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Continuing developments in the taxation of insurance companies

2011: The year in review

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Foreword

This monograph provides an overview of developments affecting the taxation of insurance companies in 2011. We have selected for specific review those developments of major significance to the insurance industry.

An outpouring of cases and rulings would presumably increase our knowledge and provide clarity with regard to previously clouded areas. As often occurs, however, the cases and rulings generate as many questions as they answer. Nonetheless, it is important to recognize the impact of these cases and rulings on current income tax filing requirements—as well as future tax planning—because the tax consequences are both immediate and far reaching.

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The heart of the matter

The 2012 elections for control of the White House and Congress will mark a key decision point for tax policy. Election-year competition over tax policy priorities may serve to define key business and individual tax issues and provide direction for the first major overhaul of US tax laws since 1986.

The year in review

Congress returned for its 2012 session to face key tax issues left unresolved from last year, including expiration of the research credit and other business tax provisions and the scheduled expiration of individual tax rates at the end of this year. Politics as well as policy differences continue to limit prospects in 2012 for Congress and the Obama Administration to reach compromises on major tax and budget issues.

Overview

Leading the list of issues this year was the debate over a 2% reduction in the 6.2% employee payroll tax, along with extensions of expanded federal unemployment benefits and Medicare physician pay rates.

On December 13, 2011, the House of Representatives passed legislation extending the payroll tax reduction through the end of 2012, extending and modifying federal unemployment benefits, and extending Medicare physician pay rates for two years. The House-passed bill was fully offset by a mix of spending reductions and increased government fees, but did not include any tax increases. On December 17, the Senate passed a two-month extension of the payroll tax reduction, federal unemployment benefits, and Medicare physician pay rates, after being unable to reach an agreement on how to offset the cost of extending those measures for all of this year. The House responded on December 20 by rejecting the Senate measure and insisting on a conference to reach an agreement on legislation that would be in effect through the end of 2012. Subsequently, Congress agreed on a two-month extension bill, which President Obama signed into law on December 23.

A House and Senate conference committee was appointed to resolve disagreements on these issues, and the committee formally approved a final agreement on legislation, H.R. 3630, which was signed by the president on February 22, 2012. The legislation extended the current 4.2% employee payroll tax rate through the end of 2012. The conference agreement also extended expanded federal unemployment benefits and Medicare physician pay rates. As a result, approximately 160 million individuals will have the benefit of the payroll tax reduction through the end of 2012.

On most other issues, the House and Senate often were unable to agree. Republican leaders last year noted that the House had passed more than 25 "economic growth" bills—including numerous measures to limit federal regulations and repeal the 2010 healthcare law—that the Senate did not adopt. Tax bills that did reach the President's desk last year included a measure repealing Form 1099 information reporting for business-to-business transactions and a bill repealing 3% withholding on government payments to businesses for goods or services. Congress and the Administration last year also reached final agreements on certain foreign trade agreements.

Having only a 53-vote majority, Senate Democratic leaders last year responded that Senate Republicans generally were able to block Democratic-supported "job creation" proposals—including measures to fund highway infrastructure spending and assistance to states for hiring teachers that were offset by tax increases—by requiring effectively that such legislation secure 60 votes to advance in the Senate.

President Obama re-proposed many of his Administration's individual and business tax policy priorities when he submitted his FY 2013 budget to Congress on February 13, 2012. President Obama proposed an FY 2013 federal budget that calls for $3.8 trillion in overall federal spending for that year. The Administration projected a $1.33 trillion federal deficit for current FY 2012, which ends September 30, or 8.5% of GDP. The Administration is projecting a $905 billion federal deficit for FY 2013, or 5.5% percent of GDP.

The Administration proposed $3 trillion in deficit reduction over 10 years, of which $1.5 trillion would come from increases in certain business and individual taxes. The Administration projected that under the president's proposals the federal deficit would be reduced to 3% of GDP by FY 2018.[1]

1 *Decision points for tax policy: 2012 Tax legislative outlook*, Washington National Tax Services, PwC, January 2012.

The Administration's budget featured tax proposals that President Obama outlined in his State of the Union address, including new tax incentives for domestic manufacturing and elimination of "tax deductions for shipping jobs overseas." Many of the business and individual tax increase proposals in the President's budget include a number of "loophole closers" and other revenue changes that have been previously proposed by the Administration. The budget also contains several new revenue-raising proposals. See WNTS Insight, *President Obama's FY 2013 budget includes business and individual tax increase proposals*, February 13, 2012.

Later this year, national elections for control of the White House and Congress will mark a key decision point for tax policy. Election-year competition over tax policy priorities may serve to define key business and individual tax issues and provide direction for the first major overhaul of US tax laws since 1986.

Selected potential insurance revenue-raising proposals

Provision	Source of proposal	10-year FY 2012–FY 2021 revenue estimate ($ millions)
Insurance		
Increase the payroll tax rate for Medicare hospital insurance by one percentage point	CBO	650,800
Expand pro rata interest expense disallowance for corporate-owned life insurance	Administration FY 2012 Budget	6,824
Modify the dividends-received deduction ("DRD") for life insurance company separate accounts	Administration FY 2012 Budget	4,940
Modify rules that apply to sales of life insurance contracts	Administration FY 2012 Budget	990

Federal deficits remain a key concern

Efforts to reduce the federal deficit are expected to be a major factor in tax policy deliberations again this year. As part of the Budget Control Act of 2011, which provided for increases in the federal debt limit, Congress last year established a Joint Select Committee on Deficit Reduction (Select Committee) to propose a $1.2 trillion deficit reduction plan that would be voted on by Congress without amendment. However, the Select Committee was unable to reach a bipartisan agreement on an acceptable mix of spending cuts, mandatory spending reductions, and revenue increases.

As a fallback, the Budget Control Act provided for an equal amount of deficit reduction through automatic across-the-board spending cuts over nine years beginning in January 2013. While some in Congress have proposed revisiting these required spending cuts, in particular for the Defense Department, President Obama has said he would veto any such legislation unless a "balanced" agreement can be reached on revenue and spending issues. The federal debt was effectively at the $15.194 trillion statutory limit as of the beginning of January 2012.

The Budget Control Act provided specific authority for President Obama to request two separate increases in the federal debt limit that altogether were projected to be sufficient to finance the government's debt obligations through 2012. The first installment of an increase in the debt limit totaling $900 billion was effective last September when the House passed a resolution of disapproval but the Senate did not. Administration officials recently indicated that President Obama soon will request the second debt limit increase of $1.2 trillion authorized by the Budget Control Act, which will go into effect automatically unless a resolution of disapproval is enacted.

Building the case for corporate tax reform

The need to strengthen the competitiveness of US firms in the global marketplace—together with slow economic growth, a continuation of high unemployment rates, and projections of significant future budget deficits under current policies—have increased bipartisan interest in tax reform as a way of promoting US economic growth, controlling federal deficits, and spurring job creation. Although it is unlikely that Congress is prepared to complete action on tax reform before the 2012 elections, key tax policy leaders in the House and Senate this year are expected to continue laying a foundation for tax reform to be prepared for any opportunity that may arise to overhaul US tax laws this year or in following years.

The House Ways and Means Committee and the Senate Finance Committee last year held more than 20 hearings altogether on tax reform issues (see Appendix E). Many of these hearings focused on the fact that the United States has one of the highest corporate tax rates in the world and that most of our major trading partners have adopted territorial tax systems, which generally exempt from tax the active business earnings of foreign subsidiaries. These hearings also have examined a range of other business tax issues, including enhanced incentives for innovation, the tax treatment of debt and equity, and the tax treatment of financial products.

As an important step in the tax reform process, Ways and Means Chairman Dave Camp (R-MI) last year released for public comment an international tax reform discussion draft that would be one component of a future comprehensive tax reform bill also addressing individual and other business tax issues. The discussion draft, examined in greater detail below, proposed a 25% top corporate tax rate and a 95% exemption for active foreign business earnings. Chairman Camp's discussion draft marked a significant milestone in advancing tax reform because it is a detailed proposal to restructure the way the United States taxes global business operations.

The draft reflects an objective that international corporate tax reform should be revenue neutral on its own. To achieve this objective, the draft included a "toll charge" tax on accumulated earnings of controlled foreign corporations, a limitation on interest deductions, and three alternative proposals designed to protect the US tax base against income being moved abroad.

Obama Administration releases business tax reform framework

In February 2012, the Obama Administration released a 25-page "framework for business tax reform" that calls for a 28% top corporate income tax rate. The framework proposes a tax rate of no more than 25% for certain domestic manufacturers and a permanent research credit. The framework also calls for a "minimum tax on overseas profits."

The Administration's framework suggests that efforts should be made to establish greater parity between C-corporations and large pass-through businesses. At the same time, the framework outlines several small business tax relief provisions. The administration states that President Obama's goal is to have a corporate tax rate more in line with major US trading partners. The administration states that for OECD countries, excluding the United States, the GDP-weighted average corporate tax rate is 27.8%, and the average corporate tax rate is 25.1%. The administration's business tax reform framework does not include any proposals for comprehensive individual tax reform. See WNTS Insight, *Obama Administration releases business tax reform framework*, February 22, 2012.

House Republican budget calls for tax reform

In March 2012, House Budget Committee Chairman Paul Ryan (R-WI) released a proposed FY 2013 House budget resolution that reaffirms support for comprehensive tax reform. The draft budget includes proposals to limit future growth in spending on Medicare and other federal mandatory spending programs, and also assumes repeal of the Affordable Care Act of 2010.

Under the budget proposed by Chairman Ryan, discretionary spending for FY 2013 would be capped at $1.028 trillion, less than the $1.047 trillion limit set under the Budget Control Act enacted last year by the House and Senate. The House proposal to reduce spending below levels agreed to as part of last year's debt limit agreement may complicate efforts to pass spending bills later this year for the federal government's new fiscal year that starts on October 1, 2012.

The budget outlined by Chairman Ryan incorporates general recommendations on tax reform principles outlined in a letter to the House Budget Committee by House Ways and Means Chairman Dave Camp (R-MI). Key goals for tax reform featured in Chairman Ryan's budget report "The Path to Prosperity: A Blueprint for American Renewal" include proposals to:

- Consolidate the current six individual tax brackets into two brackets of 10% and 25%
- Repeal the Alternative Minimum Tax
- Reduce the corporate income tax rate to 25%
- Shift from a "worldwide" system of taxation to a "territorial" tax system that "puts American companies and their workers on a level playing field with foreign competitors"

See WNTS Insight, *House Republican budget calls for tax reform; 25% top rate for individuals and corporations*, March 20, 2012.

Designing a comprehensive tax reform proposal for full consideration by Congress will necessitate considerable additional efforts, and details on domestic business and individual reform proposals are expected in the future. One common element in many discussions of tax reform is the goal of lowering individual and corporate tax rates, with the cost offset by "base-broadening" changes to the tax code.

Base broadening would be accomplished primarily by repealing or limiting targeted tax deductions, credits, and preferences. Examples of business tax provisions that some have cited as potential tax reform base-broadening proposals include repealing or limiting accelerated depreciation and the domestic manufacturing deduction. Because businesses could be affected significantly by emerging tax reform efforts, many companies and trade associations are engaged in assessing the potential benefits and risks of tax reform, and have been participating in ongoing Congressional hearings and meetings with members of Congress and their staff. Such efforts are expected to continue in 2012.

2012 elections may crystallize tax policy debate

With Presidential and Congressional election activities well underway, there will be an opportunity this year for candidates from both parties to define specific options for tax reform.

President Obama last year in his State of the Union Address called for reforming the tax code, including corporate tax provisions, without adding to the federal deficit. While Treasury Department officials last year indicated that work has been underway on a business tax reform white paper, the Obama Administration has yet to release any detailed reform proposals. Last September, as part of his deficit reduction plan, President Obama reaffirmed his support for individual and corporate tax reform but also stated that deficit reduction should be one goal of any future tax reform legislation.

The fate of expiring individual tax rates is expected to be a key focus of the 2012 elections. The 2001 and 2003 tax act provisions were extended temporarily through December 31, 2012, as part of legislation signed in late 2010 after that year's mid-term Congressional elections. President Obama and many Democrats in Congress have called for extending current tax rates only for individuals with incomes below $200,000 ($250,000 for joint filers). Republicans generally have expressed support for tax reform that would lower tax rates for all individuals on a permanent basis while also reforming business tax provisions. The Republican-controlled House of Representatives last year called for a top rate of 25% for individuals as well as corporations.

If no action is taken before the elections to address expiring individual tax rates, it is possible that a "lame-duck" Congress and President Obama could agree to extend temporarily some or all of the expiring individual tax rates to allow time for action on tax reform or other decisions on tax rates by the next Congress. Congress also could address the research credit and other expired business tax provisions at that time. Ultimately, the outcome of the 2012 elections will be the critical factor in determining what might happen on tax legislation during a lame-duck session.

In the next Congress, the prospects for the United States to overhaul its tax laws will depend on whether a consensus can emerge on the need for and direction of lasting tax reform.

Legislation

In 2011, the US Congress agreed upon and ultimately enacted few tax bills. Although several noteworthy pieces of legislation were introduced, none were enacted, including legislation to:

- Prevent the avoidance of tax by insurance companies through reinsurance with non-taxed affiliates
- Increase the premium limitation that determines whether a property & casualty insurance company may elect to be taxed only on investment income
- Repeal part of the Patient Protection and Affordable Care Act (PPACA)
- Prevent the non-disclosure of employer-owned life insurance (COLI) coverage of employees as an unfair and deceptive act or practice
- Prevent tax haven abuse

Enacted legislation

The Temporary Payroll Tax Cut Continuation Act of 2011 (H.R. 3765)

The president signed the Temporary Payroll Tax Cut Continuation Act of 2011, H.R. 3765, on December 23, 2011. In general the law:

- Extends the reduced employee Old-Age, Survivors, and Disability Insurance (OASDI) tax rate of 4.2% under the FICA tax, and the equivalent employee portion of the RRTA (railroad retirement) tax, to apply to covered wages paid in the first two months of 2012.
- Provides for a recapture of any benefit a taxpayer may have received from the reduction in the OASDI tax rate, and the equivalent employee portion of the RRTA tax, for remuneration received during the first two months of 2012 in excess of $18,350. The recapture is accomplished by a tax equal to 2% of the amount of wages (and railroad compensation) received during the first two months of 2012 that exceed $18,350. The provision directs the Secretary of the Treasury to prescribe regulations or other guidance necessary to carry the law.
- For taxable years beginning in 2012, the OASDI rate for a self-employed individual is reduced to 10.4%, for self-employment income of up to $18,350 (reduced by wages subject to the lower OASDI rate for 2012). Related rules for 2011 concerning coordination of a self-employed individual's deductions in determining net earnings from self-employment and income tax also apply for 2012, except that the income tax deduction allowed for the OASDI portion of Self-Employment Contributions Act (SECA) tax paid for taxable years beginning in 2012 is computed at the rate of 59.6% of the OASDI tax paid on self-employment income of up to $18,350. This percentage is used with respect to the first $18,350 of self-employment income as necessary to continue to allow the self-employed taxpayer to deduct the full amount of the employer portion of SECA taxes.
- The law is effective for remuneration received during the months of January and February 2012 and for self-employment income for taxable years beginning in 2012.

