General Corporate Provisions

The Act reduces the corporate tax rate from 35 percent to 21 percent for taxable years beginning after December 31, 2017. This will impact all corporations, including insurance companies, beginning in 2018. It will also affect the calculation of deferred tax assets as of 4th quarter 2017 for both GAAP (ASC 740) and STAT (SSAP 101) purposes.

The Act eliminates the corporate AMT for taxable years beginning after December 31, 2017. The Act continues to allow the prior year minimum tax credit to offset the taxpayer’s regular tax liability for any tax year. For tax years beginning after 2017 and before 2022, the prior year minimum tax credit is refundable in an amount equal to 50 percent (100 percent for tax years beginning in 2021) of the excess of the credit for the tax year over the amount of the credit allowable for the year against regular tax liability.

Insurance Provisions

Health Insurance

The Act amended the two provisions related to individual payments of health insurance premiums and medical expenses. (1) The Act does not repeal the individual mandate but reduces the penalty amount to $0; (2) For tax years beginning after Dec. 31, 2016, and ending before Jan. 1, 2019, the act reduces the medical expense deduction floor to 7.5 percent of adjusted gross income (from 10 percent) and eliminates the minimum tax preference.

Life Insurance

• Modification to rules for computing life insurance reserves

The Act makes several modifications to the computation of life insurance tax reserves. Under the new law, life insurance companies will take into account the greater of (i) the net surrender value of the contract, or (ii) 92.81% of the reserve for the contract computed as required by the National Association of Insurance Commissioners (NAIC) at the time the reserve is determined, in calculating their deductible tax reserves under IRC Section 807.

The Act maintains the rules providing that in no event shall the reserves exceed the amount which would be taken into account in determining statutory reserves. Furthermore, the Act makes clear that no amount or item shall be taken into account more than once in determining any reserve. As under prior law, no deduction for asset adequacy or deficiency reserves is allowed. The Act repeals IRC Section 807(f) which provided for a 10-year spread of the impact of a change in the method or basis of calculating life insurance company tax reserves. Insurers will now be subject to the general change in accounting method rules of IRC Section 481, generally, requiring income to be taken into account ratably over a 4-year period. The modifications are effective for tax years beginning after December 31, 2017, with a transition rule and transition relief for reserve computations under §807(d).

• Modification to capitalization of deferred acquisition costs

The act amends the rules regarding the capitalization of certain policy acquisition costs applicable to specified contracts by replacing the 120-month capitalization period with a 180-month capitalization period and increasing the percentage of net premiums used to calculate policy acquisition costs for specified contracts subject to the capitalization rules, thereby increasing the amount of expenses that must be capitalized rather than currently expensed. Specifically, the percentage for annuity contracts
increases from 1.75 percent of net premiums to 2.09 percent, for group life contracts the percentage increases from 2.05 percent to 2.45 percent, and for all other contracts the percentage increases from 7.7 percent to 9.2 percent. The act provides a transition rule for specified policy acquisition expenses first required to be capitalized in a tax year beginning before January 1, 2018, to continue to be capitalized over the 120-month period. The proposal does not change the special rule providing for the 60-month amortization of the first $5 million (with phase-out). The provision is effective for tax years beginning after December 31, 2017.

- **Modification to life insurance proration rules for purposes of determining dividends received deduction**

  The act amends the proration rules for determining a life insurance company’s dividends received deduction. Section 812 as amended provides that the company’s share is 70 percent and the policyholders’ share is 30 percent for purposes of determining the dividend received deduction allowable under §805(a)(4). The provision is effective for tax years beginning after December 31, 2017.

- **Repeal of life insurance company operations losses**

  The act repeals §810, the operations loss deduction for life insurance companies and requires life insurance companies to calculate a NOL deduction as amended under the act. As such, NOLs may be carryforward indefinitely but may only offset 80 percent of taxable income in a year. No carryback is permitted. The repeal of §810 puts life insurance companies on par with all other corporations, except for property/casualty insurers, with respect to the treatment of NOLs. The act also repeals §844, which provides a special rule allowing an NOL of a life insurance company to carry over when the life insurance company converts to a nonlife company (or vice versa). The provision is effective for NOLs arising in tax years beginning after December 31, 2017.

- **Amendment to definition of life insurance contract**

  The act amends the guideline premium requirement of §7702 to require use of the most recent commissioners’ standard tables prescribed by the NAIC and permitted to be used to compute reserves for that specific type of contract in at least 26 states when that specific type of contract was issued. As one of several conforming amendments, the act adds new §808(g), which defines the term “prevailing State assumed interest rate” and provides that the rate is determined at the beginning of the calendar year in which a life insurance contract was issued. The provision is effective for tax years beginning after December 31, 2017.

- **Reporting for life settlement transactions and death benefits**

  The act adds new reporting requirements related to the direct or indirect acquisition of an interest in a life insurance contract. A reportable policy sale is defined as one in which the acquirer has no substantial family, business, or financial relationship with the insured apart from the acquirer’s interest in the life insurance contract.

