

# Introduction to Taxation

F&I Reinsurance and Product Conference

by

**David Kaseff, CPA, JD, CGMA**

Chief Financial Officer / Partner  
MarksNelson, LLC

**Andrew J. Weill, Esq.**

Principal  
Weill & Mazer, APC

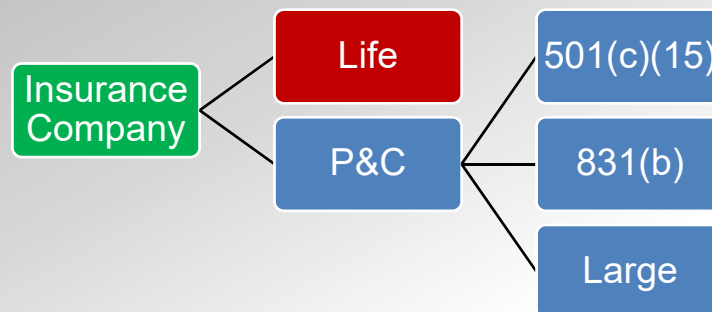
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1

# Insurance Company Taxation



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2

## Insurance Company

Defined in IRC Section 816(a):

...“the term ‘insurance company’ means any company more than half of the business of which during the taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies.”

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## Life Insurance

- More than 50% of mean total reserves are from life insurance and/or non-cancellable accident and health policies
- NOL restrictions:
  - Old Rules:
    - Carryback 3 years
    - Carry Forward 20 years
  - New Rules:
    - No Carryback
    - Unlimited Carry Forward

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## Life Insurance

- Large Life Insurance Company
  - Taxable income starts with Statutory Income
  - Special Tax Life Mortality Reserves
  - Acquisition Costs on Life insurance policies deferred and expensed over 10 years
  - General Corporate Tax Adjustments
    - Dividends Received Deduction
    - Tax Exempt Interest

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5

## Life Insurance

- Small Life Insurance Company
  - Repealed by Tax Cuts and Jobs Act of 2017
  - Not available for 2018 and future years
  - Prior Rules:
    - Under \$500 million in controlled group assets
    - 60% “haircut” of tentative Life Insurance Company Taxable Income (LICTI)

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## P&C Insurance

- Non-Life Insurance Company
- Tax Regimes
  - IRC Section 501(c)(15)
  - IRC Section 831(b)
  - Large

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7

## Internal Revenue Code Section 501(c)(15)

- Tax Exempt
  - Application to be tax exempt
  - Files Annual Form 990 return
- Qualifications
  - Gross receipts of up to \$600,000
  - 50% of total gross receipts must be from premiums
  - Includes gross receipts for all affiliates
- Abuses and IRS restrictions significantly restricted use

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8

## Internal Revenue Code Section 831(b)

- Election to be Taxable on:
  - Net Investment Income
  - Underwriting Income Exempt from Tax
- Net Operating Loss cannot be carried to, from, or past a year with an IRC Section 831(b) election in effect
- Permanent unless approved by Secretary or no longer qualifying

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## Internal Revenue Code Section 831(b)

- Net Written Premium or direct written premium (whichever is greater) does not exceed the threshold for the year
  - 2016 and Prior – \$1.2 million
  - 2017 and Future – \$2.2 Million (indexed for inflation in \$50,000 increments based on 2013)
  - 2018 and 2019 inflation indexed – \$2.3 Million

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10

## Internal Revenue Code Section 831(b)

- Two Diversification Tests
  - Premium test
  - Ownership test
  - Added to 831(b) by Protecting Americans from Tax Hikes (PATH) Act
  - Clarifications provided by Consolidated Appropriations Act, 2018 (CAA, 2018)

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11

## Internal Revenue Code Section 831(b)

### Premium Test

- No more than 20% of Net Written Premium or direct written premium (whichever is greater) comes from one policyholder
- All members of a Controlled Group count as a single policyholder
- CAA, 2018 clarified look through principal applies when determining who is the policyholder
  - Example: If a reinsurance company assumes business from one ceding company, the underlying risk covers the risk of thousands of individual consumers, therefore the reinsurance company passes the Premium Test.

