and other policy liability deduction. As under present law reduced allowances are made where the ratio is between 1.00 and 1.05.

A minor change in the definition of required interest is made. Under present law the required interest with respect to the reserve for deferred dividends is deemed to be 2 percent. Under the bill the actual interest rate is used.

SUBPART B. 1942 FORMULA

Sections 811, 812, and 813 provide that after 1955, certain provisions of the Revenue Act of 1942 are to be combined with certain of the new provisions set forth in subpart A. The particular 1942 provisions that would come back into operation would be the method of determining the reserve and other policy liability deduction by reference to the Secretary's ratio (sec. 812) and the computation of income on non-life insurance business by means of applying 3¼ percent to certain reserves (sec. 813).

The features of subpart A which are made permanent are:

- (1) The new definitions relating to investment income;
- (2) Denial of the dividends received credit;
- (3) The maximum limit on the reserve and other policy liability deduction;
- (4) The adjustment for policy loans in the 50 percent test used to define a life insurance company; and
- (5) The special interest deduction.

Section 811. Tax imposed

Subsections (a) and (b) of section 811 are in substance the same as section 802 (a) of the Internal Revenue Code of 1954, except that the special interest deduction is allowed.

Subsection (c) of section 811 provides an adjustment in computing the special interest deduction. Under this subsection, the computations under the specified provisions of the new section 805 will be made by substituting the amount of the adjustment for certain reserves provided in section 813 for the net investment income allocable to non-life insurance reserves. For purposes of section 805 (b), the substitution will be made after the net investment income has been computed without the reduction for wholly exempt interest. Under

the amendment made by your committee, in applying section 805 (b) (2) with respect to subpart B, the amount taken into account will be 50 percent of the amount of the adjustment for certain reserves, in lieu of 50 percent of the net investment income allocable to non-life insurance reserves.

Section 812. Reserve and other policy liability deduction

Section 812 is in substance the same as section 804 (a) of the Internal Revenue Code of 1954. The term "net investment income" is substituted for the term "taxable income" wherever such term is used in section 804 of the 1954 Code.

Subsection (b) contains definitions corresponding to the definitions found in subsections (c), (d), (e), and (f) of section 803 of the 1954 Code.

Subsection (c) applies the same maximum limit to the reserve and other policy liability deduction allowed by section 812 (a) as the maximum limit applied by section 804 (b).

Section 813. Adjustment for certain reserves

Section 813, in substance the same as section 806 of the Internal Revenue Code of 1954, provides for an adjustment for certain reserves in the case of a life insurance company writing contracts other than life insurance, annuity, and noncancelable health and accident insurance contracts (including life insurance or annuity contracts combined with noncancelable health and accident insurance).

SUBPART C—MISCELLANEOUS PROVISIONS

Section 816. Foreign life insurance companies

Section 816 is in substance the same as section 807 of the Internal Revenue Code of 1954.

Section 817. Denial of double deductions

Section 817 applies to part I the prohibition against double deductions found in section 803 (j) of the Internal Revenue Code of 1954.

Section 818. Certain new insurance companies

Section 818 (a) provides an alternative tax treatment for a life insurance company if the taxable year begins not more than 4 years after the first day on which the company was authorized to do business as an insurance company. If an insurance company so qualifies for the taxable year, its life insurance taxable income (for purposes of subpart A) shall not exceed the amount of the net gain from operations (after dividends to policyholders and before Federal income tax) reduced by the net investment income allocable to non-life insurance reserves and the special deduction for dividends received provided in subsection (c). Similarly, if a company so qualifies for purposes of subpart B, its life insurance company taxable income shall not exceed the amount of the net gain from operations (after dividends to policyholders and before Federal income tax) reduced by the special deduction for dividends received provided in subsection (c). Subsection (a) further provides that the net gain from operations (after dividends for policyholders and before Federal income tax) mentioned above shall be computed in the manner required for purposes of the annual statement approved by the National Convention of Insurance Commissioners.

Subsection (b) limits the relief to new insurance companies under the alternative tax treatment of this section by providing that the section shall not reduce the tax for any taxable year below the amount which (but for this section) would be imposed by section 802 or section 811 (as the case may be) computed without the limitation upon the reserve and other policy liability deduction contained in section 804 (b) or section 812 (c).

Subsection (c) provides the special rule for the dividends-received deduction referred to in paragraph (1) (B) (ii) and paragraph 2 of subsection (a). The deduction shall be an amount computed under section 804 (b) (3), except that for the purposes of such computation, the maximum limitation referred to in section 804 (b) (3) (B) (ii) shall be—

(1) in the case where the tax imposed by section 802 applies, the amount by which the net investment income (reduced by the net investment income allocable to non-life insurance reserves) exceeds the net gain from operations (after dividends to policyholders and before Federal income tax) reduced by the net investment income allocable to non-life insurance reserves, or

(2) in the case where the tax imposed by section 811 applies, the amount by which the sum of the net investment income and the amount of the adjustment for certain reserves (provided in sec. 813) exceeds the net gain from operations (after dividends to policyholders and before Federal income tax).

The application of section 818 is shown by following example:

The A life insurance company, which received its authorization to do business as an insurance company in 1953, in the taxable year 1955 received net investment income of \$300,000, of which \$200,000 was dividends (thus, the deduction that would be allowed by secs. 243, 244, and 245 is \$170,000). There were no nonlife insurance reserves. Its required interest for 1955 was \$42,500. Its net gain from operations after dividends to policyholders and before Federal income tax was \$200,000.

Under the provisions of section 802 (b) and section 804 the life insurance taxable income is computed as follows:

Net investment income.....	\$300,000
Maximum reserve and other policy liability deduction minus required interest (\$42,500) times 2.....	\$85,000
Dividends-received deduction under sec. 804 (b) (3):	
$300,000 - \frac{100}{85} (85,000)$	
$\frac{300,000}{300,000} \times (170,000)$	113,333
	<u>198,333</u>
Life insurance taxable income.....	101,667

Because the A company qualifies under the provisions of section 818 it will compute its life insurance taxable income as follows:

Net gain from operations (after dividends to policyholders and before Federal income tax).....	\$200,000
Dividends-received deduction provided by sec. 818 (c):	
$300,000 - \frac{100}{85} (100,000)$	
$\frac{300,000}{300,000} \times (170,000)$	103,333
	<u>96,667</u>
Life insurance taxable income.....	96,667

The 100,000 which was multiplied by 100/85 is the net investment income (\$300,000) less the net gain from operations, and so forth (\$200,000).

Subsection (b) provides that in no case shall the life insurance taxable income be less than the net investment income reduced by 87½ percent (85 percent of the amount over \$1 million).

SECTION 3. ADJUSTMENT TO INVESTMENT INCOME OF INSURANCE COMPANIES OTHER THAN LIFE

Subsection (a) of section 3 contains amendments to part II of subchapter L of chapter 1 of the Internal Revenue Code of 1954 (relating to mutual insurance companies other than life). These amendments conform the investment income which is used as a tax base in the case of these mutual insurance companies to the revised concept of investment income which will apply to life insurance companies under the new part I. The principal changes are the express inclusion of royalties, and the income from a trade or business other than the insurance business together with the deductions attributable thereto. No change is made in the availability of the deduction for dividends received.

Subsection (b) of section 3 contains amendments to part III of subchapter L (relating to stock insurance companies other than life). Since these companies are in effect, taxed on the regular corporate basis, no change was necessary in the definition of their investment income. However, technical amendments were made to permit them to take a deduction for depletion (which was not specifically allowed by the Internal Revenue Code of 1954), to correct the special capital loss deduction provisions, and to correct a cross reference to the definition of life insurance reserves.

SECTION 4. ANNUAL ACCOUNTING PERIOD OF INSURANCE COMPANIES TO BE A CALENDAR YEAR

This section adds section 843 to part IV of subchapter L of chapter 1 of the Internal Revenue Code of 1954. Section 843 provides that for the purposes of subtitle A of the Internal Revenue Code of 1954 the annual accounting period for each insurance company subject to a tax imposed by subchapter L shall be the calendar year.

SECTION 5. TECHNICAL AMENDMENTS

This section makes certain technical amendments to provisions of the Internal Revenue Code of 1954 outside of the first three parts of subchapter L to conform those provisions to the changes in subchapter L made by sections 2 and 3 of the bill.

Paragraph (2) of this section amends paragraph (16) of section 501 (c) of the Internal Revenue Code, which provides an exemption from tax for certain small mutual insurance companies and associations. Under present law, such a company or association is exempt if the gross amount received during the taxable year from interest, dividends, rents, and premiums (including deposits and assessments) does not exceed \$75,000. Under the amendment, the broader concept of the gross investment income contained in the bill is substituted for interest, dividends, and rents.

SECTION 6. EFFECTIVE DATE

Section 6 provides that the amendments made by the bill shall apply only to taxable years beginning after December 31, 1954.

SECTION 7. SAVINGS PROVISIONS

Section 7 provides that no addition to the tax shall be made under section 6655 of the 1954 Code with respect to the estimated tax for a taxable year beginning in 1955 for any taxpayer subject to tax under the provisions of section 802 or 807 of the 1954 Code (as such sections were in effect before the enactment of H. R. 7201). In the case of a taxpayer subject to tax under section 821 of the 1954 Code (imposing a tax on certain mutual insurance companies) any addition to the tax under section 6655 of the 1954 Code with respect to estimated tax for a taxable year beginning in 1955 shall in no case be larger than such addition would have been if this act had not been enacted.

CHANGES IN EXISTING LAW

In compliance with subsection 4 of rule XXIX of the Standing Rules of the Senate, changes in existing law made by the bill are shown as follows (existing law proposed to be omitted is enclosed in black brackets; new matter is printed in italics; existing law in which no changes are proposed is shown in roman):

Internal Revenue Code

CHAPTER 1—NORMAL TAXES AND SURTAXES

- * * * * *
- SEC. 316. DIVIDEND DEFINED.**
- (a) **GENERAL RULE.**—* * *
- * * * * *
- (b) **SPECIAL RULES—**
- (1) **CERTAIN INSURANCE COMPANY DIVIDENDS.**—The definition in subsection (a) shall not apply to the term “dividend” as used in [sections 803 (e), 821 (a) (2), 823 (2), and 832 (c) (11) (where the reference is to dividends of insurance companies paid to policyholders)] *subchapter L in any case where the reference is to dividends of insurance companies paid to policyholders as such.*
- * * * * *
- SEC. 501. EXEMPTION FROM TAX ON CORPORATIONS, CERTAIN TRUSTS, ETC.**
- (a) **EXEMPTION FROM TAXATION.** * * *
- * * * * *
- (c) **LIST OF EXEMPT ORGANIZATIONS.**—The following organizations are referred to in subsection (a):
- (1) * * *
- * * * * *
- (15) Mutual insurance companies or associations other than life or marine (including interinsurers and reciprocal underwriters) if the gross amount received during the taxable year from [interest, dividends, rents,] *the items described in section 822 (b) (other than paragraph (1) (D) thereof) and premiums (including deposits and assessments) does not exceed \$75,000.*
- * * * * *
- SEC. 594. ALTERNATIVE TAX FOR MUTUAL SAVINGS BANKS CONDUCTING LIFE INSURANCE BUSINESS.**
- (a) **ALTERNATIVE TAX.**—In the case of a mutual savings bank not having capital stock represented by shares, authorized under State law to engage in the busi-

ness of issuing life insurance contracts, and which conducts a life insurance business in a separate department the accounts of which are maintained separately from the other accounts of the mutual savings bank, there shall be imposed in lieu of the taxes imposed by section 11 or section 1201 (a), a tax consisting of the sum of the partial taxes determined under paragraphs (1) and (2):

(1) * * *

(2) a partial tax computed on [the taxable income (as defined in section 803)] *the income* of the life insurance department determined without regard to any items of gross income or deductions not properly allocable to such department, at the rates and in the manner provided in subchapter L (sec. 801 and following) with respect to life insurance companies.

* * * * *

Subchapter L—Insurance Companies

Part I. Life insurance companies.

Part II. Mutual insurance companies (other than life or marine or fire insurance companies issuing perpetual policies).

Part III. Other insurance companies.

Part IV. Provisions of general application.

[PART I—LIFE INSURANCE COMPANIES

[Sec. 801. Definition of life insurance company.

[Sec. 802. Imposition of tax.

[Sec. 803. Other definitions and rules.

[Sec. 804. Reserve and other policy liability deduction.

[Sec. 805. 1954 life insurance company taxable income.

[Sec. 806. Adjustment for certain reserves.

[Sec. 807. Foreign life insurance companies.

[SEC. 801. DEFINITION OF LIFE INSURANCE COMPANY

[For purposes of this subtitle, the term "life insurance company" means an insurance company which 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, if its life insurance reserves (as defined in section 803 (b)), plus unearned premiums and unpaid losses on noncancellable life, health, or accident policies not included in life insurance reserves, comprise more than 50 percent of its total reserves. For purposes of this section, the term "total reserves" means life insurance reserves, unearned premiums and unpaid losses not included in life insurance reserves, and all other insurance reserves required by law. 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.

[SEC. 802. IMPOSITION OF TAX.

[(a) IN GENERAL.—Except as otherwise provided in subsection (b), there shall be imposed for each taxable year on the life insurance company taxable income of every life insurance company a tax consisting of a normal tax and a surtax computed as provided in section 11. For purposes of such tax, the term "life insurance company taxable income" means the taxable income (as defined in section 803 (g)) minus the reserve and other policy liability deduction provided in section 804 and plus the amount of the adjustment for certain reserves provided in section 806. For purposes of the surtax, such taxable income shall be computed without regard to the deduction provided in section 242 for partially tax-exempt interest.

[(b) TAXABLE YEARS BEGINNING IN 1954.—In lieu of the tax imposed by subsection (a) there shall be imposed, for taxable years beginning in 1954, on the 1954 life insurance company taxable income (as defined in section 805) of every life insurance company a tax equal to the sum of the following:

[(1) 3¼ percent of the amount thereof not in excess of \$200,000, plus

[(2) 6½ percent of the amount thereof in excess of \$200,000.

[SEC. 803. OTHER DEFINITIONS AND RULES.

[(a) APPLICATION OF SECTION; GROSS INCOME.—

[(1) APPLICATION.—The definitions and rules contained in this section shall apply only in the case of life insurance companies.

[(2) GROSS INCOME.—The term "gross income" means the gross amount of income received or accrued during the taxable year from interest, dividends, and rents.

[(b) **LIFE INSURANCE RESERVES.**—The term “life insurance reserves” means amounts which are computed or estimated on the basis of recognized mortality or morbidity tables and assumed rates of interest, and which are set aside to mature or liquidate, either by payment or resinsurance, 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. Such life insurance reserves, except 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 except as hereinafter provided in the case of assessment life insurance, must also be required by law. In the case of an assessment life insurance company or association, the term “life insurance reserves” includes sums actually deposited by such company or association with State or Territorial officers pursuant to law as guaranty or reserve funds, and any funds maintained, under the charter or articles of incorporation or association (or bylaws approved by a State insurance commissioner) of such company or association, exclusively for the payment of claims arising under certificates of membership or policies issued on the assessment plan and not subject to any other use.

[(c) **ADJUSTED RESERVES.**—The term “adjusted reserves” means life insurance reserves plus 7 percent of that portion of such reserves as are computed on a preliminary term basis.

[(d) **RESERVE EARNINGS RATE.**—The term “reserve earnings rate” means a rate computed by adding 2.1125 percent (65 percent of $3\frac{1}{4}$ percent) to 35 percent of the average rate of interest assumed in computing life insurance reserves. Such average rate shall be calculated by multiplying each assumed rate of interest by the means of the amounts of the adjusted reserves computed at that rate at the beginning and end of the taxable year and dividing the sum of the products by the mean of the total adjusted reserves at the beginning and end of the taxable year.

[(e) **RESERVE FOR DEFERRED DIVIDENDS.**—The term “reserve for deferred dividends” means sums held at the end of the taxable year as a reserve for dividends (other than dividends payable during the year following the taxable year) the payment of which is deferred for a period of not less than 5 years from the date of policy contract.

[(f) **INTEREST PAID.**—The term “interest paid” means—

[(1) All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest upon which is wholly exempt from taxation under this chapter, and

[(2) All amounts in the nature of interest, whether or not guaranteed, paid or accrued within the taxable year on insurance or annuity contracts (or contracts arising out of insurance or annuity contracts) which do not involve, at the time of payment or accrual, life, health, or accident contingencies.

[(g) **TAXABLE INCOME.**—The term “taxable income” means the gross income less the following deductions:

[(1) **TAX-FREE INTEREST.**—The amount of interest received or accrued during the taxable year which under section 103 is excluded from gross income.

[(2) **INVESTMENT EXPENSES.**—Investment expenses paid or incurred during the taxable year. If any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed one-fourth of 1 percent of the mean of the book value of the invested assets held at the beginning and end of the taxable year plus one-fourth of the amount by which taxable income (computed without any deduction for investment expenses allowed by this paragraph, for tax-free interest allowed by paragraph (1), or for partially tax-exempt interest and dividends received allowed by paragraph (5)) exceeds $3\frac{3}{4}$ percent of the book value of the mean of the invested assets held at the beginning and end of the taxable year.

[(3) **REAL ESTATE EXPENSES.**—Taxes and other expenses paid or accrued during the taxable year exclusively on or with respect to the real estate owned by the company, not including taxes assessed against local benefits of a kind tending to increase the value of the property assessed, and not including any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property. The deduction allowed

by this paragraph shall be allowed in the case of taxes imposed on a shareholder of a company on his interest as shareholder, which are paid or accrued by the company without reimbursement from the shareholder, but in such cases no deduction shall be allowed the shareholder for the amount of such taxes.

[(4) DEPRECIATION.—The depreciation deduction allowed by section 167.

[(5) SPECIAL DEDUCTIONS.—The special deductions allowed by part VIII of subchapter B (except section 248).

[(h) RENTAL VALUE OF REAL ESTATE.—The deduction under subsection (g) (3) and (4) on account of any real estate owned and occupied in whole or in part by a life insurance company shall be limited to an amount which bears the same ratio to such deduction (computed without regard to this subsection) as the rental value of the space not so occupied bears to the rental value of the entire property.

