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Insurance Investment Management

AAM Technical Bulletin: IRS Issues Discount Factors

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Just in time for the Government Shutdown, the IRS has issued the discount factor information necessary to run a calculation of the potential tax reform implications for Unpaid Loss, LAE, and Salvage/Subrogation reserves and recoverables. Up to this point companies have generally not updated their financials for the tax implications of this major item. Many of you have probably put a note in your 2017 financials stating that this and other aspects of the tax reform implementation would be accounted for in 2018. Thus, you are now faced with a decision for your year-end financials on if and how to use the specified factors to generate a tax reform adjustment for tax provision. A few important observations:

1) What types of Companies are affected?

All P&C companies, as well as Life & Health companies that write certain A&H products (ex. Group Health, Med Sup, other A&H products excluding guaranteed renewable/non-cancelable, etc.)

2) What was provided in the Revenue Procedure?

a) Estimated Discount Factors to apply to all lines of business for the 2018 accident year (based on concepts in the Proposed Regulations)

b) Estimated Discount Factors to apply to all lines of business for 2017 and prior accident years to calculate the tax reform implementation adjustment to be amortized beginning in 2018 (based on concepts in the Proposed Regulations)

3) Were there any surprises in the Revenue Procedure?

One area that may provide a significantly more material impact to your financials than many were expecting is the approach to computing the tax reform adjustment and future discount factors for all accident years prior to 2018. The approach may be significantly more material as the change covered more years and more aspects of the calculation methodology than many anticipated. These are the potential computations of the tax reform adjustment that were considered, as well as the IRS' selection in the Revenue Procedure:

a) Not Selected – Follow the 2016 and prior IRS historical industry payment pattern/discount factors and continue to run off those accident years under historical IRS patterns. For the 2017 year the unpaid losses and LAE would be computed using historical industry payment patterns but with the 2017 corporate bond rate.

b) Not Selected - Follow the 2016 and prior IRS historical industry payment pattern but replace the discount factor for those years with a corporate bond rate for that vintage year. For the 2017 year the unpaid losses would be computed using IRS historical industry payment patterns but with the corporate bond rate.

c) IRS Revenue Procedure Selection – The following is the summary from our firm's discussions with Kathryn Sneade, the principle author of the Regulation and Revenue Procedure, as you will find that some of the underlying assumptions are not explicitly discussed in the Revenue Procedure. Thus, the following may ultimately be changed/clarified in future IRS commentary. Kathryn explained that for 2017 and prior they basically discarded all vintaged historical payment patterns and discount rates for all accident years 2017 and prior. They replaced those payment patterns and discount factors with the 2018 payment pattern and 2018 corporate bond rate. Thus, all years 2017 and prior are not only recomputed with a new discount rate but also with a new payment pattern independent of the payment pattern for that vintage year. For future years (i.e. 2019 and forward) she stated that they would go back to each accident year being vintaged with respect to payment pattern and interest rate. However, the 2018 and prior accident years would continue to use the 2018 payment pattern and corporate rate. Depending on the lines of business you write and the specific accident years you have with unpaid losses the materiality of this approach may be substantially more than you anticipated.

4) Will the factors in the Revenue Procedure change and are the underlying concepts final or estimates?

The factors, which affect all accident years from 2018 and prior, were generally based on the IRS concepts and positions taken in the Proposed Regulations published in November. While unusual, the IRS released the Revenue Procedure with computational results of principles still open to change, and with the provision that it may revise them further after the Regulations are finalized.

5) Will the factors be finalized before company financials are issued?

A hearing for the public to comment on the Proposed Regulations took place on December 20th. The Comment period for the Revenue Procedure is open until February 6, 2019. It's also not clear how long the Government Shutdown will last and whether it could cause a delay in this area. Thus, it's possible that there will not be Final Regulations and a final Revenue Procedure until after many companies publish year-end 2018 IFRS/GAAP/STAT financials. This leaves you with a decision to make whether your applicable financial statement guidance (i.e. GAAP/IFRS/STAT) requires you to book a tax reform implementation adjustment based on the new Revenue Procedure, as well as how to account for any future change in the computations after the Regulation and Revenue Procedures are finalized.

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Please Note: AAM is not providing tax advice. You should consult with your own tax advisor.

26 CFR 601.201: Rulings and determination letters.
(Also: Part I, Sections 832, 846; 1.832-4, 1.846-1.)

Rev. Proc. 2019-06

SECTION 1. PURPOSE

This revenue procedure prescribes unpaid loss discount factors for the 2018 accident year for use in computing discounted unpaid losses under § 846 of the Internal Revenue Code. The unpaid loss discount factors also serve as salvage discount factors for the 2018 accident year for use in computing discounted estimated salvage recoverable under § 832. The discount factors prescribed herein were determined under § 846, as amended by section 13523 of the Tax Cuts and Jobs Act, Pub. L. No. 115-97 (December 22, 2017) ("TCJA"), and proposed regulations under § 846 (REG-103163-18) published in the Federal Register (83 FR 55646) on November 7, 2018 (the "proposed regulations"). If necessary after the proposed regulations are published as final regulations, the Department of the Treasury (the "Treasury Department") and Internal Revenue Service ("IRS") intend to publish for each property and casualty line of business revised unpaid loss discount factors for the 2018 accident year for use in taxable years ending on or after the date the final regulations are published.

SECTION 2. BACKGROUND

.01 Modification of Discounting Rules

(1) Section 13523 of the TCJA amended § 846 for taxable years beginning after December 31, 2017. Section 13523(a) and (b) of the TCJA amended the definition of annual rate under § 846(c) and the computational rules for loss payment patterns under § 846(d), respectively. Section 13523(c) of the TCJA repealed the election that was previously set forth in § 846(e) to use the taxpayer's own historical loss payment pattern instead of the pattern published by the Secretary.

(2) Section 13523(e) of the TCJA provides the transitional rule for the application of the amendments in the first taxable year beginning after December 31, 2017, and for subsequent taxable years (the "TCJA transition rule"). Specifically, section 13523(e) provides that, for the first taxable year beginning after December 31, 2017, the unpaid losses and expenses unpaid (as defined in § 832(b)(5) and (6)) at the end of the preceding taxable year, and the unpaid losses (as defined in §§ 805(a)(1) and 807(c)(2)) at the end of the preceding taxable year, are determined as if the amendments made by section 13523 of the TCJA had applied to the unpaid losses and expenses unpaid in the preceding taxable year and by using the interest rate and loss payment patterns applicable to accident years ending with calendar year 2018. The resulting adjustment (the "TCJA adjustment"), if any, is included in the taxpayer's gross income ratably over an eight year period (the "TCJA period of adjustment," which is the first taxable year beginning after December 31, 2017, and the seven succeeding taxable years). Section 13523(e) also provides that, for subsequent taxable years, the amendments made by section 13523 are applied with respect to unpaid losses and

expenses unpaid for accident years ending with or before calendar year 2018 by using the interest rate and loss payment patterns applicable to accident years ending with calendar year 2018. Loss payment patterns for the 2017 determination year were previously prescribed in Rev. Proc. 2018-13, 2018-7 I.R.B. 356. In Rev. Proc. 2018-13, the Treasury Department and IRS also announced the intention to publish revised loss payment patterns for the 2017 determination year in accordance with the TCJA transition rule.

.02 Proposed Regulations

(1) Section 1.846-1(c) of the proposed regulations provides that the annual rate for any calendar year is the average of the monthly spot interest rates on corporate bonds with times to maturity of not more than seventeen and one-half years based on a yield curve that reflects the average, for the most recent 60-month period ending before the beginning of the calendar year, of monthly yields on corporate bonds described in § 430(h)(2)(D)(i).

(2) Section 1.846-1(d)(1) of the proposed regulations provides that, in general, the loss payment pattern determined by the Secretary for each line of business is determined by reference to the historical loss payment pattern applicable to such line of business determined in accordance with the method of determination set forth in § 846(d)(2) and the computational rules prescribed in § 846(d)(3) on the basis of data from annual statements described in § 846(d)(2)(A) and (B). However, under § 1.846-1(d)(2) of the proposed regulations, the Secretary may adjust the loss payment pattern for any line of business using a methodology described by the Secretary in other

published guidance if necessary to avoid negative payment amounts and otherwise produce a stable pattern of positive discount factors less than one.

.03 Discount Factors for Accident Year 2018 and Prior Accident Years

(1) The discount factors prescribed in this revenue procedure are determined by using the applicable interest rate for accident year 2018 under § 846(c) and the proposed regulations and revised loss payment patterns determined by the Secretary for the 2017 determination year under § 846(d) and the proposed regulations.

(2) Pursuant to § 846(c) and the proposed regulations, the Secretary has determined that the annual rate for the 2018 calendar year is 3.12 percent, compounded semiannually. This annual rate is the average of the monthly spot rates on corporate bonds with times to maturity of not more than seventeen and one-half years based on a yield curve that reflects the average of monthly yields on corporate bonds described in § 430(h)(2)(D)(i) for the period from January 2013 through December 2017 (that is, the most recent 60-month period ending before the beginning of the 2018 calendar year).[1]

(3) Pursuant to § 846(d) and the proposed regulations, the Secretary has determined a revised loss payment pattern for each property and casualty line of business for the 2017 determination year for use with respect to unpaid losses incurred in accident year 2018 and prior accident years. The revised loss payment patterns for the 2017 determination year are based, initially, on the aggregate loss payment

[1] The published yield curve spot rates can be found at https://home.treasury.gov/data/treasury-coupon-issues-and-corporate-bond-yield-curve/corporate-bond-yield-curve.

information reported on the 2015 annual statements of property and casualty insurance companies and compiled by A.M. Best and Co. The lines of business for the 2017 determination year are the same as the lines of business for the 2012 determination year. See Rev. Proc. 2012-44, 2012-49 I.R.B. 645. Losses are reported on the annual statement net of losses on reinsurance ceded, but include losses on assumed proportional reinsurance. Losses with respect to assumed non-proportional reinsurance are reported in three separate lines of business (for property, liability, and financial reinsurance). The loss data include defense, cost containment, adjusting, and other loss expenses, but are not reduced for salvage and subrogation receipts.

