Article from:

Taxing Times

October 2014 – Volume 10, Issue 3

HIGHLIGHTS FROM TAXATION SECTION SESSIONS AT THE LIFE AND ANNUITY SYMPOSIUM

By Jeffrey T. Stabach

The Taxation Section was active during the spring seminar season, sponsoring a number of sessions at the Life and Annuity Symposium in Atlanta on May 19–20. The seminar provided an excellent opportunity to network and learn from leading industry insurance tax experts. I would like to thank the presenters for sharing their insights, as well as Tim Branch and Jim Van Etten for taking the time to provide summaries of sessions they presented at the meeting.

16 PD—PRODUCT TAX UPDATE

Brian King, FSA, MAAA, EY
Craig Springfield, JD, Davis & Harman LLP

The Product Tax Update session included presentations from Brian King and Craig Springfield and addressed a number of current product-related topics. The session opened with a discussion of the product-related items on the 2013-2014 IRS Priority Guidance Plan, with a focus on definition of cash surrender value under Internal Revenue Code (IRC) section 7702. Craig provided an overview of the historical definition of cash surrender value and noted specific product features that might cause concern to companies, including return of premium benefits. In addition, Craig and Brian discussed the product-related provisions in recent tax reform proposals, including a discussion of the proposed changes to the interest expense disallowance for corporate-owned life insurance (COLI) under section 264(f) and proposed reporting requirements on life settlements.

Finally, the session concluded with a discussion on the recent product-related private letter rulings (PLRs) and court cases, including:

- Recent PLRs on post-death annuity issues
- Court cases involving the tax implications of over-loaned contracts
- Recent PLRs on diversification and investor control
- Recent PLRs on modification to substantially equal periodic payments
- A discussion of *U.S. vs. Woods* and the use of the Blue Book as authority

40 PD—TAX CONSIDERATIONS FOR THE LIFE ACTUARY

Kristin Norberg, ASA, MAAA, EY
Timothy Branch, FSA, MAAA, EY
Mark S. Smith, CPA, JD, PricewaterhouseCoopers, LLP

This session, presented by Tim Branch, Kristin Norberg and Mark Smith, provided an overview of the tax concepts that apply to life insurance companies, and how reserves and other actuarial items are treated for tax purposes. Mark led off the session by providing the theory and economics of insurance company taxation, highlighting the differences between the treatment of insurance and non-insurance companies. Mark's background with the Internal Revenue Service and Department of Treasury allowed him to present unique insights into the tax authorities and Internal Revenue Code.

Kristin and Tim then presented a more detailed analysis of the definition of life insurance reserves, and how tax reserves are calculated and categorized for a life insurance company's tax return. Topics included tax reserve methods and assumptions, items taken (and not taken) into consideration for tax purposes, application of the statutory reserve cap and the net surrender value floor, and spreading of reserve method changes into taxable income under IRC section 807(f).

The session concluded with Tim, Kristin and Mark addressing various miscellaneous topics of interest to life insurance actuaries, such as the tax "proxy" DAC, taxation of foreign insurance entities and a brief discussion of the proposals in the Ways and Means Committee Chairman's tax reform plan (the "Camp draft") that affect insurance companies.

45—TAXATION SECTION HOT BREAKFAST: WASHINGTON UPDATE

John T. Adney, JD, Davis & Harman LLP

At this breakfast session, the topics discussed focused on the current legislative proposals affecting life insurance companies and policyholders. While previous sessions touched on the tax reform proposals, this session's main focus was on

CONTINUED ON **PAGE 28**

Jeffrey T. Stabach is a manager, Insurance and Actuarial Advisory Services with Ernst & Young LLP and may be reached at *Jeffrey.Stabach@ey.com.*

the details surrounding the Camp draft, which offered a significant, detailed tax reform proposal. John Adney discussed how the Camp draft would potentially rewrite the rules for individuals and businesses, with specific proposed changes for life insurance companies. He gave his perspective on the prospects for the proposal, or pieces of it, being adopted. John also detailed and compared the Camp draft to provisions in the Obama Administration's budget proposals.

