List of Subjects in 14 CFR Part 39

Air transportation, Aircraft, Aviation safety, Incorporation by reference, Safety.

Adoption of the Amendment

Accordingly, pursuant to the authority delegated to me by the Administrator, the Federal Aviation Administration amends 14 CFR part 39 of the Federal Aviation Regulations as follows:

PART 39—AIRWORTHINESS DIRECTIVES

1. The authority citation for part 39 continues to read as follows:

Authority: 49 U.S.C. App. 1354(a), 1421 and 1423; 49 U.S.C. 106(g); and 14 CFR 11.89.

§ 39.13 [Amended]

2. Section 39.13 is amended by adding the following new airworthiness directive:

92-18-10 British Aerospace: Amendment 39-8354. Docket 92-NM-34-AD.

Applicability: Model ATP series airplanes; serial numbers 2001 through 2045, inclusive; which have been modified in accordance with Pratt and Whitney Service Bulletin PW100-72-21097, dated November 8, 1991; certificated in any category.

Compliance: Required as indicated, unless accomplished previously.

To prevent severe structural damage to the airplane due to an internal engine fire within the intercompressor case, accomplish the following:

(a) Within 90 days after modification in accordance with Pratt and Whitney Service Bulletin PW100-72-21097, dated November 8, 1991, or within 90 days after the effective date of this AD, whichever occurs later:

(1) Install an intercompressor case (ICC) fire detector system, in accordance with British Aerospace Service Bulletin ATP-26-5-35225A, dated October 30, 1991.

(2) Revise Section 0.25.0 of the FAA-approved Airplane Flight Manual (AFM) to include the following statement. This may be accomplished by inserting a copy of this AD in the AFM.

Modification No.	Description
35225A	Introduction of ICC Fire Detector at the Intercompressor Case.

(3) Revise the FAA-approved AFM to include operating information pertaining to the ICC fire detection systems. This may be accomplished by inserting a copy of Temporary Revision No. T/24, Issue 1, dated February 17, 1992, into the AFM.

(b) An alternative method of compliance or adjustment of the compliance time that provides an acceptable level of safety may be used if approved by the Manager, Standardization Branch, ANM-113, FAA, Transport Airplane Directorate. Operators shall submit their requests through an appropriate FAA Principal Maintenance Inspector, who may add comments and then send it to the Manager, Standardization Branch, ANM-113.

Note: Information concerning the existence of approved alternative methods of compliance with this AD, if any, may be obtained from the Standardization Branch.

(c) Special flight permits may be issued in accordance with FAR 21.197 and 21.199 to operate the airplane to a location where the requirements of this AD can be accomplished.

(d) The installation and revision of the AFM shall be done in accordance with Temporary Revision No. T/24, Issue 1, dated February 17, 1992; and British Aerospace Service Bulletin ATP-26-5-35225A, dated October 30, 1991, which contains the following list of effective pages:

Page No.	Revision level	Date
1-7, 9, 11, 13, 15, 17, 19, 21, 23, 25, 27, 29, 31, 33, 35, 37, 39, 41, 43.	Original	Oct. 30, 1991.
8, 10, 12, 14, 16, 18, 20, 22, 24, 26, 28, 30, 32, 34, 36, 38, 40, 42.	(These pages are not used).	

This incorporation by reference was approved by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR Part 51. Copies may be obtained from British Aerospace, PLC, Librarian for Service Bulletins, P.O. Box 17414, Dulles International Airport, Washington, DC 20041-0414. Copies may be inspected at the FAA, Transport Airplane Directorate, 1601 Lind Avenue, SW., Renton, Washington; or at the Office of the Federal Register, 800 North Capitol Street, NW., suite 700, Washington, DC.

(e) This amendment becomes effective on October 13, 1992.

Issued in Renton, Washington, on August 12, 1992.

Bill R. Boxwell,

Acting Manager, Transport Airplane Directorate, Aircraft Certification Service.

[FR Doc. 92-21476 Filed 9-4-92; 8:45 am]

BILLING CODE 4910-13-M

14 CFR Part 39

[Docket No. 92-NM-152-AD; Amendment 39-8355; AD 92-16-51]

Airworthiness Directives; Empresa Brasileira de Aeronautica S.A. (EMBRAER) Model EMB-120 Series Airplanes

AGENCY: Federal Aviation Administration, DOT.

ACTION: Final rule; request for comments.

SUMMARY: This document publishes in the **Federal Register** an amendment adopting Airworthiness Directive (AD) T92-16-51 that was sent previously to all known U.S. owners and operators of EMBRAER Model EMB-120 series airplanes by individual telegrams. This AD requires repetitive visual checks or inspections to verify that the flight idle stop system circuit breakers are closed, and functional tests to determine if the backup flight idle stop system is operative. This amendment is prompted by a report of an overspeed condition that occurred on both engines of one airplane during flight; the fact that both of the circuit breakers in the backup flight idle stop system circuit were open may have contributed to this condition. The actions specified by this AD are intended to prevent an inoperative backup flight idle stop system and potential engine failure.

DATES: Effective September 23, 1992, to all persons except those persons to whom it was made immediately effective by telegraphic AD T92-16-51, issued July 29, 1992, which contained the requirements of this amendment.

The incorporation by reference of certain publications listed in the regulations is approved by the Director of the Federal Register as of September 23, 1992.

Comments for inclusion in the Rules Docket must be received on or before November 9, 1992.

ADDRESSES: Submit comments in triplicate to the Federal Aviation Administration (FAA), Transport Airplane Directorate, ANM-103, Attention: Rules Docket No. 92-NM-152-AD, 1601 Lind Avenue, SW., Renton, Washington 98055-4056.

The applicable service information may be obtained from EMBRAER Aircraft Corporation, 276 SW. 34th Street, Fort Lauderdale, Florida 33315. This information may be examined at the FAA, Transport Airplane Directorate, 1601 Lind Avenue, SW., Renton, Washington; or at the Atlanta Aircraft Certification Office, FAA, Small Airplane Directorate, 1669 Phoenix Parkway, Suite 210C, Atlanta, Georgia; or at the Office of the Federal Register, 800 North Capitol Street, NW., suite 700, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Mr. Gil Carter, Aerospace Engineer, Propulsion Branch, ACE-140A, Atlanta Aircraft Certification Office, FAA, Small Airplane Directorate, 1669 Phoenix Parkway, suite 210C, Atlanta, Georgia 30349; telephone (404) 991-3810; fax (404) 991-3606.