Employee payroll tax reduction extended through the end of 2012

On February 23, 2012, the Middle Class Tax Relief and Job Creation Act of 2012 was enacted into law by President Obama, which extended the temporary 2% employee payroll tax reduction through the end of 2012.

Noteworthy legislation not enacted

Jobs and Premium Protection Act (S.1880)

On November 16, Sen. Orrin Hatch (R-UT), Sen. John Barrasso (R-WY), and Sen. Olympia Snowe (R-ME) introduced the Jobs and Premium Protection Act (S.1880), which, if enacted, would have repealed part of the Patient Protection and Affordable Care Act (PPACA).

The bill would have repealed one of several new taxes levied in the PPACA, specifically, the Health Insurance Tax (HIT). Under the law, the annual health insurance premium tax would apply to any US health insurance provider. The bill was a companion bill to H.R. 1370, introduced in the House in early 2011 by Rep. Charles Boustany (R-LA).

To amend the Internal Revenue Code of 1986 to prevent the avoidance of tax by insurance companies through reinsurance with non-taxed affiliates (S. 1683/H.R. 3157, generally known as the "Neal Bill")

On October 12, 2011, Rep. Richard Neal (D-MA), with his co-sponsor, Rep. William Pascrell (D-NJ), introduced a bill (the 2011 Neal Bill) that would have addressed the tax treatment of reinsurance with non-taxed affiliates. The bill reflects his continued concern that the use of affiliated reinsurers is a means by which US insurance risks migrate to offshore reinsurance markets so as to avoid US tax. Rep. Neal had previously introduced two foreign reinsurance tax bills—H.R. 3424 (July 30, 2009) (the 2009 Neal Bill) and H.R. 6969 (September 18, 2008) (the 2008 Neal Bill)—in the 111th and 110th Congresses, respectively. These earlier bills were significantly different from the 2011 Neal Bill. The 2011 Neal Bill is similar to an Obama administration revenue proposal that was explained in the FY 2012 Green Book.

The 2011 Neal Bill would have generally:

- Denied an insurance company a deduction for reinsurance premiums (and additional amounts properly allocable to such premiums) paid to an affiliated reinsurance company, to the extent that the reinsurer (or its US shareholder) is not subject to US income tax with respect to the premiums received.

- Excluded from the insurance company's income any return premiums, ceding commissions received, reinsurance recovered, or other amounts received with respect to the corresponding reinsurance, to the extent properly allocable to such non-taxed reinsurance premiums.

Stop Tax Haven Abuse Act (S.1346)

As he has done every year for the past few years, House Ways and Means (HW&M) Committee member Rep. Lloyd Doggett (D-TX) reintroduced a bill to address perceived abuses involving "tax havens" and "abusive tax shelters." In an effort to deter perceived offshore tax evasion, the bill established several legal presumptions against the validity of entities and transactions involving "offshore secrecy jurisdictions." The bill would have extended from three to six years the statute of limitations for IRS examinations involving offshore secrecy jurisdictions, and limit the ability of taxpayers to rely on certain tax opinions to claim a "reasonable cause" exception to penalties on transactions involving offshore secrecy jurisdictions.

To amend the Internal Revenue Code of 1986 to increase the alternative tax liability limitation for small property and casualty insurance companies (H.R. 2198)

Rep. Erik Paulsen (R-MN), member of the HW&M Committee, introduced a bill that would have increased the limitation for the alternative tax liability for small property and casualty insurance companies to $2.025 million. Currently, the limitation for alternative tax under Section 831(b)(2)(A)(i) for small property and casualty (P&C) insurance companies is $1.2 million. The proposed bill would have increased the premiums a small P&C company may earn and still elect to be taxed only on investment income.

Moreover, the proposed bill would have added an inflation adjustment to Section 831(b) of the Code, "In the case of any taxable year beginning in a calendar year after 2012, the dollar amount set forth in Subparagraph A would have been increased by an amount equal to—(i) such dollar amount, multiplied by (ii) the cost-of-living adjustment determined under Section 1(f)(3) for such calendar year."

Life Insurance Employee Notification Act (H.R. 130)

The Life Insurance Employee Notification Act (H.R. 130) was introduced in the House by Rep. Gene Green (D-TX). If enacted, the bill would have prevented the non-disclosure of employer-owned life insurance (COLI) coverage of employees as an unfair and deceptive act or practice. The bill would have required employee notice of COLI, similar to those enacted in 2006. These requirements would have been enforced through the Federal Trade Commission Act, rather than the Internal Revenue Code.

Specifically, the bill would have required written notice not later than 30 days after the date on which an employer purchases an employer-owned insurance policy on the life of an employee (or a spouse or dependent of the employee). The employer would have been required to provide to each employee for whom the employer carries such a policy, a written notice that contains the following information:

- A statement that the employer carries an employer-owned insurance policy on the life of the employee
- The identity of the insurance carrier of the policy
- The benefit amount of the policy
- The name of the beneficiary of the policy

The employer also would have been required to provide notice to current employees covered by an insurance policy not later than 90 days from the date of enactment, and to former employees covered for any length of time from January 1, 1985 until the date of enactment, not later than one year after date of enactment.

The Life Insurance Employee Notification Act (H.R. 130), was consolidated into the surface transportation bill (S. 1813), the Moving Ahead for Progress in the 21st Century Act.

Federal

Blue Cross Blue Shield

Impact of Medical Loss Ratio (MLR) requirements

Section 833 provides special rules for existing Blue Cross or Blue Shield organizations and other organizations that meet the requirements of Section 833(c)(3). Such organizations are: (1) subject to tax in the same manner as stock insurance companies; (2) allowed as a deduction against regular taxable income (not to exceed taxable income) equal to 25% of the year's claims incurred, cost-plus liabilities and claims administration expenses over beginning adjusted surplus; (3) exempt from the 20% reduction of unearned premiums set forth in Section 832(b)(4); and (4) permitted a mark-to-market on their assets existing as of January 1, 1987 for purposes of sale or exchange (fresh start tax basis).

The Patient Protection and Affordable Care Act (PPACA) added a new Section 833(c)(5), which curtails the benefits afforded to Blue Cross Blue Shield and other organizations under Section 833. Specifically, Section 833 special tax treatment will no longer apply unless the organization's MLR is greater than or equal to 85%. Failure of the Section 833(c)(5) MLR is a year by year determination–a Blue Plan may pass one year and fail the next.

An organization's MLR is equal to the amount expended on reimbursement for clinical services provided to enrolees under its policies during the tax year (as reported under Section 2718 of the Public Health Service Act) (Section 833 MLR Numerator), divided by the organization's total premium revenue (Section 833 MLR Denominator). This formula for determining the MLR as currently drafted is inconsistent with the formula enumerated in Section 2718 for purposes of determining the amount of a policyholder rebate due for any year.

Notice 2010-79 provided the first IRS guidance published on the subject and provided interim guidance to taxpayers on the interpretation and application of Section 833(c)(5), and granted interim relief to Blue Cross and Blue Shield organizations. Among other issues addressed in the Notice, it provided that a loss of Section 833 status by virtue of failing Section 833(c)(5) for the 2010 tax year, would not disturb a Blue Cross and Blue Shield organization's deemed insurance company status afforded by Section 833. Rather, the Notice provides the impacts of failing Section 833(c)(5) are limited to the loss of the 20% unearned premium haircut exemption and the loss of the Section 833(b) Special Deduction. The Notice indicated that a taxpayer would not be treated as losing its status as a stock insurance company by reason of failing Section 833(c)(5), if it meets certain enumerated conditions. The conditions essentially would require the taxpayer to meet the definition of an insurance company provided in Subchapter L, determined by excluding the administrative-service-only business from the determination.

In addition, Notice 2010-79 provided that taxpayers must use the definition of "reimbursement for clinical services provided to enrollees" that is set forth in the Health and Human Services (HHS) interim final regulations issued on November 22, 2010 for purposes of the Section 2718 rebate MLR calculation. In addition, the Notice provided that the IRS will not challenge the inclusion of "amounts expended for activities that improve health care quality" as defined in the Department of HHS regulations in the determination of the Section 833(c)(5) MLR.

Notice 2011-04 and Rev. Proc. 2011-14 resolved that a change in the treatment of unearned premiums by virtue of a taxpayer having a changed status under Section 833(c)(5) from one year to the next would be treated as an automatic method change not requiring consent of the IRS commissioner. In addition, the Notice provided that a taxpayer moving from a failed year into a passing year could recapture, via an automatic method change, the positive impact of once again passing Section 833(c)(5).

Notice 2011-51 extended to the 2011 tax year the Section 833(c)(5) guidance provided in the various Notices and rulings outlined above.

The constitutionality of the PPACA has been challenged and the Supreme Court of the United States heard arguments in March 2012. Some have interpreted the Court's questions as leaning against the law, however, it remains to be seen whether the court will it strike all or part of the law. The Court's decision is expected in June 2012.

Changes in Section 833 status

In Notice 2011-04, the IRS issued guidance on changes in accounting methods for Section 833 organizations. This IRS Notice indicated that a change in the tax treatment of unearned premiums where a Blue Cross and Blue Shield organization loses or regains its Section 833 status due to Section 833(c)(5) is an accounting method change for which the IRS will provide automatic consent.

The Notice therefore dispensed with the issue of having to file protective claims prior to the 2010 year end, and the quandary some taxpayers who are under IRS audit faced with having already missed the window for requesting a non-automatic accounting method change. The Notice is consistent with the prior IRS guidance in that the loss of the Blue Cross Blue Shield Special Deduction under Section 833 would not create an accounting method change. Thus, Blue plans that may be allowed the special deduction in one year and not the next (or vice versa) do not have a requirement to file for an accounting method change for the special deduction, but would be required to file an accounting method change for the change in the unearned premium reserve UPR treatment.

The 2011 Notice does not change the previously provided relief of Notice 2010-79, which indicates that a failure under Section 833(c)(5) would not disturb a Blue Cross and Blue Shield organization's deemed insurance company status provided under Section 833.

Captives

Investment risk vs. Insurance risk

In Technical Advice Memorandum (TAM) 201149021, the IRS ruled that residual-value insurance policies insuring assets against market decline are not insurance contracts for federal tax purposes. The IRS determined that although the contracts at issue protect against market forces that depress the value of the covered assets, they do not protect against a casualty event that damages the assets. The IRS stated that it more closely resembles investment risk, not true insurance risk, and cites Rev. Rul. 89-96. According to the IRS, citing Commissioner v. Treganowan, 183 F.2d 288, 290-91 (2d Cir. 1950), insurance risk requires a fortuitous event or hazard and not a mere timing or investment risk. A fortuitous event (such as a fire or accident) is at the heart of any contract of insurance.

The IRS also determined that the arrangement was not insurance in its commonly accepted sense. Although the contracts at issue were similar to insurance policies, they did not represent "insurance" because the taxpayer's obligation to pay was not dependent on a casualty event. On the issue of risk distribution, the IRS looked to Rev. Rul. 60-275, 1960-2 C.B. 43. In that ruling, the IRS concluded that risk distribution was not present because a major flood would affect all properties involved, since all properties were located in the same flood basin. Similarly, in the TAM, the IRS stated that the assets covered by the contracts were interdependent because depreciation would affect all the assets in the same manner. The court said that the taxpayer could not sufficiently use the law of large numbers to distribute its risk among the protected assets to achieve risk distribution. Accordingly, the IRS concluded that the contracts were not insurance contracts for federal tax purposes.

The IRS premised its conclusion on analogizing the risks insured under the contract to an "investment" risk versus an insurance risk. The IRS concluded that the risk insurance under the contract would be triggered by the same factor, thus there was no risk distribution. The IRS pointed to the fact that there was no specific casualty event insured (e.g., fire, earthquake). In concluding a lack of risk distribution, the IRS relied upon Rev. Rul. 60-275 in which a number of participants in a reciprocal arrangement were all physically located in the same flood plain. The IRS once again analogized an accepted concept (e.g., the physical concentration of risks to the risks insured under the residual-value insurance). The IRS concluded that every risk insured was inter-related to a common risk (unemployment in the present case).

Compensation

Accrued bonus

In Rev. Rul. 2011-29, the IRS provided taxpayer-favorable guidance relating to a taxpayer's ability to take into account under Section 461 accrued bonuses that were payable to a bonus pool rather than to specific individuals. Any change in a taxpayer's treatment of bonuses to conform to this revenue ruling is a change in method of accounting that must be made in accordance with Sections 446 and 481, the regulations thereunder, and the applicable administrative procedures. In general, a change to correct the timing of the deduction for the bonus payment would be an automatic method change under Section 19.02 of the Appendix to Rev. Proc. 2011-14. As a result, Form 3115 must be attached to a timely filed (including extensions) federal income tax return, and a copy must be filed with the IRS National Office no later than the filing of the tax return.

Executive compensation

The IRS issued Notice 2011-2, which provided interim guidance on PPACA limitation on the deduction of compensation paid by health insurance providers beginning in 2013. Section 162(m)(6) was enacted in 2010 as part of PPACA to limit the compensation deduction that may be taken by certain health insurance providers. Section 162(m)(6) limits the deduction to $500,000 for remuneration paid to "applicable individuals" by a "covered health insurance provider" in taxable years beginning after December 31, 2012. The limitation applies to all entities in the controlled group of a covered health insurance provider. PPACA applies different definitions to determine whether an entity is a covered health insurance provider for the periods before 2013 and after 2012. The deduction limitation applies to deferred deduction remuneration attributable to services performed in a tax year beginning after December 31, 2009, and before January 1, 2013, if: (1) the employer was a pre-2013 covered health insurance provider for the tax year in which the services to which the deferred deduction remuneration were performed; and (2) the employer is a post-2012 covered health insurance provider for the tax year in which such deferred deduction remuneration is otherwise deductible.

The IRS issued interim guidance on the application of Section 162(m)(6) in Notice 2011-2, which states the following:

- A de minimis exception will be granted for a covered health insurance provider if the premiums received by the employer on a controlled group basis for providing health insurance coverage are less than 2% of the employer's gross revenues for that tax year.
- Section 162(m)(6) does not apply to a covered health insurance provider that is within the definition prior to 2013 but is not a covered health insurance provider after 2012.
- An independent contractor who provides services to multiple unrelated entities will not be treated as an applicable individual whose compensation is subject to the deduction limit.
- Solely for purposes of determining whether a taxpayer is a "covered health insurance provider" under Section 162(m)(6), certain reinsurance premiums are not treated as premiums from providing health insurance coverage.
- Comments were requested on the notice as well as all other aspects of Section 162(m)(6).

Economic substance

The IRS issued a Large Business and International Directive, LB&I-4-0711-015, providing guidance for examiners and managers on the codified economic substance doctrine and related penalties. The purpose of this LB&I Directive was to instruct examiners and their managers how to determine when it is appropriate to seek the approval of the Director of Field Operations (DFO) in order to raise the economic substance doctrine. Once an examiner determines that raising the doctrine may be appropriate, this directive sets forth a series of inquiries the examiner must develop and analyze in order to seek approval for the ultimate application of the doctrine in the examination.

