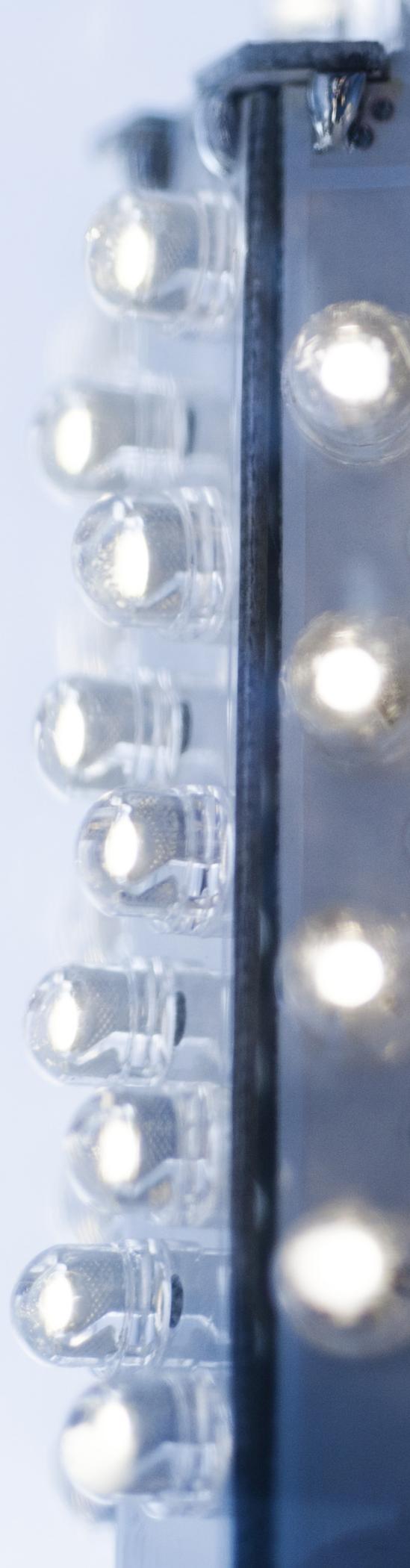




Tax reform and potential implications for the insurance industry

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Tax reform has been identified by both President Trump and congressional leadership as an important priority. Under the U.S. Constitution, revenue measures must originate in the House of Representatives. It seems likely that the House will start the tax reform process by moving a bill that is based on the "blueprint" for tax reform that House Republicans released in June 2016, modified to include additional detail and to incorporate input from the Trump Administration. During the course of the presidential campaign, President Trump modified elements of his tax proposals to correspond more closely with the blueprint, although differences remain, most importantly with respect to the blueprint's proposed border adjustment.

Both President Trump's plan and the House blueprint include high level proposals, but do not provide detailed tax provisions.

In February 2014, then-House Ways and Means Committee Chairman David Camp (R-MI) released a fully developed proposal for tax reform. The "Camp proposal" contains detailed provisions modifying the taxation of insurance companies. Although there are significant differences between the Camp proposal and the proposals from President Trump and the House Republicans, the Camp proposal includes provisions that could be incorporated into any draft tax reform legislation.

The following tables provide comparisons of tax reform proposals that may affect the insurance sector from the Trump campaign proposals, the House Republican blueprint, and the Camp proposal.

Individual tax proposals

Trump campaign proposal	House blueprint	Camp proposal
Individual ordinary income rates: 12%-25%-33%	Individual ordinary income rates: 12%-25%-33%	Individual ordinary income rates: 10%-25%-35%
Increase standard deduction to \$15K/\$30K	Consolidate personal exemption/standard deduction into a larger standard deduction (married/\$24,000)	Increase standard deduction to \$11K/ \$22K with phase out if taxpayer's modified AGI exceeds \$513,600.
Eliminate personal exemptions	See above	Eliminate personal exemptions
Cap itemized deductions at \$200K for joint filers (\$100K for single filers)	Eliminate itemized deductions other than home mortgage interest and charitable deductions (undisclosed	The Camp proposal eliminates itemized deductions for interest on home equity indebtedness,