(4) Pursuant to § 1.846-1(d)(2) of the proposed regulations, the Secretary may adjust the loss payment pattern for any line of business using a methodology described by the Secretary in other published guidance if necessary to avoid negative payment amounts and otherwise produce a stable pattern of positive discount factors less than one. For the 2017 determination year, only one line of business requires adjustments under the proposed regulations. That line of business is Other Liability – Claims Made. The initial payment pattern results in negative payment amounts for the fifth, seventh, and ninth years after the accident year. Therefore, the payment amounts for the fourth through the ninth year after the accident year are adjusted following the steps listed in the preamble to the proposed regulations. See 83 FR 55646.

SECTION 3. SCOPE

This revenue procedure applies to any taxpayer that is required to discount unpaid losses under § 846 for a line of business using the discount factors published by the Secretary, and also applies to any taxpayer that is required to discount estimated salvage recoverable under § 832. This revenue procedure applies to taxable years beginning after December 31, 2017.

SECTION 4. TABLES OF DISCOUNT FACTORS

.01 The tables in this section 4 present separately for each line of business the unpaid loss discount factors under § 846 for use in the first taxable year beginning after December 31, 2017, and for use in calculating the TCJA adjustment. All of the discount factors presented in these tables are determined by using the applicable interest rate for 2018 under § 846(c) and the proposed regulations, which is 3.12 percent, compounded semiannually, and the revised payment patterns for the 2017 determination year determined by the Secretary under § 846(d) and the proposed regulations. All of the discount factors presented in these tables are determined by assuming all loss payments occur in the middle of the calendar year.

.02 Tables 1 and 2 present separately for each line of business the unpaid loss discount factors under § 846 for use in the first taxable year beginning after December 31, 2017. Any taxpayer using discount factors prescribed in Tables 1 and 2 to compute discounted unpaid losses under § 846 for its first taxable year beginning after December 31, 2017, must use the discount factors prescribed in Tables 1 and 2 with respect to all of its property and casualty lines of business and, consistent with the TCJA transition rule, must use the discount factors prescribed in Tables 1 and 2 for all accident years ending with or before calendar year 2018. The taxpayer also must use the discount factors prescribed in Tables 1 and 2 as the salvage discount factors for the 2018 accident year and all prior accident years for purposes of determining estimated salvage recoverable under § 832 with respect to all of its property and casualty lines of business for its first taxable year beginning after December 31, 2017.

.03 Consistent with the TCJA transition rule, any taxpayer using the discount factors prescribed in Tables 1 and 2 for its first taxable year beginning after December 31, 2017, must, for that taxable year, use the discount factors prescribed in Tables 3 and 4 for purposes of determining the unpaid losses and expenses unpaid (as defined in § 832(b)(5) and (6)) at the end of the preceding taxable year, and the unpaid losses (as defined in §§ 805(a)(1) and 807(c)(2)) at the end of the preceding taxable year. The taxpayer also must, for its first taxable year beginning after December 31, 2017, use the unpaid loss discount factors prescribed in Tables 3 and 4 to determine the amount of the TCJA adjustment to be taken into account in that taxable year and, unless revised discount factors have been published, the amount of the TCJA adjustment to be taken into account in subsequent taxable years.

.04 Section V of Notice 88-100, 1988-2 C.B. 439, sets forth a composite method for computing discounted unpaid losses for accident years that are not separately reported on the annual statement. Tables 1 through 4 separately provide discount factors for taxpayers who have elected to use the composite method of Notice 88-100. See Rev. Proc. 2002-74, 2002-2 C.B. 980.

Table 1 (part A)

Factors for Discounting Unpaid Losses Under Section 846 (percent)
For the First Taxable Year Beginning After December 31, 2017
Short-Tail Lines of Business

Accident Year	Auto Physical Damage	Fidelity/Surety	Financial Guaranty/ Mortgage Guaranty	International	Other*
2018	98.2924	95.7528	95.5027	96.0825	96.9295
2017	96.9631	96.9631	96.9631	96.9631	96.9631
Years before 2017	98.4640	98.4640	98.4640	98.4640	98.4640

*** For Accident and Health lines of business (other than disability income or credit disability insurance), the discount factor for taxable year 2018 is 98.4640 percent.**

Table 1 (part B)

Factors for Discounting Unpaid Losses Under Section 846 (percent)
For the First Taxable Year Beginning After December 31, 2017
Short-Tail Lines of Business

Accident Year	Reinsurance - Nonproportional Assumed Financial Lines	Reinsurance - Nonproportional Assumed Liability	Reinsurance - Nonproportional Assumed Property	Special Property (Fire, Allied Lines, Inland Marine, Earthquake, Burglary & Theft)	Warranty	Short-Tail Composite
2018	95.3460	94.5342	96.0638	97.3657	98.0866	96.8171
2017	96.9631	96.9631	96.9631	96.9631	96.9631	96.9631
Years before 2017	98.4640	98.4640	98.4640	98.4640	98.4640	98.4640

Table 2 (part A)

Factors for Discounting Unpaid Losses Under Section 846 (percent)
For the First Taxable Year Beginning After December 31, 2017
Long-Tail Lines of Business

Accident Year	Commercial Auto/Truck Liability/Medical	Medical Professional Liability - Claims-Made	Medical Professional Liability - Occurrence	Multiple Peril Lines	Other Liability - Claims-Made	Other Liability - Occurrence
2018	93.7136	91.1847	86.1703	95.0382	90.3833	88.7841
2017	94.4581	92.2226	88.3371	93.3147	91.2289	89.6647
2016	95.0089	92.4524	89.9455	93.6251	91.7605	90.2415
2015	95.0495	92.7481	91.3552	92.8232	91.8038	90.4153
2014	94.9245	92.8961	92.3529	90.9251	91.6496	90.1639
2013	94.7625	92.9180	93.1329	91.1314	92.1818	90.2353
2012	95.0535	93.9081	93.9891	90.8234	92.6788	90.2570
2011	94.6859	94.8439	94.7064	90.5036	93.4801	91.5250
2010	96.1971	95.7805	95.8926	93.1447	94.6287	92.1970
2009	98.2598	97.6158	97.6580	94.5519	96.4911	94.1762
Taxpayer Not Using the Composite Method						
2008	98.4640	98.4640	98.4640	95.9642	97.8837	95.6063
2007	98.4640	98.4640	98.4640	97.3555	98.4640	97.0517
Years before 2007	98.4640	98.4640	98.4640	98.4640	98.4640	98.4640
Taxpayer Using the Composite Method						
Years before 2009	98.4640	98.4640	98.4640	96.7357	97.9777	96.5363

Table 2 (part B)

Factors for Discounting Unpaid Losses Under Section 846 (percent)
For the First Taxable Year Beginning After December 31, 2017
Long-Tail Lines of Business

Accident Year	Private Passenger Auto Liability/ Medical	Products Liability - Claims-Made	Products Liability - Occurrence	Workers' Compensation	Long-Tail Composite
2018	95.4241	85.1518	87.1543	87.4184	92.3564
2017	95.0203	85.6347	88.5453	85.8424	91.2748

2016	94.9784	87.5083	89.3276	84.6991	90.9788
2015	94.5984	82.9398	90.7045	83.1346	89.7633
2014	93.9009	84.2812	89.3185	82.5478	88.1393
2013	93.9524	85.6749	89.3669	81.9913	88.0168
2012	94.2025	87.1293	90.3357	82.3684	87.9945
2011	94.7658	88.4262	91.3398	83.2518	88.5587
2010	95.3902	89.7489	91.7494	83.8871	89.8408
2009	97.5924	91.0980	94.0873	85.8606	91.6956
Taxpayer Not Using the Composite Method					
2008	98.4640	92.4736	95.5247	87.1320	93.0752
2007	98.4640	93.8753	96.9877	88.4289	94.4760
2006	98.4640	95.3017	98.4640	89.7517	95.8902
2005	98.4640	96.7473	98.4640	91.1009	97.2894
2004	98.4640	98.1839	98.4640	92.4766	98.4640
2003	98.4640	98.4640	98.4640	93.8785	98.4640
2002	98.4640	98.4640	98.4640	95.3051	98.4640
2001	98.4640	98.4640	98.4640	96.7511	98.4640
2000	98.4640	98.4640	98.4640	98.1886	98.4640
Years before 2000	98.4640	98.4640	98.4640	98.4640	98.4640
Taxpayer Using the Composite Method					
Years before 2009	98.464	94.4219	96.4942	90.7644	94.8105

Table 3 (part A)

Factors for Discounting Unpaid Losses Under Section 846 (percent)
For the Taxable Year Preceding the First Taxable Year Beginning After December 31, 2017
Short-Tail Lines of Business

Accident Year	Auto Physical Damage	Fidelity/Surety	Financial Guaranty/ Mortgage Guaranty	International	Other*
2017	98.2924	95.7528	95.5027	96.0825	96.9295
2016	96.9631	96.9631	96.9631	96.9631	96.9631
Years before 2016	98.4640	98.4640	98.4640	98.4640	98.4640

*** For Accident and Health lines of business (other than disability income or credit disability insurance), the discount factor for taxable year 2017 is 98.4640 percent.**

Table 3 (part B)

Factors for Discounting Unpaid Losses Under Section 846 (percent)
For the Taxable Year Preceding the First Taxable Year Beginning After December 31, 2017
Short-Tail Lines of Business

Accident Year	Reinsurance - Nonproportional Assumed Financial Lines	Reinsurance - Nonproportional Assumed Liability	Reinsurance - Nonproportional Assumed Property	Special Property (Fire, Allied Lines, Inland Marine, Earthquake, Burglary & Theft)	Warranty	Short-Tail Composite
2017	95.3460	94.5342	96.0638	97.3657	98.0866	96.8171
2016	96.9631	96.9631	96.9631	96.9631	96.9631	96.9631
Years before 2016	98.4640	98.4640	98.4640	98.4640	98.4640	98.4640

Table 4 (part A)

Factors for Discounting Unpaid Losses Under Section 846 (percent)
For the Taxable Year Preceding the First Taxable Year Beginning After December 31, 2017
Long-Tail Lines of Business

Accident Year	Commercial Auto/Truck Liability/Medical	Medical Professional Liability - Claims-Made	Medical Professional Liability - Occurrence	Multiple Peril Lines	Other Liability - Claims-Made	Other Liability - Occurrence
2017	93.7136	91.1847	86.1703	95.0382	90.3833	88.7841
2016	94.4581	92.2226	88.3371	93.3147	91.2289	89.6647
2015	95.0089	92.4524	89.9455	93.6251	91.7605	90.2415
2014	95.0495	92.7481	91.3552	92.8232	91.8038	90.4153
2013	94.9245	92.8961	92.3529	90.9251	91.6496	90.1639
2012	94.7625	92.9180	93.1329	91.1314	92.1818	90.2353
2011	95.0535	93.9081	93.9891	90.8234	92.6788	90.2570
2010	94.6859	94.8439	94.7064	90.5036	93.4801	91.5250
2009	96.1971	95.7805	95.8926	93.1447	94.6287	92.1970
2008	98.2598	97.6158	97.6580	94.5519	96.4911	94.1762
Taxpayer Not Using the Composite Method						
2007	98.4640	98.4640	98.4640	95.9642	97.8837	95.6063
2006	98.4640	98.4640	98.4640	97.3555	98.4640	97.0517
Years before 2006	98.4640	98.4640	98.4640	98.4640	98.4640	98.4640

Taxpayer Using the Composite Method						
Years before 2008	98.4640	98.4640	98.4640	96.7357	97.9777	96.5363

Table 4 (part B)

Factors for Discounting Unpaid Losses Under Section 846 (percent)
For the Taxable Year Preceding the First Taxable Year Beginning After December 31, 2017
Long-Tail Lines of Business

Accident Year	Private Passenger Auto Liability/ Medical	Products Liability - Claims-Made	Products Liability - Occurrence	Workers' Compensation	Long-Tail Composite
2017	95.4241	85.1518	87.1543	87.4184	92.3564
2016	95.0203	85.6347	88.5453	85.8424	91.2748
2015	94.9784	87.5083	89.3276	84.6991	90.9788
2014	94.5984	82.9398	90.7045	83.1346	89.7633
2013	93.9009	84.2812	89.3185	82.5478	88.1393
2012	93.9524	85.6749	89.3669	81.9913	88.0168
2011	94.2025	87.1293	90.3357	82.3684	87.9945
2010	94.7658	88.4262	91.3398	83.2518	88.5587
2009	95.3902	89.7489	91.7494	83.8871	89.8408
2008	97.5924	91.0980	94.0873	85.8606	91.6956
<u>Taxpayer Not Using the Composite Method</u>					
2007	98.4640	92.4736	95.5247	87.1320	93.0752
2006	98.4640	93.8753	96.9877	88.4289	94.4760
2005	98.4640	95.3017	98.4640	89.7517	95.8902
2004	98.4640	96.7473	98.4640	91.1009	97.2894
2003	98.4640	98.1839	98.4640	92.4766	98.4640
2002	98.4640	98.4640	98.4640	93.8785	98.4640
2001	98.4640	98.4640	98.4640	95.3051	98.4640
2000	98.4640	98.4640	98.4640	96.7511	98.4640
1999	98.4640	98.4640	98.4640	98.1886	98.4640
Years before 1999	98.4640	98.4640	98.4640	98.4640	98.4640
<u>Taxpayer Using the Composite Method</u>					
Years before 2008	98.464	94.4219	96.4942	90.7644	94.8105

SECTION 5. APPLICATION OF DISCOUNT FACTORS IN SUBSEQUENT YEARS

Unless revised discount factors have been published, any taxpayer using discount factors prescribed herein to compute discounted unpaid losses under § 846 in the first taxable year beginning after December 31, 2017, must use the discount factors prescribed in Tables 5 and 6 in subsequent taxable years for purposes of determining the unpaid losses and expenses unpaid (as defined in § 832(b)(5) and (6)) attributable to accident year 2018, the unpaid losses (as defined in §§ 805(a)(1) and 807(c)(2)) attributable to accident year 2018, and salvage recoverable attributable to accident year 2018.

Table 5 (part A)
Factors for Discounting Unpaid Losses Under Section 846 (percent)
For Losses Incurred in Accident Year 2018 in Short-Tail Lines of Business

Taxable Year Beginning in	Auto Physical Damage	Fidelity/Surety	Financial Guaranty/ Mortgage Guaranty	International	Other*
2018	98.2924	95.7528	95.5027	96.0825	96.9295
2019	96.9631	96.9631	96.9631	96.9631	96.9631
Taxpayer Not Using Composite Method					
Years after 2019	98.4640	98.4640	98.4640	98.4640	98.4640
Composite Discount Factors					
2020	98.4640	98.4640	98.4640	98.4640	98.4640
Years after 2020	Use composite discount factors published for the relevant accident year.**				

* For Accident and Health lines of business (other than disability income or credit disability insurance), the discount factor for taxable year 2018 is 98.4640 percent. For later years, the discount factor for losses incurred in 2018 is the discount factor published for Accident and Health lines of business for losses incurred in the accident year coinciding with the taxable year.

**The relevant accident year is the accident year that is two years prior to the specified taxable year.

Table 5 (part B)

Factors for Discounting Unpaid Losses Under Section 846 (percent)

For Losses Incurred in Accident Year 2018 in Short-Tail Lines of Business

Taxable Year Beginning in	Reinsurance - Nonproportional Assumed Financial Lines	Reinsurance - Nonproportional Assumed Liability	Reinsurance - Nonproportional Assumed Property	Special Property (Fire, Allied Lines, Inland Marine, Earthquake, Burglary & Theft)	Warranty	Short-Tail Composite
2018	95.3460	94.5342	96.0638	97.3657	98.0866	96.8171
2019	96.9631	96.9631	96.9631	96.9631	96.9631	96.9631
<u>Taxpayer Not Using Composite Method</u>						
Years after 2019	98.4640	98.4640	98.4640	98.4640	98.4640	98.4640
<u>Composite Discount Factors</u>						
2020	98.4640	98.4640	98.4640	98.4640	98.4640	98.4640
Years after 2020	Use composite discount factors published for the relevant accident year.**					

**The relevant accident year is the accident year that is two years prior to the specified taxable year.

Table 6 (part A)

Factors for Discounting Unpaid Losses Under Section 846 (percent)

For Losses Incurred in Accident Year 2018 in Long-Tail Lines of Business

Taxable Year Beginning in	Commercial Auto/Truck Liability/Medical	Medical Professional Liability - Claims-Made	Medical Professional Liability - Occurrence	Multiple Peril Lines	Other Liability - Claims-Made	Other Liability - Occurrence
2018	93.7136	91.1847	86.1703	95.0382	90.3833	88.7841
2019	94.4581	92.2226	88.3371	93.3147	91.2289	89.6647
2020	95.0089	92.4524	89.9455	93.6251	91.7605	90.2415
2021	95.0495	92.7481	91.3552	92.8232	91.8038	90.4153
2022	94.9245	92.8961	92.3529	90.9251	91.6496	90.1639
2023	94.7625	92.9180	93.1329	91.1314	92.1818	90.2353
2024	95.0535	93.9081	93.9891	90.8234	92.6788	90.2570
2025	94.6859	94.8439	94.7064	90.5036	93.4801	91.5250

2026	96.1971	95.7805	95.8926	93.1447	94.6287	92.1970
2027	98.2598	97.6158	97.6580	94.5519	96.4911	94.1762
Taxpayer Not Using Composite Method						
2028	98.4640	98.4640	98.4640	95.9642	97.8837	95.6063
2029	98.4640	98.4640	98.4640	97.3555	98.4640	97.0517
Years after 2029	98.4640	98.4640	98.4640	98.4640	98.4640	98.4640
Composite Discount Factors						
2028	98.4640	98.4640	98.4640	96.7357	97.9777	96.5363
Years after 2028	Use composite discount factors published for the relevant accident year.*					

*The relevant accident year is the accident year that is ten years prior to the specified taxable year.