This LB&I directive has four steps:

1. An examiner should evaluate whether the circumstances in the case are those under which application of the economic substance doctrine to a transaction is likely not appropriate. If the examiner believes that the facts and circumstances listed in the doctrine apply to the transaction, then the examiner should continue to analyze the transaction using the guidance set forth in steps 2-4. Note that, in the first step, the directive adopts, as additional factors, the Joint Committee on Taxation's (JCT's) four categories of transactions not subject to codified economic substance.

2. An examiner should evaluate whether the circumstances in the case are those under which application of the doctrine to the transaction may be appropriate. The doctrine lists facts and circumstances that tend to show that application of the economic substance doctrine may be appropriate.

3. If an examiner determines that the application of the doctrine may be appropriate, the guidance provides a series of inquiries an examiner must make before seeking approval to apply the doctrine.

4. If an examiner and the examiner's manager and territory manager determine that application of the economic substance doctrine is merited, the directive provides guidance on how to request DFO approval.

Exempt status

Annual filing requirements

In Notice 2011-23, the IRS provided guidance on the conditions for qualified non-profit health insurance issuers (Qualified Issuers) that intend to apply for recognition of exempt status under newly enacted Section 501(c)(29), as well as the filing requirements for Qualified Issuers. Section 1322 of the PPACA requires the Department of Health and Human Services to establish the Consumer Operated and Oriented Plan Program (CO-OP program) to foster the creation of qualified non-profit health insurance issuers to offer qualified health plans in individual and small-group markets. The CO-OP program will provide loans to Qualified Issuers to assist in meeting start-up costs and/or repayable grants to provide assistance in meeting any state solvency requirements.

Section 1322 of the PPACA, codified at Section 501(c)(29), sets out conditions and requirements for an entity to be considered a Qualified Issuer. The IRS intends to recognize a Qualified Issuer that has received a loan or grant under the CO-OP program as exempt, effective from the later of the date of its formation or March 23, 2010, provided that the Qualified Issuer's purposes and activities have been consistent with the requirements for exemption since that date.

Additionally, a Qualified Issuer that claims exempt status under Section 501(c)(29) and intends to file an application for exemption should file Form 990, Return of Organization Exempt from Income Tax, for tax years that end before it receives a determination letter. The Qualified Issuer must indicate on its return that it is being filed in the belief that the Qualified Issuer is exempt under Section 501(a), but that the IRS has not yet recognized its exemption. In addition, the Qualified Issuer must also report the amount of reserves required by each state in which the organization is licensed to issue qualified health plans and the amount of reserves on hand.

Section 501(c)(15)

PLR 201121029

In this PLR, the IRS ruled that a lack of risk distribution disqualifies an arrangement as insurance, and therefore Taxpayer does not meet the statutory requirement for exemption under Section 501(c)(15) of the Internal Revenue Code. To qualify as "insurance," there must be sufficient risk-shifting and risk-distribution in a transaction. The standard for the shifting and distribution of risk have been addressed by the IRS in a number of situations. In Revenue Ruling 2002-90, the IRS concluded that insurance existed where 12 insureds each contributed 5% to 15% to the insured's total risks. Moreover, in Revenue Ruling 2002-89, the IRS ruled that insurance existed where a wholly owned subsidiary insured its parent, but the arrangement represented less than 50% of the insurer's total risk of the year. Even though

the IRS assumed that all of the contracts in this ruling covered insurable risks, risk was heavily concentrated in only a small number of insureds. Therefore, concentration of risk does not allow the insurer to reduce the possibility that a single costly claim will not exceed the amount of premiums taken in from such a limited number of insureds. Since there is insufficient risk distribution, Taxpayer does not qualify as an insurance company.

Taxpayer cited *Harper Group & Subsidiaries v. Commissioner*, 96 T.C. 45 (1991) to qualify as an insurance company; however, the IRS points out the court's analysis in *Harper Group* is not sufficiently on point. Even though Harper Group received 71% of its premiums from a single insured, the premiums received were not related to a single policyholder, rather were received from 13 related policyholders, including brother-sister corporations. Therefore, adequate risk distribution was present and the arrangement in Harper Group constituted insurance. Consequently, the IRS ruled that Taxpayer does not qualify as an insurance company and will not be exempt from federal income tax under Section 501(c)(15).

PLR 201101029

The IRS denied tax-exempt status to an organization providing auto damage and liability coverage to its members, finding that the organization did not have enough risk distribution to qualify as an insurance company. Taxpayer was formed to provide auto damage and liability coverage for its members—six taxicab companies. The Taxpayer was structured on a mutual basis with six members, and each of the six member companies was operated on a strictly independent basis with profits of each company being shared only with the shareholders of that company. Risk was primarily concentrated in two of the six member companies. Similarly, the retained risk of accidents was borne solely by the company experiencing the loss. Each of the companies determined that it was in its best interest to shift risk away from itself individually to the Taxpayer through a mutual insurance arrangement that the Taxpayer manages.

The IRS determined that the organization did not qualify for exemption under 501(c)(15). The IRS concluded that the organization had an insufficient number of insureds to provide for an adequate pooling base and risk was too heavily concentrated on two insureds. Therefore, the Taxpayer lacked one of the principal elements of insurance—risk distribution. Because the Taxpayer did not qualify as an insurance company, the Taxpayer did not meet the statutory requirement for exemptions under Section 501(c)(15) and was not granted tax-exempt status.

PLR 201133016

The IRS revoked the tax-exempt status of a mutual insurance company because the company's gross receipts exceeded the $600,000 limitation under Section 501(c)(15)(A). An insurance company as defined in Section 816(a), other than a life insurance company, is exempt from income tax under Section 501(a) if its gross receipts for the taxable year do not exceed $600,000 and more than 50% of those gross receipts consist of premiums, per Section 501(c)(15)(A)(i). Although Taxpayer filed its Form 990 as required, the amount that Taxpayer reported on Form 990 and in its statements included direct premiums minus returned premiums. Notice 2006-42 clearly states that the calculation for premiums does not include any premiums returned. Taxpayer therefore improperly excluded return premiums from its gross receipts calculation, and the IRS concluded that Taxpayer is required to file Forms 1120-PC for any years in which it did not qualify for exemption.

Section 115

In dual Private Letter Rulings, PLR 201120005 and PLR 201120006, the IRS ruled that income derived from the exercise of an essential governmental function, accruing to a state political subdivision, was excludable from gross income under Section 115 of the Internal Revenue Code.

Taxpayer is a state non-profit corporation that was formed as one of three successor organizations to the Plan. The Plan, an unincorporated association formed pursuant to Statute, served as a joint self-insurance pool for its political subdivision members. The Plan subdivided its functions in order to avoid cross-liability between its three joint self-insurance lines: Entities A, B, and C. While Entity A served as an overseer of the other two organizations and had no

members, Entity B was a joint property & casualty (P&C) self-insurance pool and Entity C was a joint healthcare self-insurance pool. The joint nature of entities B and C allowed its members to pool resources to obtain insurance coverage at a level no single member could afford to do individually. Both Entities B and C had members that were political subdivisions or entities of which income was excludable under Section 115. The IRS ruled that the income of Entities B and C was derived from the exercise of an essential governmental function and would accrue to a state or a political subdivision, making Entity B's and C's income excludable from gross income under Section 115(1).

HMO

In TAM 201117027, the IRS ruled that a health maintenance organization (HMO) that contracts with various healthcare provider networks under capitation agreements was taxable as an insurance company for federal income tax purposes. Taxpayer was a managed healthcare organization owned by four healthcare associations and did not directly provide healthcare services to its subscriber members. Instead, Taxpayer contracted with networks that arranged for the provision of healthcare services through participating healthcare providers.

In the TAM, the IRS said that these capitation arrangements were comparable to reinsurance contracts, and as such did not take the primary insurer out of the insurance business. Since Taxpayer paid its provider network on a capitated basis, the risk of loss did not shift to the provider network. The TAM held that "Absent a legitimate assumption reinsurance agreement, Taxpayer remained the party responsible to the members of the subscriber group for the provision of health care services in the form of insurance." Consequently, Taxpayer was subject to the provisions of Subchapter L of the Internal Revenue Code and taxable as an insurance company for federal income tax purposes.

Information reporting

Foreign Account Tax Compliance Act (FATCA)

In March 2010, FATCA became law. In Notice 2010-60, the IRS provided initial insights into how the US Treasury and IRS are approaching certain sections of FATCA, included in the Hiring Incentives to Restore Employment (HIRE) Act passed in March 2010. The purpose of the preliminary guidance was to ensure that affected persons have time to implement the systems and processes necessary to comply fully with the new withholding, documentation, and reporting obligations resulting from FATCA.

On July 14, 2011, IRS Notice 2011-53, which superseded IRS Notice 2010-60, provided a timeline for foreign financial institutions and US withholding agents to implement the various requirements of FATCA. Recognizing the significant implications of these requuirements, PwC has published whitepapers for the insurance industry on FATCA. Here's a look at the most recent whitepaper: *How do the proposed FATCA regulations impact Insurers?*

FATCA proposed regulations released on February 08, 2012

Among the concerns addressed by the proposed regulations were the expansion of the definition related to grandfathered obligations and the clarified definitions around financial account and account holder. Although these regulations are only proposed, they appear to provide sufficient guidance for insurers to determine what products are in scope, identify the process and system changes that will need to be made, and enable insurers to develop a communication plan with customers and distribution networks in order to address the looming effective dates of these rules.

Click here http://www.pwc.com/us/en/financial-services/what-is-fatca.jhtml to access PwC thought leadership on FATCA.

Non-application of Section 6050W

In Notice 2011-78, the IRS announced that it will amend the existing regulations under Section 6050W to expressly provide that an insurance company or an affiliate administering a self-insured arrangement on behalf of an employer or other entity on a cost-plus basis, or under an Administrative Services Only (ASO) plan or an Administrative Services Contract (ASC) plan, will not be treated as a third-party settlement organization. Insurance companies and their affiliates may rely on the interim guidance provided in Notice 2011-78 until the regulations are amended.

In August 2010, the IRS and Treasury issued final regulations [T.D. 9496] relating to information reporting requirements, information reporting penalties, and backup withholding requirements for payment card and third-party network transactions pursuant to Section 6050W. Under the final regulations, a healthcare network is generally treated as outside the scope of Section 6050W because a healthcare network does not enable the transfer of funds from buyers to sellers.

Unemployment insurance payments

In PLR 201147014, the IRS ruled that an insurer is required to file an information return for supplemental unemployment insurance benefits exceeding $600 paid to an insured, and must furnish payee a statement. For example, take the case of Company, a property and casualty insurer. Among the types of insurance, Company sells supplemental unemployment insurance. Company represents that it pays "supplemental unemployment benefits" to insured individuals for periods of involuntary unemployment. The benefits under the policy supplement public unemployment benefits paid by the State.

Section 6041(a) requires anyone "engaged in a trade or business and making payments in the course of such trade or business to another person, of $600 or more in any taxable year" to file an information return with the IRS. However, the information reporting requirement of Section 6041 applies only to payments made during the calendar year that are "fixed or determinable income." According to the IRS, while any accession to wealth is generally income, not all income is fixed or determinable. If a payor cannot determine either that a payment is in the nature of income or in what amount, then the payor is not required to file an information return under Section 6041(a).

In this example, Company is required to file an information return because the benefits paid to the insureds are fixed and determinable income. Company knows when it pays the benefits, which are paid in predetermined or "fixed" amounts, and that the benefits are entirely income. Company also knows the amount of the income to be paid.

Reporting of cash payments

In ECC 201104036, the IRS stated that an insurance company must file a Form 8300, Report of Cash Payments Over $10,000 Received in a Trade or Business, for related transactions occurring within a 24-hour period and in cases where an individual buys an insurance policy and an annuity as part of a single estate plan. Using two examples, the IRS gave its views on whether the identified transactions required a Form 8300 to be filed:

In example 1, according to the IRS, under Treas. Reg. § 1.6050I-1(a)(1)(i), any persons who receive more than $10,000 in a single transaction or in two or more related transactions while conducting their trade or business must file a Form 8300. Related transactions are transactions between a buyer (or other payer), or agent of the buyer, and a seller (or other business) that occur within a 24-hour period (Treas. Reg. § 6050I-1(c)(7)(ii)). In addition, transactions more than 24 hours apart are related if the recipient of the cash knows, or has reason to know, that each transaction is one of a series of connected transactions. Here, the transactions occurred in a 24-hour period. As such, the IRS determined that the transactions are related and that the insurance company would be required to file one Form 8300.

In example 2, the IRS described related transactions as transactions between a buyer, or agent of the buyer, and a seller that occur within a 24-hour period. In addition, Treas. Reg. § 6050I-1(c)(7)(ii) states in part that transactions more than 24 hours apart are related if the recipient of the cash knows, or has reason to know, that each transaction is one of a series of connected transactions. According to the IRS, in this case, a single premium annuity and a life insurance policy were purchased on the same day. As such, by definition,

the purchases are related transactions. A business receiving more than one cash payment for related transactions must report the multiple payments any time the total amount received exceeds $10,000 in cash within a 12-month period (Treas. Reg. § 1.6050I-1(b)). Therefore, the IRS concluded that the insurance company would be required to file a Form 8300 for these transactions. Hence, taxpayers with related transactions occurring within a 24-hour period should examine their particular set of facts and consult their tax professionals to determine whether a Form 8300 is required.

Investor control

In PLR 201105012, the IRS ruled that, for federal income tax purposes, a life insurance company that issues deferred and immediate variable annuity contracts, and not the annuity contract holders individually, will be treated as the owner of the underlying investments because only the insurer has sufficient incidents of ownership over the assets. For example, Taxpayer, a licensed insurance company, is a wholly owned subsidiary of Parent, a stock life insurance company. Taxpayer issues deferred and immediate variable annuity contracts (the Contracts) that offer both fixed and variable investment options. In the case of the variable investment options, the portion of a net premium allocated to such options under a Contract is held in the Separate Account, the assets of which are allocated into subaccounts, which, in turn, invest into a corresponding mutual fund, a Lifecycle Insurance Fund. The Lifecycle Insurance Fund intended to invest assets in regulated investment companies (RICs) that were group managed (public funds) and in group managed RICs and partnerships (central funds).

After reviewing the facts, the IRS ruled that a Lifecycle Insurance Fund's investment in public or central funds will not cause the contract owners to be treated as owners of shares of the Lifecycle Insurance Fund for tax purposes. The IRS reasoned that the contract owners did not have sufficient investment control or other incidents of ownership over the underlying assets in the lifecycle subaccounts to be considered their owner.

Net operating losses

Dual consolidated losses

In a generic legal advice memorandum (AM 2011-002) issued on August 1, 2011, the IRS Office of Chief Counsel addressed whether a dual consolidated loss (DCL) incurred by a hybrid entity separate unit may be taken into account in determining US consolidated taxable income (CTI) in the taxable year in which the DCL was incurred, absent a domestic-use election. The AM concludes that in a fact pattern where the separate unit incurs a DCL in a tax year in which it has a positive separate return limitation year (SRLY) Cumulative Register (and the consolidated group has positive income), the DCL incurred by the separate unit may be used on a current basis without entering into a domestic-use election.

