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Announcing a New Statutory Citations Guide**HOW TO FIND U.S. STATUTES and U.S. CODE CITATIONS**

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Rules and Regulations

Title 26—INTERNAL REVENUE

Chapter I—Internal Revenue Service, Department of the Treasury

SUBCHAPTER A—INCOME TAX

[T.D. 6781]

PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DE- CEMBER 31, 1953

Income of Controlled Foreign Corpo- ration From Insurance of United States Risks

On July 30, 1964, notice of proposed rule making with respect to the amendment of the Income Tax Regulations (26 CFR Part 1) to conform such regulations to section 953 of the Internal Revenue Code of 1954, as added by section 12(a) of the Revenue Act of 1962 (76 Stat. 1006), was published in the *FEDERAL REGISTER* (29 F.R. 10603). After consideration of all such relevant matter as was presented by interested persons regarding the rules proposed, the amendment to the regulations as proposed is hereby adopted, subject to the changes set forth below in paragraphs 1 through 5. In addition, paragraph 6 of this Treasury decision contains an amendment which revises paragraph (d) (3) of § 1.954-2. These amendments shall apply for taxable years of foreign corporations beginning after December 31, 1962, and for taxable years of United States shareholders within which or with which such taxable years of such corporations end.

PARAGRAPH 1. Section 1.053-1, as set forth in the notice of proposed rule making, is changed by adding after subparagraph (5) of paragraph (c) a new subparagraph (6).

PAR. 2. Section 1.953-2, as set forth in the notice of proposed rule making, is changed by revising subdivision (i) of paragraph (b) (2), by redesignating subdivisions (ii) through (ix) of paragraph (b) (2) as subdivisions (iii) through (x), by adding after subdivision (i) of paragraph (b) (2) a new subdivision (ii), by revising subdivisions (iii) (a), (iv), (v), (viii), and (x) of paragraph (b) (2), as so redesignated, and by revising paragraph (c).

PAR. 3. Section 1.953-4, as set forth in the notice of proposed rule making, is changed by revising paragraph (a) (1) and (2), by revising paragraph (c), and by revising paragraph (f) (2) (iii).

PAR. 4. Section 1.953-5, as set forth in the notice of proposed rule making, is changed by revising paragraphs (c) (2) (ii) (a) and (c) (3) (ii) (a).

PAR. 5. Section 1.953-6, as set forth in the notice of proposed rule making, is changed by revising the first sentence of paragraph (a).

PAR. 6. Paragraph (d) (3) of § 1.954-2 is amended.

Because paragraph 6 of this Treasury decision substantially conforms to provisions which were published with notice of proposed rule making on December 27, 1962 (27 F.R. 12762), it is hereby found that it is unnecessary to issue such paragraph of this Treasury decision with notice and public procedure thereon under section 4(a) of the Administrative Procedure Act, approved June 11, 1946, or subject to the effective date limitation of section 4(c) of said Act.

[SEAL] BERTRAND M. HARDING,
*Acting Commissioner
of Internal Revenue.*

Approved: December 16, 1964.

STANLEY S. SURREY,
*Assistant Secretary of the
Treasury.*

In order to conform the Income Tax Regulations (26 CFR Part 1) to section 953 of the Internal Revenue Code of 1954, as added by section 12(a) of the Revenue Act of 1962 (76 Stat. 1006), such regulations are amended to include the following new sections, effective with respect to taxable years of foreign corporations beginning after December 31, 1962, and to taxable years of United States shareholders within which or with which such taxable years of such foreign corporations end:

§ 1.953 Statutory provisions; income from insurance of United States risks.

SEC. 953. *Income from insurance of United States risks*—(a) *General rule.* For purposes of section 952(a) (1), the term "income derived from the insurance of United States risks" means that income which—

(1) Is attributable to the reinsurance or the issuing of any insurance or annuity contract—

(A) In connection with property in, or liability arising out of activity in, or in connection with the lives or health of residents of, the United States, or

(B) In connection with risks not included in subparagraph (A) as the result of any arrangement whereby another corporation receives a substantially equal amount of premiums or other consideration in respect to any reinsurance or the issuing of any insurance or annuity contract in connection with property in, or liability arising out of activity in, or in connection with the lives or health of residents of, the United States, and

(2) Would (subject to the modifications provided by paragraphs (1), (2), and (3) of subsection (b)) be taxed under subchapter L of this chapter if such income were the income of a domestic insurance corporation.

This section shall apply only in the case of a controlled foreign corporation which receives, during any taxable year, premiums or other consideration in respect of the reinsurance, and the issuing, of insurance and annuity contracts described in paragraph (1) in excess of 5 percent of the total of premiums and other consideration received during such taxable year in respect of all reinsurance and issuing of insurance and annuity contracts.

(b) *Special rules.* For purposes of subsection (a)—

(1) In the application of part I of subchapter L, life insurance company taxable income is the gain from operations as defined in section 809(b).

(2) A corporation which would, if it were a domestic insurance corporation, be taxable under part II of subchapter L shall apply subsection (a) as if it were taxable under part III of subchapter L.

(3) The following provisions of subchapter L shall not apply:

(A) Section 809(d) (4) (operations loss deduction).

(B) Section 809(d) (5) (certain nonparticipating contracts).

(C) Section 809(d) (6) (group life, accident, and health insurance).

(D) Section 809(d) (10) (small business deduction).

(E) Section 817(b) (gain on property held on December 31, 1958, and certain substituted property acquired after 1958).

(F) Section 832(b) (5) (certain capital losses).

(4) The items referred to in—

(A) Section 809(c) (1) (relating to gross amount of premiums and other considerations),

(B) Section 809(c) (2) (relating to net decrease in reserves),

(C) Section 809(d) (2) (relating to net increase in reserves), and

(D) Section 832(b) (4) (relating to premiums earned on insurance contracts),

shall be taken into account only to the extent they are in respect of any reinsurance or the issuing of any insurance or annuity contract described in subsection (a) (1).

(5) All items of income, expenses, losses, and deductions (other than those taken into account under paragraph (4)) shall be properly allocated or apportioned under regulations prescribed by the Secretary or his delegate.

[Sec. 953 as added by sec. 12(a), Rev. Act 1962 (76 Stat. 1006)]

§ 1.953-1 Income from insurance of United States risks.

(a) *In general.* The subpart F income of a controlled foreign corporation for any taxable year includes its income derived from the insurance of United States risks for such taxable year. See section 952(a) (1). A controlled foreign corporation shall have income derived from the insurance of United States risks for such purpose if it has taxable income, as determined under § 1.953-4 or § 1.953-5, which is attributable to the reinsuring or the issuing of any insurance or annuity contract in connection with United States risks, as defined in § 1.953-2 or § 1.953-3, and if it satisfies the 5-percent minimum premium requirement prescribed in paragraph (b) of this section. It is immaterial for purposes of this section whether the person insured or the beneficiary of any insurance, annuity, or reinsurance contract is, as to such corporation, a related person or a United States shareholder. For definition of the term "controlled foreign corporation" for purposes of taking into account income derived from the insurance of United States risks under section 953, see section 957 (a) and (b) and §§ 1.957-1 and 1.957-2.

(b) *5-percent minimum premium requirement.* A controlled foreign corporation shall not have income derived from the insurance of United States risks for purposes of this section unless the premiums received by such corporation during the taxable year which are attributable to the reinsuring and the issuing of insurance and annuity contracts in connection with the United States risks exceed 5 percent of the total premiums which are received by such corporation during such taxable year and which are attributable to the reinsuring and the issuing of insurance and annuity contracts in connection with all risks.

(c) *General definitions.* For purposes of §§ 1.953-1 to 1.953-6, inclusive—

(1) *Reinsurance, etc.* The terms "reinsurance", "insurance", and "annuity contract" have the same meaning which they have for purposes of applying section 809(c)(1) or section 832(b)(4), as the case may be.

(2) *Premiums.* The term "premiums" means the items taken into account for the taxable year under section 809(c)(1), or the amount computed for the taxable year under section 832(b)(4) without the application of subparagraph (B) thereof, as the case may be; except that, for purposes of determining the amount of premiums received in applying paragraph (b) of this section or paragraph (a) of § 1.953-3, advance premiums and deposits shall not be taken into account.

(3) *Insurance company.* The term "insurance company" has the same meaning which it has for purposes of applying section 801(a), determined by applying the principles of paragraph (a) of § 1.801-3.

(4) *Related person.* The term "related person", when used with respect to a controlled foreign corporation, shall have the meaning assigned to it by paragraph (e) of § 1.954-1.

(5) *Policy period.* With respect to any insurance or annuity contract under which a corporation is potentially liable at any time during its taxable year, the term "policy period" means with respect to such year each period of coverage under the contract if such period begins or ends with or within the taxable year, except that, if such period of coverage is more than one year, such term means such of the following periods as are applicable, each one of which is a policy period with respect to the taxable year:

(i) The one-year period which begins with the effective date of the contract and begins or ends with or within the taxable year,

(ii) The one-year period which begins with an anniversary of the contract and begins or ends with or within the taxable year, and

(iii) The period of less than one year if such period begins with an anniversary of the contract, ends with the date on which coverage under the contract terminates, and begins or ends with or within the taxable year.

For such purposes, the effective date of the contract is the date on which coverage under the contract begins, and the anniversary of the contract is the annual return of the effective date. The

period of coverage under a contract is the period beginning with the effective date of the contract and ending with the date on which the coverage under the contract expires; except that, if the risk under the contract has been transferred by assumption reinsurance, the period of coverage shall end with the effective date of such transfer or, if the contract is cancelled, with the effective date of cancellation. For this purpose, the term "assumption reinsurance" shall have the meaning provided by paragraph (a)(7)(ii) of § 1.809-5. The application of this subparagraph may be illustrated by the following examples:

Example (1). Controlled foreign corporation A issues to domestic corporation M an insurance contract which provides coverage for the 2½ year period beginning on July 1, 1963. Corporation A uses the calendar year as the taxable year. For 1963, the policy period under such contract as to A Corporation is July 1, 1963, to June 30, 1964. For 1964, the policy periods under such contract as to A Corporation are July 1, 1963, to June 30, 1964, and July 1, 1964, to June 30, 1965. For 1965, the policy periods under such contract as to A Corporation are July 1, 1964, to June 30, 1965, and July 1, 1965, to December 31, 1965.