[(i) AMORTIZATION OF PREMIUM AND ACCRUAL OF DISCOUNT.—The gross income, the deduction provided in subsection (g) (1), and the deduction allowed by section 242 (relating to partially tax-exempt interest) shall each be decreased to reflect the appropriate amortization of premium and increased to reflect the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures, or other evidences of indebtedness held by a life insurance company. Such amortization and accrual shall be determined—

[(1) in accordance with the method regularly employed by such company, if such method is reasonable, and

[(2) in all other cases, in accordance with regulations prescribed by the Secretary or his delegate.

[(j) DOUBLE DEDUCTIONS.—Nothing in this part shall permit the same item to be deducted more than once.

SEC. 804. RESERVE AND OTHER POLICY LIABILITY DEDUCTION.

[(a) IN GENERAL.—For purposes of this subpart, the term “reserve and other policy liability deduction” means an amount computed by multiplying the taxable income by a figure, to be determined and proclaimed by the Secretary or his delegate for each taxable year. This figure shall be based on such data with respect to life insurance companies for the preceding taxable year as the Secretary or his delegate considers representative and shall be computed in accordance with the following formula: The ratio which a numerator comprised of the aggregate of the sums of—

[(1) 2 percent of the reserves for deferred dividends,

[(2) interest paid, and

[(3) the product of—

[(A) the mean of the adjusted reserves at the beginning and end of the taxable year and

[(B) the reserve earnings rate,

bears to a denominator comprised of the aggregate of the excess of taxable incomes (computed without any deduction for tax-free interest, partially tax-exempt interest, or dividends received) over the adjustment for certain reserves provided in section 806.

[(b) SURTAX COMPUTATION.—In determining the life insurance company taxable income for purposes of the surtax, the taxable income to be multiplied by the figure determined and proclaimed under subsection (a) shall be computed without regard to the deduction provided in section 242 for partially tax-exempt interest.

SEC. 805. 1954 LIFE INSURANCE COMPANY TAXABLE INCOME.

[(a) DEFINITION.—For purposes of section 802 (b), the term “1954 life insurance company taxable income” means the taxable income (as defined in section 803 (g)), plus 8 times the amount of the adjustment for certain reserves provided in section 806, and minus the reserve interest credit, if any, provided in subsection (b) of this section.

[(b) RESERVE INTEREST CREDIT.—For purposes of subsection (a), the reserve interest credit shall be an amount determined as follows:

[(1) Divide the amount of the adjusted taxable income (as defined in subsection (c)) by the amount of the required interest (as defined in subsection (d)).

[(2) If the quotient obtained in paragraph (1) is 1.05 or more, the reserve interest credit shall be zero.

[(3) If the quotient obtained in paragraph (1) is 1.00 or less, the reserve interest credit shall be an amount equal to 50 percent of the taxable income.

[(4) If the quotient obtained in paragraph (1) is more than 1.00 but less than 1.05, the reserve interest credit shall be the amount obtained by multi-

plying the taxable income by 10 times the difference between the figures 1.05 and such quotient.

[(c) **ADJUSTED TAXABLE INCOME.**—For purposes of subsection (b) (1), the term “adjusted taxable income” means the taxable income (computed without the deductions provided in section 803 (g) (1) or (5)) minus 50 percent of the amount of the adjustment for certain reserves provided in section 806.

[(d) **REQUIRED INTEREST.**—For purposes of subsection (b) (1), the term “required interest” means the total of—

[(1) the sum of the amounts obtained by multiplying—

[(A) each rate of interest assumed in computing the taxpayer’s life insurance reserves by

[(B) the means of the amounts of the taxpayer’s adjusted reserves computed at that rate at the beginning and end of the taxable year,

[(2) 2 percent of the reserve for deferred dividends, and

[(3) interest paid.

[SEC. 806. ADJUSTMENT FOR CERTAIN RESERVES.

[(In the case of a life insurance company writing contracts other than life insurance or annuity contracts (either separately or combined with noncancellable health and accident insurance), the term “adjustment for certain reserves” means an amount equal to 3¼ percent of the unearned premiums and unpaid losses on such other contracts which are not included in life insurance reserves (as defined in section 803 (b)). For purposes of this section, such unearned premiums shall not be considered to be less than 25 percent of the net premiums written during the taxable year on such other contracts.)

[SEC. 807. FOREIGN LIFE INSURANCE COMPANIES.

[(a) **CARRYING ON UNITED STATES INSURANCE BUSINESS.**—A foreign life insurance company carrying on a life insurance business within the United States, if with respect to its United States business it would qualify as a life insurance company under section 801, shall be taxable in the same manner as a domestic life insurance company; except that the determinations necessary for purposes of this subtitle shall be made on the basis of the income, disbursements, assets, and liabilities reported in the annual statement for the taxable year of the United States business of such company on the form approved for life insurance companies by the National Association of Insurance Commissioners.

[(b) **NO UNITED STATES INSURANCE BUSINESS.**—Foreign life insurance companies not carrying on an insurance business within the United States shall not be taxable under this section but shall be taxable as other foreign corporations.]

—PART I—LIFE INSURANCE COMPANIES

*Subpart A. 1955 formula.
Subpart B. 1932 formula.
Subpart C. Miscellaneous provisions.*

Subpart A—1955 Formula

*Sec. 801. Definition of life insurance company.
Sec. 802. Tax imposed for 1955.
Sec. 803. Income and deductions.
Sec. 804. Reserve and other policy liability deduction.
Sec. 805. Special interest deduction.*

SEC. 801. DEFINITION OF LIFE INSURANCE COMPANY.

(a) **LIFE INSURANCE COMPANY DEFINED.**—For purposes of this subtitle, the term “life insurance company” means an insurance company which 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, if—

(1) its life insurance reserves (as defined in subsection (b)), plus

(2) unearned premiums and unpaid losses 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 subsection (c)).

(b) **LIFE INSURANCE RESERVES DEFINED.**—

(1) **IN GENERAL.**—For purposes of this part, the term “life insurance reserves” means amounts—

(A) which are computed or estimated on the basis of recognized mortality or morbidity tables and assumed rates of interest, and

(B) 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.

(2) **RESERVES MUST BE REQUIRED BY LAW.**—Except—

(A) 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

(B) as provided in paragraph (3),

in addition to the requirements set forth in paragraph (1), life insurance reserves must be required by law.

(3) **ASSESSMENT COMPANIES.**—In the case of an assessment life insurance company or association, the term "life insurance reserves" includes—

(A) sums actually deposited by such company or association with State or Territorial officers pursuant to law as guaranty or reserve funds, and

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

(4) **AMOUNT OF RESERVE.**—For purposes of this subsection and subsection (c) 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.

(c) **TOTAL RESERVES DEFINED.**—For purposes of subsection (a), the term "total reserves" means—

(1) life insurance reserves,

(2) unearned premiums and unpaid losses not included in life insurance reserves, and

(3) all other insurance reserves required by law.

(d) **ADJUSTMENTS IN RESERVES FOR POLICY LOANS.**—For purposes only of determining under subsection (a) whether or not an insurance company is a life insurance company, the life insurance reserves, and the total reserves, 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.

(e) **BURIAL AND FUNERAL BENEFIT INSURANCE COMPANIES.**—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 this part but shall be taxable under section 821 or section 831.

SEC. 802. TAX IMPOSED FOR 1955.

(a) **TAX IMPOSED.**—A tax is hereby imposed for each taxable year beginning in 1955 on the income of every life insurance company. Except as provided in subsection (c), such tax shall consist of a normal tax (computed under section 11 (b)) and a surtax (computed under section 11 (c) on the sum of—

(1) the life insurance taxable income (as defined in subsection (b)), plus

(2) the non-life insurance taxable income (as defined in subsection (f)).

(b) **LIFE INSURANCE TAXABLE INCOME DEFINED.**—For purposes of this subpart, the term "life insurance taxable income" means the net investment income (as defined in section 803 (c)), minus the sum of—

(1) the net investment income allocable to non-life insurance reserves (determined under section 804 (d)),

(2) the reserve and other policy liability deduction (determined under section 804), and

(3) the special interest deduction, if any, allowed by section 805.

(c) **ALTERNATIVE TAX IN THE CASE OF COMPANIES HAVING NON-LIFE INSURANCE RESERVES.**—

(1) **IN GENERAL.**—In the case of a life insurance company which has non-life insurance reserves, the tax imposed by subsection (a) of this section for any taxable year beginning in 1955 shall be the tax computed under such subsection (or under section 1201 (a) if applicable) or the tax computed under paragraph (2) of this subsection, whichever is the greater.

(2) **ALTERNATIVE 1 PERCENT TAX ON NON-LIFE INSURANCE BUSINESS.**—The tax referred to in paragraph (1) is a tax equal to the sum of the following:

(A) A partial tax consisting of a normal tax (computed under section 11 (b) and a surtax (computed under section 11 (c)) on the life insurance taxable income.

(B) A partial tax consisting of—

(i) 1 percent of the amount which bears the same ratio to the gross investment income (reduced by the deduction for wholly-exempt interest allowed by section 803 (c) (1) as the non-life insurance reserves bear to the qualified reserves (determined under section 804 (c)), plus

(ii) 1 percent of the excess of the amount by which the net premiums on contracts meeting the requirements of section 804 (d) (2) (A) exceed the dividends to policyholders on such contracts. For purposes of this clause, net premiums, and dividends to policyholders, shall be computed in the manner provided in section 823.