Table 6 (part B)
Factors for Discounting Unpaid Losses Under Section 846 (percent)
For Losses Incurred in Accident Year 2018 in Long-Tail Lines of Business

Taxable Year Beginning in	Private Passenger Auto Liability/ Medical	Products Liability - Claims-Made	Products Liability - Occurrence	Workers' Compensation	Long-Tail Composite
2018	95.4241	85.1518	87.1543	87.4184	92.3564
2019	95.0203	85.6347	88.5453	85.8424	91.2748
2020	94.9784	87.5083	89.3276	84.6991	90.9788
2021	94.5984	82.9398	90.7045	83.1346	89.7633
2022	93.9009	84.2812	89.3185	82.5478	88.1393
2023	93.9524	85.6749	89.3669	81.9913	88.0168
2024	94.2025	87.1293	90.3357	82.3684	87.9945
2025	94.7658	88.4262	91.3398	83.2518	88.5587
2026	95.3902	89.7489	91.7494	83.8871	89.8408
2027	97.5924	91.0980	94.0873	85.8606	91.6956
Taxpayer Not Using Composite Method					
2028	98.4640	92.4736	95.5247	87.1320	93.0752
2029	98.4640	93.8753	96.9877	88.4289	94.4760
2030	98.4640	95.3017	98.4640	89.7517	95.8902
2031	98.4640	96.7473	98.4640	91.1009	97.2894
2032	98.4640	98.1839	98.4640	92.4766	98.4640
2033	98.4640	98.4640	98.4640	93.8785	98.4640
2034	98.4640	98.4640	98.4640	95.3051	98.4640
2035	98.4640	98.4640	98.4640	96.7511	98.4640

2036	**98.4640**	**98.4640**	**98.4640**	**98.1886**	**98.4640**
Years after 2036	**98.4640**	**98.4640**	**98.4640**	**98.4640**	**98.4640**
<u>Composite Discount Factors</u>					
2028	**98.464**	**94.4219**	**96.4942**	**90.7644**	**94.8105**
Years after 2028	**Use composite discount factors published for the relevant accident year.***				

***The relevant accident year is the accident year that is ten years prior to the specified taxable year.**

SECTION 6. REVISED DISCOUNT FACTORS

.01 If revised unpaid loss discount factors for the 2018 accident year are published after final regulations are published in the Federal Register, the Treasury Department and IRS propose to issue guidance providing that taxpayers must use, for taxable years ending on or after the date the final regulations are published, the revised discount factors for purposes of determining, for all accident years ending with or before calendar year 2018, the unpaid losses and expenses unpaid (as defined in § 832(b)(5) and (6)) and the unpaid losses (as defined in §§ 805(a)(1) and 807(c)(2)).

.02 The Treasury Department and IRS propose that such guidance would instruct any taxpayer that used the discount factors prescribed in this revenue procedure in a taxable year beginning after December 31, 2017, and that does not amend the return filed for such taxable year to use the revised discount factors, to take into account the difference between the amount of the TCJA adjustment determined using the unpaid loss discount factors prescribed in this revenue procedure and the amount of the TCJA adjustment determined using the revised unpaid loss discount factors. The difference would be taken into account ratably over the taxable years remaining in the TCJA period of adjustment, beginning with the first taxable year in which the taxpayer uses the revised discount factors.

.03 Such guidance would also instruct any taxpayer that used the discount factors prescribed in this revenue procedure in a taxable year beginning after December 31, 2017, and that does not amend the return filed for such taxable year to use the revised discount factors, to compute, with respect to the last taxable year in which the discount factors prescribed in this revenue procedure were used, the adjustment to the amount of the discounted unpaid losses under § 846 at the end of that taxable year and the amount of discounted estimated salvage recoverable under § 832 at the end of that taxable year due to computing those amounts using the revised discount factors rather than the discount factors prescribed in this revenue procedure. The adjustment would be computed as follows: (1) from discounted unpaid losses computed using the discount factors prescribed in this revenue procedure subtract discounted unpaid losses computed using the revised discount factors, and (2) to the result so obtained, add estimated salvage computed using the revised discount factors and subtract estimated salvage computed using the discount factors prescribed in this revenue procedure. A positive adjustment would be taken into account as an addition to gross income, and a negative adjustment would be taken into account as a reduction to gross income. The adjustment would be taken into account either (1) in the first taxable year in which the taxpayer uses the revised discount factors, or (2) ratably over the taxable years remaining in the TCJA period of adjustment, beginning with the first taxable year in which the taxpayer uses the revised discount factors. For the first taxable year in which a taxpayer uses the revised discount factors, the taxpayer would determine each of the following as if the revised discount factors had applied in the preceding taxable year:

(1) the unpaid losses and expenses unpaid (as defined in § 832(b)(5) and (6)) at the end of the preceding taxable year, (2) the unpaid losses (as defined in §§ 805(a)(1) and 807(c)(2)) at the end of the preceding taxable year, and (3) the estimated salvage recoverable under § 832 at the end of the preceding taxable year.

SECTION 7. REQUEST FOR COMMENTS

The Treasury Department and IRS request comments on the proposed guidance described in section 6 of this revenue procedure. Comments should be submitted in writing on or before February 6, 2019, and should contain a reference to this Rev. Proc. 2019-06. All comments will be available for public inspection and copying. Comments may be submitted in one of three ways:

(1) By mail to Internal Revenue Service, CC:PA:LPD:PR (Rev. Proc. 2019-06), Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044.

(2) Electronically to Notice.Comments@irscounsel.treas.gov. Please include "Rev. Proc. 2019-06" in both the body of the comment and on the subject line of any electronic communications.

(3) By hand-delivery Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (Rev. Proc. 2019-06), Courier's Desk, Internal Revenue Service, 1111 Constitution Ave., NW, Washington, DC 20224.

SECTION 8. DRAFTING INFORMATION

The principal author of this revenue procedure is Kathryn M. Sneade of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure contact Ms. Sneade at (202) 317-6995 (not a toll free call).

This document is scheduled to be published in the
Federal Register on 11/07/2018 and available online at
https://federalregister.gov/d/2018-24367, and on **govinfo.gov**

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-103163-18]

RIN 1545-BO50

Modification of Discounting Rules for Insurance Companies

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking; notice of public hearing.

SUMMARY: This document contains proposed regulations providing guidance on new discounting rules for unpaid losses and estimated salvage recoverable of insurance companies for Federal income tax purposes. The proposed regulations implement recent legislative changes to the Internal Revenue Code (Code) and make other technical improvements to the derivation and use of discount factors. The proposed regulations affect entities taxable as insurance companies. This document invites comments and provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by **[INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for December 20, 2018, at 10 a.m., must be received by **[INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**.

ADDRESSES: *Comments:* Send submissions to: CC:PA:LPD:PR (REG-103163-18), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-103163-18), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC 20224, or sent electronically via the Federal eRulemaking Portal at *http://www.regulations.gov* (REG-103163-18).

Public hearing: The public hearing will be held in the IRS Auditorium, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Kathryn M. Sneade, (202) 317-6995; concerning submissions of comments and requests to speak at the public hearing, Regina L. Johnson, (202) 317-6901 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to 26 CFR part 1 under section 846 of the Code. Section 846 was added to the Code by section 1023(c) of the Tax Reform Act of 1986, Public Law 99-514 (100 Stat. 2085, 2399). Final regulations under section 846 were published in the **Federal Register** (57 FR 40841) on September 8, 1992 (T.D. 8433). See §§1.846-0 through 1.846-4 (1992 Final Regulations).

This document provides guidance on discounting rules under section 846 of the Code, which were amended on December 22, 2017 by section 13523 of "An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018," Public Law 115-97, title 1, 131 Stat. 2152 (2017) (TCJA) for taxable years beginning after December 31, 2017. The discounting rules of section 846, both prior to and after amendment by the TCJA, are used to determine discounted unpaid losses and estimated salvage recoverable of property and casualty insurance companies and discounted unearned premiums of title insurance companies for Federal income tax purposes under section 832, as well as discounted unpaid losses of life insurance companies for Federal income tax purposes under sections 805(a)(1) and 807(c)(2). These rules are discussed in greater detail in parts A and B of this Background section.

Section 13523(a) of the TCJA amended section 846(c) to provide a new definition of the “annual rate” to be used by taxpayers for discounting purposes. Section 13523(b) of the TCJA amended the computational rules for determining loss payment patterns under section 846(d). Section 13523(c) of the TCJA repealed the election under former section 846(e) to use the taxpayer’s own historical loss payment pattern instead of the pattern published by the Secretary. These changes are effective for taxable years beginning after December 31, 2017. The proposed regulations implement these changes in the law.

Part C of this Background section discusses smoothing adjustments, and part C of the Explanation of Provisions section of this preamble describes a proposed regulation authorizing the Secretary to adopt a methodology to smooth the loss payment patterns derived from the annual statement loss payment data to avoid negative payment amounts and to otherwise produce a stable pattern of positive discount factors less than one. Part A of the Other Discounting Considerations section of this preamble provides additional detail on the proposed methodology that the Department of the Treasury (Treasury Department) and the IRS anticipate developing under the authority provided in this proposed regulation. The Treasury Department and the IRS intend to describe the methodology used under the rules set forth in the proposed regulations in each revenue procedure that publishes discount factors for a determination year.

Part D of this Background section describes the existing procedures for discounting unpaid losses with respect to accident years not separately reported on the National Association of Insurance Commissioners' (NAIC) annual statement, including the method described in section V of Notice 88-100, 1988-2 C.B. 439 (composite method). Part B of the Other Discounting Considerations section of this preamble describes proposed new procedures for discounting such unpaid losses. These procedures would simplify the discounting of unpaid losses by eliminating the need for a second set of discount factors to be used with respect to accident years not separately reported on the NAIC annual statement.

Part C of the Other Discounting Considerations section of this preamble describes an approach that the Secretary intends to adopt for discounting estimated salvage recoverable by applying the unpaid loss discount factors in each line of business to the estimated salvage recoverable in that line of business.

