ACSW presentation

Tax Cuts and Jobs Act
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Sheryl B Flum (sflum@kpmg.com)

Background

Sheryl is a Managing Director in the Financial Services Tax Practice of KPMG Washington National Tax. She has over fifteen years' experience in the technical aspects of insurance law.

Professional industry experience

Sheryl previously served as the Chief of the Insurance Branch within the Financial Institutions and Products office of the Office of Chief Counsel of the Internal Revenue Service. As the Branch Chief, Sheryl was responsible for tax law implementation, tax law interpretation, and focusing on new and emerging issues in insurance tax.

Sheryl is experienced with providing IRS guidance on issues that have a broad impact on insurance company taxpayers or on those who purchase insurance products.

Sheryl has experience with IRS examination audits of insurance companies, private letter rulings on the federal tax treatment of proposed transactions and new insurance products, closing agreements between life insurance companies and the IRS, and change in method of accounting requests related to Subchapter L issues.

Sheryl is experienced with the requirements for determining reserves for life insurance products under Section 807 of Subchapter L. Additionally, Sheryl is knowledgeable about determining non-life insurance company taxable income under Section 832 of Subchapter L.

Sheryl is a frequent public speaker on insurance tax matters at many insurance tax related programs including programs sponsored by American Bar Association, Federal Bar Association, Insurance Tax Conference and Society of Actuaries.

