

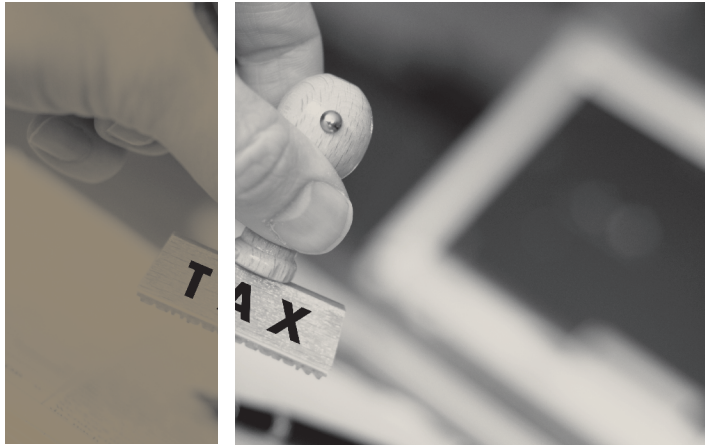


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## ACLI UPDATE

By Pete Bautz, Mandana Parsazad, and  
Walter Welsh

### INTERACTION OF ACLI STAFF ACTUARIES, ACCOUNTANTS AND TAX PROFESSIONALS

*Note from the Editor: For several years now, TAXING TIMES has included an “ACLI Update” column to keep readers informed about the organization’s work on tax issues affecting the life insurance industry. In this issue, the editorial board asked Pete Bautz to describe their current organizational structure and how the ACLI interacts with various governmental and regulatory groups, such as the Department of the Treasury, the Internal Revenue Service and the National Association of Insurance Commissioners.*

The American Council of Insurers’ (ACLI’s) Actuarial Department and Taxes and Retirement Security (TRS) Department staff is comprised of a cross-functional team of accounting, actuarial and legal professionals who regularly work together—and with technical experts from our member companies—on a broad range of actuarial, financial and tax matters. The following provides an overview of the staff functions and their areas of expertise and overlap.

At the present time, the ACLI Actuarial Department, led by Senior Vice President and Chief Actuary Paul Graham, has eight employees, including three actuaries (Paul, John Bruins and Steve Clayburn) and an accountant (Mike Monahan). The ACLI TRS Department is headed up by Executive Vice President Walter Welsh and includes three attorneys (Walter, Pete Bautz and Mandana Parsazad) who focus on tax matters.

The Actuarial Department works closely with the ACLI State Relations staff and ACLI members primarily on actuarial and accounting matters under the jurisdiction of the National Association of Insurance Commissioners (NAIC) and the various state insurance departments. For instance, the Actuarial Department has provided the NAIC and state insurance departments with the life insurance industry perspective on comprehensive new actuarial standards like AG 43 and

principle-based reserves (PBR) or on new global accounting standards, as well as on discrete actuarial projects such as the development of new mortality and morbidity tables.

The TRS Department works closely with the ACLI Federal Relations staff and ACLI members on all matters that could affect the taxation of life insurance companies and products, including tax legislation (primarily federal tax legislation), and tax regulation and administration matters. For example, the TRS Department has provided staff of the congressional tax-writing committees with industry feedback on proposed tax law changes and has shared with the Treasury Department and Internal Revenue Service (IRS) the industry’s perspective on tax regulations or IRS rulings.

Changes to, or interpretations of, certain sections of the Internal Revenue Code (“IRC” or the “Code”) including, but not limited to, section 72 on the taxation of annuities, section 807 on the tax treatment of reserves, and section 7702 on the definition of a life insurance contract, often require regular multidisciplinary consideration by ACLI’s team of tax professionals, accountants and actuaries. A very current example of this type of ongoing coordination is found in the 2001 CSO mortality table guidance plan project, which is described in detail in the next ACLI update item, below. Similarly, as the NAIC and the U.S. and global accounting standard-setters have considered changes to actuarial and accounting standards, ACLI’s multidisciplinary staff regularly collaborate on the potential impact those changes might have on the tax treatment of insurance companies and products. Recent examples of this type of coordination include ACLI’s efforts to secure IRS guidance on the tax treatment of PBR and the inclusion of the AG 43 conditional tail expectation (CTE) amount in the section 807 statutory reserve cap.

