On December 20, 2017, the House and Senate passed the final revised version of H.R. 1 (the Final Bill), which was the result of a conference agreement between the House and the Senate in connection with the Tax Cuts and Jobs Act each had passed. Prior Eversheds Sutherland alerts on the House Bill and the initial version of the Senate Bill contain previous coverage of the insurance provisions in H.R.1. The Eversheds Sutherland Tax Reform Law Blog has more general information about the provisions in the Final Bill. Although the Final Bill generally follows the Senate Bill as passed, the modifications of importance to insurance companies are highlighted below.

• **Changes to Life Insurance Reserves**

  - The Final Bill amends section 807(d) so that life insurance reserves for a contract generally equal the greater of (i) the net surrender value of the contract or (ii) 92.81% of the reserve prescribed by the National Association of Insurance Commissioners (NAIC) with respect to that contract (with CRVM and CARVM being specifically prescribed for life and annuity contracts, respectively). In the case of a variable contract, the amount of life insurance reserves for the contract is the sum of (1) the greater of (a) the net surrender value of the contract, or (b) the separate-account reserve amount under section 817 for the contract, plus (2) 92.81% of the excess (if any) of the amount determined using the tax reserve method otherwise applicable to the contract as of the date the reserve is determined over the amount determined in (1).

  - The Final Bill requires life insurance companies to report the opening balance and closing balance of their reserves and their method of computing reserves for purposes of determining income.

  - The Final Bill provides that any resulting section 481 adjustment due to the difference in computing reserves under the new law and the existing law is to be taken into account over an eight-year period.

• **Change to Policy Acquisition Expense Rules**

  - The Final Bill follows the Senate Bill with minor modifications to the increases in the proxy rates. Specifically, the proxy rates will be increased for annuities from 1.75% to 2.09%; for group life insurance contracts from 2.05% to 2.45%; and for life insurance and non-cancellable A&H insurance contracts from 7.7% to 9.20%.

  - As under the Senate Bill, the DAC amortization period will be increased
− The provision will apply to net premiums for taxable years beginning after December 31, 2017. Net premiums first required to be capitalized in a taxable year beginning before January 1, 2018, will continue to be allowed as a deduction ratably over the 120-month period beginning with the first month in the second half of such taxable year. The provision does not change the special rule providing for a 60-month amortization of the first $5 million of specified policy acquisition expenses (with a phase-out).

• Changes to Life Insurance Company Proration Rules
− The Final Bill follows the Senate Bill. Thus, for taxable years beginning after December 31, 2017, the “company’s share” of dividends will be 70%, while the policyholder’s share will be 30%.

• New Reporting Rules for Life Settlement Transactions and Related Changes to Basis and Transfer-for-Value Rules
− The Final Bill follows the Senate Bill concerning the required reporting with respect to certain life settlement transactions, modifications to the transfer-for-value rules, and a clarification that a taxpayer’s adjusted basis in a life insurance contract is not reduced by cost of insurance charges. These provisions generally apply after 2017, but the adjusted basis provision applies to transactions entered into after August 25, 2009, which is the effective date of an IRS ruling on this issue that will be overridden by these changes.

• Change to NOL Carryforward and Carryback Periods for Life Insurance Companies
− The Final Bill follows the House and Senate Bills by repealing the special carryback (three years) and carryforward (15 years plus an additional three years for a new company) provisions applicable to life insurance company net operating losses (NOLs) and conforming the treatment of life insurance companies’ NOLs to the general treatment of NOLs applicable to other companies.

− With respect to the general corporate NOL rules, the Final Bill follows the Senate Bill, but limits NOL deductions to 80% of taxable income starting in 2018, with carryovers (adjusted for the limitation) allowed indefinitely and carrybacks prohibited. The existing rules (two-year carryback and 20-year carryovers) for NOLs, without the 80% limitation, continues for property and casualty insurance companies.
• **Repeal of Small Life Insurance Company Deduction**
  - The Final Bill follows the House and Senate Bills. It repeals the small life insurance company deduction in section 806.

• **Repeal of 10-Year Spread for Changes in Basis of Computing Reserves and Application of the General Change in Accounting Method Spread Period**
  - The Final Bill follows the House and Senate Bills. Section 807 will be amended to repeal the 10-year spread period for taking into account changes in the basis of computing reserves for taxable years beginning after December 31, 2017.
  - After 2017, the general income adjustment rules under section 481 applicable to changes in methods of accounting apply to a change in basis of computing reserves.