SUPPLEMENTARY INFORMATION: On July 29, 1992, the FAA issued telegraphic AD T92-16-51, applicable to EMBRAER Model EMB-120 series airplanes, which requires repetitive visual checks, inspections, and functional checks to verify that the backup flight idle stop system is operating properly.

That action was prompted by a recent report indicating that, during a landing approach, an operator of an EMBRAER Model EMB-120 series airplane experienced an overspeed condition on both engines, apparently due to movement of the power levers below flight idle. The overspeed of the left engine reached 150% and the engine failed; the overspeed of the right engine rose to 120%. The incident occurred approximately six miles out, while the airplane was encountering severe air turbulence. Investigation revealed that both of the circuit breakers in the backup flight idle stop system circuit on the airplane were open.

The cause of the incident has not yet been determined. However, there are several items being considered: (1) Certain latent failure modes exist in the backup flight idle stop system that could render it inoperative, and an inoperative system is not annunciated to the flight crew; or (2) normal maintenance action could have led to the opening of the circuit breakers.

This condition, if not corrected, could result in an inoperative backup flight idle stop system, which could lead to possible engine failure.

EMBRAER previously had issued Service Bulletin 120-076-0009, Change No. 4, dated November 1, 1990, which describes procedures to install a flight idle position electrical lock to the power control bellcrank. This installation minimizes the possibility of setting the power control levers to angles below flight idle during flight. [Installation of such a device is the subject of AD 90-17-12, amendment 39-6696 (55 FR 33107, August 14, 1990).]

This airplane model is manufactured in Brazil and is type certificated for operation in the United States under the provisions of Section 21.29 of the Federal Aviation Regulations and the applicable bilateral airworthiness agreement.

Since the unsafe condition described is likely to exist or develop on other airplanes of the same type design registered in the United States, the FAA issued Telegraphic AD T92-16-51 to prevent an inoperative backup flight idle stop system and potential engine failure. The AD requires repetitive visual checks or inspections to verify that both flight idle stop circuit breakers for engine 1 and 2 are closed. For airplanes on which an inspection window has been installed on the left lateral console panel that permits visibility of the flight idle stop solenoid circuit breakers, a flight crew member may perform a visual check to make this verification. However, for airplanes without such an installation, a visual inspection must be accomplished by a rated mechanic.

The AD also requires repetitive functional tests to determine whether the backup flight idle stop system is operative. Depending upon what discrepancies are found, an inoperative system must either be restored to the configuration specified in the EMBRAER service bulletin described previously, or repaired in accordance with the EMB-120 maintenance manual.

Additionally, this AD requires that operators submit a report of their initial findings to the FAA.

This is considered to be interim action until final action is identified, at which time the FAA may consider further rulemaking.

Since it was found that immediate corrective action was required, notice and opportunity for prior public comment thereon were impracticable and contrary to the public interest, and good cause existed to make the AD effective immediately by individual telegrams issued on July 29, 1992, to all known U.S. owners and operators of EMBRAER Model EMB-120 series airplanes. These conditions still exist, and the AD is hereby published in the **Federal Register** as an amendment to § 39.13 of part 39 of the Federal Aviation Regulations (FAR) to make it effective as to all persons.

Comments Invited

Although this action is in the form of a final rule that involves requirements affecting flight safety and, thus, was not preceded by notice and an opportunity for public comment; comments are invited on this rule. Interested persons are invited to comment on this rule by submitting such written data, views, or arguments as they may desire. Communications shall identify the Rules Docket number and be submitted in triplicate to the address specified under the caption **"ADDRESSES."** All communications received on or before the closing date for comments will be considered, and this rule may be amended in light of the comments received. Factual information that supports the commenter's ideas and suggestions is extremely helpful in evaluating the effectiveness of the AD action and determining whether additional rulemaking action would be needed.

Comments are specifically invited on the overall regulatory, economic, environmental, and energy aspects of the rule that might suggest a need to modify the rule. All comments submitted will be available, both before and after the closing date for comments, in the Rules Docket for examination by interested persons. A report that summarizes each FAA-public contact concerned with the substance of this AD will be filed in the Rules Docket.

Commenters wishing the FAA to acknowledge receipt of their comments submitted in response to this notice must submit a self-addressed, stamped postcard on which the following statement is made: "Comments to Docket Number 92-NM-152-AD." The postcard will be date stamped and returned to the commenter.

The regulations adopted herein will not have substantial direct effects on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. Therefore, in accordance with Executive Order 12612, it is determined that this final rule does not have sufficient federalism implications to warrant the preparation of a Federalism Assessment.

The FAA has determined that this regulation is an emergency regulation and that it is not considered to be major under Executive Order 12291. It is impracticable for the agency to follow the procedures of Order 12291 with respect to this rule since the rule must be issued immediately to correct an unsafe condition in aircraft. It has been determined further that this action involves an emergency regulation under DOT Regulatory Policies and Procedures (44 FR 11034, February 26, 1979). If it is determined that this emergency regulation otherwise would be significant under DOT Regulatory Policies and Procedures, a final regulatory evaluation will be prepared and placed in the Rules Docket. A copy of it, if filed, may be obtained from the Rules Docket at the location provided under the caption **"ADDRESSES."**

List of Subjects in 14 CFR Part 39

Air transportation, Aircraft, Aviation safety, Incorporation by reference, Safety.

Adoption of the Amendment

Accordingly, pursuant to the authority delegated to me by the Administrator, the Federal Aviation Administration amends 14 CFR part 39 of the Federal Aviation Regulations as follows:

PART 39—AIRWORTHINESS DIRECTIVES

1. The authority citation for part 39 continues to read as follows:

Authority: 49 U.S.C. App. 1354(a), 1421 and 1423; 49 U.S.C. 106(g); and 14 CFR 11.89.

§ 39.13 [Amended]

2. Section 39.13 is amended by adding the following new airworthiness directive:

92–16–51 Embraer: Amendment 39–8355. Docket 92–NM–152–AD.

Applicability: All Model EMB–120 series airplanes, certificated in any category.