  Under the reporting requirement, the buyer reports information about the purchase to the IRS, to the insurance company that issued the contract, and to the seller. The information reported includes (1) the buyer’s name, address, and taxpayer identification number (“TIN”), (2) the name, address, and TIN of each recipient of a payment in the reportable policy sale, (3) the date of the sale, and (4) the amount of each payment. The issuer is required to report to the IRS and to the seller (1) the basis of the contract, (2) the name, address, and TIN of the seller or the transferor to a foreign person, and (3) the policy
number of the contract. With respect to reportable policy sales, when a reportable death benefit is paid under a life insurance contract, the insurance company is required to report (1) the gross amount of the payment; (2) the TIN of the payee; and (3) the payor’s estimate of the buyer’s basis in the contract to the IRS and to the payee.

The act also amends §101(a) by adding a new provision stating that the exception to the transfer-for-valuable consideration exception to the general exclusion from income rule applicable to death benefits paid under a life insurance policy does not apply to a transfer of a life insurance contract or any interest therein which is a reportable policy sale. The reporting requirement is effective for reportable policy sales occurring after December 31, 2017, and reportable death benefits paid after December 31, 2017. The modification of exception to the transfer for value rules is effective for transfers occurring after December 31, 2017.

- **Repeal of small life insurance company deduction**
  The act repeals the small life insurance company deduction that allowed life insurance companies with assets below $500 million to deduct 60 percent of their first $3 million in income. The provision is effective for tax years beginning after December 31, 2017.

- **Repeal of Rules for Distributions to Shareholders from Policyholder Surplus Accounts**
  The act repeals §815 and provides in its place a “phased inclusion” of any remaining balance in a policyholders’ surplus account (PSA) held by any stock life insurance company determined as of the close of such company’s last tax year beginning before January 1, 2018. Remaining PSA balances will be included in taxable income ratably for the first eight years beginning after December 31, 2017. The provision is effective for tax years beginning after December 31, 2017.

**Property/Casualty Insurance**

- **Modification to Discounting Rules for Unpaid Loss Reserves**
  The Act amends §846, which provides rules for determining discounted unpaid losses, by extending the discount period and increasing the discount interest rate. The Act replaces the applicable federal rate with a rate determined on the basis of the corporate bond yield curve that reflects the average, for the preceding 60-month period, of monthly yields on investment grade corporate bonds with varying maturities and that are in the top three quality levels available.

  The act also modifies the loss payment patterns by extending the previous 10-year period by up to 14 years, for a total of up to 24 years. The Act retains the three-year period for certain lines of business. The Act also eliminates the election to use a company’s own historical loss payment pattern, rather than industry-wide, historical loss payment patterns. The provision is effective to tax years beginning after December 31, 2017. Reserves at the end of 2017 are adjusted using the new rules, and any resulting income (or loss) is included ratably in taxable income over eight taxable years.

- **Net Operating Losses**
  For property/casualty insurers, the Act does not change current law treatment with respect to NOLs. Property/casualty insurers may continue to carryback net operating losses two years and forward 20 years. Net operating losses may continue to be utilized to offset 100 percent of taxable income.
• Proration

The Act replaces the fixed 15 percent proration percentage with a formula that is tied to the highest corporate rate. The Act sets the proration percentage as 5.25 percent divided by the highest corporate tax rate. As a result, the applicable percentage reduction for tax years after December 31, 2017 is 25 percent.

• Repeal of §847 and Special Estimated Tax Payments

The act repeals §847, which provided an additional deduction to certain insurance companies that discounted unpaid losses and made special estimated tax payments. The provision is effective for tax years beginning after December 31, 2017.

Cross Border Insurance Activities

• Base Erosion and Anti-Abuse Tax

The Act created a new IRC §59A implementing a Base Erosion and Anti-Abuse Tax (“BEAT”). "Applicable taxpayers" will be subject to a minimum tax - the “base erosion minimum tax amount” - in addition to their regular tax liability. The BEAT is designed to restrict the ability of multi-national companies to erode the U.S. tax base through deductible related-party payments. The BEAT applies to taxpayers (including certain affiliated members) that have annual gross receipts in excess of $500 million (for the three prior tax years) and that have a “base erosion percentage” of at least three percent or higher for the taxable year (two percent or higher for a member of a financial group). The tax is imposed when the tax calculated under BEAT exceeds the corporation’s regular tax liability determined after the application of certain credits allowed against the regular tax.

The BEAT rate is five percent for 2018, and 10 percent thereafter until it increases to 12.5 percent for tax years ending after December 31, 2025. Different rates apply to banks and securities dealers. The BEAT, unlike the AMT or certain other taxes, is not creditable, and as such does not reduce future regular income tax liabilities.

