

DATES: *Effective Date:* January 23, 2008.
Applicability Date: November 24, 2006.

FOR FURTHER INFORMATION CONTACT: Ainars Rodins, Director, Public and Indian Housing Special Application Center, Department of Housing and Urban Development, Ralph H. Metcalfe Federal Building, 77 West Jackson Boulevard, Room 2401, Chicago, IL 60604-3507; telephone: (312) 353-6236 (this is not a toll-free number). Persons with hearing or speech impairments may access that number toll-free through TTY by calling the Federal Relay Service at (800) 877-8339.

SUPPLEMENTARY INFORMATION:

I. Background

On October 24, 2006 (71 FR 62354), HUD published a final rule revising the Department's regulations governing demolition or disposition of public housing projects. This final rule followed a December 15, 2004 (69 FR 75188), proposed rule. The final rule became effective on November 24, 2006. These HUD regulations implement section 18 of the United States Housing Act of 1937 (42 U.S.C. 1437p) (1937 Act), and are codified at 24 CFR part 970.

A. Technical Corrections

After publication, it came to HUD's attention that certain typographical and technical errors had occurred in items in the regulatory text.

- 24 CFR 970.3(b)(4) (71 FR 62362). The phrase "incident to the normal operation * * *" found in this section should have read "incidental to the normal operation. * * *" This grammatical correction does not change the meaning or function of the paragraph and is a technical correction.

- 24 CFR 970.3(b)(13) (71 FR 62363). Section 970.3(b)(13) refers to environmental review provisions, including the provisions at § 970.7(a)(16). The environmental provision is in paragraph (15), not paragraph (16), and therefore the intended reference should have been to § 970.7(a)(15). Section 970.7(a)(16) relates to civil rights. Because it is clear from the text that § 970.7(a)(15) was the intended reference, this rule makes that technical correction.

- 24 CFR 970.9(b)(3)(vi) (71 FR 62365). Paragraph (b)(3)(vi) paragraph is out of sequence and was therefore incorrectly and inadvertently designated. This paragraph is correctly redesignated as § 970.9(b)(3)(v). This change does not alter the meaning or function of the paragraph and is a technical correction.

- 24 CFR 970.15(a) (71 FR 62367). This section makes a cross-reference to

"the criteria for disapproval under 24 CFR 270.29." There is no 24 CFR part 270. Furthermore, 24 CFR 970.29 is entitled "Criteria for disapproval of demolition or disposition applications." The intended reference was to part 970. This reference is a typographical error and this rule corrects this error and references 24 CFR 970.29.

- 24 CFR 970.27 (71 FR 62369). This section is missing a paragraph designation. The paragraph as published in the final rule is designated as § 970.27(1). However the correct designation is § 970.27(c)(1). This appears to have been the result of a GPO error. This rule makes that technical correction.

List of Subjects in 24 CFR Part 970

Grant programs—housing and community development, Public housing, Reporting and recordkeeping requirements.

The Catalog of Federal Domestic Assistance program number for the program affected by this final rule is 14.850.

■ Accordingly, HUD correctly amends 24 CFR part 970 as follows:

PART 970—PUBLIC HOUSING PROGRAM—DEMOLITION OR DISPOSITION OF PUBLIC HOUSING PROJECTS

■ 1. The authority citation for part 970 continues to read as follows:

Authority: 42 U.S.C. 1437p and 3535(d).

§ 970.3 [Amended]

■ 2. Amend § 970.3 as follows:

- a. In paragraph (b)(4), revise the phrase "incident to the normal operation" to read "incidental to the normal operation;" and

- b. In paragraph (b)(13), revise the reference to "§§ 970.7(a)(16) and 970.13(b) of this part" with the reference "§§ 970.7(a)(15) and (b)(13) of this part."

§ 970.9 [Amended]

■ 3. In 970.9, redesignate paragraph (b)(3)(vi) as paragraph (b)(3)(v).

§ 970.15 [Amended]

■ 4. In, § 970.15(a), revise the reference to "24 CFR 270.29" to read "24 CFR 970.29."

§ 970.27 [Amended]

■ 5. In § 970.27 redesignate paragraphs (b)(1) and (b)(2) as paragraphs (c)(1) and (c)(2), respectively.

Dated: January 2, 2008.

Orlando J. Cabrera,

Assistant Secretary for Public and Indian Housing.

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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[TD 9377]

RIN 1545-BF02

Application of Section 338 to Insurance Companies

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations under section 197 of the Internal Revenue Code (Code) that apply to a section 197 intangible resulting from an assumption reinsurance transaction, and under section 338 that apply to reserve increases after a deemed asset sale. The final regulations also provide guidance with respect to existing section 846(e) elections to use historical loss payment patterns. The final regulations apply to insurance companies.

DATES: *Effective Date:* These regulations are effective on January 23, 2008.

Applicability Date: For date of applicability of these regulations, see § 1.197-2(g)(5)(ii)(E), § 1.338-11(d)(7) and § 1.846-4(b).

FOR FURTHER INFORMATION CONTACT: William T. Sullivan (202) 622-7052 or Donald J. Drees, Jr. (202) 622-3970 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-1990.

The collection of information in these final regulations is in § 1.338-11(e)(2). This information is required by the IRS to allow an insurance company to choose to cease using its historical loss payment pattern, and instead use industry-wide factors, to discount unpaid losses.

An agency may not conduct or sponsor, and the person is not required

to respond to a collection of information unless the collection of information displays a valid control number.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax information are confidential, as required by 26 U.S.C. 6103.

