

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

to accident years ending with the determination year and to each of the four succeeding accident years. If a taxpayer makes the election for the 1987 determination year, the taxpayer must use its 1987 loss payment pattern (determined by reference to its 1985 annual statement) to discount unpaid losses attributable to all accident years prior to 1988.

(b) *Eligible line of business*—(1) *In general.* A line of business is an eligible line of business in a determination year if, on the most recent annual statement filed by the taxpayer before the beginning of that determination year, the taxpayer reports losses and loss expenses incurred (in Schedule P, part 1, column 24 of the 1990 annual statement or comparable location in an earlier or subsequently revised blank) for at least the number of accident years for which losses and loss expenses incurred for that line of business are required to be separately reported on that annual statement. For example, for the 1987 determination year, the 1985 annual statement is used. The annual statement to be used to determine eligibility in subsequent determination years is the annual statement for each fifth year after 1985 (e.g., 1990, 1995, etc.).

(2) *Other published guidance.* A line of business is also an eligible line of business for purposes of the election if the line is an eligible line under requirements published for this purpose in the Internal Revenue Bulletin.

(3) *Special rule for 1987 determination year.* A line of business is an eligible line of business in the 1987 determination year if it is eligible under paragraph (b) (1) or (2) of this section, or if on the most recent annual statement filed by the taxpayer before the beginning of the 1987 determination year, the taxpayer reports written premiums for the line of business for at least the number of accident years that unpaid losses for that line of business are required to be separately reported on that annual statement.

(c) *Anti-abuse rule.* To prevent avoidance of the requirement that the election to use historical loss payment patterns apply to all eligible lines of business of a taxpayer, the district director may—

(1) Nullify a taxpayer's election to compute discounted unpaid losses based on its historical loss payment pattern;

(2) Adjust a taxpayer's historical loss payment pattern; or

(3) Make other proper adjustments.

[T.D. 8433, 57 FR 40845, Sept. 8, 1992]

**§ 1.846-3 Fresh start and reserve strengthening.**

(a) *In general.* Section 1023(e) of the Tax Reform Act of 1986 ("the 1986 Act") provides rules relating to fresh start and reserve strengthening. For purposes of section 1023(e) of the 1986 Act, a taxpayer must discount its unpaid losses as of the end of the last taxable year beginning before January 1, 1987. The excess of undiscounted unpaid losses over discounted unpaid losses as of that time is not required to be included in income, except (as provided in paragraph (e) of this section) to the extent of any "reserve strengthening" in a taxable year beginning in 1986. The exclusion from income of this excess is known as "fresh start." The amount of fresh start is, however, included in earnings and profits for the first taxable year beginning after December 31, 1986.

(b) *Applicable discount factors*—(1) *Calculation of beginning balance.* For purposes of section 1023(e) of the 1986 Act, a taxpayer discounts unpaid losses as of the end of the last taxable year beginning before January 1, 1987—

(i) By using the same discount factors that are used in the succeeding taxable year to discount unpaid losses attributable to the 1987 accident year and prior accident years (see section 1023(e)(2) of the 1986 Act); and

(ii) By applying those discount factors as if the 1986 accident year were the 1987 accident year.

(2) *Example.* The following example illustrates the principles of this paragraph (b):

*Example.* X, a calendar year taxpayer, does not make an election in 1987 to use its own historical loss payment pattern. When X computes discounted unpaid losses for its last taxable year beginning before January 1, 1987, the discount factor for AY+0 published in Rev. Rul. 87-34, 1987-1 C.B. 168, must be applied to unpaid losses attributable to the 1986 accident year; the discount factor for AY+1