

Date: 7/15/20

2020 Summer National Meeting
Virtual Meeting

RECEIVERSHIP AND INSOLVENCY (E) TASK FORCE

Friday, August 7, 2020

2:00 – 1:00 p.m. ET / 1:00 – 2:00 p.m. CT / 12:00 – 1:00 p.m. MT / 11:00 a.m. – 12:00 p.m. PT

ROLL CALL

Kent Sullivan, Chair	Texas	Gary Anderson	Massachusetts
Karima M. Woods, Vice Chair	District of Columbia	Anita G. Fox	Michigan
Lori K. Wing-Heier	Alaska	Chlora Lindley-Myers	Missouri
Elizabeth Perri	American Samoa	Matthew Rosendale	Montana
Alan McClain	Arkansas	Bruce R. Ramge	Nebraska
Ricardo Lara	California	Marlene Caride	New Jersey
Michael Conway	Colorado	Mike Causey	North Carolina
Andrew N. Mais	Connecticut	Glen Mulready	Oklahoma
David Altmaier	Florida	Jessica K. Altman	Pennsylvania
Robert H. Muriel	Illinois	Elizabeth Kelleher Dwyer	Rhode Island
Doug Ommen	Iowa	Raymond G. Farmer	South Carolina
Vicki Schmidt	Kansas	Hodgen Mainda	Tennessee
Sharon P. Clark	Kentucky	Todd E. Kiser	Utah
Eric A. Cioppa	Maine		

NAIC Support Staff: Jane Koenigsmann

AGENDA

1. Consider Adoption of its March 4, Jan. 8, and 2019 Fall National Meeting Minutes
—*James Kennedy (TX)* Attachment One
2. Consider Adoption of Revisions to the *Receiver's Handbook for Insurance Company Insolvencies*
for Federal Taxes and Federal Releases—*James Kennedy (TX)* Attachment Two
3. Consider Adoption of its Working Group Reports Attachment Three
 - a. Receivership Financial Analysis (E) Working Group—*Donna Wilson (OK)*
 - b. Receivership Large Deductible Workers' Compensation (E) Working Group
—*Laura Lyon Slaymaker (PA)*
4. Discuss Key Provisions of Receivership and Guaranty Fund Laws—*James Kennedy (TX)* Attachment Pending
5. Hear Presentation on "Insurance Resolution: Preparing for Cyber Claims"
—*Roger H. Schmelzer (National Conference of Insurance Guaranty Funds—NCIGF),*
Chad Anderson (Western Guaranty Fund Services), and
Tim Schotke (Illinois Insurance Guaranty Fund)
6. Hear an Update on International Resolution Activity—*James Kennedy (TX) and Robert Wake (ME)*
7. Discuss Any Other Matters Brought Before the Task Force—*James Kennedy (TX)*

8. Adjournment

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Draft: 1/14/20

Receivership and Insolvency (E) Task Force
Conference Call
January 8, 2020

The Receivership and Insolvency (E) Task Force met via conference call Jan. 8, 2020. The following Task Force members participated: Kent Sullivan, Chair, represented by James Kennedy (TX); Stephen C. Taylor, Vice Chair, represented by N. Kevin Brown (DC); Allen W. Kerr represented by Steve Uhrynyszcz (AR); Ricardo Lara represented by Joe Holloway and David Wilson (CA); Michael Conway represented by Rolf Kaumann (CO); Andrew N. Mais represented by Jon Arsenault (CT); David Altmaier represented by Toma Wilkerson (FL); Doug Ommen represented by Carrie Mears and Kim Cross (IA); Robert H. Muriel represented by Kevin Baldwin (IL); Vicki Schmidt represented by Paige Blevins (KS); Gary Anderson represented by Christopher Joyce (MA); Chlora Lindley-Myers represented by John Rehagen (MO); Matthew Rosendale represented by Steve Matthews (MT); Mike Causey represented by Jackie Obusek (NC); Bruce R. Ramge represented by Justin Schrader and Lindsay Crawford (NE); Glen Mulready represented by Donna Wilson (OK); Jessica Altman represented by Laura Lyon Slaymaker (PA); Raymond G. Farmer represented by Lee Hill (SC); Hodgen Mainda represented by Bill Huddleston (TN); Todd E. Kiser represented by Jake Garn (UT); Scott A. White represented by Doug Stolte (VA); and Mike Kreidler represented by Ron Pastuch (WA).

1. Adopted a Referral to the Financial Condition (E) Committee

Mr. Kennedy said at the 2019 Fall National Meeting, the Task Force discussed requesting that the Financial Condition (E) Committee consider opening the *Insurance Holding Company System Regulatory Act* (#440) and *Insurance Holding Company System Model Regulation with Reporting Forms and Instructions* (#450) to consider revisions to address issues with the continuation of essential services through affiliated intercompany agreements that arise during the receivership of an insurance company, specifically agreements with affiliated entities whose sole business purpose is to provide services to the insurance company.

Iain Nasatir (Pachulski Stang Ziehl & Jones) asked if the Task Force had considered if such changes to Model #440 would conflict with federal laws, such as the McCarran-Ferguson Act or the federal bankruptcy law. Mr. Kennedy said that future discussions will include potential conflicts with other laws.

Mr. Kaumann made a motion, seconded by Mr. Hill, to adopt the referral to the Financial Condition (E) Committee (Attachment One-A). The motion passed unanimously.

2. Requested Comments on Key Provisions of Receivership and Guaranty Fund Laws

Mr. Kennedy said that as part of the Macroprudential Initiative (MPI), a recommendation was adopted by the Task Force to consider methods to encourage states to adopt provisions in receivership and guaranty fund laws that promote effectiveness and consistency, particularly with respect to receiverships of insurers operating in multiple states.

Mr. Kennedy requested that Task Force members, interested state insurance regulators, and interested parties submit suggestions for a list of key provisions that states should have in their laws to promote effectiveness and consistency in receiverships affecting multiple states. Comments should be submitted to Jane Koenigsman (NAIC) by Feb. 7, 2020.

Having no further business, the Receivership and Insolvency (E) Task Force adjourned.

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Draft: 3/11/20

Receivership and Insolvency (E) Task Force
Conference Call
March 4, 2020

The Receivership and Insolvency (E) Task Force met via conference call March 4, 2020. The following Task Force members participated: Kent Sullivan, Chair, represented by James Kennedy (TX); Karima M. Woods, Vice Chair, represented by N. Kevin Brown (DC); Lori K. Wing-Heier represented by David Phifer (AK); Allen W. Kerr represented by Steve Uhrynowycz (AR); Ricardo Lara represented by David Wilson (CA); Michael Conway represented by Rolf Kaumann (CO); Andrew N. Mais represented by Jon Arsenault (CT); David Altmaier represented by Toma Wilkerson (FL); Doug Ommen represented by Kim Cross (IA); Robert H. Muriel represented by Kevin Baldwin (IL); Vicki Schmidt represented by Tish Becker (KS); Sharon P. Clark represented by Jeff Gaither (KY); Gary Anderson represented by Christopher Joyce (MA); Chlora Lindley-Myers (MO); Matthew Rosendale represented by Steve Matthews (MT); Mike Causey represented by Jackie Obusek (NC); Bruce R. Ramge represented by Lindsay Crawford (NE); Glen Mulready represented by Donna Wilson (OK); Jessica K. Altman represented by Laura Lyon Slaymaker and Crystal McDonald (PA); Raymond G. Farmer represented by Geoffrey Bonham (SC); Hodgen Mainda represented by Nikita Hampton (TN); and Todd E. Kiser represented by Jake Garn (UT).

1. Discussed Comments on Key Provisions of Receivership and Guaranty Fund Laws

Mr. Kennedy said that as part of the Task Force's response to the Macroprudential Initiative (MPI), during its conference call on Jan. 8, the Task Force requested comments on key provisions of receivership and guaranty fund laws that states should consider adopting into their laws, particularly with respect to receiverships of insurers operating in multiple states.

Mr. Kennedy summarized the comments received from Missouri, Pennsylvania, Texas, the American Council of Life Insurers (ACLI), the National Conference of Insurance Guaranty Funds (NCIGF), and the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) (Attachment One-A).

Barbara Cox (NCIGF) said she disagrees with the comment from Pennsylvania that all states should have uniform property/casualty (P/C) guaranty fund limits as there may be local variation between states—for example, home values. The claim cap in one state may not be appropriate in another state, so some difference in claim caps is probably appropriate for P/C business. Ms. McDonald said the Pennsylvania comment was regarding medical malpractice insurance.

Bill O'Sullivan (NOLHGA) said on the life side, there has been good success in states updating their laws to adopt the provisions of *Life and Health Insurance Guaranty Association Model Act* (#520). He said 28 states have adopted the 2017 revisions to the Model #520, and another nine states are expected to propose revisions in 2020. He said NOLHGA would have concerns if Model #520 were further revised as it may create delays in states adopting the 2017 revisions. He said NOLHGA has not identified any significant issues that would require amendments to Model #520. He said NOLHGA has not discussed consideration of changes to accreditation standards. He said it would be complicated to identify the standards and to compare them to states' laws.