Example (2). The facts are the same as in example (1) except that M Corporation cancels the contract on August 31, 1963. For 1963, the policy period under such contract as to A Corporation is July 1, 1963, to August 31, 1963.

Example (3). The facts are the same as in example (1) except that on January 15, 1965, A Corporation cedes insurance under the contract to controlled foreign corporation B, which also uses the calendar year as the taxable year. For 1964, the policy periods under such contract as to A Corporation are July 1, 1963, to June 30, 1964, and July 1, 1964, to June 30, 1965. For 1965, the policy periods under such contract as to both A Corporation and B Corporation are July 1, 1964, to June 30, 1965, and July 1, 1965, to December 31, 1965.

Example (4). Controlled foreign corporation C, which uses the calendar year as the taxable year, issues to domestic corporation N an insurance contract which covers the marine risks in connection with shipping a machine to Europe. The contract does not specify the dates during which the machine is covered, but provides coverage from the time the machine is delivered alongside a named vessel in Hoboken, New Jersey, until the machine is delivered alongside such vessel in Liverpool, England. Such deliveries in New Jersey and England take place on February 1, and February 28, 1963, respectively. For 1963, the policy period under such contract as to C Corporation is February 1, to February 28, 1963.

(6) *Foreign country.* The term "foreign country" includes, where not otherwise expressly provided, a possession of the United States.

§ 1.953-2 Actual United States risks.

(a) *In general.* For purposes of paragraph (a) of § 1.953-1, the term "United States risks" means risks described in section 953(a)(1)(A)—

(1) In connection with property in the United States (as defined in paragraph (b) of this section),

(2) In connection with liability arising out of activity in the United States (as defined in paragraph (c) of this section), or

(3) In connection with the lives or health of residents of the United States

(as defined in paragraph (d) of this section).

For purposes of section 953(a), the term "United States" is used in a geographical sense and includes only the States and the District of Columbia. Therefore, the reinsuring or the issuing of insurance or annuity contracts by a controlled foreign corporation in connection with property located in a foreign country or a possession of the United States, in connection with activity in a foreign country or a possession, or in connection with the lives or health of citizens of the United States who are not residents of the United States will not give rise to income to which paragraph (a) of § 1.953-1 applies, unless the income derived by the controlled foreign corporation from such contracts constitutes income derived in connection with risks which are deemed to be United States risks, as defined in § 1.953-3.

(b) *Property in the United States.* The term "property in the United States" means property, as defined in subparagraph (1) of this paragraph, which is in the United States, within the meaning of subparagraph (2) of this paragraph.

(1) *Property defined.* The term "property" means any interest of an insured in tangible (including real and personal) or intangible property. Such interests include, but are not limited to, those of an owner, landlord, tenant, mortgagor, mortgagee, trustee, beneficiary, or partner. Thus, for example, if insurance is issued against loss from fire and theft with respect to an insured's home and its contents, such risks are risks in connection with property, whether the insured is the owner or lessee and whether the contents include furniture or cash and securities. Furthermore, if insurance is issued against all risks of damage or loss with respect to the automobile of an insured, such risks are risks in connection with property, whether the risks insured against may be caused by the insured, another person, or natural forces.

(2) *United States location—(i) In general.* Property will be considered property in the United States when it is exclusively located in the United States. Conversely, property will be considered property not in the United States when it is exclusively located outside the United States. In addition, property which is ordinarily located in, but temporarily located outside, the United States will be considered property in the United States both when it is ordinarily located in, and when it is temporarily located outside, the United States if the premium which is attributable to the reinsuring or issuing of any insurance contract in connection with such property cannot be allocated to, or apportioned between, risks incurred when such property is actually located in the United States and risks incurred when it is actually located outside the United States. If such premium can be so allocated or apportioned on a reasonable basis, however, such property will be considered property not in the United States when it is actually located outside the United States. However, property will not be considered property in the

United States if it is neither property which is exclusively located in the United States nor property which is ordinarily located in, but temporarily located outside, the United States. The rules prescribed in subdivision (ii) of this subparagraph shall apply in determining whether a premium can be allocated or apportioned on a reasonable basis to or between risks incurred when property is actually located in the United States and risks incurred when such property is actually located outside the United States. The rules prescribed in subdivisions (iii) through (x) of this subparagraph shall apply in determining whether property is, or will be considered, exclusively located in or outside the United States and whether property is, or will be considered, ordinarily located in the United States; such rules also limit the rule of premium allocation and apportionment prescribed in this subdivision and subdivision (ii) of this subparagraph. The determinations required by this subparagraph shall be made with respect to the location of property during the policy period applicable to the taxable year of the insuring or reinsuring corporation, or, if more than one policy period exists with respect to such taxable year, such determinations shall be made separately with respect to the location of property during each such policy period.

(ii) *Premium allocation or apportionment.* Whether a premium can be allocated or apportioned on a reasonable basis to or between risks incurred when property is actually located in the United States and risks incurred when such property is actually located outside the United States shall depend on the intention of the parties to the insurance contract, as determined from its provisions and the facts and circumstances preceding its execution. Contract provisions on the basis of which the premium reasonably may be so allocated or apportioned include, but are not limited to, provisions which separately describe each risk covered, the period of coverage of each risk, the special warranties for each risk, the premium for each risk (or the basis for determining such premium), and the conditions of paying the premium for each risk. For purposes of this subdivision, it shall be unnecessary formally to make a separate policy with respect to each risk covered or with respect to each clause attached to the policy, provided that the intention of the parties to the contract is reasonably clear. For example, if in the ordinary course of carrying on an insurance business an insurance policy is issued which covers fire, theft, and water damage risks incurred when property is actually located in the United States and marine risks incurred when such property is actually located outside the United States and which, pursuant to accepted insurance principles, properly describes the premium rates as percentages of the amount of coverage as ".825% plus .3% fire, etc. risks plus .12% water risks = 1.245%", a reasonable basis exists to allocate a \$124.50 premium paid for \$10,000 of such coverage to \$82.50 for foreign

risks and \$42.00 (\$30.00 + \$12.00) to United States risks.

(iii) *Property in general—(a) Ordinary and temporary location.* Except as otherwise provided in subdivisions (iv) through (x) of this subparagraph, the determination of whether property is ordinarily located in the United States will depend on all the facts and circumstances in each case. Property is ordinarily located in the United States if its location in the United States is regular, usual, or often occurring. However, in all cases property will be considered ordinarily located in the United States if it is actually located in the United States for an aggregate of more than 50 percent of the days in the applicable policy period whereas property will, under no circumstances, be considered ordinarily located in the United States if it is actually located in the United States for an aggregate of not more than 30 percent of the days in the applicable policy period. Property which is ordinarily located in the United States is temporarily located outside the United States when it is actually located outside the United States. For purposes of determining the number and percent of the days in an applicable policy period, the term "day" means, not any 24-consecutive-hour period, but a continuous period of twenty-four hours commencing from midnight and ending with the following midnight; in determining the location of property for such purposes, an amount of time which is at least one-half of such a day, but less than the entire day, shall be considered a day, and an amount of time which is less than one-half of such a day shall not be considered a day.

(b) *Illustrations.* The application of this subdivision may be illustrated by the following examples:

Example (1). Controlled foreign corporation A issues to domestic corporation M a comprehensive blanket or floater insurance policy which, for one year, covers inventory samples which M Corporation regularly ships from the United States in order to encourage sales. Such shipments are made on the condition that they be returned to the United States within 5 days after they are received. During the one-year policy period, such samples are sent from, and returned to, the United States 50 times, and during such one-year period are actually located in the United States for an aggregate of 120 days. Since the location of the samples in the United States during such one-year period is often recurring, they are property ordinarily located in, but temporarily located outside, the United States. Therefore, they will be considered property in the United States even though for such one-year period their location in the United States is not regular or usual and is not for an aggregate of more than 50 percent of the days in the policy period. However, if, by considering such factors as the terms and premium schedule of the insurance contract as well as the number, value, and duration of the location in and outside the United States, of such samples, the premium which is attributable to the issuing of such contract can be allocated to, or apportioned between, risks occurring when such samples are actually located in the United States and risks occurring when they are actually located outside the United States, such samples will be considered property not in the United States

when they are actually located outside the United States.

Example (2). A machine, located for several years in a foreign branch of a United States manufacturer, is permanently transferred to the home office of such manufacturer, where it arrives on January 1, 1963, and remains for the remainder of 1963. Under a separate insurance contract issued by a controlled foreign corporation, which uses the calendar year as the taxable year, such machine is insured against damage for the three-year period commencing on May 1, 1962. Because of the change in location of the machine, the premiums are increased as of January 1, 1963. Since the machine is in the United States from January 1, 1963, to April 30, 1963, its location in the United States is regular and usual during the policy period of May 1, 1962, to April 30, 1963. Accordingly, the machine is ordinarily located in the United States for such policy period. However, since the premium which is attributable to the issuing of such contract is allocable to risks occurring when the machine is actually located in, and when it is actually located outside, the United States, such machine will be considered property not in the United States from May 1, 1962, through December 31, 1962.

