Reflections on 2018 Tax Determination for Insurance Companies

ABA Tax Section Insurance Companies Committee
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Agenda

• The Reality and Impact of TCJA
  • Alternative Minimum Tax
  • Tax planning strategies
  • Investments
  • Financial statement considerations

• Life Insurance Companies
  • Section 807 Reserves
  • Section 848 DAC

• Property and Casualty Insurance Companies
  • Changes for Nonlife companies
  • Section 846 Loss Reserve Discounting

• Other items/open discussion
The Reality and Impact of TCJA
Alternative Minimum Tax (AMT)

• TCJA repealed AMT for corporate taxpayers
• AMT credits are refundable: 50% each year 2018-2020; 100% in 2021
• Sequestration
  • Initial concern after TCJA passed; at the time, sequestration would have haircut the AMT refund by 6.2%
  • January 14, 2019: IRS confirmed that refundable AMT credits under Section 53(e) are not subject to sequestration for taxable years beginning after December 31, 2017
• Importance of tax credit ordering rules
  • Limitation on usage of general business credits against regular tax – i.e., a “minimum” regular tax
• Timing of refunds
  • First AMT refund claims filed on 2018 tax returns
  • Reported as a tax payment on the tax return; overpayment can be applied to estimated taxes for subsequent year
Tax planning strategies

• Uncertainty as a result of pending and proposed regulations
  • Modeling multiple scenarios
  • Wait-and-see approach

• Cost-benefit analysis for tax planning with a lower tax rate

• Items to be aware of for tax planning to reduce taxable income
  • DRD donut hole can result in permanent reduction of DRD benefits
    • DRD is limited by taxable income and cannot result in a net operating loss
    • For taxpayers in a net operating loss position before the DRD, there is no limitation

• Modeling of tax considerations for establishing new business
  • Domestic or foreign entity: GILTI? BEAT?
  • 953(d) election
  • Branches
Investments

• Updates to IRR modeling for investment decisions
• General account DRD and tax-exempt interest
  • Pre-TCJA company share close to 0%
  • Post-TCJA company share at 70%
• Market discount on bonds
  • Notice 2018-80 and proposed 451(b) regulations confirm that taxpayers may continue to defer including market discount income in income for tax purposes until there is a payment or sale at a gain
• Partnership investments where partnership is invested in a CFC
  • The partner only increases tax basis in the partnership interest for its allocable share of the GILTI inclusion or foreign dividend income allocable to its partnership interest. If the consolidated group has an no overall GILTI inclusion, no amount is attributable to the partnership interest.
Financial statement considerations

• Disclosures regarding tax reform related impacts
  • SEC Staff Accounting Bulleting No. 118
    • Year of enactment: disclosure of the impact of TCJA in three categories (1) matters for which the accounting can be completed, (2) provisional amounts to the extent that they are reasonably estimable, and (3) any specific income tax effects for which a reasonable estimate cannot be determined
    • Periods that are within 12 months from enactment date: updates to (2) and (3) and disclosure on when accounting for the impact of the Act is completed
  • AMT credit refund: recorded as DTA or current receivable
  • GILTI accounting policy: period cost method or deferred method

• GILTI
  • GILTI foreign tax credits do not carry forward: permanent loss of benefits for GILTI foreign tax credits if not utilized

• APB 23 considerations after deemed repatriation
  • Determine if an outside basis difference exists and whether the outside basis difference will remain indefinitely reinvested
  • If distributions are anticipated after deemed repatriation, consider whether a DTL is required for withholding taxes on the distributions

• FIN 48
  • BEAT interpretations regarding claims payments

Note: Consultation with your attest firm is recommended.
International Tax Items

• Section 954(i)
  • No rulings
  • Item on IRS Priority Guidance Plan

• Branch filings on Form 8858
  • New TCJA definitions for branches
Life Insurance Companies
Tax Reserving Issues – Section 807(c)(1)

