Administrative, Procedural, and Miscellaneous

26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also: Part I, §§ 446, 481, 807.)

Rev. Proc. 2019-10

SECTION 1. PURPOSE

This revenue procedure provides procedures for an insurance company changing its basis of computing reserves pursuant to § 807(f) of the Internal Revenue Code (Code), as amended by section 13513 of the Tax Cuts and Jobs Act, Pub. L. No. 115-97 (December 22, 2017) (TCJA). This revenue procedure modifies Rev. Proc. 2018-31, 2018-22 I.R.B. 637, to provide procedures under § 446 and § 1.446-1(e) of the Income Tax Regulations for an insurance company to obtain automatic consent of the Commissioner of Internal Revenue (Commissioner) to change its method of accounting to comply with § 807(f). This revenue procedure also modifies Rev. Rul. 94-74, 1994-2 C.B. 157, and Rev. