(2) by any member of such arrangement or association.

''(B) RETURN OF CONTRIBUTIONS.—

''(i) IN GENERAL.—The repayment to any member of any amount of any payment excluded under subparagraph (A) shall not be treated as policyholder dividend, and is not deductible by the arrangement or association.

''(ii) SOURCE OF RETURNS.—Except in the case of the termination of a member's interest in the arrangement or association, any amount distributed to any member shall be treated as paid out of surplus in excess of amounts excluded under subparagraph (A).

''(2) DEDUCTION FOR MEMBERS OF ELIGIBLE ARRANGEMENTS OR ASSOCIATIONS.—

''(A) PAYMENT AS TRADE OR BUSINESS EXPENSES.—To the extent not otherwise allowable under the Internal Revenue Code of 1986, any member of any eligible arrangement or association may treat any initial payment referred to in paragraph (1) made during a taxable year to such arrangement or association as an ordinary and necessary expense incurred in connection with a trade or business for purposes of the deduction allowable under section 162, to the extent such payment does not exceed the amount which would be payable to an independent insurance company for similar annual insurance coverage (as determined by the Secretary), and further reduced by any annual dues, assessments, or premiums paid during such taxable year. Such deduction shall not be allowable as to any initial payment referred to in paragraph (1) made to an eligible arrangement or association by any person who is a member of any other eligible arrangement or association on or after the effective date of the Tax Reform Act of 1986. Any excess amount not allowed as a deduction for the taxable year in which such payment was made pursuant to the limitation contained in the 1st sentence of this subparagraph shall, subject to such limitation, be allowable as a deduction in any of the 5 succeeding taxable years, in order of time, to the extent not previously allowed as a deduction under this sentence.

''(B) REFUNDS OF INITIAL PAYMENTS.—Any amount attributable to any initial payment referred to in paragraph (1) to such arrangement or association described in paragraph (1) which is later refunded for any reason shall be included in the gross income of the recipient in the taxable year received, to the extent a deduction for such payment was allowed. Any amount refunded in excess of such payment shall be included in gross income except to the extent otherwise excluded from income by the Internal Revenue Code of 1986.

''(3) ELIGIBLE ARRANGEMENTS OR ASSOCIATIONS.—The terms 'eligible physicans' [sic] and surgeons' mutual protection and interindemnity arrangement or association' and 'eligible arrangement or association' mean and are limited to any mutual protection and interindemnity arrangement or association that provides only medical malpractice liability protection for its members or medical malpractice liability protection in conjunction with protection against other liability claims incurred in the course of, or related to, the professional practice of a physician or surgeon and which—

''(A) was operative and was providing such protection, or had received a permit for the offer and sale of memberships, under the laws of any State before January 1, 1984,

''(B) is not subject to regulation by any State insurance department,

''(C) has a right to make unlimited assessments against all members to cover current claims and losses, and

''(D) is not a member of, nor subject to protection by, any insurance guaranty plan or association of any State.

''(b) EFFECTIVE DATE.—The provisions of subsection (a) shall apply to payments made to and receipts of physicians' and surgeons' mutual protection and interindemnity arrangements or associations, and refunds of payments by such arrangements or associations, after the date of the enactment of this Act [Oct. 22, 1986], in taxable years ending after such date.''

TREATMENT AS UNEARNED PREMIUMS OF ADDITIONS TO RESERVES REQUIRED BY STATE LAW OR REGULATIONS FOR MORTGAGE GUARANTY INSURANCE LOSSES

Pub. L. 90–240, §5(g), Jan. 2, 1968, 81 Stat. 779, as amended by Pub. L. 99–514, §2, Oct. 22, 1986, 100 Stat. 2095, provided that:

''(1) In the case of taxable years beginning before 1967, a company shall treat additions to a reserve, required by State law or regulations for mortgage guaranty insurance losses resulting from adverse economic cycles, as unearned premiums for purposes of section 832(b)(4) of the Internal Revenue Code of 1986 [formerly I.R.C. 1954], but the amount so treated as unearned premiums in a taxable year shall not exceed 50 percent of premiums earned on insurance contracts (as defined in section 832(b)(4) of such Code), determined without regard to amounts added to the reserve, with respect to mortgage guaranty insurance for such year. The amount of unearned premiums at the close of 1966 shall be determined without regard to the preceding sentence for the purpose of applying section 832(b)(4) of such Code to 1967. Additions to such a reserve shall not be treated as unearned premiums for any taxable year beginning after 1966.