- 92.81% of reserve computed using NAIC-prescribed method applicable to the contract at the valuation date
- Net surrender value floor and statutory cap by contract
- Still exclude:
  - Deficiency reserves
  - Asset adequacy testing (AAT) reserves
  - Reserves attributable to deferred and uncollected (D&U) premiums (if premiums not included in income)
- Special rule for variable contracts
Tax Reserving Issues – Section 807(c)(1)

- Separate rule for “variable contracts” as defined in section 817(d) – Tax reserve equals:
  - Greater of net surrender value or separate account portion of reserve, plus
  - 92.81% of excess (if any) of reserve computed using NAIC-prescribed method applicable to the contract at the valuation date over item 1
- Statutory cap by contract
Tax Reserving Issues – Section 807(c)(1)

• Transition rule in P.L. 115-97 section 13517(c) – In general, impact as of 12/31/2017 is spread over eight taxable years

  • Apply 2017 section 807(f) changes first before computing eight-year spread (section 2.09)

  • Confirms eight-year spread as prescribed in P.L. 115-97
  • Automatic consent is granted and no Form 3115 is required if taxpayer complies with Rev. Proc. 2019-34 and applicable provisions of Rev. Proc. 2015-13
Tax Reserving Issues – Section 807(c)(1)

- Practical considerations in computing life insurance reserves under new section 807(d)
  - Variation from NAIC methods or minimum assumptions
  - Software challenges
  - Product-specific items

- Specific considerations for 2018 tax return preparation
  - Reconciling Form 1120-L Schedule F at beginning of 2018 vs. end of 2017
  - Where to report the eight-year spread
Tax Reserving Issues – Section 807(c)(1)

• Thinking ahead to 2019+
  • Section 807 item still on IRS Priority Guidance Plan
  • Fully establishing reserve infrastructure, including in projections
  • Changes afoot at the NAIC
    • Life PBR (principle-based reserves) – Valuation Manual Section 20 (VM-20)
    • Variable annuities – VM-21
    • Non-variable annuities – VM-22
    • Changes to contract-level allocation methodology
Tax Reserving Issues – Section 807(c)(3)

• “The amounts (discounted at the appropriate rate of interest) necessary to satisfy the obligations under insurance and annuity contracts, but only if such obligations do not involve (at the time with respect to which the computation is made under this paragraph) life, accident, or health contingencies”

• Discount at the highest rate or rates permitted to be used to discount the obligations by the NAIC as of the date the reserve is determined

• Net surrender value floor
Tax Reserving Issues – Section 807(c)(3)

• Transition rules
  • Not mentioned in P.L. 115-97 section 13517(c) – only refers to amounts “determined under section 807(d),” i.e., life insurance reserves
  • If controlled by section 807(f) – compute impact as of 12/31/2018 with respect to pre-2018 contracts, and take section 481(a) adjustment beginning in 2018
    • Would need to file Form 3115 pursuant to Rev. Proc. 2019-10
  • Rev. Proc. 2019-34 provided another option
    • Compute impact as of 12/31/2017
    • Take section 481(a) adjustment beginning in 2018
    • Company may still elect to follow Rev. Proc. 2019-10
Tax Reserving Issues – Section 807(c)(3)

• Practical considerations for 2018 tax return preparation
  • Transition rules

• Thinking ahead to 2019+
  • VM-22 and continued complexity of prescribed interest rates
Tax Reserving Issues – Section 807(f)

• Changes in basis of computing any item in section 807(c)
  • Compute impact as of close of the year of change, with respect to contracts issued prior to the year of change
  • Difference “shall be taken into account under section 481 as adjustments attributable to a change in method of accounting initiated by the taxpayer and made with the consent of the Secretary”
    • Generally, one year if it creates a deduction, four years if it creates income
Tax Reserving Issues – Section 807(f)

• Rev. Proc. 2019-10
  • Reaffirms section 807(f) computation and section 481(a) timing (one year / four years)
  • Establishes new automatic change in method of accounting
    • Requires shortened Form 3115, with specified information about the changes, to be attached to timely filed tax return
  • Multiple basis changes in single year – netting at the level of “the same type of contract (life insurance, annuity, etc.)”
  • Requires continuation of ten-year spreads arising from changes in basis in 2017 or earlier – had been unclear in P.L. 115-97 transition rules
Tax Reserving Issues – Section 807(f)

• Practical considerations for 2018 tax return
  • Preparing Form 3115 and complying with all procedural requirements
  • Tracking mix of ten-year spreads, four-year spreads, and one-year items
  • Netting
  • Identifying changes – ongoing relevance of Rev. Rul. 94-74?