To prevent an inoperative backup flight idle stop system and potential engine failure, accomplish the following:

(a) Within 5 days after the effective date of this AD, and thereafter prior to the first flight of each day, accomplish paragraph (a)(1) or (a)(2) of this AD, as applicable:

(1) For airplanes on which an inspection window has been installed on the left lateral console panel that permits visibility of the flight idle stop solenoid circuit breakers: Using an appropriate light source, perform a visual check to verify that both "FLT IDLE STOP SOL" circuit breakers CB0582 and CB0583 for engine 1 and engine 2 are closed.

Note 1: This check may be performed by a flight crew member.

Note 2: Instructions for installation of an inspection window can be found in EMBRAER Information Bulletin 120–076–0003, dated November 19, 1991; or EMBRAER Service Bulletin 120–076–0014, dated July 29, 1992.

(2) For airplanes on which an inspection window has not been installed on the left lateral console panel: Perform a visual inspection to verify that both "FLT IDLE STOP SOL" circuit breakers CB0582 and CB0583 for engine 1 and engine 2 are closed.

(b) As a result of the check or inspection performed in accordance with paragraph (a) of this AD: If circuit breakers CB0582 and CB0583 are not closed, prior to further flight, reset them and perform the functional test specified in paragraph (c) of this AD.

(c) Within 5 days after the effective date of this AD and thereafter at intervals not to exceed 75 hours time-in-service, or immediately following any maintenance action where the power levers are moved with the airplane on jacks, conduct a functional test of the backup flight idle stop system for engine 1 and engine 2 by performing the following steps:

(1) Move both power levers to the "MAX" position.

(2) Turn the aircraft power select switch on.

(3) Open both "AIR/GROUND SYSTEM" circuit breakers CB0283 and CB0286 to simulate in-flight conditions with weight-off-wheels. Wait for at least 15 seconds, then move both power levers back toward the propeller reverse position with the flight idle gate triggers raised. Verify that the power lever for each engine cannot be moved below the flight idle position, even though the flight idle gate trigger on each power lever is raised.

(4) If the power lever can be moved below the flight idle position, prior to further flight, restore the backup flight idle stop system to the configuration specified in EMBRAER Service Bulletin 120–076–0009, Change No. 4, dated November 1, 1990, and perform a functional test.

Note: If the power lever can be moved below flight idle, this indicates that the backup flight idle stop system is inoperative.

(5) Move both power levers to the "MAX" position.

(6) Close both "AIR/GROUND SYSTEM" circuit breakers CB0283 and CB0286. Wait for at least 15 seconds, then move both power levers back toward the propeller reverse position with the flight idle gate triggers raised. Verify that the power lever for each engine can be moved below the flight idle position.

(7) If either or both power levers cannot be moved below the flight idle position, prior to further flight, inspect the backup flight idle stop system and the flight idle gate system, and accomplish either paragraph (c)(7)(i) or (c)(7)(ii) of this AD, as applicable:

(i) If the backup flight idle stop system is failing to disengage with weight-on-wheels, prior to further flight, restore the system to the configuration specified in EMBRAER Service Bulletin 120–076–0009, Change No. 4, dated November 1, 1990.

(ii) If the flight idle gate system is failing to open even though the trigger is raised, prior to further flight, repair in accordance with the EMBRAER Model EMB–120 maintenance manual.

(8) Turn the power select switch off. The functional test is completed.

(d) Within 10 days after accomplishing the initial visual inspection/check and initial functional test required by paragraphs (a) and (c) of this AD, report the results of those tests, positive or negative, to the Manager, Atlanta Aircraft Certification Office (ACO), FAA, Small Airplane Directorate, 1669 Phoenix Parkway, Suite 210C, Atlanta, Georgia 30349; fax (404) 991–3606. Information collection requirements contained in this regulation have been approved by the Office of Management and Budget (OMB) under the provisions of the Paperwork Reduction Act of 1980 (44 U.S.C. 3501 *et seq.*) and have been assigned OMB Control Number 2120–0056.

(e) An alternative method of compliance or adjustment of the compliance time that provides an acceptable level of safety may be used if approved by the Manager, Atlanta ACO, FAA, Small Airplane Directorate. Operators shall submit their requests through an appropriate FAA Principal Maintenance Inspector, who may add comments and then send it to the Manager, Atlanta ACO.

Note: Information concerning the existence of approved alternative methods of compliance with this AD, if any, may be obtained from the Atlanta ACO.

(f) Special flight permits may be issued in accordance with FAR 21.197 and 21.199 to operate the airplane to a location where the requirements of this AD can be accomplished.

(g) The restoration procedure shall be done in accordance with EMBRAER Service Bulletin 120–076–0009, Change No. 4, dated November 1, 1990. This incorporation by reference was approved by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR part 51. Copies may be obtained from EMBRAER Aircraft Corporation, 276 SW. 34th Street, Fort Lauderdale, Florida 33315. Copies may be inspected at the FAA, Transport Airplane Directorate, 1601 Lind Avenue, SW., Renton, Washington; or at the Atlanta Aircraft Certification Office (ACO), FAA, Small Airplane Directorate, 1669 Phoenix Parkway, Suite 210C, Atlanta, Georgia; or at the Office of the Federal Register, 800 North Capitol Street, NW., Suite 700, Washington, DC.

(h) This amendment becomes effective on September 23, 1992, to all persons except those persons to whom it was made immediately effective by telegraphic AD T92–16–51, issued July 29, 1992, which contained the requirements of this amendment.

Issued in Renton, Washington, on August 12, 1992.

Bill R. Boxwell,

Acting Manager, Transport Airplane Directorate, Aircraft Certification Service.

[FR Doc. 92–21477 Filed 9–4–92; 8:45 am]

BILLING CODE 4910–13–M

DEPARTMENT OF COMMERCE

Bureau of the Census

15 CFR Part 60

[Docket No. 920240–2040]

Public Information

AGENCY: Bureau of the Census, Commerce.

ACTION: Final rule.

SUMMARY: The Bureau of the Census is amending its rule at 15 CFR, part 60, to repeal its existing guidelines for the disclosure of information to the public, and to refer any subsequent inquiries to 15 CFR part 4. The purpose of this rule-making notice is to implement updated policies and procedures for handling public requests for materials pursuant to the requirements of the Freedom of Information Act (FOIA), 5 U.S.C. 552, as amended.

EFFECTIVE DATE: September 8, 1992.

FOR FURTHER INFORMATION CONTACT: J. Patrick Heelen, Deputy Chief Counsel, Bureau of the Census, U.S. Department of Commerce, Federal Building 3, room 3077, Washington, DC 20233, (301) 763–2818.

