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ACLI Update

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SENATOR WYDEN'S "PLAN TO FIX OUR BROKEN TAX CODE, ENSURE THE WEALTHY PAY THEIR FAIR SHARE, AND PROTECT SOCIAL SECURITY"

Senate Finance Committee Ranking Member Sen. Ron Wyden released a plan ("the Plan") on Sept. 12, 2019, to tax currently the assets of certain high-income or high-worth individual taxpayers on a mark-to-market basis, requiring taxes to be paid on built-in unrealized gain of most assets held by them annually. The Plan would also equalize the treatment of ordinary and capital income by eliminating the preferential rate applied to long-term capital gains.

Individuals who have more than $1 million in income or own more than $10 million in assets in any year are deemed high-income or high-worth and subject to a mark-to-market regime. A taxpayer must meet either the income or the asset threshold for three consecutive years to be subject to the mark-to-market taxation. Once a taxpayer is subject to the mark-to-market rules, they continue to be subject to them until they fail the threshold income or asset test for three consecutive tax years, at which point they have an option to elect out of the mark-to-market rules. The mark-to-market rules would eliminate the step up in basis that changes an asset's basis to the fair market value at the time of inheritance.

Assets of high-income or high-wealth individuals that are non-tradable will be subject to a lookback rule that would assess a tax when an asset is sold and would reduce incentives for the taxpayer to defer the sale of an asset. Possible lookback rules could include an interest charge on deferred tax, a yield-based tax designed to eliminate the benefits of deferral or a surtax based on an asset's holding period.

The Plan acknowledges the importance of retirement savings by continuing their taxation under current law. Assets held in retirement accounts [pension, 401(k), 403(b), 457 plans, IRAs (Simple, SEPs, Traditional or ROTH), HSAs, Archer MSAs, 529 plans and Coverdell accounts] continue under current law even if they belong to high-income or high-worth individuals whose other assets are marked to market. However, retirement accounts of more than $3 million, family farms worth more than $5 million and primary and secondary homes totaling more than $2 million are considered when calculating the threshold $10 million in assets.

The Plan requests comments on "how anti-deferral accounting may interact with existing provisions of the tax code," such as "nonqualified deferred compensation" and "nonterm life insurance and annuities," and whether "changes to such provisions may be necessary to implement this proposal." While an antideferral regime is inherently inconsistent with risk protection products, public policy and tax policy should provide incentives for buying and maintaining important risk protection products like life insurance and annuities. We look forward to conveying this important message to Senator Wyden and his staff.

PRIORITY GUIDANCE PLAN

On Oct. 8, the Department of the Treasury ("Treasury") and the Internal Revenue Service ("IRS") released the 2019–2020 Priority Guidance Plan ("PGP") covering the period of July 2019 through June 2020. The PGP continues to prioritize implementation of the Tax Cuts and Jobs Act ("TCJA"), while taking into consideration the Trump Administration's goals to reduce regulatory burdens as expressed in Executive Orders 13789 and 13777. Several guidance projects of particular interest to the life insurance industry in which ACLI has been actively engaged were included in the PGP projects. The following list identifies items of interest to our industry, indicating when guidance has been issued and whether more is expected.

TCJA Implementation

- Guidance under §§ 101, 1016 and 6050Y regarding reportable policy sales of life insurance contracts. Notice 2018-41 was published May 14, 2018. Proposed regulations were published March 25, 2019.

- Guidance under § 807 regarding the determination of life insurance reserves for life insurance and annuity contracts, including guidance to implement changes under § 13517 of the TCJA.

  - Published Aug. 26, 2016, in IRB 2019-35 as Rev. Proc. 2019-34 (released Aug. 6, 2019).

- **New:** Revenue procedure providing guidance for an insurance company to obtain automatic consent to change its method of accounting to comply with § 846, as amended by § 13523 of the TCJA.

  - Published Aug. 12, 2019, in IRB 2019-33 as Rev. Proc. 2019-30 (released July 22, 2019).

- Regulations under §§ 1295, 1297 and 1298, including regulations addressing when foreign insurance income is excluded from passive income under § 1297(f).

  - Published July 11, 2019, in Fed. Reg. as REG-105474-18 (NPRM).

- Final regulations under § 2010 addressing the computation of the estate tax in the event of a difference between the basic exclusion amount applicable to gifts and that applicable at the donor's date of death. Proposed regulations were published Nov. 23, 2018.

Burden Reduction

- Guidance under § 954, including regarding the use of foreign statement reserves for purposes of measuring qualified insurance income under § 954(i).

- Regulations under § 871(m), including with respect to non-delta-one transactions. Final and temporary regulations were issued Jan. 24, 2017. Notice 2018-72 (delaying the applicability date of portions of the final regulations) was published Oct. 1, 2018.

- Final regulations under Chapter 3 (§§ 1441–1446) and Chapter 4 (§§ 1471–1474), including rules addressing withholding on gross proceeds and foreign passthrough payments under Chapter 4; withholding requirements on insurance premiums under Chapter 4; and certain due diligence requirements of withholding agents under Chapter 3, including issues related to refunds and credits. Proposed regulations were published Dec. 18, 2018.

General Guidance

- Regulations under § 401(a)(9) updating life expectancy and distribution period tables for purposes of the required minimum distribution rules and addressing certain other issues under § 401(a)(9).

- **New:** Guidance on contributions to and benefits from paid family and medical leave programs.

- Regulations under § 72 on the exchange of property for an annuity contract. Proposed regulations were published Oct. 18, 2006.