(iv) *Commercial motor vehicles, ships, aircraft, railroad rolling stock, and containers.* Any motor vehicle, ship, aircraft, railroad rolling stock, or any container transported thereby, which is used exclusively in the commercial transportation of persons or property to or from the United States (including such transportation from one place to another in the United States) and is ordinarily located in the United States will be considered property in the United States both when such property is ordinarily located in, and when such property is temporarily located outside, the United States. Whether such property is used in the transportation of persons or property to or from the United States and is ordinarily located in the United States are issues to be determined from all the facts and circumstances in each case. However, in all cases such transportation property will be considered ordinarily located in the United States if either more than 50 percent of the miles traversed during the applicable policy period in the use of such property are traversed within the United States or such property is located in the United States more than 50 percent of the time during such period. Further, such transportation property will not at any time be considered property in the United States if either not more than 30 percent of the miles traversed during the applicable policy period in the use of such property are traversed within the United States or such property is located in the United States for not more than 30 percent of the time during such period. Nevertheless, if not more than 30 percent of the miles traversed during the applicable policy period in the use of such transportation property are traversed within the United States, such property will be considered ordinarily located in the United States if it is located in the United States more than 50 percent of the time during such period. Moreover, if such transportation property is located in the United States for not more than 30 percent of the time

during the applicable policy period, such property will be considered ordinarily located in the United States if more than 50 percent of the miles traversed during such period in the use of such property are traversed within the United States. If such transportation property is considered property in the United States because more than 50 percent of the miles traversed during the applicable policy period in the use of such property are traversed within the United States, the apportionment of premium provided in subdivision (i) of this subparagraph shall be made on a mileage basis. If, however, such property is considered property in the United States because such property is located in the United States more than 50 percent of the time during the applicable policy period, the apportionment of premium provided in subdivision (i) of this subparagraph shall be made on a time basis.

(v) *Noncommercial motor vehicles, ships, aircraft, and railroad rolling stock.* Except as provided in subdivision (iv) of this subparagraph, any motor vehicle, ship or boat, aircraft, or railroad rolling stock which at any time is actually located in the United States and which either (a) is registered with the United States, a State (including any political subdivision thereof), or any agency thereof or (b), if not so registered, is owned by a citizen, resident, or corporation of the United States will be considered property which is ordinarily located in the United States. Unless the premium which is attributable to the reinsuring or issuing of any insurance contract in connection with such property considered ordinarily located in the United States is specifically allocated under the contract to risks incurred when such property is actually located in the United States and to risks incurred when it is actually located outside the United States, such property will be considered property in the United States both when it is ordinarily located in, and when it is temporarily located outside, the United States; under no circumstances will such property be considered outside the United States on the basis of any apportionment of such premium.

(vi) *Property exported or imported by railroad or motor vehicle.* Any property which is exported from, or imported to, the United States by railroad or motor vehicle will be considered property ordinarily located in the United States which, when such property is not actually located in the United States, is temporarily located outside the United States. For example, if an insurance contract reinsured or issued in connection with property exported from the United States by motor vehicle covers risks commencing when such property is loaded on the motor vehicle at the United States warehouse and terminating when such property is unloaded at the foreign warehouse, and if the premium payable with respect to risks incurred when the property is in the United States and risks incurred when the property is in the foreign country is not separately stated, such property will be considered property in the United States only until such property is actually located outside the United States,

provided that the premium can be properly apportioned (for example) on the basis of time or mileage, between risks incurred when the property is actually located in the United States and risks incurred when it is actually located outside the United States. If in such case the premium is not so apportionable, such property will be considered property in the United States both when such property is ordinarily located in, and when it is temporarily located outside, the United States.

(vii) *Property exported by ship or aircraft.* If an insurance contract which is reinsured or issued in connection with property which is exported from the United States by ship or aircraft covers risks all of which terminate when such property is placed aboard a ship or aircraft at the United States port of exit for shipment from the United States, such property will be considered property in the United States. If such insurance contract covers risks all of which commence when such property is placed aboard a ship or aircraft at the United States port of exit for shipment from the United States, such property will be considered property not in the United States. If such insurance contract covers risks commencing before, and terminating after, such property is placed aboard a ship or aircraft at the United States port of exit for shipment from the United States, such property will be considered property ordinarily located in the United States which, after such property is placed aboard such ship or aircraft at the United States port of exit, is temporarily located outside the United States. The application of this subdivision may be illustrated by the following example:

Example. A controlled foreign corporation issues an insurance contract in connection with property exported from the United States by ship. The contract covers risks commencing after such property is removed from the United States warehouse and terminating when such property is unloaded at the foreign port of entry. Assuming that the premium payable with respect to the risks incurred before and the risks incurred after the property is placed aboard the ship at the United States port of exit for shipment from the United States or with respect to the steps in handling such property during such coverage, such as transporting the property to the United States port of exit, unloading the property there, placing the property aboard the ship, holding the property aboard the ship in port, the actual voyage, and unloading the property at the foreign port of entry, is separately stated in, or is determinable from, such contract, the property will be considered property in the United States only until such property is placed aboard the ship at the United States port of exit for shipment from the United States. Assuming, however, that the premiums payable with respect to such steps, or with respect to the risks incurred before and the risks incurred after the property is placed aboard the ship at the United States port of exit, are not allocable or apportionable under the contract, such property will be considered property in the United States both before and after such property is placed aboard the ship at the United States port of exit.

(viii) *Property imported by ship or aircraft.* If an insurance contract which is reinsured or issued in connection with

property which is imported to the United States by ship or aircraft covers risks all of which terminate when such property is unloaded at the United States port of entry, such property will be considered property not in the United States. If such insurance contract covers risks all of which commence after such property is unloaded at the United States port of entry, such property will be considered property in the United States. If such insurance contract covers risks commencing before, and terminating after, such property is unloaded at the United States port of entry, such property will be considered property ordinarily located in the United States which, before such property is unloaded at the United States port of entry, is temporarily located outside the United States. For an illustration pertaining to the allocation or apportionment of the premium, see the example in subdivision (vii) of this subparagraph.

(ix) *Shipments originating and terminating in the United States.* Any property which is shipped from one place in the United States to another place in the United States, on or over a foreign country, the high seas, or the coastal waters of the United States will be considered property actually located at all times in the United States. For example, property which is shipped from New York City to Los Angeles via the Panama Canal or from San Francisco to Hawaii or Alaska will be considered property actually located at all times in the United States.

(x) *Shipments originating and terminating in a foreign country.* Any property which is shipped by any means, or a combination of means, of transportation from one foreign country to another foreign country, or from a contiguous foreign country to the same contiguous foreign country, on or over the United States will be considered property exclusively located outside the United States. Notwithstanding the foregoing, any property which is shipped by any means, or a combination of means, of transportation from one contiguous foreign country to another contiguous foreign country on or over the United States will be considered property ordinarily located in the United States which, when such property is not actually located in the United States, is temporarily located outside the United States.

(c) *Liability from United States activity.* The term "liability arising out of activity in the United States" means a loss, as described in subparagraph (1) of this paragraph, or a liability, as described in subparagraph (2) of this paragraph, which could arise from activity performed in the United States, as defined in subparagraph (3) of this paragraph.

(1) *Loss described.* The term "loss" includes all loss of an insured which could arise from the occurrence of the event insured against except that such term does not include any loss in connection with property described in paragraph (b) of this section. For example, such term includes, in the case of a promoter of outdoor sporting events, the

loss which could arise from the cancellation of such an event because of inclement weather.

(2) *Liability described.* The term "liability" includes all liability of an insured in tort, contract, property, or otherwise. It includes, for example, the liability of a principal for the acts of his agent, of a husband for the acts of his spouse, and of a parent for the acts of his child. The term not only includes the direct liability which may be incurred, for example, by a tortfeasor to the person harmed, but also the indirect liability which may be incurred, for example, by a manufacturer to the purchaser at retail for a breach of warranty.

(3) *Activity in the United States—(i) In general.* A loss or liability will be considered a loss or liability which could arise from activity performed in the United States if the loss or liability would result, if at all, from an activity exclusively carried on in the United States. Conversely, a loss or liability will be considered a loss or liability which could not arise from activity performed in the United States if the loss or liability would result, if at all, from an activity exclusively carried on outside the United States. In addition, a loss or liability will be considered a loss or liability which could arise from activity performed in the United States if the loss or liability would result, if at all, from an activity ordinarily carried on in, but partly carried on outside, the United States. If the premium which is attributable to the reinsuring or issuing of any insurance contract in connection with an activity ordinarily carried on in, but partly carried on outside, the United States can, on a reasonable basis, be allocated to, or apportioned between, the risks incurred with respect to the activity carried on in, and the risks incurred with respect to the activity carried on outside, the United States, such loss or liability will be considered a loss or liability which could not arise from activity performed in the United States to the extent the loss or liability would result, if at all, from that activity carried on outside the United States. However, a loss or liability will not be considered a loss or liability which could arise from an activity performed in the United States if such loss or liability would result, if at all, from an activity which is neither exclusively carried on in the United States nor ordinarily carried on in, but partly carried on outside, the United States. The principles of paragraph (b) (2) (ii) of this section for allocating or apportioning a premium on a reasonable basis to or between risks incurred when property is actually located in the United States and risks incurred when such property is actually located outside the United States shall apply for allocating or apportioning a premium on a reasonable basis to or between the risks incurred with respect to the activity carried on in, and the risks incurred with respect to the activity carried on outside, the United States. The rules prescribed in subdivisions (ii) through (vi) of this subparagraph shall apply in determining whether an activity is, or will be considered, exclusively carried on in

or outside the United States and whether an activity is, or will be considered, ordinarily carried on in the United States and in determining what is the activity which is performed by the insured from which a loss or liability results or could result; such rules also limit the rule of premium allocation and apportionment prescribed in this subdivision. The determinations required by this subparagraph shall be made with respect to the location of an activity of the insured performed during the policy period applicable to the taxable year of the insuring or reinsuring corporation, or, if more than one policy period exists with respect to such taxable year, such determinations shall be made separately with respect to the location of the activity during each such policy period.

