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ACLI Update

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HOUSE TAX REFORM BLUEPRINT

On June 24, House Republicans released their tax reform blueprint (the Blueprint), the final piece of a multi-part plan designed to set the House Republicans' policy agenda before the party's national convention in July. The 35-page document calls for an across-the-board reduction in tax rates, including a corporate tax rate of 20 percent, a pass-through tax rate of 25 percent and a top individual tax rate of 33 percent (with two lower individual tax brackets of 12 and 25 percent). On the domestic side, the plan introduces consumption-like tax features into the Internal Revenue Code (the Code). Businesses will be allowed 100 percent expensing of both tangible and intangible assets (except for land), but will no longer be able to deduct interest expense in excess of interest income. Any nondeductible net interest expense may be carried forward indefinitely and allowed as a deduction against net interest income in future years. This is similar to provisions in the American Business Competitiveness Act sponsored by Rep. Devin Nunes (R-CA), a senior House Ways & Means Committee (W&M) member. Corporations will still be able to claim research credits. Net operating losses (NOLs) can be carried forward indefinitely but will be limited to ninety percent of net taxable income for any year without regard to the carryforward. NOL carryforwards will be inflation-adjusted. Carrybacks of NOLs will no longer be permitted. The Blueprint eliminates special interest deductions (mostly unspecified) such as the Section 199 deduction for domestic production. In addition, the corporate alternative minimum tax (AMT) will be eliminated.

The plan calls for a territorial rather than the current worldwide system of taxation for international profits, including a 100 percent exemption for dividends from foreign subsidiaries. The Blueprint contains a border adjustability provision that exempts exports and taxes imports. Accumulated foreign earnings will be deemed repatriated and taxed at 8.75 percent to the extent held in cash or cash equivalents, and otherwise taxed at 3.5 percent (with companies allowed to pay this tax over an eight-year period). The Subpart F rules for controlled foreign corporations will be significantly streamlined and simplified to focus on countering shifts of truly passive income to low-tax jurisdictions.

On the individual side, both the individual AMT and the estate tax will be eliminated and there will be a 50 percent exclusion for capital gains, dividends and interest income. Personal exemptions and standard deductions, along with the child tax credit, will be consolidated into a larger standard deduction and an enhanced child and dependent tax credit aimed at reducing the number of taxpayers who itemize deductions from one-third to approximately 5 percent. All itemized deductions except the deductions for mortgage interest and charitable contributions are eliminated.

All taxes that were part of the Affordable Care Act, including the 3.8 percent net investment income tax, the additional .9 percent payroll tax, the medical device tax, and the health insurance tax would be repealed as part of the Health Care Task Force Blueprint that was released in late June. The exclusion for employer-provided health insurance and related health provisions are maintained as part of the Health Care Task Force Blueprint; however, the health blueprint imposes undefined caps on the employer-provided health insurance exclusion.

There is little detail in the Blueprint with respect to our industry. The Blueprint continues tax incentives for retirement savings. However, the Blueprint instructs W&M to work toward the creation of more general savings vehicles and to attempt to "consolidate and reform the multiple different retirement savings provisions in the current tax code to provide effective and efficient incentives for savings and investment." The Blueprint also notes that W&M will "work to develop special rules with respect to interest expense for financial services companies, such as banks, insurance, and leasing, that will take into account the role of interest income and interest expense in their business models."

W&M has been tasked by House Speaker Paul Ryan (R-WI) and W&M Chairman Kevin Brady (R-Texas) with developing legislative language that details the high level concepts contained in the Blueprint. W&M staff intends to work with U.S. businesses as it goes about this work, and ACLI met with W&M staff in late July and plans to engage with staff as it considers industry-specific issues over the course of the next few months. Much of the work we have previously done regarding tax reform will help inform how we approach the details of the Blueprint. Both Speaker Ryan and Chairman Brady want the additional work on the Blueprint to be completed by January 2017.

NEW TREASURY PROPOSED DEBT-EQUITY REGULATIONS

On April 4, Treasury/IRS released proposed section 385 debt/equity regulations that were designed to combat the earnings stripping benefits of cross-border indebtedness. The proposed rules would (i) impose on large taxpayer groups burdensome contemporaneous documentation requirements that must be satisfied for certain related party debt to be respected for federal income tax purposes; (ii) treat certain related party debt as stock

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for all purposes of the Internal Revenue Code when issued in connection with certain distributions and acquisitions; and (iii) authorize IRS to broadly treat certain related party debt as part equity and part debt for federal income tax purposes. Unfortunately, the proposed debt-equity rules are overly broad and, if adopted in their present form, would significantly impact many ordinary business transactions and restructurings of even purely domestic corporations. Moreover, our members have expressed serious concerns that certain aspects of the proposed regulations would have particularly adverse impacts on life insurers. On June 17, ACLI submitted a comment letter to Treasury/IRS addressing our concern that the life/nonlife rules create additional detriment for life insurers since they—unlike companies in other industries—cannot fully consolidate with domestic affiliates in certain circumstances and therefore would not be able to fully avail themselves of the "consolidation" exception provided under the proposed Section 385 regulations. A second ACLI comment letter, which addresses issues under the proposed rules for certain common life insurance arrangements (including surplus notes and funds withheld reinsurance), was filed with Treasury/IRS on the July 7 comment due date.

ACLI staff and member company representatives met with Treasury in late June to discuss these concerns. Following the Treasury meeting, ACLI staff and member company representatives had numerous meetings with staff of the Congressional tax-writing committees to share the concerns noted above. Meanwhile, a bipartisan and bicameral cross-section of lawmakers has been sharing with Treasury their high-level concerns about the proposed rules. In fact, the Joint Committee on Taxation held a briefing on the proposed regulations in early July with two top Treasury officials, Mark Mazur, Treasury assistant secretary for tax policy, and Robert Stack, Treasury deputy assistant secretary (international tax affairs). At a three-hour-long IRS hearing on July 14, many of the 16 speakers raised very significant concerns about the proposed rules. Following that hearing, government officials reiterated their intention to consider all comments, but push to finalize these rules promptly.

SENATOR WYDEN'S DERIVATIVE TAX PROPOSAL

Draft legislation released on May 18 by Senate Finance Committee ranking member Ron Wyden (D-OR) would mark derivatives to market for tax purposes. In addition to taxing derivatives as if they had been sold and repurchased at the end of each year, the draft legislation—the Modernization of Derivatives Tax Act, or MODA—would require ordinary tax treatment of resulting gains and losses and establish a source rule based on a taxpayer's country of residence.

For insurers, a key component of MODA is the definition of "derivatives." Specifically, the bill would include exceptions from the definition of derivatives for, among other things, business hedging and for insurance, annuity or endowment contracts. In addition, the bill would modify the definition of capital asset under section 1221(a) of the Code to exclude "any bond, debenture, note, or certificate or other evidence of indebtedness held by an applicable insurance company." Taken together, these changes would mean that (i) insurance products would continue to be taxed under the provisions in the tax code that specifically address those products, and (ii) insurance company hedges relating to bonds and other evidences of indebtedness would qualify as hedging transactions under section 1221(b) of the Code and not as derivatives subject to the mark-to-market and related rules.

According to an estimate by the Joint Committee on Taxation, Senator Wyden's proposal would raise $16.5 billion over 10 years. Senator Wyden has requested comments on the draft legislation within 90 days of its May 18 release. ACLI is working with its member companies to analyze and comment on the proposal. ■

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