



NAIC Re-exposes Income Tax Guidance

The National Association of Insurance Commissioners (NAIC) recently re-exposed for comment SSAP No. 101, which would supersede current income tax statutory accounting guidance in SSAP No. 10 and SSAP No. 10R.¹ SSAP No. 101 was first exposed at the Spring National Meeting in March. Since the original exposure draft, the Statutory Accounting Principles Working Group has held numerous conference calls and a half-day interim meeting to discuss industry comments. This edition of *Issues & Trends* compares current statutory accounting for income taxes in SSAP No. 10R with proposed changes in the March and August SSAP No. 101 exposure drafts.

If adopted as exposed, SSAP No. 101 would become effective January 1, 2012 and would correspond to the sunset provision in SSAP No. 10R that would have reverted statutory accounting guidance for income taxes to SSAP No. 10 after December 31, 2011. On a July 27 conference call, the Statutory Accounting Principles Working Group stated its goal of adopting SSAP No. 101 at the Summer National Meeting at the end of August. The comment deadline is August 15.

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Current Statutory Accounting under SSAP No. 10R	SSAP No. 101 (March exposure draft)	SSAP No. 101 (August re-exposure)
Tax-Loss Contingencies		
Based on SSAP No. 5R model using a <i>probable</i> and <i>reasonably estimated</i> criterion. ²	Based on FIN 48 model in U.S. GAAP using a <i>more-likely-than-not</i> recognition threshold. ³	Based on SSAP No. 5R model using a <i>more-likely-than-not</i> and <i>reasonably estimated</i> criterion.
Recognition and Measurement		
Tax benefit is recognized with a liability recorded if the related tax contingency is considered <i>probable</i> and can be <i>reasonably estimated</i> . The amount of the contingency is measured at management's best estimate.	Tax benefit of uncertain tax position measured as the largest amount of tax benefit that has a greater than 50 percent (cumulative probability) likelihood of being realized. Difference between tax benefit recognized and 100 percent of the tax benefit taken or to be	Tax benefit is recognized with a liability recorded if the related tax-loss contingency is <i>more-likely-than-not</i> and can be reasonably estimated. The amount of the tax-loss contingency is measured at management's best estimate. However, if the estimated tax-loss

¹ SSAP No. 101, Income Taxes, A Replacement of SSAP No. 10R and SSAP No. 10, available at www.naic.org, SSAP No. 10, Income Taxes, and SSAP No. 10R, Income Taxes – A Temporary Replacement of SSAP No. 10.

² SSAP No. 5R, Liabilities, Contingencies and Impairments of Assets – Revised.

³ FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes – an interpretation of FASB Statement No. 109 (FASB ASC Topic 740, Income Taxes), available at www.fasb.org.

Current Statutory Accounting under SSAP No. 10R	SSAP No. 101 (March exposure draft)	SSAP No. 101 (August re-exposure)
	taken in the tax return is recorded as a liability.	contingency is greater than 50 percent of the tax benefit originally recognized (amount taken or to be taken in the tax return), the tax-loss contingency recorded shall be equal to 100 percent of the original tax benefit recognized (amount taken or to be taken in the tax return).
Detection risk not addressed.	Management presumes that the tax position will be examined by the relevant taxing authority that has full knowledge of all relevant information.	Management presumes that the tax position will be examined by the relevant taxing authority that has full knowledge of all relevant information.
Tax-Loss Contingency Disclosures		
No required disclosures of tax-loss contingencies.	Adopted FIN 48 disclosures applicable to non-public entities.	Eliminates FIN 48 disclosures applicable to non-public entities except for disclosure of tax-loss contingencies for which it is reasonably possible that the total liability will significantly increase within 12 months of the reporting date. For such tax-loss contingencies, entities must disclose an estimate of the range of the reasonably possible increase or state that an estimate of the range cannot be made.

Recognition and Measurement Examples

The following examples highlight the differences in the recognition and measurement guidance under current guidance in SSAP No. 10R and the August exposure draft of SSAP No. 101 using a *more-likely-than-not* SSAP No. 5R approach.