Background and Explanation of Provisions

On March 8, 2002, the IRS and the Treasury Department published a notice of proposed rulemaking REG-118861-00 in the **Federal Register** (67 FR 10640) (2002-1 Cumulative Bulletin (CB) 651) (the 2002 proposed regulations) that set forth rules applying to taxable acquisitions and dispositions of insurance businesses, including those that are deemed to occur when an election under section 338 of the Code is made. (See § 601.601(d)(2)(ii)(b)). The CB is made available by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402. Written comments were received in response to the 2002 proposed regulations, and a public hearing was held. After consideration of all the comments, the IRS and the Treasury Department published final regulations in the **Federal Register** on April 10, 2006, (TD 9257) (71 FR 17990), as corrected in the **Federal Register** (TD 9257) (71 FR 26826) to remove an error that might have proven to be misleading.

TD 9257 also contains temporary regulations under sections 197, 338, and 846, which serve as the basis for a cross-reference notice of proposed rulemaking published in the **Federal Register** (REG-146384-05) (71 FR 18053) with respect to issues that were the subject of comments on the 2002 proposed regulations. Specifically, § 1.197-2T(g)(5)(ii) provides guidance with regard to the interplay between section 197(f)(5) (concerning the treatment of certain reinsurance transactions) and section 848 (requiring the capitalization of certain policy acquisition expenses); § 1.338-11T(d) addresses reserve increases after a deemed asset sale that results from a section 338 election; and § 1.338-11T(e) provides guidance on the effect of a section 338 election on an insurance company's election under section 846(e) to use its historical loss payment pattern to discount certain unpaid losses.

Although the 2002 proposed regulations generated a number of comments which are discussed in detail in the preamble to TD 9257, no new

comments were received with respect to the temporary regulations that served as a cross-reference notice of proposed rulemaking in 2006. Accordingly, this Treasury decision adopts the proposed regulations without substantive change and removes the corresponding temporary regulations. This Treasury decision also revises cross-references where appropriate to reflect the removal of temporary regulations and their replacement with final regulations and corrects two obvious errors, one a mathematical error in the last sentence of § 1.381(c)(22)-1(b)(7)(v), Example 3, the other an error in the captioning of § 1.338(i)-1(c)(2)(ii)(B).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that the collection of information requirement in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations do not have a substantial economic impact because they merely provide guidance about the operation of the tax law in the context of acquisitions of insurance companies and businesses. Moreover, they are expected to apply predominantly to transactions involving larger businesses. In addition, the collection of information requirement merely requires a taxpayer to prepare a written representation that contains minimal information relating to the making of an election. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Under section 7805(f) of the Code, the notice of proposed rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of the final regulations is William T. Sullivan, Office of Chief Counsel (Financial Institutions and Products). However, other personnel from the IRS and the Treasury Department participated in the development of these regulations.

List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

■ Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 is amended by removing the entries for §§ 1.197-2T, 1.338-1T, and 1.338-11T to read, in part, as follows:

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

■ **Par. 2.** Section 1.197-0 is amended by:

- 1. Revising the introductory text and the entries for § 1.197-2(g)(5)(ii).
- 2. Removing the entries for § 1.197-2T.

The revisions read as follows:

§ 1.197-0 Table of contents.

This section lists the headings that appear in § 1.197-2.

§ 1.197-2 Amortization of goodwill and certain other intangibles.

* * * * *

(g) * * *

(5) * * *

(ii) Determination of adjusted basis of amortizable section 197 intangible resulting from an assumption reinsurance transaction.

(A) In general.

(B) Amount paid or incurred by acquirer (reinsurer) under the assumption reinsurance transaction.

(C) Amount required to be capitalized under section 848 in connection with the transaction.

(1) In general.

(2) Required capitalization amount.

(3) General deductions allocable to the assumption reinsurance transaction.

(4) Treatment of a capitalization shortfall allocable to the reinsurance agreement.

(i) In general.

(ii) Treatment of additional capitalized amounts as the result of an election under § 1.848-2(g)(8).

(5) Cross references and special rules.

(D) Examples

(E) Effective/applicability date.

■ **Par. 3.** Section 1.197-2(g)(5)(ii) is revised to read as follows:

§ 1.197-2 Amortization of goodwill and certain other intangibles.

* * * * *

(g) * * *

(5) * * *

(ii) *Determination of adjusted basis of amortizable section 197 intangible resulting from an assumption*

reinsurance transaction—(A) In general. Section 197(f)(5) determines the basis of an amortizable section 197 intangible for insurance or annuity contracts

acquired in an assumption reinsurance transaction. The basis of such intangible is the excess, if any, of—

(1) The amount paid or incurred by the acquirer (reinsurer) under the assumption reinsurance transaction; over

(2) The amount, if any, required to be capitalized under section 848 in connection with such transaction.

(B) *Amount paid or incurred by acquirer (reinsurer) under the assumption reinsurance transaction.* The amount paid or incurred by the acquirer (reinsurer) under the assumption reinsurance transaction is—

(1) In a deemed asset sale resulting from an election under section 338, the amount of the adjusted grossed-up basis (AGUB) allocable thereto (see §§ 1.338-6 and 1.338-11(b)(2));

(2) In an applicable asset acquisition within the meaning of section 1060, the amount of the consideration allocable thereto (see §§ 1.338-6, 1.338-11(b)(2), and 1.1060-1(c)(5)); and

(3) In any other transaction, the excess of the increase in the reinsurer's tax reserves resulting from the transaction (computed in accordance with sections 807, 832(b)(4)(B), and 846) over the value of the net assets received from the ceding company in the transaction.