Original issue discount

The IRS issued Rev. Rul. 2011-15, concluding that the 1994 final regulations concerning original issue discount (OID) rendered Rev. Rul. 58-225 obsolete. Rev. Rul. 58-225 concludes that interest collected in advance by a life insurance company on policyholder loans (prepaid interest) constitutes taxable income in the year received.

Under the final OID regulations published in 1994, a payment of an amount designated as "prepaid interest" is not includible in the holder's taxable income in the year received. Instead, Section 1.1273-(2)(g) of the final OID regulations provides that a payment from the borrower to the lender (other than a payment for property or for services provided by the lender…) reduces the issue price of the debt instrument evidencing the loan. The adjustment functions to increase the spread between the amount loaned and the amount due at maturity and is included in taxable income as OID over the life of the loan using a constant yield methodology. For this reason, the final OID regulations rendered Rev. Rul. 58-225 obsolete.

Policyholder dividend deduction

In a case involving New York Life Insurance Co.'s request for a refund of approximately $100 million in taxes, a US District Court judge concluded that New York Life failed to properly show that the claimed deductions for policyholder dividends were, in fact, not contingent liabilities. The court ruled that New York Life's internal accounting practices do not fix liability for purposes of the all-events test and that, despite the fact that New York Life paid all dividends that had been credited to an account, the company was unable to support that it was required to do so. The Court concluded that New York Life's obligation to pay arose only if the policy had not been terminated prior to its anniversary and it was merely "contingent" prior to that date. Since the all-events test was not satisfied, the Court ruled that it need not evaluate the other two conditions that must be satisfied to qualify for deductibility and the case was dismissed.

Policyholder Taxation

In INFO 2011-0054, the IRS explained that it does not agree with the holding of Fisher v. United States and therefore will not issue refunds to taxpayers who paid tax on sales of stock received in a demutualization pending resolution of the issue.

Products

Annuities

PLR 201105004

The IRS ruled that a certificate issued by a life insurance company through a wholly owned subsidiary to the owners of managed investment accounts will be considered an annuity contract within the meaning of Section 72 for federal income tax purposes, and would be eligible for the life insurance products exemption from the Section 475 mark-to-market rules. The IRS reviewed the structure of the transaction in twin rulings aimed at the investor and the life insurance company, and independently addressed (1) the application of the annuity rules and concluded that the Certificate is in fact an annuity and will be treated as such, and (2) that it will not be subject to the mark-to-market rules, as it falls within the life insurance exception to those rules.

Massachusetts Mutual Life Insurance Company v. United States

In February 2012 the United States Court of Federal Claims ruled that the plaintiff, Massachusetts Mutual Life Insurance Company is allowed a deduction for the declared guaranteed minimum amount of policyholder dividends in the year of declaration.

Conclusions of the IRS included:

- A Group Contract that is participated out to Account Owners through Certificates is considered an annuity under Section 72, giving rise to life insurance income for the Issuer and receipt of annuity income by the Account Holder.
- The expansion of the definition of an annuity provides greater flexibility to qualify and classify instruments as insurance products under Section 72.
- Because the Certificates are annuities under Section 72, the Issuer is not subject to the mark-to-market rules, as the annuity is an excluded life insurance product.
- Certificates are subject to the deduction for losses that are not reimbursed under Section 165(a), as the annuity is not insurance for the underlying assets, nor is it considered to reimburse the Account Owner.

PLR 201128017

The IRS ruled that contracts that require an insurance company to pay a benefit to an owner of an investment account if the value of the account falls below a specified amount will be treated as an annuity contract. In this case, Taxpayer is an insurance company taxable under part I of subchapter L of the Internal Revenue Code. Taxpayer plans to offer contracts to customers with an ownership interest in investment accounts at a financial institution. The contracts would obligate Taxpayer to pay the customers a benefit for the covered lives if the value of the account falls below a specified minimum while the contract is in force. To keep the contract in force, the customer must pay a fee and the account must at all times be invested consistent with the current permitted investment profile. The fee for the contract is imposed quarterly, resulting from the application of a formula. The IRS examined whether the contracts will be treated as an annuity within the meaning of Section 72.

Regulation Section 1.72-2(a)(1) provides that the contracts under which amounts paid will be subject to the provisions of Section 72 include contracts that are considered to be life insurance, endowment, and annuity contracts in accordance with the customary practice of life insurance companies. Under Section 1.72-1(b) and (c), as a general rule "amounts received as an annuity" are amounts that are payable at regular intervals over a period of more than one full year from the date on which they are deemed to begin.

The IRS determined that the contracts and the amounts paid under them meet the requirements of an annuity contract and annuity payment as provided by Section 1.72-1(b) and (c), 1.72-2(a)(1) and (b)(3), and 1.72-4(b)(1). The IRS stated that the contract is purchased "by making periodic payments" of premium for "a promise by a life insurance company to pay the beneficiary a given sum for a specified period …", and is "used to provide long-term income security." Moreover, the IRS said that the contracts had "the determining characteristic…that the annuitant has an interest only in the periodic payments and not in any principal fund or source from which they may be derived."

Revenue Procedure 2011-38

This Revenue ruling is a modification to prior guidance concerning partial exchanges of annuity contracts. The revenue procedure provided that the direct transfer of a portion of the cash surrender value of an existing annuity contract for a second annuity contract will be treated as a tax-free exchange under Section 1035 if no amount, other than an amount received as an annuity for 10 years or more or during one or more lives, is received under the original contract or the new contract during the 180 days beginning on the date of the transfer. A subsequent direct transfer is not taken into account if it qualifies as a Section 1035 tax-free exchange. Other transactions will be characterized consistent with their substance.

Notice 2011-68

The IRS provided interim guidance on the application of amendments made by the Pension Protection Act of 2006 (PPA) to qualified long-term care insurance, annuity, and life insurance contracts, and requested comments on certain other issues to be addressed in future guidance concerning the taxation of annuity and life insurance contracts with a long-term care insurance feature.

The PPA amended Section 72(e) by adding a new paragraph, Section 72(e)(11). Section 72(e)(11) provides that a charge against the cash value of an annuity contract or the cash surrender value of a life insurance contract made as payment for coverage under a qualified long-term care insurance contract that is part of or a rider to the annuity or life insurance contract is not includible in income. The investment in the contract is reduced (but not below zero) by the charge.

The IRS believes that all premiums paid for a combination contract that is an annuity and also provides long-term care insurance are generally included in investment in the contract under Section 72 if: (1) the premiums are credited to the contract's cash value (rather than directly to the long-term care insurance contract that is part of or a rider to the contract); and (2) coverage under the long-term care insurance contract is paid for by charges against the cash value of the contract. Thus, a waiver of premiums under such a contract, such as due to disability or because the annuitant has become chronically ill, should be accounted for in the same manner as a waiver of premiums under other contracts for which "investment in the contract" is determined under Section 72(c)(1) or 72(e)(6).

The amendments made by the PPA are effective generally for contracts issued after December 31, 1996, but only with respect to tax years beginning after December 31, 2009. The amendments relating to tax-free exchanges apply with respect to exchanges occurring after December 31, 2009.

Cash surrender value

In PLR 201137008, the IRS stated that for purposes of the necessary premium test under Section 7702A(c)(3)(B)(i), a life insurance company's reasonable expense charges are taken into account when determining the deemed cash surrender value of a policy intended to satisfy the cash value accumulation test under Section 7702(b).

Long-term care rider

In PLR 201105001, the IRS ruled that a long-term care benefits rider added to single premium deferred fixed annuity contracts and flexible premium deferred variable annuity contracts offered by a stock life insurance company will be treated as an insurance contract under Section 7702B(b)(1). In this case, Taxpayer is a stock life insurance company taxable under Section 801 and is the issuer of certain annuity contracts, which include a single premium deferred fixed annuity contract and a flexible premium deferred variable annuity contract. Taxpayer proposes to offer a rider option (Rider) for these contracts to provide certain long-term care benefits during the time the person covered by the Rider is a chronically ill individual with the meaning of Section 7702B(c)(2) and receiving qualified long-term care services within the meaning of Section 7702B(c)(1) through the agency or facility identified in the plan of care.

The IRS ruled that the insured has a risk of economic loss if that person suffers "prolonged morbidity," meaning that he/she becomes chronically ill. Through the Rider, the Taxpayer assumes the risk that the insured will be eligible for long-term care benefits. The risk assumed by Taxpayer will be distributed across the large number of insureds who purchase the Rider. The Rider conforms to the definition of insurance in the commonly accepted sense. Accordingly, the IRS concluded that the Rider constitutes an insurance contract for purposes of Section 7702B(b)(1).

Tax-free exchanges

In Rev. Rul. 2011-09, the IRS addressed whether life insurance contracts received in tax-free exchanges must be re-tested under the pro rata interest expense disallowance rule of Section 264(f)(1). The IRS concluded that when a tax-free exchange of life insurance contracts occurs, the new contract must be tested to determine if it qualifies for an exception to the pro rata interest disallowance rule under Section 264(f)(1). The rule denies a deduction for the portion of the taxpayer's interest expense that is allocable to unborrowed policy cash values.

Reserves

Loss discount factors

Rev. Proc. 2011-53 sets forth for purposes of Section 846 the loss payment patterns and discount factors for each property and casualty line of business for the 2011 accident year. These factors are to be used by property and casualty insurance companies in discounting unpaid losses.

Rev. Proc. 2011-54 sets forth for purposes of Section 832 the salvage discount factors for the 2011 accident year that must be used for each line of business to compute discounted estimated salvage recoverable under Section 832. All the discount factors were determined using the applicable interest rate under Section 846(c) for 2011, which is 3.46%, and by assuming all estimated salvage is recovered in the middle of each calendar year.

Prevailing interest rates

In Rev. Rul. 2011-23, the IRS provided prevailing-state assumed interest rates and applicable federal rates for the determination of reserves under Section 807 for insurance contracts issued in 2010 and 2011. This information should be used by insurance companies in computing their reserves for: (1) life insurance and supplementary total and permanent disability benefits; (2) individual annuities and pure endowments; and (3) group annuities and pure endowments.

To access the IRS discount factors webpage, click here.

To access the prevailing interest rates, click here.

International

Controlled foreign corporations

The IRS solicited comments on Notice 2002-69, which provides interim guidance for determining the interest rates and appropriate foreign loss payment patterns to be used by controlled foreign corporations (CFC) in calculating their qualified insurance income under Section 954(j).

Comments were invited on:

- Whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information shall have practical utility
- The accuracy of the agency's estimate of the burden of the collection of information
- Ways to enhance the quality, utility, and clarity of the information to be collected
- Ways to minimize the burden of the collection of information on respondents, including through the use of automated collection techniques or other forms of information technology
- Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information

Domestic asset liability percentages

As it does every year, the IRS, in Rev. Proc. 2011-45, provided the domestic asset/liability percentages and domestic investment yields needed by foreign life insurance companies and foreign property and liability insurance companies to compute their minimum effectively connected net investment income under Section 842(b) for tax years beginning after December 31, 2009.

For the first tax year beginning after December 31, 2009, the relevant domestic asset/liability percentages and domestic investment yields are:

Type of Company	Domestic Asset/Liability Percentages	Domestic Investment Yields
Foreign Life Insurance Companies	143.7%	3.3%
Foreign Property and Liability Insurance Companies	190.5%	3.4%

International comparison of insurance taxation, 2011

PwC has updated its publication ***International comparison of insurance company taxation, 2011.*** It contains chapters on individual countries, each of which provide an overview of the accounting and taxation rules that apply to life and non-life insurance business in their jurisdiction. While we feel sure that you will find the overview helpful, it is intended only to give an indication of the regime applying within a country.

Excise tax

The IRS Small Business/Self-Employed Division recently reissued interim guidance SBSE-04-1210-073 on referrals of cases involving a captive foreign insurance subsidiary to the IRS's International Excise Tax Group for examination. Clarifying language has been added to the interim guidance requesting information on controlled industry case and closing agreements.

According to the Notice, when a case involving a foreign captive insurance entity arises, the Excise Tax Examiner must obtain the following information, to be forwarded by e-mail to the International Excise Tax Group through the Examiner's Group Manager:

- Name and employer ID number (EIN) of parent company (or entity currently under audit) and indicate whether the parent company is a Coordinated Industry Case (CIC) (if known)
- Full name and EIN of the captive subsidiary
- Location or country of domicile of the captive subsidiary
- Amount of premiums insured with the captive subsidiary
- Amount of premiums reinsured by the captive subsidiary to reinsurance companies (if known)
- Whether the captive subsidiary has a Section 953(d) election (if known)
- Whether the captive subsidiary has a Closing Agreement (CLAG) (if known)

A determination will be made within 10 days of receipt. Any examination to be conducted by an International Excise Group Agent will be coordinated with the Excise Tax Examiner assigned to the parent/related entity case, as well as with the CIC Coordinator assigned to the parent/related entity case, if applicable.

Foreign report reserves

In PLR 201151008, the IRS ruled that underwriting reserves and loss reserves for life insurance and annuity contracts, required to be maintained by controlled foreign corporations in annual financial statement reporting to a foreign regulatory agency, are an appropriate means of measuring income within the meaning of Section 954(i)(4)(B)(ii) and, accordingly, are the amount of reserves that may be used in determining each company's foreign personal holding company income under Section 954.

Multi-state

Federal developments affecting state taxation of insurers

Dodd-Frank Act & Non-admitted and Reinsurance Reform Act/Non-admitted Insurance Tax

Act provisions:

- No state other than the home state of an insured may require any premium tax payment for non-admitted insurance.
- Definitions:
  - "Home state" is defined as either:
    - Where an insured maintains its principal place of business
- The state assigned the greatest percentage of premium if 100% of the insured risk is outside of the state where the insured maintains its principal place of business
- "Non-admitted insurance" is any property and casualty insurance permitted to be placed directly or through a surplus lines broker with an insurer not licensed to engage in the business of insurance in a state.
  - States may enter into a multi-jurisdictional compact to administer and allocate the premium tax paid to the insured's home state.
  - The Act is generally effective 07/21/2011.
  - Nexus impacts:
    - Prior to Dodd-Frank, *Todd Shipyards* was arguably the standard that states used as a basis for determining nexus for non-admitted insurers. This nexus standard requires more than just the mere presence of insured property within the state in order to impose a state premium-based tax.
    - Does Dodd-Frank overturn the Due Process protection for non-admitted insurers per *Todd Shipyards?*
  - All states (excepting CO, IL, MI, SC, WI, and DC) have passed legislation to provide some degree of conformity to the Act; CO and IL have issued bulletins detailing how their current tax regimes may meet the Dodd-Frank provisions. However, state adoption has not been uniform, and conforming states are split on what multi-jurisdictional compact to join.

Multi-state developments

MTC Pass-Through Entity Tax Project

The Multi-state Tax Commission's (MTC's) continued effort to impose income tax at the flow-through entity level if at least 50% owned by and the entity is not subject to state income tax. Industry efforts to educate the MTC fell short, but a reprieve was achieved by National Association of Insurance Commissioners testimony. Recent "re-education" efforts by industry members was met with continued MTC bias that the industry was avoiding tax on activities held in flow-through entities.

