

Internal Revenue Service, Treasury

§ 1.846-0

actual unpaid losses as nearly as it is possible to ascertain them.

(b) Every insurance company to which this section applies must be prepared to establish to the satisfaction of the district director that the part of the deduction for "losses incurred" which represents unpaid losses at the close of the taxable year comprises only actual unpaid losses stated in amounts which, based upon the facts in each case and the company's experience with similar cases, can be said to represent a fair and reasonable estimate of the amount the company will be required to pay. Amounts included in, or added to, the estimates of such losses which in the opinion of the district director are in excess of the actual liability determined as provided in the preceding sentence will be disallowed as a deduction. The district director may require any such insurance company to submit such detailed information with respect to its actual experience as is deemed necessary to establish the reasonableness of the deduction for "losses incurred".

(c) That part of the deduction for "losses incurred" which represents an adjustment to losses paid for salvage and reinsurance recoverable shall, except as hereinafter provided, include all salvage in course of liquidation, and all reinsurance in process of collection not otherwise taken into account as a reduction of losses paid, outstanding at the end of the taxable year. Salvage in course of liquidation includes all property (other than cash), real or personal, tangible or intangible, except that which may not be included by reason of express statutory provisions (or rules and regulations of an insurance department) of any State or Territory or the District of Columbia in which the company transacts business. Such salvage in course of liquidation shall be taken into account to the extent of the value thereof at the end of the taxable year as determined from a fair and reasonable estimate based upon either the facts in each case or the company's experience with similar cases. Cash received during the taxable year with respect to items of salvage or reinsurance shall be taken into account in computing losses paid during such taxable year.

(d) This section is effective for taxable years beginning before January 1, 1990.

[T.D. 8266, 54 FR 38970, Sept. 22, 1989; T.D. 8293, 55 FR 9425, Mar. 14, 1990]

§ 1.846-0 Outline of provisions.

The following is a list of the headings in §§ 1.846-1 through 1.846-4.

§ 1.846-1 Application of discount factors.

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- (b) Applicable discount factors.
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 - (iii) Reinsurance for accident years before 1988.
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§ 1.846-2 Election by taxpayer to use its own historical loss payment pattern.

- (a) In general.
- (b) Eligible line of business.
 - (1) In general.
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 - (3) Special rule for 1987 determination year.
- (c) Anti-abuse rule.

§ 1.846-3 Fresh start and reserve strengthening.

- (a) In general.
- (b) Applicable discount factors.
 - (1) Calculation of beginning balance.
 - (2) Example.
 - (c) Rules for determining the amount of reserve strengthening.
 - (1) In general.
 - (2) Accident years after 1985.
 - (i) In general.
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 - (3) Accident years before 1986.
 - (i) In general.
 - (ii) Exceptions.
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 - (d) Section 845.

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- (e) Treatment of reserve strengthening.
- (f) Examples.

§ 1.846-4 Effective date.

[T.D. 8433, 57 FR 40843, Sept. 8, 1992; 57 FR 48563, Oct. 27, 1992]

§ 1.846-1 Application of discount factors.

(a) *In general*—(1) *Rules*. A separate series of discount factors are computed for, and applied, to undiscounted unpaid losses attributable to each accident year of each line of business shown on the annual statement (as defined by section 846(f)(3)) filed by that taxpayer for the calendar year ending with or within the taxable year of the taxpayer. See § 1.832-4(b) relating to the determination of unpaid losses. Paragraph (b) of this section provides rules relating to applicable discount factors and § 1.846-3(b) contains guidance relating to discount factors applicable to accident years prior to the 1987 accident year. Once a taxpayer applies a series of discount factors to unpaid losses attributable to an accident year of a line of business, that series of discount factors must be applied to discount the unpaid losses for that accident year for that line of business for all future taxable years. The discount factors cannot be changed to reflect a change in the taxpayer's loss payment pattern during a subsequent year or to reflect a different interest rate assumption. However, discount factors may be changed for taxpayers who elect to use their own historical loss payment pattern, if information upon which the pattern is based is adjusted upon examination by the district director.

(2) *Examples*. The following examples illustrate the principles of paragraph (a)(1) of this section:

Example 1. A taxpayer discounts unpaid losses attributable to all accident years prior to 1992 using discount factors published by the Service. In 1992, the taxpayer elects, under § 1.846-2, to compute discount factors using its own historical loss payment pattern. The taxpayer must continue to discount unpaid losses attributable to pre-1992 accident years using the discount factors published for those accident years by the Service.

Example 2. On its annual statements through 1987, a taxpayer did not allocate unpaid losses attributable to proportional rein-

surance to the line of business associated with the risks being reinsured. Beginning with the 1988 annual statement, the taxpayer allocated those losses for all accident years to the line of business being reinsured. The taxpayer must continue to discount the unpaid losses attributable to proportional reinsurance from pre-1988 accident years using the discount factors that were used in determining tax reserves for the 1987 tax year. (See paragraph (b)(3) of this section for rules relating to the application of discount factors to reinsurance unpaid losses.)

(3) *Increase in discounted unpaid losses shown on the annual statement*. If the amount of unpaid losses shown on the annual statement is determined on a discounted basis, and the extent to which the unpaid losses were discounted can be determined on the basis of information disclosed on or with the annual statement, the amount of the unpaid losses to which the discount factors are applied shall be determined without regard to any reduction attributable to the discounting reflected on the annual statement.

(4) *Increase in unpaid losses which take into account estimated salvage recoverable*. If the amount of unpaid losses shown on the annual statement reflects a reduction for estimated salvage recoverable and the extent to which the unpaid losses were reduced by estimated salvage recoverable is appropriately disclosed as required by § 1.832-4(d)(2), the amount of unpaid losses shall be determined without regard to the reduction for salvage recoverable.

(b) *Applicable discount factors*—(1) *In general*. Except as otherwise provided in section 846(f)(6) (relating to certain accident and health lines of business), in § 1.846-2 (relating to a taxpayer's election to use its own historical loss payment pattern), in this paragraph (b), or in other guidance published in the Internal Revenue Bulletin, the following factors must be used—

(i) *Discount factors published by the Service*. If the Service has published discount factors for a line of business, a taxpayer must discount unpaid losses attributable to that line by applying those discount factors; and

(ii) *Composite discount factors*. If the Service has not published discount factors for a line of business, a taxpayer