(C) *Amount required to be capitalized under section 848 in connection with the transaction—*(1) *In general.* The amount required to be capitalized under section 848 for specified insurance contracts (as defined in section 848(e)) acquired in an assumption reinsurance transaction is the lesser of—

(i) The reinsurer's required capitalization amount for the assumption reinsurance transaction; or

(ii) The reinsurer's general deductions (as defined in section 848(c)(2)) allocable to the transaction.

(2) *Required capitalization amount.* The reinsurer determines the required capitalization amount for an assumption reinsurance transaction by multiplying the net positive or net negative consideration for the transaction by the applicable percentage set forth in section 848(c)(1) for the category of specified insurance contracts acquired in the transaction. See § 1.848-2(g)(5). If more than one category of specified insurance contracts is acquired in an assumption reinsurance transaction, the required capitalization amount for each category is determined as if the transfer of the contracts in that category were made under a separate assumption reinsurance transaction. See § 1.848-2(f)(7).

(3) *General deductions allocable to the assumption reinsurance transaction.* The reinsurer determines the general

deductions allocable to the assumption reinsurance transaction in accordance with the procedure set forth in § 1.848-2(g)(6). Accordingly, the reinsurer must allocate its general deductions to the amount required under section 848(c)(1) on specified insurance contracts that the reinsurer has issued directly before determining the general deductions allocable to the assumption reinsurance transaction. For purposes of allocating its general deductions under § 1.848-2(g)(6), the reinsurer includes premiums received on the acquired specified insurance contracts after the assumption reinsurance transaction in determining the amount required under section 848(c)(1) on specified insurance contracts that the reinsurer has issued directly. If the reinsurer has entered into multiple reinsurance agreements during the taxable year, the reinsurer determines the general deductions allocable to each reinsurance agreement (including the assumption reinsurance transaction) by allocating the general deductions allocable to reinsurance agreements under § 1.848-2(g)(6) to each reinsurance agreement with a positive required capitalization amount.

(4) *Treatment of a capitalization shortfall allocable to the reinsurance agreement—*(i) *In general.* The reinsurer determines any capitalization shortfall allocable to the assumption reinsurance transaction in the manner provided in §§ 1.848-2(g)(4) and 1.848-2(g)(7). If the reinsurer has a capitalization shortfall allocable to the assumption reinsurance transaction, the ceding company must reduce the net negative consideration (as determined under § 1.848-2(f)(2)) for the transaction by the amount described in § 1.848-2(g)(3) unless the parties make the election provided in § 1.848-2(g)(8) to determine the amounts capitalized under section 848 in connection with the transaction without regard to the general deductions limitation of section 848(c)(2).

(ii) *Treatment of additional capitalized amounts as the result of an election under § 1.848-2(g)(8).* The additional amounts capitalized by the reinsurer as the result of the election under § 1.848-2(g)(8) reduce the adjusted basis of any amortizable section 197 intangible with respect to specified insurance contracts acquired in the assumption reinsurance transaction. If the additional capitalized amounts exceed the adjusted basis of the amortizable section 197 intangible, the reinsurer must reduce its deductions under section 805 or section 832 by the amount of such excess. The additional capitalized amounts are treated as specified policy acquisition expenses attributable to the premiums and other

consideration on the assumption reinsurance transaction and are deducted ratably over a 120-month period as provided under section 848(a)(2).

(5) *Cross references and special rules.* In general, for rules applicable to the determination of specified policy acquisition expenses, net premiums, and net consideration, see section 848(c) and (d), and § 1.848-2(a) and (f). However, the following special rules apply for purposes of this paragraph (g)(5)(ii)(C)—

(i) The amount required to be capitalized under section 848 in connection with the assumption reinsurance transaction cannot be less than zero;

(ii) For purposes of determining the company's general deductions under section 848(c)(2) for the taxable year of the assumption reinsurance transaction, the reinsurer takes into account a tentative amortization deduction under section 197(a) as if the entire amount paid or incurred by the reinsurer for the specified insurance contracts were allocated to an amortizable section 197 intangible with respect to insurance contracts acquired in an assumption reinsurance transaction; and

(iii) Any reduction of specified policy acquisition expenses pursuant to an election under § 1.848-2(i)(4) (relating to an assumption reinsurance transaction with an insolvent insurance company) is disregarded.

(D) *Examples.* The following examples illustrate the principles of this paragraph (g)(5)(ii):

Example 1. (i) Facts. On January 15, 2006, P acquires all of the stock of T, an insurance company, in a qualified stock purchase and makes a section 338 election for T. T issues individual life insurance contracts which are specified insurance contracts as defined in section 848(e)(1). P and new T are calendar year taxpayers. Under §§ 1.338-6 and 1.338-11(b)(2), the amount of AGUB allocated to old T's individual life insurance contracts is \$300,000. On the acquisition date, the tax reserves for old T's individual life insurance contracts are \$2,000,000. After the acquisition date, new T receives \$1,000,000 of net premiums with respect to new and renewal individual life insurance contracts and incurs \$100,000 of general deductions under section 848(c)(2) through December 31, 2006. New T engages in no other reinsurance transactions other than the assumption reinsurance transaction treated as occurring by reason of the section 338 election.