SUPPLEMENTARY INFORMATION: 15 CFR, part 60, contains outdated information. The information found in 15 CFR, part 4, which is the Department of Commerce's rules on FOIA procedures, provides a more updated explanation of the scope, purpose, policies, and guidelines for

making publicly available certain records as specified in 5 U.S.C. 552(a)(2) and 552(a)(3). As part of the Department of Commerce, the Bureau of the Census follows the rules set forth in 15 CFR part 4.

The Bureau of the Census finds good cause to dispense with the notice and comment and delayed effective date requirements of the Administrative Procedures Act (APA) for this rule. These APA requirements are unnecessary because the Bureau of the Census is deleting superseded regulations and substituting a cross-reference for currently operating regulations.

Since a notice and an opportunity for comment are not required to be given for the rule under section 533 of the APA (5 U.S.C. 533) or any other law, under sections 603(a) and 604(a) of the Regulatory Flexibility Act (5 U.S.C. 603(a) and 604(a)), no initial or final Regulatory Flexibility analysis has to be or will be prepared.

List of Subjects in 15 CFR Part 60

Freedom of information.

PART 60—PUBLIC INFORMATION

1. The Authority citation is revised to read as follows:

Authority: 5 U.S.C. 301, 552, 553, Reorganization Plan No. 5 of 1950; 31 U.S.C. 3717.

§§ 60.2–60.11 [Removed]

2. Part 60 is amended by removing §§ 60.2 through 60.11, and by revising § 60.1 to read as follows:

§ 60.1 Public information.

The rules and procedures regarding public access to the records of the Bureau of the Census are found at 15 CFR part 4.

Date: September 2, 1992.

Barbara Everitt Bryant,

Director, Bureau of the Census.

[FR Doc. 92–21522 Filed 9–4–92; 8:45 am]

BILLING CODE 3510–07–M

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[T.D. 8433]

RIN 1545–AJ51

Discounted Unpaid Losses

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the discounting of unpaid losses of insurance companies for federal income tax purposes. Changes to the applicable law were made by the Tax Reform Act of 1986. The regulations affect insurance companies and provide the guidance needed to comply with these changes.

EFFECTIVE DATE: The regulations are effective for taxable years beginning after December 31, 1986.

FOR FURTHER INFORMATION CONTACT: Katherine A. Hossofsky, (202) 622–3970 (not a toll-free call) or Ann H. Logan, (202) 622–3970 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

This document sets forth final income tax regulations relating to the discounting of unpaid losses under section 846 of the Internal Revenue Code. Section 846 was added to the Code by section 1023(c) of the Tax Reform Act of 1986 (100 Stat. 2399). Proposed regulations under section 846 were published in the **Federal Register** on May 2, 1991 (56 FR 20161). Written comments were received from the public and a public hearing was held on September 24, 1991. Guidance on certain issues relating to section 846 was provided in Notice 88–100, 1988–2 C.B. 439.

Explanation of Provisions

The deduction for losses incurred provided to property and casualty insurance companies under section 832(b)(5)(A) of the Code takes into account changes in the amount of discounted unpaid losses for contracts other than life insurance contracts. In addition, section 807(c) requires life insurance companies to discount unpaid losses (other than losses on life insurance contracts) for purposes of sections 807(c)(2) and 805(a)(1). Section 846 provides rules for the discounting of unpaid losses. These regulations provide guidance on certain issues arising under section 846.

Requirements for Election To Use Own Experience

Although taxpayers generally must discount unpaid losses using the loss payment patterns determined by the Secretary and published by the Internal Revenue Service (Service), section 846(e) allows a taxpayer to elect to discount unpaid losses using the company's own historical loss payment pattern. Under section 846(e), the taxpayer's loss payment pattern must be determined using the information provided on the most recent annual statement filed before the beginning of the accident year for which the loss payment pattern is computed. The election is made separately for each determination year (1987 and each fifth calendar year thereafter) and applies to all of the taxpayer's lines of business that are eligible lines during the determination year. Section 846(e)(4) directs the Secretary to provide that the election is not available for a line of business for which the taxpayer does not have sufficient historical experience to determine a loss payment pattern.

The proposed regulations provided that a taxpayer's election to compute discounted unpaid losses based on its own historical loss payment pattern would apply to a line of business only if the taxpayer, on its most recent annual statement filed before the beginning of the determination year, reported unpaid losses for that line of business for at least the number of accident years for which unpaid losses in that line are required to be separately reported on the annual statement.

Commentators have suggested that the "unpaid losses" standard is not the appropriate criterion for determining whether a taxpayer has sufficient historical experience in a line of business. A taxpayer with sufficient historical experience in a line of business could nevertheless report on its annual statement no unpaid losses for one or more of the requisite accident years. This could occur if, for a particular accident year, all of the losses incurred in a line of business have been paid.

In response to these comments, the final regulations provide that a taxpayer's election to compute discounted unpaid losses based on its own historical payment pattern generally will apply to a line of business if the taxpayer, on its most recent annual statement filed before the beginning of the determination year, reports "losses and loss expenses incurred" for that line of business for at least the number of accident years for which losses and loss expenses incurred in that line are required to be separately stated. Further, in recognition of the need for flexibility to adapt to changes in business practice or annual statement presentation, the final regulations provide that for the 1992 and subsequent determination years a line of business will also be considered an eligible line of business if it satisfies conditions set forth in other published guidance provided by the Service. In connection with the finalization of these regulations, the Service is publishing Rev. Proc. 92–76, 1992–38 I.R.B. to

address certain situations that have been identified in comments. Taxpayers may provide the Service with data concerning lines of business and loss payment patterns to enable the Service to determine if additional guidance is warranted.

The final regulations include a transition rule for the 1987 determination year. The transition rule, which was initially published in Notice 88–100, provides that a taxpayer has sufficient historical experience for a line of business for the 1987 determination year if the taxpayer reports written premiums for at least the number of accident years for which unpaid losses for that line are required to be separately reported on the annual statement. The transition rule is not adopted for determination years after 1987 because a taxpayer may write premiums for several accident years before having unpaid losses relating to those premiums. Thus, the transition rule does not provide adequate assurance of the availability of loss payment information for each of those accident years to warrant its adoption as a final rule.