A. *Discounted Unpaid Losses, Estimated Salvage Recoverable, and Discounted Unearned Premiums*

Under section 832, the taxable income of a property and casualty insurance company (non-life insurance company), including a title insurance company, is the sum of its underwriting income and investment income (as well as gains and other income items), reduced by allowable deductions. Under section 832(b)(3), a non-life insurance company's "losses incurred" is a component of the company's underwriting income.

Under section 832(b)(5)(A), the change over a taxable year in the company's "discounted unpaid losses" (as defined in section 846) is a component of its losses incurred for the taxable year. Discounting of unpaid losses is required to take into account the time value of money. See H. Rept. 115-466, at 470 (2017) (Conf. Rep.). Under section 832(b)(3), (4), and (8), a title insurance company's "discounted unearned premiums" is a component of the company's underwriting income. Under section 832(b)(8), a title insurance company must discount its unearned premiums by using the applicable interest rate and the applicable statutory premium recognition pattern. The applicable interest rate for purposes of section 832(b)(8) is the annual rate determined under section 846(c)(2).

Section 832(b)(5)(A) also requires that the change in discounted estimated salvage recoverable be taken into account in computing the losses incurred component of underwriting income. Under section 832(b)(5)(A), the amount of discounted estimated salvage recoverable is determined in accordance with procedures established by the Secretary. Section 1.832-4(c) provides that, except as otherwise provided in guidance published by the Commissioner in the Internal Revenue Bulletin, estimated salvage recoverable must be discounted either (1) by using the applicable discount factors published by the Commissioner for estimated salvage recoverable; or (2) by using the loss payment pattern for a line of business as the salvage recovery pattern for that line of business and by using the applicable interest rate for calculating unpaid losses under section 846(c). In prior years, guidance published by the Commissioner in the Internal Revenue Bulletin has always directed taxpayers to discount estimated salvage recoverable for each line of business using the applicable discount factors published by the Commissioner for estimated salvage recoverable and has not allowed the use of the second option provided for by regulations. These discount factors were determined using the salvage recovery pattern for the line of business and the applicable interest rate for calculating unpaid losses under section 846. See, e.g., Rev. Proc. 2018-13, 2018-7 I.R.B. 356, and Rev. Proc. 2016-59, 2016-51 I.R.B. 849.

The section 846 discounting rules are also relevant for life insurance companies. Section 807(c) provides that, for life insurance companies, the amount of unpaid losses (other than losses on life insurance contracts) is the amount of discounted unpaid losses as defined in section 846 for purposes of both sections 805(a)(1) and 807(c)(2). Section 805(a)(1) provides life insurance companies with a deduction for losses incurred during the taxable year on insurance and annuity contracts. Section 807(c)(2) provides that unpaid losses included in total reserves under section 816(c)(2) are taken into account under section 807(a) and (b) by a life insurance company. In general, section 807(a) provides that a decrease in discounted unpaid losses over the taxable year is included in life insurance company gross income under section 803(a)(2), while section 807(b) provides that an increase in discounted unpaid losses over the taxable year is deductible under section 805(a)(2).

B. *Discounting Rules for Unpaid Losses*

Section 846(a)(1) provides that the amount of discounted unpaid losses as of the end of any taxable year is the sum of the discounted unpaid losses, as of such time, separately computed with respect to unpaid losses in each line of business for each accident year. The amount of discounted unpaid losses in a line of business that is attributable to a specified accident year is calculated by multiplying that accident year's undiscounted unpaid losses at the end of each taxable year by a published discount factor associated with that line of business, accident year, and taxable year. Discount factors are published annually by the IRS. See, e.g., Rev. Proc. 2018-13 and Rev. Proc. 2016-58, 2016-51 I.R.B. 839. These discount factors are derived using the applicable loss payment pattern, determined under section 846(d) using aggregate industry loss payment data, and the applicable interest rate determined by the Secretary under section 846(c).

1. Modification of the Applicable Rate of Interest Used to Discount Unpaid Losses

The "applicable interest rate" used to determine the discount factors associated with any accident year and line of business is the "annual rate" determined under section 846(c)(2).

Before amendment by section 13523(a) of the TCJA, section 846(c)(2) provided that the annual rate for any calendar year was a rate equal to the average of the applicable Federal mid-term rates (as defined in section 1274(d) but based on annual compounding) effective as of the beginning of each of the calendar months in the most recent 60-month period ending before the beginning of the calendar year for which the determination is made. The applicable Federal mid-term rate is determined by the Secretary based on the average market yield on outstanding marketable obligations of the United States with remaining periods of over three years but not over nine years. See section 1274(d)(1).

As amended by section 13523(a) of the TCJA, section 846(c)(2) provides that the annual rate for any calendar year will be determined by the Secretary based on the corporate bond yield curve (as defined in section 430(h)(2)(D)(i), determined by substituting "60-month period" for "24-month period" therein). Section 430, which relates to minimum funding standards for single-employer defined benefit pension plans, includes other rules for determining an "effective interest rate," such as segment rate rules. The term "effective interest rate" along with these other rules, including the segment rate rules, do not apply for purposes of property and casualty insurance reserve discounting. See H. Rept. 115-466, at 471, fn. 979. The corporate bond yield curve is published on a monthly basis by the Treasury Department and consists of spot interest rates for each stated time to maturity. See, e.g., Notice 2018-60, 2018-31 I.R.B. 275. The spot rate for a given time to maturity represents the yield on a bond that gives a single payment at that maturity. For the stated yield curve, times to maturity are specified at half-year intervals from 0.5 year through 100 years. Section 846(c)(2) does not specify how the Secretary is to determine the annual rate for any calendar year based on the corporate bond yield curve.

2. Modification of Computational Rules for Loss Payment Patterns

Under section 846(d)(1), the Secretary determines a loss payment pattern for each line of business by reference to the historical aggregate loss payment data applicable to that line of business for each determination year. Under section 846(d)(4), the determination year is the calendar year 1987 and each fifth calendar year thereafter. Any loss payment pattern determined by the Secretary applies to the accident year ending with the determination year and to each of the four succeeding accident years. Section 846(d)(2)(A) and (B) provide that the determination of a loss payment pattern for any determination year is made using the aggregate experience reported on the annual statements of insurance companies on the basis of the most recent published aggregate data relating to loss payments available on the first day of the determination year. For instance, the payment data used to determine the loss payment patterns for 2017 (the most recent determination year) were reported on annual statements filed for the year 2015.

The loss payment pattern for each line of business is determined in accordance with the computational rules of section 846(d)(3). These rules determine different loss payment patterns for “long-tail” lines of business (any line of business reported in the schedule or schedules of the annual statement relating to auto liability, other liability, medical malpractice, workers’ compensation, and multiple peril lines) and “short-tail” lines of business (all lines of business other than long-tail lines of business).

For short-tail lines of business, section 846(d)(3) provides that losses unpaid at the end of the first year following the accident year are treated as paid equally in the second and third years following the accident year. For long-tail lines of business, section 846(d)(3) provides that unpaid losses remaining after ten years are treated as paid in the tenth year following the accident year, except as otherwise provided in that section.

Before amendment by section 13523(b) of the TCJA, section 846(d)(3) provided for the extension of the ten-year payment period specified for long-tail lines by not more than five years provided certain conditions were met.

As amended by section 13523(b) of the TCJA, section 846(d)(3) provides for the extension of the ten-year payment period for a maximum of fourteen additional years if the amount of losses that would have been treated as paid in the tenth year after the accident year exceeds the average of the loss payments treated as paid in the seventh, eighth, and ninth years after the accident year. In that case, the amount of losses that would have been treated as paid in the tenth year after the accident year are treated as paid in such tenth year and each subsequent year in an amount equal to the average of the loss payments treated as paid in the seventh, eighth, and ninth years after the accident year (or, if less, the portion of the unpaid losses not previously taken into account). To the extent such unpaid losses have not been treated as paid before the twenty-fourth year after the accident year, they are to be treated as paid in such twenty-fourth year.

In addition to extending the ten-year payment period, section 13523(b) of the TCJA repealed section 846(d)(3)(E) through (G). Former section 846(d)(3)(G) is discussed in part C of this Background section. Former section 846(d)(3)(F) provided for the Secretary to make appropriate adjustments if annual statement data with respect to payment of losses was available for longer periods after the accident year than the periods assumed under section 846(d). The annual statement requires the reporting of ten years of loss payment data for the international line of business and the three lines of business for non-proportional reinsurance, as it does for long-tail lines of business. Losses from proportional reinsurance are reported in the annual statement schedules related to the underlying line of business, which may be short-tail or long-tail. Under section 846(d)(3), proportional reinsurance unpaid losses are discounted using the discount factors published for the underlying line of business. Former section 846(d)(3)(E) provided special rules for determining loss payment patterns for the international line of business and for reinsurance lines of business based on the combined losses for all long-tail lines of business and provided explicit authority to the Secretary to override these special rules.

The repeal of section 846(d)(3)(E) and (F) means that the statute no longer explicitly provides for the determination of loss payment patterns for non-proportional reinsurance and international lines of business extending beyond three calendar years following the accident year. Non-proportional reinsurance and international lines of business are not included in the list of long-tail lines set forth in section 846(d)(3)(A)(ii). The Treasury Department and the IRS request comments regarding the length of the loss payment patterns for non-proportional reinsurance and international lines of business to be determined under section 846, as amended, and the legal basis for limiting the loss payment patterns for these lines of business to three calendar years following the accident year or extending the loss payment patterns beyond those years.