''(2) If a mortgage guaranty insurance company made additions to a reserve which were so treated as unearned premiums described in paragraph (1), such company, in taxable years beginning after 1966, shall include in gross income (in addition to the items specified in section 832(b)(1) of such Code) the sum of the following amounts until there is included in gross income an amount equal to the aggregate additions to the reserve described in paragraph (1) for taxable years beginning before 1967:

''(A) an amount (if any) equal to the excess of losses incurred (as defined in section 832(b)(5) of such Code) for the taxable year over 35 percent of premiums earned on insurance contracts during the taxable year (as defined in section 832(b)(4) of such Code), determined without regard to amounts added to the reserve referred to in paragraph (1), with respect to mortgage guaranty insurance,

''(B) the amount (if any) remaining which was added to the reserve for the tenth preceding taxable year, and

''(C) the excess (if any) of—

''(i) the aggregate of amounts so treated as unearned premiums for all taxable years beginning before 1967 less the total of the amounts included in gross income under this paragraph for prior taxable years and the amounts included in gross income under subparagraphs (A) and (B) for the taxable year, over

''(ii) the aggregate of the additions made for taxable years beginning before 1967 which remain in the reserve at the close of the taxable year.

Amounts shall be taken into account on a first-in-time basis. For purposes of section 832(e) of such Code and this paragraph, if part of the reserve is reduced under State law or regulation, such reduction shall first apply to the extent of amounts added to the reserve for taxable years beginning before 1967, and only then to amounts added thereafter.

''(3) The provisions of this subsection shall apply to taxable years beginning after December 31, 1956.''

§ 833. Treatment of Blue Cross and Blue Shield organizations, etc.

(a) General rule

In the case of any organization to which this section applies—

(1) Treated as stock company

Such organization shall be taxable under this part in the same manner as if it were a stock insurance company.

(2) Special deduction allowed

The deduction determined under subsection (b) for any taxable year shall be allowed.

(3) Reductions in unearned premium reserves not to apply

Subparagraph (B) of paragraph (4) of section 832(b) shall be applied by substituting ''100 percent'' for ''80 percent'', and subparagraph (C) of such paragraph (4) shall not apply.

(b) Amount of deduction

(1) In general

Except as provided in paragraph (2), the deduction determined under this subsection for any taxable year is the excess (if any) of—

(A) 25 percent of the sum of—

(i) the claims incurred during the taxable year and liabilities incurred during the taxable year under cost-plus contracts, and

(ii) the expenses incurred during the taxable year in connection with the administration, adjustment, or settlement of claims or in connection with the administration of cost-plus contracts, over

(B) the adjusted surplus as of the beginning of the taxable year.

(2) Limitation

The deduction determined under paragraph (1) for any taxable year shall not exceed taxable income for such taxable year (determined without regard to such deduction).

(3) Adjusted surplus

For purposes of this subsection—

(A) In general

The adjusted surplus as of the beginning of any taxable year is an amount equal to the adjusted surplus as of the beginning of the preceding taxable year—

(i) increased by the amount of any adjusted taxable income for such preceding taxable year, or

(ii) decreased by the amount of any adjusted net operating loss for such preceding taxable year.

(B) Special rule

The adjusted surplus as of the beginning of the organization's 1st taxable year beginning after December 31, 1986, shall be its surplus as of such time. For purposes of the preceding sentence and subsection (c)(3)(C), the term ''surplus'' means the excess of the total assets over total liabilities as shown on the annual statement.

(C) Adjusted taxable income

The term ''adjusted taxable income'' means taxable income determined—

(i) without regard to the deduction determined under this subsection,

(ii) without regard to any carryforward or carryback to such taxable year, and

(iii) by increasing gross income by an amount equal to the net exempt income for the taxable year.

(D) Adjusted net operating loss

The term ''adjusted net operating loss'' means the net operating loss for any taxable year determined with the adjustments set forth in subparagraph (C).

(E) Net exempt income

The term ''net exempt income'' means—

(i) any tax-exempt interest received or accrued during the taxable year, reduced by any amount (not otherwise deductible) which would have been allowable as a deduction for the taxable year if such interest were not tax-exempt, and

(ii) the aggregate amount allowed as a deduction for the taxable year under sections 243 and 245.

The amount determined under clause (ii) shall be reduced by the amount of any decrease in deductions allowable for the taxable year by reason of section 832(b)(5)(B) to the extent such decrease is attributable to deductions under sections 243 and 245.