Wayne Mehlman (ACLI) said an ad hoc committee of the ACLI has had these comments under consideration. He said the comments address holistic improvements to the system rather than specific provisions. Ms. Wilkerson asked for clarification on ACLI's comment related to timing of orders of liquidation. Mr. Mehlman said the intent was to address the length of time a rehabilitation order can continue as the administrative expenses of receivership consume resources before liquidation. Mr. Kennedy said Texas had a provision that imposed a deadline for closing a rehabilitation, but it created many legal problems, was unworkable and was repealed. He said there may be other ways to address the issue other than time limits in state statutes.

Mr. Kennedy said NAIC staff would circulate a list of the items identified in the comment letters to all members, interested state insurance regulators and interested parties and request feedback on each item: 1) agree or disagree to include the item in a response to the Financial Stability (EX) Task Force that this provision(s) is critical for states to have in law for a multi-jurisdiction receivership as it addresses financial stability concerns in resolution; and 2) agree or disagree that this provision(s) is critical for states to have in law for a multi-jurisdiction receivership and should be considered in further discussions regarding a possible update to accreditation standards. He requested responses by March 13.

Having no further business, the Receivership and Insolvency (E) Task Force adjourned.

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Draft Pending Adoption

Draft: 12/18/19

Receivership and Insolvency (E) Task Force New York, New York December 8, 2019

The Receivership and Insolvency (E) Task Force met in Austin, TX, Dec. 8, 2019. The following Task Force members participated: Kent Sullivan, Chair, represented by James Kennedy (TX); Stephen C. Taylor, Vice Chair, represented by N. Kevin Brown (DC); Lori K. Wing-Heier represented by David Phifer (AK); Allen W. Kerr represented by Mel Heaps (AR); Ricardo Lara represented by Joe Holloway (CA); Michael Conway represented by Rolf Kaumann and Eric Unger (CO); Andrew N. Mais represented by Jared Kosky (CT); David Altmaier represented by Toma Wilkerson (FL); Doug Ommen represented by Carrie Mears and Kim Cross (IA); Robert H. Muriel represented by Kevin Baldwin (IL); Vicki Schmidt represented by Tish Becker (KS); Nancy G. Atkins represented by Sandy Batts (KY); James J. Donelon represented by Stewart Guerin (LA); Gary Anderson represented by Christopher Joyce (MA); Chlora Lindley-Myers represented by Shelley Forrest (MO); Matthew Rosendale represented by Steve Matthews (MT); Mike Causey represented by Jackie Obusek (NC); Bruce R. Ramage represented by Lindsay Crawford (NE); Marlene Caride, represented by Diana Sherman (NJ); John G. Franchini represented by Leatrice Geckler (NM); Glen Mulready represented by Donna Wilson (OK); Jessica Altman represented by Crystal McDonald (PA); Elizabeth Kelleher Dwyer represented by Matt Gendron (RI); Raymond G. Farmer represented by Lee Hill (SC); Hodgen Mainda represented by Bill Huddleston (TN); Todd E. Kiser represented by Jake Garn (UT); Scott A. White represented by Vicki Ayers (VA); and Mike Kreidler represented by Steve Drutz (WA). Also participating was: Robert Wake (ME).

1. Adopted its 2019 Summer National Meeting Minutes

Mr. Phifer made a motion, seconded by Ms. Obusek, to adopt the Task Force's Aug. 4 minutes (*see NAIC Proceedings – Summer 2019, Receivership and Insolvency (E) Task Force*). The motion passed unanimously.

2. Adopted the Report of the Receivership Financial Analysis (E) Working Group

Mr. Baldwin said the Receivership Financial Analysis (E) Working Group met Aug. 4 in regulator-to-regulator session, pursuant to paragraph 3 (specific companies, entities or individuals) of the NAIC Policy Statement on Open Meetings. The Working Group discussed the status of individual receiverships and related issues.

Ms. Wilson made a motion, seconded by Mr. Joyce, to adopt the Working Group's report. The motion passed unanimously.

3. Adopted the Report of the Receivership Large Deductible Workers' Compensation (E) Working Group

Ms. Wilson said the Receivership Large Deductible Workers' Compensation (E) Working Group met Dec. 2 and Oct. 24 and took the following action: 1) exposed a draft model guideline that provides alternative language for the *Insurer Receivership Model Act* (#555) Section 712—Administration of Loss Reimbursement Policies for a public comment period ending Jan. 31, 2020; and 2) adopted draft guidance for the *Receiver's Handbook for Insurance Company Insolvencies* (Receiver's Handbook) for best practices in administering a large deductible workers' compensation receivership.

Ms. Wilson made a motion, seconded by Mr. Phifer, to adopt the Working Group's report, including its Dec. 2 (Attachment One) and Oct. 24 minutes. The motion passed unanimously.

4. Adopted Revisions to the Receiver's Handbook

Mr. Baldwin made a motion, seconded by Ms. Wilkerson, to adopt the Receiver's Handbook for large deductible workers' compensation receiverships (Attachment Two). The motion passed unanimously.

5. Exposed Revisions to the Receiver's Handbook

Mr. Kennedy said the Macroprudential Initiative (MPI) report adopted at the Summer National Meeting identified outdated references in the Receiver's Handbook for federal taxes and federal releases was outdated. Revisions were requested and received from several state insurance regulators and interested parties.

Draft Pending Adoption

The Task Force agreed to expose draft guidance for the Receiver's Handbook for best practices in handling taxes and federal releases in receivership for public comment ending Jan. 31, 2020.

6. Discussed Recommendations from the MPI Report

Mr. Kennedy summarized recommendations from the MPI report. The first item involves legal remedies that ensure the continuity of essential services in a receivership by affiliated entities within the group, including non-regulated entities. This is especially problematic in situations where the insurer has no employees, and all services, employees, and records are provided by an affiliate or the holding company, whose sole purpose is to administer the insurance business. Mr. Kennedy recommended having a discussion with the Financial Condition (E) Committee chair about possible legal remedies in the *Insurance Holding Company System Regulatory Model Act* (#440) and *Insurance Holding Company Systems Model Regulation with Reporting Forms and Instructions* (#450). He asked states to consider their own experiences with this issue in order to have a productive future discussion on this issue. There was no objection to this plan.

The second item is to identify methods for encouraging states to adopt key provisions in receivership laws. Model #555 is not widely adopted by states, and past efforts to encourage states to adopt key provisions from the current model have largely been unsuccessful. One exception is Florida, which amended its laws to incorporate certain Model #555 provisions. Mr. Kennedy recommended delegating the development of recommendations to the Receivership Model Law (E) Working Group, which is within the scope of its charges. He suggested that the Working Group's process include: 1) identifying a short list of key provisions critical to consistency, focusing on issues in multistate receiverships; 2) determining which states do not currently have those key provisions in their laws, and any impediments to adopting those provisions; and 3) identifying options to encourage states' adoption of those provisions, including a discussion of the Financial Regulation Standards and Accreditation Program Part A standards for receivership and guaranty fund laws. Currently, these standards include a broad requirement for a receivership scheme and a regulatory framework for guaranty funds. There was no objection to this plan.

Francine Semaya (Legal and Insurance Regulatory Consulting) spoke about an issue in the liquidation of Oceanus Insurance Risk Retention Group (Oceanus), a South Carolina Risk Retention Group (RRG). Ms. Semaya is counsel to the Liquidator and has encountered difficulties with the enforcement of the receivership stay and permanent injunction in other states. Oceanus was defending over 200 cases in New York. An appellate court recently ruled that the stay should not be recognized because Oceanus is an RRG, and the stay is not entitled to recognition under New York's Uniform Insurers Liquidation Act. Another ruling found that South Carolina courts had no jurisdiction over the plaintiffs, and it was a matter of public policy to provide plaintiffs with a forum in their state of residence. She expressed concerns that the decisions are so broad, they might create precedents in receiverships involving other types of insurers and could be followed in other states. She urged the Task Force to discuss this issue. Mr. Kennedy noted that the Task Force reviewed the enforcement of stays in 2017 and issued guidance to the states regarding stay provisions in receivership laws. He said that the Receivership Model Law (E) Working Group will consider this issue in the context of the MPI work that is delegated to it.

7. Heard a Presentation on the IAIR Designation Program

Wayne Johnson (Risk & Regulatory Consulting LLC) provided an overview of the revised professional designation program adopted by the International Association of Insurance Receivers (IAIR). The program includes requirements, testing and qualifications of an Accredited Insurance Resolutions Director and a Certified Insurance Resolutions Director. The intent of the revised program is to ensure broader expertise for insurance resolutions, promote consistent standards for the administration of receiverships and deepen the pool of qualified individuals (Attachment Three).

