Differential Earnings Rate for Mutual Life Insurance Companies

Notice 2001–24

This notice publishes a tentative determination under § 809 of the Internal Revenue Code of the "differential earnings rate" for 2000 and the rate that is used to calculate the "recomputed differential earnings amount" for 1999. (The latter rate is referred to in this notice as the "recomputed differential earnings rate" for 1999.) These rates are used by mutual life insurance companies to calculate their federal income tax liability for taxable years beginning in 2000.

BACKGROUND

Section 809(a) provides that, in the case of any mutual life insurance company, the amount of the deduction allowable under § 808 for policyholder dividends is reduced (but not below zero) by the "differential earnings amount." Any excess of the differential earnings amount over the amount of the deduction allowable under § 808 is taken into account as a reduction in the closing balance of reserves under subsections (a) and (b) of § 807. The "differential earnings amount" for any taxable year is the amount equal to the product of (a) the life insurance company's average equity base for the taxable year multiplied by (b) the "differential earnings rate" for that taxable year. The "differential earnings rate" for the taxable year is the excess of (a) the "imputed earnings rate" for the taxable year over (b) the "average mutual earnings rate" for the second calendar year preceding the calendar year in which the taxable year begins. The "imputed earnings rate" for any taxable year is the amount that bears the same ratio to 16.5 percent as the "current stock earnings rate" for the taxable year bears to the "base period stock earnings rate."

Section 809(f) provides that, in the case of any mutual life insurance company, if the "recomputed differential earnings amount" for any taxable year exceeds the differential earnings amount for that taxable year, the excess is included in life insurance gross income for the succeeding taxable year. If the differential earnings amount for any taxable year exceeds the recomputed differential earnings amount for that taxable year, the excess is allowed as a life insurance deduction for the succeeding taxable year. The "recomputed differential earnings amount" for any taxable year is an amount calculated in the same manner as the differential earnings amount for that taxable year, except that the average mutual earnings rate for the calendar year in which the taxable year begins is substituted for the average mutual earnings rate for the second calendar year preceding the calendar year in which the taxable year begins.

The stock earnings rates and mutual earnings rates taken into account under § 809 generally are determined by dividing statement gain from operations by the average equity base. For this purpose, the term "statement gain from operations" means "the net gain or loss from operations required to be set forth in the annual statement, determined without regard to Federal income taxes, and ... properly adjusted for realized capital gains and losses...." *See* § 809(g)(1). The term "equity base" is defined as an amount determined in the manner prescribed by regulations equal to surplus and capital increased by the amount of nonadmitted financial assets, the excess of statutory reserves over the amount of tax reserves, the sum of certain other reserves, and 50 percent of any policyholder dividends (or other similar liability) payable in the following taxable year. *See* § 809(b)(2), (3), (4), (5) and (6). Section 1.809–10 of the Income Tax Regulations provides that the equity base includes both the asset valuation reserve and the interest maintenance reserve for taxable years ending after December 31, 1991.

Section 1.809–9(a) of the regulations provides that neither the differential earnings rate under § 809(c) nor the recomputed differential earnings rate that is used in computing the recomputed differential earnings amount under § 809(f)(3) may be less than zero.

Rev. Rul. 99–3, 1999–1 C.B. 313, provides that a life insurance subsidiary of a mutual holding company is not a mutual life insurance company for which the deduction for policyholder dividends is reduced pursuant to §§ 808(c)(2) and 809.

As described above, the differential earnings rate for 2000 and the recomputed differential earnings rate for 1999 affect the income and deductions reported by mutual life insurance companies on their federal income tax returns for the 2000 taxable year.

Data necessary to determine the tentative differential earnings rate for 2000 and the tentative recomputed differential earnings rate for 1999 have been compiled from returns filed by mutual life insurance companies and certain stock life insurance companies. The Internal Revenue Service is currently examining these returns. This examination will not be completed before the March 15, 2001, due date for filing 2000 calendar year returns.

NOTICE OF TENTATIVE RATES

This notice publishes a tentative determination of the differential earnings rate for 2000 and of the recomputed differential earnings rate for 1999. This notice also publishes a tentative determination of the rates on which the calculation of the differential earnings rate for 2000 and the recomputed differential earnings rate for 1999 are based. The final determination of these rates is expected to be published before September 1, 2001.

The tentative determination of the differential earnings rate for 2000 and the tentative determination of the recomputed differential earnings rate for 1999 that are published in this notice should be used by mutual life insurance companies to calculate the amount of tax liability for taxable years beginning in 2000 (in the case of companies that file returns before publication of the final determination of these rates) or to calculate the amount of estimated unpaid tax liability for taxable years beginning in 2000 (in the case of companies that are allowed an extension of time to file returns). Companies that file returns before publication of the final determination of these rates should file amended returns after the final determination of these rates is published. If there is a failure to pay tax for a taxable year beginning in 2000 and the failure is attributable to a difference between (a) the tentative determination of the differential earnings rate for 2000 and recomputed differential earnings rate for 1999 and (b) the final determination of these rates, then any such failure through September 17, 2001, will be treated as due to reasonable cause and will not give rise to any addition to tax under § 6651.

The tentative determination of the rates is set forth in Table 1.

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Tentative Determination of Rates To Be Used For Taxable Years Beginning in 2000

Differential earnings rate for 2000	0
Recomputed differential earnings rate for 1999	0
Imputed earnings rate for 1999	15.815
Imputed earnings rate for 2000	15.358
Base period stock earnings rate	18.221
Current stock earnings rate for 2000	16.960
Stock earnings rate for 1997	19.321
Stock earnings rate for 1998	15.836
Stock earnings rate for 1999	15.724
Average mutual earnings rate for 1998	16.011
Average mutual earnings rate for 1999	16.164

DRAFTING INFORMATION

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