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12

## Internal Revenue Code Section 831(b)

### Ownership Test

- No specified holder owns (directly or indirectly) more of the insurance company, directly or indirectly, than that specified holders owns of the specified assets (insured assets/business/etc.)
- Specified holder (as clarified by CAA, 2018)
  - Lineal descendent of an owner of specified assets or the owner's spouse
  - A spouse of any lineal descendent described above
  - Spouse of an owner of specified assets, if the spouse is not a citizen of the United States
- 2% de minimis safe harbor

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## Internal Revenue Code Section 831(b)

### Example

Net Written Premium	\$900,000
Change in Unearned Premium	<u>300,000</u>
Earned Premium	\$600,000
Losses Incurred	<u>325,000</u>
Underwriting Gain	\$275,000
Net Investment Income	20,000
General Expenses	<u>5,000</u>
Net Income (book)	\$290,000
Taxable Income	\$ 20,000
<b>Tax</b>	<b>\$ 4,200</b>

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14

## Polling Question

What is the Net Written Premium cap for 831(b) for 2019?

- A. \$1.2 Million
- B. \$1.3 Million
- C. \$2.2 Million
- D. \$2.3 Million

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15

## Large P&C

- Large does not qualify for or did not make IRC Section 831(b) election
- Only allowed to deduct 80% of Unearned Premium Reserve change: aka 20% Haircut
- NOL restrictions:
  - Carryback 2 years
  - Carryforward 20 years
  - Different from other corporations

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16



## Large P&C

### Example

Net Written Premium	\$900,000
Change in Unearned Premium	<u>300,000</u>
Earned Premium	\$600,000
Losses Incurred	<u>325,000</u>
Underwriting Gain	\$275,000
Net Investment Income	20,000
General Expenses	<u>5,000</u>
Net Income (book)	\$290,000
Tax Adjustments:	
Add: 20% Discount of UEP	<u>60,000</u>
Taxable income	\$350,000
<b>Tax</b>	<b>\$ 73,500</b>

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17

## Internal Revenue Code Section 831(b) vs. Large P&C Example

### w/ IRC Section 831(b) election

Taxable Investment Income	\$ 20,000
<b>Tax</b>	<b>\$ 4,200</b>

### w/o IRC Section 831(b) election

Net Income (book)	\$290,000
Tax Adjustments:	
Add: 20% of UEP change	<u>60,000</u>
Taxable income	\$350,000
<b>Tax</b>	<b>\$ 73,500</b>

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18

## Internal Revenue Code Section 953(d)

- Election for foreign insurance company to be treated as a U.S. domestic insurance company
- Owned 25% or more by U.S. Shareholders
- Qualify as insurance company under Subchapter L
- Must waive treaty benefits
- Office in U.S.
- U.S. assets greater than or equal 10% of base year gross income

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19

## Internal Revenue Code Section 953(d)

- Revenue Procedure 2003-47
  - Election statement
  - Attachment format
- Due by tax return filing due date (including extensions)
- Effective first day of the tax year
- Once approved company is no longer a foreign corporation for the purposes of the IRC

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20

## Non-Insurance Products

- Generally treated as income when payment is received
- Cannot deduct amounts set aside for future payments of claims or refunds
- Timing difference creates cash strain from needing to pay taxes while still maintaining liquidity to pay claims and refunds

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21

## Service Warranty Income Method (SWIM)

- Revenue Procedure 92-98 covering insurance payments made for Dealer Obligor (DO) service warranty contracts at the dealership level
- Service Warranty Contracts
  - Fixed-term service arrangements for motor vehicles or durable goods that customer has the option to buy for a separately stated price
  - Begins in year of purchase or expiration of manufacturer's warranty
- Qualified Advance Payment Amount
  - Paid to unrelated third party insurance company for CLIP within 60 days
  - Included in income plus imputed interest over 6 years or the contract's term, whichever is shorter

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22

## Tax Issues with Foreign Entities

- U.S. Shareholder Taxation and Disclosures
  - Subpart F/Form 5471
  - Specified Foreign financial Assets Disclosures
- Excise Tax

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23

## Subpart F/Form 5471

- Information Return of U.S. Persons With Respect To Certain Foreign Corporations (CFCs)
- U.S. owners of CFCs taxes on pro rata share of CFC's Subpart F income
- Subpart F income
  - Foreign base company income
    - Personal holding company income
    - Sales income
    - Services income
    - Oil related income
  - Limited to CFC's earnings and profits
  - Taxable on shareholder's annual personal income tax return

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24

## Subpart F/Form 5471

- Controlled Foreign Corporation (CFC) is any foreign corporation where:
  - more than 50% of the vote or value of the stock of such corporation is owned by a U.S. Shareholder on any day of the tax year
  - a special rule for insurance companies substitutes 25% for 50% in the ownership test
- U.S. Shareholder is defined as a U.S. person who owns 10% or more of:
  - the voting power of all stock in a foreign corporation
  - the value of the company
- Foreign corporation is any corporation that is not created or organized in the U.S. or under the law of the U.S. or any state or the District of Columbia