Mr. Kennedy commented that a tremendous amount of work was expended to ensure that this is a robust, meaningful process with standards that can be relied upon. He said that state insurance commissioners entrust the handling of receiverships to special deputy receivers, and there needs to be a mechanism to ensure that they are qualified. He said that the life & health and property & casualty guaranty funds have been supportive of this initiative. Mr. Gendron asked if IAIR had consulted with the Society of Financial Examiners (SOFE) or the NAIC about the IAIR classes counting toward continuing education (CE) credits for SOFE or NAIC designations. Mr. Johnson replied he had spoken to SOFE.

8. Heard an Update on International Resolution Activities

Mr. Wake reported that the International Association of Insurance Supervisors (IAIS) Resolution Working Group (ReWG) met in September to finalize the *Application Paper on Recovery Planning* and to continue development of the *Application Paper on Resolution Planning*. He said that the U.S. submitted its response to an ReWG questionnaire on resolution authority. Work will continue in 2020. Mr. Kennedy said that states can volunteer to assist in reviewing the ReWG's drafts.

Draft Pending Adoption

Having no further business, the Receivership and Insolvency (E) Task Force adjourned.
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CHAPTER 10 – CLOSING ESTATES

*****TEXT NOT SHOWN TO CONSERVE SPACE*****

III. CONSIDERATIONS PRIOR TO CLOSURE OF A LIQUIDATION

B. Tax Issues to be Considered Prior to Closure

1. General

Generally, federal and state tax returns should be filed by the liquidator throughout the liquidation. The final returns will be filed as of December 31 of the year during which final distributions are paid. As set forth above, the expenses that will be incurred to prepare the returns should be prepaid, as the actual filings will occur in the year subsequent to closure.

With each of the federal tax returns filed during the liquidation, the liquidator may consider the submission of a written application requesting a Prompt Audit and Determination under Revenue Procedure ~~76-23~~ 2006-24 to the IRS. Generally, this will expedite the entire process and end the statute of limitations for the returns. Technically, this procedure only applies to companies in a bankruptcy proceeding (Title 11), but in the past the IRS has extended it to insurers in receivership. If this procedure is not extended to an insurer in receivership, However, the IRS has taken the position that Revenue Procedures 76-23 and 81-17 do not apply to insurance companies in receivership. This position requires insurance company receivers are required to file federal income tax returns in the normal course of business as if the insolvent insurer were a perpetual concern, with no mechanism to sever the statute of limitations period. As it stands, this is an impediment to closure of an estate that must be dealt with by receivers on a case by case basis through closing agreements with the IRS.

For more information regarding tax issues, refer to Chapter 3—Accounting and Financial Analysis. *It is strongly recommended that the receiver consult and retain a tax expert for all tax related issues.*

~~2. Phase III Tax of Life Insurance Companies~~

~~Any life insurance company that was a stock life insurance company before 1984 potentially has a balance in a Policyholder Surplus Account (as defined in Section 815 of the Internal Revenue Code). The balance represents previously deferred income, which is potentially subject to recapture at some point prior to closure of the estate, producing a tax liability without an increase in the ability to pay.~~

~~Some estates have recently filed returns taking the position that the recapture event does not occur in the course of an insolvency proceeding. One theory is based on an assertion that the legislative history of Section 815 provides ample evidence of a Congressional intent not to impose the Phase III tax when a Policyholder Surplus Account is eliminated due to events occurring in a liquidation. This theory seems enhanced by the obvious statutory reliance on regulatory accounting principles, under which the real surplus of the company has been obliterated by losses.~~

~~Another theory that has been advanced is that, as a result of the changes made by the Tax Reform Act of 1984, a literal interpretation of the statute allows the recapture to be offset by operating losses, clearly a benefit not previously allowable.~~

~~While these techniques for achieving a non-taxable (or partially sheltered) elimination of the Policyholder Surplus Account seem quite credible, the IRS has opposed their use in some cases. Nevertheless, on November 8, 1994, in *Monat Capital Corporation v United States*, 869 F. Supp. 1513 (D. Kansas 1994), the federal district court in Kansas ruled that in the case of an insolvent life insurance company where no shareholder will receive any distribution from the Policyholder Surplus Account, the account should not be restored to taxpayers' income. Accordingly, these theories should be explored with tax counsel and, if any such position is taken on a tax return, it is recommended that adequate disclosure be made in the return to maximize protection against the imposition of the 20% penalty under Section 6662 of the Internal Revenue Code. Of course, absolute immunity from penalties can only be secured by taking this position and claiming a refund of Phase III tax paid in an amended return, which can be filed immediately after the original return has been filed. These issues must be addressed prior to closure.~~

3. Internal Revenue Codes Relative to Insurance Contracts and Distributions

Tax implications and/or consequences of assumption transactions, 1035 exchanges or other such transfer of policyholder liabilities or payout of policyholder benefits is also an area of concern and consideration by the receiver. In response to insurer insolvencies, the IRS has addressed several issues affecting such taxation and tax implications. Such rulings have addressed issues such as funding in "steps,"¹ tax free exchanges,² multiple contract issues³ and contract dates and testing for compliance,⁴ to name a few, and specifically relate to Internal Revenue Codes 72 and 7702.

Section 72 of the IRC, "Annuities; Certain Proceeds of endowment and life insurance contracts," specifically subsection (s), references required distributions where the holder of an annuity dies before the entire interest is distributed. The rules in Section 72 govern the income taxation of all amounts received under annuity contracts and living proceeds from life insurance policies and endowment contracts. Section 72 also covers the tax treatment of policy dividends and forms of premium returns.

¹ (Rev. Rul.) 92-43, 1992-1 CB 288. The IRS will allow a valid exchange where funds come into the contract or policy in a series of transactions if the insurer issuing the contract or policy to be exchanged is subject to a "rehabilitation, conservatorship or similar state proceeding." Funds may be transferred in this "serial" manner if: (1) the old policy or contract is issued by an insurer subject to a "rehabilitation, conservatorship, insolvency or similar state proceeding" at the time of the cash distribution; (2) the policy owner withdraws the full amount of the cash distribution to which he is entitled under the terms of the state proceeding; (3) the exchange would otherwise qualify for Section 1035 treatment; and (4) the policy owner transfers the funds received from the old contract to a single new contract issued by another insurer not later than 60 days after receipt or, if later, September 13, 1992. If the amount transferred is not the full amount to which the policy owner is ultimately entitled, the policy owner must assign his right to any subsequent distributions to the issuer of the new contract for investment in that contract. Revenue Proc. (Rev. Proc.) 92-44, 1992-1 CB 875, as modified by Rev. Proc. 92-44A, 1992-1 CB 876; (Let. Rul.) 9335054.

² If a non-qualified annuity contract is exchanged under Section 1035 within the scope of Rev. Rul. 92-43 (i.e., as part of a rehabilitation proceeding), the annuity received will retain the attributes of the annuity for which it was exchanged for purposes of determining when amounts are to be considered invested and for computing the taxability of any withdrawals.

³ An annuity that is received as part of a Section 1035 exchange that was undertaken as part of a troubled insurer's rehabilitation process under Rev. Rul. 92-43 is considered to have been entered into for purposes of the multiple contract rule on the date that the new contract is issued. The newly-received contract is not "grandfathered" back to the issue date of the original annuity for this purpose. Let. Rul. 9442030.

⁴ The IRS, in response to insurer insolvency proceedings, stated that modification of an annuity, life insurance, or endowment contract after Dec. 31, 1990, that is necessitated by the insurer's insolvency will not affect the date on which such contract was issued, entered into or purchased for purposes of IRC Section 72, 101(f) 264, 7702 and 7702A and also as not resulting in retesting or the start of a new test period under §§7702(f)(7)(B)-(E) and 7702A(c). Rev. Proc. 92-57, 1992-2 CB 410; Let. Rul. 9239026. See also Let. Rul. 9305013. The date is not affected by assumption reinsurance transactions entered into by the insurer provided that the terms and conditions of the policies, other than the insurer, do not change. Let. Ruls. 9323022, 9305013. The IRS also concluded that where a nonqualified annuity is exchanged for another via Section 1035 as part of a troubled insurer's rehabilitation process under Rev. Rul. 92-43, the annuity received in the exchange will be treated as issued, entered into, or purchased as of the date of the exchange except as provided in IRC Sections 72(e)(5) and 72(q)(2)(F). Let. Rul. 9442030.

Chapter 10 – Closing Estates

IRC Section 7702 relates to the definition of a life insurance contract. For purposes of this section, the term “life insurance contract” means any contract that is a life insurance contract under the applicable law, but only if such contract meets the cash value accumulation test as defined in Section 7702(b), or meets the guideline premium requirements of Section 7702(c) and falls within the cash value corridor of Section 7702(d).

a. Cash Value Accumulation Test

Generally, a contract meets the cash value accumulation test if, by the terms of the contract, the cash surrender value of the contract may not at any time exceed the net single premium that would have to be paid at such time to fund future benefits under the contract.

b. Guideline Premium Requirement and Cash Value Corridor

With respect to the guideline premium, a contract generally meets this requirement if the sum of the premiums paid under the contract does not at any time exceed the guideline premium limitation as of such time. Guideline premium limitation means, as of any date, the greater of the guideline single premium or the sum of the guideline level premiums to such date. Guideline single premium means the premium at issue with respect to future benefits under the contract. Guideline level premium means the level annual amount, payable over a period not ending before the insured attains age 95, computed on the same basis as the guideline single premium.