Premium or other consideration for reinsurance payments that are considered under Section 803(a)(1)(B) (return premiums, and premiums and other consideration arising out of indemnity reinsurance of life insurance companies) or 832(b)(4)(A) (return premiums and premiums paid for reinsurance of other insurance companies) are specifically included in the definition of the base erosion payment. A deduction is allowed for the taxable year with respect to a base erosion payment for any reduction of life insurance premiums for indemnity insurance and of P&C premiums for premiums paid for reinsurance.

The Act; however, does not address the treatment of payments related to the same transaction. Questions have been raised whether claims payments or ceding commissions may be deducted or netted for purposes of the BEAT.

• Global Intangible Low-Taxed Income

The Act create a new IRC §951A subjecting a 10% U.S. shareholder of a controlled foreign corporation (“CFC”) to current taxation on its “global intangible low-taxed income” (“GILTI”). GILTI generally equals
the portion of a CFC’s net income that exceeds a 10 percent return on its foreign tangible assets. The GILTI rate is 10.5 percent through 2025, increases to 13.25 percent thereafter. The GILTI also limits the use of the foreign tax credit to 80 percent. GILTI provisions could affect non-U.S. insurance companies. The ultimate impact will be determined by policy decisions to be resolved in regulation.

• Modification to Exception to Definition of Passive Income Derived by an Insurance Business

The act modifies the passive foreign investment company (PFIC) rules by amending the exception to the definition of passive income in §1297(b)(2)(B) applicable to income derived in the active conduct of an insurance business. The act amends this exception to provide that passive income does not include income derived in the active conduct of an insurance business “by a qualifying insurance corporation” and defines a qualifying insurance corporation as a foreign corporation that would be subject to tax under subchapter L if it were a domestic corporation that meets the insurance liabilities to assets ratio test. If the foreign corporation fails the 25 percent test, an alternative facts and circumstances test is available for certain foreign corporations.

Small Business Provisions

• Pass-through Entity Taxation

Many agents and other insurance professionals are self-employed or otherwise receive income from a partnership or other pass-through entity that is taxed once at the owner's individual rates, rather than through the corporate tax structure. Considering the dramatic reduction in the corporate rate, the Act provides a new deduction equal to 20 percent of “qualified business income”. The deduction is available to most pass-through businesses except those defined in the Act as "specified service trade or business" when the income exceeds threshold levels of $157,500 for single filers and $315,000 for joint filers.

Specified service trade or business is identified by reference to IRC §1202(e)(3)(A) and includes any trade or business involving the performance of services in the fields of health, law, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners, or which involves the performance of services that consist of investing and investment management trading, or dealing in securities, partnership interests, or commodities. Agent groups and insurance companies are seeking clarification from Treasury and the Internal Revenue Service that insurance agent commission income will not be classified as specified trade or business income.

Qualified business income eligible for the 20 percent deduction includes all domestic business income except investment income (i.e., dividends, interest income, short-term capital gains, long-term capital gains, commodities gains, foreign currency gains, etc.). For taxpayers in the highest marginal individual income tax bracket and eligible for the full 20 percent deduction, the Act will result in an effective marginal tax rate of 29.6 percent.

The Act imposes significant and complicated limitations and phase-ins for the use of the deduction. The deduction is capped at the excess of taxable income over capital gains and is limited to the greater of (i) 50 percent of the taxpayer’s pro rata share of wages paid by the business, or (ii) 25 percent of the taxpayer’s pro rata share of the wages paid by the pass-through plus 2.5 percent of the unadjusted basis, immediately after acquisition, of qualified property (i.e., property subject to depreciation and used in the trade or business). This second limitation applies only to partners, shareholders, or sole proprietors.
with taxable income in excess of the thresholds and will phase in over the next $50,000 of income ($100,000 for joint filers) above these thresholds.

For example, if an individual has qualified business income of $250,000 from a partnership that paid a total of $40,000 of wages and has no qualified property and spousal income of $50,000 filing jointly. The couple would have income of $300,00, below the $315,000 threshold. As such, the individual would be eligible to deduct $50,000 (20 percent of $250,000). If the couple’s income exceeded the threshold, the deduction would be limited to the greater of:
  o 50% of wages of $40,000 = $20,000, or
  o 25% of wages of $40,000 plus 2.5% of qualified property of $0 = $10,000.

Retirement Savings Provisions

The Act is more notable in what is not included related to retirement savings than what is included. Congress did not include provisions requiring individual retirement account provisions to be contributed with after-tax dollars (Roth IRA) rather than the option for pre-tax contributions (Traditional IRA). Also, not included were additional limitations on employer sponsored plans and deferred compensation arrangements.

The Act, however, does introduce changes potentially affecting retirement savings. The Act institutes the use of a "chained" Consumer Price Index (CPI) as the measure of inflation used by the federal government for indexing. Adjustments going forward will be determined by the Department of Labor's Chained Consumer Price Index for All Urban Consumers (C-CPI-U).

Generally, using chained CPI inflation will track more slowly. Retirement plan contribution limits adjustments could be smaller than previous adjustments as a result.