Insurance Tax Guidance Update

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Subchapter L Guidance under the TCJA

Subchapter L guidance to date: It’s (almost) all about Accounting Methods!
- Rev. Proc. 2019-34 – Automatic permission to comply with TCJA provisions
- Rev. Proc. 2019-10 and -43 – Routine, year-over-year changes in basis under 807(f)
- Insurance accounting methods: The resulting landscape
- CCA 201939033 – Old Law, New Guidance

Guidance to come: The Priority Guidance Plan (and more?)
- Guidance under section 807 – What might this cover?
- Guidance under section 817(h) for UMBS
- NOL guidance
- Private annuity regs
- International projects
Revenue Procedure 2019-34

Automatic permission to change methods of accounting to comply with TCJA changes to 3 provisions:

- Section 807(d) (Life insurance reserves) – 8-year spread, no audit protection
- Section 807(c)(3) (Interest rate) – 1- or 4-year spread, audit protection
- Section 848 (DAC) – no spread because implemented on a cutoff basis, audit protection

No Form 3115 required
- A company that complies correctly need not do anything it would not have done anyway

One-time procedure applies only for TCJA-required changes

- IRS took a similar approach to TCJA amendment to section 451(b)
- Query why permission is needed to comply with an amendment to the Code
- Would a formal 3115 be required for future amendments to the Code if no automatic procedure were published?
Revenue Procedure 2019-34 (cont.)

“If you do what you were already planning to do, you don’t have to file Form 3115 that you didn’t think was required”
  • Presumably, preserving the principle that all changes require permission

How could there possibly be implementation issues, right?
  • Why no audit protection for life insurance reserves?
  • Treatment of transition adjustments as “section 481(a) adjustments”
  • Confusion about the relationship between Rev. Procs. 2019-34 and 2019-10/43

Background section references only section 446
  • What about sections 811(a) and 807(f)?
Revenue Procedures 2019-10 and 2019-43

Automatic Change in Accounting Method

• Routine, year-over-year changes in basis under 807(f)
• Abbreviated Form 3115 attached to return
• Section 481(a) adjustment
  • 1 year versus 4 year spread
  • End of Year versus Beginning of Year
  • Netting
• Audit protection, but no ruling protection
Revenue Procedures 2019-30 and 2019-31

• Rev. Proc. 2019-31
  • Prescribes revised discount factors to reflect Final Regulations under section 846
  • The revised discount factors differ from those proposed in Rev. Proc. 2019-06
Revenue Procedures 2019-30 and 2019-31 (cont.)

• Rev. Proc. 2019-30 – Provides simplified procedures for companies to change their methods of accounting to comply with changes made to section 846 by TCJA
  • Revised factors used in all years
    • TCJA Adjustment (8 years)
    • Salvage Adjustment (1 or 4 years)
  • Proposed factors in first TCJA year, revised factors in later years
    • Partial TCJA Adjustment (8 years)
    • Partial Salvage Adjustment (1 or 4 years)
    • Remainder TCJA Adjustment (7 years)
    • Supplemental Adjustment (1 or 7 years, elective)
  • Audit Protection
Where does that leave us for insurance company accounting methods?
## Guidance Summary

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CCA 201939033: Old Law, New Guidance

• Before TCJA
  • Federally Prescribed Reserve (subject to cap and floor)
    • Tax Reserve Method
    • Prevailing (26-state) mortality/morbidity tables
    • Greater of PSAIR (26-state) or AFR
  • Company could elect to redetermine AFR every 5 years, permission needed to revoke
    • Few companies made the election
    • Two companies revoked in past 5 years or so
    • Provision repealed by TCJA
    • Renewed interest due to decrease in tax rate
CCA 201939033: Old Law, New Guidance

• The CCA
  • Company elected in 2017
  • Original plus 3 amended returns
  • All contracts issued after 1987
• IRS response
  • No election on amended returns
  • Apply to only 5 years of contracts
  • No practical effect because PSAIR > AFIR anyway
• What’s next on this issue?
More to Come: The PGP (and more?)

