



The Impact of the Tax Reform Act for P/C Insurers

By Allan Autry and Brandy Vannoy

The Tax Cuts and Jobs Act was signed into law by President Trump on December 22, 2017, and will go into effect in January 2018, unless otherwise stated below. The bill contains many provisions that will impact corporations; in this article, we cover the provisions that will likely have the greatest effects on your business. General impacts are detailed first, and property and casualty (P/C) insurer-specific details follow.

General corporate highlights

Here are some of the key elements in the act that affect all corporations:

- The corporate alternative minimum tax (AMT) will be repealed. Existing AMT credits can be utilized from 2018 to 2021 to the extent of a taxpayer's regular tax liability, and 50% of any credits in excess of the regular tax position may be refundable. The amount refundable increases to 100% beginning in 2021.

- Net operating losses (NOL) will only be allowed to be carried forward and can only offset 80% of taxable income. The duration of the carry forward will be indefinite.
- The corporate dividends received deduction (DRD) rates decrease to 50% to 65%, depending on the level of stock ownership held.
- Bonus depreciation increases to 100% for qualifying assets purchased and placed in service after September 27, 2017, which will be phased out starting in 2023. Immediate expensing under Section 179 increases to \$1 million for taxpayers with total fixed asset additions up to \$2.5 million.
- The deduction for business interest will be limited to 30% of adjusted taxable income for any excess net business interest expense.
- Certain meals that were previously 100% deductible are now subject to the 50% limitation. No deduc-

tion is allowed for entertainment expenses or for qualified transportation fringe benefits.

Observations: general corporate provisions

Impact in 2017. The presentation of the December 31, 2017, net deferred tax position for calendar year end taxpayers must be recorded at the future 21%, which becomes effective as of January 1, 2018.

Impact in 2018 and forward. The corporate tax rate changes from a graduated rate structure to a flat tax of 21%, and with this change comes the elimination of a special tax rate for personal service corporations, which will now be taxed like other corporations. This change could encourage the use of personal service corporations, since they will now be taxed at 21%, while the maximum individual tax bracket is 37%, with a deduction for pass-through income of only 20%.

Taxpayers can also use the 100% bonus depreciation and increased Section 179 limit to their benefit by investing in qualifying property and thereby further reducing their taxable income base. However, a reduced taxable income base will now limit the amount of deductible business interest, since this deduction is limited to 30% of adjusted taxable income for any excess net business interest expense. Any excess nondeductible amounts become an indefinite deferred asset.

Taxpayers may wish to reassess company policy with regard to certain entertainment and qualified transportation fringe benefit expenses that will now become nondeductible under the tax reform rules. While there may still be value in providing client outings or reimbursing employees for on-site parking, the fact that these will be non-deductible starting in 2018 may necessitate that certain budgets be put in place to minimize the overall impact on the company.

Further, taxpayers may need to revalue the cumulative benefit to be realized from existing or future-generated net operating losses (NOLs), now that an indefinite carryforward is offered. Prior valuation allowances may need to be modified.

P/C highlights

Key provisions of particular interest to the P/C sector include:

- The proration adjustment, for tax-exempt interest and the dividends received deduction, increases from 15% to 25%; however, the net tax impact remains the same, at 5.25%.
- Taxpayers will be required to discount loss reserves based solely on IRS factors and no longer by reference to historical payment patterns. The IRS factors will now be determined using a higher interest rate.

- The special estimated tax payment provisions are repealed.
- Existing NOL carryover and carryback periods are retained, and P/C taxpayers can offset 100% of taxable income with NOLs.

Observations: P/C provisions

Impact in 2017. The presentation of the December 31, 2017 net deferred tax position for calendar year end taxpayers must be recorded at the future 21%

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deferred tax assets, surplus will decrease accordingly. Furthermore, admissibility of the 2017 deferred tax position under SSAP 101 will be impacted by the new lower tax rate.

Impact in 2018 and forward. Modification to the proration calculation has been set such that there will be no net tax impact for any future year, regardless of fluctuations in the corporate tax rate. Instead, it will be calculated at 5.25%, divided by the highest corporate rate in effect at the time. For 2018, this results in a 25% proration.

P/C insurers will also see no change to the NOL rules, which provide for a two-year carryback, 20-year carryforward, and the ability to offset 100% of taxable

income in the year of utilization. However, now that the NOL rules diverge between P/C insurers and regular corporations, additional questions arise: What rules are applicable to consolidated groups with both insurance and non-insurance companies? What does it mean when a tax-sharing agreement refers to tax-sharing based on separate company taxable income?

The changes intended to simplify loss reserve discounting will have a greater impact on P/C insurers. Beginning in 2018, taxpayers will be required to use the IRS-prescribed factors to determine the loss discount. The IRS will now use a corporate bond yield curve to determine the discount factors, and this is expected to generate higher discounts (i.e., more taxable income). The election to use a company's own historical payment pattern has been repealed.

Transition rules will require that when taxpayers are determining their 2018 taxable income, they recalculate the 2017 reserve discount as if the 2018 tax reform rules had been in effect at that time, compare it to the actual 2017 reserve discount, and amortize the difference into taxable income over the eight years beginning in 2018.

Notably, the 2017 tax year is an election year for using company payment patterns. It may still be worth making the election in 2017, if the company's history results in a favorable discount, even though the change will be reversed in future years. By doing so, taxpayers can minimize their discount in this last year of the higher tax brackets and shift the recovery of the taxable difference to future years with a lower rate. 

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