Notice 88–100 also required that the amount of unpaid losses a taxpayer reports on its annual statement for a line of business be equal to or greater than the amounts reported by at least 10 percent of all other companies that report unpaid losses for that line of business. The final regulations do not adopt this rule because of its potentially adverse impact on small companies and because determination of the 10th percentile threshold amount was administratively burdensome for taxpayers.

Anti-Abuse Rules

Section 846(e)(4)(B) directs the Secretary to issue regulations to prevent the avoidance (through the use of separate corporations or otherwise) of the requirement that the election to use historical loss payment patterns apply to all lines of business of a taxpayer. In response to commentators' requests for an expansion of the lines of business eligible for the historical loss experience election, the final regulations adopt a less restrictive criterion for determining whether a taxpayer has sufficient historical experience in a line of business and authorize further guidance to expand the definition of eligible lines of business. In view of this liberalization, safeguards are provided to prevent the avoidance of the requirement that the election apply to all eligible lines through the use of reinsurance agreements or separate corporations. Specifically, the final regulations provide that the district director may (1) nullify a taxpayer's election to compute discounted unpaid losses based on its historical loss payment pattern, (2) adjust a taxpayer's historical loss payment pattern, or (3) make other proper adjustments, to prevent avoidance of the requirement of section 846 that the election apply to all eligible lines of business of a taxpayer.

Determination of Discount Tables To Be Used

The final regulations generally provide for application of a composite schedule of discount factors to unpaid losses of a line of business for which the Service has not published discount factors.

Rev. Proc. 91–21, 1991–1 C.B. 525, provided an administrative procedure under which certain taxpayers could elect to use composite discount factors for unpaid losses on certain insurance contracts written on a claims-made basis. Neither the revenue procedure nor the final regulations permit this election for unpaid losses attributable to the 1992 accident year or any subsequent accident year.

If the groupings of individual lines of business on the annual statement change, taxpayers must discount unpaid losses on the resulting lines of business using the discounting patterns that would have applied to those unpaid losses based on their annual statement classification prior to the change. This is appropriate because the Service has published discount factors based on the classification of unpaid losses on the most recent annual statement filed before the beginning of the determination year.

In certain cases, the final regulations specify other factors that must be applied to unpaid losses for which the Service has not published discount factors. For example, for purposes of discounting unpaid losses from nonproportional reinsurance for accident years after 1991, the proposed regulations are modified to reflect changes in the information required on the annual statement. As a result of the additional information contained in the 1990 annual statement, the Secretary is able to calculate discount tables from nonproportional reinsurance for short-tailed lines of business, long-tailed lines of business, and financial guarantee/surety type business.

The final regulations also provide that the 90 percent rule applies to reinsurance and international business for all accident years. The 90 percent rule requires that reinsurance which is not allocated to a specific line of business must nonetheless be discounted using the factors associated with that line of business if 90 percent of the unallocated unpaid losses relate to underlying line of business.

Fresh Start

The final regulations adopt with one modification the rules contained in the proposed regulations concerning the computation of the "fresh start" provided by section 1023(e)(3) of the Tax Reform Act of 1986 (the Act). The fresh start provides a double deduction by allowing a taxpayer to not take into account the difference between undiscounted and discounted losses as of the end of the last taxable year beginning before January 1, 1987. However, under section 1023(e)(3)(B) of the Act, the fresh start does not apply to any "reserve strengthening" in a taxable year beginning in 1986. Congress imposed this rule to limit the double deduction benefit allowed by the fresh start.

The proposed regulations provided a mechanical test which was applied to reserves to determine the existence of reserve strengthening for purposes of the fresh start provisions. Commentators suggested a number of different alternatives to the mechanical test. One commentator proposed that the final regulations provide specific instances and safe harbors under which certain reserve adjustments would not be treated as reserve strengthening under section 1023(e)(3)(B) of the Act. The commentator suggested that reserve strengthening should not be deemed to occur in situations where a taxpayer's reserves, based on hindsight, were deficient at the beginning of 1986 and also suggested that the following types of reserve increases not be treated as reserve strengthening under section 1023(e)(3)(B): (a) reserve increases based on normal business practice, (b) reserve increases attributable to changes in law, (c) reserve increases attributable to writing off reinsurance recoverable from reinsurers that became impaired, (d) reserve increases for reinsurance attributable to increases in reserves reported to the taxpayer by the primary insurer, (e) reserve increases resulting from the acquisition in 1986 of an insolvent insurer that was under-reserved, (f) losses paid or reserves established in 1986 where there was no reserve at the end of 1985 for pre-1986 accident years, (g) reserve increases for a particular line of business, to the extent that other companies with which the taxpayer has entered into a pool or quota share arrangement have combined reserve weakening for that line of business, and (h) reserve increases

attributable to correction of an error in reserve determinations for one or more prior years. Alternatively, the commentator suggested the use of a facts and circumstances test.

Another commentator asked that reserve strengthening be defined to exclude reserve increases necessary for business reasons. An alternative suggestion was that non-artificial reserve increases be identified based on a runoff of the taxpayer's loss reserves held at the end of 1986.

The final regulations generally adopt the mechanical test of the proposed regulation. Congress did not limit the imposition of the reserve strengthening rule to tax motivated transactions. The legislative history indicates that for purposes of the fresh start adjustment the term "reserve strengthening" includes "all additions to reserves attributable to an increase in an estimate of reserve established for a prior accident year (taking into account claims paid with respect to that accident year), and all additions to reserves resulting from a change in the assumptions (other than changes in the assumed interest rates applicable to reserves for the 1986 accident year) used in estimating losses for the 1986 accident year, as well as all unspecified or unallocated additions to loss reserves". See 2 H.R. Conf. Rep. 841, 99th Cong., 2d Sess. II-367 (1986), 1986-3 (Vol. 4), C.B. 367. Thus, Congress adopted an expansive and mechanical definition of reserve strengthening that is reflected in the final regulations.

Proposed § 1.846-3(c)(3)(iii) provided that, for purposes of the reserve strengthening rule applicable to pre-1986 accident years:

> reinsurance assumed (ceded) in the final quarter of a taxable year beginning in 1985 is treated as assumed (ceded) during the immediately succeeding taxable year if the appropriate unpaid loss reserve is not adjusted to take into account the reinsurance until that immediately succeeding year.

Several commentators noted that reporting lags of more than one calendar quarter frequently occur in the ceding company's reporting of 1985 loss information to the assuming company. In response to these comments, the final regulations include within the rule reinsurance assumed (ceded) at any time in the taxable year beginning in 1985, if the reserve is not adjusted until the first taxable year beginning in 1986.