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25

## Subpart F/Form 5471

- Form 5471 shareholder's statuses:
  - Officer or director who has acquired 10% or more of the stock vote or value in the foreign corporation
  - U.S. person acquires or disposes of stock to meet or fall below the 10% or more of the stock vote or value limit
  - U.S. person who has control of the foreign corporation by owning more than 50% of the stock vote or value limit
  - U.S. person who owns 10% or more of the stock vote or value limit for an uninterrupted period of 30 days or more and owned the stock on the last day of the tax year
- Must report for all statuses, if more than one applies

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26

## Form 5471 Disclosures

### Foreign Company's

- Name
- Address
- Tax identification number
- Incorporation date
- Business activity
- Business activity code
- Functional currency
- Statutory or resident agent information
- Location of books and records
- Person responsible for the books and records
- Company financial information

### Shareholders'

- Names
- Addresses
- Tax identification numbers
- Tax year
- Share ownership by class of stock
- Ownership percentage by class
- Filer category

### Company Financial Information

- Income statement
- Balance sheet
- Earnings and profits calculations
- Transactions between the company and its shareholders

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27

## Specified Foreign Financial Assets Disclosures

- Requires U.S. persons to file a disclosure statement with their personal tax returns if they hold any interest in a specified foreign financial asset(s) whose aggregate value exceeds the threshold for their filing status (Form 8938)
- Penalties for underpayments related to undisclosed foreign financial assets and extension of statute of limitations

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28

## Specified Foreign Financial Assets

- Any financial account maintained by a foreign financial institution
- Any of the following assets which are not held in an account maintained by a financial institution
  - Any stock or security issued by a person other than a U.S. person
  - Any financial instrument or contract held for investment that has an issuer or counterparty which is other than a U.S. person
  - Any interest in a foreign entity

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29

## Reporting Thresholds

Filing Status	Living	Value on 12/31	Maximum Value
Single	In U.S.	\$ 50,000	\$ 75,000
Married Filing Jointly	In U.S.	\$100,000	\$150,000
Married Filing Separately	In U.S.	\$ 50,000	\$ 75,000
Single	Abroad <sup>^</sup>	\$200,000	\$300,000
Married Filing Jointly	Abroad <sup>^</sup>	\$400,000	\$600,000
Married Filing Separately	Abroad <sup>^</sup>	\$200,000	\$300,000

<sup>^</sup> Must be bona fide resident of a foreign country(ies)

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30

## Form 8938 Disclosures

- Value as of the last day of the tax year or maximum value during the tax year
- Typically fair market value
- Negative values are treated as zero from maximum value and aggregation
- Sources of fair market value
  - Periodic account statements for financial accounts
  - Reported stock price for publically traded foreign securities with daily price information available
  - Based on distributions received from foreign trusts

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31

## Form 8938 Disclosures: Planning

- Value used is the greater of year-end or high point during the year
  - Most NCFE programs produce both mid-year and year-end shareholder statements
  - Must add back any distributions taken during the year to determine appropriate value
  - Should use highest value on shareholder statement if more than one basis is provided (Book Value vs. Adjusted Book Value)
- Be careful of stock certificates titled in more that one persons name
- Avoid duplicative reporting

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32



## Excise Tax

- Excise Tax Rates
  - 4% on Casualty insurance or indemnity bonds
  - 1% on Life, sickness, accident insurance or annuity contracts
  - 1 % on Reinsurance
- Validus case ended cascading of excise tax

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33

## Polling Question

What does IRS stand for?

- A. Irritating Reporting System
- B. Internal Revenue Service
- C. Intelligent Receipt Structure
- D. Inconceivable Regulation Supplier

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34

## Questions



David Kaseff, CPA, JD, CGMA  
Chief Financial Officer / Partner  
MarksNelson, LLC  
1310 E. 104<sup>th</sup> Street, Suite 300  
Kansas City, MO 64131  
816.743.7700  
[dkaseff@marksnelsoncpa.com](mailto:dkaseff@marksnelsoncpa.com)  
[www.marksnelson.com](http://www.marksnelson.com)

Andrew J. Weill, Esq.  
Principal  
Weill & Mazer, APC  
200 California Street, Suite 400  
San Francisco, CA 94111  
415.421.0730  
[Weill@weillmazer.com](mailto:Weill@weillmazer.com)  
[www.weillmazer.com](http://www.weillmazer.com)

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