Agenda

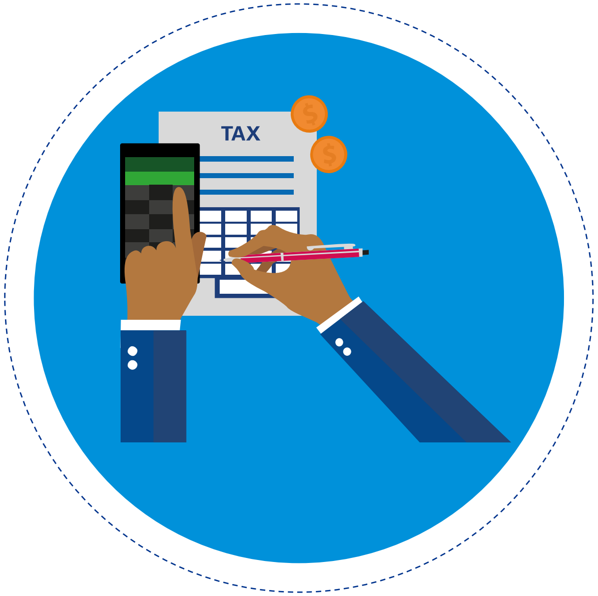
Background

Highlights

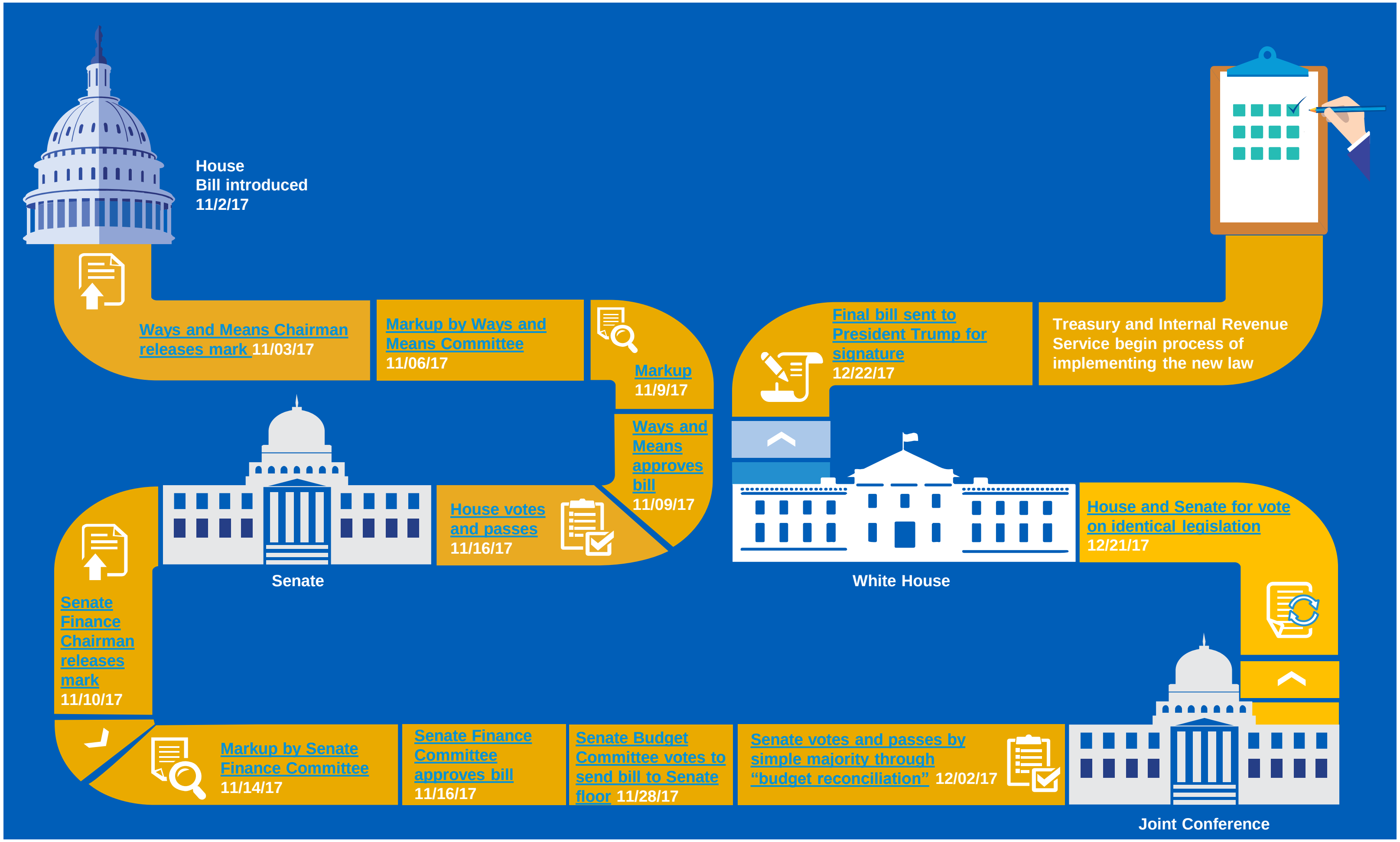
Overview of H.R. 1

How will things change?

1. Background



A whirlwind tax bill



Political and policy drivers

Politics

- Healthcare Reform
- Mid-term Elections

Policy

- Reduce rates on business income
- End the deferral system
- Deter inversions and respond to BEPS