A contract generally falls within the cash value corridor if the death benefit under the contract at any time is not less than the applicable percentage of the cash surrender value.

As with any tax issue, the implications of all Internal Revenue Codes to a particular liquidation proceeding and that proceeding’s specific transactions should be explored with tax counsel.

4. Collection of Tax

Under Section 801 of IRMA, claims of the federal government are assigned a Class 5 priority and claims of state or local government are assigned a Class 8 priority, unless the claims represent losses incurred under policies of insurance (Class 3 or 4 claims). Thus, tax liabilities not properly characterized as an expense of receivership administration (Class 1) rank behind any claims for guaranty fund administrative expenses (Class 2) and all claims of policyholders (Class 3 or 4), including guaranty funds. Conversely, under the federal “super-priority” statute, 31 U.S.C. § 3713, claims of the federal government (in cases not covered by the bankruptcy code) are given first priority. The Supreme Court of the United States has resolved this conflict in *United States Department of the Treasury, et al v. Fabe*, 508 U.S., 491, 113 S. Ct. 2202, 124 L. Ed. 2d 449 (1993). The Court held that the Ohio priority of distribution statute was not pre-empted by the federal statute to the extent that the Ohio law protects policyholders, because to that extent it constitutes a law enacted “for the purpose of regulating the business of insurance.” Since the court also viewed administrative expenses as incurred in the process of protecting policyholders, administrative expenses also were ranked ahead of federal claims.

More recently, the 1st U.S. Circuit Court of Appeals has ruled that the federal government does not automatically have priority over other creditors, including state guaranty funds, in insurer liquidations. The 1st Circuit panel’s ruling in *Ruthardt vs. United States of America* (see Chapter 9—Legal Considerations, section on Federal Government Claims) affirmed a Massachusetts district court’s decision. In this litigation, the federal government challenged two aspects of the Massachusetts liquidation statute. First, the government argued that the liquidation priority provision

in the statute is preempted by federal law to the extent it provides for payment of guaranty association claims ahead of claims of the federal government. The federal government also argued that the state's statutory bar date for filing claims against the insolvent insurer's estate does not apply to claims of the federal government. The federal district court ruled that the provision affording priority to guaranty association claims under the Massachusetts statute is a provision enacted for the purpose of regulating the business of insurance and is therefore shielded from federal pre-emption in accordance with the McCarran-Ferguson Act. With respect to the claims bar date, the district court concluded that it was bound by a controlling 1993 First Circuit decision finding that the benefits provided to policyholders by a state's claim bar date were too tenuous for that provision to constitute the regulation of the business of insurance subject to the McCarran-Ferguson protections. The Court of Appeals affirmed on both issues.

Generally, taxes are, at most, an expense of administration if the taxes arise during the period of administration (as distinguished from unpaid taxes for periods ending before commencement of liquidation) and are incurred by the estate, i.e., imposed on income from which the estate derived some benefit. ~~While the matter has not yet been tested in court, it is likely that the Phase III tax would not be treated as an expense of administration, since the income upon which it was imposed was obviously earned, collected and dissipated before the liquidation commenced.~~ Decisions regarding the payment of computed taxes should only be made after consultation with legal counsel.

5. Filing of Tax Returns

The entry of an order of liquidation does not terminate the existence of the insurer for tax purposes, regardless of the impact the order may have under state law. The taxable entity remains in existence until the liquidation is complete, i.e., all the assets have been distributed. Accordingly, the liquidator must attend to the continued filing of tax returns during the liquidation proceeding, which may include several taxable years. Therefore, the liquidator should recognize the need to undertake tax planning.

As set forth above, it is possible that over the period of administration, an insolvent insurer may lose its status as an insurance company or become exempt from taxation altogether. Since these classifications are based on a testing of the company's activities and reserve characteristics, as activities cease, premium diminishes and insurance obligations are ceded under assumption reinsurance arrangements, the company ~~will~~may begin to fail these tests. The liquidator should anticipate the occurrence of this, and plan for the attendant consequences (reserve restoration, ~~Phase III tax~~, etc.).

If the insurance company placed in liquidation is the common parent of a group that has been filing consolidated returns, the receiver may have to continue filing on that basis. If the company was a subsidiary in a consolidated group, it is arguable that an order of liquidation should cause a termination of membership in the group. It should be noted that the only apparent pronouncement in this area is a 1985 private ruling (LTR 8544018) in which the IRS held that continued inclusion in a consolidated group is required of an insurer throughout the period of administration. However, among the consequences of entering an order of liquidation are the facts that the liquidator is given the power to exercise all shareholder rights (Section 504A(16) of IRMA), the receiver may contemporaneously dissolve the corporate existence under state law (Section 503) and the shareholders, in their capacity as owners, become creditors of the estate (Section 501). Any one of these conditions, and certainly all of them in combination, would seem to indicate that the parent company no longer has any stock ownership interest in the insurer, much less any voting rights. Furthermore, considering that this is a permanent stockholder displacement rather than a mere suspension of rights, the ruling seems rather questionable. In this situation, tax counsel should be consulted. When dealing with tax sharing agreements and consolidated tax returns, the need for termination of any prior agreements should

Chapter 10 – Closing Estates

quickly be assessed. Termination of these agreements could prevent a parent of a subsidiary insurance company from taking away tax benefits that rightfully belong to the estate.

The liquidator needs to also be aware of the tax consequences for a member of a consolidated group upon its ceasing to be a member. It will have two short-period years, one ending on the day it leaves the group that will be included in the group's consolidated return, and one beginning on the next day and ending at the insurer's normal year-end that will require a separate return. Even though the insurer might be included in the group's consolidated return for a small portion of the year, it will be jointly and severally exposed to the group's consolidated tax for the entire year, which tax could be increased by the recognition of an excess loss account (i.e., negative basis) that the group might have in the stock of the insurer. If gains of the insurer on prior transactions with other members were deferred, the gains must be recognized in the consolidated return upon the member's departure. The tax thereon can come back to the insurer, either through joint and several liability or under a tax allocation agreement of the group. Any estimated tax payments made by the group during the year must be allocated. Operating losses sustained by the insurer in subsequent periods that can be carried back to prior consolidated returns will produce refunds that will be made to the common parent of the group.

Affiliates' use of losses within a consolidated return presents a difficult issue regarding the estate's ability to recover any portion of the benefit. If the group had entered into a tax allocation agreement, the estate's benefit would be determined pursuant to that agreement. However, absent a written agreement, as a matter of equity, courts seem to allocate tax benefits according to which entities paid the tax being recovered, or whose income is being offset (thus giving value to the loss). Note that the rules contained in the Department of the Treasury's regulations regarding allocations of consolidated tax are effective only for determining income tax consequences and do not, in and of themselves, create a contractual right of any member to receive any tax payments from another member.

Accordingly, a loss of the insurer, which can only be used against income of other members in the current year or another year and producing a refund of consolidated tax paid in by other members, is not likely to provide a material benefit for the insurer. If a refund potential exists, the liquidator might consider taking the position that inclusion in a consolidated return by a subsidiary insurer is no longer permitted or required (pursuant to the discussion above), thereby perhaps developing some leverage in negotiating a tax allocation agreement.

6. Net Operating Losses

An insurer placed under a liquidation order will ordinarily have incurred large operating losses, some of which may have been realized prior to the receivership and remain eligible for carryover to periods ending after the receivership began, and some of which may be realized during the receivership and may be carried back to earlier periods. Operating losses incurred by life insurers may no longer be carried back for taxable years beginning after December 31, 2017. Net operating loss deductions ("NOLs") are limited to 80 percent of taxable income (without regard to the deduction) for losses arising in taxable years beginning after December 31, 2017. Carryovers to other years are adjusted to take accounting of this limitation and may be carried forward indefinitely. Property and casualty insurers may carry back losses 2 years and forward 20 years. The 80 percent limitation on use of NOLs does not apply to a property and casualty insurance company.

Under general rules, loss carryovers expire if not used within a certain period of time. It may be, therefore, necessary for the liquidator to project the probable timing of income realization, particularly for property and casualty insurers where loss carryovers expire if not used within a

certain period of time. ¶The major item of income realization~~which~~ may be debt cancellation income when advances from guaranty funds, for example, are forgiven at closing.

The general rules for carryback and carryover of losses are modified if there is a change in the status of the insurer before January 1, 2018. A loss of a life insurance company may only be carried back to a year in which it qualified as a life insurance company if the loss occurs prior to January 1, 2018. For years beginning after December 31, 2017, life insurance companies are allowed the NOL deduction under section 172. A similar rule exists for property and casualty companies. As to loss carryovers, a change in character does not result in denial of the carryover, but the amount of loss from the earlier year may not exceed the amount it would have been if the insurer had the same character in all relevant years as it has in the year to which the loss is carried.

