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KPMG report: Guidance on accounting method change for insurance companies (Rev. Proc. 2019-34)

The IRS earlier this week released an advance version of Rev. Proc. 2019-34 that provides simplified procedures for insurance companies to obtain automatic consent to account for changes in computing their reserves as required by sections 807 and 848 as amended by the new U.S. tax law (Pub. L. No. 115-97, enacted December 22, 2017, and referred to as the “Tax Cuts and Jobs Act” or TCJA).

In general, if the requirements of Rev. Proc. 2019-34 are met, there is no requirement to file Form 3115, *Application for Change in Accounting Method*, with respect to the method change.

Read [Rev. Proc. 2019-34](#) [PDF 48KB]

Background

Life insurance reserves

Section 801(a) imposes a tax on the “life insurance company taxable income” of a life insurance company. For purposes of computing life insurance company taxable income, a decrease in reserves results in an increase to gross income, whereas an increase in reserves results in a deduction.

Section 831(a) imposes a tax on the taxable income of a non-life insurance company. For purposes of computing taxable income of a property and casualty company (similar to the above treatment), an increase in life insurance reserves over the tax year reduces premiums earned and a decrease in life insurance reserves over the tax year increases premiums earned.

In general, the amount of life insurance reserves is required to be computed as provided in section 807(d), as amended by the TCJA to provide a new method for computing the amount of life insurance reserves, effective for tax years beginning after December 31, 2017.

Additionally, the TCJA provides a transitional rule for the first tax year beginning after December 31, 2017, with respect to reserves at the end of the preceding tax year. The transitional rule requires an insurance company to take into account the difference between: (1) the amount of life insurance

reserves with respect to any contract as of the close of the tax year preceding the first tax year beginning after December 31, 2017, computed using the method prescribed by the TCJA; and (2) the amount of such reserves computed using the method prior to the amendments by the TCJA. The difference between these amounts is the "TCJA Transition Adjustment." The TCJA Transition Adjustment must be taken into account ratably over each of the eight tax years following that preceding tax year.

Section 807(c)(3) reserves

Section 807(c) describes items that a life insurance company must account for on a reserve basis and take into account under section 807(a) and (b). Section 807(c)(3) describes amounts (discounted at the appropriate rate of interest) necessary to satisfy the obligations under insurance and annuity contracts if the obligation does not involve (at the time with respect to which the computation is made) life, accident or health contingencies. Such amount for any contract, however, may not be less than the net surrender value of such contract.

The TCJA amended section 807(c) to provide that the appropriate rate of interest to discount the amounts in section 807(c)(3) is the highest rate or rates permitted to be used to discount the obligations by the National Association of Insurance Commissioners as of the date the reserve is determined. This amendment applies to tax years beginning after December 31, 2017.

Capitalization of specified policy acquisition expenses

Section 848 generally requires "specified policy acquisition expenses" for a tax year to be capitalized and amortized over a defined period. Specified policy acquisition expenses are calculated as a certain percentage of net premiums on specified insurance contracts for the tax year. Special rules may apply if the specified policy acquisition expenses of an insurance company (determined on a controlled group basis) are less than \$15 million.

The TCJA amended section 848 by extending the general amortization period from 120 months to 180 months and changing the percentage of net premiums that are determined to be specified policy acquisition expenses. These amendments apply to net premiums for tax years beginning after December 31, 2017. A transition rule in the TCJA provides that specified policy acquisition expenses required to be capitalized in a tax year beginning before January 1, 2018, will continue to be amortized ratably over the 120-month period.

Changes in method of accounting

A change in the method of computing any of the above items is a change in method of accounting subject to section 446(e) and Reg. section 1.446-1. In general, a taxpayer must file Form 3115 during the tax year for which the taxpayer desires to make the proposed change in method of accounting (i.e., the year of change). The Commissioner of Internal Revenue may prescribe terms and conditions for effecting a change in method of accounting, including providing for simplified procedures with respect to a method change.

Previously, Rev. Proc. 2019-10 was issued to provide procedures for an insurance company to obtain automatic consent of the Commissioner to change its method of accounting to comply with section 807(f), as amended by the TCJA. Read [TaxNewsFlash](#)

Rev. Proc. 2019-34

For taxpayers that fall within the scope of, and make all adjustments in accordance with, Rev. Proc. 2019-34 are not required to file Form 3115 in order to make a change in method of accounting. The following discussion highlights the relevant requirements.