Guidance under section 807 – What might this cover?
• TCJA amendment to section 807(d) – reserve and separate account reporting?
• Guidance on asset adequacy reserves?
• Updates to regulations under Part I of Subchapter L, generally?
• Further guidance on section 807(f)?

Guidance under section 817(h) for UMBS
• FNMA and FHLMC Single Security Initiative (UMBS) raise unique diversification issues under section 817(h), particularly during the period in which an unstipulated trade is in TBA status
• Rev. Proc. 2018-54 addressed some issues, but proved difficult to apply in practice
• The government has a strong interest in making the program work. IRS and Treasury may take a fresh look at the procedures provided in Rev. Proc. 2018-54
More to Come: The PGP (and more?)

NOL guidance

- TCJA modified NOL rules for most companies to permit only carryforwards, and subject to a limitation of 80% of taxable income; it also conformed rules for losses life insurance companies to the rules that apply to everyone else
- NOL rules remain unchanged for nonlife companies
- As a result, guidance is expected in three areas
  - Transition guidance
  - Guidance to explain how losses are assigned to P&C and non-P&C members
  - Update of life-nonlife consolidated returns regulations?

Private annuity regs

- Regulations proposed in 2006 would address exchange of property for an annuity contract.
Overview of BEAT Final and Proposed Regulations
On December 2, 2019, the IRS and Treasury released final and proposed regulations under section 59A.

• General Highlights of the guidance include the following:
  • No carve-out for GILTI/subpart F inclusions
  • Relief for corporate nonrecognition transactions
  • Losses with respect to the sale or transfer of property are not base erosion payments
  • Waiver of allowable deductions (proposed regulations)
  • No section 15 blending for fiscal year 2019
• General Highlights of the guidance include the following:
  • Modifications to applicable taxpayer rules
    • Final regulations adopt “with-or-within” rule for applicable taxpayer tests for groups with taxpayers with different taxable years; the proposed regs contain additional rules to implement the with-or-within rule
    • Proposed regulations provide rules for applying applicable taxpayer tests when entities join or leave an aggregate group
  • Retained “add-back” method for computing MTI
  • Retained and expanded aggregate treatment for partnerships
  • Revised treatment of section 988 losses in the denominator of the BEP
Final Regulations

- The final regulations (other than reporting for QDPs) apply to tax years ending on or after December 17, 2018
- Taxpayers may apply final regulations in their entirety for tax years ending before December 17, 2018
- Taxpayers may rely on the 2018 proposed regulations in lieu of the final regulations for all taxable years ending on or before December 6, 2019, provided the taxpayer applies the 2018 proposed regulations in their entirety (subject to exception noted on next slide)
Proposed Regulations

- The rules in Prop. Reg. §1.59A-7(c)(5)(v) (regarding partnership allocations in lieu of deductions), 1.59A-9(b)(5) (anti-abuse – partner derivative rule) and (6) (anti-abuse – allocation to eliminate or reduce base erosion payment) apply to tax years ending on or after December 2, 2019

- The rules in Prop. Reg. §1.59A-2(c)(2)(ii) and (c)(4) through (6) (for determining applicable taxpayer status) and 1.59A-3(c)(5) and (6) (relating to the waiver of deductions) apply to taxable years beginning on or after December 6, 2019

- Taxpayers may rely on the 2019 proposed regulations in their entirety for tax years beginning after December 31, 2017 and before the final regulations are applicable

- If a taxpayer chooses to apply both the 2019 proposed regulations and the 2018 proposed regulations to a tax year ending on or before December 6, 2019, the taxpayer is not required to apply the proposed aggregate group rules to that tax year
Base Erosion Anti-Abuse Tax
Significant Changes Impacting the Insurance Industry
BEAT: Items to Address

**Base erosion payments and BEP considerations**
- Losses (claims) on reinsurance contracts (life and non-life) ultimately paid to unrelated persons
- Mark-to-market tax accounting
- Section 988
- Transfers of loss property
- Non-recognition transactions
- Treatment of interest allocable to ECI or under an applicable tax treaty
- Election to waive deductions
- Extension of de minimis bank or registered securities dealer exception to base erosion tax rate (in addition to exception from lower base erosion percentage threshold)