Loss carryforwards generally become severely restricted upon a substantial change in the ownership of the stock of a corporation. However, the rules requiring this result should not apply in these cases. If the IRS takes the position that the entry of an order of liquidation does not affect stock ownership (as, for example, in LTR 8544018), then the rules are not invoked. Conversely, if the entry of the order, in fact, does represent a complete change in ownership, then the exception for “Title 11 or similar case,” e.g., bankruptcy or receivership, should be available (see 26 U.S.C. § 382(l)(5)).

The liquidator should consider techniques having the effect of accelerating income, such as the sale of appreciated property, reserve adjustments or reinsurance transactions. If the insurer can remain in a profitable consolidated group with which it has a tax allocation agreement, benefits can be realized without regard to extraordinary transactions.

7. Federal Claims and Releases

a. Communicating with the Department of Justice.

Contact with the Department of Justice (“DOJ”) at the inception of a receivership estate is critical to obtaining a prompt release of personal liability of the Receiver under 31. U.S.C. 3713(b) (the “3713 Release”) to facilitate estate distributions to policyholders, claimants against policyholders, guaranty associations and other creditors. DOJ has historically identified a single Assistant U.S. Attorney as gatekeeper between the receiver and all federal agencies, except for the Internal Revenue Service, that may have claims against the receivership estate. Receivers may want to limit the number of people communicating with the DOJ to reduce the possibility of mixed messages, or messages going to the wrong person. Additionally it is recommended that Receivers follow the checklist provided by the DOJ when submitting documents. Contact the NAIC’s office in DC if you need assistance to identify the current DOJ receivership contact

b. Identifying potential federal claims, particularly long tail claims.

The Receiver’s initial goal should be to identify potential federal claims from the insurer’s claim and corporate files. Federal claims that are classified at the policyholder priority level as claims under an insurance policy or against an insured under an insurance policy should be reviewed and adjusted as soon as possible and their resolution and adjudication should be summarized for the DOJ in connection with the 3713 Release request. In addition to potential federal claims identified by the receiver, DOJ will typically request the receiver to identify all former policyholders of the insurer, including policy periods and limits of coverage so that federal agencies can perform their own search of potential claims against the insurer. An example of claims with a federal agency as a claimant are claims identified as having an environmental exposure.

Chapter 10 – Closing Estates

c. Classification and handling of federal claims.

Pursuant to *United States Dept. of Treas. v. Fabe*, 508 U.S. 491 (1993), state law may prioritize payment of administrative expenses and policyholder claims, including claims by third parties against policyholders and claims by guaranty associations, ahead of claims of all other general unsecured creditors, provided that the priority of federal claims immediately follows that of policyholders and precedes all other creditor classes. Claims of federal agencies under a policy of insurance or against a policyholder, however, are entitled to policyholder priority treatment.

d. Facilitating the process of obtaining a federal release.

All federal claims that are prioritized at the policyholder priority level should be identified and resolved before applying to the DOJ for a 3713 Release. The process of interacting with the DOJ, including the DOJ's survey of federal agencies for potential federal claims can take several years. Long-tail claims, such as claims involving environmental liability and coverage, as well as the number of policy years that the insurer provided coverage for long-tail exposures, is likely to increase the amount of time needed to resolve the potential federal claims and obtain the 3713 Release.

A best practice is to provide the DOJ with very detailed information on policies and claim information in order to avoid prolonging the process unnecessarily and lead to a long series of back-and-forth requests and production of additional data. For example, include a list of all policyholders unless the lines of business were limited to medical insurance. It may be helpful to segregate the various lines of business as the Environmental Protection Agency (EPA) is more interested in general liability lines as opposed to workers compensation exposures. If the company uses specific policy prefixes for different lines of business, a listing of the policy prefix definitions should be submitted with the list of policies. DOJ resource are usually limited, so key to successfully receiving the Release, it is helpful to keep the lines of communication open, not press for immediate results, consider routine follow-ups with the DOJ such as scheduled monthly status calls.

e. Impact of federal release on receivership closure.

Obtaining the 3713 Release is essential to protecting the receiver against the personal liability imposed under 31 U.S.C. s.3713, and accordingly impacts the receiver's ability to make final distributions of estate assets and close the estate. The foregoing practices should be commenced at the outset of the receivership and pursued with diligence throughout the life of the estate to ensure that the ultimate discharge of the estate is not prolonged.

7. Closing Agreement

The liquidator may want to consider utilizing a closing agreement pursuant to Revenue Procedure 201998-1, IRS Procedures for providing advice to taxpayers in the form of letter rulings, closing agreements, determination letters and information letters, and orally on issues Issuing Rulings, Determination Letters, and Information Letters, and for Entering Into Closing Agreements on Specific Issues Under the Jurisdiction of the Associate Chief Counsels (Domestic Corporate), (Employee Benefits and Exempt Organizations Financial Institutions & Products), (Income Tax & Accounting), (International), (Passthroughs & Special Industries), (Procedure and Administration) and (Enforcement Litigation) Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). The closing agreement is a final agreement between the IRS and the taxpayer on a specific issue or liability and is entered into under the authority in §7121. The closing agreement would provide for a final determination to be made by the IRS with respect to tax returns filed on

behalf of the insolvent company for specific years and would be final and conclusive except in the event of fraud, malfeasance or misrepresentation of material fact.

Additionally, retaining a Taxpayer Advocate's opinion is a possible best practice to address potential tax liability after receivership closure. Because the Taxpayer Advocate is associated with the IRS, this type of opinion could create an obstacle for tax authorities if they decide to revisit a tax return.

*****TEXT NOT SHOWN TO CONSERVE SPACE*****

CHAPTER 3 – ACCOUNTING AND FINANCIAL ANALYSIS

******TEXT NOT SHOWN TO CONSERVE SPACE******

VIII. TAX ISSUES

In virtually every receivership federal tax issues must be considered. The insurer cannot be discharged or liquidated without the filing of federal income tax returns. In addition, consideration should be given to the payment of federal corporate income and other taxes. The receiver can be held personally liable for the payment of certain unpaid taxes if specific procedures are not followed.

Because of the complexity of federal income taxation issues, the potential personal liability of the Receiver and the additional complexities associated with receiverships, and the significant impact on the estate from items such as forgiveness of debt, ~~alternative minimum tax, Phase III tax triggering for life companies~~, consolidation rules and other matters, the receiver should hire individuals with expertise in these areas. Such experts could include independent CPAs or counsel with experience in such matters. Furthermore, because of the continuously evolving nature of federal income taxation issues, many of the issues addressed in this chapter may have changed. This is a reason that the receiver should hire individuals that will be as up-to-date as possible in these areas, and why receivers should seek updated guidance on tax matters (both federal income and state premium tax issues) in reference to the issues addressed in this Handbook.

The receiver should ascertain the insurer's tax status as part of the takeover procedure, in addition to securing copies of tax returns and company tax payment records. Foremost, the receiver should learn whether all tax returns due have been filed and any amounts owing have been paid. In addition, the receiver should learn whether the insurer was part of a consolidated group filing or party to any tax sharing or similar contractual agreements. The receiver should also obtain and carefully review and understand the provisions of any tax sharing agreements between the insurer and any related parties. In almost all receiverships, the receiver takes over the insurer, but not necessarily its holding company or other affiliated group with which the insurer may be consolidated for tax purposes. In addition, the insurer may own non-regulated subsidiaries that are taxed differently from the insurer.

Prior years' returns and any correspondence with the IRS also should be reviewed. Discussion may be held with any outside CPAs or counsel who may have been involved in filing the returns or in handling any disputes with the IRS. The receiver should be alert to any contingencies that may exist for payment of taxes, penalties and interest resulting from failure to file on time, failure to pay tax due on the return, inappropriate treatment of income or deductions on the return, etc. Contingency reserves recorded on the balance sheet of the insurer or its parent should be reviewed and analyzed for purposes of determining tax positions taken by the company which are not "more likely than not." The receiver should consider these contingencies when allocating distributable assets of the estate in light of the priority generally alleged by the federal government and accorded by the applicable priority statute (see Chapter 9—Legal Considerations).

The receiver may request an "Account Transcript" from the IRS for the receivership entity. The transcript, available by type of tax (Form 1120, Form 941, etc.) and year, may be obtained by filing form 4506-T, Request for Transcript of Tax Return. An account transcript typically contains information on tax payments (amounts and dates) and filing of returns (dates).

Income taxation of insurers is somewhat different from conventional corporations, with additional provisions that are applicable to life insurers contained in Part I of Subchapter L of the Internal Revenue Code ("IRC") and specific provisions applicable to other insurance companies contained in Part II of Subchapter L of the IRC. and taxation of life insurers differs to some extent from taxation of property and casualty insurers. To further confuse the issue, mutual life insurers are subject to tax adjustments not applicable to stock life insurers.