Trump campaign proposal	House blueprint	Camp proposal
	changes could be made to home mortgage interest deductions)	certain types of business expenses incurred by an employee, state and local property taxes not incurred in carrying on a trade or business, and personal casualty and theft losses. The Camp proposal also imposes a 2% floor on charitable deductions.
Provide benefits for childcare and dependent eldercare, including exemptions, rebates, and Dependent Care Savings Accounts (with some limits and caps)	Enhanced child and dependent care tax credit	The Camp proposal repeals the dependent care credit, the health care credit and certain other individual credits.
Tax carried interest as ordinary income	For pass-through entities, amount equal to “reasonable compensation” would be taxed as ordinary income	The Camp proposal characterizes certain capital gains as ordinary income.
Repeal AMT	Repeal AMT	Repeal AMT
Repeal net investment income tax	Repeal net investment income (as part of healthcare reform legislation)	The 3.8% tax on net investment income is not affected by the proposal.
Retain 20% maximum capital gain rate	50% deduction for capital gains, interest, and dividends (6%, 12.5%, 16.5% rates)	The Camp proposal provides for a 40% deduction equal to the adjusted net capital gain.
Repeal estate tax, but tax certain capital gains over \$10 million at death	Repeal estate tax	No analogous provision

Business tax proposals

Trump campaign proposal	House blueprint	Camp proposal
15% business rate for “all businesses, both small and large, that want to retain the profits within the business”	Lower corporate rate to 20%	Reduce the maximum corporate tax rate to 25% (over a five-year transition period).
No analogous provision	Special rate of 25% for business income earned by	No analogous provision.

Trump campaign proposal	House blueprint	Camp proposal
	pass-through entities. Backstopped by reasonable compensation requirement	
Allow firms engaged in manufacturing in the United States to elect to expense capital investment and lose the deductibility of corporate interest expense	Allow businesses to fully and immediately expense the cost of investment in tangible property (such as buildings and equipment) and intangible assets (such as intellectual property), but not land	Simplifies depreciation for tangible property by requiring a straight line method among other changes.
No analogous provision	Allow businesses to deduct interest expense only against interest income, with any net interest expense that is not deductible being carried forward indefinitely	No analogous provision.
No analogous provision	NOLs to be carried forward indefinitely and indexed for inflation, but no carry back. Carry forwards limited to 90% of the net taxable amount for the year of the carry forward	Modification of net operating loss (NOL) deduction. Section 3106 of the draft legislation would limit a corporation's NOL deduction to 90% of taxable income. The proposal would also repeal the special NOL carryback provisions other than the provision relating to certain casualty and disaster losses. The proposal would repeal the limitation on the carryback of excess interest losses attributable to corporate equity reduction transactions (CERTs).
Increase cap on business tax credit for on-site childcare and allow businesses that pay a portion of employee childcare expenses to exclude those contributions from income	No analogous proposal	Section 3211 of the draft legislation would repeal the credit for employer provided child care.

Trump campaign proposal	House blueprint	Camp proposal
Eliminate most “tax expenditures” (but not R&D credit)	Eliminate various “special interest deductions and credits” designed to encourage particular business activities (except R&D and LIFO)	Eliminates various tax credits.
Repeal corporate AMT	Repeal corporate AMT	Repeal corporate AMT
Tax incentives for infrastructure	No analogous proposal	No analogous proposal
No analogous proposal	No analogous proposal	Modification of amortization of goodwill and certain other intangibles. Section 3119 of the draft legislation would extend from 15 years to 20 years the amortization period for acquired Code section 197 intangibles, which include purchased goodwill and going concern value, certain covenants not to compete, trademarks, trade names, and franchises. Also, acquired mortgage servicing rights would be amortized over 20 years rather than over 108 months.

International tax proposals

Trump campaign proposal	House blueprint	Camp proposal
No analogous provision	U.S. international tax system moves toward a destination-based tax system under which the taxing jurisdiction for business income would be based on the location of consumption – where goods are sold or services are performed – rather than the location of production	Generally, under the Camp proposal, a United .S. corporate shareholder would be entitled to a 95% deduction for the foreign sourced portion of dividends received from certain foreign subsidiaries. The proposal includes complex provisions to prevent offshore shifting

Trump campaign proposal	House blueprint	Camp proposal
		of profits. To protect against base erosion, the proposal imposes a minimum tax of 15% on a controlled foreign corporation's (CFC) foreign earnings by creating a new category of subpart F income (foreign base company intangible income) for foreign earnings subject to an effective tax rate below 15%. The proposal would exclude from the FBCII tax base a specified percentage (10%) of the CFC's qualified business asset investment, defined as the aggregate adjusted basis of certain tangible depreciable property used in the CFC's trade or business.
No analogous provision	Replace current system of taxing U.S. persons on their worldwide income with a territorial tax system	See above description.
No analogous provision	Provide for border adjustments exempting exports and taxing imports. The Blueprint states that this move towards a consumption based tax approach allows border adjustments consistent with World Trade Organization (WTO) rules.	See above description.
No analogous provision	System would provide a 100% exemption for dividends from foreign subsidiaries	See above description.
Deemed repatriation at one-time 10% rate	Foreign earnings accumulated under old system repatriated by paying tax of 8.75% to the extent held in cash or cash	Deemed repatriation of pro rata share of non-previously taxed, post-1986, foreign earnings of certain foreign corporations with an

Trump campaign proposal	House blueprint	Camp proposal
	equivalents or 3.5% otherwise (payable in installments over 8 years)	offsetting deduction of up to 90%.