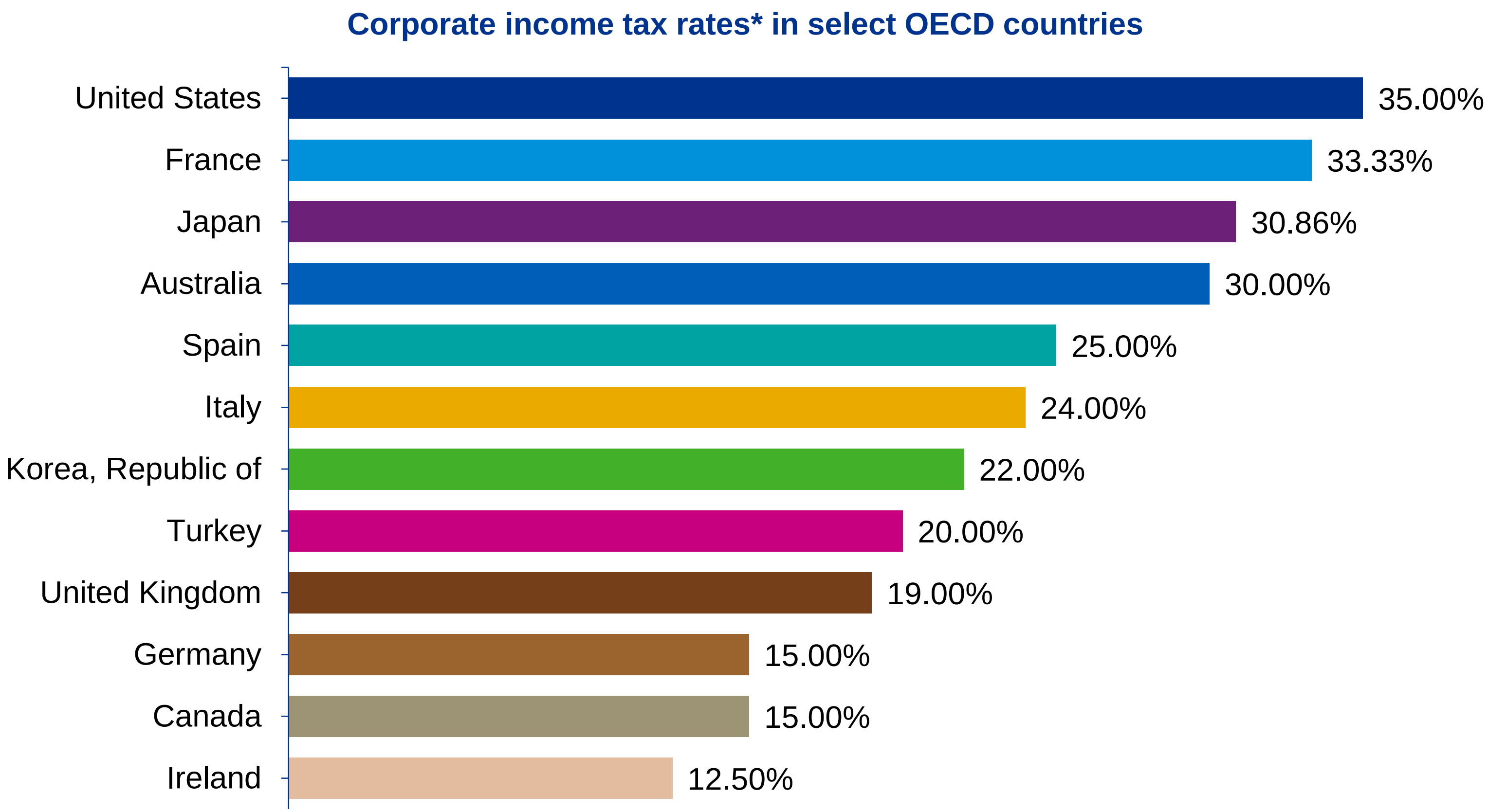
Aspirations

- Simplification
- Estate tax repeal
- AMT repeal
- Pass-thru parity

H.R. 1 Signed into law

- On December 22, 2017, President Trump signed H.R. 1 into law
- The new law completes a long process in pursuit of business tax reform
- Most of the new law was effective on Jan. 1, 2018, though some provisions have delayed (or other) effective dates
- The massive bill reflects a net tax cut of about $1.5 trillion over a 10-year period (according to JCT conventional estimates).
- The bill will almost certainly be subject to changes, corrections and regulatory interpretation over the coming years

U.S. and other OECD statutory corporate tax rates (2017)



*Basic, top corporate income tax rate levied by central government. Local level taxes and surtaxes are not included.
Source: KPMG International, Tax Rates Online, 2017 data,
https://home.kpmg.com/xx/en/home/services/tax/tax-tools-and-resources/tax-rates-online.html