(d) DEDUCTIONS FOR PARTIALLY TAX-EXEMPT INTEREST.—

(1) **COMPUTATIONS UNDER SUBSECTION (a).**—For purposes of computing the normal tax under subsection (a), there shall be allowed as a deduction an amount which bears the same ratio to the amount of the deduction provided by section 242 for partially tax-exempt interest as (A) the sum of the life insurance taxable income and the net investment income allocable to non-life insurance reserves bears to (B) the net investment income.

(2) **COMPUTATIONS UNDER SUBSECTION (c) (2) (A).**—In computing the normal tax for purposes of subsection (c) (2) (A), there shall be allowed as a deduction an amount which bears the same ratio to the amount of the deduction provided by section 242 for partially tax-exempt interest as (A) the life insurance taxable income bears to (B) the net investment income.

(e) **ALTERNATIVE TAX ON CAPITAL GAINS.**—In the case of a life insurance company which has non-life insurance reserves, the term "excess" used in section 1201 (a) (relating to alternative tax on capital gains of corporations) means, for purposes of section 1201 (a), an amount which bears the same ratio to the excess described in such section as the non-life insurance reserves (determined under section 804 (d) bear to the qualified reserves (determined under section 804 (c)). For purposes of any such computation, a net capital loss for any taxable year beginning before January 1, 1955, shall not be taken into account.

(f) **NON-LIFE INSURANCE TAXABLE INCOME DEFINED.**—For purposes of this subpart, the term "non-life insurance taxable income" means the net investment income allocable to non-life insurance reserves (determined under section 804 (d))—

(1) increased by an amount which bears the same ratio to the net capital gain as the non-life insurance reserves bear to the qualified reserves; and

(2) decreased by an amount which bears the same ratio to the total of the deductions provided in sections 243, 244, and 245 as the non-life insurance reserves bear to the qualified reserves.

In computing a net capital gain for purposes of paragraph (1) of this subsection, a net capital loss for any taxable year beginning before January 1, 1955, shall not be taken into account.

SEC. 803. INCOME AND DEDUCTIONS.

(a) **APPLICATION OF SECTION.**—The definitions and rules contained in this section shall apply only in the case of life insurance companies.

(b) **GROSS INVESTMENT INCOME.**—For purposes of this part, the term "gross investment income" means the sum of the following:

(1) The gross amount of income received or accrued from—

(A) interest, dividends, rents, and royalties,

(B) the entering into of any lease, mortgage, or other instrument or agreement from which the life insurance company derives interest, rents, or royalties, and

(C) the alteration or termination of any instrument or agreement described in subparagraph (B).

(2) The gross income from any trade or business (other than an insurance business) carried on by the life insurance company, or by a partnership of which the life insurance company is a partner. In computing gross income under this paragraph, there shall be excluded any item described in paragraph (1). In computing gross investment income under this subsection, there shall be excluded any gain from the sale or exchange of a capital asset, and any gain considered as gain from the sale or exchange of a capital asset.

(c) **NET INVESTMENT INCOME DEFINED.**—The term "net investment income" means the gross investment income less the following deductions:

(1) **TAX-FREE INTEREST.**—The amount of interest received or accrued during the taxable year which under section 103 is excluded from gross income.

(2) **INVESTMENT EXPENSES.**—

(A) Investment expenses paid or accrued during the taxable year.

(B) If any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed—

(i) one-fourth of 1 percent of the mean of the book value of the invested assets held at the beginning and end of the taxable year, plus
 (ii) one-fourth of the amount by which the net investment income (computed without any deduction for investment expenses allowed by this paragraph, or for tax-free interest allowed by paragraph (1)) exceeds $3\frac{1}{4}$ percent of the book value of the mean of the invested assets held at the beginning and end of the taxable year.

(3) **REAL ESTATE EXPENSES.**—Taxes (as provided in section 164), and other expenses, paid or accrued during the taxable year exclusively on or with respect to the real estate owned by the company. No deduction shall be allowed under this paragraph for any amount paid out for new buildings, or for permanent improvement or betterments made to increase the value of any property.

(4) **DEPRECIATION.**—The depreciation deduction allowed by section 167.

(5) **DEPLETION.**—The deduction allowed by section 611 (relating to depletion).

(6) **TRADE OR BUSINESS DEDUCTIONS.**—The deductions allowed by this subtitle (without regard to this part) which are attributable to any trade or business (other than an insurance business) carried on by the life insurance company, or by a partnership of which the life insurance company is a partner; except that for purposes of this paragraph—

(A) There shall be excluded losses from—

(i) sales or exchanges of capital assets,

(ii) sales or exchanges of property used in the trade or business (as defined in section 1231 (b)), and

(iii) the compulsory or involuntary conversion (as a result of destruction, in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the trade or business (as so defined).

(B) Any item, to the extent attributable to the carrying on of the insurance business, shall not be taken into account.

(C) The deduction for net operating losses provided in section 172, and the special deductions for corporations provided in part VIII of subchapter B, shall not be allowed.

(d) **RENTAL VALUE OF REAL ESTATE.**—The deduction under subsection (c) (3) and (4) on account of any real estate owned and occupied in whole or in part by a life insurance company shall be limited to an amount which bears the same ratio to such deduction (computed without regard to this subsection) as the rental value of the space not so occupied bears to the rental value of the entire property.

(e) **AMORTIZATION OF PREMIUM AND ACCRUAL OF DISCOUNT.**—The gross investment income, the deduction for wholly exempt interest allowed by subsection (c) (1), and the deduction allowed by section 242 (relating to partially tax-exempt interest) shall each be decreased to reflect the appropriate amortization of premium and increased to reflect the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures, or other evidences of indebtedness held by a life insurance company. Such amortization and accrual shall be determined—

(1) in accordance with the method regularly employed by such company, if such method is reasonable, and

(2) in all other cases, in accordance with regulations prescribed by the Secretary or his delegate.

SEC. 804. RESERVE AND OTHER POLICY LIABILITY DEDUCTION.

(a) **GENERAL RULE.**—Except as provided in subsection (b), for purposes of this subpart the term “reserve and other policy liability deduction” means the sum of the amounts determined by applying the following percentages to the excess of the net investment income over the net investment income allocable to non-life insurance reserves (determined under subsection (d)):

(1) 87.5 percent of so much of such excess as does not exceed \$1,000,000; and

(2) 85 percent of so much of such excess as exceeds \$1,000,000.

(b) **MAXIMUM DEDUCTION.**—

(1) **IN GENERAL.**—The reserve and other policy liability deduction shall in no case exceed that amount which is equal to the sum of the following:

(A) the amount equal to 2 times the amount determined under paragraph (1) of section 805 (c) (relating to required interest on life insurance reserves);

(B) the amount determined under paragraph (2) of section 805 (c) (relating to required interest on reserves for deferred dividends);

(C) the amount of the interest paid (as defined in section 805 (d));

(D) the dividends to policyholders paid or declared (other than dividends on contracts meeting the requirements of subsection (d) (2) (A); and

(E) in the case of a mutual assessment life insurance company or association, the amount equal to 2 times whichever of the following is the lesser:

(i) the amount of the net investment income on life insurance reserves described in subparagraph (A) or (B) of section 801 (b) (3), or (ii) 3 percent of the life insurance reserves so described, reduced by the amount of the adjustment for policy loans provided in paragraph (2) of this subsection. For purposes of subparagraph (D) of the preceding sentence, the term "paid or declared" shall be construed according to the method of accounting regularly employed in keeping the books of the insurance company.

(2) REDUCTION FOR CERTAIN POLICY LOANS.—The adjustment described in paragraph (1) of this subsection shall be an amount equal to—

(A) the mean of the aggregates, at the beginning and end of the taxable year, of the outstanding policy loans with respect to contracts for which life insurance reserves are maintained, multiplied by

(B) the average rate of interest applicable to life insurance reserves.

For purposes of subparagraph (B) of the preceding sentence, the term "average rate of interest applicable to life insurance reserves" means the ratio obtained by dividing the sum obtained under paragraph (1) of section 805 (c) by the sum obtained under paragraph (1) (B) of section 805 (c).

(3) DIVIDENDS RECEIVED DEDUCTION WHERE MAXIMUM LIMIT APPLIES.—

(A) If paragraph (1) of this subsection reduces the reserve and other policy liability deduction allowed by this section or section 812 for the taxable year, then in computing life insurance taxable income under section 802 (b), and in computing life insurance company taxable income under section 811 (b), there shall be allowed an additional deduction in an amount determined under subparagraph (B).

(B) The amount of the additional deduction referred to in subparagraph (A) shall be the amount which bears the same ratio to the total of the deductions provided in sections 243, 244, and 245 as the net investment income reduced by the sum of—

(i) the net investment income allocable to non-life-insurance reserves (or, for purposes of section 811 (b), the amount of the adjustment for certain reserves provided in section 813), and

(ii) 100/85 of the maximum limitation determined under paragraphs (1) and (2) of this subsection,

bears to the net investment income.