(ii) *Analysis.* The transfer of insurance contracts and the assumption of related liabilities deemed to occur by reason of the election under section 338 is treated as an assumption reinsurance transaction. New T determines the adjusted basis under section 197(f)(5) for the life insurance contracts acquired in the assumption reinsurance

transaction as follows. The amount paid or incurred for the individual life insurance contracts is \$300,000. To determine the amount required to be capitalized under section 848 in connection with the assumption reinsurance transaction, new T compares the required capitalization amount for the assumption reinsurance transaction with the general deductions allocable to the transaction. The required capitalization amount for the assumption reinsurance transaction is \$130,900, which is determined by multiplying the \$1,700,000 net positive consideration for the transaction (\$2,000,000 reinsurance premium less \$300,000 ceding commission) by the applicable percentage under section 848(c)(1) for the acquired individual life insurance contracts (7.7 percent). To determine its general deductions, new T takes into account a tentative amortization deduction under section 197(a) as if the entire amount paid or incurred for old T's individual life insurance contracts (\$300,000) were allocable to an amortizable section 197 intangible with respect to insurance contracts acquired in the assumption reinsurance transaction. Accordingly, for the year of the assumption reinsurance transaction, new T is treated as having general deductions under section 848(c)(2) of \$120,000 (\$100,000 + \$300,000/15). Under § 1.848-2(g)(6), these general deductions are first allocated to the \$77,000 capitalization requirement for new T's directly written business (\$1,000,000 × .077). Thus, \$43,000 (\$120,000 - \$77,000) of the general deductions are allocable to the assumption reinsurance transaction. Because the general deductions allocable to the assumption reinsurance transaction (\$43,000) are less than the required capitalization amount for the transaction (\$130,900), new T has a capitalization shortfall of \$87,900 (\$130,900 - \$43,000) with regard to the transaction. Under § 1.848-2(g), this capitalization shortfall would cause old T to reduce the net negative consideration taken into account with respect to the assumption reinsurance transaction by \$1,141,558 (\$87,900 ÷ .077) unless the parties make the election under § 1.848-2(g)(8) to capitalize specified policy acquisition expenses in connection with the assumption reinsurance transaction without regard to the general deductions limitation. If the parties make the election, the amount capitalized by new T under section 848 in connection with the assumption reinsurance transaction would be \$130,900. The \$130,900 capitalized by new T under section 848 would reduce new T's adjusted basis of the amortizable section 197 intangible with respect to the specified insurance contracts acquired in the assumption reinsurance transaction. Accordingly, new T would have an adjusted basis under section 197(f)(5) with respect to the individual life insurance contracts acquired from old T of \$169,100 (\$300,000 - \$130,900). New T's actual amortization deduction under section 197(a) with respect to the amortizable section 197 intangible for insurance contracts acquired in the assumption reinsurance transaction would be \$11,273 (\$169,100 ÷ 15).

Example 2. (i) *Facts.* The facts are the same as *Example 1*, except that T only issues

accident and health insurance contracts that are qualified long-term care contracts under section 7702B. Under section 7702B(a)(5), T's qualified long-term care insurance contracts are treated as guaranteed renewable accident and health insurance contracts, and, therefore, are considered specified insurance contracts under section 848(e)(1). Under §§ 1.338-6 and 1.338-11(b)(2), the amount of AGUB allocable to T's qualified long-term care insurance contracts is \$250,000. The amount of T's tax reserves for the qualified long-term care contracts on the acquisition date is \$7,750,000. Following the acquisition, new T receives net premiums of \$500,000 with respect to qualified long-term care contracts and incurs general deductions of \$75,000 through December 31, 2006.

(ii) *Analysis.* The transfer of insurance contracts and the assumption of related liabilities deemed to occur by reason of the election under section 338 is treated as an assumption reinsurance transaction. New T determines the adjusted basis under section 197(f)(5) for the insurance contracts acquired in the assumption reinsurance transaction as follows. The amount paid or incurred for the insurance contracts is \$250,000. To determine the amount required to be capitalized under section 848 in connection with the assumption reinsurance transaction, new T compares the required capitalization amount for the assumption reinsurance transaction with the general deductions allocable to the transaction. The required capitalization amount for the assumption reinsurance transaction is \$577,500, which is determined by multiplying the \$7,500,000 net positive consideration for the transaction (\$7,750,000 reinsurance premium less \$250,000 ceding commission) by the applicable percentage under section 848(c)(1) for the acquired insurance contracts (7.7 percent). To determine its general deductions, new T takes into account a tentative amortization deduction under section 197(a) as if the entire amount paid or incurred for old T's insurance contracts (\$250,000) were allocable to an amortizable section 197 intangible with respect to insurance contracts acquired in the assumption reinsurance transaction. Accordingly, for the year of the assumption reinsurance transaction, new T is treated as having general deductions under section 848(c)(2) of \$91,667 (\$75,000 + \$250,000/15). Under § 1.848-2(g)(6), these general deductions are first allocated to the \$38,500 capitalization requirement for new T's directly written business (\$500,000 × .077). Thus, \$53,167 (\$91,667 - \$38,500) of general deductions are allocable to the assumption reinsurance transaction. Because the general deductions allocable to the assumption reinsurance transaction (\$53,167) are less than the required capitalization amount for the transaction (\$577,500), new T has a capitalization shortfall of \$524,333 (\$577,500 - \$53,167) with regard to the transaction. Under § 1.848-2(g), this capitalization shortfall would cause old T to reduce the net negative consideration taken into account with respect to the assumption reinsurance transaction by \$6,809,519 (\$524,333 ÷ .077) unless the parties make the election under § 1.848-2(g)(8) to capitalize specified policy

