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A Few Thoughts About Tax Reform

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With tax reform passing in December 2017, insurance companies had some extra work to do for year-end 2017:

- The net deferred tax assets had to reflect the new tax law.
- Tax reserves had to be calculated the old way and the new way to be used in the net deferred tax calculation.
- Appointed actuaries had to decide what to do with asset adequacy analysis.

As with most new legislation or regulations, the new tax law had to be interpreted, and not all the details were clear. Actuaries and accountants used their best interpretations of the law to do their year-end work.

In this article, we summarize what is our best understanding, as of the date this article is written, of key provisions of the tax law. Our understanding of how to interpret the tax law will no doubt change as time goes on and certain provisions are clarified.

1. Small life insurance company deduction is repealed beginning with 2018 tax returns. The old law allowed lower marginal tax rates for certain amounts of taxable income if companies met the asset qualification test.
2. Capitalization and amortization of the policy deferred acquisition costs (DAC tax) rates increase, starting with 2018 premiums:
   a. Nonqualified annuities go from 1.75 percent to 2.09 percent.
   b. Group life goes from 2.05 percent to 2.45 percent.
   c. All other business goes from 7.70 percent to 9.20 percent.

   For companies that have used a 10-year amortization, the amortization period will increase to 15 years. However, companies can still use a five-year amortization for the first $5 million of specified policy acquisition expenses. Some small companies only ever have to use the five-year amortization.

3. Adjustments for changes in basis to tax reserves after 2017 (strengthening or weakening) go from a 10-year amortization to four years. Companies may also need to review what results in a change in basis that must be spread.
4. Life insurance tax reserves calculation is changed. For nonvariable contracts, it is, as of Jan. 1, 2018, the greater of:
   a. The contract's net surrender value (cash value) or
   b. 92.81 percent × (statutory reserve minus statutory net due and deferred premium).

   However, the tax reserve cannot be greater than the statutory reserve and cannot include asset adequacy or deficiency reserves.

   Our interpretation is that the 92.81 percent applies to (statutory reserve minus statutory net due and deferred premium). However, there are other interpretations that call for applying the 92.81 percent to just the statutory reserve. It is an important difference!

   Our interpretation is that the contract's cash value is compared to 92.81 percent × (statutory reserve minus statutory net due and deferred premium). However, as noted above, there are other interpretations that would compare it to 92.81 percent of the statutory reserve. Another important difference!

   If your statutory reserves are not calculated using the minimum standards (state required mortality table, interest rate and method) as of the policy effective date, it is our interpretation that statutory reserves will need to be adjusted to minimum to be used for this calculation.

5. The difference between old and new tax reserves as of Dec. 31, 2017, is amortized into taxable income over eight years, starting with the 2018 tax return.

For asset adequacy analysis, some actuaries will at least perform sensitivity analysis projecting the new tax reserves and marginal tax rates. This could be difficult as actuarial modeling software isn't set up to calculate tax reserves in this way. Some actuaries are doing the sensitivity but approximating the new tax reserve calculations.

For more details, see "President Signs Tax Reform Bill With Numerous Changes Affecting the Insurance Industry." ■

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