Section 846(f) (as redesignated by section 13523(c) of the TCJA) provides the Secretary with authority to prescribe such regulations as may be necessary or appropriate to carry out the purposes of section 846, including an explicit grant of authority to prescribe regulations for providing proper treatment of allocated reinsurance. The 1992 Final Regulations provide special rules for the determination of discount factors for proportional and non-proportional reinsurance lines of business and the international line of business. Section 1.846-1(b)(3) of the 1992 Final Regulations provides rules for the determination of discount factors for reinsurance lines of business. Section 1.846-1(b)(3)(i) provides that, with respect to proportional reinsurance lines of business (for accident years after 1987), unpaid losses are discounted using discount factors applicable to the line of business to which those unpaid losses are allocated as required on the annual statement. Section 1.846-1(b)(3)(ii)(A) provides that unpaid losses for non-proportional reinsurance (for accident years after 1991) are discounted using the discount factors published by the IRS for the appropriate reinsurance line of business, subject to an exception set forth in §1.846-1(b)(3)(iv) (if more than 90 percent of the unallocated losses of a taxpayer for an accident year relate to one underlying line of business, the taxpayer must discount all unallocated reinsurance unpaid losses attributable to that accident year using the discount factors published by the IRS for the underlying line of business). Section 1.846-1(b)(3)(ii)(B) provides rules for unpaid losses for non-proportional reinsurance for accident years 1988 through 1991, and §1.846-1(b)(3)(iii) provides rules for certain reinsurance unpaid losses for accident years before 1988.

Section 1.846-1(b)(4) of the 1992 Final Regulations provides rules for the determination of discount factors for the international line of business. Section 1.846-1(b)(4) provides that unpaid losses attributable to the international line of business are discounted using the discount factors determined for a “composite” long-tail line of business, unless more than 90 percent of such losses for that accident year are related to a single line of business, in which case the international unpaid losses are discounted using that accident year’s published discount factors for the underlying line of business.

3. Repeal of Historical Loss Payment Pattern Election

Before amendment by section 13523(c) of the TCJA, section 846(e) permitted a taxpayer to elect to use its own historical loss payment pattern with respect to all lines of business rather than the industry-wide loss payment pattern determined by the

Secretary under section 846(d), provided that applicable requirements were met. Section 13523(c) of the TCJA repealed that election.

4. Transition Rule

The transition rule set forth in section 13523(e) of the TCJA provides that, for the first taxable year beginning after December 31, 2017, the unpaid losses and expenses unpaid (as defined in section 832(b)(5) and (6)) at the end of the preceding taxable year, and the unpaid losses (as defined in sections 805(a)(1) and 807(c)(2)) at the end of the preceding taxable year, are determined as if the amendments made by section 13523 of the TCJA had applied to such unpaid losses and expenses unpaid in the preceding taxable year and by using the interest rate and loss payment patterns applicable to accident years ending with calendar year 2018. Any adjustment resulting from this transition rule is taken into account ratably in such first taxable year and the seven succeeding taxable years. For subsequent taxable years, such amendments are applied with respect to unpaid losses and expenses unpaid for accident years ending with or before calendar year 2018 by using the interest rate and loss payment patterns applicable to accident years ending with calendar year 2018.

C. *Smoothing Adjustments*

As described in part B(2) of this Background section, section 846(d)(1) requires the Secretary to determine, for each determination year, a loss payment pattern for each line of business by reference to the historical aggregate loss payment data applicable to that line of business. The Secretary makes such determination using the aggregate experience reported on the annual statements of insurance companies on the basis of the most recent published aggregate data from such annual statements relating to loss payment patterns available on the first day of the determination year. Because historical loss payment patterns change from accident year to accident year, the annual payment amounts determined on the basis of data taken from a single year's annual statements are not always non-negative and may vary significantly from year to year. Accordingly, use of the annual statement payment data to determine the loss payment pattern without any adjustment to compensate for changes from year to year may produce discount factors that vary widely from one year to the next or discount factors for a particular year or years that are negative or greater than one. See Rev. Proc. 2003-17, 2003-1 C.B. 427.

Former section 846(d)(3)(G), prior to its repeal by section 13523 of the TCJA, provided guidance on one aspect of smoothing. Former section 846(d)(3)(G) provided that, if the amount of losses treated as paid in the ninth year after the accident was negative or zero, the average of the losses treated as paid in the seventh, eighth, and ninth years after the accident year would be used instead to determine the amount of losses treated as paid in the following years. Section 846(d)(3)(B)(ii)(II), as amended by section 13523(b) of the TCJA, provides that the average of the loss payments treated as paid in the seventh, eighth, and ninth years after the accident year is used to determine the amount of losses treated as paid in the following years. Section 846, as amended, provides no additional specific guidance regarding smoothing of the loss payment patterns.

In section 2.03(4) of Rev. Proc. 2003-17 and section 3.04 of Rev. Proc. 2007-9, 2007-3 I.R.B. 278, comments were requested as to whether a methodology should be adopted to smooth the annual statement payment data, and thus produce a more stable pattern of discount factors. The Treasury Department and the IRS received comments that agreed that such a methodology should be adopted and suggested specific methods that could be used.

D. *Composite Method*

Rules for discounting unpaid losses with respect to accident years not separately reported on the NAIC annual statement are described in section V of Notice 88-100 and in Rev. Proc. 2002-74, 2002–2 C.B. 980.

After the enactment of section 846 in 1986, the Treasury Department and the IRS published Notice 88-100 to provide guidance with respect to several issues that were expected to be addressed in then forthcoming regulations under section 846. Section V of Notice 88-100 stated that regulations under section 846 would provide that taxpayers may not use information that does not appear on their NAIC annual statements to allocate aggregate unpaid losses among several accident years, but rather must use a composite discount factor for such aggregated unpaid losses. The notice set forth a method for computing a composite discount factor to be used to compute discounted unpaid losses with respect to accident years not separately reported on the NAIC annual statement, referred to as the "composite method." The notice provided a simplified example to illustrate the operation of this method.

The 1992 Final Regulations provided guidance on several issues addressed in Notice 88-100, rendering portions of Notice 88-100 obsolete. However, the 1992 Final Regulations did not adopt the rule anticipated by section V of Notice 88-100 requiring that taxpayers use a composite discount factor for the aggregate unpaid losses from accident years not separately reported on the NAIC annual statement, and therefore section V of Notice 88-100 was not rendered obsolete.

The 1992 Final Regulations adopted a rule requiring taxpayers to use composite discount factors with respect to any line of business for which the IRS has not published discount factors. See §1.846-1(b)(1)(ii) and (5) of the 1992 Final Regulations. Composite discount factors determined on the basis of the appropriate composite loss payment pattern are published annually by the IRS for use with respect to such lines of business. However, these composite discount factors are unrelated to the composite discount factors of Notice 88-100 that relate to discounting unpaid losses from accident years not separately reported on the NAIC annual statement.

Section 3.01 of Rev. Proc. 2002-74 clarifies that the composite method described in section V of Notice 88-100 is permitted but not required to be used by insurance companies. Section 3.01 also provides that the Secretary will publish composite discount factors annually for use by taxpayers that have not elected under section 846(e) to use their historical loss payment patterns, and such factors have been published annually since 2002, along with the Secretary’s tables containing the section 846 loss payment patterns and discount factors and the section 832 salvage discount factors. See, e.g., Rev. Proc. 2016-58. Section 3.02 of Rev. Proc. 2002-74 provides, in part, that taxpayers who do not use a composite method described in section 3.01 of Rev. Proc. 2002-74 should instead use the discount factors for the appropriate year in the Secretary's table for the appropriate line of business. Sections 3.01 and 3.02 of Rev. Proc. 2002-74 also provide instructions for taxpayers that have elected under section 846(e) to use their historical loss payment patterns. However, as discussed in part B(3) of this Background section, section 13523(c) of the TCJA repealed section 846(e).

Explanation of Provisions

A. Modification of the Applicable Rate of Interest Used to Discount Unpaid Losses

Proposed §1.846-1(c) provides that the applicable interest rate is the annual rate determined by the Secretary for any calendar year on the basis of the corporate bond yield curve (as defined in section 430(h)(2)(D)(i), determined by substituting "60-month period" for "24-month period" therein). The annual rate for any calendar year is the average of the corporate bond yield curve's monthly spot rates with times to maturity of not more than seventeen and one-half years, computed using the most recent 60-month period ending before the beginning of the calendar year for which the determination is made.

Consistent with the text of section 846, as amended by the TCJA, and the statutory structure as a whole, the proposed regulations provide for the use of a single annual rate applicable to all lines of business as was the case under section 846 prior to amendment by the TCJA. Under section 846(c)(2) prior to amendment by section 13523(a) of the TCJA, a single annual rate was used for all lines of business, and the amendments made by the TCJA do not clearly indicate an intent to change from the historical practice of applying a single rate to all loss payment patterns. The change from using the average of the applicable Federal mid-term rates to the averaged corporate bond yield curve, however, indicates that the annual rate should be determined in a manner that more closely matches the investments in bonds used to fund the undiscounted losses to be incurred in the future by insurance companies.

An alternative approach would be the direct application of the corporate bond yield curve to the loss payment pattern for each line of business, which would result in a more accurate measure of the present value of the unpaid losses for each line of business. In light of the investment in corporate bonds to fund the unpaid losses to be paid in the future, the result is a more accurate reflection of the time value of money in the measure of income. Using this approach, for each taxable year, each future loss payment incurred in a line of business for an accident year (as determined by the loss payment pattern determined for that line of business) would be discounted using the spot rate from the corporate bond yield curve with a time to maturity that matches the time between the end of the accident year and the middle of the year of the loss payment.

