KPMG

# TaxNewsFlash

United States

No. 2023-063
February 21, 2023

# KPMG report: Observations from Notice 2023-20 (guidance regarding certain insurance related issues under corporate alternative minimum tax)

The IRS released an advance version of Notice 2023-20 [PDF 112 KB] (21 pages) on February 17, 2023. The notice provides interim guidance intended to help avoid substantial unintended adverse consequences to the insurance industry from the application of the new corporate alternative minimum tax (CAMT) created by Pub. L. No. 117-169 (commonly called the "Inflation Reduction Act of 2022" (IRA)).

**Background and summary**

In addition to announcing that the Treasury Department and the IRS intend to issue proposed regulations addressing the application of the CAMT, sections 3 through 7 of Notice 2023-7 provided interim guidance regarding certain time sensitive CAMT issues that taxpayers may rely on until the issuance of the proposed regulations. Read ***TaxNewsFlash***

Notice 2023-7 also stated that Treasury and the IRS intended to issue additional interim guidance expected to address, among other issues, certain issues related to the treatment under the CAMT of life insurance company separate account assets that are marked to market for financial statement purposes, the treatment of certain items reported in other comprehensive income (OCI), and the treatment of embedded derivatives arising from certain reinsurance contracts.

Section 2 of Notice 2023-20 defines terms used throughout the rest of the notice. Sections 3 through 5 of Notice 2023-20 provide additional interim guidance regarding those issues and other issues intended to be addressed by the proposed regulations that taxpayers may rely on until the issuance of the proposed regulations.

**Section 3 describes rules that address certain CAMT issues regarding variable contracts and similar contracts.**

Generally, a life insurance company is required to hold assets (covered investment pool) in a separate account to support its contractual obligations (covered obligations) to a covered variable contract or other similar contracts under section 817(c). For purposes of determining applicable financial statement income (AFSI), section 56A(c)(2)(C) provides that for any corporation not included in the taxpayer's consolidated federal income tax return, such as separate account, AFSI includes only dividends received from the corporation, and other amounts includable in gross income or deductible for tax purposes. The result of these adjustments for life insurance companies may exclude from AFSI unrealized gains and losses attributable to stock held in the separate account, without a corresponding adjustment for the offsetting effect on the reserves.

Pursuant to section 3.02(1) of the notice, for purposes of determining AFSI of a life insurance company issuing covered variable contracts, the change in the amount of the covered obligations for the tax year is disregarded to the extent of the section 56A(c)(2) exclusion amount for the tax year. Thus, both the unrealized gain and offsetting change in the covered obligations are disregarded for purposes of determining the AFSI, which eliminates what would otherwise be a difference between the AFSI and the life insurance company taxable income.

**Section 4 describes rules that address certain CAMT issues regarding funds withheld reinsurance (FWH) and modified coinsurance agreements (Modco).**

Typically, in a FWH and Modco reinsurance, the ceding company transfers the reserves to the reinsure but retains the assets that support the reserves (in Modco, also retains the reserves). The ceding company records an offsetting withheld assets payable to the reinsurer. Subsequently, the ceding company records in OCI the unrealized gains and losses in the retained assets, and in net income the corresponding changes in the offsetting withheld assets payable. The reinsurer books a withheld assets receivable with respect to the retained assets and accounts for the change in value of the receivable as part of its net income. The fair value option can be made by the ceding company to run through the offsetting changes both in OCI or both in net income. Absent the fair value option, this unique accounting rule may result in the inclusion of OCI in AFSI.

Pursuant to section 4.02(1) of the notice, if the fair value option is not elected, for the ceding company, changes in net income as a result of changes in the value of Withheld Assets Payable is excluded from AFSI to the extent that such corresponding unrealized gains and losses in the withheld assets are excluded in AFSI. For the reinsurer, changes in net income as a result of changes in the amount of the withheld assets receivable is excluded from AFSI. Exclusions may be limited as result of retrocession of the reinsured risk.

**Section 5 describes rules that address certain issues that arise under the CAMT for certain formerly tax-exempt entities whose exemption from federal income taxation was repealed by statute and as to which Congress provided special rules for determining the federal income tax basis in their assets held when the repeal of their exemption became effective.**

According to a **Treasury release**, Notice 2023-20 "addresses significant distortions that could arise as corporations determine their tax owed under the CAMT because of the interaction of financial accounting rules for certain life insurance assets and the CAMT. To prevent unintended inclusion of non-economic gains or losses that appear on financial statements when determining tax owed under the CAMT, the notice allows taxpayers to use accounting practices that are in line with existing financial statement and tax treatment of these transactions. The guidance also clarifies that certain statutory 'fresh start' basis rules for corporations following bankruptcies apply to determine gains or losses under the CAMT."

**Proposed effective date and request for comments**

Notice 2023-20 provides that it is anticipated that the proposed regulations will provide that rules consistent with the rules described in sections 3 through 5 of the notice apply for tax years beginning after December 31, 2022.

Treasury and the IRS request comments on any questions arising from the interim guidance set forth in the notice. Commenters are encouraged to specify the issues on which additional guidance (including additional interim guidance) is needed most quickly, as well as the most important issues on which guidance is needed. Treasury and the IRS also request comments with respect to certain specific questions laid out in the notice. Comments are due by April 3, 2023.

Read the related IRS release—IR-2023-30 (February 17, 2023)

**KPMG observation**

The notice is a welcome piece of guidance that provides relief to the insurance industry. It shows how collaboration between affected taxpayers and the Treasury and IRS can lead to remedies for unintended consequences from tax legislation.

While this guidance is specific to insurance company taxpayers, there is no reason why the government would provide relief strictly to this group of taxpayers and not to other similarly affected taxpayers.

For more information contact a tax professional with KPMG's Washington National Tax:

Sheryl Flum | +1 (202) 533-3687 | sflum@kpmg.com

Lori Robbins | +1 (202) 533-3491 | lorirobbins@kpmg.com

Shuang Tan | +1 (202) 954-4505 | shuangtan@kpmg.com



The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.