(ii) *Substantial activity carried on in the United States.* The term "activity" is used in its broadest sense and includes the performance of an act unlawfully undertaken, the wrongful performance of an act lawfully undertaken, and the wrongful failure to perform an act lawfully required to be undertaken. With respect to a loss described in subparagraph (1) of this paragraph, the term "activity" includes the occurrence of the event insured against. The determination of whether an activity ordinarily is carried on in, but is partly carried on outside, the United States will depend on all the facts and circumstances in each case. An activity ordinarily is carried on in the United States if a substantial amount of such activity is carried on in the United States. Factors which will be taken into account in determining whether a substantial amount of activity is carried on in the United States are those which are connected with the activity and include, but are not limited to, the location of the insured's assets, the place where personal services are performed, and the place where sales occur, but only if such assets, services, and sales are connected with the activity. In all cases an activity will be considered substantially carried on in the United States if more than 50 percent of the insured's total assets, personal services, and sales, if any, connected with such activity are located, performed, or occur in the United States. On the other hand, an activity will, under no circumstances, be considered substantially carried on in the United States if not more than 30 percent of the insured's total assets, personal services, and sales, if any, connected with such activity are located, performed, or occur in the United States. For this purpose, the mean of the value of the total assets at the beginning and end of the policy period shall be used, determined by taking assets into account at their actual value (not reduced by liabilities), which, in the absence of affirmative evidence to the contrary, shall be deemed to be (a) face value in the case of bills receivable, accounts receivable, notes receivable, and open accounts held by an insured using the cash receipts and disbursements method of accounting and (b) adjusted basis in the case of all other assets. Personal services shall be measured by the amount of compensation paid or accrued for such services,

and sales shall be measured by the volume of gross sales. An activity is carried on partly outside the United States if it is carried on, whether substantially or insubstantially, outside the United States.

(iii) *Manufacturing, producing, constructing, or assembling activity.* If a person who manufactures, produces, constructs, or assembles property is liable with regard to the consumption or use of such property, such liability will be considered to result from the activity performed of manufacturing, producing, constructing, or assembling such property. If such person manufactures, produces, constructs, or assembles more than one type of product, the liability with regard to the consumption or use of one of such products will be considered to result from the activity performed of manufacturing, producing, constructing, or assembling that particular product. For example, the liability of a building contractor, which constructs apartment buildings only in the United States, for the improper construction of, or the failure to construct, an apartment building, will be considered to result from an activity exclusively carried on in the United States and will be considered a liability which could arise from activity performed in the United States. In further illustration, the liability (which is covered by a single policy of insurance) of a domestic corporation, which assembles refrigerators exclusively in the United States and manufactures automobiles both in a foreign country and in the United States through substantial activity carried on in each of such countries, for the negligent manufacturing of a part for one of the automobiles by the foreign branch, will be considered to result from an activity ordinarily carried on in, but partly carried on outside, the United States and will be considered a liability which could arise from activity performed in the United States.

(iv) *Selling activity.* If a person is liable with regard to selling activity performed, such liability will be considered, except as provided in subdivisions (iii), (v), and (vi) of this subparagraph, to result from such selling activity. A person will be considered to be engaged in selling activity if such person engages in an activity resulting in the sale of property. Thus, it is immaterial that, under the Code, such activity would not constitute engaging in or carrying on a trade or business in the country in which such activity is carried on, the property in the goods does not pass in such country, or delivery of the property is not made in such country. For example, if a foreign wholesale distributor, which manages its entire business operations in a foreign country and sells its inventory exclusively in the United States—its only contact in the United States being the promotion of such sales to United States retail outlets by advertising in trade publications and distributing sales catalogues—is liable for a breach of warranty with regard to the sale of property to a United States retail outlet, such liability will be considered to result from an activity exclusively carried on in the United States and will be considered a liability

which could arise from activity performed in the United States.

(v) *Liability from service or driving activity*—(a) *In general.* If a person is liable with regard to any service activity performed, or is liable with regard to driving activity performed in connection with a motor vehicle, ship or boat, aircraft, or railroad rolling stock, whether or not exclusively used in the commercial transportation of persons or property, such liability will be considered to result from such service or driving activity. For example, if an oil company which drills for oil exclusively in a foreign country is liable with regard to the negligent handling by its employees of explosives in the course of such drilling there, such liability will be considered to result from an activity exclusively carried on outside the United States and will be considered a liability which could not arise from activity performed in the United States. In further illustration, if a corporation which services machinery exclusively in a foreign country under servicing contracts is liable with regard to the negligent repairing of a machine under such a contract, such liability will be considered to result from an activity exclusively carried on outside the United States and will be considered a liability which could not arise from activity performed in the United States.

(b) *Location of activities in connection with transportation property.* For purposes of subdivision (a) of this subdivision, service or driving activity performed in connection with a motor vehicle, ship or boat, aircraft, or railroad rolling stock, whether or not exclusively used in the commercial transportation of persons or property, will be considered activity performed in the United States if the activity is carried on at a time when such property is or will be considered, in accordance with subdivision (iv) or (v) of paragraph (b) (2) of this section, actually in the United States or ordinarily located in the United States. However, if the premium which is attributable to the reinsuring or issuing of any insurance contract in connection with such service or driving activity which is carried on at a time when such property is, or will be considered, ordinarily located in the United States can be allocated to, or apportioned between, the risks incurred when such property is actually located in the United States and risks incurred when it is actually located outside the United States, such liability will be considered a liability which could arise from activity performed in the United States only when such property is actually located in the United States. Any allocation or apportionment of premium under the preceding sentence shall be made in accordance with the rules of allocation and apportionment provided in subdivision (iv) or (v) of paragraph (b) (2) of this section. For example, if a person is liable with regard to the performance of services outside the United States in the operation of a motor vehicle which is used exclusively in the commercial transportation of persons to and from the United States and which, because more than 50 percent of the miles

traversed during the applicable policy period in the use of such property are traversed within the United States, is considered ordinarily located in the United States, such liability will be considered to be a liability which could not arise from activity performed in the United States only to the extent that the premium which is attributable to the reinsuring or issuing of any insurance contract in connection with such service activity is apportioned on a mileage basis between the risks incurred when such motor vehicle is actually located in the United States and when such vehicle is actually located outside the United States. See paragraph (b) (2) (iv) of this section. In further illustration, if a person is liable with regard to his negligent driving of a motor vehicle which is not used exclusively in the commercial transportation of persons or property, which is registered with any State, and which is driven both in the United States and a foreign country, such liability will be considered a liability which could arise from activity performed in the United States, unless the premium which is attributable to the reinsuring or issuing of an insurance contract in connection with such driving performed in such motor vehicle ordinarily located in the United States is specifically allocated under the contract to risks incurred with respect to driving performed in, and to risks incurred with respect to driving performed outside, the United States. See paragraph (b) (2) (v) of this section.

(c) *Illustration.* The application of this subdivision may be further illustrated by the following example:

Example. Controlled foreign corporation A is a wholly owned subsidiary of domestic corporation M. Both corporations are insurance companies and use the calendar year as the taxable year. Corporation M is exclusively engaged in issuing to owners of commercial rental property which is located in the United States insurance contracts which cover any harm which may be caused in 1963 by the tortious conduct of the owners' employees in managing and maintaining such property. The owners insured under such contracts include both residents and nonresidents of the United States. In 1963, M Corporation cedes to A Corporation one-half of the insurance contracts issued by M Corporation in that year, including the contracts issued to nonresidents. Income of A Corporation derived in 1963 from reinsuring the risks of M Corporation is income from the insurance of United States risks since all the insurance contracts reinsured by it are in connection with a liability which could arise from service activity performed in the United States.

(vi) *Liability from delivery of property.* If the person who is obligated to deliver property is liable with regard to such delivery, such liability will be considered to result from the activity performed of delivering such property. For example, if a corporation which exports all of its inventory from the United States to foreign countries or possessions of the United States is liable with regard to its failure to make delivery outside the United States of inventory it has sold, such liability will be considered to result from an activity exclusively carried on outside the United States and will be considered a liability which could

not arise from activity performed in the United States. In further illustration, if a corporation which exports all of its inventory from a foreign country to the United States is liable with regard to its improper delivery in the United States of inventory it has sold, such liability will be considered to result from an activity exclusively carried on in the United States and will be considered a liability which could arise from activity performed in the United States.

(d) *Lives or health of United States residents.* Risks in connection with the lives or health of residents of the United States include those risks which are the subject of insurance contracts referred to in section 801(a), relating to the definition of a life insurance company. If the insured is a resident of the United States at the time the insurance contract is approved, the risk is in connection with the life or health of a resident of the United States for the period of coverage under the contract. However, if during such period of coverage the insured notifies the insurer, or circumstances known to the insurer indicate, that the insured is no longer a resident of the United States, the risk shall cease to be a risk in connection with the life or health of a resident of the United States for the policy period in which the insured gives such notice or such circumstances are known to the insurer, and for each subsequent policy period. Conversely, if the insured is a resident of a particular foreign country at the time the insurance contract is approved, the risk is in connection with the life or health of a resident of such foreign country for the period of coverage under the contract. However, if during such period of coverage the insured notifies the insurer, or circumstances known to the insurer indicate, that the insured is no longer a resident of such foreign country, the risk shall cease to be a risk in connection with the life or health of a resident of such particular foreign country for the policy period in which the insured gives such notice or such circumstances are known to the insurer, and for each subsequent policy period. In determining the country of residence of an insured, the principles of §§ 1.871-2 to 1.871-5, inclusive, and of paragraph (a) of § 1.911-2, relating to the determination of residence and nonresidence in the United States, and of foreign residence, shall apply. Citizens of the United States are not residents of the United States merely because of their citizenship. The application of this paragraph may be illustrated by the following example:

Example. Controlled foreign corporation A is a wholly owned subsidiary of domestic corporation M. Corporation A uses the calendar year as the taxable year and is engaged in the life insurance business in foreign country X. In 1963, A Corporation issues ordinary life insurance contracts on the lives of residents of the United States, including one issued on February 1, 1963, to R, a citizen of foreign country Y and a resident of the United States on such date. All activity in connection with the issuing of such contracts is transacted by mail. On May 1, 1963, R abandons his United States residence and establishes residence in foreign country Z. There are no circumstances known to A Corporation that R has changed his residence

until R, on March 1, 1964, actually notifies A Corporation of that change. Income of A Corporation for the policy period of February 1, 1963, to January 31, 1964, from issuing such insurance contracts is income derived from the insurance of United States risks. However, income of A Corporation derived for the policy period of February 1, 1964, to January 31, 1965, from R's insurance contract is not income derived from the insurance of United States risks.

§ 1.953-3 Risks deemed to be United States risks.