acquisition expenses in connection with the assumption reinsurance transaction without regard to the general deductions limitation. If the parties make the election, the amount capitalized by new T under section 848 in connection with the assumption reinsurance transaction would increase from \$53,167 to \$577,500. Pursuant to paragraph (g)(5)(ii)(C)(4) of this section, the additional \$524,333 (\$577,500 - \$53,167) capitalized by new T under section 848 would reduce new T's adjusted basis of the amortizable section 197 intangible with respect to the insurance contracts acquired in the assumption reinsurance transaction. Accordingly, new T's adjusted basis of the section 197 intangible with respect to the insurance contracts is reduced from \$196,833 (\$250,000 - \$53,167) to \$0. Because the additional \$524,333 capitalized pursuant to the § 1.848-2(g)(8) election exceeds the \$196,833 adjusted basis of the section 197 intangible before the reduction, new T is required to reduce its deductions under section 805 by the \$327,500 (\$524,333 - \$196,833).

(E) *Effective/applicability date.* This section applies to acquisitions and dispositions of insurance contracts on or after April 10, 2006.

* * * * *

§ 1.197-2T [Removed]

■ **Par. 4.** Section 1.197-2T is removed.

■ **Par. 5.** Section 1.338-0 is amended by revising the entries for § 1.338-11(d) and (e) to read as follows:

§ 1.338-0 Outline of topics.

* * * * *

§ 1.338-11 Effect of section 338 election on insurance company targets.

* * * * *

(d) Reserve increases by new target after the deemed asset sale.

(1) In general.

(2) Exceptions.

(3) Amount of additional premium.

(i) In general.

(ii) Increases in unpaid loss reserves.

(iii) Increases in other reserves.

(4) Limitation on additional premium.

(5) Treatment of additional premium under section 848.

(6) Examples.

(7) Effective/applicability date.

(i) In general.

(ii) Application to pre-effective date increases to reserves.

(e) Effect of section 338 election on section 846(e) election.

(1) In general.

(2) Revocation of existing section 846(e) election.

* * * * *

■ **Par. 6.** Section 1.338-1 is amended by adding paragraph (b)(2)(vii) to read as follows:

§ 1.338-1 General principles; status of old target and new target.

* * * * *

(b) * * *

(2) * * *

(vii) Section 846(e) (relating to an election to use an insurance company's historical loss payment pattern).

* * * * *

§ 1.338-1T [Removed]

■ **Par. 7.** Section 1.338-1T is removed.

■ **Par. 8.** Section 1.338-11 is amended by revising paragraphs (d) and (e) to read as follows:

§ 1.338-11 Effect of section 338 election on insurance company targets.

* * * * *

(d) *Reserve increases by new target after the deemed asset sale*—(1) *In general.* If in new target's first taxable year or any subsequent year, new target increases its reserves for any acquired contracts, new target is treated as receiving an additional premium, which is computed under paragraph (d)(3) of this section, in the assumption reinsurance transaction described in paragraph (c)(1) of this section. New target includes the additional premium in gross income for the taxable year in which new target increases its reserves for acquired contracts. New target's increase in reserves for the insurance contracts acquired in the deemed asset sale is a liability of new target not originally taken into account in determining AGUB that is subsequently taken into account. Thus, AGUB is increased by the amount of the additional premium included in new target's gross income. See §§ 1.338-5(b)(2)(ii) and 1.338-7. Old target has no deduction under this paragraph (d) and makes no adjustments under §§ 1.338-4(b)(2)(ii) and 1.338-7.

(2) *Exceptions.* New target is not treated as receiving additional premium under paragraph (d)(1) of this section if—

(i) It is under state receivership as of the close of the taxable year for which the increase in reserves occurs; or

(ii) It is required by section 807(f) to spread the reserve increase over the 10 succeeding taxable years.

(3) *Amount of additional premium*—(i) *In general.* The additional premium taken into account under this paragraph (d) is an amount equal to the sum of the positive amounts described in paragraphs (d)(3)(ii) and (d)(3)(iii) of this section. However, the additional premium cannot exceed the limitation described in paragraph (d)(4) of this section.

(ii) *Increases in unpaid loss reserves.* The positive amount with respect to unpaid loss reserves is computed using the formula $A/B \times (C - [D + E])$ where—

(A) A equals old target's discounted unpaid losses (determined under section 846) included in AGUB under paragraph 11(b)(1) of this section;

(B) B equals old target's undiscounted unpaid losses (determined under section 846(b)(1)) as of the close of the acquisition date;

(C) C equals new target's undiscounted unpaid losses (determined under section 846(b)(1)) at the end of the taxable year that are attributable to losses incurred by old target on or before the acquisition date;

(D) D (which may be a negative number) equals old target's undiscounted unpaid losses as of the close of the acquisition date, reduced by the cumulative amount of losses, loss adjustment expenses, and reinsurance premiums paid by new target through the end of the taxable year for losses incurred by old target on or before the acquisition date; and

(E) E equals the amount obtained by dividing the cumulative amount of reserve increases taken into account under this paragraph (d) in prior taxable years by A/B.

(iii) *Increases in other reserves.* The positive amount with respect to reserves other than discounted unpaid loss reserves is the net increase of those reserves due to changes in estimate, methodology, or other assumptions used to compute the reserves (including the adoption by new target of a methodology or assumptions different from those used by old target).