Although the proposed regulations do not adopt this approach in light of the text of section 846 and the statutory structure as a whole, the maturity range used to determine the single rate applicable to all unpaid losses for all lines of business (times to maturity of not more than seventeen and one-half years) was selected to minimize the differences in taxable income, in the aggregate, resulting from the use of a single discount rate for a given accident year versus the direct application of the corporate bond yield curve for that accident year. For this purpose, losses incurred for the accident year were assumed to be those reported for 2015, and loss payments for each line of business were assumed to follow the loss payment pattern for that line of business determined using aggregate data reported on annual statements filed for 2015. Each maturity range considered had a half-year time to maturity as a lower bound, but had a different upper bound. Discount factors for all lines of business were calculated using the loss payment patterns and the discount rate applicable to the 2018 accident year, and a different discount rate was used for each maturity range being considered. For each maturity range, discounted unpaid losses and taxable income effects were computed for each line of business for the accident year and for each following taxable year. A present value of the taxable income effects for each line of business was calculated and subtracted from the present value of the taxable income effects calculated for that line of business using a direct application of the applicable corporate bond yield curve. Each present-value difference was expressed as a positive number, and these amounts were summed over all lines of business. The selected maturity range was the one that generated the smallest sum of present-value differences in taxable income effects.

In addition to the approach underlying the proposed regulations, the Treasury Department and the IRS considered a number of other options for determining the annual rate on the basis of the corporate bond yield curve. The Treasury Department and the IRS considered other ranges of maturities that could be used to determine a single annual rate applicable to all lines of business, such as the range of maturities used to determine the applicable Federal mid-term rate (over three years but not over nine years), as well as different maturity ranges of the same width (five and one-half years). The Treasury Department and the IRS also considered the use of a variable maturity range. Under a variable maturity range approach, the annual rate for any calendar year would be the average of the corporate bond yield curve's monthly spot rates with times to maturity contained within the range that would minimize, for that calendar year, the sum of differences in taxable income effects, selected in the same fashion as was the range adopted in the proposed regulations. Additionally, the Treasury Department and the IRS also considered (1) the use of two rates, one for long-tail lines of business, and one for short-tail lines of business; (2) the use of a different annual rate for each line of business; and (3) the direct application of the corporate bond yield curve.

The Treasury Department and the IRS request comments on the method of determining the annual rate on the basis of the corporate bond yield curve, including comments on whether a different option than the one incorporated in the proposed regulations should be adopted in the final regulations and, if so, the legal basis for that alternative option and explanation of how that option would more clearly reflect income.

B. *Proposed Removal of Regulations*

The proposed regulations propose to remove §1.846-1(a)(2) of the 1992 Final Regulations because the examples are no longer relevant. The proposed regulations propose to remove §1.846-1(b)(3)(ii)(B) and (b)(3)(iii) of the 1992 Final Regulations because these provisions apply only to accident years before 1992. The proposed regulations propose to remove §1.846-1(b)(3)(iv) and (b)(4) of the 1992 Final Regulations because section 13523 of the TCJA repealed section 846(d)(3)(E). Section 1.846-1(b)(3)(i) and (b)(3)(ii)(A) of the 1992 Final Regulations are retained (with §1.846-1(b)(3)(ii)(A) being redesignated as §1.846-1(b)(3)(ii)) because these rules continue to provide for the proper treatment of reinsurance unpaid losses. The proposed regulations also propose to make conforming changes to §1.846-1(a) and (b) of the 1992 Final Regulations to reflect the removal of various §1.846-1 provisions, as well as the removal of §§1.846-2 and 1.846-3 of the 1992 Final Regulations.

Section 13523 of the TCJA repealed the section 846(e) election permitting a taxpayer to use its own historical loss payment pattern with respect to all lines of business rather than the industry-wide loss payment pattern determined by the Secretary under section 846(d), provided that applicable requirements were met. Section 1.846-2 of the 1992 Final Regulations, which provides rules for applying the section 846(e) election, is proposed to be removed.

Section 1.846-3 of the 1992 Final Regulations provides “fresh start” and reserve strengthening rules applicable to the last taxable year beginning before January 1, 1987, and the first taxable year beginning after December 31, 1986. Because the rules in §1.846-3 are no longer applicable, §1.846-3 is proposed to be removed.

Section 1.846-4 of the 1992 Final Regulations provides applicability dates for §§1.846-1 through 1.846-3 of the 1992 Final Regulations. Under §1.846-4(a), §1.846-1 applies to taxable years beginning after December 31, 1986. Because §§1.846-2 and 1.846-3 are proposed to be removed, a separate applicability date section for §1.846-1 is no longer needed, and, therefore, §1.846-4 is proposed to be removed. The applicability dates for §1.846-1 are proposed to be included in proposed §1.846-1(e), including the original applicability date for those portions of §1.846-1 that are not proposed to be revised.

Section 1.846-0 of the 1992 Final Regulations, which provides a list of the headings in §§1.846-1 through 1.846-4 of the 1992 Final Regulations, is proposed to be removed.

On April 10, 2006, the Treasury Department and the IRS published in the **Federal Register** (71 FR 17990) a Treasury decision (T.D. 9257) containing §§1.846-

2T and 1.846-4T. On January 23, 2008, the Treasury Department and the IRS published in the **Federal Register** (73 FR 3868) a Treasury decision (T.D. 9377) that finalized the rules contained in §1.846-2T in §1.846-2 and finalized the rules contained in §1.846-4T in §1.846-4. T.D. 9377, however, did not remove §§1.846-2T and 1.846-4T from the Code of Federal Regulations (CFR). Because these sections are obsolete, the Treasury Department and the IRS intend to remove §§1.846-2T and 1.846-4T from the CFR when the proposed regulations in this document are finalized.

C. *Smoothing Adjustments*

Section 846(d) instructs the Secretary to determine a loss payment pattern for each line of business for each determination year "by reference to" the historical loss payment pattern applicable to such line of business "on the basis of" the most recent published aggregate data from annual statements of insurance companies available on the first day of the determination year. Section 846 provides broad discretion to the Secretary to make needed adjustments when determining the loss payment patterns for each line of business. Use of loss payment patterns with negative payment amounts may produce discount factors that vary widely from year to year or discount factors that are negative or that exceed one. Commenters responding to prior requests for comments agreed that a methodology should be adopted to smooth the loss payment patterns. Proposed §1.846-1(d)(2) provides that the Secretary may, if necessary to avoid negative payment amounts and otherwise produce a stable pattern of positive discount factors less than one, adjust the loss payment pattern for any line of business using a methodology described by the Secretary in other published guidance.

Part A of the Other Discounting Considerations section of this preamble provides additional detail on the methodology that the Treasury Department and the IRS anticipate using to adjust loss payment patterns.

Proposed Applicability Dates

The rules in proposed §1.846-1(c) and (d) are proposed to apply to taxable years beginning after December 31, 2017.

Other Discounting Considerations

A. *Smoothing Adjustments*

1. Proposed Methodology

The Treasury Department and the IRS intend to describe the adjustments made to the loss payment patterns produced using annual statement payment data and the methodology used to make such adjustments under the rule set forth in proposed §1.846-1(d)(2) for each determination year in the revenue procedure publishing discount factors for that determination year. The methodology that the Treasury Department and the IRS anticipate using to make adjustments to loss payment patterns for lines of business described in section 846(d)(3)(A)(ii) is illustrated by the following computational steps.

Step 1. Compute the yearly payment amounts and cumulative payment amounts for the accident year and the nine years following the accident year using the most recent published aggregate data from annual statements relating to loss payment patterns available on the first day of the determination year. If any of the payment amounts for the seventh, eighth, or ninth year following the accident year are negative, or if the sum of these amounts is zero (and the cumulative payment amount for the ninth year following the accident year is not 1 (one)), go to Step 2 of this illustration. Otherwise, compute the average of the payment amounts for these three years for later reference in Step 3 and use in Step 7 of this illustration, and proceed to Step 3 of this illustration.

Step 2. Average the payments for the seventh, eighth, and ninth years after the accident year. If that average is non-positive, include in the average the payment for the immediate prior year (that is, the sixth year following the accident year). If the average payment is still non-positive, continue including payments (from the fifth, fourth, etc. years after the accident year) until a positive average is produced. When a positive average payment amount is achieved, assign this payment amount to all years for which payment amounts were included in the average, and recalculate the cumulative payments for those years.

Step 3. Identify the payment for the year immediately prior to the earliest year included in the average computed in Step 1 or Step 2 of this illustration. Call that year the "current year," and go to Step 4 of this illustration.

Step 4. If the payment for the current year is negative, go to Step 5 of this illustration. If it is non-negative, keep that payment amount for the current year, go to the next prior year, call it the "current year," and repeat this Step 4. Repeat until all payments are non-negative, then go to Step 7 of this illustration.

Step 5. If the payment amount for the current year is negative, average that amount with the payment amounts from an even number of adjacent years, before and after the current year. Choose the minimum number of adjacent years necessary to achieve a non-negative average payment amount. This average may include amounts that were the result of a previous averaging calculation, but may not include any payment amount for a year following the sixth year after the accident year. If including payments for all prior years in the average does not achieve a non-negative average, include as many additional payments from years following the current year as necessary to achieve a non-negative average. Assign the non-negative average payment amount to all years for which payment amounts were included in the calculation of the average, and recalculate the cumulative payments for those years.

Step 6. Identify the payment for the year immediately prior to the earliest year included in the average of Step 5 of this illustration. Call it the “current year,” and go to Step 4 of this illustration.

Step 7. Apply the rules of section 846(d)(3)(B)(ii), using the average payment for the seventh, eighth, and ninth year after the accident year, to produce payment amounts for years following the ninth year after the accident year.