Even though an insurer may have substantial statutory losses, it is possible that based on its taxable income, federal income taxes will may be due. See discussion in this chapter of deferred income that may be taxed when a company loses its status as a life insurance company for federal tax purposes. There also exists the possibility that the insurer is entitled to recover prior years' taxes because of the existence of capital losses, operating losses or tax credits. Operating losses, ~~which~~ can be carried back two years and forward 20 years by property and casualty insurers. Prior to 2018, life insurers were allowed to carry back ordinary losses for 3 years and carry forward losses for 15 years. No carryback is allowed for operating losses of insurers other than property and casualty insurers for taxable years after December 31, 2017, but these insurers are allowed indefinite carryforwards which are limited to 80% of taxable income in each year to which the operating loss is carried. All insurers are allowed to carry back capital losses 3 years and forward up to 5 years to offset capital gains and tax credit carrybacks vary depending upon the type of credit, so you should always check with a tax advisor. The insurer may also have made estimated tax payments that can be recovered. An insurer may also be entitled to a tax recovery because of its inclusion in a consolidated tax filing where its losses were used to set off taxable income from affiliated entities. Tax recovery due to tax sharing agreements will not be recoverable from the IRS but must be recovered from affiliated entities. Therefore, income tax recoverable may not be collectible and, as such, should not be booked. In addition, under Section 848 of the Internal Revenue Code, an insurer must capitalize its estimated acquisition expenses, which are then amortizable (deductible) over the ensuing 10-year period for amounts capitalized prior to through Dec. 31, 2017 and over a 15-year period for amounts capitalized after December 31, 2017 (five years for smaller companies).

The receiver should be aware that IRC Section 6511(a) places a deadline by which claims for credit or refund of taxes must be made. In many instances, this deadline will be three years from the due date of the return for which the claim for refund is being made. However, if the claim for refund results from the carryback of a net operating losses to ~~the~~ preceding tax years, the deadline will be three years from the due date of the return which generated the net operating loss. Due to the critical nature of properly determining these deadlines, the receiver should consider consulting independent CPAs or counsel with experience with these matters.

In addition to federal corporate income taxes, the receiver also has to be concerned about state corporate income taxes, federal and state payroll taxes, premium taxes, real estate taxes, federal excise taxes, state franchise and excise taxes, sales taxes, and personal property taxes, along with myriad reporting and filing requirements. The receiver will also need to file final tax returns upon the closing of the receivership estate.

A. Notice

Within 10 days from the date a receiver is appointed, Form 56 (Notice Concerning Fiduciary Relationship) must be filed with the IRS. A certified copy of the court appointment should be attached. This form should be filed for all forms of receivership. The receiver should specify that he is to receive notice concerning income, excise, sales and property, and payroll tax matters. The list of tax forms should include Form 1120L (for life companies) or Form 1120PC (for property and casualty companies), Form 941 (quarterly payroll tax returns), Form 940 (Federal Unemployment Compensation Tax), and Form 720 (Federal Quarterly Excise Tax Return). If the insurer owns subsidiaries, the receiver should also file a Form 56 notice for each subsidiary.

In addition to the federal filing, many states have similar notice requirements. Even without a specific requirement, sending similar notice to the taxing authorities of those states and foreign countries where the insurer did business or had employees should be considered.

Form 56 is not to be used to update the last known address of the receivership entity. The receiver should file form 8822, Change of Address, with the IRS.

B. Income Taxes

Under Section 1.6012-3(b)(4) of the Federal Income Tax Regulations, a receiver or trustee who, by order of a court of competent jurisdiction, by operation of law or otherwise, has possession of or holds title to

Chapter 3 – Accounting and Financial Analysis

all, or substantially all, the property or business of a corporation, must file a return in the same manner and form as the corporation.

The due date for filing federal corporate income tax returns for insurance companies is the 15th day of the fourth month (generally ~~March-April~~ 15) of the ~~following~~-year following the year end of the company. [For years beginning prior to 2016, the due date was the 15th day of the third month (generally March 15) of the year following the year end of the company.] A six-month extension to October 15 can be obtained for the filing of the return, if the extension form is sent to the IRS prior to the ~~March-April~~ 15 deadline. This extension, however, is only for the filing of the return and not for the payment of tax liabilities. The ~~March-April~~ 15 deadline is applicable to calendar-year companies only. There may be certain non-insurance companies under the receiver’s authority that have fiscal year-ends.

Once an affiliated group of corporations files a consolidated return, it must continue to do so as long as the group remains in existence. Therefore, consolidated returns must continue to be filed with the insurer’s subsidiaries. In addition, the IRS has ruled under PLR 9246031 that an insurer in liquidation under state law generally is required to be included in its common parent’s consolidated federal income tax return. The receiver may request approval from the IRS to file separate returns. This permission may be granted on a case-by-case basis for good cause shown. Pursuant to the consolidated return regulations (1.1502-75), the parent of the affiliated group must request deconsolidation for good cause. A deconsolidation may weaken the IRS’s position; as such, the granting of a deconsolidation is not guaranteed~~may not be likely~~.

Following is a list of various insurance or insurance-related entities and the Federal Income Tax Form that should be filed:

Type of Insurer (Based on Business Written)	Federal Income Tax Form
Property/Casualty	1120- <u>PC</u>
Life	1120- <u>L</u>
HMO	1120- <u>PC</u>
Staff Model HMO	1120
501(c)(15)(A) - tax exempt	990
Title	1120- <u>PC</u>
Blue Cross/Blue Shield	1120- <u>PC</u>
Health	1120- <u>PC</u>
Health w/ noncancellable and/or Guaranteed renewable contracts	1120- <u>L</u>

For a company to be considered an “insurance company,” at least half of its business during the taxable year must be the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies.

For a company to be considered a “life insurance company,” it must be engaged in the business of issuing life insurance and annuity contracts (either separately or combined with accident and health insurance), or noncancellable and/or guaranteed renewable contracts of health and accident insurance. Also, its life insurance reserves plus unearned premiums—and unpaid premiums on unpaid losses and on noncancellable life, accident, or health policies not included in life reserves—must make up 50 percent or more of its total reserves.

In certain special situations, managed care organizations may qualify for tax exempt status; if so, they would file Form 990.

1. Life Insurance Companies

Life insurers (whether stock, mutual or mutual benefit) that meet certain reserve requirements file Form 1120-L. If a life insurer does not meet the reserve requirements, then it must file Form 1120-PC. If a stock life insurer loses its life insurance tax status because its life insurance reserves fall below the minimum requirement, then taxes that were deferred in earlier years may now become due. In Revenue Procedure 2018-31, Section 26.03 provides for an automatic accounting method change when there's a change in qualification as a life insurance company as defined in Internal Revenue Code ("IRC") Section 816(a).~~This happens when, under prior federal law, a portion of the income earned by a life insurer was considered to belong to the policyholders and was excluded from income. It was segregated and carried on the tax return in an account called "policyholder surplus." Upon loss of life insurance company tax status, or certain other events, all or a portion of the "policyholder surplus" account may be taxed. This is referred to as "Phase III tax liability" and can be a material amount for some life insurers. Phase III tax liability also can result from losses exceeding prior years' accumulated taxable income and reduction of premium volume or reserves or loss of insurance company status.~~

~~Phase III tax may be a liability which arises prior to the receivership or during the administration of the estate. This may have a significant impact on the statute of limitations for assessment of the tax as well as the priority of the claim for payment of the tax relative to creditors and policyholders. The existence of net operating losses may be unavailable in reducing or avoiding a Phase III tax liability.~~

For taxable years ending before January 1, 2018, life insurers with less than \$500 million in assets are entitled to a small life insurer deduction of 60 percent of their "life insurance company taxable income." This deduction is available for income up to \$3 million and then is gradually phased out on income from \$3 million to \$15 million. Alternative minimum tax should be considered in calculating the benefit of the small company deduction. For taxable years after December 31, 2017, the small life insurer company deduction is repealed, and the alternative minimum tax for corporations is repealed as well.

2. Non-Life Insurance Companies

Non-life insurers (stock and mutual) file Form 1120-PC. Non-life companies generally are taxed on their statutory income with certain modifications, including the discounting of loss reserves and the non-deductibility of 20% of the increase of the unearned premium reserves. The non-deductible 20% of the unearned premium reserve (UPR) gives the taxpayer a tax benefit when the UPR is reduced but the effect of the reversal of the 80% deductible portion has a greater impact and may create taxable income. As previously stated, the receiver should consult their tax consultant regarding the ramifications of these issues.

Non-life insurers whose written premiums for the year do not exceed \$~~4~~2.2 million (an amount which is inflation-adjusted for each taxable year beginning after 2015) may elect to be taxed only on investment income under Code Section 831(b). The premium limits are based upon the premiums of a "controlled group" of corporations as defined by Code Section 1563(a), with the exception that more than 50% is the definition of control. The fact that an insurer is in receivership does not remove it from a "controlled group." The company also must meet certain diversification requirements with regard to premiums and owners as prescribed in IRC Section (831(b)(2)(B)). Taxation on investment income may not be advantageous to companies that are currently generating or utilizing net operating losses, as the company may lose the benefit of those losses. IRC Section 831(b)(3) prescribes limitations on the use of net operating losses for insurance companies taxed only on investment income.