Alaska

3 AAC 31.210/Insurance Fees

Alaska has repealed the retaliatory filing fee requirement for insurers. (Effective 01/01/2011)

Arizona

Letter Ruling 11-001/Income Tax

The Arizona Department of Revenue ruled that an out-of-state insurance company that is subject to and pays premium taxes to another state and is the sole member of an Arizona Single Member Limited Liability Company (SMLLC) that is disregarded for federal income tax purposes is not subject to Arizona corporate income tax. The SMLLC is not subject to Arizona's corporate income tax either. (02/08/2011)

Arkansas

H. 1912/Credits and Incentives

The expiration date has been extended to December 31, 2021 (from December 31, 2015) for the historic rehabilitation tax credit that insurance companies may apply against the insurance premium tax. (Effective 07/27/2011)

H. 1813/Reporting Requirements

Arkansas has amended the reporting requirements imposed on insurers by requiring a Market Conduct Annual Statement to be filed in electronic format with the Insurance Commissioner for property and casualty insurers reporting $7 million or more in homeowner or private passenger automobile gross premiums. (Effective 07/27/2011)

California

A 21 [Special Session]/Premium Tax

The sunset date for the California gross premium tax on Medi-Cal managed-care plans has been extended from July 1, 2011 to July 1, 2012. (Effective 09/16/2011)

Legal Ruling 2011-01/Franchise Tax

The Franchise Tax Board (FTB) held that the activities of a disregarded entity in California would cause such entity's owner to have nexus with the state. Of note, the FTB addressed the situation where a disregarded SMLLC with California business activities sufficient to constitute "doing business" in the state filed an annual California LLC Return of Income, but did not include a signed statement for its owner consenting to California's tax jurisdiction. (01/11/2011)

Board of Equalization v. State of California, California Supreme Court, No. S189996, petition for review denied 03/16/2011/Franchise Tax

The California Board of Equalization denied an appeal by Total Claims Management, Inc. for penalty abatement, because the company did not give reasonable cause for its failure to timely file a corporate income tax return and respond to demand letters.

FTB Public Service Bulletin 11-25/Franchise Tax

An upgrade to the FTB secure email service is effective November 27, 2011. The FTB has been using secure email to send encrypted confidential information to external customers since 2010, as a faster, more cost-effective and secure way to communicate information to customers. The new service provides an easier-to-use web-based interface. Current customers must reregister for secure email and will no longer have access to open secure email sent before the upgrade; they will be redirected to a website advising them to contact the sender. (11/15/2011)

Connecticut

DOR Announcement 2011(2)/Premium Tax

The announcement informs each insurer that is a member of the Connecticut Insurance Guaranty Association that on or before Monday, February 14, 2011, the member insurer must repay a portion of the December 27, 2010 refunded assessments related to Credit General Insurance Company, Reliance Insurance Company, and PHICO Insurance Company. (Effective 01/18/2011)

S. 1001/Credits and Incentives

The Department of Economic and Community Development has been authorized to establish a "First Five" program to encourage business expansion and job creation. The Department may provide substantial financial assistance to up to five eligible business development projects in each of the fiscal years ending June 30, 2012 and June 30, 2013. (Effective 07/01/2011)

H. 6525/Credits and Incentives

Insurers may transfer the insurance investment fund credit against insurance premiums taxes to an affiliated business or entity. (Effective 07/08/2011)

H. 6652/Credits and Incentives

Applicable to calendar years 2011 and 2012, the premium tax credit cap is revised to classify digital animation credits as type 1 credits (70% cap), insurance reinvestment fund credits as type 2 credits (55% cap), and all other credits as type 3 credits (30% cap). Depending on the mix of credits used, the cap on available offset is 30%, 55%, or 70%. The prior flat cap of 70% will be reinstated in 2013. (Effective 06/21/2011; also see S.1239)

Special Notice 2011(19)/Credits and Incentives

Discusses the 2011 legislation limiting the application of credits against the insurance premiums tax. For calendar years 2011 and 2012 only, the amount of tax credit or credits otherwise allowable against the insurance premiums tax for any calendar year may generally not exceed the 30% threshold. For purposes of the tax credit cap, general business tax credit or credits do not mean and include the guaranty association assessment offsets. The Special Notice explains the tax cap expander and exceptions to the tax credit cap. (12/29/2011)

Special Notice 2011(7)/General Tax

Notified taxpayers that under new electronic payment rules effective for tax periods beginning on or after January 1, 2012, taxpayers will now have additional time to initiate their electronic funds transfer (EFT) tax payment without the payment being treated as late. Under legislation passed earlier this year (2011 Conn. Pub. Acts 61, Section 65), all electronic filing payments will be considered on time as long as they are made before midnight on the day they are due. Previously, a payment was considered on time if the money was credited to the DRS bank account on the due date. Depending on the EFT payment method used by the taxpayer and their financial institution, some taxpayers would have to make payments days in advance to ensure DRS received it on time, the agency said. (12/29/2011)

Delaware

Insurance Commissioner of State of Del. v. Sun Life Assurance Co., Del. S. Ct., Dkt. No. 535, 2010, 05/13/2011/Premium Tax

The Delaware Supreme Court, reversing a decision by the Superior Court, has denied the taxpayer, a Delaware insurance company, a refund of gross premium taxes it paid on employer- and trust-owned life insurance policies issued pursuant to separate private placements. The court accepted the Delaware Department of Insurance's position that the term case included only those policies issued to participants in a single private placement. Consequently, the taxpayer could not aggregate seven insurance policies that it had issued via separate private placements into one case.

S. 109/Surplus Lines Tax

Delaware enacted an increase in the premium tax on brokers of surplus lines insurance from 1.75% to 2% on policies that are placed or procured in Delaware. (Effective 08/16/2011)

Florida

Rule 12-24.003/Premium Tax

Online filing is available on the Department of Revenue's (DOR's) website for the Insurance Premium Taxes and Fees Return (DR-908) and the Insurance Premium Installment Payment (DR-907). As of January 1, 2011, insurers that paid $20,000 or more in insurance premium taxes and fees in the prior fiscal year would have been required to file and pay electronically. After being pressured by the trade associations, the DOR issued a Notice of Change for Rule 12-24.003 allowing insurers to request a waiver from hand-entering premium tax return information. (Effective 01/01/2011)

H. 7185/Income Tax

The corporate income tax exemption has been increased from $5,000 to $25,000 as of tax year 2012. (Effective 01/01/2012)

Emergency Rule 12ER11-01/Credits and Incentives

The rule establishes procedures governing the Florida Tax Credit Scholarship Program, which allows taxpayers to receive a credit against premium and income taxes. (Effective 01/21/2011)

Tax Information Publication 10(B)8-05: Credits and Incentives

The publication provides guidance concerning the repeal of the certified capital company investment credit. (04/21/2011)

Admin. Code § 12-29.001–12-29.003/Credits and Incentives

Several new rules concerning the tax credit scholarship program that provide for the administration of tax credits for contributions made to non-profit scholarship funding organizations under the Florida Tax Credit Scholarship Program. The rules discuss: (1) the taxpayers eligible to participate in the program; (2) how to apply for and claim the credit; (3) procedures to carry forward a tax credit for a period of up to three years; and (4) applications used by the Department in the administration of the Florida Tax Credit Scholarship Program. (Effective 06/06/2011)

H. 965/Credits and Incentives

Revises provisions relating to the amount of a tax credit allowed for a contribution made to an eligible non-profit scholarship-funding organization. The amended law eliminates the current restriction in the program which

provides that the corporate income tax credit and insurance premium tax credits for contributions to scholarship funding organizations may not exceed 75% of the taxpayer's tax due for the taxable year. (Effective 07/01/2011; DOR Tax Information Publication 11ADM-02, July 15, 2011, provides further information and guidance)

Georgia

H. 346/Credits and Incentives

The premium tax credit for clean energy property is extended to property placed into service up to 2014. Credit may not be taken for the year when the property is placed in service but must be taken in four equal installments over four successive taxable years. Total credits must not exceed $5 million each for taxable years 2012, 2013, and 2014. (Effective 01/01/11)

Idaho

H. 240/Premium Tax

Idaho has temporarily reduced the workers' compensation insurance premium tax on insurance companies and self-insured employers from 2.5% to 2.0% for calendar years 2012 and 2013. Additionally, the deduction for insurers on payments of the workers' compensation premium tax is permanently modified to 50% of the premium tax paid, which previously was 1.3% of the premium written. (Effective 07/01/2011)

Illinois

S. 2505/Income Tax

The tax rate on corporations, including insurers, is increased as follows (corporations remain subject to the 2.5% property replacement tax):

- 2011–2014 7.0%
- 2015–2024 5.6%
- 2025 and forward 4.9% (i.e., the pre-legislation rate)

The measure also suspends the use of net operating losses (NOLs) generated in tax years 2003 and forward for usage in tax years 2011–2014. It adds an additional four years of carryforward to any suspended year. (Retroactively effective 01/01/2011)

S. 397 [Special Session]/Income Tax

Includes numerous provisions and clarifications, including: (1) on July 1, 2013, an Independent Tax Tribunal Board is to assume all rights and powers pertaining to the protest of notices of tax liabilities or deficiencies for all taxes administered by the Department of Revenue (DOR), replacing the current Administrative Hearings; (2) reinstates and extends the R&D credit for five years, to tax years ending prior to January 1, 2016; (3) revises the NOL suspension to permit an NOL carryover deduction for tax years ending on or after December 31, 2012, but caps the deduction at $100,000 for all tax years ending prior to December 31, 2014; (4) extends by five years any tax credit or deduction scheduled to expire under the statutory automatic sunset provision in 2011, 2012, or 2013. (Passed, effective as noted)

H. 2955/Income Tax

Apportionment for reinsurers is now permitted under the pre-2008 allocation methods (allocate to the ceding insurer's home state or allocate on a look-through basis to the ceding insurer's Schedule T) but would lock in the method thereafter. Additionally, defines the term "holding company," updates the statute to permit allocation of a holding company parent between insurance and non-insurance subsidiary groups via gross receipts or other reasonable method, and specifies that apportionment for the holding company take on the same apportionment factor basis as the group it is included in. (Effective 08/23/2011)

General Information Letter IT 11-0019-GIL/Income Tax

The DOR stated that insurance companies, whether domiciled in state or out of state, were not exempt from Illinois income taxation. The DOR pointed out that the law related to the apportionment formula for insurance companies was the same whether an insurance company is domiciled in Illinois or outside Illinois. However, an insurance company formed under the laws of another state that imposes a retaliatory tax on Illinois insurance companies may reduce the otherwise-applicable income and replacement tax rates. The rate is reduced such that the total amount of Illinois income and replacement tax imposed on the foreign insurance company is equal to the amount of income tax that its home state would have imposed on its Illinois income, but cannot reduce the overall state tax burden below 1.75% of taxable premium. (09/30/2011)

Indiana

United Parcel Service Inc. v. Department of Revenue, 49T10-0704-TA-24, 940 N.E.2d 870, 12/29/2010 [non-published opinion]/Premium Tax

The Indiana Tax Court originally held that a delivery service company properly excluded two foreign reinsurance companies from its corporate income tax returns because the reinsurance companies were subject to the gross premium privilege tax. The Indiana Supreme Court has granted acceptance of UPS's request for petition for review on December 1, 2011. Indiana Supreme Court Case Number is: 49T10-0704-TA-00417. (Oral arguments held 12/21/2011)

H. 1004/Income Tax

Makes several applicable tax changes: (1) decreases the state corporate income tax rate over four years, as follows: before July 1, 2012, 8.5%; before July 1, 2013, 8.0%; July 1, 2015, 7.0%; and after June 30, 2015, 6.5%; (2) eliminates the net operating loss carryback after 2011; (3) imposes tax on interest income for investment companies from state and local bonds issued by other states for investments after December 31, 2011; and (4) repeals various tax credits over multiple periods. (Effective as noted)

Letter of Findings No. 02-20100739/Income Tax

The Indiana Department of Revenue issued a letter ruling that, for corporate income tax purposes, extended warranty providers are classified as insurance businesses rather than service providers. (06/29/2011)

Iowa

S. 302/Credits and Incentives

Increases the aggregate tax credit amount under the Endow Iowa program from $2.7 million to $3.5 million. The Endow Iowa credit can be applied to the premium tax. (Effective retroactively to 01/01/2011, for tax credits authorized on or after that date)

S. 521/Credits and Incentives

Provides that the historic preservation and cultural and entertainment district tax credit applies if there are "substantial rehabilitation" costs incurred for the qualified property, which means qualified rehabilitation costs that meet or exceed the costs totaling at least 50% of commercial property's assessed value, excluding the land, before the rehabilitation. This bill repeals a provision that for property classified as residential or commercial with multifamily residential units, the rehabilitation costs could not exceed $100,000 per residential unit. Additionally, this bill lengthens the period during which eligible property must be placed in service to 60 months after the project application approval date [previously 36 months]. (Effective retroactively to 07/01/2009 for projects approved and tax credits reserved on or after that date)

S. 260/Insurance Administration

Iowa has eliminated the transfer tax imposed on insurance companies organized in other states that elect to become domestic insurers in Iowa and have created or will create jobs in Iowa. Before its repeal, the transfer tax collected was equal to 25% of the Iowa premiums tax paid for the preceding year or $10,000, whichever was less. (Effective 07/01/2011)

Kansas

H. 2339: Premium Tax

Made technical changes to the Emergency Medical Services Board tax paid by fire insurance companies doing business in Kansas. (Effective 07/01/2011)

Kentucky

Kentucky Tax Alert 2/Non-admitted Insurance Tax

Clarifies that the Surplus Lines Insurance Multi-State Compliance Compact will not immediately impact the current premium surcharge tax rate of $1.80 per $100 of premiums. (05/01/2011)

H. 1 [Special Session]/Municipal Premium Tax

Provides that no municipal premium tax or fee applies to premiums paid by non-profit self-insurance groups whose membership consists of cities, counties, charter county governments, urban county governments, consolidated local governments, school districts, or any other political subdivisions of the Commonwealth. (Effective 03/25/2011)

Bulletin 2011-01/Municipal Premium Tax

Notifies insurers of requirements for the filing and payment of local government premium taxes. Includes details on the determination of tax liability, tax credits, requirements for disclosures to policyholders, tax on life insurance, and exemptions from tax liability. Replaces Bulletin 2010-04. (04/06/2011)

DOI Advisory Opinion 2011-03/Municipal Premium Tax
Municipal premium tax advisory opinion stating that risk-retention groups are subject to the tax; captive insurers are exempt from the tax; and reinsurance companies are exempt from the tax except for their direct written premiums. Additionally, all reinsurance companies holding a certificate of authority are responsible for filing applicable local government premium tax reports, even if the reinsurance company did not directly underwrite any business under the company's lines of authority. (05/25/2011)

Regulation 806 KAR 2:150/Municipal Premium Tax
Clarifies that the maximum fee to be retained by an insurance company as compensation for collecting local government premium tax is set forth in KRS 91A.080(4). (Effective 06/03/2011)

Louisiana

***UTELCOM. Inc. and UCOM, Inc. v. Department of Revenue,* La. Ct. of App., Dkt. No. 535, 407, Division "D", September 12, 2011 (unpublished as of January 2012)/ Income Tax**
The Louisiana Court of Appeals held that mere passive ownership of an interest in a limited partnership that conducts business in Louisiana, by itself, was not sufficient to subject the foreign corporate limited partner to Louisiana franchise tax.