The final regulations also clarify the treatment of reinsurance assumed during the taxable year beginning in 1986 in the determination of reserve strengthening. The final regulations provide that taxpayers take into account neither the end of the year reserve nor the payments made prior to the end of the year with respect to the assumed reinsurance in determining reserve strengthening. A corresponding clarification is made in the example illustrating this rule.

Adjustment of Annual Statement Reserves

The final regulations incorporate existing guidance for the two situations in which reserves shown on the annual statement may be increased due to disclosure of additional information. The first situation corresponds to the adjustment of reserves under section 846(b)(2), and the second situation makes the treatment of estimated salvage recoverable in determining unpaid losses symmetrical with the treatment of salvage recoverable provided in the regulations under section 832 of the Code.

Title Insurers

The final regulations do not allow title insurance companies to make an election to use their historic loss payment pattern for purposes of discounting case reserves. This modification is necessary as the annual statement does not provide the taxpayer with the information necessary to calculate its historical loss payment pattern. Further, as the annual statement does not provide the Secretary with the information necessary to construct a loss payment pattern specifically for case reserves of title insurers, the final regulations requires title insurers to discount their case reserves based on a miscellaneous casualty pattern.

Other Comments That Were Not Adopted

Commentators suggested a number of additional modifications to the proposed regulations. In the consolidated return context, several commentators suggested that a net reserve weakening for one member of an affiliated group should be netted with a net reserve strengthening of another member. Another commentator proposed that the final regulations permit companies included in intercompany pooling arrangements to demonstrate historical experience on a group basis. These comments have not been adopted.

Notice 88-100

Sections II, III, and VI of Notice 88-100, 1988-2 C.B. 439, are now obsolete.

Effective Date

Notice 88-100 set forth guidance regarding the forthcoming regulations that taxpayers were able to rely upon prior to the publication of final regulations. The final regulations follow most of the guidance in Notice 88-100 and provide relief from certain of its rules. Therefore, retaining the effective date announced in Notice 88-100 is appropriate.

Special Analyses

It has been determined that these rules are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a final Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking for the regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal authors of these regulations are Katherine A. Hossofsky and Ann H. Logan of the Office of the Assistant Chief Counsel (Financial Institutions and Products), Internal Revenue Service. Other personnel from the Service and Treasury Department participated in their development.

List of Subjects

26 CFR 1.801-1 through 1.846

Income taxes; Insurance companies.

Adoption of Amendments to the Regulations

For the reasons set forth in the preamble, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Paragraph 1. The authority for part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7805 * * * Sections 1.846-1 through 1.846-4 also issued under 26 U.S.C. 846.

Par. 2. Sections 1.846-0 through 1.846-4 are added to read as follows:

§ 1.846-0 Outline of provisions.

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

§ 1.846-1 Application of discount factors.

(a) In general.
(1) Rules.
(2) Examples.

§ 1.846–1 Application of discount factors.

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

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

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

Example 2. On its annual statements through 1987, a taxpayer did not allocate unpaid losses attributable to proportional reinsurance to the line of business associated with the risks being reinsured. Beginning with the 1988 annual statement, the taxpayer allocated those losses for all accident years to the line of business being reinsured. The taxpayer must continue to discount the unpaid losses attributable to proportional reinsurance from pre-1988 accident years using the discount factors that were used in determining tax reserves for the 1987 tax year. (See paragraph (b)(3) of this section for rules relating to the application of discount factors to reinsurance unpaid losses.)

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

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

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

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

(ii) *Composite discount factors.* If the Service has not published discount factors for a line of business, a taxpayer must discount unpaid losses attributable to that line by applying composite discount factors.

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

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

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

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

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

discounted using composite discount factors.

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

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

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

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

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

(a) *In general.* If a taxpayer has one or more eligible lines of business in a determination year, the taxpayer may elect on the taxpayer's timely filed Federal income tax return for the determination year to discount unpaid losses using its own historical loss payment pattern instead of the industry-wide pattern determined by the Secretary. A taxpayer making the election must use its own historical loss payment pattern in discounting unpaid losses for each line of business that is an eligible line of business in that determination year. The election applies to accident years ending with the determination year and to each of the four succeeding accident years. If a taxpayer makes the election for the 1987 determination year, the taxpayer must use its 1987 loss payment pattern (determined by reference to its 1985 annual statement) to discount unpaid losses attributable to all accident years prior to 1988.

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

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

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

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

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

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

(3) Make other proper adjustments.

§ 1.846–3 Fresh start and reserve strengthening.

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

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

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

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

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

Example. X, a calendar year taxpayer, does not make an election in 1987 to use its own historical loss payment pattern. When X computes discounted unpaid losses for its last taxable year beginning before January 1, 1987, the discount factor for AY+0 published in Rev. Rul. 87–34, 1987–1 C.B. 168, must be applied to unpaid losses attributable to the 1986 accident year; the discount factor for AY+1 is applied to unpaid losses attributable to the 1985 accident year; etc.

(c) *Rules for determining the amount of reserve strengthening (weakening)*—(1) *In general.* The amount of reserve strengthening (weakening) is the amount that is determined under paragraph (c)(2) or (3) to have been added to (subtracted from) an unpaid loss reserve in a taxable year beginning in 1986. For purposes of section 1023(e)(3)(B) of the 1986 Act, the amount of reserve strengthening (weakening) must be determined separately for each unpaid loss reserve by applying the rules of this paragraph (c). This determination is made without regard to the reasonableness of the amount of the unpaid loss reserve and without regard

to the taxpayer's discretion, or lack thereof, in establishing the amount of the unpaid loss reserve. The amount of reserve strengthening for an unpaid loss reserve may not exceed the amount of the reserve, including any undiscounted strengthening amount, as of the end of the last taxable year beginning before January 1, 1987. For purposes of this section, an "unpaid loss reserve" is the aggregate of the unpaid loss estimate for losses (whether or not reported) incurred in an accident year of a line of business.

(2) *Accident years after 1985*—(i) *In general.* The amount of reserve strengthening (weakening) for an unpaid loss reserve for an accident year after 1985 is the amount by which that reserve at the end of the last taxable year beginning in 1986 exceeds (is less than) a hypothetical unpaid loss reserve.