65 TS—INTERNAL REVENUE CODE SECTIONS 7702 AND 7702A: INTRODUCTION TO THE TAX RULES AFFECTING LIFE INSURANCE PRODUCTS

Brian King, FSA, MAAA, EY
Craig Springfield, JD, Davis & Harman LLP
Jeffrey Stabach, FSA, MAAA, EY

The Taxation Section has made an effort recently to provide more basic learning and training sessions. The goal is to provide more opportunities for younger actuaries to learn about tax related topics and to provide more information to those that have not had exposure in this area. The effort has extended to local actuarial clubs and annual industry meetings. The Introduction to the Tax Rules Affecting Life Insurance Products was a teaching session that addressed the qualification of life insurance products under IRC sections 7702 and 7702A. The session was moderated by Brian King. Brian opened up the session with a discussion of why the rules are important, and why it is important for companies to understand the rules of sections 7702 and 7702A. He discussed tax implications for policies that comply with section 7702 and the treatment of withdrawals and loans for policies that are considered Modified Endowments Contracts. Craig Springfield and Jeff Stabach walked through the qualification tests of sections 7702 and 7702A (the cash value accumulation test, guideline premium and cash value corridor test, and the 7-pay test) and the computational rules and assumptions that are associated with each test. In addition, Craig and Jeff also discussed:

- The definition of cash surrender value and premiums paid
- The definition of Qualified Additional Benefits (QABs) and the distinction between those benefits that are considered non-QABs
- The rules for administering policy adjustments
- The effect of the necessary premium exception on the 7-pay test

The session concluded with a discussion on why tax compliance is difficult for companies to administer and what they can do to limit their risk in this area.

82 PD—NO SURPRISES-TAX CONSIDERATIONS IN PRODUCT DESIGN

Jacqueline Yang, FSA, ACIA, MAAA, KPMG
Jean Baxley, KPMG
Jim Van Etten, FSA, MAAA, Van Etten Actuarial Services, LLC
Judy Jaffess, Prudential

In conjunction with the Product Development Section, the Taxation Session sponsored an in-depth session designed (1) to provide an awareness of common product tax-related challenges in the industry and (2) to outline practices and strategies to address these challenges. After Jacqueline introduced the topic, the panelists took turns providing their perspectives.

The session described the phases in the product development life cycle from initial planning to ongoing management, and pointed out that every aspect involves tax considerations. Those phases and the discussions surrounding each phase included:

1. Planning phase - where broad considerations such as evaluation of the opportunities and risks related to tax, whether the circumstances call for rulings such as a PLR, and how tax should be taken into account in pricing are considered. For the development process to be successful, it is important for tax to be included on a cross functional team.

2. Analysis phase - where the feasibility of handling tax issues is addressed by considering tax rules and related systems capabilities as part of an overall cost benefit analysis.

3. Design phase - where the product features are established in detail; in this phase, the product design should be finalized after considering recent law, regulations and guidelines, the approach to marketing and illustrating (with appropriate tax disclosures and accurate tax calculations) and administering (with software or manual processes that implement applicable tax rules) the product are defined.

4. Implementation phase - where important tax aspects, include ensuring assumptions for tax reserves and product tax rules are correct, product filings address IRS requirements where applicable, product tax training for sales

force and operations is appropriate, and that the Tax area understands how the product will be marketed and its associated risks.

5. Management phase - where important tax considerations include ongoing monitoring of tax legislative changes (with product adjustments as appropriate), monitoring of post-issue product changes (to assure there are no adverse tax impacts), technical support to operations areas, providing tax guidance in resolving customer complaints, and reviewing ongoing tax reporting to assure compliance with requirements.

Next, the panel discussed a number of product-specific tax requirements. This was followed by presentation of a number of scenarios to show instances where complaints, litigation, remediation or adverse publicity occurred, with discussion of whether/how the scenario could have had a better outcome.

Finally, the panel provided a list of better practices which should help companies achieve these better outcomes. The high level guidance from this list is that one should "Develop a robust product development process—make sure tax is involved at all of the various stages of development." ◂