(c) QUALIFIED RESERVES DEFINED.—For purposes of this subpart, the term "qualified reserves" means the sum of the following:

(1) The life insurance reserves (as defined in section 801 (b)), plus 7 percent of that portion of such reserves as are computed on a preliminary term basis.

(2) The non-life insurance reserves (as defined in subsection (d) (2)).

(3) The amounts (discounted at the rates of interest assumed by the company) necessary to satisfy the obligations under insurance and annuity contracts (including contracts supplementary thereto), but only if (A) such obligations when satisfied will reflect an increment in the nature of interest, and (B) such obligations do not involve (at the time with respect to which the computation is made under this paragraph) life, health, or accident contingencies.

(4) The amounts held at the end of the taxable year as reserves for dividends to policy holders, the payment of which dividends is deferred for a period which expires not earlier than 5 years from the date of the policy contract. This paragraph does not apply to dividends payable during the year following the taxable year.

(5) Dividend accumulations, and other amounts, held at interest in connection with insurance or annuity contracts (including contracts supplementary thereto).

(6) Premiums received in advance, and liabilities for premium deposit funds. In applying this subsection, the same item shall be counted only once. For purposes of this section (other than paragraph (4) of this subsection), 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.

(d) NET INVESTMENT INCOME ALLOCABLE TO NON-LIFE INSURANCE RESERVES.—

(1) ALLOCATION RATIO.—For purposes of this subpart, the net investment income allocable to non-life insurance reserves is that amount which bears the same ratio to the net investment income as such reserves bear to the qualified reserves.

(2) NON-LIFE INSURANCE RESERVES DEFINED.—For purposes of this subpart, the term "non-life insurance reserves" means the sum of the unearned premiums and the unpaid losses (whether or not ascertained)—

(A) on contracts other than life insurance, annuity, and noncancellable health and accident insurance contracts (including life insurance or annuity

contracts combined with noncancellable health and accident insurance), and (B) which are not included in life insurance reserves (as defined in section 801 (b)).

For purposes of this paragraph, such unearned premiums shall not be considered to be less than 25 percent of the net premiums written during the taxable year on such other contracts.

(3) **ADJUSTMENTS WITH RESPECT TO CERTAIN NON-LIFE INSURANCE CONTRACTS.**—For purposes of this subpart, if—

(A) any computation under this subpart is made by reference to a contract meeting the requirements of paragraph (2) (A) of this subsection, and (B) part of the reserves for such contract are life insurance reserves, then, under regulations prescribed by the Secretary or his delegate, proper adjustment shall be made in the amount taken into account with respect to such contract for purposes of such computation.

SEC. 805. SPECIAL INTEREST DEDUCTION.

(a) **SPECIAL INTEREST DEDUCTION.**—For purposes of the tax imposed by section 802 (and the tax imposed by section 811), there shall be allowed a special interest deduction determined as follows:

(1) Divide the amount of the adjusted net investment income (as defined in subsection (b)) by the amount of the required interest (as defined in subsection (c)).

(2) If the quotient obtained in paragraph (1) is 1.05 or more, the special interest deduction shall be zero.

(3) If the quotient obtained in paragraph (1) is 1.00 or less, the special interest deduction shall be an amount equal to 50 percent of the amount by which—

(A) the net investment income (reduced by the net investment income allocable to non-life insurance reserves), exceeds

(B) the reserve and other policy liability deduction for the taxable year.

(4) If the quotient obtained in paragraph (1) is more than 1.00 but less than 1.05, the special interest deduction shall be the amount obtained by multiplying—

(A) the amount by which (i) the net investment income (reduced by the net investment income allocable to non-life insurance reserves) exceeds

(ii) the reserve and other policy liability deduction for the taxable year, by

(B) 10 times the difference between the figure 1.05 and the quotient obtained in paragraph (1).

(b) **ADJUSTED NET INVESTMENT INCOME.**—For purposes of subsection (a) (1), the term "adjusted net investment income" means—

(1) the net investment income (computed without the deduction for wholly-exempt interest allowed by section 803 (c) (1)), minus

(2) 50 percent of the net investment income allocable to non-life insurance reserves.

(c) **REQUIRED INTEREST.**—For purposes of subsection (a) (1), the term "required interest" means the total of—

(1) the sum of the amounts obtained by multiplying—

(A) each rate of interest assumed in computing the taxpayer's life-insurance reserves, by

(B) the means of the amounts of the taxpayer's life-insurance reserves computed at such rate at the beginning and end of the taxable year, plus 7 percent of the portion of such reserves at such rate as are computed on a preliminary term basis;

(2) the sum of the amounts obtained by multiplying—

(A) each rate of interest assumed in computing the taxpayer's reserves for deferred dividends described in section 804 (c) (4), by

(B) the means of the amounts of such reserves computed at such rate at the end of the taxable year; and

(3) interest paid.

(d) **INTEREST PAID.**—For purposes of subsection (c) (3), the term "interest paid" means—

(1) all interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest on which is wholly exempt from taxation under this chapter; and

(2) all amounts in the nature of interest, whether or not guaranteed, paid or accrued within the taxable year on insurance or annuity contracts (or contracts arising out of insurance or annuity contracts) which do not involve, at the time of payment or accrual, life, health, or accident contingencies.

Subpart B—1942 Formula

Sec. 811. Tax imposed.

Sec. 812. Reserve and other policy liability deduction.

Sec. 813. Adjustment for certain reserves.

SEC. 811. TAX IMPOSED.

(a) **TAX IMPOSED.**—A tax is hereby imposed, on the life insurance company taxable income of every life insurance company, for each taxable year beginning after December 31, 1955. Such tax shall consist of—

- (1) a normal tax on such income computed under section 11 (b), and
- (2) a surtax on such income computed under section 11 (c).

(b) **LIFE INSURANCE COMPANY TAXABLE INCOME DEFINED.**—For purposes of this subpart, the term "life insurance company taxable income" means the net investment income (as defined in section 803 (c))—

- (1) minus the reserve and other policy liability deduction allowed by section 812,
- (2) minus the special interest deduction, if any, allowed by section 805, and
- (3) plus the amount of the adjustment for certain reserves provided in section 813.

For purposes of the normal tax, the life insurance company taxable income shall be reduced by the deduction provided in section 242 for partially tax-exempt interest.

(c) **RULE FOR COMPUTATION OF SPECIAL INTEREST DEDUCTION.**—In computing the special interest deduction under section 805 in the case of any taxable year with respect to which a tax is imposed under this section—

- (1) in lieu of the reduction of the net investment income provided in paragraphs (3) (A) and (4) (A) of section 805 (a), the net investment income shall be reduced by the amount of the adjustment for certain reserves provided in section 813, and
- (2) in lieu of subtracting the amount provided in paragraph (2) of section 805 (b), subtract 50 percent of the amount of the adjustment for certain reserves provided in section 813.

SEC. 812. RESERVE AND OTHER POLICY LIABILITY DEDUCTION.

(a) **GENERAL RULE.**—For purposes of this subpart, the term "reserve and other policy liability deduction" means an amount computed by multiplying the net investment income by a figure, to be determined and proclaimed by the Secretary or his delegate for each taxable year with respect to which a tax is imposed by section 811. This figure shall be based on such data with respect to life insurance companies for the preceding taxable year as the Secretary or his delegate considers representative and shall be computed in accordance with the following formula: The ratio which a numerator comprised of the aggregate of the sums of—

- (1) 2 percent of the reserves for deferred dividends,
- (2) interest paid, and
- (3) the product of—

(A) the mean of the adjusted reserves at the beginning and end of the taxable year, and

(B) the reserve earnings rate,

bears to a denominator comprised of the aggregate of the excess of net investment incomes (computed without the deduction for wholly-exempt interest allowed by section 803 (c) (1) over the adjustment for certain reserves provided in section 813.

(b) **DEFINITIONS.**—For purposes of subsection (a)—

(1) **RESERVES FOR DEFERRED DIVIDENDS.**—The term "reserves for deferred dividends" has the same meaning as when used in section 804 (c) (4).

(2) **INTEREST PAID.**—The term "interest paid" has the meaning given to such term by section 805 (d).

(3) **ADJUSTED RESERVES.**—The term "adjusted reserves" means the life insurance reserves (as defined in section 801 (b)), plus 7 percent of that portion of such reserves as are computed on a preliminary term basis.

(4) **RESERVE EARNINGS RATE.**—The term "reserve earnings rate" means a rate computed by adding 2.1125 percent (65 percent of $3\frac{1}{4}$ percent) to 35 percent of the average rate of interest assumed in computing life insurance reserves. Such average rate shall be calculated by multiplying each assumed rate of interest by the means of the amounts of the adjusted reserves computed at that rate at the beginning and end of the taxable year and dividing the sum of the products by the mean of the total adjusted reserves at the beginning and end of the taxable year.

(c) **MAXIMUM DEDUCTION.**—The reserve and other policy liability deduction allowed by subsection (a) of this section shall in no case exceed an amount equal to the amount which would be determined under subsection (b) of section 804 if such subsection applied with respect to the taxable year.

SEC. 813. ADJUSTMENT FOR CERTAIN RESERVES.