Maine

H. 1109/Premium Tax
Creates a statutory framework within which service contracts are defined and regulated, including rules on when insurance premium taxes apply. The provider fees collected on service contracts are not subject to premium taxes. However, premiums for reimbursement insurance policies are subject to premium taxes. (Effective 1/1/2012)

Rule 102/General Tax
The scheduled reduction of the threshold for electronic payment of taxes is phased down from $25,000 to $18,000, effective January 1, 2011, with further reduction in subsequent years. (Effective 08/23/2010, with scheduled annual reductions in the threshold until tax year 2015)

H. 993/Non-admitted Insurance Tax
Provides that all gross direct insurance premiums and annuity considerations paid to insurers that do not have certificates of authority to do business in Maine are subject to taxation if Maine is the insured's home state. Note that this is an exception to the normal legislative efforts on Dodd-Frank conformity, as annuities are generally not discussed. (Effective 04/16/2011)

Maryland

H. 72/Premium Tax
Provides that the Injured Workers' Insurance Fund is subject to the tax on all new and renewable gross premiums that are allocable to Maryland. (Effective 06/01/2011)

H. 173/Credits and Incentives
Creates InvestMaryland, which offers insurance premium tax credits at a discounted rate of 70% of the credits' value, with the possibility of a different rate if warranted by market conditions. Allows for a maximum of $100 million in credits and requires a minimum investment of at least $1 million worth of credits, which are claimed in tax years 2015 through 2019 at 20% per year. Unused credits can be carried forward indefinitely and used without the 20% restriction after 2019. (Effective 07/01/2011)

H. 601/Credits and Incentives
The Director of the Maryland Historical Trust is now allowed to accept a sustainable-communities tax credit application for a commercial rehabilitation in which the proposed rehabilitation work has begun, if the work has been approved under the federal historic tax credit. The credit is applicable against the premium tax. (Effective 07/01/2011)

H. 877/Credits and Incentives
Replaces obsolete references to "designated neighborhood" with "sustainable community" for purposes of the sustainable-communities tax credit, applicable against the premium tax. (Effective 06/01/2011)

H. 1196/Credits and Incentives

Maryland has increased the fee that the Director of the Maryland Historical Trust is authorized to charge for certifying historic structures and rehabilitations from a maximum of 1% to a maximum of 3% of the amount of the initial credit certificate issued. The tax credit of 25% of qualified rehabilitation expenditures for certified historic structures and high-performance buildings and the tax credit of 10% of qualified rehabilitation expenditures for qualified rehabilitated structures are applicable only to commercial rehabilitations. (Effective 07/01/2011)

Michigan

S. 348/Health Assessment

Replaces the state's use tax on Medicaid managed-care entities with a 1% assessment on most paid health insurance claims. Technically, the new assessment is not considered a tax for the purposes of the insurance taxes collected under the state's insurance laws. Revenue collected from the assessment would be deposited in the health insurance claims assessment fund, which would be used to support the Medicaid program. (Effective 01/01/2012)

DOR Notice/Health Assessment

All payments for the 1% health assessment under the HICA Act are required to be remitted to the Michigan Department of Treasury by electronic funds transfer (EFT). Quarterly payments are due April 30, July, 30, October 30, and January 30. In order to be registered to make payments by EFT, a taxpayer must complete and submit Form 4926, Electronic Funds Transfer Application — Health Insurance Claims Assessment, to the treasury. An EFT application could take at least four weeks to process. An annual return must be filed using an online interface to e-file directly to the treasury. The first annual return for tax year 2012 is due February 28, 2013. The annual return will be available at a later date and will be posted on the treasury's website. (10/20/2011; updated 11/03/11)

Self-Insurance Institute of America v. Snyder, No. 2:11-15602 (E.D. Mich. filed Dec. 22, 2011)/ Health Assessment

The Self-Insurance Institute of America Inc. filed a complaint in federal district court requesting a declaration that Michigan's new assessment on most paid health insurance claims is pre-empted by ERISA and violates the US Constitution's supremacy clause. The non-profit trade association also is seeking an injunction against Michigan's enforcement of the new law.

H. 4361/H. 4362/H. 4479/Income Tax

Repeals the Michigan Business Tax and replaces it with a 6% income tax on corporations. Nexus standards, apportionment (single-sales factor), and sourcing methodology (market sourcing) will generally remain the same. Insurance and financial institutions will retain their same basic tax structure. (Effective 01/01/2012)

S. 366/Income Tax

Defines a corporation as a taxpayer that is required or has elected to file as a C corporation, and would refer to a "person" instead of a "taxpayer." (Effective 01/01/2012)

S. 653/Income Tax

Amends the definition of a flow-through entity for purposes of the new corporate income tax. (Effective 01/01/2012)

S. 368/S. 369/Michigan Business Tax

Clarifies the treatment of investment income under the former Single Business Tax and the Michigan Business Tax. (Effective 12/27/2011, but the bills indicate they will be applied retroactively with no specified starting date)

Notice to Taxpayers/Michigan Business Tax

A third revised clarification to taxpayers, providing that disregarded entities for federal tax purposes, including SMLLCs or qualified subchapter S susidiaries, now have until July 1, 2012 to file a separate return (or file as a member of a unitary business group, if applicable) for Michigan Business Tax purposes. (11/15/2011)

Minnesota

DOR Notice/Insurance Assessment

As of June 1, 2011, property and casualty insurance companies must report and pay a 2% surcharge on insurance coverage written on property located within the City of Rochester city limits. The 2% firefighter relief surcharge applies to all fire, lightning, and sprinkler-leakage premiums written on property located in a first-class city within Minnesota. First-class cities are generally defined as those having populations greater than 100,000. (05/10/2011)

Mississippi

H. 1528/Credits and Incentives

Provides a premium tax credit for insurance companies that invest designated capital in Mississippi small business investment companies for investment in qualified businesses of 80% of the participating investor's investment. A participating investor can annually claim the credit in an amount equal to 16% of the participating investor's investment of designated capital for the 2014, 2015, 2016, 2017, and 2018 taxable years, and the excess credit can be carried over for five years from the date the credit is earned. (Effective 07/01/2011)

AG Opinion No. 2011-00429/Surplus Lines Tax

Clarifies that the surplus lines insurance producer and not the insured is responsible for the surplus lines tax. Additionally, specifies that the Department of Finance has no authority to make additional payments for the surplus lines insurance producer's taxes once the policy premium amount has been set. The conclusion notes that tax and other costs of conducting business may be factored into the amount of a proposed premium when a producer submits a proposal or quote to a party seeking insurance and if originally contracted to pay a higher premium amount that included consideration of the premium tax to be paid by the producer, then the governmental insured party would be authorized to pay such amount. (10/14/2011)

Missouri

S. 132/Premium Tax

Clarifies that an insurance company claiming a premium tax credit or deduction must not be required to pay any additional retaliatory tax as a result of claiming such credit or deduction. (Effective 08/28/2011)

Midwest Builders' Casualty Mutual Insurance Co. v. Director of Revenue, 10-1964 RG, August 15, 2011/ Premium Tax

The Administrative Hearing Commission held that Kansas workers' compensation fund assessments are "other obligations" imposed on the insurer and therefore a legitimate home state retaliatory tax burden. The Missouri workers' compensation surcharges do not offset the Kansas workers' compensation fund assessment, as they are imposed as a policyholder surcharge.

Shelter Mutual Insurance Company v. Director of Revenue, et al., No. 09-1317 RG, December 23, 2010/ Premium Tax

The Missouri Administrative Hearing Commission has ruled that a mutual insurance company's monthly payment plan and reinstatement fees and filing charges constitute taxable premiums and that the company is not entitled to a premium tax deduction for fees paid to its accounting firm.

Private Letter Ruling LR 6612/Income Tax

The Missouri DOR ruled that an insurance company formed to offer Medicare Part D drug plans is not exempt from the corporate income tax because it is not subject to premium tax on its premium receipts from such prescription drug plans in Missouri. (04/02/2011)

New Jersey

A. 2670/Surplus Lines Tax

Provides that a domestic surplus lines insurer is considered an eligible, unauthorized insurer for purposes of writing surplus lines insurance coverage, and is subject to the 5% insurance gross premiums tax imposed on surplus lines coverage. (Effective 06/20/3011)

A. 2360/Captive Insurance Regulation

Allows New Jersey to license and regulate captives. Sets forth the initial license fee of $200 and annual renewal of $300 thereafter. The annual tax is a minimum of $7,500 and is tiered at 0.214% on the first $20 million of direct written premium 0.143% on the second $20 million, 0.048% on the next $20 million, and 0.024% on any additional premium up to a maximum tax of $200,000. (Effective 02/21/2011)

S. 2370/Credits and Incentives

Broadens the availability and revises the terms of financial assistance under New Jersey's Business Retention and Relocation Assistance Grant Program. (Effective 01/06/2011)

Nevada

DOI Bulletin 11-015/Premium Tax

Insurers doing business in Nevada are no longer required to furnish copies of their quarterly and annual premium tax returns to the Division of Insurance, as previously required by Bulletin 09-003. (11/22/2011)

State of Nevada Tax Commission v. American Home Shield of Nevada, Nev. S. Ct., Dkt. No. 55470, July 7, 2011/Premium Tax

An insurance company's refund request for insurance premium taxes erroneously paid on service contracts in 2003 and 2004 was barred by the one-year statute of limitations period. NRS § 680B.120 applies to all overpayments of insurance premium taxes and does not provide for interest on the overpayment of insurance premium taxes. Note that this case serves as the basis of contention in many Nevada premium tax audits, as the state took the position that the one-year statute of limitations was applicable to overpayment carryforwards listed on tax returns being "unperfected" refund claims. The state will now concede this position for properly documented payments and carryforwards.

Ohio

H. 58/Credits and Incentives

Allows insurance companies currently claiming the non-refundable job-retention tax credit against the insurance premium tax to claim a new, refundable job-retention tax credit. (Effective 03/07/2011)

Oregon

Standard Financial Group, Inc., v. Department of Revenue, Or. Tax Ct. Magis Div., Dkt. No. TC-MD 070881B, August 18, 2011/Excise Tax

The taxpayer corporation had to include the intercompany distribution from its wholly owned insurance subsidiary in its Oregon taxable income. Entities that engage in the insurance business in Oregon must file separate Oregon returns even if an entity is a unitary member of an affiliated group that files a federal consolidated return. Intercompany transactions between an insurance company and its unitary group are not eliminated when the insurance company is excluded from the Oregon consolidated return.

Pennsylvania

Allstate Life Insurance Company v. Commonwealth of Pennsylvania, 89 F.R. 1997, 10/15/2010/Premium Tax

At issue in the litigation is the tax offset treatment of annuity considerations under Section 1711(a) and (b) of the Pennsylvania Life and Health Insurance Guaranty Association law. The Court of Appeals has ruled that it is appropriate to calculate a tax credit separately for each type of insurance policy assessment and to include annuities in the numerator of the factor. The state has appealed the Court of Appeals decision to the state Supreme Court during 2011.

Philadelphia Bill No. 110554/Business Privilege Tax

Makes significant changes to the Philadelphia Business Privilege Tax Law, including (1) amending the definitions of "net income" and "receipts"; (2) providing an exclusion for the first $50,000 in taxable receipts received for tax year 2014, the first $75,000 in taxable receipts received in tax year 2015, and the first $100,000 in taxable receipts received for tax years 2016 and thereafter; (3) changing both the millage and net income tax rates for tax year 2014 and thereafter; (4) providing a single sales factor apportionment tax credit starting in tax year 2013; and (5) providing an exception to the new provisions for purposes of calculating estimated tax. (Effective 11/14/2011)

Rhode Island

Regulation CT 11-15/Income Tax

Clarifies and specifies the combined reporting requirements in the state. Insurance companies are specifically excluded from the combined filing group. (11/15/2011)

DOI OPTins Notice/Premium Tax

The Department of Insurance revised a bulletin that would have mandated the OPTins system as of 02/18/2011 to facilitate submission of premium tax forms and payments. OPTins is now optional, although, from the Department's perspective, it is the preferred method of filing estimated payments and tax return filings for calendar years 2010 and 2011. (02/14/2011)

H. 7397/Premium Tax

Provides for an increase in the tax rate on surplus lines insurance from 3% to 4% of gross premium. Also imposes a 2% tax on gross insurance premium to the Medical Malpractice Joint Underwriters Association, which was previously exempt from tax. (Effective 01/01/2011)

South Carolina

Bulletin 2010-2012/Premium Tax

Announces that an online premium tax return application has been implemented that enables an insurer to prepare and submit its premium tax returns electronically. Also, the insurer can pay any taxes due by electronic check, paper check, or credit card. An insurer paying by automated clearinghouse that has a block on its bank account should use the information provided in the bulletin to allow Department of Insurance to successfully debit its account. (02/15/2011)

South Dakota

H. 1157/Premium Tax

Imposes a 1% premium tax on premiums for court appearance bonds and establishes an annual renewal of certificate of authority fee of $6,000 for domestic insurers issuing court appearance bonds. (Effective 03/11/2011)

Rule 20:06:16:04/Premium Tax

Adds a new section to define "annuity considerations returned" to ensure that consideration for an annuity contract is correctly calculated for premium tax purposes. (09/20/2011)

Tennessee

H. 2007/Captive Insurance Regulation

Revises the tax imposed on captive insurance companies. Each captive insurance company is required to pay to the Department of Insurance, on or before March 1 of each year, a tax at the rate of 0.4% on the first $20 million, and 0.3% on each dollar thereafter, on the direct premiums collected or contracted for on policies or contracts of insurance written by the captive insurance company during the year. (Effective 09/01/2011)

Texas

Policy Letter Ruling 201109204L/Franchise Tax

The Texas Comptroller's Office ruled that an insurance company paying gross premium tax to a state other than Texas should be included in the combined Texas franchise tax report unless exempt. In order to be exempt, the insurance entity must be paying the Texas gross premium tax. (09/30/2011)

Policy News 201112313L/Captive Insurance Regulation

The Texas Insurance Code provisions under Chapter 101 recognize only "single-parent captives" or captives that are formed to cover the risks of its parent or affiliated companies (i.e., "in-house" insurance that is not available to the general public). Section 101.053(b)(6) provides an exemption or "safe harbor" from the consequences of conducting unauthorized insurance for activities in this state by or on the sole behalf of a non-admitted captive insurance company that insures solely: (1) directors' and officers' liability insurance for the directors and officers of the company's parent and affiliated companies; (2) the risks of the company's parent and affiliated companies; or (3) both one and two. Subsection 101.053(c) states that Subsection (b)(6) does not exempt an insured or insurer from the payment of an applicable tax on premium or from another applicable provision of this code. Under Section 524(a) of the NRRA, a state still has the authority to determine eligibility of US insurers for surplus lines as long as its requirements are no more restrictive than those under the National Association of Insurance Commissioners (NAIC) Non-Admitted Insurance Model Act, unless a state has joined an agreement that includes alternative eligibility requirements. (That is, a Vermont captive that is a single-parent captive would be considered an unauthorized insurer but is not subject to the regulatory provisions of Chapter 101.) (12/01/2011)