• Thinking ahead to 2019+
  • Section 807 guidance is still on IRS Priority Guidance Plan
  • Watch for mass automatic change ruling and any refinements to Rev. Proc. 2019-10 (e.g., netting)
  • Other section 807 guidance
DAC Issues – Section 848

• Congressional intent was apparently to change capitalization rates

<table>
<thead>
<tr>
<th>Type of specified insurance contract</th>
<th>Prior rate</th>
<th>Intended rate</th>
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<tbody>
<tr>
<td>Annuity contract</td>
<td>1.75%</td>
<td>2.09%</td>
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<tr>
<td>Group life insurance contract</td>
<td>2.05%</td>
<td>2.45%</td>
</tr>
<tr>
<td>Other</td>
<td>7.70%</td>
<td>9.20%</td>
</tr>
</tbody>
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• But only annuities were actually changed; others had incorrect cites
• Also changed regular amortization period to 15 years instead of ten
DAC Issues – Section 848

• Form 1120-L Schedule G
  • Left the capitalization rates blank (had been pre-populated prior to 2018)
  • No mention in instructions

• Rev. Proc. 2019-34
  • Granted automatic consent to follow TCJA amendments, with no Form 3115 required
  • Cut-off method – no section 481(a) adjustment
  • Silent on capitalization rates
DAC Issues – Section 848

• Practical considerations for 2018 tax return
  • Capitalization rates
  • Tracking mix of amortization periods

• Thinking ahead to 2019+
  • Technical corrections?
Property and Casualty Insurance Companies
Changes for Nonlife Companies

• Loss reserve discounting-discussed next

• Proration of DRD and tax-exempt interest
  • Proration percentage for 2018 is 25%
  • Proration percentage based on specified relationship to corporate tax rate.

• Section 847 special deduction repealed
  • Transition rule/conversion of SETPs to regular estimated tax
LRD Proposed and Final Regulations

• Proposed Regs (Nov. 2018)
  • Interest maturity range: Extended from 3.5-9 years to .5-17 years
  • Repeal of “composite” method
  • Alignment of discount rates for LRD and S&S
  • Payment pattern smoothing mechanism

  • Relies on interest rate window established in the proposed regs.
  • Provides composite factors as well as factors out 24 accident years.
  • Treats reinsurance and international LOBs as short-tails.
  • Provides guidance for companies in the event that revised factors are issued in conjunction with final regulations.
LRD Proposed and Final Regulations

- Final Regs (June 2019)
  - Interest maturity range narrowed to 4.5-10 years. Maturity window will not be revisited.
  - Composite method permanently reinstated.
  - Adopted LRD/S&S alignment and smoothing mechanism.

  - Applicable interest rate drops approx. .2%.
  - Taxpayers have option of using Proposed or Revised Factors on 2018 return.
  - All adjustments (including 8-year transition under TCJA) are 481(a).
LRD Discussion Points

• International and reinsurance lines are short-tail

• Application of transition rule in situations where more than one methodology used in prior years
  • Changes in method?

• Relationship between annual statement and tax return

• Documentation of methodology/decisions in work papers
Other items/Open discussion
Other Potential Discussion Topics

• New regime for net operating losses, operations loss deductions
  • Life companies have no carryback
  • Nonlife companies back 2 years, forward 20 years
  • Non-insurance companies
    • Carryforwards only-unlimited number of years
    • 80% taxable income limitation

• Life settlement reporting
  • Readiness
  • Documentation
Reserves Guidance under TCJA

• Revenue Procedure 2019-10 (change in basis)(12/13/2018)
• Revenue Procedure 2019-6 (section 846 LRD)(12/19/2018)
• Joint Committee on Taxation Explanation (“Blue Book”)(12/20/2018)
• T.D. 9863 (6/13/2019)