(4) Only health-related items taken into account

Any determination under this subsection shall be made by only taking into account items attributable to the health-related business of the taxpayer.

(c) Organizations to which section applies

(1) In general

This section shall apply to—

(A) any existing Blue Cross or Blue Shield organization, and

(B) any other organization meeting the requirements of paragraph (3).

(2) Existing Blue Cross or Blue Shield organization

The term ''existing Blue Cross or Blue Shield organization'' means any Blue Cross or Blue Shield organization if—

(A) such organization was in existence on August 16, 1986,

(B) such organization is determined to be exempt from tax for its last taxable year beginning before January 1, 1987, and

(C) no material change has occurred in the operations of such organization or in its structure after August 16, 1986, and before the close of the taxable year.

To the extent permitted by the Secretary, any successor to an organization meeting the requirements of the preceding sentence, and any organization resulting from the merger or consolidation of organizations each of which met such requirements, shall be treated as an existing Blue Cross or Blue Shield organization.

(3) Other organizations

(A) In general

An organization meets the requirements of this paragraph for any taxable year if—

(i) substantially all the activities of such organization involve the providing of health insurance,

(ii) at least 10 percent of the health insurance provided by such organization is provided to individuals and small groups

(not taking into account any medicare supplemental coverage),

(iii) such organization provides continuous full-year open enrollment (including conversions) for individuals and small groups,

(iv) such organization's policies covering individuals provide full coverage of pre-existing conditions of high-risk individuals without a price differential (with a reasonable waiting period), and coverage is provided without regard to age, income, or employment status of individuals under age 65,

(v) at least 35 percent of its premiums are determined on a community rated basis, and

(vi) no part of its net earnings inures to the benefit of any private shareholder or individual.

(B) Small group defined

For purposes of subparagraph (A), the term ''small group'' means the lesser of—

(i) 15 individuals, or

(ii) the number of individuals required for a small group under applicable State law.

(C) Special rule for determining adjusted surplus

For purposes of subsection (b), the adjusted surplus of any organization meeting the requirements of this paragraph as of the beginning of the 1st taxable year for which it meets such requirements shall be its surplus as of such time.

(4) Treatment as existing Blue Cross or Blue Shield organization

(A) In general

Paragraph (2) shall be applied to an organization described in subparagraph (B) as if it were a Blue Cross or Blue Shield organization.

(B) Applicable organization

An organization is described in this subparagraph if it—

(i) is organized under, and governed by, State laws which are specifically and exclusively applicable to not-for-profit health insurance or health service type organizations, and

(ii) is not a Blue Cross or Blue Shield organization or health maintenance organization.

(5) Nonapplication of section in case of low medical loss ratio

Notwithstanding the preceding paragraphs, paragraphs (2) and (3) of subsection (a) shall not apply to any organization unless such organization's percentage of total premium revenue expended on reimbursement for clinical services and for activities that improve health care quality provided to enrollees under its policies during such taxable year (as reported under section 2718 of the Public Health Service Act) is not less than 85 percent.

(Added Pub. L. 99–514, title X, § 1012(b)(1), Oct. 22, 1986, 100 Stat. 2391; amended Pub. L. 104–191, title III, § 351(a), Aug. 21, 1996, 110 Stat. 2071; Pub. L. 105–34, title XVI, § 1604(d)(2)(A), Aug. 5, 1997, 111 Stat. 1098; Pub. L. 111–148, title IX, § 9016(a), Mar. 23, 2010, 124 Stat. 872; Pub. L. 113–235, div. N, § 102(a), Dec. 16, 2014, 128 Stat. 2773; Pub. L. 113–295, div. A, title II, § 221(a)(41)(G), Dec. 19, 2014, 128 Stat. 4044.)

REFERENCES IN TEXT

Section 2718 of the Public Health Service Act, referred to in subsec. (c)(5), is classified to section 300gg–18 of Title 42, The Public Health and Welfare.

AMENDMENTS

2014—Subsec. (b)(3)(E). Pub. L. 113–295 struck out '', 244,'' after ''sections 243'' in cl. (ii) and in concluding provisions.

Subsec. (c)(5). Pub. L. 113–235 substituted ''paragraphs (2) and (3) of subsection (a)'' for ''this section'' and inserted ''and for activities that improve health care quality'' after ''clinical services''.

2010—Subsec. (c)(5). Pub. L. 111–148 added par. (5).

