Article from

Taxing Times

February 2019

Vol. 15 Issue 1

ACLI Update

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The end of 2018 brought with it several tax proposals and changes, impacting retirement, savings, business interest expenses and risk-based capital. Let's look at these further.

RETIREMENT, SAVINGS AND OTHER TAX RELIEF ACT

On Nov. 26, 2018, House Ways & Means Chairman Kevin Brady released a tax and oversight package that includes the Retirement, Savings, and Other Tax Relief Act of 2018 and the Taxpayer First Act of 2018. The bill contains five titles: (1) Extension of Expiring Provisions, (2) Disaster Tax Relief, (3) Retirement and Savings, (4) American Innovation, and (5) Certain Tax Technical Corrections. It also contains the Taxpayer First Act of 2018, which proposes to redesign the Internal Revenue Service. On Nov. 28, the House Rules Committee adopted a Manager's Amendment, which clarifies that the scope of areas covered by the Disaster Tax Relief Title, and adds a sixth title on "Exempt Organizations," eliminating the increase in unrelated business taxable income related to certain transportation fringe benefits and modifying the rules related to business holdings of private foundations. On Nov. 29, the nonpartisan Joint Committee on Taxation released the estimated budget effect of the revenue provisions contained in the bill, determining the cost of the package to be about $54 billion.

The title on "Certain Tax Technical Corrections" contains only five tax technical corrections provisions to the Tax Cuts and Jobs Act (TCJA) but notably includes a provision to clarify that remittances of tax in excess of the regular tax are not required to be applied to any remaining installments under section 965(h). Overpayments are not allowed to be credited to installments due under section 965(h) until the date on which the tax installment is due. Many companies, both life insurers as well as companies in other industries, have advocated for this correction to TCJA. The four other technical corrections provide clarifications to several items, including the cost recovery period for qualified improvement property, the effective date of net operating loss modifications in TCJA, non-deductibility of attorneys' fees in section 162(q), and application of the 20 percent deduction to REIT dividends in section 852(b).

Title I on "Extension of Expiring Provisions" makes limited extensions and key reforms of certain expiring tax provisions. Namely, it modifies and makes permanent the railroad track maintenance credit, extends and phases out the biodiesel and renewable diesel credit, extends expiring trust fund taxes for 2019 only and generally extends other expiring tax provisions for 2018 only.

Title II on "Disaster Tax Relief" provides special rules allowing access to retirement funds; temporary suspension of limits on deductions for charitable contributions; allowance of deductions for personal casualty disaster losses; special rules for measurement of earned income for purposes of qualification for tax credits; and a special credit for employees to individuals and businesses affected by certain hurricanes, typhoons, California fires, Hawaii volcanic eruptions and earthquakes, and Hawaii severe storms, flooding, landslides, and mudslides. As noted, a Manager's Amendment clarified the scope of the areas covered and the applicability period for modifications with respect to section 403(b) plans in this regard.

Title III contains a number of important retirement and savings provisions, which life insurers have strongly supported: provisions expanding open Multiple Employer Plans (MEPs), lifetime income portability, a fix to the current annuity provider selection safe harbor, a lifetime income disclosure provision, and a repeal of the maximum age for IRA contributions. The bill includes the previously introduced House of Representatives Family Savings Act provision allowing for penalty free withdrawals from retirement plans in the case of birth of child or adoption but not its universal savings account provision.

Title IV on American Innovation would allow new businesses to write off more of their initial start-up costs and allows start-ups to expand without triggering limits on tax benefits, such as net operating losses and the R&D tax credit.

The Taxpayer First Act of 2018 modernizes the IRS and makes taxpayer service the focus of the agency by improving the ease and efficiency of the taxpayer experience when filing taxes, retrieving information, resolving issues and making payments. Notably, the bill codifies the requirement of an independent administrative appeals function at the IRS, ensures that staff working in the Independent Office of Appeals does not receive advice from the Office of Chief Counsel or from IRS employees working on the case prior to its referral for administrative review. Further, it provides taxpayers access to "the case against them," if requested.

The House of Representatives passed the Retirement, Savings, and Other Tax Relief Act late in the end of the 115th Congress and sent it to the Senate, where the bill did not receive any consideration.

BUSINESS INTEREST EXPENSE DEDUCTION PROPOSED REGULATIONS

On Nov. 26, 2018, the IRS issued proposed regulations concerning the business interest expense deduction for certain taxpayers in TCJA.

The regulations state that, for tax years beginning after Dec. 31, 2017, the deduction for business interest expense is generally limited to the sum of a taxpayer's business interest income, 30 percent of adjusted taxable income and floor plan financing interest. The regulations confirm the information contained in Notice 2018-28 that net interest will be calculated at the consolidated group level and that business interest income is inclusive of income earned on insurer's portfolios. Wholly owned partnerships and members of an affiliated group that do not file a consolidated return would not be aggregated with the consolidated group for purposes of the limitation.

Business interest is defined broadly in the regulations, including loan commitment fees and swap payments made or received on interest-bearing assets or liabilities. In addition, the regulations indicate that investment interest, expenses or income that a partnership allocates to a C corporation partner would be recharacterized as interest, expenses or income allocable to a trade or business of the C corporation.

Taxpayers will use the new Form 8990, Limitation on Business Interest Expense Under Section 163(j), to calculate and report their deduction and the amount of disallowed business interest expense to carry forward to the next tax year.

This limit does not apply to taxpayers whose average annual gross receipts are $25 million or less for the three prior tax years. This amount will be adjusted annually for inflation starting in 2019.

RISK-BASED CAPITAL RESULTING FROM TAX REFORM

All life insurance companies and fraternal benefit societies will be faced with a significant increase in risk-based capital (RBC) requirements resulting from tax reform, because RBC is designed as an after-tax calculation. As part of the changes made to reflect the impacts of tax reform, the NAIC Life RBC Working Group also made technical changes to the RBC components other than simply changing the tax rates from 35 percent to 21 percent, because that change alone would have caused RBC required capital to increase approximately 21.5 percent and would have decreased RBC ratios at companies by approximately 18 percent. Changes proposed by the American Academy of Actuaries as well as by the ACLI were adopted by the Life RBC Working Group on its June 8, 2018, conference call and by the NAIC Capital Adequacy Task Force on its June 28, 2018, conference call. The NAIC Executive Committee and Plenary accepted these changes by unanimous consent following the summer NAIC meeting in Boston.

The offsetting adjustments adopted by the NAIC moderated the impact of lowering the tax rates and generally increased RBC requirements 10 to 15 percent, depending upon the company. This translates into a reduction in RBC ratios from 9 to 13 percent.

To help ensure that the RBC changes would have minimal impact on companies' ratings, the industry worked with Moody's (the only rating agency that does not use its own required capital model) to explain the changes and what they mean for a well-capitalized company.

ACLI has requested that NAIC develop a document that describes the changes made to RBC as a result of the TCJA to assist state financial examiners and other state regulators with an explanation of why lower RBC ratios do not correlate with riskier companies. The NAIC tasked the American Academy of Actuaries with developing the first draft, which has been delivered to the Life RBC Working Group and was exposed for public comment. This will be a public document and should be able to be used by companies with other constituents who have questions about their lower RBC ratios. The finalized document should be available by year-end 2018.

The document will contain detailed information explaining why tax reform impacted Life RBC, how Total Adjusted Capital (TAC) is impacted, how Authorized Control Level (ACL) RBC changes as a result of the Life RBC formula, how the changes resulting from tax reform may cause more companies than normal to trigger the Life RBC Trend Test at Dec. 31, 2018, and how regulators and examiners should respond when the Life RBC Trend Test is triggered as a result of tax reform changes. The document will examine in detail the changes to ACL RBC, TAC and RBC results due to the TCJA. This includes why a reduction in tax rates cause an increase in ACL RBC, what changes in ACL RBC will be effective for the 2018 filing year, how TAC is affected by the TCJA, how effects of the TCJA should be factored into the interpretation of RBC results, and how elements of the TCJA will affect the components of the Life RBC calculation in the future. ■

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