KPMG

TaxNewsFlash

United States

No. 2019-414
August 21, 2019

KPMG report: Non-life insurance companies and "BEAT" considerations

Non-life insurance companies need to carefully consider their tax return presentation if they plan to treat claims payments as offsets to income under section 832(b)(3)—rather than deductions under section 832(c)(4)

BEAT measures, overview

The U.S. tax law commonly referred to as the "Tax Cuts and Jobs Act" (TCJA) (Pub. L. No. 115-97, enacted December 22, 2017) introduced section 59A to the Code. Section 59A imposes a minimum tax (the base erosion and anti-abuse tax or "BEAT") on certain applicable taxpayers calculated with reference to payments made to foreign related parties.

Applicable taxpayers are U.S. corporations or U.S. branches of foreign corporations that, combined with other members of their aggregate group of corporations, have average gross receipts of greater than $500 million over the prior three years and a base erosion percentage of greater than 3% (2% for certain financial institutions). The base erosion percentage is generally the amount of base erosion tax benefits over the amount of deductions plus base erosion tax benefits for reinsurance premiums.

A base erosion tax benefit is generally the deduction allowed (or reduction of gross income in the case of reinsurance premiums paid to foreign related parties) for payments made to foreign related parties. The minimum tax for applicable taxpayers is an amount equal to 10% (5% for tax years beginning in 2018) of modified taxable income over the regular tax liability of the corporation (adjusted for certain credits). Modified taxable income is generally regular taxable income plus base erosion tax benefits (including the base erosion tax benefit related to post-2017 net operating losses (NOLs).

Losses of non-life insurance companies

Insurance companies that are not life insurance companies and are therefore taxable under section 831 have two statutory options for taking certain losses incurred into account.

- Section 832(a) defines taxable income as the "gross income as defined in subsection (b)(1) less the deductions allowed by subsection (c)."

- Section 832(b)(1)(A) states that gross income includes in part "underwriting income as provided in this subsection."

- Section 832(b)(3) defines underwriting income as "the premiums earned on insurance contracts during the taxable year less losses incurred and expenses incurred."

- Section 832(c)(4) includes as a deduction "losses incurred, as defined in subsection (b)(5) of this section."

- Section 832(d) includes a double deduction rule that states "nothing in this section shall permit the same item to be deducted more than once" in part recognizing that there are multiple statutory routes for the consideration of losses incurred.

Rules for overlapping treatment

The preamble to the proposed regulations under section 59A (REG-104259-18 (December 21, 2018)) recognized the overlapping treatment of certain claims payments and concluded that, in the case of an insurance company other than a life insurance company that reinsures foreign risk, certain of the claims payments may be treated as reductions in gross income under section 832(b)(3), which are not deductions and also not the type of reductions in gross income described in sections 59A(d)(3). The Treasury Department and IRS requested comments on the appropriate treatment of these items under subchapter L.

Implications of BEAT for non-life insurance companies

While the existence of multiple statutory routes for taking into account losses incurred has not previously had much impact on a company's calculation of tax, this is important in light of the BEAT—that is because the definition of a base erosion tax benefit generally excludes reductions of gross income (other than reinsurance premiums) and instead disfavors deductions. Section 832(b)(3) considers losses incurred as a reduction of gross income, and section 832(c)(4) considers the same losses incurred as a deduction.

For U.S. companies that engage in related-party reinsurance into the United States and therefore make claims payments to foreign related parties, taking such payments into account under section 832(b)(3)—instead of section 832(c)(4)—could result in a reduction of their BEAT liability by reducing base erosion tax benefits. It could also change the taxpayer's base erosion percentage.

Form 1120-PC considerations

For most insurance companies, the calendar year 2018 tax returns will be the first to incorporate the impact of the BEAT. Companies that have over $500 million in gross receipts in any of the last three tax years must file Form 8991, *Tax on Base Erosion Payments of Taxpayers With Substantial Gross Receipts*, to establish whether or not they are an applicable taxpayer and to calculate the BEAT. For companies that are taking the position that claims paid are losses incurred under section 832(b)(3), instead of section 832(c)(4), they need also to carefully consider the tax return presentation for such items on their Form 1120-PC.

Form 1120-PC, *U.S. Property and Casualty Insurance Company Income Tax Return*, includes Schedule F which calculates "Losses Incurred." Importantly, the last line of Schedule F states that the result of the schedule is the "Losses incurred deductible under Section 832(c)(4)." The result flows to Schedule A line 26 which is in the deduction section of the taxable income calculation. Most companies have, in the past, completed Schedule F as presented because there was no meaningful distinction between considering loss payments under section 832(b)(3) or section 832(c)(4). Most tax return preparation software is set up to complete the schedule as described. There appears to be no natural way of completing the Form 1120-PC in order to take the section 832(b)(3) route.

In order to provide consistency within the tax return, companies considering certain of their claims payments as losses incurred under section 832(b)(3) for purposes of the BEAT may need to consider reporting such under one of two alternative methods.

- Not completing Schedule F and instead present losses incurred as a reduction of Schedule E, line 1: "Net Premiums Written."
    - Include a statement replicating the Schedule F mechanics and reconciling to the annual statement.
    - Specifically reference that losses incurred are a reduction of underwriting income under section 832(b)(3).
- Not completing Schedule F and instead present losses incurred as a negative item of other income on Schedule A, line 13.
    - Include a statement replicating the Schedule F mechanics.
    - Specifically reference that losses incurred are a reduction of underwriting income under section 832(b)(3).

Companies that are not making claims payments to foreign related parties would likely complete Schedule F so that their total claims payments would be considered deductions and thus would be included in the denominator of their base erosion percentage.

KPMG observation

As noted above, the Treasury Department and IRS have asked for comments on the treatment of certain insurance payments under the BEAT regulations. Final regulations may provide additional guidance on the interaction of the subchapter L provisions and the BEAT.

For more information contact a KPMG tax professional:

Patrick Styles | +44 (0)20 7311 3404 | patrickstyles@kpmg.com

Clarissa Potter | +1 (212) 872-6913 | clarissapotter@kpmg.com

Fred Campbell-Mohn | +1 (212) 954-8316 | fcampbellmohn@kpmg.com

Stuart Katz | +1 (212) 954-6674 | stuartkatz@kpmg.com

Direct comments, including requests for subscriptions, to Washington National Tax. For more information, contact KPMG's Federal Tax Legislative and Regulatory Services Group at + 1 202.533.4366, 1801 K Street NW, Washington, DC 20006-1301.