In the case of a life insurance company writing contracts other than life insurance, annuity, and noncancellable health and accident insurance contracts (including life insurance or annuity contracts combined with noncancellable health and accident insurance), the term "adjustment for certain reserves" means for purposes of this subpart, an amount equal to $3\frac{1}{4}$ percent of the unearned premiums and unpaid losses on such other contracts which are not included in life insurance reserves (as defined in section 801 (b)). For purposes of this section, such unearned premiums shall not be considered to be less than 25 percent of the net premiums written during the taxable year on such other contracts.

Subpart C—Miscellaneous Provisions

Sec. 816. Foreign life insurance companies.

Sec. 817. Denial of double deductions.

SEC. 816. FOREIGN LIFE INSURANCE COMPANIES.

(a) **CARRYING ON UNITED STATES INSURANCE BUSINESS.**—A foreign life insurance company carrying on a life insurance business within the United States, if with respect to its United States business it would qualify as a life insurance company under section 801, shall be taxable in the same manner as a domestic life insurance company; except that the determinations necessary for purposes of this subtitle shall be made on the basis of the income, disbursements, assets, and liabilities reported in the annual statement for the taxable year of the United States business of such company on the form approved for life insurance companies by the National Association of Insurance Commissioners.

(b) **NO UNITED STATES INSURANCE BUSINESS.**—Foreign life insurance companies not carrying on an insurance business within the United States shall not be taxable under this part but shall be taxable as other foreign corporations.

SEC. 817. DENIAL OF DOUBLE DEDUCTIONS.

Nothing in this part shall permit the same item to be deducted more than once.

SEC. 818. CERTAIN NEW INSURANCE COMPANIES.

(a) **GENERAL RULE.**—If the taxable year begins not more than 4 years after the first day on which the taxpayer was authorized to do business as an insurance company, then—

(1) for purposes of subpart A, the life insurance taxable income shall not exceed (A) the amount of the net gain from operations after dividends to policyholders, reduced by (B) (i) the net investment income allocable to non-life insurance reserves and (ii) the special reduction for dividends received provided by subsection (c); or

"(2) for purposes of subpart B, the life insurance company taxable income shall not exceed (A) the amount of the net gain from operations after dividends to policyholders, reduced by (B) the special reduction for dividends received provided by subsection (c).

For purposes of this subsection, the net gain from operations after dividends to policyholders shall be computed in the manner required for purposes of the annual statement approved by the National Convention of Insurance Commissioners, except that no reduction shall be made for any Federal income tax.

(b) **LIMITATION.**—This section shall not reduce the tax for any taxable year below the amount which (but for this section) would be imposed by section 802 or section 811, as the case may be, computed without the applicable limitation on the reserve and other policy liability deduction contained in section 804 (b) or section 812 (c).

"(c) **SPECIAL RULE FOR DIVIDENDS RECEIVED.**—The reduction referred to in paragraph (1) (B) (ii) and in paragraph (2) (B) of subsection (a) shall be an amount computed under section 804 (b) (3), except that, for purposes of such computation, the maximum limitation referred to in section 804 (b) (3) (B) (ii) shall be—

(1) in the case of a taxable year with respect to which tax is imposed by section 802, the amount by which (A) the net investment income (reduced by the net investment income allocable to non-life insurance reserves), exceeds (B) the life insurance taxable income (computed without regard to the reduction provided by this subsection); or

(2) in the case of a taxable year with respect to which tax is imposed by section 811, the amount by which (A) the sum of the net investment income and the amount of the adjustment for certain reserves provided in section 813, exceeds (B) the life insurance company taxable income (computed without regard to the reduction provided by this subsection).

PART II—MUTUAL INSURANCE COMPANIES (OTHER THAN LIFE OR MARINE OR FIRE INSURANCE COMPANIES ISSUING PERPETUAL POLICIES)

- Sec. 821. Tax on mutual insurance companies (other than life or marine or fire insurance companies issuing perpetual policies).
 Sec. 822. Determination of mutual insurance company taxable income.
 Sec. 823. Other definitions.

SEC. 821. TAX ON MUTUAL INSURANCE COMPANIES (OTHER THAN LIFE OR MARINE OR FIRE INSURANCE COMPANIES ISSUING PERPETUAL POLICIES).

(a) **IMPOSITION OF TAX ON MUTUAL COMPANIES OTHER THAN INTERINSURERS.**—There shall be imposed for each taxable year on the income of every mutual insurance company (other than a life or a marine insurance company or a fire insurance company subject to the tax imposed by section 831 and other than an interinsurer or reciprocal underwriter) a tax computed under paragraph (1) or paragraph (2), whichever is the greater:

(1) If the mutual insurance company taxable income (computed without regard to the deduction provided in section 242 for partially tax-exempt interest) is over \$3,000, a tax computed as follows:

(A) **NORMAL TAX.**—

(i) **TAXABLE YEARS BEGINNING BEFORE APRIL 1, 1955.**—In the case of taxable years beginning before April 1, 1955, a normal tax of 30 percent of the mutual insurance company taxable income, or 60 percent of the amount by which such taxable income exceeds \$3,000, whichever is the lesser;

(ii) **TAXABLE YEARS BEGINNING AFTER MARCH 31, 1955.**—In the case of taxable years beginning after March 31, 1955, a normal tax of 25 percent of the mutual insurance company taxable income, or 50 percent of the amount by which such taxable income exceeds \$3,000, whichever is the lesser; plus

(B) **SURTAX.**—A surtax of 22 percent of the mutual insurance company taxable income (computed without regard to the deduction provided in section 242 for partially tax-exempt interest) in excess of \$25,000.

(2) If for the taxable year the gross amount of income from [interest, dividends, rents,] *the items described in section 822 (b) (other than paragraph (1) (D) thereof)* and net premiums, minus dividends to policyholders, minus the interest which under section 103 is excluded from gross income exceeds \$75,000, a tax equal to 1 percent of the amount so computed, or 2 percent of the excess of the amount so computed over \$75,000, whichever is the lesser.

(b) **IMPOSITION OF TAX ON INTERINSURERS.**—In the case of every mutual insurance company which is an interinsurer or reciprocal underwriter (other than a life or a marine insurance company or a fire insurance company subject to the tax imposed by section 831), if the mutual insurance company taxable income (computed as provided in subsection (a) (1)) is over \$50,000, there shall be imposed for each taxable year on the mutual insurance company taxable income a tax computed as follows:

(1) **NORMAL TAX.**—

(A) **TAXABLE YEARS BEGINNING BEFORE APRIL 1, 1955.**—In the case of taxable years beginning before April 1, 1955, a normal tax of 30 percent of the mutual insurance company taxable income, or 60 percent of the amount by which such taxable income exceeds \$50,000, whichever is the lesser;

(B) **TAXABLE YEARS BEGINNING AFTER MARCH 31, 1955.**—In the case of a taxable year beginning after March 31, 1955, a normal tax of 25 percent of the mutual insurance company taxable income, or 50 percent of the amount by which such taxable income exceeds \$50,000, whichever is the lesser; plus

(2) **SURTAX.**—A surtax of 22 percent of the mutual insurance company taxable income (computed as provided in subsection (a) (1)) in excess of \$25,000, or 33 percent of the amount by which such taxable income exceeds \$50,000, whichever is the lesser.

(c) **GROSS AMOUNT RECEIVED, OVER \$75,000 BUT LESS THAN \$125,000.**—If the gross amount received during the taxable year from [interest, dividends, rents,] *the items described in section 822 (b) (other than paragraph (1) (D) thereof)* and premiums (including deposits and assessments) is over \$75,000 but less than \$125,000, the tax imposed by subsection (a) or subsection (b), whichever applies,

shall be reduced to an amount which bears the same proportion to the amount of the tax determined under such subsection as the excess over \$75,000 of such gross amount received bears to \$50,000.

(d) **NO UNITED STATES INSURANCE BUSINESS.**—Foreign mutual insurance companies (other than a life or marine insurance company or a fire insurance company subject to the tax imposed by section 831) not carrying on an insurance business within the United States shall not be subject to this part but shall be taxable as other foreign corporations.

(e) **ALTERNATIVE TAX ON CAPITAL GAINS.**—

For alternative tax in case of capital gains, see section 1201 (a).

SEC. 822. DETERMINATION OF MUTUAL INSURANCE COMPANY TAXABLE INCOME.

(a) **DEFINITION.**—For purposes of section 821, the term “mutual insurance company taxable income” means the gross investment income minus the deductions provided in subsection (c).

[(b) **GROSS INVESTMENT INCOME.**—For purposes of subsection (a), the term “gross investment income” means the gross amount of income during the taxable year from interest, dividends, rents, and gains from sales or exchanges of capital assets to the extent provided in subchapter P (sec. 1201 and following, relating to capital gains and losses).]

(b) **GROSS INVESTMENT INCOME.**—For purposes of subsection (a), the term “gross investment income” means the sum of the following:

(1) *The gross amount of income during the taxable year from—*

(A) *interest, dividends, rents, and royalties,*

(B) *the entering into of any lease, mortgage, or other instrument or agreement from which the insurance company derives interest, rents, or royalties,*

(C) *the alteration or termination of any instrument or agreement described in subparagraph (B), and*

(D) *gains from sales or exchanges of capital assets to the extent provided in subchapter P (sec. 1201 and following, relating to capital gains and losses).*

(2) *The gross income during the taxable year from any trade or business (other than an insurance business) carried on by the insurance company, or by a partnership of which the insurance company is a partner. In computing gross income under this paragraph, there shall be excluded any item described in paragraph (1).*

(c) **DEDUCTIONS.**—In computing mutual insurance company taxable income, the following deductions shall be allowed:

(1) **TAX-FREE INTEREST.**—The amount of interest which under section 103 is excluded for the taxable year from gross income.