S. 1/Credits and Incentives

The omnibus fiscal matters bill repeals the insurance premium tax credit for examination fees or evaluations paid in calendar year 2012 or 2013. (Effective 09/28/2011 and expires on 01/01/2014)

Utah

H. 316/Surplus Lines Tax

Prohibits a Utah county, city, or municipality from imposing an occupation tax or other tax or fee on a surplus lines insurance transaction. (Effective 06/10/2011)

H. 19/Captive Insurance Regulation

Clarifies that captive insurance companies are subject to the following taxes and fees: fees under Title 31, Chapter 3, Department Funding, Fees, and Taxes; fees under the Captive Insurance Companies Act (Chapter 37); and fees under the Special Purpose Financial Captive Insurance Company Act (Chapter 37a). The state, or any county, city, or town in the state, may not levy or collect an occupation tax or other fee against a captive insurance company. Further, the state may not levy, assess, or collect a withdrawal fee against a captive insurance company. Annual fees to obtain or renew a certificate of authority will be due to the Utah Insurance Commissioner by June 20 of each year (previously March 31). (Effective 03/25/2011)

H. 209/Insurance Assessment

Modifies the limits on the amount of the workers' compensation premium assessment and makes technical and conforming changes. An admitted insurer writing workers' compensation insurance in Utah must pay to the Tax Commission, on or before March 31 of each year, a premium assessment on the basis of the total workers' compensation premium income received at a variable rate between 1% to 4.25% through 2017, and at a fixed rate of 1.25% for 2018 and thereafter. (Effective 06/10/2011)

Vermont

H. 438/Captive Insurance Regulation

Extends a non-refundable credit against Vermont gross premiums captive insurance tax to captive insurance companies first licensed on or after January 1, 2011. The $7,500 credit applies against the aggregate taxes owed for the first taxable year for which the company has liability. Applies to the insurance company as a whole, not each protected cell, as it was previously. (Effective 07/01/2011)

Virginia

S. 1359/H. 2335/Credits and Incentives

Decreases the eligible credit percentage for retaliatory tax paid by domestic insurance companies from 100% to 60% for tax years after 2006; eliminates the 10-year limitation on the carryforward period for excess retaliatory tax credits; and increases the annual refundable amount of excess credits from $800,000 to $7,000,000 for qualified companies that received a credit in tax year 2000, beginning with tax year 2011. (Effective 07/01/2011)

H 2385/Premium Tax Credits

Creates a barge and rail usage credit that can be claimed by qualifying international trade facilities to offset insurance tax liability. (Effective 07/01/2011)

S. 1124/Insurance Regulation

Administration of the insurance premiums tax is transferred from the State Corporation Commission to the Department of Taxation. The bill also allows for the exchange of information between the Department and the Commission. (Effective 01/01/2013)

Washington

S. 5213/Premium Tax

The due date for the regulatory surcharge is moved from June 15 to July 15 of each year. Organizations failing to pay regulatory surcharges by July 31 (formerly June 30) are subject to penalties. Healthcare service providers must report premiums and prepayments on a written basis or on a paid-for basis consistent with the basis required by the annual statement. (Effective 07/22/2011)

DOR Notice/Sales Tax

Provides revised guidance on sales and use tax liability for insurers. Income received by insurers that is subject to the premiums tax is exempt from business and occupation (B&O) tax, but the B&O tax exemption does not extend to sales or use tax. Insurers are subject to sale or use tax on tangible personal property, extended warranties, digital goods and codes, and retail services. All insurers and affiliates are responsible for paying either sales tax or use tax on goods and retail services used in their businesses. (11/01/2011)

Wisconsin

DOI Notice/Premium Tax

Beginning with 2010 year-end payments and continuing with quarterly premium tax payments due in 2011, companies paying taxes and fees required under Sections 76.60 et al. will be given the option to remit payments through the Office of the Commission of Insurance's Electronic Payments (e-payments) process. Payments may also be made under the current method. However, effective June 17, 2011, Drawer 566 will be shut down and e-payments will be required for all payments of premium taxes and fees. (01/03/2011)

DOR Tax Bulletin 171/Income Tax

Domestic insurance companies can comply with Wisconsin's electronic filing mandate for combined returns even though IRS guidelines do allow insurance companies that have a property and casualty insurance company or life insurance company as a parent to electronically file a consolidated federal return. The federal/state program allows insurance companies using supporting software to file just a Wisconsin combined return with federal return information and any other schedules attached as a PDF file. (04/01/2011)

Emergency Tax Rule 2.957/Credits and Incentives

Establishes procedures to be used in determining and administering income and franchise tax credits and deductions for businesses that relocate to Wisconsin. (Effective 04/07/2011. Emergency rule expired 09/03/2011)

Emergency Tax Rule 3.05/Credits and Incentives

Clarifies certain terms as they apply to the job-creation tax deduction and prescribed the methods by which the average employee count is computed for purposes of determining the amount of the deduction. (Effective 04/07/2011. Emergency rule expired 09/03/2011)

Tax accounting

Tax accounting this year was dominated by the codification and promulgation of Statement of Statutory Accounting Principles (SSAP) No. 101, Income Taxes, a Replacement of SSAP No. 10R and SSAP No. 10. In May 2011, the Interested Parties provided comments on the exposure draft of SSAP 101. Then, in August, the NAIC's Statutory Accounting Principles Working Group released an exposure draft of SSAP 101. In September, the NAIC's Financial Condition Committee approved the adoption of SSAP No. 101, and it was unanimously adopted on November 6, 2011.

SSAP 101

In 2011, the NAIC adopted SSAP No. 101, which contains significant changes to accounting for current and deferred federal and foreign income taxes that are described below.

Major highlights include:

- Federal and foreign income tax contingencies are governed by a modified version of SSAP 5R. FIN 48 is expressly rejected, along with its two-step recognition and measurement model and most of the required disclosures (other than the "early warning" disclosure).

- The statutory valuation allowance concept continues as the initial step in determining the amount of the admitted deferred tax asset (DTA). The applicable text from FAS 109 has been added.

- Expanded admissibility is no longer elective.

- In the first part of the admissibility test, all filers will be allowed to use a reversal period that corresponds to the tax loss carryback provisions of the Internal Revenue Code (not to exceed three years).

- In the second part of the admissibility test:

  - The reversal period and surplus limitation parameters (one year/10% or three years/15%) are determined based upon risk-based capital levels. Companies not meeting the minimum threshold would admit nothing in this part of the admissibility test.

  - Non-RBC reporting entities and financial/mortgage guaranty companies are provided special tables for determining admissibility.

  - For purposes of determining year-end parameters, calculations of RBC or surplus thresholds will use current reporting period information.

- The third part of the admissibility test adds a requirement that the reporting entity shall consider the reversal patterns of temporary differences; however, this consideration does not require scheduling beyond that required in Paragraph 7.e. (the valuation allowance test).

- Disclosure requirements have been modified but retain the need to disclose the impact of tax planning strategies. SSAP No. 101 adds a required disclosure for tax planning strategies involving reinsurance.

Tax loss contingencies

The use of "more likely than not" (MLTN) as the recognition threshold is expected to result in earlier recording of income tax loss contingencies (compared to existing SSAP No. 5R) and produce a result roughly equivalent to US GAAP. Although it is rare in application, there can be differences because US GAAP does not require a 100% contingent liability, as SSAP 101 does, if the measurement step produces a future benefit of less than 50% of the tax position.

Because statutory accounting for income taxes is applied on a separate entity basis, application of this provision must be at a separate entity level. This requires that each reporting entity conduct a review of federal and foreign income tax positions and apply the MLTN loss contingency standard. Absent any guidance regarding materiality, each reporting entity is required to establish and support uncertainties (and the basis for management's conclusions) at the level at which this guidance is applied. As with any area of judgment, preparers should get agreement from all key stakeholders as to how much documentation is enough to support management's conclusions—including Model Audit Rule considerations.

If a tax loss contingency (uncertain tax position) relates to a temporary difference, the indicated current tax liability and offsetting gross deferred tax asset are not recognized until an "event has occurred that would cause a re-evaluation" of the probability of assessment (¶3.c.). This concept is aimed at the "gross-up" of the financial accounts for contingent tax liabilities related to temporary differences that would generate a DTA. There is no such delay under US GAAP. Under SAP, however, the delay was justified because the DTA admissibility rules could operate to produce a net surplus decrease if the DTA was non-admitted. Presumably, this provision would apply when a temporary item would otherwise result in an income tax loss contingency under the MLTN standard.

Statutory valuation allowance

As necessary, the gross DTA is reduced by a statutory valuation allowance (SVA). The SVA assessment applies the MLTN standard based upon the available evidence. As with SSAP No. 10R, footnotes clarify that the assessment is performed on a separate entity basis and that this provision "…shall not result in a statutory valuation allowance reserve within the statutory financial statements, but rather should result in a reduction of the gross DTA."

The "but rather…" language is new. It can be supposed that this was an attempt to clarify the practical financial statement impact of recording an SVA. Two alternatives have existed. One alternative treats the SVA as simply a component of the non-admitted DTA; therefore, the change in the SVA would be included with the change in non-admitted assets. The second alternative treats the SVA outside of the non-admitted DTA. By doing so, the reporting entity reduces the amount of DTA reported in column 1 of the annual statement asset page. This reduction necessitates the recognition of an effective tax rate reconciling item to track movement in this "missing" DTA. Both positions are reasonable, technically supportable, and acceptable absent clarification from the NAIC.

No election of expanded admissibility parameters

Unlike SSAP No. 10R's expanded admissibility regime, SSAP 101's admissibility regime is not elective. The first and third parts of the admissibility test are identical for all filers. The second part of the admissibility test provides three levels of reversal periods and surplus limitations that are based upon thresholds discussed below.

First part of the admissibility test–Carryback taxes

All insurers will be able to consider for admissibility federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences reversing within a timeframe corresponding to Internal Revenue Code (IRC) loss carryback provisions.

For non-life companies, ordinary and capital temporary differences reversing within two and three years, respectively, of the balance sheet date can be carried back to recoup prior-year taxes. For life companies, a three-year period applies to both ordinary and capital items. Applicable IRC sections, for example AMT loss carryback limitations, should be considered. However, SSAP 101 provides that the maximum reversal period is three years, regardless of a longer period under the tax law.

Second part of the admissibility test–Offset of future years' income

The reversal period and adjusted capital and surplus limitation that apply in the second part of the admissibility test depend upon the type of insurer and whether the insurer meets the relevant threshold.

Companies that are subject to risk-based capital (RBC) requirements (or required to file an RBC report with the domiciliary state) will qualify for a three-year reversal period and 15% adjusted capital and surplus limitation if ExDTA ACL RBC (authorized control level RBC computed without admitted DTAs) exceeds 300%. If ExDTA ACL RBC falls within the 200% to 300% range, a one-year reversal period and 10% adjusted capital and surplus limitation apply. No DTA is admissible under this part of the admissibility test if ExDTA ACL RBC is less than 200%.

Mortgage and financial guaranty companies have separate thresholds based upon ExDTA surplus (surplus without admitted DTAs) over policyholders and contingency reserves. If the reporting entity is a non-RBC filer and is not a mortgage or financial guaranty insurer, a third set of thresholds applies based upon the ratio of adjusted gross DTAs (the numerator) to adjusted capital and surplus (the denominator).

There is also guidance with respect to calculating RBC for interim periods. The numerator is based upon current period Total Adjusted Capital (ExDTA) while the denominator uses the Authorized Control Level as filed for the most recent calendar year.

Definition of adjusted capital and surplus

Under SSAP No. 10 and SSAP No. 10R, adjusted capital and surplus was defined as statutory capital and surplus from the most recently filed statement, adjusted to exclude any net DTAs, EDP equipment and operating system software, and any net positive goodwill. Thus, companies calculating admitted DTAs at year end were required to refer to the most recently filed statement (generally September 30) in calculating adjusted capital and surplus.

SSAP No. 101 requires filers to look to adjusted capital and surplus for the current period (as opposed to the most recently filed statement). This approach also applies when calculating the adjusted capital and surplus denominator (referred to above) for non-RBC filers that are not mortgage or financial guaranty companies.

Third part of the admissibility test– DTA/DTL offset

The guidance provides that the offset of DTAs and DTLs should consider the impact of reversal patterns; however this may not require detailed scheduling.

The SVA analysis, borrowed from the GAAP world, looks to four sources of taxable income in determining if DTAs will meet the MLTN standard:

- Taxable income in prior carryback years
- Future taxable income
- Tax planning strategies
- Future reversals of existing taxable temporary differences

Any of the four sources of income, taken individually, may support a conclusion that a statutory valuation allowance is not necessary. Depending upon the level of negative evidence, consideration of one or two sources of taxable income may be sufficient to establish that a DTA meets the "more likely than not" realization standard.

These same sources of taxable income are also inherent in the three-part admissibility test. The first source listed above corresponds to the first part of the admissibility test (carryback taxes). The second and third sources are components of the second part of the admissibility test (offset of future income with tax planning strategies serving to increase income or accelerate reversals). The fourth source, once tax effected, is essentially identical to the DTA/DTL offset provision.

As an example, consider ABC Insurance Company, which has gross DTAs and DTLs as follows:

DTA for Unearned Premiums	$70
DTA for Deferred Compensation	10
Gross DTAs	$80
DTL for Bond Market Discount	(20)
Net DTA (Before SVA and Admissibility Test)	$60

ABC is a historically profitable entity and it is expected that this trend will continue. The company has significant taxes paid in the carryback period (well in excess of the aforementioned DTAs) and never has had a tax attribute (net operating loss or capital loss, for example) expire unused. Between recoverable taxes and future income, ABC concludes that an SVA is not necessary because it is "more likely than not" that the DTAs will generate a tax benefit.

The only DTA reversing within the two to three year reversal period is the Unearned Premium DTA of $70. Assume this is admitted under the first or second part of the admissibility test. Thus, the long-term DTA related to deferred compensation is analyzed for admissibility in the DTA/DTL offset provision.

SSAP No. 101, Paragraph 11.c., states that companies "… shall consider the reversal patterns of temporary differences; however, this consideration does not require scheduling beyond that required in Paragraph 7.e." If scheduling of DTAs and DTLs was not necessary because there was sufficient taxable income from other sources to support the conclusion that no SVA was necessary, one could argue that no additional scheduling (or no scheduling at all in this example) is required in Paragraph 11.c. and the ordinary DTA (related to deferred compensation) would be offset against the DTL (related to market discount on bonds). Thus, no effort would be expended to determine when the DTA and DTL would, in fact, offset.

However, assume that information related to reversal patterns, although not considered in the SVA analysis, is readily available for consideration. Assume that the DTA for unearned premiums is expected to reverse within one year of the balance sheet date. The DTA for deferred compensation is expected to reverse within 10 years of the balance sheet date due to IRC Section 409A elections. The company has no prudent and feasible way to change the timing of the reversal. The DTL related to the bond market discount is scheduled to reverse over four years (consistent with portfolio turnover).