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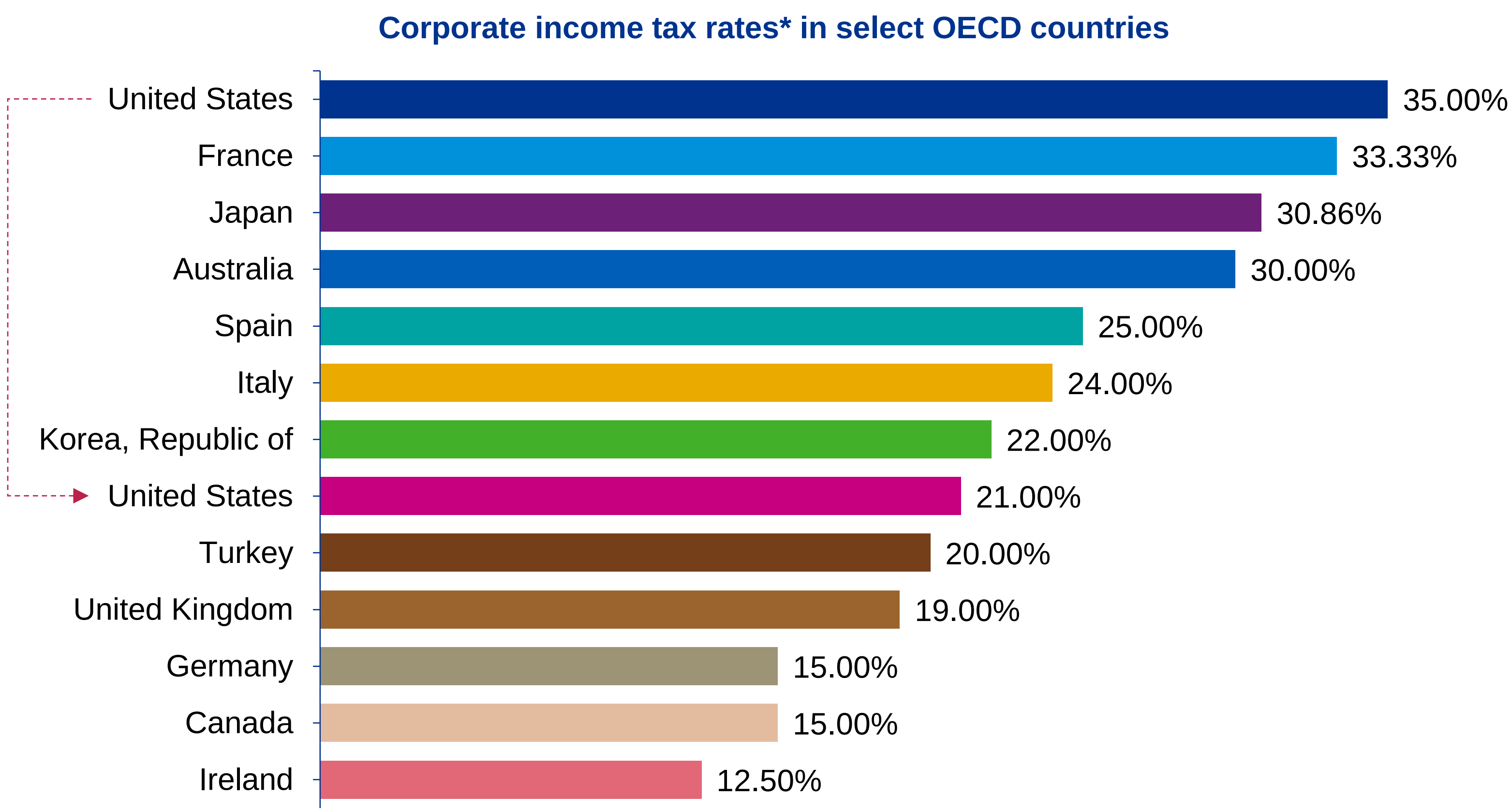

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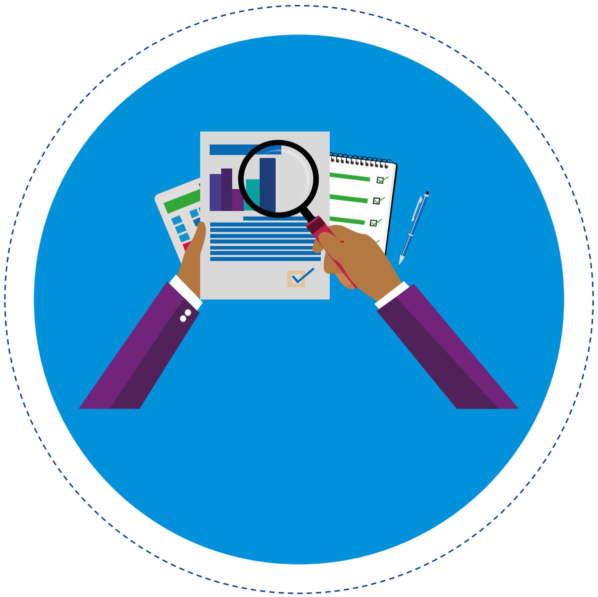

2. Highlights of H.R. 1

Cornerstone provisions of U.S. tax reform

Lower Corporate Rate – 21%

Participation Exemption and Mandatory Repatriation Tax

Immediate Expensing But Strengthened Interest Expense Limitation Rule

Net Operating Loss (“NOL”) Limitation Modifications

Base Erosion Anti-Avoidance Tax (the “BEAT”)

New Global Intangible Low Taxed Income (“GILTI”) Tax vs. Deduction for Foreign Derived Intangible Income (“FDII”)

The numbers tell the story

Revenue impact[1]	Final bill provisions
$1,349	Reduce corporate rate to 21%
$415	Passthroughs
$86.3	Temporary, limited expensing
$212	Territoriality
$64	Domestic IP Incentive (foreign-derived intangible income (“FDII”) deduction)
$339	Mandatory repatriation
$150	Base erosion and anti-abuse tax (“BEAT”)
$113	Super Subpart F (incl. global intangible low-taxed income (“GILTI”) inclusion)
$253	Interest expense reforms
$201	NOL reform
$98	Repeal section 199