(a) *Artificial arrangements.* For purposes of paragraph (a) of § 1.953-1, the term "United States risks" also includes under section 953(a)(1)(B) risks which are deemed to be United States risks. They are risks (other than United States risks described in section 953(a)(1)(A) and § 1.953-2) which a controlled foreign corporation reinsures under an insurance or annuity contract, or with respect to which a controlled foreign corporation issues any insurance or annuity contract, in accordance with any arrangement whereby another corporation which is not a controlled foreign corporation receives an amount of premiums (for reinsuring or issuing any insurance or annuity contract in connection with the United States risks described in section 953(a)(1)(A) and § 1.953-2) which is substantially equal to the amount of premiums which the controlled foreign corporation receives under its contracts. Arrangements to which this rule applies include those entered into by the controlled foreign corporation, by its United States shareholders, or by a related person.

(b) *Evidence of arrangements.* The determination of the existence of an arrangement referred to in paragraph (a) of this section shall depend on all the facts and circumstances in each case. In making this determination, it will be recognized that arrangements of this type generally are orally entered into outside the United States and that direct evidence of such an arrangement is not ordinarily available. Therefore, in determining the existence of such an arrangement, consideration will be given to whether or not there is substantial similarity between the type, location, profit margin expected, and loss experience of the risks which the corporation which is not a controlled foreign corporation insures or reinsures and the risks which the controlled foreign corporation insures or reinsures. Further, consideration will be given to the existence of prior similar arrangements between, and the identity of the directors or shareholders of, the corporation which is not a controlled foreign corporation, its shareholders, or related persons and the controlled foreign corporation, its shareholders, or related persons. However, the absence of such prior arrangements or identity of directors or shareholders will not of itself establish the nonexistence of an arrangement referred

to in paragraph (a) of this section. In determining whether the amounts received by the controlled foreign corporation and the corporation which is not a controlled foreign corporation are substantially equal, the period in which the controlled foreign corporation receives premiums need not be the same as, or identical in length with, that of the corporation which is not a controlled foreign corporation nor limited to a taxable year of the controlled foreign corporation.

(c) *Illustrations.* The application of this section may be illustrated by the following examples:

Example (1). Controlled foreign corporation A is a wholly owned subsidiary of domestic corporation M. Foreign corporation B is a wholly owned subsidiary of foreign corporation R. All corporations use the calendar year as the taxable year. Corporations M and R, which are not related persons, agree that from July 1, 1963, through December 31, 1963, B Corporation will reinsure all risks of M Corporation which are United States risks described in section 953(a)(1)(A), and that from January 1, 1964, through June 30, 1964, A Corporation will reinsure all risks of R Corporation which are not United States risks described in section 953(a)(1)(A). The amount of premiums received by A Corporation and B Corporation, respectively, as a result of the agreement are substantially equal. The income of A Corporation derived in 1964 from reinsuring the risks of R Corporation is income derived from the insurance of United States risks described in section 953(a)(1)(B).

Example (2). Assume the same facts as in example (1), except that M and R Corporations also agree, as part of their arrangement, that from July 1, 1964, through December 31, 1964, B Corporation will reinsure all risks of M Corporation which are United States risks described in section 953(a)(1)(A), and that from January 1, 1965, through June 30, 1965, A Corporation will reinsure all risks of R Corporation which are not United States risks described in section 953(a)(1)(A). The amount of premiums derived by B Corporation from July 1, 1963, through December 31, 1963, under the agreement is not substantially equal to the amount of premiums derived by A Corporation from January 1, 1964, through June 30, 1964, and the amount of premiums derived by B Corporation from July 1, 1964, through December 31, 1964, is not substantially equal to the amount of premiums derived by A Corporation from January 1, 1965, through June 30, 1965. However, the aggregate amount of premiums received by B Corporation under the arrangement is substantially equal to the aggregate amount of premiums received by A Corporation. The income of A Corporation derived in 1964 and 1965 from reinsuring the risks of R Corporation is income derived from the insurance of United States risks described in section 953(a)(1)(B).

Example (3). Assume the same facts as in example (1), except that foreign corporation C is also a wholly owned subsidiary of R Corporation. Assume that C Corporation uses the calendar year as its taxable year. Assume further that M Corporation and R Corporation agree that from July 1, 1963, through December 31, 1963, B Corporation and C Corporation together will reinsure the United States risks described in section 953(a)(1)(A) of M Corporation. The amount of

premiums received by B Corporation in respect of such United States risks is equal to one-third of the amount received by A Corporation in respect of the risks which are not United States risks described in section 953(a)(1)(A), and the amount of premiums received by C Corporation in respect of such United States risks is equal to two-thirds of the amount so received by A Corporation. The income of A Corporation derived in 1964 from reinsuring the risks of R Corporation is income derived from the insurance of United States risks described in section 953(a)(1)(B).

Example (4). Assume the same facts as in example (3), except that controlled foreign corporation D is also a wholly owned subsidiary of M Corporation and uses the calendar year as its taxable year. Assume further that M Corporation and R Corporation agree that in 1964 R Corporation will pay premiums of \$300,000 to A Corporation and \$700,000 to D Corporation to reinsure all risks of R Corporation which are not United States risks described in section 953(a)(1)(A), and that in 1963 M Corporation will pay premiums of \$400,000 to B Corporation and \$600,000 to C Corporation to reinsure all risks of M Corporation which are United States risks described in section 953(a)(1)(A). The income of A Corporation and D Corporation derived in 1964 from reinsuring the risks of R Corporation is income derived from the insurance of United States risks described in section 953(a)(1)(B).

Example (5). Controlled foreign corporation A is a wholly owned subsidiary of domestic insurance corporation M. Controlled foreign corporation B is a wholly owned subsidiary of domestic insurance corporation N. All corporations use the calendar year as the taxable year. As a result of an arrangement between M Corporation and N Corporation, in 1963 A Corporation reinsures all the United States risks described in section 953(a)(1)(A) of N Corporation, and B Corporation reinsures all the United States risks described in section 953(a)(1)(A) of M Corporation. The premiums and other consideration received by A Corporation and B Corporation in respect of such reinsurance are not substantially equal. The income of A Corporation and B Corporation in 1963 from reinsuring the risks of N Corporation and M Corporation, respectively, is income derived from the insurance of United States risks described in section 953(a)(1)(A) and is not income derived from the insurance of United States risks described in section 953(a)(1)(B).

Example (6). Assume the same facts as in example (5), except that B Corporation is not a controlled foreign corporation. The income of A Corporation in 1963 from reinsuring the risks of N Corporation is income derived from the insurance of United States risks described in section 953(a)(1)(A) and is not income derived from the insurance of United States risks described in section 953(a)(1)(B).

§ 1.953-4 Taxable income to which section 953 applies.

(a) *Taxable income defined—(1) Life insurance taxable income.* For a controlled foreign corporation which is engaged in the business of reinsuring or issuing insurance or annuity contracts and which, if it were a domestic corporation engaged only in such business, would be taxable as a life insurance company to which part I (sections 801

through 820) of subchapter L of the Code applies, the term "taxable income" means for purposes of paragraph (a) of § 1.953-1 the gain from operations, as defined in section 809(b) and as modified by this section, derived from, and attributable to, the insurance of United States risks. For purposes of determining such taxable income, the provisions of section 802(b) (relating to the definition of life insurance company taxable income) shall not apply. Determinations for purposes of this subparagraph shall be made without regard to section 501(a).

(2) *Mutual and other insurance taxable income.* For a controlled foreign corporation which is engaged in the business of reinsuring or issuing insurance or annuity contracts and which, if it were a domestic corporation engaged only in such business, would be taxable as a mutual insurance company to which part II (sections 821 through 826) of subchapter L of the Code applies or a mutual marine insurance or other insurance company to which part III (sections 831 and 832) of subchapter L of the Code applies, the term "taxable income" means for purposes of paragraph (a) of § 1.953-1 taxable income, as defined in section 832(a) and as modified by this section, derived from, and attributable to, the insurance of United States risks. Determinations for purposes of this subparagraph shall be made without regard to section 501(a).

(3) *Corporations not qualifying as insurance companies.* For special rules applicable under this section in the case of a controlled foreign corporation which, if it were a domestic corporation, would not qualify as an insurance company, see § 1.953-5.

(b) *Certain provisions inapplicable.* In determining taxable income under this section, the following provisions of subchapter L of the Code shall not apply:

- (1) Section 809(d) (4), relating to the operations loss deduction;
- (2) Section 809(d) (5), relating to certain nonparticipating contracts;
- (3) Section 809(d) (6), relating to certain accident and health insurance and group life insurance;
- (4) Section 809(d) (10), relating to small business deduction;
- (5) Section 817(b), relating to gain on property held on December 31, 1958, and certain substituted property acquired after 1958; and
- (6) Section 832(c) (5), relating to capital losses.

(c) *Computation of reserves required by law.*—(1) *Law applicable in determining reserves.* The reserves which will be taken into account as reserves required by law under section 801(b) (2), both in determining for any taxable year whether a controlled foreign corporation is a controlled foreign corporation described in paragraph (a) (1) or para-

graph (2) of this section and in determining taxable income of such corporation for the taxable year under paragraph (a) of this section, shall be the following reserves:

(i) *Reserves required by the law of a State.* The reserves which are required by the law of the State or States to which the insurance business of the controlled foreign corporation is subject, but only with respect to its United States business, if any, which is taxable under section 819(a).

(ii) *Reserves deemed to be required.* To the extent of such controlled foreign corporation's insurance business not taxable under section 819(a)—

(a) Except as provided in subdivision (b) of this subdivision (ii), the reserves which would result if such reserves were determined by applying the minimum standards of the law of New York as if such controlled foreign corporation were an insurance company transacting all of its insurance business (other than its United States business which is taxable under section 819(a)) for such taxable year in such State, and

(b) With respect to all risks covered by insurance ceded to such controlled foreign corporation by an insurance company to which apply the provisions of subchapter L of the Code (determined without regard to section 501(a)) and in respect of which an election is made by or on behalf of such controlled foreign corporation to determine its reserves in accordance with this subdivision (b), the amount of reserves against such risks which would result if all of such reserves were determined by applying the law of the State, to which the risks in the hands of such insurance company are subject, as if such controlled foreign corporation were an insurance company engaged in reinsuring such risks in such State.