International insurance – specific provisions

Trump campaign proposal	House blueprint	Camp proposal
No analogous provision	No analogous provision	Reinsurance with affiliates. Section 3701 of the draft legislation would prohibit a deduction of property and casualty reinsurance premiums paid to a related company that is not subject to U.S. taxation on the premiums, unless the related company elects to treat the premium income as effectively connected to a U.S. trade or business (and thus subject to U.S. tax). If the taxpayer demonstrates that a foreign jurisdiction taxes the reinsurance premiums at a rate equal to or greater than the U.S. corporate rate, then the deduction for reinsurance premiums would be allowed. Any income from reinsurance recovered by the U.S. ceding insurance company, as well as any ceding commissions received in connection with a premium deduction that has been disallowed, would not be subject to US tax. Estimated revenue impact (2014 – 2023): \$8.7 billion in revenue
No analogous provision	No analogous provision	Restriction on insurance business exception to PFIC rules. Section 3703 of the draft legislation would amend the insurance exception to the passive foreign investment (PFIC) rules to apply only if (1) the PFIC would be taxed as an insurance company were it a U.S. corporation; (2) more than 50% of the PFIC’s gross receipts for the tax year consist of premiums; and (3) loss and loss adjustment expenses, unearned premiums and certain reserves constitute

Trump campaign proposal	House blueprint	Camp proposal
		more than 35% of the PFIC's total assets. Estimated revenue impact (2014 – 2023): \$.4 billion in revenue
No analogous provision	No analogous provision	Changes in threshold in the high tax exception to subpart F income; exception no longer optional. Section 4201 of the proposal would amend Code section 953 and 954 by changing the tax rate threshold that must be met in order for the high tax exception to subpart F income to apply. Under the exception, an item of insurance income is not treated as subpart F income if it has been taxed at or above a threshold rate of foreign tax. The proposal would change the threshold rate for insurance from 90% to a 100% of the maximum corporate U.S. tax rate (i.e. from a 25% to a 31.5% tax rate). Estimated revenue impact (2014 – 2023): \$115.6 billion in revenue for overall subpart F reform.

Life insurance company – specific provisions

Trump campaign proposal	House blueprint	Camp proposal
No analogous provision	No analogous provision	Excise tax on systemically important financial institutions. Section 7004 of the Camp Draft would impose a quarterly excise tax of 0.035% on systemically important financial institutions as defined under the Dodd-Frank Wall Street Reform and Consumer Protection Act. Estimated revenue impact (2014 – 2023): \$86.4 billion in revenue.

Trump campaign proposal	House blueprint	Camp proposal
No analogous provision	No analogous provision	<p>Computation of life insurance reserves. Section 3504 of the Camp Draft would eliminate the prevailing state assumed interest rate and make the discount rate the 60-month rolling average applicable Federal midterm rate plus 3.5 percentage points. Revenue estimate: Estimated revenue impact (2014 – 2023): \$24.5 billion in revenue</p>
No analogous provision	No analogous provision	<p>Capitalization of certain policy acquisition expenses (DAC). Section 3512 of the draft legislation would substantially increase the capitalization rates applicable to specified insurance contracts under Code section 848, would replace the current three categories of contracts with only two categories: Group contracts (5%); and all other specified contracts (12%). Estimated revenue impact (2014 – 2023): \$11.7 billion in revenue</p>
No analogous provision	No analogous provision	<p>Modification of rules for life insurance proration for purposes of determining the dividends received deduction. Section 3506 would change life insurance company proration rules for the dividends received deduction in Code section 805(a)(4) by amending the proration formula to compare mean reserves to mean assets of each account, rather than the formulaic computation under current law. Estimated revenue impact (2014 – 2023): \$4.5 billion in revenue</p>