For example, using this methodology, if the tentative payment amount for the fifth year following the accident year is negative, that amount is averaged with the tentative payment amounts for the fourth and sixth years following the accident year. If that average is negative, the tentative payment amount for the third year following the accident year is included in the average. If that average is non-negative, it becomes the tentative payment amount for the third through sixth years following the accident year.

2. Comparison to Other Suggested Methods

The methods suggested by commenters responding to the requests for comments in Rev. Proc. 2003-17 and Rev. Proc. 2007-9 can be described in general terms as follows:

(1) Treat a negative estimated loss paid as zero.

(2) Average the negative estimated loss paid with estimated losses from other years to yield a positive result. For instance, commenters suggested two different methods for eliminating a negative estimated loss paid in the ninth year after the accident year: averaging the negative estimated loss with estimated losses from as many earlier years as needed to yield a positive result, and averaging the negative estimated loss with the estimated losses for all later years.

(3) Adjust the negative estimated loss paid to equal the lesser of the value for the next younger year and the amount that brings the cumulative losses paid to 100 percent.

(4) Adjust the negative estimated loss paid using a smoothing calculation that results in younger years having a lower “Estimated Cumulative Losses Paid” than more mature years.

(5) Adjust the negative estimated loss paid by ensuring the percent paid in any year is no higher than the year before.

The Treasury Department and the IRS considered the methods suggested by commenters responding to prior requests for comments, but anticipate using the proposed methodology to adjust loss payment patterns for several reasons. Among other things, the proposed methodology, to the extent possible, centers the average on the negative payment year and therefore should not display a bias towards increasing or decreasing discount factors. The proposed methodology ensures that the amount used to extend the loss payment pattern past the ninth year after the accident year is positive, and preserves the average for the seventh, eighth, and ninth years after the accident year when that average is initially positive.

B. *Discontinuance of Composite Method*

This document proposes to eliminate the need to determine a second set of discount factors to be used with respect to accident years not separately reported on the NAIC annual statement by providing that, effective for taxable years beginning on or after the date the proposed regulations are published as final regulations in the **Federal Register**, a taxpayer that has unpaid losses relating to an accident year not separately reported on the NAIC annual statement must compute discounted unpaid losses with respect to that year using the discount factor published by the Secretary for that year for the appropriate line of business.

The methods described in Rev. Proc. 2002-74, including the composite method described in section 3.01 of Rev. Proc. 2002-74 and section V of Notice 88-100, would not be permitted methods, effective for taxable years beginning on or after the date the proposed regulations are published as final regulations in the **Federal Register**. Section V of Notice 88-100 and Rev. Proc. 2002-74 would be obsolete for taxable years beginning on or after that date. The Treasury Department and the IRS anticipate providing rules applicable to taxpayers that seek to change a method of accounting to comply with these changes. The Treasury Department and the IRS anticipate that these rules will provide that a taxpayer seeking to change to the method of accounting prescribed must follow the applicable procedures for obtaining the Commissioner's automatic consent to a change in accounting method.

C. *Determination of Estimated Discounted Salvage Recoverable*

In prior years, guidance published by the Commissioner in the Internal Revenue Bulletin has directed taxpayers to discount estimated salvage recoverable for each line of business using the applicable discount factors published by the Commissioner for estimated salvage recoverable. See, e.g., Rev. Proc. 2018-13 and Rev. Proc. 2016-59. These discount factors were determined using the salvage recovery pattern for the line of business and the applicable interest rate for calculating unpaid losses under section 846. *Id.* The Treasury Department and the IRS anticipate providing in similar future guidance published in the Internal Revenue Bulletin that estimated salvage recoverable is to be discounted using the published discount factors applicable to unpaid losses. This treatment of estimated salvage recoverable is equivalent to netting undiscounted unpaid losses with estimates of salvage recoverable and discounting the net amount using the unpaid loss discount factors. This method is permitted under section 832(b)(5)(A) and §1.832-4(c) and should reduce compliance complexity and costs. Separate discount factors for estimated salvage recoverable (including anticipated recoveries on account of subrogation claims) would no longer be published by the IRS. The Treasury Department and the IRS request comments on whether net payment data (loss payments less salvage recovered) and net losses incurred data (losses incurred less salvage recoverable) should be used to compute loss discount factors.

Effect on Other Documents

Section V of Notice 88-100 and Rev. Proc. 2002-74 are proposed to be obsolete for taxable years beginning on or after the date the proposed regulations are published as final regulations in the **Federal Register**.

Special Analyses

This regulation is not subject to review under section 6(b) of Executive Order 12866 pursuant to the Memorandum of Agreement (April 11, 2018) between the Treasury Department and the Office of Management and Budget regarding review of tax regulations. Because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the **ADDRESSES** heading. The Treasury Department and the IRS request comments on all aspects of the proposed rules. All comments that are submitted by the public will be available for public inspection and copying at *http://www.regulations.gov* or upon request.

A public hearing has been scheduled for December 20, 2018, at 10 a.m., in the IRS Auditorium, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than thirty (30) minutes before the hearing starts. For more information about having your name placed on the building access list to attend the hearing, see the **FOR FURTHER INFORMATION CONTACT** section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments and an outline of the topics to be discussed and the time to be devoted to each topic by **[INSERT DATE 30 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER]**. Such persons should submit a signed paper original and eight (8) copies or an electronic copy. A period of ten (10) minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Kathryn M. Sneade, Office of Associate Chief Counsel (Financial Institutions and Products), IRS. However, other personnel from the Treasury Department and the IRS participated in their development.

Statement of Availability of IRS Documents

The IRS notices and revenue procedures cited in this preamble are published in the Internal Revenue Bulletin (or Cumulative Bulletin) and are available from the Superintendent of Documents, U.S. Government Publishing Office, Washington, DC 20402, or by visiting the IRS website at *http://www.irs.gov*.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for §1.846-2(d), removing the entry for §§1.846-1 through 1.846-4, and adding an entry in numerical order for §1.846-1. The addition reads in part as follows:

Authority: 26 U.S.C. 7805 * * *

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Section 1.846-1 also issued under 26 U.S.C. 846.

* * * * *

§1.846-0 [Removed]

Par. 2. Section 1.846-0 is removed.

Par. 3. Section 1.846-1 is amended by:

1. Removing "section 846(f)(3)" from the first sentence of paragraph (a)(1) and adding "section 846(e)(3)" in its place.
2. Removing "and §1.846-3(b) contains guidance relating to discount factors applicable to accident years prior to the 1987 accident year" from the third sentence of paragraph (a)(1).
3. Removing the last sentence of paragraph (a)(1).
4. Removing paragraph (a)(2) and redesignating paragraphs (a)(3) and (4) as paragraphs (a)(2) and (3), respectively.

5. In the first sentence of paragraph (b)(1), removing “section 846(f)(6)” and adding “section 846(e)(6)” in its place; and removing “, in §1.846-2 (relating to a taxpayer’s election to use its own historical loss payment pattern)”.
6. Removing “for accident years after 1987” from the heading for paragraph (b)(3)(i).
7. Removing the designation “(A)” and the accompanying heading “Accident years after 1991” after the heading of paragraph (b)(3)(ii).
8. Removing paragraphs (b)(3)(ii)(B), and (b)(3)(iii) and (iv).
9. Removing paragraph (b)(4) and redesignating paragraph (b)(5) as paragraph (b)(4).
10. Adding paragraphs (c), (d), and (e).

The additions read as follows:

§1.846-1 Application of discount factors.

* * * * *

(c) *Determination of annual rate.* The applicable interest rate is the annual rate determined by the Secretary for any calendar year on the basis of the corporate bond yield curve (as defined in section 430(h)(2)(D)(i), determined by substituting “60-month period” for “24-month period” therein). The annual rate for any calendar year is determined on the basis of a yield curve that reflects the average, for the most recent 60-month period ending before the beginning of the calendar year, of monthly yields on corporate bonds described in section 430(h)(2)(D)(i). The annual rate is the average of that yield curve’s monthly spot rates with times to maturity of not more than seventeen and one-half years.

(d) *Determination of loss payment pattern*--(1) *In general.* Under section 846(d)(1), the loss payment pattern determined by the Secretary for each line of business is determined by reference to the historical loss payment pattern applicable to such line of business determined in accordance with the method of determination set forth in section 846(d)(2) and the computational rules prescribed in section 846(d)(3) on the basis of the annual statement data from annual statements described in section 846(d)(2)(A) and (B). However, the Secretary may adjust the loss payment pattern for any line of business as provided in paragraph (d)(2) of this section.

(2) *Smoothing adjustments.* The Secretary may adjust the loss payment pattern for any line of business using a methodology described by the Secretary in other published guidance if necessary to avoid negative payment amounts and otherwise produce a stable pattern of positive discount factors less than one.

(e) *Applicability date*. (1) Except as provided in paragraph (e)(2) of this section, this section applies to taxable years beginning after December 31, 1986.

(2) Paragraphs (c) and (d) of this section apply to taxable years beginning after December 31, 2017.

§1.846-2 [Removed]

Par. 4. Section 1.846-2 is removed.

§1.846-2T [Removed]

Par. 5. Section 1.846-2T is removed.

§1.846-3 [Removed]

Par. 6. Section 1.846-3 is removed.

§1.846-4 [Removed]

Par. 7. Section 1.846-4 is removed.

§1.846-4T [Removed]

Par. 8. Section 1.846-4T is removed.

Kirsten Wielobob,

Deputy Commissioner for Services and Enforcement.

[FR Doc. 2018-24367 Filed: 11/5/2018 4:15 pm; Publication Date: 11/7/2018]