The Tax Cuts and Jobs Act (“the Act”) is the most sweeping piece of US tax legislation in over 30 years, particularly for insurance companies. Although most of the Act’s provisions were first effective in 2018, it already is having wide impacts on insurers’ operations. As was the case in late 2017, the Act also has been central to many business decisions in 2018, not just in tax departments but also in other functions, including the C-suite.

Just as insurers spent 2018 adapting and complying with the Act’s new provisions, the IRS and Treasury Department proposed an impressive volume of guidance under the Act. We anticipate that the IRS will issue much of the final form of its guidance during the first half of 2019.

We describe in detail elsewhere the Act’s technical details and will continue to address what insurers need to do to comply with it as its implications become clearer. On a broader level, and as we describe below, the Act has clear business impacts that go far beyond tax.

Although the reduced corporate tax rate may be a long-term benefit to most insurers, application is uneven across the industry.

The sweeping tax rate cut from 35% to 21% reduced cash tax rates over time, but also reduced deferred taxes recorded on insurers’ balance sheets. The industry (and life insurers in particular) experienced a reduction in deferred taxes for NAIC Statutory accounting purposes. Decreases to admitted deferred tax assets resulting from the decrease in the tax rate generally resulted in a reduction to regulatory capital and created some stress on risk-based capital (“RBC”). While the tax rate decrease might be considered to be a net win for companies over time, the timing difference of writing down deferreds today that provide a cash tax benefit in the future has a significant impact on RBC for some insurers. Those hardest hit have included companies with large deferred tax asset balances and those that lack excess capital.
The NAIC published “Interpretation of 2018 Life Risk Based Capital Results” to help regulators understand the expected impacts on RBC of tax reform in several scenarios. While the guidance does help explain the anticipated impacts of tax reform on RBC, companies still must contend with reduced capital levels. The NAIC released SAB 118 in 2018, granting companies a one year window to complete their tax accounting calculations associated with tax reform. In addition, the NAIC is considering additional changes to SSAP 101 guidance and has published such guidance in the form of two exposure drafts. These changes should help clarify how some of the pre-reform tax accounting principles apply in a post-tax reform world. Public comments are due June 12, 2019.

Analysts, rating agencies and regulators will continue to work through how to interpret the industry’s after-tax income and capital results. Executives should work with their tax teams to familiarize themselves with any possible questions that may arise.

Changes in the regime for taxing US corporations on offshore business and foreign corporations on US domestic business have had varying effects and, in some cases, unintended consequences.

Many of the tax reform provisions and subsequent IRS guidance have impacted both foreign insurers doing business in the US and US insurers with global operations. The Base Erosion & Anti-Abuse Tax (“BEAT”) in particular had a significant effect on foreign-parented companies and made it more difficult for multinational groups to manage capital. Many companies responded by repricing products and bringing business onshore.

In addition, the potential application of the BEAT to claims and other payments on inbound reinsurance changed the economics of existing structures and ran counter to the stated policy of the provision. Companies are anxiously awaiting the next round of guidance in this area, which may not come by the June 22, 2019 deadline, and therefore may not be retroactive to the date of tax reform. The outcome of this guidance will affect planning for transactions, the launch of new products, and selecting an overall business model. Insurers should continue to monitor ongoing developments in this area.

The Global Intangible Low Taxed Income (“GILTI”) provisions had some unexpected effects, and appear to have the greatest impact on insurers when capital markets trend downward. GILTI is effectively operating as a minimum tax for companies and will need further consideration now that Year One of the rule has passed. Because most companies elected to treat GILTI as a period cost, anticipating the future impacts in projections and product pricing could prove challenging.
There are many other international provisions insurers must contend with post-reform that will impact how they project net income, capital, and free cash. They should be mindful that some provisions that operate on a controlled or consolidated group basis for Federal purposes will operate under a separate company approach or entirely different rules for state tax purposes. As a result, keeping abreast of how post-Federal tax reform affects the state tax landscape will remain a priority for the industry.

Other changes in the taxation of insurance companies also had significant impacts beyond the tax function of many companies.

Perhaps the most important domestic changes in the Act were a 40% reduction in the corporate tax rate, from 35% to 21% and the repeal of the Corporate Alternative Minimum Tax (“AMT”). The refund of prior-year AMT credits and Treasury Department determination that those credits would not be subject to sequestration were welcome relief for insurers’ treasury functions.