Trump campaign proposal	House blueprint	Camp proposal
No analogous provision	No analogous provision	<p>Repeal of Code section 807(f) spread. Code Section 807(f) provides an exception from the normal accounting method change rules for changes to life insurance reserves. These changes do not require the consent of the IRS and are spread over 10 years. Section 3505 of the draft legislation would repeal the special 10-year period for section 807(f) adjustments and would make them subject to the normal spread periods, now four years for positive adjustments and one year for negative adjustments. Estimated revenue impact (2014 – 2023): \$2.5 billion in revenue</p>
No analogous provision	No analogous provision	<p>Operations loss deductions of life insurance companies. Section 3502 of the draft legislation would change the operations loss carryover and carryback periods for life insurance companies under Code section 810. Operations losses of life insurance companies would be carried back 2 tax years (instead of 3) and forward up to 20 tax years (instead of 15) in conformity with the general net operating loss carryover rules. Estimated revenue impact (2014 – 2023): \$0.3 billion in revenue</p>
No analogous provision	No analogous provision	<p>Repeal of the small life insurance company deduction. Section 3503 of the draft legislation would repeal Code section 806 special deduction for small life insurance companies. Estimated revenue impact (2014 – 2023): \$0.3 billion in revenue</p>

Property and casualty insurance company – specific provisions

Trump campaign proposal	House blueprint	Camp proposal
No analogous provision	No analogous provision	<p>Modification of discounting rules for property and casualty insurance companies. Pursuant to Code section 846, nonlife insurers are required to discount their unpaid losses using an interest rate equal to the 60-month rolling average of the applicable Federal midterm interest rate. Section 3510 of the draft legislation would require P&C insurance companies to use a higher rate – the corporate bond yield curve (as specified by Treasury) to discount their unpaid losses under Code section 846. In addition, the proposal would modify the special rules for long-tail lines of business and repeal the election to use company specific historical loss patterns. Estimated revenue impact (2014 – 2023): \$17.9 billion in revenue</p>
No analogous provision	No analogous provision	<p>Modification of proration rules for P&C insurance companies. Nonlife insurance companies are currently required to reduce the exclusion from income for tax-exempt interest income by 15%. The adjustment is accomplished by a reduction in the deduction allowed for unpaid losses. Section 3508 of the draft legislation would replace the fixed 15% reduction with a formula for reducing the reserve deduction by an amount equal to the tax exempt income of the company multiplied by a percentage equal to the ratio of the tax-exempt assets of the company total assets. Estimated revenue impact (2014 – 2023): \$2.9 billion in revenue.</p>

Trump campaign proposal	House blueprint	Camp proposal
No analogous provision	No analogous provision	<p>Interest expense incurred for tax-exempt obligations. Section 3124 of the draft legislation would substantially modify the ‘tax arbitrage’ rules of Code section 265 as follows: C corporations (including insurance companies) would be required to calculate the amount of the interest disallowed under Code section 265 based on a single method, which disallows interest deductions based on the percentage of the taxpayer’s assets comprised of tax-exempt obligations. In addition, the special rule for qualified small issuer tax-exempt obligations would also be repealed. Estimated revenue impact (2014 – 2023): \$1.6 billion in revenue</p>
No analogous provision	No analogous provision	<p>Repeal of special estimated tax payments. Section 3511 of the draft legislation would repeal the Code section 847 elective deduction and related special estimated tax payment rules. Estimated revenue impact (2014 – 2023): Less than \$50 million in revenue.</p>
No analogous provision	No analogous provision	<p>Repeal of special treatment of Blue Cross and Blue Shield organizations, etc. Section 3509 of the draft legislation would repeal the special rules for Blue Cross Blue Shield and certain other health insurance organizations, i.e. the 25% deduction, the exception from the application of the 20% unearned premium haircut, and the treatment as stock insurance companies. Estimated revenue impact (2014 – 2023): \$4.0 billion in revenue</p>