(2) *Rules of application.* For purposes of subparagraph (1) of this paragraph, the following rules shall apply:

(i) *Life insurance reserves computed on preliminary term basis.* For purposes of determining under paragraph (a) of this section the taxable income of a controlled foreign corporation, an election may be made by or on behalf of such corporation that the amount of reserves which are taken into account as life insurance reserves with respect to contracts for which reserves are computed on a preliminary term basis shall be determined as provided in section 818(c). This election shall apply, subject to section 818(c), to all life insurance reserves of the controlled foreign corporation, whether or not reserves applicable to the United States business taxable under section 819(a). However, reserves determined as provided in section 818(c) shall not be taken into account in determining whether a controlled foreign corporation is a controlled foreign corporation described in paragraph (a) (1) or paragraph (2) of this section.

(ii) *Actual reserves required.* (a) A controlled foreign corporation will be considered to have a reserve only to the extent the reserve has been actually held during the taxable year for which such reserve is claimed.

(b) For determining when reserves are required by the law of a State, see paragraph (b) of § 1.801-5 of this chapter.

(iii) *Total reserves to be taken into account.* The total reserves of a controlled foreign corporation shall be taken into account in determining whether such corporation is a controlled foreign corporation described in paragraph (a) (1) or paragraph (2) of this section. Therefore, in making such determination, the reserves which, under subparagraph (1) (i) of this paragraph, are required by the law of any State shall be taken into account together with the reserves which, under subparagraph (1) (ii) of this paragraph, are deemed to be required. Moreover, reserves applicable to the reinsuring or the issuing of insurance or annuity contracts of both United States risks and foreign risks shall be taken into account. Finally, except as provided in subdivision (i) of this subparagraph, the reserves which are taken into account in determining whether a controlled foreign corporation is a controlled foreign corporation described in paragraph (a) (1) or paragraph (2) of this section shall be the same reserves which are taken into account in determining under paragraph (a) of this section the taxable income of such corporation.

(iv) *Method of comparing reserves when subject to more than one State.* If the insurance business of a controlled foreign corporation is subject to the law of more than one State, the amount of reserves taken into account under subparagraph (1) (i) of this paragraph shall be the amount of the highest aggregate reserve required by any State, determined as provided in paragraph (a) of § 1.801-5 of this chapter.

(d) *Domestic corporation tax attributes.* In determining taxable income of a controlled foreign corporation under this section there shall be allowed, except as provided in section 953(b), this section, and § 1.953-5, the exclusions and deductions from gross income which would be allowed if such corporation were a domestic insurance company engaged in the business of only reinsuring or issuing the insurance or annuity contracts which have been reinsured or issued by such corporation. For this purpose, the provisions of sections 819, 821(e), 822(e), 831(b), and 832(d), relating to foreign insurance companies, shall not apply; however, for the exclusion from the taxable income determined under section 953 of amounts derived from sources within the United States, see section 952 (b) and paragraph (b) of § 1.952-1. Furthermore, taxable income shall be determined under this section without regard to section 882(b) and (c), re-

lating to gross income and deductions of a foreign corporation, and without regard to whether the controlled foreign corporation is carrying on an insurance business in the United States. For other rules relating to the determination of gross income and taxable income of a foreign corporation for purposes of subpart F, see § 1.952-2.

(e) *Limitation on certain amounts in respect of United States risks.* In determining taxable income under this section the following amounts shall not, in accordance with section 953(b)(4), be taken into account except to the extent they are attributable to the reinsuring or issuing of any insurance or annuity contract in connection with United States risks described in § 1.953-2 or § 1.953-3:

- (1) The amount of premiums determined under section 809(c)(1);
- (2) The net decrease in reserves determined under section 809(c)(2);
- (3) The net increase in reserves determined under section 809(d)(2); and
- (4) The premiums earned on insurance contracts during the taxable year, as determined under section 832(b)(4).

For the allocation and apportionment of such amounts to income from the insurance of United States risks, see paragraphs (f) and (g) of this section.

(f) *Items allocated or apportioned—*

(1) *Rules of allocation or apportionment.* In determining taxable income under this section, first determine all items of income, expenses, losses, and other deductions which directly relate to the premiums received for the reinsuring or the issuing of any insurance or annuity contract in connection with United States risks, as defined in §§ 1.953-2 and 1.953-3, and allocate such items to the insurance of United States risks. For example, the deductions allowed by section 809(d)(1), relating to death benefits, section 809(d)(3), relating to dividends to policyholders, and section 809(d)(7), relating to the assumption by another person of liabilities under insurance contracts, shall be allocated to the insurance of United States risks to the extent they relate directly to the premiums received for reinsuring or issuing insurance or annuity contracts in connection with United States risks. Next, determine all items of income, expenses, losses, and other deductions which directly relate to the premiums received for the reinsuring or the issuing of any insurance or annuity contract in connection with foreign risks and allocate such items to the reinsuring of foreign risks. Finally, determine all items of income, expenses, losses, and other deductions which relate to the premiums received for the reinsuring or the issuing of any insurance or annuity contract in connection with both United States risks and foreign risks, and, except as provided in paragraph (g) of this section, apportion such items between the insurance of United States risks and the insurance

of foreign risks in the manner prescribed in subparagraph (2) or (3) of this paragraph, as the case may be. As used in this section, the term "foreign risks" means risks which are not United States risks as defined in § 1.953-2 or § 1.953-3.

(2) *Method of apportionment in determination of life insurance taxable income—*(i) *Investment yield and net long-term capital gain.* Unless they can be allocated to the insurance of United States risks, as provided in subparagraph (1) of this paragraph, in determining a controlled foreign corporation's taxable income for any taxable year under paragraph (a)(1) of this section—

(a) The investment yield under section 804(c),

(b) The amount (if any) under section 809(b)(1)(B) by which the net long-term capital gain exceeds the net short-term capital loss, and

(c) Those deductions allowed under section 809(d)(8), (9), and (12) which relate to gross investment income

shall be apportioned to the reinsuring and issuing of insurance and annuity contracts in connection with United States risks in an amount which bears the same ratio to each of such amounts of investment yield, excess gain, and deductions as the sum of the mean of each of the items described in section 810(c) at the beginning and end of the taxable year attributable to reinsuring and issuing any insurance and annuity contracts in connection with United States risks bears to the sum of the mean of each of the items described in section 810(c) at the beginning and end of the taxable year attributable to reinsuring and issuing all insurance and annuity contracts. Thus, for example, if the ratio which the sum of the mean of each of the items described in section 810(c) at the beginning and end of the taxable year attributable to reinsuring and issuing insurance and annuity contracts in connection with United States risks bears to the sum of the mean of each of the items described in section 810(c) at the beginning and end of the taxable year attributable to reinsuring and issuing all insurance and annuity contracts in one to three, then, unless an allocation to the insurance of United States risks can be made as provided in subparagraph (1) of this paragraph, one-third of each of such amounts of investment yield, excess gain, and deductions shall be apportioned to the reinsuring and issuing of insurance and annuity contracts in connection with United States risks, and two-thirds of each of such amounts shall be apportioned to the reinsuring and issuing of insurance and annuity contracts in connection with foreign risks.

(ii) *Other income and deductions—*

(a) *Amount taken into account.* In determining a controlled foreign corporation's taxable income for any taxable year under paragraph (a)(1) of this section, all items of income taken into ac-

count under section 809(c)(3), relating to other amounts of gross income, and the other deductions allowed under section 809(d)(12) to the extent that such other deductions do not relate to gross investment income shall be apportioned to the reinsuring and issuing of insurance and annuity contracts in connection with United States risks in an amount which bears the same ratio to each of such items of income or of such other deductions as the numerator determined under (b) of this subdivision bears to the denominator determined under (c) of this subdivision.

(b) *Numerator.* The numerator used for purposes of the apportionment under (a) of this subdivision shall be an amount which equals the amount determined under (c) of this subdivision, but only to the extent that the amount so determined is taken into account under paragraph (e) of this section in determining taxable income for the taxable year.

(c) *Denominator.* The denominator used for purposes of the apportionment under (a) of this subdivision shall be an amount which equals—

(1) The amount of premiums determined under section 809(c)(1) for the taxable year, plus

(2) The net decrease in reserves determined under section 809(c)(2) for such year, minus

(3) The net increase in reserves determined under section 809(d)(2) for such year.

(iii) *Reserves used in apportionment formula.* The rules for determining which reserves are taken into account in determining the taxable income of a controlled foreign corporation under paragraph (a) of this section shall also apply under subdivision (ii) (b) and (c) of this subparagraph in determining the net decrease in reserves under section 809(c)(2) or the net increase in reserves under section 809(d)(2). See paragraph (c) of this section.

(3) *Method of apportionment in determination of mutual and other insurance income—*(i) *In general.* In determining a controlled foreign corporation's taxable income for any taxable year under paragraph (a)(2) of this section, any item which is required to be apportioned under subparagraph

(1) of this paragraph shall be apportioned to the reinsuring and issuing of insurance and annuity contracts in connection with United States risks in an amount which bears the same ratio to the total amount of such item as the amount of premiums earned on insurance contracts during the taxable year which is required to be taken into account by such corporation under paragraph (e)(4) of this section in determining such taxable income bears to the total amount of all its premiums earned (as determined under section 832(b)(4)) on insurance contracts during the taxable year.

(ii) *Reserves used in apportionment formula.* The principles of subparagraph (2)(iii) of this paragraph shall apply in determining the reserves included in premiums earned on insurance contracts during the taxable year for purposes of subdivision (i) of this subparagraph.