(4) *Limitation on additional premium.* The additional premium taken into account by new target under paragraph (d)(1) of this section is limited to the excess, if any, of—

(i) The fair market value of old target's assets acquired by new target in the deemed asset sale (other than Class VI and Class VII assets); over

(ii) The AGUB allocated to those assets (including increases in AGUB allocated to those assets as the result of reserve increases by new target in prior taxable years).

(5) *Treatment of additional premium under section 848.* If a portion of the positive amounts described in paragraphs (d)(3)(ii) and (iii) of this section are attributable to an increase in reserves for specified insurance contracts (as defined in section 848(e)), new target takes an allocable portion of the additional premium in determining its specified policy acquisition expenses under section 848(c) for the taxable year of the reserve increase.

(6) *Examples.* The following examples illustrate this paragraph (d):

Example 1. (i) *Facts.* On January 1, 2006, P purchases all of the stock of T, a non-life

insurance company, for \$120 and makes a section 338 election for T. On the acquisition date, old T has total reserve liabilities under state law of \$725, consisting of undiscounted unpaid losses of \$625 and unearned premiums of \$100. Old T's tax reserves on the acquisition date are \$580, which consist of discounted unpaid losses (as defined in section 846) of \$500 and unearned premiums (as computed under section 832(b)(4)(B)) of \$80. Old T has Class I through Class V assets with a fair market value of \$800. Old T also has a Class VI asset with a fair market value of \$75, consisting of the future profit stream of certain insurance contracts. During 2006, new T makes loss and loss adjustment expense payments of \$200 with respect to the unpaid losses incurred by old T before the acquisition date. As of December 31, 2006, new T reports undiscounted unpaid losses of \$475 attributable to losses incurred before the acquisition date. The related amount of discounted unpaid losses (as defined in section 846) for those losses is \$390.

(ii) *Computation and allocation of AGUB.* Under § 1.338-5 and paragraph (b)(1) of this section, as of the acquisition date, AGUB is \$700, reflecting the sum of the amount paid for old T's stock (\$120) and the tax reserves assumed by new T in the transaction (\$580). The fair market value of old T's Class I through V assets is \$800, whereas the AGUB available for such assets under § 1.338-6 is \$700. There is no AGUB available for old T's Class VI assets, even though such assets have a fair market value of \$75 on the acquisition date.

(iii) *Adjustments for increases in reserves for unpaid losses.* Under paragraph (d) of this section, new T must determine whether there are any amounts by which it increased its unpaid loss reserves that will be treated as an additional premium and an increase in AGUB. New T applies the formula of paragraph (d)(3) of this section, where A equals \$500, B equals \$625, C equals \$475, D equals \$425 (\$625 - \$200), and E equals \$0. Under this formula, new T is treated as having increased its reserves for discounted unpaid losses attributable to losses incurred by old T by \$40 ($\$500/\$625 \times (\$475 - [\$425 + 0])$). The limitation under paragraph (d)(5) of this section based on the difference between the fair market value of old T's Class I through Class V assets and the AGUB allocated to such assets is \$100. Accordingly, new T includes an additional premium of \$40 in gross income for 2006, and increases the AGUB allocated to old T's Class I through Class V assets to reflect this additional premium.

Example 2. (i) *Facts.* Assume the same facts as in *Example 1*. Further assume that during 2007 new T deducts total loss and loss expense payments of \$375 with respect to losses incurred by old T before the acquisition date. On December 31, 2007, new T reports undiscounted unpaid losses of \$150 with respect to losses incurred before the acquisition date. The related amount of discounted unpaid losses (as defined in section 846) for those unpaid losses is \$125.

(ii) *Analysis.* New T must determine whether any amounts by which it increased its unpaid losses during 2007 will be treated as an additional premium in paragraph (d)(3)

of this section. New T applies the formula under paragraph (d)(3) of this section, where A equals \$500, B equals \$625, C equals \$150, D equals \$50 (\$625 - \$575), and E equals \$50 (\$40 divided by .8). In paragraph (d)(3) of this section, new T is treated as increasing its reserves for discounted unpaid losses by \$40 during 2007 with respect to losses incurred by old T ($\$500/\$625 \times (\$150 - [\$50 + \$50])$). New T determines the limitation of paragraph (d)(5) of this section by comparing the \$800 fair market value of the Class I through V assets on the acquisition date to the \$740 AGUB allocated to such assets (which includes the \$40 addition to AGUB included during 2006). Thus, new T recognizes \$40 of additional premium as a result of the increase in reserves during 2007, and adjusts the AGUB allocable to the Class I through V assets acquired from old T to reflect such additional premium.

Example 3. (i) Facts. The facts are the same as *Example 2*, except that on January 1, 2008, new T reinsures the outstanding liability with respect to losses incurred by old T before the acquisition date through a portfolio reinsurance transaction with R, another non-life insurance company. R agrees to assume any remaining liability relating to losses incurred by old T before the acquisition date in exchange for a reinsurance premium of \$200. Accordingly, as of December 31, 2008, new T reports no undiscounted unpaid losses with respect to losses incurred by old T before the acquisition date.