Investment specific provisions

Trump campaign proposal	House blueprint	Camp proposal
No analogous provision	No analogous provision	<p>Derivatives marked to market; ordinary gain or loss. Section 3401 of the draft legislation would require that derivative financial transactions be marked to market annually with the resulting gain or loss treated as ordinary. Such gain or loss would be attributable to a trade or business of the taxpayer for the purposes of determining nonbusiness deductions, which are allowed in computing a net operating loss. The provision would not apply to derivatives accounted for as part of a hedging transaction. The Camp proposal would repeal several Code sections related to the timing and character of gain or loss with respect to derivatives, including sections 1233, 1234, 1234A, 1256, 258, and 1259. Insurance, annuity, and endowment contracts issued by a subchapter L insurance company would be excluded from mark-to-market treatment.</p>
No analogous provision	No analogous provision	<p>Hedge identification. Section 3402 of the draft legislation would generally permit (1) a taxpayer’s identification of a hedge for GAAP to qualify as an identification for tax purposes; and (2) an insurance company to hedge debt instruments that are capital assets. A transaction treated as a hedging transaction for GAAP would still have to qualify as a hedging transaction for tax purposes.</p>
No analogous provision	No analogous provision	<p>Current inclusion of income of market discount. Section 3411 of the draft legislation contains three changes to the market discount rules. First, market discount would be includible in income as it accrues for all holders. Second, the amount of market discount that accrues would be determined under original issue discount (“OID”) principles. Third, the total amount of market discount that a holder would be required to include in income for</p>

Trump campaign proposal	House blueprint	Camp proposal
		<p>any accrual period would be capped at the greater of: (1) the bond's original yield to maturity plus 5%; or (2) the applicable Federal rate at the time of acquisition (based on the remaining term of the bond) plus 10% times the adjusted basis of the bond, less the amount of OID and qualified stated interest accrued during such period. Under the proposal, if a taxpayer disposes of a market discount bond at a loss, the loss would be ordinary to the extent of previously accrued market discount.</p>
No analogous provision	No analogous provision	<p>Treatment of certain exchanges of debt instruments. Section 3412 of the Camp Draft would add a new Code section 1274B, which would provide that if an issuer issues a new debt instrument in exchange for (including in a significant modification of) its existing debt instrument, the issue price of the new debt instrument would be the lesser of: (1) the adjusted issue price of the existing debt instrument; (2) the stated principal amount of the new debt instrument; or (3) the imputed principal amount of the new debt instrument. The Camp Draft would also amend Code section 1037 to provide that holders of debt instruments would recognize no gain or loss if an existing debt instrument is exchanged (including in a significant modification) solely for a new debt issued by the same issuer. The rule would not apply to any property the holder receives that is attributable to accrued interest on the existing debt. If a debt holder received cash or other property in addition to the new debt, the holder's gain would be limited to the gain that the holder would have recognized had section 1274B not applied.</p>

Trump campaign proposal	House blueprint	Camp proposal
No analogous provision	No analogous provision	Cost basis of specified securities determined without regard to identification. Section 3421 of the draft legislation would amend Code section 1012 to require taxpayers that sell a portion of their holdings of a “specified security” to determine gain or loss on a first-in, first-out basis, eliminating specific identification. “Specified securities” would include stock, debt, options, commodities, commodity derivatives contracts (to the extent Treasury requires basis reporting for these contracts), and any other financial instruments for which Treasury requires basis reporting.

Takeaways

- The Camp proposals contain numerous detailed additional taxes on the insurance industry. These revenue raisers do not generally further the overall goals of the House Blueprint or President Trump’s tax reform agenda, but were considered by Camp reforms of current law consistent with the proposed reduction in the corporate rate, and could potentially reduce or eliminate any benefits associated with the lower corporate tax rates.
- The House Republican Tax Reform Blueprint’s destination-based cash flow tax proposal would be the most substantial change in a century to how businesses are taxed. Rather than taxing companies based on income generated in the U.S., the proposal would tax a company’s U.S. cash flow, while exempting foreign sales and taxing imports. The proposal, which is aimed at boosting U.S. business and exports and reducing the U.S. trade deficit, could have material implications to the U.S. dollar, as well as other economic effects. In addition, critics argue that the border adjustment element of the proposal could be protectionist and a violation of the General Agreement on Tariffs and Trade, as well as U.S. tax treaties. KPMG is actively analyzing these developing facts and issues to evaluate the impact on our clients and the insurance industry, in particular.
- Lower corporate tax rates will impact a company’s financial statements. The reduction in corporate tax rates will require companies to revalue their existing inventory of deferred tax assets and liabilities. The immediate consequence would

go through the income statement as income or expense depending on whether the insurance company is in a net deferred tax liability or asset position.

- Certain provisions could potentially have a significant effect on a company's statutory admitted deferred tax assets. For example, the elimination of the net operating loss carryback could reduce admissible deferred tax assets.
- Both the life and non-life insurance industries have been proactively working with Congress to ensure that the tax law writers understand the unique aspects of the insurance business.

We are continuing to identify and analyze the implications of tax reform to the insurance industry. Your KPMG insurance tax resources can assist you in understanding and analyzing the potential impact of these provisions.

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