(g) *Separate accounting.* The methods of apportionment prescribed in subparagraphs (2) and (3) of paragraph (f) of this section for determining taxable income under this section shall not apply if the district director determines that the controlled foreign corporation, in good faith and unaffected by considerations of tax liability, regularly employs in its books of account a detailed segregation of receipts, expenditures, assets, liabilities, and net worth which clearly reflects the income derived from the reinsuring or issuing of insurance or annuity contracts in connection with United States risks. The district director, in making such determination, shall give effect to any foreign law, satisfactory evidence of which is presented by the United States shareholder to the district director, which requires a reasonable segregation of those items of income, expense, losses, and other deductions which relate to determining such taxable income.

(h) *Illustration.* The application of paragraphs (e) and (f) of this section

may be illustrated by the following example:

Example. Controlled foreign corporation A, incorporated under, and engaged in an insurance business subject to, the laws of foreign country X, is a wholly owned subsidiary of domestic corporation M. Both corporations use the calendar year as the taxable year. Corporation M is a life insurance company as defined in section 801(a); A Corporation would, if it were a domestic corporation, be taxable under part I of subdivision L of the Code. In 1963, A Corporation derives income from the insurance of United States risks as a result of reinsuring the life insurance policies issued by M Corporation on lives of residents of the United States. In 1963, A Corporation also issues policies of life insurance on individuals who are not residents of the United States, but its premiums from the reinsuring of United States risks exceed the 8-percent minimum premium requirement prescribed in paragraph (b) of § 1.953-1. Based upon the facts set forth in paragraph (a) of this example, A Corporation for 1963 has taxable income under this section of \$40,000, which is attributable to the reinsuring of life insurance contracts in connection with United States risks, determined in the manner provided in paragraphs (b), (c), and (d) of this example.

(a) A summary of the entire operations of A Corporation for 1963, determined under this section as though such corporation were a domestic life insurance company but without applying paragraph (f) of this section, is as follows:

Item	Attributable to all insurance	Attributable to reinsuring U.S. risks	Attributable to insuring foreign risks
Investment Income:			
(1) Investment yield under sec. 804(c)	\$90,000	Unallocable	Unallocable
(2) Sum of the mean of each of the items described in sec. 810(c) at beginning and end of 1963, attributable to reinsuring U.S. risks (paragraph (a)(2))	2,600,000	\$1,000,000	\$1,500,000
(3) Required interest under sec. 809(a)(2)	60,000	25,000	35,000
(4) Deductions allowed under sec. 809(d) (8), (9), and (12) which relate to gross investment income			
Underwriting Income:			
(5) Premiums under sec. 809(c)(1)	10,000	Unallocable	Unallocable
(6) Net decrease in reserves under sec. 809(c)(2)	600,000	200,000	400,000
(7) Net increase in reserves under sec. 809(d)(2)	10,000	None	10,000
(8) Deductions allowed under sec. 809(d) (8) other than those deductions allowed under sec. 809(d) (8), (9), and (12) which relate to gross investment income:	40,000	40,000	None
(i) allocable	330,000	110,000	220,000
(ii) unallocable	60,000	Unallocable	Unallocable

(b) The unallocable investment yield (\$90,000) under paragraph (a)(1) of this example and the unallocable deductions (\$10,000) under paragraph (a)(4) relating to gross investment income are apportioned to the reinsuring of United States risks under paragraph (f)(1)(i) of this section in the amounts of \$36,000, and \$4,000, respectively, determined as follows:

- (1) Sum of the mean of each of the items described in sec. 810(c) at beginning and end of 1963, attributable to reinsuring U.S. risks (paragraph (a)(2)) ----- \$1,000,000
- (2) Sum of the mean of each of the items described in sec. 810(c) at beginning and end of 1963, attributable to all insurance (paragraph (a)(2)) ----- \$2,500,000
- (3) Ratio of amount under subparagraph (1) to amount under subparagraph (2) (\$1,000,000/\$2,500,000) ----- 40%
- (4) Amount of investment yield attributable to reinsuring of U.S. risks (40% of \$90,000) ----- \$36,000
- (5) Amount of such deductions attributable to reinsuring of U.S. risks (40% of \$10,000) ----- \$4,000
- (c) The unallocable deductions (\$60,000) under paragraph (a)(8)(ii) of this example which do not relate to gross investment income are apportioned to the reinsuring of United States risks under paragraph (f)(2)(ii) of this section in the amount of \$16,800, determined as follows:
- (1) The numerator determined under paragraph (f)(2)(ii)(b) of this section is \$160,000, determined as follows:
- (i) Premiums under sec. 809(c)(1) attributable to reinsuring U.S. risks (paragraph (a)(5)) ----- \$200,000
- (ii) Plus: Net decrease in reserves under sec. 809(c)(2) attributable to reinsuring U.S. risks (paragraph (a)(6)) ----- none
- (2) \$200,000

Item:	Attributable to all insurance	Attributable to reinsuring U.S. risks	Attributable to insuring foreign risks
(1) Investment yield under sec. 804(c) (paragraph (a)(3)), unallocable but as apportioned under paragraph (b)(4)	\$90,000	\$36,000	\$54,000
(2) Less: Required interest under sec. 809(a)(2) (paragraph (a)(3))	60,000	25,000	35,000
(3) Life insurance company's share of investment yield under sec. 809(b)(1)(A)	\$30,000	\$11,000	\$19,000
Plus sum of:			
(4) Premiums under sec. 809(c)(1) (paragraph (a)(5))	600,000	200,000	400,000
(5) Net decrease in reserves under sec. 809(c)(2) (paragraph (a)(6))	10,000	None	10,000
Sum determined under sec. 809(b)(1)	640,000	211,000	429,000
Less sum of:			
(6) Net increase in reserves under sec. 809(d)(2) (paragraph (a)(7))	40,000	40,000	None
(7) Deductions allowed under sec. 809(d) (8), (9), and (12) which relate to gross investment income (paragraph (a)(4)), unallocable but as apportioned under paragraph (b)(5)	10,000	4,000	6,000

- (iii) Less: Net increase in reserves under sec. 809(d)(2) attributable to reinsuring U.S. risks (paragraph (a)(7)) ----- \$40,000
- (2) The denominator determined under paragraph (f)(2)(ii)(c) of this section is \$570,000, determined as follows:

- (1) Premiums under sec. 809(c)(1) attributable to all insurance (paragraph (a)(5)) ----- \$600,000
- (ii) Plus: Net decrease in reserves under sec. 809(c)(2) attributable to all insurance (paragraph (a)(6)) ----- 10,000
- (iii) Less: Net increase in reserves under sec. 809(d)(2) attributable to all insurance (paragraph (a)(7)) ----- 40,000

- (3) Ratio which the numerator determined under subparagraph (1) bears to the denominator determined under subparagraph (2) (\$160,000/\$570,000) ----- 28%

- (4) Amount of deductions attributable to reinsuring of U.S. risks (28% of \$60,000) ----- \$16,800

- (d) The taxable income of A Corporation for 1963 which constitutes its income derived from the insurance of United States risks for purposes of paragraph (a) of § 1.953-1 is \$40,200, determined as follows:

(g) Deductions allowed under sec. 809(d) (other than deduction allowed under sec. 809(d)(2) and other than those deductions allowed under sec. 809(d) (8), (9), and (12) which relate to gross investment income) (paragraph (a)(8)):

(i) allocable
(ii) unallocable, but as apportioned under paragraph (c)(4)

Gain from operations

	Attributable to all insurance	Attributable to re-insuring U.S. risks	Attributable to insuring foreign risks
	\$330,000	\$110,000	\$220,000
	60,000	\$440,000	16,800
			\$170,800
			43,200
			\$260,200
		200,000	40,200
			169,800

§ 1.953-5 Corporations not qualifying as insurance companies.

(a) *In general.* A controlled foreign corporation is not excluded from the application of paragraph (a) of § 1.953-1 because such corporation, if it were a domestic corporation, would not be taxable as an insurance company to which subchapter L of the Code applies. Thus, if a controlled foreign corporation reinsures or issues insurance or annuity contracts in connection with United States risks, as defined in § 1.953-2 or § 1.953-3, and satisfies the 5-percent minimum premium requirement prescribed in paragraph (b) of § 1.953-1, such corporation may derive income from the insurance of United States risks even though the primary and predominant business activity of such corporation during the taxable year is not the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies.

(b) *Income from insurance of United States risks by noninsurance company.* For purposes of paragraph (a) of § 1.953-1, the taxable income derived from the reinsuring or the issuing of any insurance or annuity contract in connection with United States risks by a controlled foreign corporation which, if it were a domestic corporation, would not be taxable as an insurance company to which subchapter L of the Code applies shall be determined under § 1.953-4, subject to, and to the extent not inconsistent with, the special rules prescribed in paragraph (c) or (d) of this section, whichever applies.

(c) *Special rules in determining taxable income—(1) In general.* The rules prescribed in this paragraph apply in order to exclude from the determination under § 1.953-4 of the taxable income described in paragraph (b) of this section those items of the controlled foreign corporation's gross income and deductions which are not attributable to the reinsuring and issuing of insurance and annuity contracts.

(2) *Life insurance taxable income—(i) Amount of investment yield taken into account.* For purposes of determining the taxable income of a controlled foreign corporation which would not be taxable as an insurance company to which subchapter L of the Code applies if it were a domestic corporation but would be taxable as an insurance company to which part I of such subchapter applies if it were a domestic insurance company engaged in the business of only reinsuring or issuing the insurance or annuity contracts which have been reinsured or issued by such corporation, the investment yield under section 804(c), the amount (if any) by which the net

long-term capital gain exceeds the net short-term capital loss, and all items of income taken into account under section 809(c)(3) shall be taken into account, subject to the provisions of paragraphs (e) and (f) of § 1.953-4, in an amount which bears the same ratio to each of such amounts of investment yield, excess gain, and income items, as the case may be, as the numerator determined under subdivision (ii) of this subparagraph bears to the denominator determined under subdivision (iii) of this subparagraph.