**Other items without significant changes**
- Re-emphasis of principles against netting
- Anti-abuse, anti-conduit rules
BEAT: Insurance Claims

2018 Proposed Regulations
• Recognized that insurance companies (non-life) could treat claims payments as either deductions or reductions to gross income and asked for comments

Final Regulations
• Excludes from base erosion payments amounts paid or accrued to a related foreign insurance company pursuant to a reinsurance contract that:
  • are life benefits (under section 805(a)) or losses incurred (as defined in section 832(b)(5))
  • would otherwise be within the definition of section 59A(d)(1)
  • are properly allocable to amounts required to be paid pursuant to an insurance, annuity, or reinsurance contract, to a non-related party
• Clarifies that life benefits or losses incurred are included in the denominator of the base erosion percentage, unless excluded from base erosion payments
BEAT: Reinsurance Premiums

2018 Proposed Regulations
- Asked for comments about reinsurance contracts that settle on a net basis (e.g., modified co-insurance or funds withheld reinsurance)
- Recognized that insurance companies (non-life) could treat claims payments as either deductions or reductions to gross income and asked for comments

Final Regulations
- Does not allow netting for insurance contracts, even if settled on a net basis
BEAT: Base Erosion Percentage – MTM Positions

2018 Proposed Regulations

• Taxpayer determines its gain or loss with respect to a MTM position by combining all items of income, gain, loss, or deduction arising with respect to the position during the tax year (the “MTM netting rule”)

• If the combined amounts on the position are in a loss position, the taxpayer includes the net loss in the denominator (unless the QDP exception applies), as well as the numerator if with a foreign related party

Final Regulations

• Retain the MTM netting rule in final regulations

• Preamble clarifies that payments on physical securities (e.g., dividends, interest) are subject to the MTM netting rule
BEAT: Base Erosion Percentage - Section 988

2018 Proposed Regulations

• Exchange losses on transactions with foreign related parties are excluded from the definition of a base erosion payment
• All section 988 losses are excluded from the denominator, including exchange losses on contracts with third-parties

Final Regulations

• Exchange losses on contracts entered into with foreign related parties continue to be excluded from the definition of a base erosion payment
• Exchange losses are only excluded from the denominator to the extent they are also excluded from the definition of a base erosion payment (i.e., arise from transactions with foreign related parties)
BEAT: Transfers of loss property

2018 Proposed Regulations

- Base erosion payments include losses recognized on the transfer of property to a foreign related party
- For dealers, this rule created uncertainty as to whether losses on securities/commodities that are marked-to-market could give rise a base erosion payment if sold to a foreign related party

Final Regulations

- Losses on the transfer of property to a foreign related party are not base erosion payments
- If the transfer of property to a foreign related party gives rise to a deductible payment, the amount of the base erosion payment is limited to the FMV of the property
BEAT: Non-recognition Transactions

2018 Proposed Regulations
• No exclusion for certain corporate transactions – sections 332, 351, 355, 368

Final Regulations
• Base erosion payments do not include amounts transferred to a foreign related party in a transaction to which sections 332, 351, 355 and 368 apply
  • Other property (boot) is not excepted
• Section 301 transactions are not exchanges, and as a result, are not base erosion payments
• Redemptions are exchanges that could give rise to a base erosion payment
• Anti-abuse rule:
  • If a transaction (or series of transactions), plan, or arrangement has a principal purpose of increasing the adjusted basis of property that a taxpayer acquires in a specified nonrecognition transaction, such nonrecognition transaction will constitute a base erosion payment
  • Per se principal purpose if basis step-up transaction between related parties within 6 months of non-recognition transaction
BEAT: QDPs – Repos/Securities loans

2018 Proposed Regulations

- Qualified derivative payments are excluded from BEPs and Base Erosion Percentage.
- Excludes payments with respect to sale repurchase agreements and securities lending transactions from the definition of derivatives that can qualify for QDP

