A Few Thoughts About Tax Reform
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Small Talk

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Chairperson’s Corner
By Mark Rowley

We are pleased to offer this special newsletter that focuses on the urgent issue of tax reform. With the passage of tax reform in December 2017, there has been challenging work for actuaries and accountants this year-end. We hope this short newsletter will be beneficial as you work through tax reform in 2018. We will look to disseminate more information about tax reform as it becomes available.

Look for our April webinar on tax reform.

We have at least eight channels to disseminate information:

- Webinars
- Town halls
- Meeting sessions, especially the Valuation Actuary Symposium and Society of Actuaries (SOA) Annual Meeting & Exhibit
- Podcasts
- This newsletter (twice per year; see https://www.soa.org/sections/small-insurance/small-insurance-newsletter/)
- Research projects
- Blast emails
- Section webpage (https://www.soa.org/sections/small-insurance/small-insurance-landing/, check this often for more information!)

We will use all these tools in 2018 to get helpful information out to small company actuaries.

It is a joy to serve this group!

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A Few Thoughts About Tax Reform
By Pam Hutchins and Mark Rowley

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 Small life insurance company deduction is repealed beginning with 2018 tax returns.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 non-variable 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 \times (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 \times (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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President Signs Tax Reform Bill With Numerous Changes Affecting the Insurance Industry

By Ann Cammack, Michael Beaty, Norman Hannawa, Scott Guasta, Howard Stecker and Jeff Levey

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On December 22, 2017, the President signed the “Tax Cuts and Jobs Act” (H.R. 1) (referred to herein as the final bill, the bill or the new law) into law, the first major overhaul of the federal income tax in more than 30 years. The enactment of the bill came a week after the House and Senate conferees to the Tax Cuts and Jobs Act released a Conference Agreement (December 15, 2017), which was ultimately approved by the Senate (December 19, 2017) and the House (December 20, 2017). Previously, the House of Representatives passed its version of the Tax Cuts and Jobs Act on November 16th (House Bill) and, two weeks later, the Senate passed its tax reform bill on December 2nd (Senate Bill).

The bill dramatically lowers the corporate tax rate from 35% to 21% beginning in 2018. This rate reduction, as well as other changes, did come at a significant revenue cost and, as a result, the bill needed to raise revenue through other changes in the tax law. Among these changes were provisions that directly impact insurance companies. All of the insurance-specific provisions in the final bill were scored as revenue raisers by the Joint Committee on Taxation (JCT), with the largest revenue being generated from the changes in the tax reserve calculations for life and property/casualty companies. In all, the bill’s insurance tax provisions are expected to raise approximately $40 billion over the next 10 years, excluding the other revenue raisers on corporations that are also applicable to insurers. This Alert identifies key changes in the new law relevant to the insurance industry. Companies must study the bill closely, assess its impact and immediately begin the process of recording and disclosing the financial reporting effects of the new law.


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