Prior to January 1, 2005, small non-life insurers with less than \$350,000 of premium income could qualify to be exempt from income tax under Code Section 501(c)(15). Many receivers took advantage

Chapter 3 – Accounting and Financial Analysis

of this provision to exempt liquidation estates from federal income taxation. In 2004, [IRC Code Section 501\(c\)\(15\)](#) was amended to provide tax exempt status only to those non-life insurers with gross receipts less than \$600,000, and then only if more than 50% of the gross receipts were from premiums. Since most companies in liquidation have virtually zero premium income after the first couple of years of the liquidation, and since most have annual income exceeding the \$600,000 cap, this amendment to Code Section 501(c)(15) generally eliminated its applicability to insurance receiverships.

The impact upon insurance companies in receivership was considered as Code Section 501(c)(15) was being amended in 2004, and the applicability of the exemption to insurance companies in receivership was specifically extended through calendar year 2007. However, as of January 1, 2008, any insurers in liquidation that may have previously been qualified for exemption under the pre-2005 provisions of Code Section 501(c)(15) became ineligible for such exemption and are subject to federal income tax from that time forward unless they met the new requirements.

3. Special Relief

Under Revenue Procedure 84-59, the receiver may apply to the District Director of Internal Revenue for relief from the filing requirements under limited circumstances. In order to request this relief, the insurer has to have ceased operations and no longer have assets or income.

4. Prompt Audit

The receiver may request that a prompt determination be made under Revenue Procedure [2006-2476-23](#) whether the income tax return is being selected for examination by the IRS or is accepted as filed. The receiver will be discharged from any liability upon payment of the tax shown on the return if the IRS does not notify the receiver within 60 days after the request that the return has been selected for examination, or if the IRS does not complete the examination and notify the receiver of any tax due within 180 days after the request. This procedure enables the receiver to proceed with the receivership, or enhances the possible sale of the insurer, by resolving contingencies relating to taxes due for prior periods. The prompt audit provisions specifically apply to bankruptcy proceedings, not state liquidations. Certain IRS offices have approved applying the provisions to state liquidations; however, the approval is not automatic. When this is the case, a request for prompt assessment should be made under I.R.C. §6501(d). This will reduce the statute of limitations for assessment to 18 months. The request contemplates a corporate dissolution in 18 months and requires the submission of Form 4810 to the IRS.

5. Carrybacks

An insurer often becomes financially troubled because it incurred operating and/or other losses. Such losses may be deductible for income tax purposes. A review may be made of the deductibility of such losses to determine if the losses were deducted in the correct fiscal year and may be carried back to recover previously paid income taxes. If the losses were not deducted in the correct years, prior years' income tax returns may have to be amended. [Net operating losses can be carried back for two years, and capital losses can be carried back for three years.](#)

[Under the Tax Cuts and Jobs Act of 2017 \(TCJA\) net operating losses of non-life insurance companies can still be carried back two years and carried forward 20 years \(Internal Revenue Code Section 172\(b\)\(1\)\(C\)\). However, there is no carryback for life insurance company net operating losses arising in 2018 and later years and an unlimited carry forward period \(Internal Revenue Code Section 172\(b\)\(1\)\(A\)\). Operational losses of life insurers arising in 2017 and earlier are carried back three years and forward fifteen years. A non-life insurance company can use the full amount of its net](#)

operating losses to offset taxable income (Internal Revenue Code Section 172(f)). A life insurance company is limited to an 80% net operating loss deduction against taxable income (Internal Revenue Code Section 172(a)(2)).

An example of a restructuring technique used in the liquidation of Reliance Insurance Company to address significant net operating loss carryovers is available in Exhibit 3-4.

6. Carryovers

To the extent that there is a discharge of indebtedness, any net operating loss carryover may be reduced by the amount of the discharge, ~~which may trigger alternative minimum tax liabilities. A company could have alternative minimum tax, even if there are net operating losses available to offset the income, because of the 90% limitation for alternative minimum tax net operating losses.~~ If guaranty funds or other creditors are entitled to future funds, there may not have been a complete discharge.

Net operating losses are allowed an indefinite carryover period in taxable years beginning after December 31, 2017. The net operating loss deduction is limited to 80 percent of taxable income (without regard to the deduction) for losses arising in taxable years beginning after December 31, 2017. Therefore, even when there are net operating loss carryovers available, discharge of indebtedness could still result in income tax liabilities due because of the carryover taxable income limitations.

C. Premium Taxes

If the insurer is in rehabilitation, the receiver may be required to continue paying state and municipal premium taxes. Insurers are usually required to pay premium taxes that are calculated as a percent of direct premiums written. Many state and local tax authorities require insurers to pay estimated premium taxes. In many cases, a financially troubled insurer may experience a decrease in premium volume, or policies in force may be canceled. This may result in a reduction in premiums written and the related premium taxes. A review may be made to determine whether the insurer is entitled to premium tax refunds. It may then be necessary to refile the most recent returns to reflect the reduction in premium income. In addition, the receiver may attempt recovery of any prepaid or estimated premium taxes. If premium taxes are owed in a liquidation many states may relegate premium tax claims to a lower or general creditor status.

D. Payroll Taxes

Insurers are required to withhold federal income tax and social security tax (as well as state and local income taxes) from the wages and salaries of their employees. All of these taxes are considered “trust fund taxes” and must be remitted periodically to the various taxing authorities. The receiver should promptly ascertain that all payroll tax payments have been remitted by the insurer. If the receiver finds that taxes have not been paid, the Special Procedures Office of the IRS should be notified. In this way, the taxes or 100% penalty can be assessed against the former officers or persons with the responsibility for paying the taxes. The receiver may be asked to complete Form 4180 or Form 4181, which are questionnaires relating to the payment of “trust fund taxes.”

If the receiver fails to follow these procedures and funds that could have been used to pay “trust fund liabilities” are used for other purposes, the receiver may be held personally liable. The receiver should make certain that any plan filed with the court for the distribution of assets provides for the payment of these outstanding federal tax liabilities.

Chapter 3 – Accounting and Financial Analysis

Many states have similar laws relating to withheld payroll taxes, and the receiver should be aware of the responsibilities imposed by these laws. The receiver should continue to file W-2s, [as well as Forms 940 and 941](#), for employees of the insolvent insurer.

E. Other Taxes and Assessments

1. Real Estate and Corporate Personal Property Taxes

The receiver should ascertain whether all real estate tax payments have been made, including those that the insurer has been collecting on mortgages it holds or services. The tax collector should be notified of the receivership proceeding and instructed to send any notices to the receiver.

2. Guaranty Fund Assessments

State guaranty funds periodically assess insurers to cover their administrative and claim costs. If the insurer is operating under supervision or rehabilitation, it may still be liable for guaranty fund assessments. If the insurer is in liquidation, the funds will typically waive payment of the assessment upon notice of the insolvency.

3. Excise Taxes

Some insurers are required to remit excise taxes to the IRS because of foreign reinsurance premiums. These taxes are also considered “trust fund taxes,” and the same care should be afforded these taxes as is given to withheld payroll taxes.

4. Commissions and Other Payments

At year-end, insurers are required to file Forms [W-2 and/or-1099](#) for all commissions and other payments to an individual or partnership in excess of \$600 during the year. [In addition, t](#)~~he~~ receiver is required to prepare Form [1099](#) and send the forms to policyholders of life companies while business is still being serviced by the insolvent insurer. In addition, if the insurer has received interest from mortgages, the receiver is required to prepare and provide Form 1098 to the payer. If more than 250 1099 forms are to be issued, the filing is required to be done electronically. However, relief from this electronic filing may be secured upon request to the IRS. The receiver should be able to demonstrate that an electronic filing would place an undue hardship on the insolvent insurer. The IRS can assess penalties for both the failure to issue the forms to agents and the failure to file the forms with the IRS. If the receiver has not already sought relief and the estate is assessed, the IRS may waive the assessment upon request. Additionally, most states and some localities have filing requirements.

5. Franchise Taxes

Several states have franchise taxes. The tax basis can be the net worth of the insurer, the assets of the insurer, the number of shares of authorized stock or the amount of paid-in capital. The failure to file and pay these taxes may result in the cancellation of the insurer’s corporate certificate of authority.

6. Other State Taxes and Licenses

Insurers are subject to numerous state taxes and assessments, including: workers’ compensation; second injury funds; firemen’s and policemen’s pension funds; medical disaster funds; major medical insurance funds; arson, fire and fraud prevention funds; fire marshal tax; insurance department administrative assessments; “Fair Plan” assessments; and motor vehicle insurance funds. In addition, many localities have licenses and taxes unique to insurers. Comprehensive summaries are published

by several insurers groups, including the Property Casualty Insurers Association of America (PCI), the American Insurance Association (AIA) and the American Council of Life Insurers (ACLI). The receiver should also ascertain if the insurer has any responsibility for filing informational returns and/or paying other state or local taxes such as sales and use taxes, water and sewer taxes, business and occupational privilege licenses, and taxes for employment training funds. Before paying these taxes, consideration should be given to the importance or lack of importance of maintaining state corporate certificates of authority and/or licenses.

