

## § 1.846-1

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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

must discount unpaid losses attributable to that line by applying composite discount factors.

(iii) *Annual statement changes.* If the groupings of individual lines of business on the annual statement changes, taxpayers must discount the unpaid losses on the resulting lines of business with the discounting patterns that would have applied to those unpaid losses based on their annual statement classification prior to the change.

(2) *Title insurance company reserves.* A title insurance company may only take into account case reserves (relating to claims which have been reported to the insurance company). Unless the Service publishes other guidance, the reserves must be discounted using the "Miscellaneous Casualty" discount factors published by the Service. Section 832(b)(8) provides rules for determining the discounted unearned premiums of a title insurance company.

(3) *Reinsurance business*—(i) *Proportional reinsurance for accident years after 1987.* For the 1988 accident year and subsequent accident years, unpaid losses for proportional reinsurance must be discounted using discount factors applicable to the line of business to which those unpaid losses are allocated as required on the annual statement.

(ii) *Non-proportional reinsurance*—(A) *Accident years after 1991.* For the 1992 accident year and subsequent accident years, unpaid losses for non-proportional reinsurance must be discounted using the applicable discount factors published by the Service for the appropriate reinsurance line of business.

(B) *Accident years 1988 through 1991.* For the 1988, 1989, 1990, and 1991 accident years unpaid losses for non-proportional reinsurance must be discounted using composite discount factors.

(iii) *Reinsurance for accident years before 1988.* If on its annual statement a taxpayer does not allocate unpaid losses to the applicable line of business for proportional or nonproportional reinsurance attributable to the 1987 accident year or a prior accident year, those losses must be discounted using composite discount factors. If on its annual statement a taxpayer allocates to the underlying line of business rein-

surance unpaid losses that are attributable to the 1987 accident year or a prior accident year, those losses must be discounted using discount factors applicable to the underlying line of business.

(iv) *90 percent exception.* For purposes of § 1.846-1(b)(3) (ii) and (iii), if more than 90 percent of all the unallocated losses of a taxpayer for an accident year relate to one underlying line of business, the taxpayer must discount all unallocable reinsurance unpaid losses attributable to that accident year using the discount factors published by the Service for the underlying line of business.

(4) *International business.* For any accident year, unpaid losses which are attributable to international business must be discounted using composite discount factors unless more than 90 percent of all losses for that accident year relate to one underlying line of business. If more than 90 percent of all losses for an accident year relate to one underlying line of business, the taxpayer must discount the losses attributable to that accident year using discount factors published by the Service for the underlying line of business.

(5) *Composite discount factors.* For purposes of the regulations under section 846, "composite discount factors" means the series of discount factors published annually by the Service determined on the basis of the appropriate composite loss payment pattern.

[T.D. 8433, 57 FR 40844, Sept. 8, 1992]

**§ 1.846-2 Election by taxpayer to use its own historical loss payment pattern.**

(a) *In general.* If a taxpayer has one or more eligible lines of business in a determination year, the taxpayer may elect on the taxpayer's timely filed Federal income tax return for the determination year to discount unpaid losses using its own historical loss payment pattern instead of the industry-wide pattern determined by the Secretary. A taxpayer making the election must use its own historical loss payment pattern in discounting unpaid losses for each line of business that is an eligible line of business in that determination year. The election applies