(ii) *Hypothetical unpaid loss reserve.* For purposes of this paragraph (c)(2), the term "hypothetical unpaid loss reserve" means a reserve computed for losses the estimates of which were included, at the end of the last taxable year beginning in 1986, in the unpaid loss reserve for which reserve strengthening (weakening) is being determined. The hypothetical unpaid loss reserve must be computed using the same assumptions, other than the assumed interest rates in the case of reserves determined on a discounted basis for annual statement reporting purposes, that were used to determine the 1985 accident year reserve, if any, for the line of business for which the hypothetical reserve is being computed. If there was no 1985 accident year reserve for that line of business, the hypothetical unpaid loss reserve is the reserve, at the end of the last taxable year beginning in 1986, for which reserve strengthening (weakening) is being determined (and thus there is no reserve strengthening or weakening).

(3) *Accident years before 1986*—(i) *In general.* For each taxable year beginning in 1986, the amount of reserve strengthening (weakening) for an unpaid loss reserve for an accident year before 1986 is the amount by which the reserve at the end of that taxable year exceeds (is less than)—

(A) The reserve at the end of the immediately preceding taxable year; reduced by

(B) Claims paid and loss adjustment expenses paid ("loss payments") in the taxable year beginning in 1986 with respect to losses that are attributable to the reserve. The amount by which a reserve is reduced as a result of reinsurance ceded during a taxable year beginning in 1986 is treated as a loss payment made in that taxable year.

(ii) *Exceptions.* Notwithstanding paragraph (c)(3)(i) of this section, the amount of reserve strengthening (weakening) for an unpaid loss reserve for an accident year before 1986 does not include—

(A) An amount added to the reserve in a taxable year beginning in 1986 as a result of a loss reported to the taxpayer from a mandatory state or federal assigned risk pool if the amount of the loss reported is not discretionary with the taxpayer; or

(B) Payments made with respect to reinsurance assumed during a taxable year beginning in 1986 or amounts added to the reserve to take into account reinsurance assumed for a line of business during a taxable year beginning in 1986, but only to the extent that the amount does not exceed the amount of a hypothetical reserve for the reinsurance assumed. The amount of the hypothetical reserve is determined using the same assumptions (other than the assumed interest rates) that were used to determine a reserve for reinsurance assumed for the line of business in a taxable year beginning in 1985.

(iii) *Certain transactions deemed to be reinsurance assumed (ceded) in 1986.* For purposes of this paragraph (c)(3), reinsurance assumed (ceded) in a taxable year beginning in 1985 is treated as assumed (ceded) during the succeeding taxable year if the appropriate unpaid loss reserve is not adjusted to take into account the reinsurance transaction until that succeeding taxable year.

(d) *Section 845.* Any reinsurance transaction that has as one of its purposes the avoidance of the reserve strengthening limitation is subject to section 845.

(e) *Treatment of reserve strengthening.* The fresh start provision of section 1023(e)(3)(A) of the 1986 Act does not apply to the portion of the taxpayer's unpaid losses attributable to reserve strengthening. Thus, the difference between the undiscounted unpaid losses attributable to reserve strengthening and the discounted unpaid losses attributable to reserve strengthening must be included in income and, therefore, included in earnings and profits for the first taxable year beginning after December 31, 1986. The amount that a taxpayer must include in income for its first taxable year beginning after December 31, 1986, as a result of reserve strengthening is equal to the excess (if any) of—

(1) The sum of each amount of reserve strengthening multiplied by the difference between 100 percent and the discount factor that, under paragraph (b) of this section, is applicable to the unpaid loss reserve which was strengthened; over

(2) The sum of each reserve weakening multiplied by the difference between 100 percent and the discount factor that, under paragraph (b) of this section, is applicable to the unpaid loss reserve which was weakened.

(f) *Examples.* The following examples illustrate the principles of this section. For purposes of these examples, it is assumed that the taxpayers are property and casualty insurance companies that in 1987 did not elect to use their own historical loss payment patterns.

Example 1. (i) As of the end of 1985, X, a calendar year taxpayer, had undiscounted unpaid losses of $1,000,000 in the workers' compensation line of business for the 1984 accident year. The same reserve had undiscounted unpaid losses of $900,000 at the end of 1986. During 1986, X's loss payments for this reserve were $300,000. Accordingly, under paragraph (c)(3)(i) of this section, X has a reserve strengthening of $200,000 ($900,000–($1,000,000–$300,000)).

(ii) This was X's only reserve strengthening or weakening. Thus, under paragraph (e) of this section, for 1987 must include in income $54,361.40 ($200,000 × (100%–72.8193%)). The factor of 72.8193% is the AY+2 factor from the workers' compensation series of discount factors published in Rev. Rul. 87–34, 1987–1 C.B. 168.

Example 2. The facts are the same as in *Example 1*, except that X's 1986 loss payments for the reserve were $1,100,000. If only paragraph (c)(3)(i) of this section were applied, X would have a $1,000,000 reserve strengthening ($900,000–($1,000,000–$1,100,000)). Under paragraph (c)(1) of this section, however, the amount of reserve strengthening for the reserve is limited to the amount of the reserve at the end of 1986. Accordingly, X has a reserve strengthening of $900,000 and for 1987 must include in income $244,626.30 ($900,000 × (100%–72.1893%)).

Example 3. (i) As of the end of 1985, Y, a calendar year taxpayer, had undiscounted unpaid losses of $1,000,000 in the auto physical damage line of business for the 1985 accident year. The same reserve included undiscounted unpaid losses of $600,000 at the end of 1986. During 1986, Y had loss payments of $300,000 for this line of business. Under paragraph (c)(3)(i) of this section Y has a $100,000 reserve weakening ($600,000–($1,000,000–$300,000)).

(ii) Under paragraph (e) of this section, the only effect of the reserve weakening is to reduce the amount that Y is required to include in income as a result of any strengthening of another reserve.

Example 4. The facts are the same as in *Example 1* except that X also has a $100,000 reserve weakening for the 1985 accident year in its auto physical damage line of business. Under paragraph (b) of this section, the reserve discount factor for the reserve is 93.3400, the AY+1 factor from the auto physical damage series of discount factors published in Rev. Rul. 87–34. Thus, under paragraph (e) of this section, the amount that

X is required to include in income in 1987 is reduced by $6,660 ($100,000 × (100%–93.3400%)), resulting in an amount of $47,761.40 ($54,361.40–$6,660).