(2) **INVESTMENT EXPENSES.**—Investment expenses paid or accrued during the taxable year. If any general expenses are in part assigned to or included in the investment expenses, the total deduction under this paragraph shall not exceed one-fourth of 1 percent of the mean of the book value of the invested assets held at the beginning and end of the taxable year plus one-fourth of the amount by which mutual insurance company taxable income (computed without any deduction for investment expenses allowed by this paragraph, for tax-free interest allowed by paragraph (1), or for partially tax-exempt interest and dividends received allowed by paragraph (7)), exceeds 3¾ percent of the book value of the mean of the invested assets held at the beginning and end of the taxable year.

[(3) **REAL ESTATE EXPENSES.**—Taxes and other expenses paid or accrued during the taxable year exclusively on or with respect to the real estate owned by the company, not including taxes assessed against local benefits of a kind tending to increase the value of the property assessed, and not including any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property. The deduction allowed by this paragraph shall be allowed in the case of taxes imposed on a shareholder of a company on his interest as shareholder, which are paid or accrued by the company without reimbursement from the shareholder, but in such cases no deduction shall be allowed the shareholder for the amount of such taxes.)]

(3) **REAL ESTATE EXPENSES.**—Taxes (as provided in section 164), and other expenses, paid or accrued during the taxable year exclusively on or with respect to the real estate owned by the company. No deduction shall be allowed under this paragraph for any amount paid out for new buildings, or for permanent improvements or betterments made to increase the value of any property.

(4) **DEPRECIATION.**—The depreciation deduction allowed by section 167.

(5) **INTEREST PAID OR ACCRUED.**—All interest paid or accrued within the taxable year on indebtedness, except on indebtedness incurred or continued

to purchase or carry obligations (other than obligations of the United States issued after September 24, 1917, and originally subscribed for by the taxpayer) the interest on which is wholly exempt from taxation under this subtitle.

(6) **CAPITAL LOSSES.**—Capital losses to the extent provided in subchapter P (sec. 1201 and following) plus losses from capital assets sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders. Capital assets shall be considered as sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders to the extent that the gross receipts from their sale or exchange are not greater than the excess, if any, for the taxable year of the sum of dividends and similar distributions paid to policyholders, losses paid, and expenses paid over the sum of [interest, dividends, rents, and net premiums received. In the application of section 1211] the items described in subsection (b) (other than paragraph (1) (D) thereof) and net premiums received. In the application of section 1212 for purposes of this section, the net capital loss for the taxable year shall be the amount by which losses for such year from sales or exchanges of capital assets exceeds the sum of the gains from such sales or exchanges and whichever of the following amounts is the lesser:

(A) the mutual insurance company taxable income (computed without regard to gains or losses from sales or exchanges of capital assets or to the deduction provided in section 242 for partially tax-exempt interest); or

(B) losses from the sale or exchange of capital assets sold or exchanged to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders.

(7) **SPECIAL DEDUCTIONS.**—The special deductions allowed by part VIII (except section 248) of subchapter B (sec. 241 and following, relating to partially tax-exempt interest and to dividends received).

(8) **TRADE OR BUSINESS DEDUCTIONS.**—The deductions allowed by this subtitle (without regard to this part) which are attributable to any trade or business (other than an insurance business) carried on by the insurance company, or by a partnership of which the insurance company is a partner; except that for purposes of this paragraph—

(A) any item, to the extent attributable to the carrying on of the insurance business, shall not be taken into account, and

(B) the deduction for net operating losses provided in section 172 shall not be allowed.

(9) **DEPLETION.**—The deduction allowed by section 611 (relating to depletion).

(d) **OTHER APPLICABLE RULES.**—

(1) **RENTAL VALUE OF REAL ESTATE.**—The deduction under [subsection (e) (3) or (4)] subsection (c) (3) or (4) on account of any real estate owned and occupied in whole or in part by a mutual insurance company subject to the tax imposed by section 821 shall be limited to an amount which bears the same ratio to such deduction (computed without regard to this paragraph) as the rental value of the space not so occupied bears to the rental value of the entire property.

(2) **AMORTIZATION OF PREMIUM AND ACCRUAL OF DISCOUNT.**—The gross amount of income during the taxable year from interest, the deduction provided in subsection (c) (1), and the deduction allowed by section 242 (relating to partially tax-exempt interest) shall each be decreased to reflect the appropriate amortization of premium and increased to reflect the appropriate accrual of discount attributable to the taxable year on bonds, notes, debentures, or other evidences of indebtedness held by a mutual insurance company subject to the tax imposed by section 821. Such amortization and accrual shall be determined—

(A) in accordance with the method regularly employed by such company, if such method is reasonable, and

(B) in all other cases, in accordance with regulations prescribed by the Secretary or his delegate.

(3) **DOUBLE DEDUCTIONS.**—Nothing in this part shall permit the same item to be deducted more than once.

(e) **FOREIGN MUTUAL INSURANCE COMPANIES OTHER THAN LIFE OR MARINE.**—In the case of a foreign mutual insurance company (other than a life or marine insurance company or a fire insurance company subject to the tax imposed by section 831), the mutual insurance company taxable income shall be the taxable income from sources within the United States (computed without regard to the deductions allowed by subsection (c) (7)), and the gross amount of income from

the [interest, dividends, rents,] items described in subsection (b) (other than paragraph (1) (D) thereof) and net premiums shall be the amount of such income from sources within the United States. In the case of a company to which the preceding sentence applies, the deductions allowed in this section shall be allowed to the extent provided in subpart B of part II of subchapter N (sec. 881 and following) in the case of a foreign corporation engaged in trade or business within the United States.

SEC. 823. OTHER DEFINITIONS.

For purposes of this part—

(1) **NET PREMIUMS.**—The term “net premiums” means gross premiums (including deposits and assessments) written or received on insurance contracts during the taxable year less return premiums and premiums paid or incurred for reinsurance. Amounts returned where the amount is not fixed in the insurance contract but depends on the experience of the company or the discretion of the management shall not be included in return premiums but shall be treated as dividends to policyholders under paragraph (2).

(2) **DIVIDENDS TO POLICYHOLDERS.**—The term “dividends to policyholders” means dividends and similar distributions paid or declared to policyholders. For purposes of the preceding sentence, the term “paid or declared” shall be construed according to the method regularly employed in keeping the books of the insurance company.

PART III—OTHER INSURANCE COMPANIES

Sec. 831. Tax on insurance companies (other than life or mutual), mutual marine insurance companies, and mutual fire insurance companies issuing perpetual policies.

Sec. 832. Insurance company taxable income.

SEC. 831. TAX ON INSURANCE COMPANIES (OTHER THAN LIFE OR MUTUAL), MUTUAL MARINE INSURANCE COMPANIES AND MUTUAL FIRE INSURANCE COMPANIES ISSUING PERPETUAL POLICIES.

(a) **IMPOSITION OF TAX.**—Taxes computed as provided in section 11 shall be imposed for each taxable year on the taxable income of every insurance company (other than a life or mutual insurance company), every mutual marine insurance company, and every mutual fire insurance company exclusively issuing either perpetual policies or policies for which the sole premium charged is a single deposit which (except for such deduction of underwriting costs as may be provided) is refundable on cancellation or expiration of the policy.

(b) **NO UNITED STATES INSURANCE BUSINESS.**—Foreign insurance companies (other than a life or mutual insurance company), foreign mutual marine insurance companies, and foreign mutual fire insurance companies described in subsection (a), not carrying on an insurance business within the United States, shall not be subject to this part but shall be taxable as other foreign corporations.

(c) **ALTERNATIVE TAX ON CAPITAL GAINS.**—

For alternative tax in case of capital gains, see section 1201 (a).

SEC. 832. INSURANCE COMPANY TAXABLE INCOME.

(a) **DEFINITION OF TAXABLE INCOME.**—In the case of an insurance company subject to the tax imposed by section 831, the term “taxable income” means the gross income as defined in subsection (b) (1) less the deductions allowed by subsection (c).

(b) **DEFINITIONS.**—In the case of an insurance company subject to the tax imposed by section 831—

(1) **GROSS INCOME.**—The term “gross income” means the sum of—

(A) the combined gross amount earned during the taxable year, from investment income and from underwriting income as provided in this subsection, computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Convention of Insurance Commissioners,

(B) gain during the taxable year from the sale or other disposition of property, and

(C) all other items constituting gross income under subchapter B, except that, in the case of a mutual fire insurance company described in section 831 (a), the amount of single deposit premiums paid to such company shall not be included in gross income.

(2) **INVESTMENT INCOME.**—The term “investment income” means the gross amount of income earned during the taxable year from interest, dividends, and rents, computed as follows: To all interest, dividends, and rents

received during the taxable year, add interest, dividends, and rents due and accrued at the end of the taxable year, and deduct all interest, dividends, and rents due and accrued at the end of the preceding taxable year.