This cooperation among ACLI’s multidisciplinary staff is extremely helpful, allowing for seamless consideration of issues as they arise.

## IRS PRIORITY GUIDANCE PLAN PROJECT ON 2001 CSO MORTALITY TABLES

The IRS 2013–2014 Priority Guidance Plan once again lists guidance clarifying whether the AG 43 CTE amount should be taken into account for purposes of the IRC section 816(a) Reserve Ratio Test and the section 807(d)(6) statutory reserve cap. During 2014, ACLI expects to work closely with the IRS on this guidance project. We will also continue to seek IRS guidance at the earliest possible time on the tax treatment of PBR, an issue that does not appear on the 2013–2014 Priority Guidance Plan.

For the past two years, the “Insurance Companies and Products” section of the IRS priority guidance plan has listed another project: “Guidance to clarify which table to use for section 807(d)(2) purposes when there is more than one applicable table in the 2001 CSO mortality table.” Over the last year, ACLI TRS and Actuarial Department staff have had several conversations with IRS Chief Counsel and Treasury Department staff regarding the nature and scope of this project. A little background information on this project is in order.

For purposes of computing the federally prescribed reserve in section 807(d)(2), section 807(d)(2)(C) provides that the “prevailing commissioners’ standard tables” for mortality and morbidity are used, adjusted as appropriate for risks not addressed in the table. Section 807(d)(5) explains that the prevailing commissioners’ standard tables are the most recent commissioners’ standard tables prescribed by the National Association of Insurance Commissioners which are permitted to be used in computing reserves under the insurance laws of at least 26 states. Section 807(d)(5)(E) then provides a special rule to address situations in which more than one mortality table or table option may apply. In these situations, section 807(d)(5)(E) requires that the table or table option “which generally yields the lowest reserves must be used for purposes of [section 807(d)(2)(C)].” It is this statutory language that the priority guidance plan is seeking to address.

We reviewed this issue with our members and made the following points to the IRS:

- The plain language of the Code calls for an industry-level determination of which table or table option generally produces the lowest reserve;
- The design of the federally prescribed reserve and its interaction with the statutory reserve cap reinforces an industry-level approach to section 807(d)(5)(E); and

- Life PBR—and the introduction of new mortality tables—provide an appropriate opportunity for mortality table guidance.

ACLI also recommended that the IRS and Treasury affirm (1) their long-standing interpretation of section 807(d)(5)(E) to the effect that the table (or table option) that generally yields the lowest reserve is determined at the industry level, rather than on a contract-by-contract or company-by-company basis, and (2) that the conclusions reached by the American Academy of Actuaries in connection with the development of the 2001 CSO mortality tables (i.e., that reserves produced by the ultimate table generally yielded the lowest reserve) should be relied upon.

We suggested that in the event the IRS and Treasury consider other approaches to guidance on the 2001 CSO table issue, the affected taxpayers should be given notice of those approaches and an opportunity to comment. Specifically, ACLI said that guidance inconsistent with the Service’s historic position in Rev. Rul. 87-26 and industry practice should (1) apply only to contracts written in the future, with adequate time to modify systems, contracts and pricing; and (2) be limited to future CSO mortality tables rather than the 2001 CSO table.

## SNFL CHANGE

The statutory valuation and non-forfeiture interest rates are dynamic. Therefore, it is possible in a prolonged very low interest rate environment for the statutory rate to drop below the 4 percent rate specified in IRC section 7702. If this were to happen, products using the cash value accumulation test (CVAT) would not qualify for federal tax treatment as life insurance. Last spring, the ACLI recommended to NAIC changes to the statutory standard non-forfeiture model law and the valuation manual to provide a temporary resolution to the potential conflict. ACLI recommended that the standard non-forfeiture law (SNFL) and the valuation manual be amended to set a floor for the minimum non-forfeiture interest rate at 4 percent. ACLI’s recommendation was approved by the NAIC at its December 2013 meeting. ACLI is advocating for state enactment of the model SNFL and standard valuation law changes in all 50 states and the District of Columbia. ◀

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