(ii) Analysis. New T must determine whether any amount by which it increased its unpaid loss reserves will be treated as an additional premium under paragraph (d) of this section. New T applies the formula of paragraph (d)(3) of this section, where A equals \$500, B equals \$625, C equals \$0, and D equals $-\$150 (\$625 - (\$575 + \$200))$, and E equals \$100 ($\80 divided by .8). Thus, new T is treated as having increased its discounted unpaid losses by \$40 in 2008 with respect to losses incurred by old T before the acquisition date ($\$500/\$625 \times (0 - [-\$150 + \$100])$). New T includes this positive amount in gross income, subject to the limitation of paragraph (d)(4) of this section. The limitation of paragraph (d)(4) of this section equals \$20, which is computed by comparing the \$800 fair market value of the Class I through V assets acquired from old T with the \$780 AGUB allocated to such assets (which includes the \$40 addition to AGUB in 2006 and the \$40 addition to AGUB in 2007). Thus, New T includes \$20 in additional premium, and increases the AGUB allocated to the Class I through V assets acquired from old T by \$20. As a result of these adjustments, the limitation under paragraph (d)(4) of this section is reduced to zero.

(7) Effective/applicability date—(i) In general. This section applies to increases to reserves made by new target after a deemed asset sale occurring on or after April 10, 2006.

(ii) Application to pre-effective date increases to reserves. If either new target makes an election under § 1.338(i)-1(c)(2) or old target makes an election under § 1.338(i)-1(c)(3) to apply the rules of this section, in whole, to a qualified stock purchase occurring before April 10, 2006, then the rules contained in this section shall apply in whole to the qualified stock purchase.

(e) Effect of section 338 election on section 846(e) election—(1) In general. New target and old target are treated as the same corporation for purposes of an election by old target to use its historical loss payment pattern under section 846(e). See § 1.338-1(b)(2)(vii). Therefore, if old target has a section 846(e) election in effect on the acquisition date, new target will continue to use the historical loss payment pattern of old target to discount unpaid losses incurred in accident years covered by the election, unless new target elects to revoke the section 846(e) election. In addition, new target may consider old target's historical loss payment pattern when determining whether to make the section 846(e) election for a determination year that includes or is subsequent to the acquisition date.

(2) Revocation of existing section 846(e) election. New target may revoke old target's section 846(e) election to use its historical loss payment pattern to discount unpaid losses. If new target elects to revoke old target's section 846(e) election, new target will use the industry-wide patterns determined by the Secretary to discount unpaid losses incurred in accident years beginning on or after the acquisition date through the subsequent determination year. New target may revoke old target's section 846(e) election by attaching a statement to new target's original tax return for its first taxable year.

§ 1.338-11T [Removed]

- **Par. 9.** Section 1.338-11T is removed.
- **Par. 10.** Section 1.338(i)-1 is amended by:

- 1. Revising the section heading to read as set forth below.
- 2. Redesignating paragraph (c)(2)(ii)(b) as paragraph (c)(2)(ii)(B).

The revisions read as follows:

§ 1.338(i)-1 Effective/applicability date.

* * * * *

■ **Par. 11.** Section 1.381(c)(22)-1(b)(7)(v) is amended by revising the last sentence of *Example 3* to read as follows:

§ 1.381(c)(22)-1 Successor life insurance company.

* * * * *

- (b) * * *
- (7) * * *
- (v) * * *

Example 3. * * * In that case, in the taxable year of the indemnity reinsurance transaction, S takes into account as ordinary income the portion of the old T's accounts (\$1) that old T or S has not previously taken into account as income.

* * * * *

§ 1.846-0 [Amended]

■ **Par. 12.** Section 1.846-0 is amended by removing the entries for §§ 1.846-2T and 1.846-4T.

■ **Par. 13.** Section 1.846-2(d) is revised to read as follows:

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

* * * * *

(d) Effect of section 338 election on section 846(e) election. For rules regarding qualified stock purchase occurring on or after April 10, 2006, see §§ 1.338-1(b)(2)(vii) and 1.338-11(e).

■ **Par. 14.** Section 1.846-4 is amended by revising the section heading and paragraph (b) to read as follows:

§ 1.846-4 Effective/applicability date.

* * * * *

(b) Section 338 election. Section 1.846-2(d) applies to section 846(e) elections made with regard to a qualified stock purchase made on or after April 10, 2006.

■ **Par. 15.** For each entry in the "Section" column remove the phrase in the "Remove" column and add the phrase in the "Add" column in its place.

Section	Remove	Add
§ 1.338(i)-1(c)(2)(i)	§§ 1.338-11 and 1.338-11T(d)	§ 1.338-11
§ 1.338(i)-1(c)(2)(i)	1.197-2T(g)(5)(ii),	
§ 1.338(i)-1(c)(2)(ii)	§§ 1.338-11 and 1.338-11T(d)	§ 1.338-11
§ 1.338(i)-1(c)(2)(ii)	1.197-2T(g)(5)(ii),	
§ 1.338(i)-1(c)(2)(ii)(B) (First sentence)	§§ 1.338-11 and 1.338-11T(d)	§ 1.338-11
§ 1.338(i)-1(c)(2)(ii)(B) (First sentence)	1.197-2T(g)(5)(ii),	