All taxes should be reviewed to determine how any liability should be included in the priority scheme. The receiver should consider whether the certificate of authority or licenses have value before they are allowed to expire or be cancelled.

IX. INVESTMENTS

*****TEXT NOT SHOWN TO CONSERVE SPACE*****

F. Other Considerations

The insurer may be the owner of various tangible and intangible assets that may not be apparent on ~~its~~the insurer's statutory balance sheet. The receiver should try to identify and value all possible assets of the insurer, including ~~the~~ insurance licenses, the value of the shell of the company, assets that have been previously written off, and any assets that are listed in Schedule X of the annual statement.

1. Pension and Deferred Compensation Plans

The insurer's employee benefits may include participation in either a defined-benefit or defined-contribution pension plan. The plan may require or allow that a percentage of the assets of the plan be invested in shares of the insurer. It is not uncommon for ~~The trustees of the plan to be~~ are usually officers of the insurer. Also, t~~The~~ plan administrator may be the insurer itself or an outside financial institution. The regulatory action will create several uncertainties in relation to the plan. The receiver should be familiar with the provisions of the plan and whether a complete liquidation and distribution is required. The provisions of the pension plan agreement and the Employee Retirement Income Security Act of 1974 (ERISA) may clarify some of ~~these~~ these issues. It is recommended that the receiver retain the services of a consultant CPA firm to audit and provide independent opinion regarding compliance with IRS and ERISA requisites.

If the insurer is insolvent and the plan is heavily invested in shares of the insurer, then the plan may be insolvent also. The administrator, therefore, may need to liquidate the plan. If the pension plan is solvent, the administrator must continue with ~~his~~its duties. If the insurer is the plan administrator, the receiver may become the plan administrator by succession. If the plan administrator is a third party, the receiver may wish to evaluate the propriety of changing administrators.

The insurer may have hidden equity in other employee benefit plans. A saving plan that requires the insurer to partially match amounts contributed by the employees may be such a plan. The plan agreement will detail the operation of the plan and when the insurer's contributions vest to the employees. The plan should have provisions for possible employee termination on a voluntary or involuntary basis. Depending upon the terms of the plan, t~~The~~ receiver may recover contributions that have not vested to the employees, or amend terms, for example, to eliminate employer matching of contributions.

Pension considerations may be further complicated if an employee benefit plan is established to cover the employees of a parent holding company and its many subsidiaries, of which the receiver has

Chapter 3 – Accounting and Financial Analysis

authority only for one or more insurer subsidiaries. The desire of the receiver to terminate the plan and attach excess assets (or reduce additional exposure to underfunding) may be mitigated by excise tax issues on termination, ERISA and other considerations.

It should be noted that under some state liquidation priority statutes, amounts and priorities due employees may be limited. Compensation and benefits due officers and directors may also be excluded in their entirety.

******TEXT NOT SHOWN TO CONSERVE SPACE******

3. Structured Settlements

In the insolvency of an annuity insurer, special consideration should be given to any single premium immediate annuities that were issued to form the basis of funding ~~of~~ periodic or lump sum payments in personal injury settlements, commonly known as “structured settlement annuities.”

These annuities are normally issued to qualified assignment (QA) companies in order to comport with numerous IRS Tax Codes (primarily 104 (a)(2)) and various Revenue Ruling in order to preserve the tax benefit to the beneficiary or payee. However, some older annuities (prior to 1986), although not issued to a QA company, may nonetheless enjoy the same tax benefits. Generally, periodic payments are excludable from the recipient’s gross income only if the payee is not the legal or constructive owner of the annuity and does not have the current economic benefit of the sum required to purchase the periodic payments.

When these blocks of business are resolved in the insolvency context (typically through assumption reinsurance), extreme care must be taken to ensure that the resolution does not compromise the tax benefits to the payees. It is strongly recommended that competent and experienced tax counsel be retained to guide the receiver through this potentially complicated process.

******TEXT NOT SHOWN TO CONSERVE SPACE******

Example: Restructuring Transaction

When placed into liquidation, Reliance was part of a three-tiered holding company structure, whereby 100% of the stock of Reliance was owned by Reliance Financial Services Corp (“RFS”). RFS, in turn, was wholly-owned by Reliance Group Holdings, Inc. (“RGH”).^[1] In 2003, a settlement agreement was entered into between Reliance, RFS, and RGH whereby, among other things, the parties created a new consolidated tax group for federal income tax purposes with RFS as the common parent and with Reliance as a member.

In 2015, after collection of certain assets, RFS desired to terminate its existence and dissolve. Because Reliance is part of the consolidated tax group, the dissolution of RFS could have led to a change in ownership of Reliance which, under §382 of the Internal Revenue Code of 1986, as amended (“Code”), could have adversely affected the significant net operating loss carryovers (“NOLs”)^[2] held by Reliance which may be used to offset future net income, thereby reducing tax liabilities. Therefore, Reliance and its advisors developed a restructuring plan and a transaction which was approved by this Court and executed as of December 31, 2016.

The transaction resulted in an ownership change of Reliance which qualified for the bankruptcy exception under §382(l)(5) of the Code. Pursuant to the plan, all of the issued Reliance common shares are now owned by 4 GAs (“Participating GAs”) who paid Reliance policyholder claims and who received Reliance stock in exchange for the partial cancellation of such indebtedness. Each Participating GA has entered into a shareholder’s agreement which restricts the sale, transfer, pledge or assignment of the shares, and each shareholder executed a revocable proxy granting the right to vote all the shares to the Pennsylvania Insurance Commissioner as Liquidator. The Participating GAs will receive no preference as to their claims against Reliance due to their new ownership status. ~~Furthermore, the Reliance stock issued to the Participating GAs provides them with no additional viable claim against Reliance as assets will be insufficient for distributions to any creditors below priority class (b), much less priority class (i) shareholders.~~ Furthermore, the Reliance stock issued to the Participating GAs provides them with no additional viable claim against Reliance as assets will be insufficient for distributions to class (i) creditors (shareholders).

The transaction received a favorable private letter ruling on August 24, 2016 from the Internal Revenue Service holding that the Participating GAs would be treated as receiving the Reliance stock in their capacity as creditors of Reliance for purposes of the Code. The plan preserved the substantial NOLs for the benefit of the Reliance estate and allows Reliance to control its own future regarding tax positions and negotiations with the Internal Revenue Service. As a result of the restructuring, Reliance will become its own tax filer and will no longer be part of a consolidated tax group.^[3]

^[1] RGH and RFS jointly filed for bankruptcy in 2001 and the RGH and RFS reorganization plan was approved in 2005 with RGH converting into a liquidating trust and RFS converting into Reorganized RFS Corporation.

^[2] As a result of the large losses suffered by Reliance during the final years of its independent operations and during its liquidation, in excess of \$4 billion of NOLs were accumulated through 2014. Approximately \$1.5 billion of that \$4 billion was utilized in the 2015 consolidated tax return.

^[3] For additional details, see the Liquidator’s Application for Approval of Restructuring Proposal filed with the Court on October 7, 2016, which is document # 3745 on the www.reliancedocuments.com website.

Draft: 03/13/20

Receivership Large Deductible Workers' Compensation (E) Working Group
Conference Call
March 2, 2020

The Receivership Large Deductible Workers' Compensation (E) Working Group of the Receivership and Insolvency (E) Task Force met via conference call March 2, 2020. The following Working Group members participated: Donna Wilson, Co-Chair (OK); Laura Lyon Slaymaker, Co-Chair (PA); Steve Uhrynowycz (AR); Toma Wilkerson (FL); Kevin Baldwin (IL); Robert Wake (ME); John Rehagen (MO); Tom Green (NE); Mark Jordan (NM); and James Kennedy (TX).

1. Reviewed the Exposure of a Memorandum Regarding Model #555

Ms. Wilson presented an overview of the memorandum (Attachment Three-A) from NAIC staff regarding a guideline for an alternative to Section 712 of the *Insurer Receivership Model Act* (#555) (Attachment Three-B) that was exposed until Jan. 31, 2020.

2. Considered Comment Letters from the Exposure of a Model #555 Guideline

Ms. Slaymaker informed the Working Group that two comment letters had been received during the comment period from Mr. Wake and Barbara F. Cox (National Conference on Insurance Guaranty Funds—NCIGF). Mr. Wake presented a summary (Attachment Three-C) of the original comment (Attachment Three-D) submitted to the Working Group. Based on Mr. Wake's comments, the Working Group agreed to form an ad hoc drafting group consisting of Mr. Wake, Mr. Kennedy, Ms. Wilkerson, Ms. Wilson, Ms. Cox and Rowe W. Snider (Locke Lord LLP) to develop revisions based on the comments received from Maine and NCIGF.

Having no further business, the Receivership Large Deductible Workers' Compensation (E) Working Group adjourned.

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