

COMPLIANCE UPDATE

Joint Committee on Taxation's Technical Explanation of the Protecting Americans from Tax Hikes Act of 2015 [Abridged]

On December 18, 2015, President Obama signed into law the Protecting Americans from Tax Hikes Act of 2015. §333 of the Act amends §831(b) of the Internal Revenue Code in a number of ways that may affect the tax treatment of small property and casualty insurance companies, including captive insurance companies.



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Joint Committee on Taxation’s Technical Explanation of the Protecting Americans from Tax Hikes Act of 2015 [Abridged].....	1
Resources	i
Online Support Information	i
Important Knowledge-Based Articles.....	i
Information on Administrative & Consulting Services	i
Industry Resources & General Guidelines.....	i
About RMC Group.....	iii

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The following excerpt from the “Technical Explanation of the Protecting Americans from Tax Hikes Act of 2015” was produced by the U.S. Congress Joint Committee on Taxation. For a full copy of the report, please visit www.jct.gov or <http://www.rmcbp.com/pathact>.

**TECHNICAL EXPLANATION OF THE PROTECTING AMERICANS
FROM TAX HIKES ACT OF 2015, HOUSE AMENDMENT #2
TO THE SENATE AMENDMENT TO H.R. 2029
(RULES COMMITTEE PRINT 114-40)**

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION



December 17, 2015
JCX-144-15

JOINT COMMITTEE ON TAXATION'S TECHNICAL EXPLANATION OF THE PROTECTING AMERICANS FROM TAX HIKES ACT OF 2015 [ABRIDGED]

3. Modification to alternative tax for certain small insurance companies (sec. 333 of the bill and sec. 831(b) of the Code)

Present Law

Under present law, the taxable income of a property and casualty insurance company is the sum of the amount earned from underwriting income and from investment income (as well as gains and other income items), reduced by allowable deductions. For this purpose, underwriting income and investment income are computed on the basis of the underwriting and investment exhibit of the annual statement approved by the National Association of Insurance Commissioners. Insurance companies are subject to tax at regular corporate income tax rates.

In lieu of the tax otherwise applicable, certain property and casualty insurance companies may elect to be taxed only on taxable investment income under section 831(b). The election is available to mutual and stock companies with net written premiums or direct written premiums (whichever is greater) that do not exceed \$1,200,000.

For purposes of determining whether a company meets this dollar limit, the company is treated as receiving during the taxable year amounts of net or direct written premiums that are received during that year by all other companies that are members of the same controlled group as the company. A controlled group means any controlled group of corporations as defined in section 1563(a), but applying a “more than 50 percent” threshold in lieu of the “at least 80 percent” threshold in the requirement that one of the corporations own at least 80 percent of the total combined voting power of all classes of stock entitled to vote or at least 80 percent of the total value of share of all classes of stock of each of the corporations; without treating insurance companies as a separate controlled group; and without treating life insurance companies as excluded members.¹

Explanation of Provision

The provision modifies the section 831(b) eligibility rules for a property and casualty insurance company to elect to be taxed only on taxable investment income.

Increase and indexing of dollar limits

The provision increases the amount of the limit on net written premiums or direct written premiums

¹ Secs. 1563(a)(1), (a)(4), and (b)(2)(D), as modified by sec. 831(b)(2)(B).

(whichever is greater) from \$1,200,000 to \$2,200,000 and indexes this amount for inflation starting in 2016. The base year for calculating the inflation adjustment is 2013. If the amount, as adjusted, is not a multiple of \$50,000, it is rounded to the next lowest multiple of \$50,000.

Diversification requirements

The provision adds diversification requirements to the eligibility rules. A company can meet these in one of two ways.

Risk diversification test

An insurance company meets the diversification requirement if no more than 20 percent of the net written premiums (or, if greater, direct written premiums) of the company for the taxable year is attributable to any one policyholder. In determining the attribution of premiums to any policyholder, all policyholders that are related² or are members of the same controlled group³ are treated as one policyholder.

Relatedness test

If the company does not meet this 20-percent requirement, an alternative diversification requirement applies for the company to be eligible to elect 831(b) treatment.⁴ Under this requirement, no person who holds (directly or indirectly) an interest in the company is a specified holder who holds (directly or indirectly) aggregate interests in the company that constitute a percentage of the entire interests in the company that is more than a de minimis percentage higher than the percentage of interests in the specified assets with respect to the company held (directly or indirectly) by the specified holder. Except as otherwise provided in regulations or other guidance, two percentage points or less is treated as de minimis. An indirect interest for this purpose includes any interest held through a trust, estate, partnership, or corporation.

