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ACLI Update

By Mandana Parsazad and Regina Rose

SECTION 807 REGULATORY PROJECT

In the 2019–2020 Priority Guidance Plan ("PGP"), the Internal Revenue Service ("IRS") and Department of the Treasury ("Treasury") have indicated their intent to provide "[g]uidance under § 807 regarding the determination of life insurance reserves for life insurance and annuity contracts, including guidance to implement changes under section 13517 of the TCJA." No activity has been noted to date on the quarterly updates to the PGP related to this item.

In public statements at tax conferences earlier this year, the IRS laid out several areas that will be covered as part of the Section 807 guidance. First, the IRS has indicated that the Section 807 regulations will address asset adequacy reserves. Asset adequacy is a non-tax, actuarial concept that doesn't exist outside of the NAIC Valuation Manual. Asset adequacy reserves are not part of CRVM or CARVM and are covered by a separate section (chapter 30) of the NAIC Valuation Manual. As a result, under Section 807(d), no deduction is allowed (or ever has been allowed) for asset adequacy reserves. The General Explanation of Public Law 115-97 (otherwise known as the "Blue Book") published following the Tax Cuts and Jobs Act ("TCJA") indicates that "under NAIC-prescribed principle-based reserve methodology in effect at the time of the enactment of the [reserve] provision, principle-based reserves for any contract do not include any asset adequacy reserve component." Given the statutory deference to NAIC principles for reserves in Section 807, it is unclear how the IRS may be approaching asset adequacy guidance or whether guidance is even necessary.

A second item that the IRS has indicated will be covered by the Section 807 regulations is further guidance under Section 807(f). Section 807(f) governs changes in basis for computing life insurance reserves. The TCJA amended Section 807(f) to require that the difference between the old basis and the new basis of reserves "be taken into account under section 481 as adjustments attributable to a change in method of accounting initiated by the taxpayer and made with the consent of the Secretary." In Rev. Proc. 2019-10 (which provides procedural guidance for post-TCJA reserve basis changes under Section 807(f)), the IRS deemed certain holdings of previous Section 807(f) rulings (Rev. Ruls. 94-74 and 2002-6) inconsistent with the general rules for changing a method of accounting under Section 446(e) and Section 1.446-1(e), and modified those rulings to the extent they were deemed to be so inconsistent. While the new Section 807(f) provision makes reference to Section 481 of the IRC to prescribe spread periods consistent with general rules for other changes in accounting method, there is no mention in the statute of Section 446 or an intent to subject life reserve basis changes to all other accounting method rules. In fact, Section 811, not Section 446, contains the general rule for accounting methods of a life insurance company, including reserves. It is fundamental to the taxation of life insurers and would need to be carefully considered if any further guidance is proposed on the application of Section 446 to reserve basis changes.

Apart from the Section 811/446 matter, ACLI believes additional guidance under Section 807(f) would be useful and has advocated for such, particularly with regard to what is and what is not a Section 807(f) change in basis. Rev. Rul. 94-74 provided such guidance under pre-TCJA law but is now largely obsolete post-TCJA. ACLI believes that this revenue ruling should be updated to provide guidance promoting consistent application of basis change rules across the industry. Many of the future questions that will arise about reserve basis changes under Section 807(f) will be driven either by existing NAIC reserving methodologies or future NAIC-mandated changes in reserving methodologies applicable to every company in the industry, and guidance would promote consistency and reduce controversy. Dating back even further, there is a long history of IRS guidance on reserve basis changes. While much of this prior guidance is now obsolete, substantial portions of it remain potentially relevant, and ACLI has advocated an update of the relevant guidance as part of the Section 807 project.

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A third area of guidance the IRS expects to cover in Section 807 regulations is the requirement of expanded reserve reporting requirements. Section 807(e)(6) of the IRC instructs the Secretary to require reporting with respect to the opening balance and closing balance of reserves and with respect to the method of computing reserves for purposes of determining income. The IRS has indicated it is working to require additional reporting

in three areas: (1) electronic filing of all insurance tax returns, whether included in a consolidated group or filed individually; (2) electronic filing of annual statements with returns; and (3) modification of Form 1120L to add lines for expanded reporting that would assist revenue estimators and examiners in the future, particularly as it relates to reporting for separate accounts.

The fourth item the IRS has publicly acknowledged it plans to cover in Section 807 regulations is cleanup of obsolete references in the IRC and regulations. There are many sections of the regulations, in particular, that are wholly or partially obsolete as a result of both the 1984 Tax Act and the TCJA. A thorough job of cleanup would involve deletion of obsolete regulations, retention and update of still-relevant regulations, and renumbering of regulation sections to correspond with the current IRC sections.

The ACLI has been working to provide information to Treasury and the IRS that would be helpful as part of the 807 regulation project. To date, there is no estimated timeline for the release of Section 807 regulations.

FINAL, TEMPORARY AND PROPOSED REGULATIONS IMPLEMENTING TCJA INTERNATIONAL RULES

On June 21, Treasury and the IRS published final and temporary regulations to implement the global intangible low-taxed income ("GILTI") ("Final GILTI Regulations"). Treasury and the IRS confirmed in this guidance that in determining the tested income or loss of a controlled foreign corporation ("CFC"), the rules of IRC sections 953 and 954(i) would apply, including the rules of reserve computation under section 954(i).

While the Final GILTI Regulations confirmed prior guidance issued in September 2018, that the GILTI high tax exclusion applies only to income that is excluded from foreign base company income ("FBCI") and insurance income solely by reason of an election made to exclude the income under the high tax exception of IRC section 954(b)(4), proposed regulations also published on June 21 ("Proposed GILTI Regulations") provided an expanded high tax exclusion from the GILTI tax base.

In the Proposed Regulations, the GILTI high tax exclusion was expanded to include certain high-taxed income even if that income would not otherwise be FBCI or insurance income. Gross income subject to foreign income tax that is subject to an effective rate of 18.9 percent (90 percent of the U.S. statutory corporate tax rate) or higher would be excluded from the GILTI tax base. Such an effective rate is determined on a qualified business unit by qualified business unit basis. Treasury and the IRS outline the options considered regarding the scope and basis for determining income that would qualify for the newly proposed GILTI high tax exclusion, and request comments.

The Proposed Regulations provide for a revocable election, which U.S. shareholders may make to avail themselves of the high-taxed exclusion; such election, once made, is binding on all U.S. shareholders and may not be revoked for 60 months. Moreover, the Proposed Regulations state, "if a CFC is a member of a controlling domestic shareholder group, the election applies with respect to each member of the domestic shareholder group." The Proposed Regulations also state that the proposed expanded GILTI high-taxed exclusion will be effective as of the date the guidance is finalized.

The TCJA also amended the passive foreign investment company ("PFIC") rules under section 1297. On July 11, Treasury and the IRS issued proposed regulations under sections 1291, 1297 and 1298 regarding the determination of ownership in a PFIC, when a foreign corporation is a qualifying insurance company, and the amounts of income and assets such a company may exclude from passive income and assets pursuant to section 1297(a). The guidance also clarified the application and scope of rules that determine whether a foreign corporation is a PFIC and whether a U.S. person who holds stock in a PFIC is treated as a shareholder of a PFIC. ■

Mandana Parsazad is vice president, Taxes & Retirement Security, for the American Council of Life Insurers and may be reached at *mandanaparsazad@acli.com*.

Regina Rose is senior vice president, Taxes & Retirement Security, for the American Council of Life Insurers and may be reached at *reginarose@acli.com*.