1. Based on 10-year scores provided by the Joint Committee on Taxation. U.S. Dollar amounts are in billions.

3. An Overview of H.R. 1

Key proposals

Individual

Provision	Conference agreement (Most individual changes expire after 12/31/25)
Ordinary income rate	10% – 12% – 22% – 24% – 32% – 35% – 37% Uses “chained CPI” for indexing of tax rate thresholds, standard deduction amounts, and other; use of chained CPI not subject to sunset
Standard deduction/ personal exemption	Consolidate personal exemption/standard deduction into nearly double standard deduction ($24,000/$12,000)
Itemized deductions	Allow state and local tax deduction up to $10,000; charitable deductions preserved. Home mortgage interest limited. Eliminates other itemized deductions.
Sale of residence	No provision

Key proposals

Individual (continued)

Provision	Conference agreement (Most individual changes expire after 12/31/25)
Retirement savings	No provision to shift from 401(k) to Roth
Child tax credit	Increase the credit to \$2,000 per child, up to \$1,400 of which is refundable; create \$500 credit for nonchild dependents
Individual alternative minimum tax (AMT)	Retain. Increase exemptions (\$109,400/joint) and phase-outs (\$1 million/joint)
Net investment income tax	Retain
Investment income rate	Current rates maintained (with “breakpoints” indexed for inflation)
Estate tax/ generation-skipping transfer (GST)	Increase exemption to \$10 million (indexed for inflation)
Individual Mandate	“Individual shared responsibility payment” penalty changed to \$0 in 2019; **this item not scheduled to expire**

Key proposals

Business

Provision	Conference agreement
Corporate rate	21%, effective for taxable years beginning after 12/31/17. Special rules for fiscal year filers.
Individual owners of passthroughs and proprietorships	Create a 20% deduction to be taken against “qualified business income”; numerous limitations apply; service businesses generally excluded with special rules for taxpayers with taxable income below $157,500 (single) or $315,000 (joint) **Deduction expires after December 31, 2025**
Carried interest	Three-year holding period for long-term capital gain (LTCG) in the case of certain partnership interests received for services
Cost recovery	100% expensing for investments in depreciable property other than real property or certain utility property and certain businesses with floor plan indebtedness; applies to both new and used property; applies to investments after September 27, 2017 and before January 1, 2023; phase-out 2023 – 2026
Real property cost recovery	No general provision. Includes special rules for certain leasehold, restaurant, retail and residential rental property.

Business (continued)

Provision	Conference agreement
Interest expense	Disallow net business interest deductions in excess of 30% of "adjusted taxable income"; adjusted taxable income generally is EBITDA from 2018 – 2021 and EBIT thereafter; does not apply to certain small businesses, real estate businesses, utilities, and floor plan indebtedness; disallowed interest carried forward indefinitely
Net operating losses (NOLs)	Limited to 80% of taxable income (for losses arising in tax years beginning after 2017); generally no carrybacks; indefinite carryforward.
Corporate AMT	Repeal corporate AMT; credit carryforwards partially refundable in years 2019, 2020 and 2021; fully refundable by 2022
Research activities	No changes to research credit; Sec. 174 costs generally amortized over 60 months beginning in 2022
Like-kind exchange	Nonrecognition is eliminated for exchanges of property other than real property
Selected revenue raisers/other	Repeal Sec. 199 beginning 2018. Other deductions and preferences limited or eliminated. Narrows Historic Rehab credit, and Rare Disease credit.

Key proposals

Life insurance provisions

Provision	Conference agreement
Life insurance reserves	Deduction for life insurance reserves = 92.81% of reserve required by NAIC at the time the reserve is determined. Tax reserves cannot be less than the contracts cash surrender value or greater than the statutory reserve. Transition rule: Impact on reserves for pre-2018 contracts is spread over 8 years (**S**)
Treatment of reserve calculation changes	Prior law had a 10 year spread. Under revision, generally one-year spread for reserve increases and four-year spread for reserve decreases. Generally conforms to tax accounting method change rules.
Proration of dividends received deduction & tax exempt interest	Life companies entitled to 70% of the benefit of tax exempt interest and the dividends received deduction.
Tax deferred acquisition costs	Capitalize expenses and amortize expenses over 15 years. Capitalization amount generally based on premiums (2.09% Annuity; 2.45% Group Life; 9.2% other specified contracts)

Key proposals

Life insurance provisions (continued)

Provision	Conference agreement
Operations loss deduction	Conform OLD to general section 172 net operating loss deduction. Generally, $0 carryback and unlimited carryover subject to an annual cap of 80% of taxable income starting in 2018. Pre-2018 OLD carryovers are grandfathered.
Small Life Co. deduction	Repealed.
Policyholder surplus account	Any remaining amounts taken into income over 8 years.