SSAP No. 10R

Assume a company has an uncertain tax position of \$100. Based on management's past experience and assumptions on how the tax position will be examined by the relevant taxing authority, a tax-loss contingency is *probable* and can be *reasonably estimated*. Management's best estimate of the tax-loss contingency is \$20. Under SSAP No. 10R, a tax benefit of \$100 would be recorded with a corresponding tax-loss contingency liability of \$20.

SSAP No. 101 (August exposure draft)

Assume a company has an uncertain tax position of \$100. A tax-loss contingency is *more-likely-than-not* and can be *reasonably estimated*. Management's best estimate of the tax-loss contingency, presuming the tax position will be examined by the relevant taxing authority and the taxing authority has full knowledge of all relevant information, is \$20. Under the August exposure draft of SSAP No. 101, a tax benefit of \$100 would be recorded with a corresponding tax-loss contingency liability of \$20. However, if management's best estimate of the tax-loss contingency is \$55 (an amount greater than 50 percent of the tax benefit originally recognized (amount taken or to be taken on the tax return)), the tax-loss contingency would be recorded as \$100 (100 percent of the original tax benefit recognized).

Observations

The August exposure draft of SSAP No. 101 also addresses the *gross-up* issue that was not addressed in the March exposure draft of SSAP No. 101. The gross up issue relates to tax positions recognized in the financial statements related to temporary differences. These tax positions affect the tax bases of assets or liabilities and change or create temporary differences. Under the March and August exposure drafts of SSAP No. 101, SSAP No. 10, and SSAP No. 10R, when tax contingencies are recognized in the financial statements, based on the recognition and measurement guidance under each of the respective standards, and relate to deductible temporary differences, current tax liabilities are increased and a corresponding deferred tax asset is adjusted or recorded for the same amount. However, implementation guidance for SSAP No. 10 and SSAP No. 10R only required this gross up if certain triggering events had occurred (e.g. certain communications from the taxing authority).⁴

SSAP No. 101, as exposed in March, did not incorporate this implementation guidance, and thus the gross up of the current tax liability and deferred tax asset would have been recorded based on the recognition and measurement criteria in SSAP No. 101. The March exposure draft of SSAP No. 101 would have required current tax liabilities to be recorded more often with a corresponding deferred tax asset that would be subject to the admissibility criteria in SSAP No. 101, and may not provide a full capital and surplus offset to the current liability recorded.

⁴ SSAP No. 10, Exhibit A, Implementation Questions and Answers, question number 9.

The August exposure draft of SSAP No. 101 addresses the gross up issue in two ways. First, the August exposure draft only requires the gross up if certain triggering events had occurred by incorporating the language in the implementation guidance of SSAP No. 10 and 10R. Secondly, the August exposure draft considers accruals for tax-loss contingencies along with income taxes paid in prior years in Step 1 of the admissibility determination.

Current Statutory Accounting under SSAP No. 10R	SSAP No. 101 (March exposure draft)	SSAP No. 101 (August re-exposure)
Admissibility of Deferred Tax Assets		
Step 1		
Limits admissibility to recovering income taxes through carrybacks to those that occur by the end of the subsequent year. If certain risk-based capital levels were achieved, this limit would be increased to three years.	Allows SSAP No. 10R's three-year limit without requiring a risk-based capital limitation.	Allows SSAP No. 10R's three-year limit without requiring a risk-based capital limitation. Would also include accruals for tax-loss contingencies along with income taxes paid in prior years in the determination.
Step 2		
Limits the admissibility of deferred tax assets to the lesser of the amount of adjusted gross deferred tax assets expected to be realized in one year, or 10 percent of the most recently filed statutory capital and surplus (adjusted to exclude any net deferred tax assets, electronic data processing equipment and operating software, and any net positive goodwill). If certain risk-based capital levels were achieved, allows companies to elect to increase those limits to three years or 15 percent. Adjusted gross deferred tax assets are calculated as gross deferred tax	Admissibility limits are either zero years and zero percent, one year and 10 percent, or three years and 15 percent depending on the risk-based capital level at the end of the reporting period and the ratio of adjusted gross deferred tax assets over adjusted capital and surplus (adjusted to exclude any net deferred tax assets, electronic data processing equipment and operating software, and any net positive goodwill) for the current reporting period. The admissibility limits are determined by using one of two realization	Admissibility limits are either zero years and zero percent, one year and 10 percent, or three years and 15 percent. RBC reporting entities refer to a table that <i>only</i> references the Authorized Control Level risk-based capital level at the end of the reporting period (excluding any net deferred tax assets) and eliminates the original exposure draft's reference to the ratio of adjusted gross deferred tax assets over adjusted capital and surplus for the current reporting period. See Table 3 (RBC entities) in the <i>Admissibility Tables</i>