1997—Subsec. (b)(1)(A)(i). Pub. L. 105–34, § 1604(d)(2)(A)(i), inserted ''and liabilities incurred during the taxable year under cost-plus contracts'' before the comma.

Subsec. (b)(1)(A)(ii). Pub. L. 105–34, § 1604(d)(2)(A)(ii), inserted ''or in connection with the administration of cost-plus contracts'' before the last comma.

1996—Subsec. (c)(4). Pub. L. 104–191 added par. (4).

EFFECTIVE DATE OF 2014 AMENDMENT

Amendment by Pub. L. 113–295 not applicable to preferred stock issued before Oct. 1, 1942 (determined in the same manner as under section 247 of this title as in effect before its repeal by Pub. L. 113–295), see section 221(a)(41)(K) of Pub. L. 113–295, set out as a note under section 172 of this title.

Except as otherwise provided in section 221(a) of Pub. L. 113–295, amendment by Pub. L. 113–295 effective Dec. 19, 2014, subject to a savings provision, see section 221(b) of Pub. L. 113–295, set out as a note under section 1 of this title.

Pub. L. 113–235, div. N, § 102(b), Dec. 16, 2014, 128 Stat. 2773, provided that: ''The amendments made by this section [amending this section] shall apply to taxable years beginning after December 31, 2009.''

EFFECTIVE DATE OF 2010 AMENDMENT

Pub. L. 111–148, title IX, § 9016(b), Mar. 23, 2010, 124 Stat. 872, provided that: ''The amendment made by this section [amending this section] shall apply to taxable years beginning after December 31, 2009.''

EFFECTIVE DATE OF 1997 AMENDMENT

Pub. L. 105–34, title XVI, § 1604(d)(2)(B), Aug. 5, 1997, 111 Stat. 1098, provided that: ''The amendment made by subparagraph (A) [amending this section] shall take effect as if included in the amendments made by section 1012 of the Tax Reform Act of 1986 [Pub. L. 99–514].''

EFFECTIVE DATE OF 1996 AMENDMENT

Pub. L. 104–191, title III, § 351(b), Aug. 21, 1996, 110 Stat. 2071, provided that: ''The amendment made by this section [amending this section] shall apply to taxable years ending after December 31, 1996.''

EFFECTIVE DATE

Pub. L. 99–514, title X, § 1012(c), Oct. 22, 1986, 100 Stat. 2393, as amended by Pub. L. 100–647, title I, § 1010(b)(1), (2), Nov. 10, 1988, 102 Stat. 3451, provided that:

''(1) IN GENERAL.—The amendments made by this section [enacting this section and amending section 501 of this title] shall apply to taxable years beginning after December 31, 1986.

''(2) STUDY OF FRATERNAL BENEFICIARY ASSOCIATIONS.—The Secretary of the Treasury or his delegate

shall conduct a study of organizations described in section 501(c)(8) of the Internal Revenue Code of 1986 and which received gross annual insurance premiums in excess of $25,000,000 for the taxable years of such organizations which ended during 1984. Not later than January 1, 1988, the Secretary of the Treasury shall submit to the Committee on Ways and Means of the House of Representatives, the Committee on Finance of the Senate, and the Joint Committee on Taxation the results of such study, together with such recommendations as he determines to be appropriate. The Secretary of the Treasury shall have authority to require the furnishing of such information as may be necessary to carry out the purposes of this paragraph.

''(3) SPECIAL RULES FOR EXISTING BLUE CROSS OR BLUE SHIELD ORGANIZATIONS.—

''(A) IN GENERAL.—In the case of any existing Blue Cross or Blue Shield organization (as defined in section 833(c)(2) of the Internal Revenue Code of 1986 as added by this section)—

''(i) no adjustment shall be made under section 481 (or any other provision) of such Code on account of a change in its method of accounting for its 1st taxable year beginning after December 31, 1986, and

''(ii) for purposes of determining gain or loss, the adjusted basis of any asset held on the 1st day of such taxable year shall be treated as equal to its fair market value as of such day.

''(B) TREATMENT OF CERTAIN DISTRIBUTIONS.—For purposes of section 833(b)(3)(B), the surplus of any organization as of the beginning of its 1st taxable year beginning after December 31, 1986, shall be increased by the amount of any distribution (other than to policyholders) made by such organization after August 16, 1986, and before the beginning of such taxable year.

''(C) RESERVE WEAKENING AFTER AUGUST 16, 1986.—Any reserve weakening after August 16, 1986, by an existing Blue Cross or Blue Shield organization shall be treated as occurring in such organization's 1st taxable year beginning after December 31, 1986.

''(4) OTHER SPECIAL RULES.—

''(A) The amendments made by this section shall not apply with respect to that portion of the business of Mutual of America which is attributable to pension business.

''(B) The amendments made by this section shall not apply to that portion of the business of the Teachers Insurance Annuity Association-College Retirement Equities Fund which is attributable to pension business.

''(C) The amendments made by this section shall not apply to—

''(i) the retirement fund of the YMCA,

''(ii) the Missouri Hospital Plan,

''(iii) administrative services performed by municipal leagues, and

''(iv) dental benefit coverage provided by a Delta Dental Plans Association organization through contracts with independent professional service providers so long as the provision of such coverage is the principal activity of such organization.

''(D) For purposes of this paragraph, the term 'pension business' means the administration of any plan described in section 401(a) of the Internal Revenue Code of 1954 [now 1986] which includes a trust exempt from tax under section 501(a), any plan under which amounts are contributed by an individual's employer for an annuity contract described in section 403(b) of such Code, any individual retirement plan described in section 408 of such Code, and any eligible deferred compensation plan to which section 457(a) of such Code applies.''

[The due date for the report referred to in section 1012(c)(2) of Pub. L. 99–514, set out above, extended to July 1, 1992, by Pub. L. 101–508, title XI, §11831(b), Nov. 5, 1990, 104 Stat. 1388–559.]

TERMINATION OF CERTAIN EXCEPTIONS FROM RULES RELATING TO EXEMPT ORGANIZATIONS WHICH PROVIDE COMMERCIAL-TYPE INSURANCE

Pub. L. 105–277, div. J, title IV, §4003(g), Oct. 21, 1998, 112 Stat. 2681–910, provided that: ''Rules similar to the rules of section 1.1502–75(d)(5) of the Treasury Regulations shall apply with respect to any organization described in section 1042(b) of the 1997 Act [section 1042(b) of Pub. L. 105–34, set out below].''

Pub. L. 105–34, title X, §1042, Aug. 5, 1997, 111 Stat. 939, provided that:

''(a) IN GENERAL.—Subparagraphs (A) and (B) of section 1012(c)(4) of the Tax Reform Act of 1986 [Pub. L. 99–514, set out as an Effective Date note above] shall not apply to any taxable year beginning after December 31, 1997.

''(b) SPECIAL RULES.—In the case of an organization to which section 501(m) of the Internal Revenue Code of 1986 applies solely by reason of the amendment made by subsection (a)—

''(1) no adjustment shall be made under section 481 (or any other provision) of such Code on account of a change in its method of accounting for its first taxable year beginning after December 31, 1997, and

''(2) for purposes of determining gain or loss, the adjusted basis of any asset held on the 1st day of such taxable year shall be treated as equal to its fair market value as of such day.

''(c) RESERVE WEAKENING AFTER JUNE 8, 1997.—Any reserve weakening after June 8, 1997, by an organization described in subsection (b) shall be treated as occurring in such organization's 1st taxable year beginning after December 31, 1997.

''(d) REGULATIONS.—The Secretary of the Treasury or his delegate may prescribe rules for providing proper adjustments for organizations described in subsection (b) with respect to short taxable years which begin during 1998 by reason of section 843 of the Internal Revenue Code of 1986.''

RULES PROVIDING ADJUSTMENTS FOR CERTAIN TAXPAYERS AFFECTED BY SECTION 1012 OF PUB. L. 99–514

Pub. L. 100–647, title I, §1010(b)(3), Nov. 10, 1988, 102 Stat. 3451, provided that: ''The Secretary of the Treasury or his delegate may prescribe rules providing proper adjustments for taxpayers which become subject to subchapter L of chapter 1 of the 1986 Code by reason of the amendments made by section 1012 of the Reform Act [Pub. L. 99–514, enacting this section and amending section 501 of this title] with respect to short taxable years which begin during 1987 by reason of section 843 of such Code.''

§ 834. Determination of taxable investment income

(a) General rule

For purposes of section 831(b), the term ''taxable investment income'' means the gross investment income, minus the deductions provided in subsection (c).

(b) Gross investment income

For purposes of subsection (a), the term ''gross investment income'' means the sum of the following:

(1) The gross amount of income during the taxable year from—

(A) interest, dividends, rents, and royalties,

(B) the entering into of any lease, mortgage, or other instrument or agreement from which the insurance company derives interest, rents, or royalties,