Property & casualty insurance provisions

Provision	Conference agreement
Loss reserve discounting	Increases discount rate to corporate bond yield. Payment pattern extended to 24 years. Repeals company experience election. Transition rule: Impact on reserves for pre-2018 contracts is spread over 8 years.
Proration of dividends received deduction & tax exempt interest	Nonlife companies entitled to 75% of the benefit of tax exempt interest and the dividends received deduction. Proration percentage automatically adjusts based on changes in the corporate tax rate.
Net Operating Loss	Retain prior law. NOLs may be carried back two years and forward 20 years to offset 100% of taxable income.
S. 847 Special estimated payments	Repealed.

Key proposals

International

Provision	Conference agreement
Participation exemption system	Create a 100% exemption for dividends received from 10% owned foreign corporations
Repatriation of existing Earnings and Profits (E&P)	Foreign earnings accumulated under old system deemed repatriated; rate of 15.5% for cash/cash equivalents and 8% for illiquid assets; the tax is payable over 8 years (backloaded); E&P determined as of November 2, 2017 or December 31, 2017 (whichever is higher)
Current tax on certain foreign income (aka "mintax")	Create a current tax on global intangible low-taxed income (GILTI); taxed amount is generally CFC income in excess of a 10% return on basis in business property; partial FTC offset permitted (no carryforward) Domestic corporations are allowed 50% (37.5% after December 31, 2025) deduction for GILTI amount and a 37.5% (21.875% after December 31, 2025) deduction for income deemed derived from foreign intangibles (FDII)

International (continued)

Provision	Conference agreement
Related-party transaction base erosion measures	Create a base erosion anti-abuse tax (BEAT) that functions as an alternative minimum tax by adding back related party deductions (not including COGS) and certain credits; applies to taxpayers with annual domestic gross receipts in excess of $500 million (S). Effective for tax years beginning after 12/31/2017.
Limitation of interest for domestic corporations part of an international financing reporting group	No provision
Section 956	No provision
CFC look-through rule	No provision
Other Base Erosion measures	Limits on income shifting through intangible property transfers, limitation on amounts paid through hybrid transactions/entities, others

4. How will things change?

Some provisions change over time

- Significant delegation to Treasury
- Dynamic provisions
  - Interest Expense → shift from EBITDA to EBIT in 2022
  - R&E Amortization → begins in 2022
  - BEAT → rates increase in 2026
  - Section 250 deductions (GILTI/FDII) → decrease in 2026
  - Expensing → 100% through 2022, phases out through 2026
  - Mandatory Repatriation → payable over 8 years
  - And many individual provisions sunset by 2026

Changing behaviors?

- Mergers & Acquisitions
  - Influx of cash available in U.S. that has historically been held offshore
    - U.S. deal valuations could increase?
  - Current expensing
    - Revisit benefits/detriments of asset vs. share deals
  - Limitations on interest deductibility
    - Changes to transaction financing?
- Value Chain
  - New provisions (e.g., GILTI, BEAT, and FDII) change the landscape and necessitate revisiting tax benefits and costs of global supply chains
  - But don't forget other potential regulatory factors that affect desired outcomes
    - BREXIT, BEPS-inspired legislation, changes to trade agreements, etc.
  - And all of this needs to be considered along with mega trends
    - Technology/innovation, industry consolidation, global capacity and demographics, etc.

Potential M&A pricing implications

Provision	Pricing impact
Tax rates	— Increase in value due to increase in cash flow from reduced tax rates
Interest deductibility	— Decrease in value for highly leveraged companies due to decrease in cash flow from reduced interest deductions
Expensing	— Increase in value for asset intensive businesses due to increase in cash flow from immediate tax deductions — Potential expensing of a portion of the purchase price in asset acquisitions
International tax	— Potential benefit for U.S. corporate targets from ability to receive tax free dividends from foreign subsidiaries, but consider expected amount and timing of repatriation tax cost and going forward effect of GILTI tax on cash flows — For U.S. corporate targets, potential impact of BEAT, if applicable, and FDII deduction
NOLs, credits, and incentives	— Value of company's tax attributes or other preference items may be affected

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