Current Statutory Accounting under SSAP No. 10R	SSAP No. 101 (March exposure draft)	SSAP No. 101 (August re-exposure)
Admissibility of Deferred Tax Assets		
<p>assets reduced by a valuation allowance determined using Statement 109 guidance.⁵</p>	<p>threshold limitation tables, depending on whether the company is required to file a risk-based capital report with its domiciliary state. See Table 1 (RBC entities) and Table 2 (non-RBC entities) in the <i>Admissibility Tables</i> section.</p> <p>Similar to SSAP No. 10R, adjusted gross deferred tax assets would be calculated as gross deferred tax assets reduced by a valuation allowance determined under Statement 109.</p>	<p>section.</p> <p>Mortgage and financial guaranty insurers have a new table based on the ratio of surplus (excluding any admitted deferred tax assets) over policyholder and contingency reserves. See Table 4 (mortgage and financial guaranty insurers) in the <i>Admissibility Tables</i> section.</p> <p>Non-RBC reporting entities that are not mortgage or financial guaranty insurers have a third table based on the percentage of adjusted gross deferred tax assets to adjusted capital and surplus. See Table 5 (non-RBC entities that are not mortgage or financial guaranty insurers) in the <i>Admissibility Tables</i> section.</p>
Step 3		
<p>Allows additional deferred tax assets to be admitted to the extent they are offset by deferred tax liabilities of the same tax character under current tax laws.</p>	<p>Allows additional deferred tax assets to be admitted to the extent they are offset by deferred tax liabilities of the same tax character if the period of reversal between the applicable deferred tax assets and liabilities is not greater than five years.</p>	<p>Eliminates the five-year requirement in the original exposure draft.</p> <p>Adds consideration of the reversal pattern of deferred tax assets and deferred tax liabilities (consistent with the determination of the statutory valuation allowance prior to the</p>

⁵ FASB Statement No. 109, Accounting for Income Taxes, included in FASB ASC Topic 740, Income Taxes, available at www.fasb.org.

Current Statutory Accounting under SSAP No. 10R	SSAP No. 101 (March exposure draft)	SSAP No. 101 (August re-exposure)
Admissibility of Deferred Tax Assets		
		admissibility test) and provides guidance similar to U.S. GAAP on the level of detail required in scheduling deferred tax assets and liabilities.

Observations

The March exposure draft of SSAP No. 101 did not explicitly state what risk-based capital (RBC) measure should be used when determining the admissibility limits in the Realization Threshold Limitation Table for RBC Entities. The August exposure draft of SSAP No. 101 addressed this issue by requiring the Authorized Control Level RBC. The March exposure draft of SSAP No. 101 also did not explicitly state if the RBC of the current reporting period or some other period should be used. The August exposure draft of SSAP No. 101 addressed this issue by requiring the use of the RBC of the current reporting period.

The limitation on the admissibility of deferred tax assets as a percentage of capital and surplus in the March exposure draft of SSAP No. 101 referred to capital and surplus for the current reporting period, or December 31 for calendar-year companies. Under that requirement, companies may have needed to assess the impact of this change to their existing year-end reporting processes and timelines. The August exposure draft of SSAP No. 101 addressed this issue for RBC reporting entities and mortgage and financial guaranty companies by not requiring reference to a percentage of capital and surplus to determine the admissibility limits. However, this issue still exists in the August exposure draft for non-RBC entities that are not mortgage or financial guaranty insurers.

The August exposure draft also addressed the issue of the additional effort that may have been required by companies to schedule the timing of realization of deferred tax assets and deferred tax liabilities by eliminating the five-year reversal provision in step 3 of the admissibility calculation, which many found to be confusing. Language similar to U.S. GAAP related to the consideration of reversal patterns when determining the statutory valuation allowance was added to the guidance and also applies to admissibility.