• **Repeal of Rules for Pre-1984 Policyholders Surplus Accounts**
  - The Final Bill follows the House and Senate Bills and repeals for taxable years beginning after December 31, 2017, the policyholders surplus account rules applicable to stock life insurance companies in section 815. Remaining policyholders surplus account balances are subject to tax over an eight-year period starting in 2018.

• **Changes to Discounting Rules for Property and Casualty Insurance Companies**
  - The Final Bill generally follows the House Bill, which modified the method for discounting reserves in three important ways:
    - The interest rate that must be used for discounting is based upon the corporate bond yield curve, which is defined as a yield curve reflecting the average monthly yields for the preceding 60-month period on investment grade corporate bonds in the top three quality levels available, at varying maturities.
    - The computational rules for loss payment patterns for long tail business are modified by extending the payout periods by up to a 14-year period (i.e., up to 24 years for the current 10-year payment pattern).
Current section 846(e), which permits a taxpayer to elect to use its own loss payment pattern, is repealed.

- The provision generally applies to taxable years beginning after 2017. There is a transitional rule whereby the impact of applying the new rules relating to pre-effective date losses and expenses is taken into account over an eight-year period.

Changes to Property and Casualty Proration Rules

- The Final Bill follows the Senate Bill, replacing the current 15% reduction under current law with a reduction equal to 5.25% divided by the current maximum corporate tax rate (a 25% reduction when the top rate is 21%).

- This provision is effective for all taxable years after 2017.

Repeal of Rules for Special Estimated Tax Payments

- The Final Bill repeals section 847 for all taxable years after 2017.

INTERNATIONAL PROVISIONS OF IMPORTANCE TO INSURANCE COMPANIES

Move to Territorial System

- The Final Bill moves to a territorial system of international taxation and modifies the subpart F regime applicable to controlled foreign corporations (CFCs), following the Senate Bill with mostly minor changes. Most significantly, the Final Bill retains section 956 (the tax on a CFC’s investment in US property), which both the House and Senate Bills proposed eliminating.

- The transition rule was retained, largely in the form set forth in the Senate Bill, except that under the Final Bill deferred foreign earnings are taxed at a rate of 15.5% on the foreign corporation’s cash positions and 8% on all other earnings. The Final Bill also includes several anti-abuse provisions that allow the Treasury to adopt regulations to prevent avoidance of the transition tax.

- The territorial and subpart F/CFC regime modifications are not insurance-industry specific. See the prior Eversheds Sutherland International Legal Alert for a more complete description of the territorial system in the Final Bill.
• **Base Erosion Anti-Abuse Tax (the BEAT)**

  The Final Bill principally follows and expands the Senate Bill, which creates a new minimum tax on excess "modified taxable income," which in general is a US group’s taxable income after removing all "base erosion tax benefits" from the income calculation.

  The provision in the Final Bill applies to US groups that have a "base erosion percentage" of at least 3% or higher for the taxable year. The base erosion percentage is defined as the aggregate amount of the base erosion tax benefits (generally deductible payments made to a related foreign person) divided by the aggregate amount of deductions (subject to certain adjustments).

  **Eversheds Sutherland Observation:** The BEAT applies in addition to any excise tax due under section 4371, even if the payment would generate subpart F income in the CFC. In addition, the BEAT imposed on reinsurance premiums will not be netted against payments made by a foreign reinsurer to a US ceding company.

  This provision applies to all taxable years after 2017.

• **Revised Insurance Company Exception from Passive Foreign Investment Company (PFIC) Rules**

  The Final Bill follows the House and Senate Bills and will significantly narrow the scope of the insurance exception from the PFIC rules.

  This provision will be effective for all taxable years after 2017.

  **Eversheds Sutherland Observation:** The Final Bill, like the House and Senate Bills, excludes unearned premium reserves from the calculation of “applicable insurance liabilities,” despite contentions by some in the insurance industry that unearned premium reserves should be included in the determination of the applicable reserves for purposes of determining whether a corporation is engaged in an active insurance business.

If you have any questions about this legal alert, please feel free to contact any of the attorneys listed under 'Related People/Contributors' or the Eversheds Sutherland attorney with whom you regularly work.