² For this purpose, persons are related within the meaning of section 267(b) or 707(b).

³ Members of the same controlled group are determined as under present law for purposes determining whether a company meets the dollar limit applicable to net written premiums (or, if greater, direct written premiums). The provision relocates the controlled group definition, as modified for purposes of section 831, in section 831(b)(2)(C).

⁴ These added eligibility rules reflect the concern expressed by the Finance Committee upon reporting out S.905, “A Bill to Amend the Internal Revenue Code of 1986 to Increase the Limitation on Eligibility for the Alternative Tax for Certain Small Insurance Companies,” when the Committee stated, “The Committee notes that the provision does not include a related proposal that would narrow eligibility to elect the alternative tax in a manner intended to address abuse potential, but that may cause problems for certain States. The Committee therefore wants the Treasury Department to study the abuse of captive insurance companies for estate planning purposes, so Congress can better understand the scope of this problem and whether legislation is necessary to address it.” S. Rep. 114-16, April 14, 2015, page 2.

A specified holder means, with respect to an insurance company, any individual who holds (directly or indirectly) an interest in the insurance company and who is a spouse or lineal descendant (including by adoption) of an individual who holds an interest (directly or indirectly) in the specified assets with respect to the insurance company.

The specified assets with respect to an insurance company mean the trades or businesses, rights, or assets with respect to which the net written premiums (or direct written premiums) of the company are paid.

For example, assume that in 2017, a captive insurance company does not meet the requirement that no more than 20 percent of its net (or direct) written premiums is attributable to any one policyholder. The captive has one policyholder, Business, certain of whose property and liability risks the captive covers (the specified assets), and Business pays the captive \$2 million in premiums in 2017. Business is owned 70 percent by Father and 30 percent by Son. The captive is owned 100 percent by Son (whether directly, or through a trust, estate, partnership, or corporation). Son is Father's lineal descendant. Son, a specified holder, has a non-de minimis percentage greater interest in the captive (100 percent) than in the specified assets with respect to the captive (30 percent). Therefore, the captive is not eligible to elect section 831(b) treatment.

If, by contrast, all the facts were the same except that Son owed 30 percent and Father owned 70 percent of the captive, Son would not have a non-de minimis percentage greater interest in the captive (30 percent) than in the specified assets with respect to the captive (30 percent). The captive would meet the diversification requirement for eligibility to elect section 831(b) treatment. The same result would occur if Son owned less than 30 percent of the captive (and Father more than 70 percent), and the other facts remained unchanged.

Any insurance company for which an 831(b) election is in effect for a taxable year must report information required by the Secretary relating to the diversification requirements imposed under the provision.

The provision also makes a technical amendment striking an unnecessary redundant parenthetical reference to interinsurers and reciprocal underwriters.

Effective Date

The provision is effective for taxable years beginning after December 31, 2016.

END OF REPORT

RESOURCES

ONLINE SUPPORT INFORMATION

Customers may access support information related to captive insurance on rmcgp.com/user

IMPORTANT KNOWLEDGE BASED ARTICLES

New knowledge based articles have been posted online to assist with captive insurance questions, as well as other areas of interest, including:

- Retirement
- Insurance
- Self-Insurance
- Risk Management
- Employee Benefits
- Health & Welfare Plans

INFORMATION ON ADMINISTRATIVE & CONSULTING SERVICES

For more information about RMC Group's Administrative and Consulting Services, there are three easy ways to contact us:

web: www.rmcgp.com/products-services

email: rmc@rmcgp.com

call: [888.599.5553](tel:888.599.5553)

INDUSTRY RESOURCES & GENERAL GUIDELINES

For more industry information and general guidelines on captive insurance:

Captive Insurance Companies Association (CICA):

www.cicaworld.com/Resources.aspx

Self-Insurance Institute of America (SIIA):

www.siaa.org/i4a/doclibrary/

The Risk Management Society (RIMS):

www.rims.org/resources/ERM/Pages/default.aspx

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Since 1974, members of the RMC Group have represented the interests of their clients by helping them make sense of an increasingly complex world. We work with clients of all sizes by defining, designing, and delivering solutions to better manage risk.

RMC's team brings deep intellectual capacity, industry-specific expertise, global experience, and collaboration. We offer risk consulting and management, insurance brokering, alternative risk financing, retirement consulting and administration, and insurance program management services to businesses, government entities, organizations, and individuals.

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