(ii) *Numerator.* The numerator used for purposes of the apportionment under subdivision (i) of this subparagraph shall be the sum of—

(a) The mean of each of the items described in section 810(c) at the beginning and end of the taxable year, determined in accordance with the rules prescribed in paragraph (c) of § 1.953-4 for purposes of determining taxable income of a controlled foreign corporation under paragraph (a) of § 1.953-4,

(b) The mean of other liabilities at the beginning and end of the taxable year which are attributable to the reinsuring and issuing of insurance and annuity contracts, and

(c) The mean of the earnings and profits accumulated by the controlled foreign corporation at the beginning and end of the taxable year (determined without diminution by reason of any distributions made during the taxable year) which are attributable to the reinsuring and issuing of insurance and annuity contracts.

(iii) *Denominator.* The denominator used for purposes of the apportionment under subdivision (i) of this subparagraph shall be the mean of the value of the total assets held by the controlled foreign corporation at the beginning and end of the taxable year, determined by taking assets into account at their actual value (not reduced by liabilities), which, in the absence of affirmative evidence to the contrary, shall be deemed to be (a) face value in the case of bills receivable, accounts receivable, notes receivable, and open accounts held by a controlled foreign corporation using the cash receipts and disbursements method of accounting and (b) adjusted basis in the case of all other assets.

(3) *Mutual and other insurance taxable income—(i) Amount of insurance income taken into account.* For purposes of determining the taxable income of a controlled foreign corporation which, if it were a domestic corporation, would not be taxable as an insurance company to which subchapter L of the Code applies but which if it were a domestic insurance company engaged in the business of only reinsuring or issuing

the insurance or annuity contracts which have been reinsured or issued by such corporation, would be taxable as a mutual insurance company to which part II of subchapter L of the Code applies, or would be taxable as a mutual marine insurance or other insurance company to which part III of subchapter L of the Code applies, the sum of the items of gross income referred to in section 832(b)

(1) (except the gross amount earned during the taxable year from underwriting income described in section 832(b)(1)(A)) reduced by the deductions allowable under section 832(c) which are related to such items of gross income shall be taken into account, subject to the provisions of paragraphs (e) and (f) of § 1.953-4, in an amount which bears the same proportion to the sum of such items of gross income reduced by such deductions as the numerator determined under subdivision (ii) of this subparagraph bears to the denominator determined under subdivision (iii) of this subparagraph.

(ii) *Numerator.* The numerator used for purposes of the apportionment under subdivision (i) of this subparagraph shall be the sum of—

(a) The mean of the controlled foreign corporation's unearned premiums at the beginning and end of the taxable year, determined under section 832(b)(4)(B) and in accordance with the rules prescribed in paragraph (c) of § 1.953-4 for purposes of determining taxable income of a controlled foreign corporation under paragraph (a) of § 1.953-4,

(b) The mean of such corporation's unpaid losses at the beginning and end of the taxable year, determined under section 832(b)(5)(B),

(c) The mean of the items described in section 810(c)(4) at the beginning and end of the taxable year, to the extent allowable to such corporation under section 832(c)(11),

(d) The mean of other liabilities at the beginning and end of the taxable year which are attributable to the reinsuring and issuing of insurance and annuity contracts, and

(e) The mean of the earnings and profits accumulated by such corporation at the beginning and end of the taxable year (determined without diminution by reason of any distributions made during the taxable year) which are attributable to the reinsuring and issuing of insurance and annuity contracts.

(iii) *Denominator.* The denominator used for purposes of the apportionment under subdivision (i) of this subparagraph shall be the mean of the value of the total assets held by the controlled foreign corporation at the beginning and end of the taxable year, determined in the manner prescribed in subparagraph (2)(iii) of this paragraph.

(d) *Separate accounting.* The special rules prescribed in paragraph (c) of this section shall not apply if the district director determines that the controlled foreign corporation, in good faith and unaffected by considerations of tax liability, regularly employs in its books of account a detailed segregation of receipts, expenditures, assets, liabilities, and net worth which clearly reflects the income

derived from the reinsuring or issuing of insurance or annuity contracts. The district director, in making such determination, shall give effect to any foreign law, satisfactory evidence of which is presented by the United States shareholder to the district director, which requires a reasonable segregation of the insurance assets of the controlled foreign corporation.

§ 1.953-6 Relationship of sections 953 and 954.

(a) *Priority of application.* For purposes of determining the subpart F income of a controlled foreign corporation under section 952 for any taxable year, the provisions of section 954, relating to foreign base company income, shall be applied, after first applying section 953, only with respect to income which is not income derived from the insurance of United States risks under section 953. For example, the provisions of section 954 may be applied with respect to the income of a controlled foreign corporation which is not income derived from the insurance of United States risks under section 953 because such corporation does not satisfy the 5-percent minimum premium requirement prescribed in paragraph (b) of § 1.953-1, even though such corporation has taxable income, as determined under § 1.953-4, which is attributable to the reinsuring or the issuing of any insurance or annuity contracts in connection with United States risks. In addition, the provisions of section 954 may apply with respect to the income of a controlled foreign corporation to the extent such income is not allocated or apportioned under § 1.953-4 to the insurance of United States risks.

(b) *Decrease in income not material.* It is not material that the income of a controlled foreign corporation is decreased as a result of the application of paragraph (a) of this section. Thus, in applying § 1.953-4 to the income of a controlled foreign corporation described in paragraph (c) (2) of § 1.953-5 which would, but for paragraph (a) of this section, be subject to the provisions of section 954, there shall be allowed, in determining the taxable income derived from the insurance of United States risks under § 1.953-4, a deduction under section 809(a) (1) for the share of each and every item of investment yield set aside for policyholders; it is not material that in determining foreign base company income such deduction would not be allowed under section 954(b) (5). Further, income of a controlled foreign corporation which is required to be taken into account under section 953 in determining income derived from the insurance of United States risks and would, but for the provisions of paragraph (a) of this section, constitute foreign base company income under section 954 shall not be taken into account under section 954(b) (3) (B) in determining whether foreign base company income exceeds 70 percent of gross income for the taxable year.

(c) *Increase in income not material.* It is not material that the income of a controlled foreign corporation is increased as a result of the application of

paragraph (a) of this section. Thus, in applying § 1.953-4 to income of a controlled foreign corporation which would, but for paragraph (a) of this section, be subject to the provisions of section 954, it is not material that the dividends, interest, and gains from the sale or exchange of stock or securities derived from certain investments which would not be included in foreign personal holding company income under section 954 (c) (3) (B) are included under section 953 in income derived from the insurance of United States risks. Further, income of a controlled foreign corporation which is required to be taken into account under section 953 in determining income derived from the insurance of United States risks and would, but for paragraph (a) of this section, constitute foreign base company income shall not be excluded under section 954(b) (3) (A) for the taxable year.

§ 1.954-2 Foreign personal holding company income.

(d) *Certain income received from unrelated persons in the active conduct of a trade or business.* * * *

(3) *Dividends, interest, and gains on securities, derived from investments by insurance companies and received from unrelated persons—*

(i) *In general.* Foreign personal holding company income of a controlled foreign corporation which is an insurance company does not include dividends or interest derived from, or the excess of gains over losses from sales or exchanges of stock or securities held as, investments if its unearned premiums or of its reserves which are ordinary and necessary for the proper conduct of its insurance business, if such dividends or interest is received from, or if such sales or exchanges are made to or with, unrelated persons, as defined in paragraph (e) (2) of § 1.954-1. See section 954(c) (3) (B). Although the name, charter powers, and subjection to the insurance laws of a foreign country are significant in determining the business which a controlled foreign corporation is authorized and intends to carry on, the character of the business actually done in the taxable year shall determine whether it is an insurance company for purposes of section 954(c) (3) (B). The term "unearned premium," as used in this subparagraph, means the amount which will cover the cost of carrying the insurance risk for the period for which the premium has been paid in advance.

(ii) *Reserves which are ordinary and necessary.* In determining, for purposes of this subparagraph, whether a reserve is ordinary and necessary for the proper conduct of an insurance business, an insurance company will be permitted to make use of the highest reserve which it is required to maintain with respect to such business by a foreign country or State or possession of the United States, in which it carries on insurance business. If no jurisdiction in which an insurance company carries on its insurance business requires a reserve to be maintained, the district director may require the United States shareholder of such insurance company to submit such detailed

information with respect to such company's actual experience as is deemed necessary to establish that the reserve is ordinary and necessary for the proper conduct of its insurance business; however, for this purpose, reserves which are determined on the basis of recognized mortality or morbidity tables and assumed rates of interest will generally be accepted by the district director as being ordinary and necessary. For purposes of this subparagraph, a reserve must actually be held by the insurance company for the taxable year (or for such part of such year as may be applicable) for which the reserve is claimed in order to be considered ordinary and necessary for the proper conduct of the insurance business. Notwithstanding the foregoing provisions of this subdivision, a reserve will be considered ordinary and necessary for the proper conduct of the insurance business for purposes of this subparagraph if, assuming the controlled foreign corporation were for the taxable year an insurance company to which section 953 applies for such year, such reserve would be taken into account in determining the taxable income of such corporation for such year under paragraph (a) of § 1.953-4.

(Sec. 7805, Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805))

[F.R. Doc. 64-13092; Filed, Dec. 22, 1964; 8:45 a.m.]

Title 7—AGRICULTURE

Chapter XIV—Commodity Credit Corporation, Department of Agriculture

SUBCHAPTER B—LOANS, PURCHASES, AND OTHER OPERATIONS

[Amdt. 4]

PART 1421—GRAINS AND RELATED COMMODITIES

Subpart—Provisions for Participation of Commercial Banks in Pools of CCC Price Support Loans on Certain Commodities

INCREASE IN RATE OF INTEREST

The regulations issued by the Commodity Credit Corporation published in 29 F.R. 3614, as amended, containing the terms and conditions for participation in pools of CCC price support loans on certain commodities, are hereby further amended to increase from 3.875 to 4.1 percent per annum, effective December 27, 1964, the rate of interest on certificates evidencing participation in financing price support loans.

I. Section 1421.3825(a) is amended to read as follows:

§ 1421.3825 Rate of interest and basis of computation of interest earned.

(a) *Rate of interest.* Certificates shall earn interest at the rate of 3.70 percent per annum through and including November 14, 1964, 3.875 percent per annum from November 15, 1964, through and including December 26, 1964, and 4.1 percent per annum thereafter.