In the fact pattern presented, the reversal patterns of both the DTA and DTL are arguably relevant, although it was not necessary, given the extent of positive evidence, to look to reversing taxable temporary differences as a source of income in the SVA assessment. Under current US tax law, the tax created by the DTL reversal in year four will not be recoverable via a carryback of the loss created by the DTA reversal in year 10. Merely offsetting the DTA and DTL does not seem to square with the Paragraph 11.c. mandate that the company "…consider the reversal patterns of temporary differences…"

In its current form, especially given the drafting history, it is difficult to interpret the intention of the Statutory Accounting Principles Working Group (SAPWG). As illustrated by the second part of the example, without further guidance as to the SAPWG's intent, there would likely be significant diversity in practice.

What does appear clear is that any company that considered DTLs as a source of taxable income in the SVA analysis should also consider reversal patterns in determining if DTA/DTL offset is appropriate in the third part of the admissibility test.

Tax planning strategies

The basics of a tax planning strategy are consistent with US GAAP and prior statutory guidance. SSAP No. 101 clarifies that tax planning strategies are considered in the statutory valuation allowance assessment as well as the calculation of admitted deferred tax assets.

Q&A adopted for SSAP No. 101

In May 2012, during a SAPWG call on the topic, by unanimous voice vote, the SSAP 101 Q&A was adopted. For more information visit www.naic.org

Presentation and disclosure

Beginning in 2012, the additional surplus realized from electing expanded admissibility under SSAP No. 10R will no longer be separately presented in the balance sheet, and surplus reconciliation as expanded admissibility is no longer elective. Disclosures related to the benefits from electing expanded admissibility are no longer required, as well.

The disclosure related to tax planning strategies has been expanded. In addition to disclosing the impact of tax planning strategies on adjusted gross DTAs and admitted DTAs (by percentage and character), insurers must disclose whether they have availed themselves of a tax planning strategy involving reinsurance (Paragraph 22.f.). For example, in particular instances, companies have asserted the use of a reinsurance strategy to accelerate the reversal of reserve-related DTAs or increase income in the one- to three-year reversal period. However, the disclosure does not require that the magnitude of the reinsurance-related tax planning strategy be disclosed.

Lastly, any change resulting from the adoption of SSAP 101 shall be accounted for as a change in accounting principle pursuant to SSAP 3. Look for a revised annual statement reporting format before year-end. A revised annual statement reporting format is expected by December 2012.

Schedule UTP

The IRS Large Business and International division (LB&I) issued a directive providing guidance covering the use of Schedule UTP as part of the Compliance Assurance Process (CAP) program. The guidance applies only to CAP returns filed for the 2010 tax year by CAP taxpayers that were in CAP in 2010.

According to the guidance, the CAP team should follow existing CAP guidance in reviewing tax returns during the post-file period. The issues listed on the Schedule UTP should be considered and compared to the list of taxpayer disclosures made during the CAP year.

Appendix A

Cases

New York Life Insurance Co. v. US

A US District Court judge dismissed New York Life Insurance Co.'s suit, which requested a refund of approximately $100 million in taxes, concluding that New York Life failed to properly show that the claimed deductions for policyholder dividends were, in fact, not contingent liabilities. The Court ruled that the New York Life's internal accounting practices do not fix liability for purposes of the all-events test and, despite the fact that New York Life paid all dividends that had been credited to an account, the company was unable to support that it was required to do so.

Massachusetts Mutual Life Insurance Company v. United States

In February 2012 the United States Court of Federal Claims ruled that the plaintiff, Massachusetts Mutual Life Insurance Company is allowed a deduction for the declared guaranteed minimum amount of policyholder dividends in the year of declaration.

IRS rulings/procedures/notices/announcements/IRs/FAAs

ECC 201104036

The IRS stated that an insurance company must file a Form 8300, Report of Cash Payments Over $10,000 Received in a Trade or Business, for related transactions occurring within a 24-hour period and in cases where an individual buys an insurance policy and an annuity as part of a single estate plan.

Generic legal advice memorandum: AM 2011-002

The IRS concluded that in a fact pattern where the separate unit incurs a dual consolidated loss (DCL) in a tax year in which it has a positive SRLY Cumulative Register and the consolidated group has positive income, the DCL incurred by the separate unit may be used on a current basis without entering into a domestic-use election.

INFO 2011-0054

The IRS explained that it does not agree with the holding of Fisher v. United States and therefore will not issue refunds to taxpayers who paid tax on sales of stock received in a demutualization pending resolution of the issue.

LB&I-4-0711-015

The purpose of this LB&I Directive is to instruct examiners and their managers how to determine when it is appropriate to seek the approval of the DFO in order to raise the economic substance doctrine. Once an examiner determines that raising the doctrine may be appropriate, this Directive sets forth a series of inquiries the examiner must develop and analyze in order to seek approval for the ultimate application of the doctrine in the examination.

Notice 2011-02

The Notice provides a de minimis exception for a covered health insurance provider if the premiums received by the employer on a controlled group basis for providing health insurance coverage are less than 2% of the employer's gross revenues for that tax year. Section 162(m)(6) does not apply to a covered health insurance provider that is within the definition prior to 2013 but is not a covered health insurance provider after 2012. An independent contractor who provides services to multiple unrelated entities will not be treated as an applicable individual whose compensation is subject to the deduction limit. Solely for purposes of determining whether a taxpayer is a "covered health insurance provider" under Section 162(m)(6), certain reinsurance premiums are not treated as premiums from providing health insurance coverage.

Notice 2011-04

The IRS indicated that a change in the tax treatment of unearned premiums where a Blue Cross and Blue Shield organization loses or regains its Section 833 status due to Section 833(c)(5) is an accounting method change for which the IRS will provide automatic consent.

Notice 2011-23

The IRS provided guidance on the conditions for qualified non-profit health insurance issuers (Qualified Issuers) that intend to apply for recognition of exempt status under newly enacted Section 501(c)(29), as well as the filing requirements for Qualified Issuers. The Qualified Issuer must indicate on

its return that it is being filed in the belief that the Qualified Issuer is exempt under Section 501(a), but that the IRS has not yet recognized its exemption. In addition, the Qualified Issuer must also report the amount of reserves required by each state in which the organization is licensed to issue qualified health plans and the amount of reserves on hand.

Notice 2011-51

The Notice gave an additional year's reprieve on some of the ambiguity associated with the medical loss ratio (MLR) calculation by providing that, as specified in Notice 2010-79, taxpayers must use the definition of "reimbursement for clinical services provided to enrollees." Moreover, it extended the purposes of determining whether the 85% requirement is satisfied. The IRS will not challenge the inclusion of "amounts expended for activities that improve health care quality."

Notice 2011-53

The IRS provided a workable timeline for foreign financial institutions (FFIs) and US withholding agents to implement the various requirements of the Foreign Account Tax Compliance Act (FATCA). Specifically, the Notice phases in the implementation of FATCA in the following manner:

- An FFI must enter an agreement with the IRS by June 30, 2013 in order to ensure that it will be identified as a participating FFI in sufficient time to allow withholding agents to refrain from withholding beginning on January 1, 2014.
- Withholding on US-source dividends and interest paid to non-participating FFIs will begin on January 1, 2014, and withholding on all withholdable payments (including on gross proceeds) will be fully phased in on January 1, 2015.
- Due diligence requirements for identifying new and pre-existing US accounts (including certain high-risk accounts) will begin in 2013.
- Reporting requirements will begin in 2014.
- For purposes of the Notice, high risk accounts include private banking accounts with a balance that is equal to or greater than $500,000.

Notice 2011-68

The IRS provided interim guidance on the application of amendments made by the Pension Protection Act of 2006 (PPA) to qualified long-term care insurance, annuity, and life insurance contracts, and requested comments on certain other issues to be addressed in future guidance concerning the taxation of annuity and life insurance contracts with a long-term care insurance feature.

Notice 2011-78

The IRS announced that it will amend the existing regulations under Section 6050W to expressly provide that an insurance company or an affiliate administering a self-insured arrangement on behalf of an employer or other entity on a cost-plus basis, or under an Administrative Services Only (ASO) plan or an Administrative Services Contract (ASC) plan, will not be treated as a third-party settlement organization.

Revenue Procedure 2011-38

The IRS provided that the direct transfer of a portion of the cash surrender value of an existing annuity contract for a second annuity contract will be treated as a tax-free exchange under Section 1035 if no amount, other than an amount received as an annuity for 10 years or more or during one or more lives, is received under the original contract or the new contract during the 180 days beginning on the date of the transfer.

Revenue Procedure 2011-45

The IRS provided the domestic asset/liability percentages and domestic investment yields needed by foreign life insurance companies and foreign property and liability insurance companies to compute their minimum effectively connected net investment income under Section 842(b) for tax years beginning after December 31, 2009.

Revenue Procedure 2011-53

The IRS sets forth for purposes of Section 846 the loss payment patterns and discount factors for each property and casualty line of business for the 2011 accident year. These factors are to be used by property and casualty insurance companies in discounting unpaid losses.

Revenue Procedure 2011-54
The IRS sets forth for purposes of Section 832 the salvage discount factors for the 2011 accident year that must be used for each line of business to compute discounted estimated salvage recoverable under Section 832. All the discount factors were determined using the applicable interest rate under Section 846(c) for 2011, which is 3.46%, and by assuming all estimated salvage is recovered in the middle of each calendar year.

Revenue Ruling 2011-09
The IRS addressed whether life insurance contracts received in tax-free exchanges must be re-tested under the pro rata interest expense disallowance rule of Section 264(f)(1). The IRS concluded that when a tax-free exchange of life insurance contracts occurs, the new contract must be tested to determine if it qualifies for the pro rata interest disallowance rule under Section 264(f)(1). The rule denies a deduction for the portion of the taxpayer's interest expense that is allocable to unborrowed policy cash values.

Revenue Ruling 2011-15
The IRS concluded that the 1994 final regulations concerning original issue discount (OID) rendered Rev. Rul. 58-225 obsolete. Rev. Rul. 58-225 concludes that interest collected in advance by a life insurance company on policyholder loans (prepaid interest), constitutes taxable income in the year received.

Revenue Ruling 2011-23
The IRS provided prevailing state assumed interest rates and applicable federal rates for the determination of reserves under Section 807 for insurance contracts issued in 2010 and 2011. This information should be used by insurance companies in computing their reserves for: (1) life insurance and supplementary total and permanent disability benefits; (2) individual annuities and pure endowments; and (3) group annuities and pure endowments.

Revenue Ruling 2011-29
The IRS explained the taxpayer-favorable guidance relating to a taxpayer's ability to take into account under Section 461 accrued bonuses that are payable to a bonus pool rather than to specific individuals. Any change in a taxpayer's treatment of bonuses to conform to this revenue ruling is a change in method of accounting that must be made in accordance with Sections 446 and 481, the regulations thereunder, and the applicable administrative procedures.

Private letter rulings/technical advice/industry memorandums

PLR 201101029
The IRS denied tax-exempt status to an organization providing auto damage and liability coverage to its members, finding it does not have enough risk distribution to qualify as an insurance company.

PLR 201105001
The IRS ruled that a long-term care benefits rider added to single-premium deferred fixed annuity contracts and flexible-premium deferred variable annuity contracts offered by a stock life insurance company will be treated as an insurance contract under Section 7702B(b)(1).

PLR 201105004
The IRS ruled that a certificate issued by a life insurance company through a wholly owned subsidiary to the owners of managed investment accounts will be considered an annuity contract within the meaning of Section 72 for federal income tax purposes, and would be eligible for the life insurance products exemption from the Section 475 mark-to-market rules.

PLR 201105012
The IRS ruled that, for federal income tax purposes, a life insurance company that issues deferred and immediate variable annuity contracts, and not the annuity contract holders individually, will be treated as the owner of the underlying investments because only the insurer has sufficient incidents of ownership over the assets.

PLR 201120005 and PLR 201120006
In dual private letter rulings, the IRS ruled that income derived from the exercise of an essential governmental function, accruing to a state political subdivision, is excludable from gross income under Section 115 of the Internal Revenue Code.

PLR 201121029
The IRS ruled that a lack of risk distribution disqualifies an arrangement as insurance and therefore Taxpayer does not meet the statutory requirement for exemption under Section 501(c)(15) of the Internal Revenue Code.

PLR 201128017
The IRS ruled that contracts that require an insurance company to pay a benefit to an owner of an investment account if the value of the account falls below a specified amount, will be treated as an annuity contract under Section 72 and will qualify for exemption from Section 475 mark-to-market rules.

PLR 201133016
The IRS revoked the tax-exempt status of a mutual insurance company because the company's gross receipts exceeded the $600,000 limitation under Section 501(c)(15)(A). An insurance company as defined in Section 816(a), other than a life insurance company, is exempt from income tax under Section 501(a), if its gross receipts for the taxable year do not exceed $600,000 and more than 50% of those gross receipts consist of premiums. Section 501(c)(15)(A)(i).

PLR 201137008
The IRS stated that for purposes of the necessary premium test under Section 7702A(c)(3)(B)(i), a life insurance company's reasonable expense charges are taken into account when determining the deemed cash surrender value of a policy intended to satisfy the cash value accumulation test under Section 7702(b).

PLR 201147014
The IRS ruled that an insurer is required to file an information return for supplemental unemployment insurance benefits exceeding $600 paid to an insured, and must furnish payee a statement. The information reporting requirement of Section 6041 applies only to payments made during the calendar year that is "fixed or determinable income."

PLR 201151008
The IRS concluded that underwriting reserves and loss reserves for life insurance and annuity contracts, required to be maintained by controlled foreign corporations in annual financial statement reporting to a foreign regulatory agency, are an appropriate means of measuring income within the meaning of Section 954(i)(4)(B)(ii) and, accordingly, are the amount of reserves that may be used in determining each company's foreign personal holding company income under Section 954.

PLR 201152014
The IRS ruled that the transfer of life insurance policies by two banks to a limited liability company in exchange for membership interests in the LLC will not be treated as a transfer to an investment company, within the meaning of Section 351, if the company were incorporated.

SBSE-04-1210-073
The IRS ruled that when a case involving a foreign captive insurance entity arises, Excise Tax Examiner must obtain the following information to be forwarded by e-mail to the International Excise Tax Group through the Examiner's Group Manager: name and EIN of parent company (or entity currently under audit) and whether the parent company is a controlled industry case (CIC) (if known); full name and EIN of the captive subsidiary; location or country of domicile of the captive subsidiary; amount of premiums insured with the captive subsidiary; amount of premiums reinsured by the captive subsidiary to reinsurance companies (if known); whether the captive subsidiary has a Section 953(d) election (if known); and whether the captive subsidiary has a Closing Agreement (CLAG) (if known).

TAM 201117027
The IRS ruled that a health maintenance organization (HMO) that contracts with various healthcare provider networks under capitation agreements is taxable as an insurance company for federal income tax purposes.

TAM 201149021
The IRS stated that residual-value insurance policies that insure assets against market decline are not insurance contracts for federal tax purposes. The IRS determined that although the contracts at issue protect against market forces that depress the value of the covered assets, they do not protect against a casualty event that damages the assets.

Appendix B

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