Revenue Estimate of a Proposal to Treat Debt Investments as Ordinary Assets

Prepared for American Council of Life Insurers
Joint Committee on Taxation
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Present Law

- Insurance companies are subject to Federal income tax computed under section 11. In the case of a life insurance company, however, the tax base is life insurance company taxable income as opposed to taxable income.
- A capital asset is property held by the taxpayer whether or not connected with the taxpayer's trade or business, subject to certain exceptions (section 1221).
  - In the case of certain financial institutions, the sale or exchange of a bond, debenture, note, or certificate or other evidence of indebtedness ("debt investments") shall not be considered a sale or exchange of a capital asset (section 582(c)).
  - Neither an insurance company nor a face-amount certificate company (defined *infra*) is treated as a financial institution for purposes of this rule.
  - Therefore, a debt investment is treated as a capital asset in the hands of such companies.
- Loss carryback and carryovers
  - A corporation the amount of a net capital loss for any taxable year is a capital loss carryback to each of the 3 taxable years preceding the loss year and a capital loss carryover to each of the 5 taxable years succeeding the loss year (section 1212).
  - A net operating loss (which is ordinary in nature) may not be carried back but may be carried forward indefinitely subject to a limitation of 80 percent of taxable income. In the case of an insurance company other than a life insurance company, the net operating loss may be carried back 2 years and forward 20 years (section 172).

Summary of Legislative Proposal

A capital asset does not include any debt investment held by an applicable insurance company or a face-amount certificate company.

- An applicable insurance company is a company
  - more than half the business of which during the taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies;
  - subject to tax under section 801(a) or section 831(a); and
  - with respect to which section 831(b) (relating to an election to be taxed only on taxable investment income), section 835 (relating to an election by a reciprocal underwriter), section 842 (relating to foreign companies carrying on insurance business), and section 833(a)(1) (relating to Blue Cross or Blue Shield organizations) do not apply.
- A face-amount certificate company is an investment company which is
  - engaged or proposes to engage in the business of issuing face-amount certificates of the installment type, or which has engaged in such business and has any such certificate outstanding (as defined in 15 USC section 80a-4(1)) and
  - registered under the Investment Company Act of 1940 prior to the effective date of the proposal.
- The proposal is effective for debt investments held or acquired after the date of enactment.
- A transition rule treats as short-term capital gain (rather than as ordinary income) future gains on debt investments to the extent of capital loss carryovers from taxable years beginning before the effective date.

Primary Data Sources

- Congressional Budget Office (“CBO”) annual calendar year February 2023 baseline
  - Nominal gross domestic product (“GDP”), interest rates, etc.
- S&P Global Market Intelligence, Capital IQ
  - Realized capital gains and losses by asset type, change in unrealized capital gains and losses, interest maintenance reserve (“IMR”) data
- American Council of Life Insurers (“ACLI”)
  - Realized capital losses, capital loss carryback capacity, change in unrealized losses, unrealized losses, IMR data, corporate alternative minimum tax (“CAMT”) applicability
- Face-amount certificate company
  - Realized capital losses, capital loss carryback capacity, change in unrealized losses, unrealized losses
- Internal Revenue Code
  - Statutory corporate income tax rate, CAMT

Primary Assumptions

- Realized bond losses in 2023 are related to forecasted changes in the 10-year Treasury note interest rate.
- Realized bond losses in 2024 and beyond are related to the relative size of the economy.
- The fraction of realized bond losses that result in a revenue effect is reduced to the extent a company would have been able to offset such losses against 1) current year realized capital gain and 2) prior year capital loss carryback capacity.
  - Capital loss carryback capacity is limited in the short-term due to large realized losses in 2022 and 2023.
  - Companies will rebuild that capacity slowly before realized bond losses in excess of carryback capacity return to historical levels.
- Realized bond losses are constrained to the extent a company may face a negative IMR adjustment that is greater than historical average levels.
- Companies respond to the change in law by adjusting behavior to realize more losses than under present law.
- The effective marginal tax rate is affected by companies that may not have sufficient ordinary income (or capital gains) to use the losses. Reduction in regular tax for CAMT taxpayers has no revenue effect in the current year but creates additional CAMT credit carryforwards for future years.
- The transition rule treating as short-term capital gain (rather than as ordinary income) future gains on debt investments to the extent of capital loss carryovers from taxable years beginning before the effective date eliminates any behavioral response of deferring or accelerating realization of losses.

Revenue Estimate

Estimated Revenue Effects of a Proposal to Treat Debt Investments
Held by Insurance and Other Specified Companies as Ordinary Assets

Fiscal Years 2024-2033
[Millions of Dollars]

Assumed Effective Date	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2024-2033
10/1/2023	-351	-108	-104	-95	-88	-84	-84	-84	-86	-88	-1,172
1/1/2024	-35	-45	-52	-60	-65	-70	-74	-77	-81	-84	-643

- While CBO forecasts interest rates in 2023 to be significantly higher than in 2022, it forecasts rates to be relatively flat thereafter. As a result, losses related to forecast interest rate changes are reduced precipitously in 2024, with a corresponding reduction in the revenue consequences if the proposal is effective in 2024.

Caveats and Limitations

- Because data necessary to estimate the proposals are limited and require projections over the 10-year budget period, these revenue estimates are subject to uncertainty.

Sensitivity Analysis

Estimated Revenue Effects of a Proposal to Treat Debt Investments
Held by Insurance and Other Specified Companies as Ordinary Assets

Fiscal Years 2024-2033
[Millions of Dollars]

Assumed Effective Date	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2024-2033
10/1/2023	-373	-136	-136	-131	-128	-128	-129	-132	-136	-140	-1,569
1/1/2024	-57	-73	-83	-96	-105	-112	-118	-124	-130	-135	-1,032

- These estimates make an alternative assumption about the level of losses relative to the size of the economy, using the average share of losses for 2019-2021.

Caveats and Limitations

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Thank you

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