Example 5. (i) At the end of 1985, Z, a calendar year taxpayer, had undiscounted unpaid losses of $1,000,000 in the workers' compensation line of business for the 1984 accident year. On May 1, 1986, Z ceded $130,000 of the reserve to an unrelated reinsurer. Z added $250,000 to the 1985 year end reserve to take into account workers' compensation risks for the 1984 accident year that Z assumed in a reinsurance transaction on September 1, 1986. Z had $230,000 of 1986 loss payments related to the 1984 accident year of its workers' compensation line, $60,000 of which was attributable to the reinsurance assumed by Z. At the end of 1986, Z's reserve for the workers' compensation line for the 1984 accident year was $1,100,000.

(ii) If only paragraph (c)(3)(i) of this section were applied, Z would have a $460,000 reserve strengthening ($1,100,000–($1,000,000–230,000–$130,000)). Under paragraph (c)(3)(ii)(B) of this section, however, reserve strengthening does not include the $250,000 that Z added to the reserve to take into account the reinsurance assumed. Also, none of the $60,000 of loss payments attributable to the reinsurance assumed in 1986 are taken into account. Accordingly, Z has $150,000 of reserve strengthening ($460,000–$250,000–$60,000). If this is Z's only reserve strengthening or weakening, then the amount that Z must include in income for 1987 under paragraph (e) of this section is $40,771.05 ($150,000 × (100%–72.8193%)). The factor of 72.8193% is the AY+2 factor from the workers' compensation series of discount factors published in Rev. Rul. 87–34.

Example 6. (i) X was a calendar year taxpayer before July 1, 1986, the date on which X became a member of an affiliated group of corporations that files a consolidated return with a June 30 year end. Thus, X had two taxable years beginning in 1986: a short taxable year ending June 30, 1986, and a fiscal taxable year ending June 30, 1987.

(ii) As of the end of 1985, X had undiscounted unpaid losses of $800,000 in the automobile liability line of business for the 1983 accident year. At the end of the short taxable year, X had reserves of $700,000 of undiscounted unpaid losses, and on June 30, 1987, had reserves of $600,000 of undiscounted unpaid losses. During the short taxable year, ending June 30, 1986, X's loss payments for this reserve were $120,000. During the taxable year ending June 30, 1987, X's loss payments for this reserve were $180,000. Under paragraph (c)(3)(i) of this section, X has a $100,000 reserve strengthening: of which $20,000 ($700,000–($800,000–$120,000)) is attributable to the short taxable year ending June 30, 1986 and $80,000 ($600,000–($700,000–$180,000)) is attributable to the taxable year ending June 30, 1987.

(iii) The amount of reserve strengthening for this line of business is determined pursuant to the principles of paragraph (c)(2) of this section.

§ 1.846–4 Effective date.

Sections 1.846–1 through Sections 1.846–3 apply to taxable years beginning after December 31, 1986.

Approved: August 14, 1992.

Shirley D. Peterson,

Commissioner of Internal Revenue.

Alan J. Wilensky,

Assistant Secretary of the Treasury.

[FR Doc. 92–21299 Filed 9–4–92; 8:45 am]

BILLING CODE 4830–01–M

Bureau of Alcohol, Tobacco and Firearms

27 CFR Part 20

[T.D. ATF–332, Re: Notice No. 743]

Specially Denatured Spirits; Miscellaneous Amendments

AGENCY: Bureau of Alcohol, Tobacco and Firearms (ATF), Department of the Treasury.

ACTION: Treasury decision, final rule.

SUMMARY: This final rule amends regulations to eliminate the requirement that a person obtain a permit as a dealer in specially denatured spirits with respect to shipments of specially denatured spirits which that person never physically received nor intended to receive; clarify a reference to specially denatured spirits, and to correct a regulatory reference; allow for the notification of adoption of formulas and statements of process to be filed at the regional level; allow distributors of an article to place minimal identifying information (name, address and phrase such as "distributed by") on the label of that article without qualifying in any manner under agency regulations on the distribution and use of denatured alcohol and rum; allow that, in certain cases, code marks may be used on the container of an article, in lieu of a permit number, to identify the site where the article was manufactured; and revise the procedures for the disposition of specially denatured spirits from one user to another.

These changes are intended to liberalize the procedures applicable to the distribution of specially denatured spirits, and reduce regulatory burdens.

EFFECTIVE DATE: September 8, 1992.

FOR FURTHER INFORMATION CONTACT: Tamara Light, Distilled Spirits and Tobacco Branch, Bureau of Alcohol, Tobacco and Firearms, 650 Massachusetts Avenue NW., Washington, DC 20226 ((202) 927–8210).

SUPPLEMENTARY INFORMATION:

Background

Dealer Redefined

26 U.S.C. 5271 provides, in part, that persons who deal in specially denatured spirits shall obtain a permit which authorizes that activity. ATF has interpreted the term "deal in" to mean the purchase and sale of specially denatured spirits. This interpretation has sometimes required a person who merely takes orders for specially denatured spirits, and arranges for the shipment to an eligible user, to qualify with ATF as a dealer, to file a bond and to otherwise comply with the regulatory provisions of 27 CFR part 20, because that person is buying and selling specially denatured spirits. Since a person acting in this manner never physically receives a shipment of specially denatured spirits, and never intends to receive such shipment, ATF feels that by revising the definition of the term dealer, only those persons who engage in activities involving physical possession of denatured spirits will be required to obtain a permit.

It is ATF's view that product accountability should rest with persons who physically receive specially denatured spirits. This view is based on the fact that specially denatured spirits may only be transferred between persons who hold a permit authorizing them to receive, store, use or denature such products. This means that ATF can establish the accountability of specially denatured spirits by verifying that the consignor and consignee are operating in compliance with the provisions of 27 CFR parts 19 and/or 20. There is no need for ATF to consider the ownership (without physical receipt) of specially denatured spirits by intervening third parties. Accountability and tax liability relating to specially denatured spirits will reside with those persons who are accountable for the specially denatured spirits because they physically possess the product.

Regulation 27 CFR 20.25 Clarified

The phrase "specially denatured alcohol" in § 20.25 is revised to read "specially denatured spirits." Section 20.25 is revised to correct the reference to § 20.222 to read § 20.241.

Regulation in 20.63 Revised

The regulations in 27 CFR 20.63 provide for the adoption of a predecessor's formulas and statements of process by a successor. Current regulations require the successor to submit to the Director a certificate containing information regarding the proposed adoption. ATF is revising