- Guidance relating to the diversification requirements under § 817(h) for certain mortgage-backed securities purchased in the To-Be-Announced (TBA) market and for certain TBA contracts. Rev. Proc. 2018-54 was published Nov. 5, 2018.

The PGP also includes an appendix, which lists regularly scheduled publications. Of significance this year for the industry is the revenue procedure providing the annual update to the list of automatic changes for taxpayer changes in method of accounting, which is discussed in more detail in the next section.

IRS ISSUES REV. PROC. 2019-43 TO UPDATE PROCEDURES FOR § 807(f) RESERVE BASIS CHANGES

Late in 2018, the IRS issued Rev. Proc. 2019-10, which provided procedural requirements for post-TCJA reserve basis changes under IRC § 807(f). It did so by modifying Rev. Proc. 2018-31 to add new § 26.04 to the list of automatic changes of accounting methods.

In February of this year, ACLI worked with the IRS Insurance Branch to seek clarification of two aspects of § 26.04. In Rev. Proc. 2019-43, a number of changes were made to § 26.04.

Section 26.04 as added by Rev. Proc. 2019-10 provided that a taxpayer "may receive" audit protection for prior taxable years as provided in Rev. Proc. 2015-13 (the procedure for accounting method changes generally). The IRS indicated that the requirements of Rev. Proc. 2015-13 would need to be fully satisfied in order to provide audit protection. ACLI suggested that the language be changed to say a taxpayer "will receive" audit protection provided the requirements of Rev. Proc. 2015-13 are satisfied, and Rev. Proc. 2019-43 incorporates that change.

ACLI also discussed with the IRS the language of § 26.04 as added by Rev. Proc. 2019-10 that dealt with multiple reserve basis changes in a single taxable year. Rev. Proc. 2019-10 provided that multiple changes "for the same type of contract (life insurance, annuity, etc.)" would be considered a single change with a single net positive or negative IRC § 481(a) adjustment. It also provided that "a change in basis of computing the reserve for each type of contract (life insurance, annuity, etc.) is considered a separate change in basis." This language could have been construed to require much greater netting than had historically been the case for companies, and even could require netting for changes to vastly different types of life insurance and annuity contracts—*e.g.*, whole life and term insurance, or immediate annuities and deferred variable annuities. In the updated revenue procedure, the parenthetical is removed from the first quote, and the second quote is deleted entirely. It appears that the IRS intended that there be some flexibility for determining when netting should be done.

Most of the other changes to § 26.04 are relatively minor wording changes, such as clarifying that reserves include any item referred to in IRC § 807(c). However, two other changes are of note:

- A sentence is added to clarify that § 26.04 does not apply to any change to which Rev. Proc. 2019-30 or 2019-34 applies (relating to reserve changes required for 2018 tax returns by the statutory language of TCJA).
- Another sentence is added to require that termination of a company's status as a life insurance company would, in accordance with IRC § 807(f)(2), require acceleration of any remaining § 481(a) adjustments for reserve basis changes.

PROPOSED REGULATIONS UNDER § 382(h)

On Sept. 10, proposed regulations were published regarding the items of income and deduction included in the calculation of built-in gains and losses under IRC § 382 that would affect utilization of losses by corporations that experience an ownership change. Because these proposed regulations presented issues that were of importance to the life insurance industry, ACLI filed comments on the proposed regulations.

IRC § 382 imposes a limitation on the ability of a "loss corporation" to offset its taxable income in periods subsequent to an ownership change with losses attributable to periods prior to the ownership change. On the one hand, if the loss corporation has a net unrealized built-in loss ("NUBIL"), the use of any recognized built-in loss ("RBIL") recognized during the five-year post-change recognition period also is subject to the § 382 limitation. On the other hand, if the loss corporation has a net unrealized built-in gain ("NUBIG"), the § 382 limit for any year during the recognition period is increased by the recognized built-in gain ("RBIG") for that year.

The IRS previously had provided, in Notice 2003-65, two methodologies for computing NUBIG/NUBIL and determining RBIG/RBIL. In general, the proposed regulations follow one of those methodologies (the "1374 approach"), with a few significant and largely taxpayer-unfriendly modifications. ACLI's comment letter on the proposed regulations focused on the following matters of particular importance to the life insurance industry:

- The primary intangible asset in life insurance company acquisitions generally is the value of insurance-in-force ("VIF") that arises from long-term contractual relationships with policyholders and that does not have value independent of the contractual obligations. In computing NUBIG/NUBIL, the proposed regulations' hypothetical sale of assets to a buyer that assumes no liabilities is impossible to apply in the valuation of VIF.
- The valuation of VIF is dependent in part on the measurement of liabilities for policy reserves. Life insurance companies are allowed a tax deduction for life insurance reserves and should use those reserves in determining the value of VIF. Tax deductible reserves should not be treated as noncontingent or contingent liabilities in the computation of NUBIG/NUBIL, and post-ownership decreases/increases in such reserves should not give rise to RBIG/RBIL.
- The proposed regulations violate the "neutrality principle" underlying the statutory provisions of § 382 by denying, except in the case of a disposition, recognition of VIF as RBIG, as it is earned during the recognition period.
- A binding contract exception should be included in the applicability dates provision of the regulations that recognizes the customary regulatory approval conditions applicable to life insurance company acquisitions.

These proposed regulations are a matter of great interest to the U.S. corporate business community as a whole, and a great many comment letters were filed prior to the end of the comment period. For this and other reasons, it is not expected that further action will be taken by the IRS with respect to the proposed regulations for many months to come. ■

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