Final Regulations

- Sale repurchase agreements continue to be excluded from derivative definition
- Cash leg of securities lending transactions expressly excluded from definition of derivative but securities leg is eligible
- Includes anti-abuse rule directed at securities lending transactions that have a significant financing component

Continued Challenges

- Distinguishing between repos and securities loans – matters for reporting
- Disaggregating payments
- Satisfying other requirements to qualify for QDP exception – MTM, reporting
BEAT: QDPs – Reporting

2018 Proposed Regulations
• Regulations clarify that failure to comply with QDP reporting requirements for one derivative will not disqualify all QDPs
• Requires reporting of aggregate QDPs by type of derivative and counterparty, and requires identification of counterparties

Final Regulations
• Transition period for QDP reporting extended until taxable years beginning on or after June 7, 2021
• During the transition period, the QDP reporting requirement is satisfied if a taxpayer reports the aggregate amount of QDPs in “good faith”
• Eliminates requirement to report by counterparty and type of derivative. Taxpayers are only required to report the total aggregate amount of QDPs for the year, together with a representation that all payments to which the QDP exception is applied satisfy the QDP reporting requirement
• Reporting applies the MTM netting rule (see prior discussion)
BEAT: Election to waive deductions

Proposed Reg. §1.59A-3(c)(6) provides an election to permanently forego a deduction for all U.S. federal income tax purposes (including as a BETB)

• Deductions may be waived in whole or in part

• All deductions that are not waived, even if not claimed, are considered “allowed” and therefore BEAT-able
  • I.e., If a taxpayer does not elect to waive a deduction that could be properly claimed for the taxable year, and the deduction would be a base erosion tax benefit, the deduction is treated as a BETB and taken into account in the taxpayer’s base erosion percentage and modified taxable income
  • Election is made on an annual basis and taxpayers may choose not to make the election for a subsequent year (but may not reverse an election)

Regulation language would appear to exclude reinsurance premiums from amounts to which a waiver can be made

• Treasury has commented that they are considering extending waiver availability to reinsurance premiums
BEAT: Election to waive deductions (cont’d)

Election is disregarded in determining –

• Amount allowable for depreciation or amortization under sections 167(c) and 1016(a)(2) or (3), and any other adjustment to basis under section 1016(a)
• Section 482,
• A taxpayer’s E&P, and
• Any other item as necessary to prevent a taxpayer from receiving the benefit of a waived deduction

Mechanics

• Waiver may be elected on an original return, an amended return, or during exam
• Until the 2019 proposed regulations are final, a taxpayer may rely on the proposed regulations and make the election by attaching a statement to its Form 8991 with the required information
BEAT: Partnership Transactions

2018 Proposed Regulations
• Generally take aggregate approach to partnerships
• Payments to partnerships treated as payments to its partners; payments by partners treated as made by the partners
• Relatedness tested at partner level

2019 Final and Proposed Regulations
• Final regulations retain and expand aggregate approach
• No exception for §721 contributions
• Final regulations provide new specific rules regarding application of aggregate approach to transfers of property by or to partnerships, transfers of partnership interests by a partner, contributions of property to partnerships, and certain distributions of property by partnerships that result in stepped-up asset basis
• Final regulations retain, but decline to expand, small partner exception
• Proposed regulations would add two new anti-abuse rules for partnership transactions, rules for certain allocations of income instead of deductions under curative method, and new reporting requirements
BEAT: Additional items without significant changes

• Definition of gross receipts
• SCM exception – Final regulations add examples of documentation requirements
• ECI exception
• Add-back approach when calculating MTI
• Vintage-year approach to identify the applicable BEP of an NOL deduction
• No exception for hedging transactions
• No “fixed ratio” for interest allocable to ECI
• No change to impact of FTCs on adjusted regular tax liability
• No increase to the de minimis exception for banks and regulated securities dealers
  • Do clarify that the 1% increase to the BEAT rate does not apply to taxpayers that are part of an affiliated group with de minimis banking and securities dealer activity