



SOCIETY OF ACTUARIES

Article from:

Taxing Times

Ugr vgo dgt 2010 – Volume 6, Issue 4

ACLI UPDATE LEGISLATIVE AND REGULATORY DEVELOPMENTS

By Walter Welsh and Mandana Parsazad

There have been several developments affecting taxation of life insurance companies and products since our last report in the May 2010 edition. ACLI and its many members have been engaged with regulators and legislators as they have considered new guidance and legislation.

GUIDANCE ON ACTUARIAL GUIDELINE 43 - NOTICE 2010-29

Notice 2010-29, issued by the Treasury Department (Treasury) and the Internal Revenue Service (IRS), was a welcome step in their ongoing effort to provide guidance to life insurers on the tax aspects of new rules for reserves established by the National Association of Insurance Commissioners (NAIC). The Notice described the following interim conclusions about some of the issues identified in Notice 2008-18, that might result from the adoption of either AG-VACARVM or life PBR.

1. The Standard Scenario Amount (SSA) will be treated as a life insurance reserve for federal income tax purposes. For purposes of the reserve ratio test, the SSA is included in life insurance reserves as defined in Section 816(b) and in total reserves as defined in section 816(c).
2. For purposes of determining the statutory cap on reserves under section 807(d)(1), the term “statutory reserves” under section 807(d)(6) includes the SSA.
3. For purposes of determining the amount of the reserve under section 807(d)(2) with respect to a contract falling within the scope of AG 43 and issued on or after Dec. 31, 2009, the provisions for determining the SSA are taken into account. The provisions for determining the CTE amount are not taken into account.
4. If, with the consent of the state insurance commissioner, a company implements AG 43 over a period of up to three years, then the company must likewise implement the changeover to AG 43 over the same period of years for tax purposes.

This interim guidance is especially important for life insurers as they bring products to market in 2010. ACLI and its member companies understand the need to resolve other open



issues and we are eager to work with the Treasury and the IRS as we have in the past on these reserve issues.

LIFE PBR

Our Company Tax Committee continues to review and analyze ACLI suggestions for the valuation manual for any potential tax issues. As the NAIC moves forward with consideration of the net premium floor, we will engage Treasury to continue consideration of the tax aspects of life PBR.

SEPARATE ACCOUNT DIVIDENDS RECEIVED DEDUCTION

ACLI also met with Commissioner Heather Maloy, the IRS Commissioner LMSB, and her staff as well as the Chief Counsel to discuss IRS exam issues affecting the life insurance industry. In that meeting, we had the opportunity to specifically focus on the audits of separate account dividends received deductions (DRD) and the adjustments which were being made without national office guidance. We were informed in the following week by the Director of Appeals that the Appeals Office intends to concede the outstanding DRD cases at Appeals. On May 20, 2010 Walter Harris, the industry director for Financial Services, issued an Industry Director Directive (IDD) in which he referenced favorable technical advice memoranda issued in 2000 and 2002 as consistent with section 812 and which states that Treas. Reg. § 1.8101-8(e)¹ describes the method to be used in computing DRD.

The goal of the Commissioner and the ACLI is to have a regular dialogue on significant industry issues. The Commissioner and her staff have established informal groups with other industries. We think that this initial meeting was a good first step in establishing an improved dialogue between the IRS and the life insurance industry.

HEALTHCARE BILL—MEDICARE CONTRIBUTION INVESTMENT TAX

On the legislative front, in March a “Medicare Contribution Investment Tax” was passed as part of the reconciliation bill. This provision imposes a 3.9 percent tax on the “net investment income” of individuals earning more than \$200,000

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and couples earning more than \$250,000. “Net investment income” was defined to include income from annuities; income from interest, dividends, royalties, rents, gross income from a trade or business involving passive activities, and net gain from disposition of property (other than property held in a trade or business) were also included in the definition of investment income. Income from qualified annuities is not subject to the tax; such income however is taken into account in determining the threshold income amounts of \$200,000 and \$250,000 for single and married individuals respectively. ACLI worked with the Administration and legislators to develop an exception for income from qualified annuities to avoid additional taxes on the retirement income of Americans who planned responsibly for their retirement needs.

FINANCIAL CRISIS RESPONSIBILITY FEE — BANK TAX

The Financial Crisis Responsibility Fee (“Bank Tax”), as originally described in the Administration’s Fiscal Year 2011 Budget, would impose a fee of 15 basis points on the consolidated liabilities of financial firms with consolidated assets of \$50 billion on banks, thrifts, bank or thrift holding companies, brokers, and securities dealers as of Jan. 14, 2010. While as described, the proposal seems to be aimed at banks and broker-dealers, the description that includes “U.S. companies owning or controlling these types of entities” causes concern for insurance companies.

On May 4, 2010, AEGON Chairman Pat Baird testified on behalf of ACLI before the Senate Finance Committee as it took up the Bank Tax. His testimony and comments made it clear that imposing a tax on life insurers with banks or thrifts or broker-dealers is not consistent with the stated goals of the proposed tax: to repay the federal government for costs it incurred during the financial crisis, and to deter excess leverage for the largest financial firms. In a prior panel before the Committee, Secretary Geithner testified about the proposed fee and members raised a number of concerns about the tax, including a request that the tax should not be applied to an insurer that owns a small broker dealer or a bank. The Secretary indicated a willingness to consider other approaches to the tax and referenced “risk weighted assets.”

ACLI and its members and their representatives continue to meet with members and key staff from the House and Senate Tax Committees to voice our strong opposition to including life insurers in the scope of the proposal. Our Company Tax Committee will continue to analyze and prepare responses to any other approaches suggested by Treasury or the tax writing committees. ◀

END NOTE

¹ See, TAM 20003808 (Jun. 13, 2000) and TAM 200339049 (Aug. 20, 2002)

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