–37PTH, –52B, –61BT, –61BTH, and –69BTH.

* * * * *

Dated at Rockville, Maryland, this 24th day of October 2018.

For the Nuclear Regulatory Commission.

Margaret M. Doane,

Executive Director for Operations.

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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 December 7, 2018. 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 December 7, 2018.

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 December 7, 2018. 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 * * *

* * * * *

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

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§ 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 11–5–18; 4:15 pm]

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 53

[REG–107163–18]

RIN 1545–BO80

Regulations To Prescribe Return and Time for Filing for Payment of Section 4960, 4966, 4967, and 4968 Taxes and To Update the Abatement Rules for Section 4966 and 4967 Taxes

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations specifying which return to use to pay certain excise taxes and the time for filing the return. The regulations also implement the statutory addition of two excise taxes to the first-tier taxes subject to abatement. These regulations affect applicable tax-exempt