The benefit of these items was reduced and in some cases offset by a number of provisions that broadened the tax base against which this rate applied. Three insurance-specific base broadening provisions were especially important to insurers: deferred acquisition costs (“DAC”), reserves, and proration. Many companies have felt the impact of these provisions across the entire organization because they affect product pricing, investment decisions, gross margins on business, and capital planning.

DAC represents an amount that is capitalized up-front, when amounts are received under life insurance, annuity, and other “specified” contracts. The Act generally increased the capitalized amount by 20 percent and extended the period over which amounts are deducted from 10 to 15 years. Even though DAC impacts only the timing for deducting acquisition costs (e.g., commissions), it sometimes is analyzed as a tax or an up-front assessment for purposes of product pricing.
Reserves and claims are typically the largest tax deductions for an insurer. The Act’s changes to the computation of tax reserves likewise resulted in a renewed emphasis on product pricing, and as a result increased insurers’ reliance on company actuaries. For life insurance reserves, the Act’s change will greatly simplify the computation of tax reserves, especially in cases where statutory reserves are principle-based, by increasing reliance on the assumptions used for statutory purposes. For nonlife reserves (such as property, casualty, and health), the Act changed both the interest rates and loss payment patterns for most lines of business. Regulations proposed in the fall of 2018 were controversial, and had the greatest impact on longer-tail lines of business. Together, these changes could affect product pricing, asset and liability matching, and treasury decisions.

Changes in the rules for net operating losses apply differently to non-life insurance companies than to life insurers and other corporate taxpayers. The changes to NOL provisions have introduced a new level of complexity and are causing both the IRS and companies to consider how to account for them. Although no operational changes result in the short term, the learning curve is steep, and incorporating these rules into projection tools can become cumbersome. In the longer term, companies may take a closer look at their tax status and structure to determine what efficiencies they may gain. In addition, these rules impact after-tax value of target companies and should be factored into determinations of purchase price.

Finally, some provisions of the Act have affected some insurers’ investment decisions. For example, a sharp decrease in marginal tax rates affects the decision of any company to invest in taxable versus tax-preferred assets. The disparity between higher individual tax rates and lower corporate rates also has made it difficult for insurers to compete with individual buyers on tax-exempt bond pricing. For insurers, a concept known as “proration” also somewhat limits the benefits that otherwise would be associated with tax-preferred investments such as tax-free bonds and corporate stock that pays DRD-eligible dividends. Changes in proration rules for life insurance companies has greatly simplified compliance but also has affected companies in different ways. Changes in the proration rules for nonlife companies preserved the pre-Act effective tax rate on tax-preferred investments. Moreover, the Opportunity Zone Fund, a new investment vehicle, has enabled some insurers to defer the capital gains they’ve realized on other investments.
Final IRS guidance will be a primary focus in 2019

The IRS published a record volume of guidance during the first year after the Act’s passage, including on the BEAT and other international provisions, changes in the rules for life and nonlife insurance reserves, and changes to other items such as interest expense. Three factors account for the push for guidance.

1. First, the IRS and Treasury naturally prioritize guidance under any significant tax legislation, and this is reflected in the annual “Priority Guidance Plan.”

2. Second, during the partial government shutdown of 2018-2019, many employees worked exclusively on guidance under the Act because that work had its own funding.

3. Third, the IRS and Treasury will be allowed to apply regulations under the Act retroactively only to the extent they are finalized by June 22, 2019.

We expect that the IRS will continue to publish guidance at a record rate throughout the first half of 2019, and insurers will continue to focus on and adapt to it. The post-tax reform “limbo” that companies will linger even though more guidance is forthcoming in the near term. Companies that have taken action in the first year post-reform may need to consider longer term strategies once the additional guidance becomes available. Business executives and transaction executives should stay close to their tax departments in order to ensure they incorporate the latest perspectives into the business strategies they consider.
For more information

Julie Goosman
US Insurance Tax Leader
+1 617 530 5645
julie.v.goosman@pwc.com

Mark Smith
Managing Director, Tax Services
+1 202 312 7518
mark.s.smith@pwc.com

www.pwc.com/us/insurance

At PwC, our purpose is to build trust in society and solve important problems. We’re a network of firms in 158 countries with more than 236,000 people who are committed to delivering quality in assurance, advisory and tax services.

Find out more and tell us what matters to you by visiting us at www.pwc.com.

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PwC does not accept or assume any liability, responsibility or duty of care for any consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it.

© 2019 PwC. All rights reserved. PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see www.pwc.com/structure for further details.