Section	Remove	Add
§ 1.338(i)-1(c)(2)(ii)(B) (Second sentence)	§§ 1.338-11 and 1.338-11T(d)	§ 1.338-11
§ 1.338(i)-1(c)(2)(ii)(B) (Second sentence)	1.197-2T(g)(5)(ii),	
§ 1.338(i)-1(c)(3)(i)	§§ 1.338-11 and 1.338-11T(d)	§ 1.338-11
§ 1.338(i)-1(c)(3)(i)	1.197-2T(g)(5)(ii),	
§ 1.338(i)-1(c)(3)(ii)	§§ 1.338-11 and 1.338-11T(d)	§ 1.338-11
§ 1.338(i)-1(c)(3)(ii)	1.197-2T(g)(5)(ii),	
§ 1.338(i)-1(c)(3)(ii)(B) (First sentence)	§§ 1.338-11 and 1.338-11T(d)	§ 1.338-11
§ 1.338(i)-1(c)(3)(ii)(B) (First sentence)	1.197-2T(g)(5)(ii),	
§ 1.338(i)-1(c)(3)(ii)(B) (Second sentence)	§§ 1.338-11 and 1.338-11T(d)	§ 1.338-11
§ 1.338(i)-1(c)(3)(ii)(B) (Second sentence)	1.197-2T(g)(5)(ii),	
§ 1.1060-1(a)(2)(i)	§§ 1.338-11 and 1.338-11T(d)	§ 1.338-11
§ 1.1060-1(a)(2)(i)	1.197-2T(g)(5)(ii),	
§ 1.1060-1(a)(2)(ii)	§§ 1.338-11 and 1.338-11T(d)	§ 1.338-11
§ 1.1060-1(a)(2)(ii)	1.197-2T(g)(5)(ii),	
§ 1.1060-1(a)(2)(ii)(B)	§§ 1.338-11 and 1.338-11T(d)	§ 1.338-11
§ 1.1060-1(a)(2)(ii)(B)	1.197-2T(g)(5)(ii),	
§ 1.1060-1(a)(2)(iii)	§§ 1.338-11T(d) and 1.338-11T(d)	§ 1.338-11(d)
§ 1.1060-1(a)(2)(iii)	1.197-2T(g)(5)(ii),	
§ 1.1060-1(a)(2)(iii)(B)	§§ 1.338-11 and 1.338-11T(d)	§ 1.338-11
§ 1.1060-1(a)(2)(iii)(B)	1.197-2T(g)(5)(ii),	

PART 602—OMB CONTROL NUMBERS UNDER PAPERWORK REDUCTION ACT

■ **Par. 16.** The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

■ **Par. 17.** In § 602.101, paragraph (b) is amended by removing the entry for § 1.338-11T from the table and adding an entry to the table in numerical order to read as follows:

§ 602.101 OMB Control numbers.

* * * * *
(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	* * * * *
1.338-11	1545-1990
* * * * *	* * * * *

Linda Stiff,
Deputy Commissioner for Services and Enforcement.

Approved: January 9, 2008.

Eric Solomon,
Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. E8-729 Filed 1-22-08; 8:45 am]

BILLING CODE 4830-01-P

DEPARTMENT OF HEALTH AND HUMAN SERVICES

42 CFR PART 72

RIN 0920-AA19

Interstate Shipment of Etiologic Agents

AGENCY: Centers for Disease Control and Prevention (CDC), HHS.

ACTION: Final rule.

SUMMARY: HHS is removing Part 72 of Title 42, Code of Federal Regulations, which governs the interstate shipment of etiologic agents, because the U.S. Department of Transportation (DOT) already has in effect a more comprehensive set of regulations applicable to the transport in commerce of infectious substances. DOT harmonizes its transport requirements with international standards adopted by the United Nations (UN) Committee of Experts on the Transport of Dangerous Goods for the classification, packaging, and transport of infectious substances. Rescinding the rule eliminates duplication of the more current DOT regulations that cover intrastate and international, as well as interstate, transport. HHS replaced those sections of Part 72 that deal with select biological agents and toxins with a new set of regulations found in Part 73 of Title 42. Removal of Part 72 alleviates confusion and reduces the regulatory burden with no anticipated adverse impact on public health and safety.

DATES: Effective Date: This final rule is effective 30 days after publication in the **Federal Register**.

FOR FURTHER INFORMATION CONTACT: Dr. Janet K. Nicholson, National Center for Infectious Diseases/OD, Centers for

Disease Control and Prevention, U.S. Department of Health and Human Services, 1600 Clifton Rd., NE (MS-D10), Atlanta, GA 30333; *telephone:* 404-639-2100; *e-mail* *jkn1@cdc.gov*.

SUPPLEMENTARY INFORMATION: On January 3, 2007, HHS published a notice of proposed rulemaking (NPRM) to remove Part 72 of Title 42 of the Code of Federal Regulations. The comment period for the proposed rule closed on March 5, 2007. HHS received no comments on the proposed rule.

With minor modification for clarification, this supplementary information is the same as was in the NPRM.

Part 72 (being removed by this final rule) provides minimal requirements for packaging and shipping materials, including diagnostic specimens and biological products, reasonably believed to contain an etiologic agent. It provides more detailed requirements, including labeling, for materials containing certain etiologic agents, with a list of the biological agents and toxins provided. For agents on the list, the rule requires reporting to HHS/CDC damaged packages and packages not received. The rule also requires sending certain agents on the list by registered mail or an equivalent system.

42 CFR 72, as currently promulgated, is out-of-date, and duplicates more current regulations of DOT. Further, the regulation is inconsistent with the procedures of other transport governing bodies, such as the International Civil Aviation Organization (ICAO) and the International Air Transport Association (IATA), for air, and the U.S. Postal Service for ground.

Section 72.6, a major portion of 42 CFR 72 that dealt with transporting select agents, was superseded by the