Life insurance reserves

Rev. Proc. 2019-34 applies to any insurance company that changes its method of computing life insurance reserves to comply with amendments to section 807 made by the TCJA for the first tax year beginning after December 31, 2017, and properly accounts for the section 481(a) adjustment. As relevant here, the section 481(a) adjustment is the sum of the TCJA Transition Adjustments. The period for the section 481(a) adjustment period is eight tax years (i.e., the year of change and the seven succeeding tax years).

The audit protection (described in section 8 of Rev. Proc. 2015-13) does not apply to the above change in method of accounting.

Section 807(c)(3) reserves

Rev. Proc. 2019-34 also applies to any insurance company that changes its method of computing amounts under section 807(c)(3) to comply with amendments to section 807 made by the TCJA for the first tax year beginning after December 31, 2017, and properly accounts for the "section 481 adjustment."

The section 481 adjustment is the difference between: (1) the amount determined under section 807(c)(3) as of the close of the tax year preceding the first tax year beginning after December 31, 2017, determined using the appropriate rate of interest required after the amendments to section 807(c) by the TCJA; and (2) such amount determined at such time using the appropriate rate of interest required prior to the amendments to section 807(c) by the TCJA. The section 481(a) adjustment period is one tax year (i.e., the year of change) for a negative section 481(a) adjustment and four tax years (i.e., the year of change and the three succeeding tax years) for a positive section 481(a) adjustment. Alternatively, such insurance company may take a positive section 481(a) adjustment into account entirely in the year of change.

The audit protection described in section 8 of Rev. Proc. 2015-13 generally applies to the above change in method of accounting. The IRS may change an insurance company's method of accounting for the same item that is an issue under consideration (e.g., under examination, before an IRS Appeals Office or before a federal court). The exceptions to audit protection set forth in section 8.02 of Rev. Proc. 2015-13 do not apply to an insurance company within the scope of Rev. Proc. 2019-34.

Capitalization of specified policy acquisition expenses

Additionally, Rev. Proc. 2019-34 applies to any insurance company that changes its method of capitalizing and amortizes specified policy acquisition expenses to comply with amendments to section 848 made by the TCJA for the first tax year beginning after December 31, 2017. The change in method of accounting is made using a cut-off method because the TCJA amendments to section 848 apply to net premiums for tax years beginning after December 31, 2017. Accordingly, a section 481(a) adjustment is neither required nor permitted.

The audit protection described in section 8 of Rev. Proc. 2015-13 generally applies to the above change in method of accounting. The IRS may change an insurance company's method of accounting for the same item that is an issue under consideration (e.g., under examination, before IRS Appeals or before a federal court). The exceptions to audit protection set forth in section 8.02 of Rev. Proc. 2015-13 do not apply to an insurance company within the scope of Rev. Proc. 2019-34.

Form 3115 transition rule

If before August 26, 2019, (1) a taxpayer properly filed a Form 3115 under the non-automatic change procedures in Rev. Proc. 2015-13 requesting the Commissioner's consent for a change in method of accounting (described above); and (2) the Form 3115 is pending with the IRS National Office on August

26, 2019, then the taxpayer may choose to make the change in method of accounting under the automatic change procedures in Rev. Proc. 2019-34.

To do so, the taxpayer must notify the National Office contact person for the Form 3115 of the taxpayer's intent to make the change in method of accounting under the automatic change procedures in Rev. Proc. 2015-13 before the later of (1) September 25, 2019, or (2) the issuance of a letter ruling granting or denying consent for the change. The notification needs to indicate that the taxpayer chooses to convert the Form 3115 to the automatic change procedures in Rev. Proc. 2019-34 and Rev. Proc. 2015-13.

If the taxpayer timely notifies the IRS National Office that it chooses to convert the Form 3115 to the automatic change procedures in Rev. Proc. 2019-34 and Rev. Proc. 2015-13, the National Office will send a letter to the taxpayer acknowledging its request and will return the user fee submitted with the Form 3115.

KPMG observation

Rev. Proc. 2019-34 provides helpful guidance regarding method changes required by the TCJA, and is similar to Rev. Proc. 2019-30 that provides a similar method change with respect to section 846.

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