(3) **UNDERWRITING INCOME.**—The term “underwriting income” means the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred.

(4) **PREMIUMS EARNED.**—The term “premiums earned on insurance contracts during the taxable year” means an amount computed as follows:

(A) From the amount of gross premiums written on insurance contracts during the taxable year, deduct return premiums and premiums paid for reinsurance.

(B) To the result so obtained, add unearned premiums on outstanding business at the end of the preceding taxable year and deduct unearned premiums on outstanding business at the end of the taxable year.

For purposes of this subsection, unearned premiums shall include life insurance reserves, as defined in [section 806] *section 801 (b)*, pertaining to the life, burial, or funeral insurance, or annuity business of an insurance company subject to the tax imposed by section 831 and not qualifying as a life insurance company under section 801.

(5) **LOSSES INCURRED.**—The term “losses incurred” means losses incurred during the taxable year on insurance contracts, computed as follows:

(A) To losses paid during the taxable year, add salvage and reinsurance recoverable outstanding at the end of the preceding taxable year and deduct salvage and reinsurance recoverable outstanding at the end of the taxable year.

(B) To the result so obtained, add all unpaid losses outstanding at the end of the taxable year and deduct unpaid losses outstanding at the end of the preceding taxable year.

(6) **EXPENSES INCURRED.**—The term “expenses incurred” means all expenses shown on the annual statement approved by the National Convention of Insurance Commissioners, and shall be computed as follows: To all expenses paid during the taxable year, add expenses unpaid at the end of the taxable year and deduct expenses unpaid at the end of the preceding taxable year. For the purpose of computing the taxable income subject to the tax imposed by section 831, there shall be deducted from expenses incurred (as defined in this paragraph) all expenses incurred which are not allowed as deductions by subsection (c).

(c) **DEDUCTIONS ALLOWED.**—In computing the taxable income of an insurance company subject to the tax imposed by section 831, there shall be allowed as deductions:

(1) all ordinary and necessary expenses incurred, as provided in section 162 (relating to trade or business expenses);

(2) all interest, as provided in section 163;

(3) taxes, as provided in section 164;

(4) losses incurred, as defined in subsection (b) (5) of this section;

(5) capital losses to the extent provided in subchapter P (sec. 1201 and following, relating to capital gains and losses) plus losses from capital assets sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders. Capital assets shall be considered as sold or exchanged in order to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders to the extent that the gross receipts from their sale or exchange are not greater than the excess, if any, for the taxable year of the sum of dividends and similar distributions paid to policyholders in their capacity as such, losses paid, and expenses paid over the sum of [interest, dividends, rents, and net premiums received. In the application of section 1211] *the items described in section 822 (b) (other than paragraph (1) (D) thereof) and net premiums received. In the application of section 1212* for purposes of this section, the net capital loss for the taxable year shall be the amount by which losses for such year from sales or exchanges of capital assets exceeds the sum of the gains from such sales or exchanges and whichever of the following amounts is the lesser:

(A) the taxable income (computed without regard to gains or losses from sales or exchanges of capital assets or to the deductions provided in section 242 for partially tax-exempt interest); or

- (B) losses from the sale or exchange of capital assets sold or exchanged to obtain funds to meet abnormal insurance losses and to provide for the payment of dividends and similar distributions to policyholders;
- (6) debts in the nature of agency balances and bills receivable which become worthless within the taxable year;
- (7) the amount of interest earned during the taxable year which under section 103 is excluded from gross income;
- (8) the depreciation deduction allowed by section 167 and the deduction allowed by section 611 (relating to depletion);
- (9) charitable, etc., contributions, as provided in section 170;
- (10) deductions (other than those specified in this subsection) as provided in part VI of subchapter B (sec. 161 and following, relating to itemized deductions for individuals and corporations);
- (11) dividends and similar distributions paid or declared to policyholders in their capacity as such, except in the case of a mutual fire insurance company described in section 831 (a). For purposes of the preceding sentence, the term "paid or declared" shall be construed according to the method of accounting regularly employed in keeping the books of the insurance company; and
- (12) the special deductions allowed by part VIII of subchapter B (sec. 241 and following, relating to partially tax-exempt interest and to dividends received).

(d) **TAXABLE INCOME OF FOREIGN INSURANCE COMPANIES OTHER THAN LIFE OR MUTUAL AND FOREIGN MUTUAL MARINE.**—In the case of a foreign insurance company (other than a life or mutual insurance company), a foreign mutual marine insurance company, and a foreign mutual fire insurance company described in section 831 (a), the taxable income shall be the taxable income from sources within the United States. In the case of a company to which the preceding sentence applies, the deductions allowed in this section shall be allowed to the extent provided in subpart B of part II of subchapter N (sec. 881 and following) in the case of a foreign corporation engaged in trade or business within the United States.

(e) **DOUBLE DEDUCTIONS.**—Nothing in this section shall permit the same item to be deducted more than once.

PART IV—PROVISIONS OF GENERAL APPLICATION

- Sec. 841. Credit for foreign taxes.
 Sec. 842. Computation of gross income.
 Sec. 843. Annual accounting period.

SEC. 841. CREDIT FOR FOREIGN TAXES.

The taxes imposed by foreign countries or possessions of the United States shall be allowed as a credit against the tax of a domestic insurance company subject to the tax imposed by section 802, 811, 821, or 831, to the extent provided in the case of a domestic corporation in section 901 (relating to foreign tax credit). For purposes of the preceding sentence, the term "taxable income" as used in section 904 means—

(1) in the case of the tax imposed by [section 802, the taxable income (as defined in section 803 (g))] *section 802 or 811, the net investment income (as defined in section 803 (c)),*

(2) in the case of the tax imposed by section 831, the taxable income (as defined in section 832 (a)).

SEC. 842. COMPUTATION OF GROSS INCOME.

The gross income of insurance companies subject to the tax imposed by section [802 or 831] 802, 811, or 831 shall not be determined in the manner provided in part I of subchapter N (relating to determination of sources of income).

SEC. 843. ANNUAL ACCOUNTING PERIOD.

For the purposes of this subtitle, the annual accounting period for each insurance company subject to a tax imposed by this subchapter shall be the calendar year.

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SEC. 891. DOUBLING OF RATES OF TAX ON CITIZENS AND CORPORATIONS OF CERTAIN FOREIGN COUNTRIES.

Whenever the President finds that, under the laws of any foreign country, citizens or corporations of the United States are being subjected to discriminatory or extraterritorial taxes, the President shall so proclaim and the rates of tax imposed by sections 1, 3, 11, 802, 811, 821, 831, 852, 871, and 881 shall, for the taxable year during which such proclamation is made and for each taxable year thereafter, be doubled in the case of each citizen and corporation of such foreign

country; but the tax at such doubled rate shall be considered as imposed by such sections as the case may be. In no case shall this section operate to increase the taxes imposed by such sections (computed without regard to this section) to an amount in excess of 80 percent of the taxable income of the taxpayer (computed without regard to the deductions allowable under section 151 and under part VIII of subchapter B). Whenever the President finds that the laws of any foreign country with respect to which the President has made a proclamation under the preceding provisions of this section have been modified so that discriminatory and extraterritorial taxes applicable to citizens and corporations of the United States have been removed, he shall so proclaim, and the provisions of this section providing for doubled rates of tax shall not apply to any citizen or corporation of such foreign country with respect to any taxable year beginning after such proclamation is made.

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SEC. 1201. ALTERNATIVE TAX.

(a) **CORPORATIONS.**—If for any taxable year the net long-term capital gain of any corporation exceeds the net short-term capital loss, then, in lieu of the tax imposed by sections 11, 511, 802 (a), 821 (a) (1) or (b), and 831 (a), there is hereby imposed a tax (if such tax is less than the tax imposed by such sections) which shall consist of the sum of—

(1) a partial tax computed on the taxable income reduced by the amount of such excess, at the rates and in the manner as if this subsection had not been enacted, and

(2) an amount equal to 25 percent of such excess, or, in the case of a taxable year beginning before April 1, 1954, an amount equal to 26 percent of such excess.

In the case of a taxable year beginning before April 1, 1954, the amount under paragraph (2) shall be determined without regard to section 21 (relating to effect of change of tax rates).

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SEC. 1504. DEFINITIONS.

(a) **DEFINITION OF "AFFILIATED GROUP".**—* * *

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(b) **DEFINITION OF "INCLUDIBLE CORPORATION".**—As used in this chapter, the term "includible corporation" means any corporation except—

(1) Corporations exempt from taxation under section 501.

(2) Insurance companies subject to taxation under section [802 or 821] 802, 811, or 821.

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SEC. 4371. IMPOSITION OF TAX.

There shall be imposed a tax on each policy of insurance, indemnity bond, annuity contract, or policy of reinsurance issued by any foreign insurer or reinsurer at the following rates:

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(2) **LIFE INSURANCE, SICKNESS, AND ACCIDENT POLICIES, AND ANNUITY CONTRACTS.**—One cent on each dollar, or fractional part thereof, of the premium charged on the policy of life, sickness, or accident insurance, or annuity contract, unless the insurer is subject to tax under section [807] 816;