The August exposure draft provides relief to non-RBC reporting entities by allowing the three year or 15 percent admissibility limits in step 2 of the admissibility calculation, if the applicable capital ratio requirements are met. Under SSAP No. 10R and the March exposure draft, non-RBC reporting entities were limited to maximum admissibility limits in step 2 of one year or 10 percent.

Current Statutory Accounting under SSAP No. 10R	SSAP No. 101 (March exposure draft)	SSAP No. 101 (August re-exposure)
Tax-Planning Strategies		
<p>Consideration of tax-planning strategies is implicit when determining statutory valuation allowances consistent with Statement 109's requirements.</p>	<p>Consideration of tax-planning strategies is explicitly required when determining statutory valuation allowances and when considering the realization of deferred tax assets for the admissibility calculation.</p> <p>Tax-planning strategies that are considered in the realization of deferred tax assets must be prudent and feasible.</p> <p>In determining the potential impact of tax-planning strategies, the recognition and measurement requirements for uncertain tax positions using a FIN 48 model needs to be considered.</p> <p>Retained SSAP No. 10R's disclosure requirement about the impact of tax-planning strategies on determining adjusted gross deferred tax assets and the net admitted deferred tax assets by percentage and by tax character.</p>	<p>Consistent with March exposure draft except it requires application of the tax-loss contingency guidance based on SSAP No. 5R to any tax-loss contingencies that would be created as part of the tax-planning strategy.</p> <p>Requires an additional disclosure of whether reinsurance related tax-planning strategies are used.</p>

Overall Observations

- The NAIC has indicated SSAP No. 10 Implementation Questions and Answers will be updated for SSAP No. 101.
- The NAIC has indicated an Issue Paper for SSAP No. 101 discussing the rationale and basis for its conclusions will be drafted and available for review.
- The August exposure draft of SSAP No. 101 also maintained the guidance in SSAP No. 10R related to intercompany transactions, interperiod tax allocation, and interim periods.

Admissibility Tables

Table 1: March SSAP No. 101 Exposure Draft Realization Threshold Limitation Table – Risk-Based Capital (RBC) Reporting Entities

Risk-Based Capital (Excluding Net Deferred Tax Assets)	Adjusted Gross Deferred Tax Assets (DTA) / Adjusted Capital and Surplus (%)	Limit on Timing of Realization	Limit Based on Adjusted Capital and Surplus
300+%	0 – 50%	3 years	15%
	51 – 75%	1 year	10%
	Greater than 75%	0 years	0%
200 – 299%	0 – 50%	1 year	10%
	51 – 75%	1 year	10%
	Greater than 75%	0 years	0%
Less than 200%	0 – 50%	0 years	0%
	51 – 75%	0 years	0%
	Greater than 75%	0 years	0%

Table 2: March SSAP No. 101 Exposure Draft Realization Threshold Limitation Table – Non-Risk-Based Capital (RBC) Reporting Entities

Adjusted Gross Deferred Tax Assets (DTA) / Adjusted Capital & Surplus (%)	Limit on Timing of Realization	Limit Based on Adjusted Capital and Surplus
0 – 75%	1 year	10%
Greater than 75%	0 years	0%

Table 3: August SSAP No. 101 Re-Exposure Draft Realization Threshold Limitation Table – Risk-Based Capital (RBC) Reporting Entities

Risk-Based Capital (Excluding Net Deferred Tax Assets)	Limit on Timing of Realization	Limit Based on Adjusted Capital and Surplus
Greater than 300%	3 years	15%
200 – 300%	1 year	10%
Less than 200%	0 years	0%

Table 4: August SSAP No. 101 Re-Exposure Draft Realization Threshold Limitation Table – Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entities

ExDTA Surplus/Policyholders and Contingency Reserves (%)	Limit on Timing of Realization	Limit Based on Adjusted Capital and Surplus
Greater than 115%	3 years	15%
100% - 115%	1 year	10%
Less than 100%	0 years	0%

Table 5: August SSAP No. 101 Re-Exposure Draft Realization Threshold Limitation Table – Other Non-RBC Reporting Entities

Adjusted Gross DTA/Adjusted Capital & Surplus(%)	Limit on Timing of Realization	Limit Based on Adjusted Capital and Surplus
Less than 50%	3 years	15%
50% - 75%	1 year	10%
Greater than 75%	0 years	0%

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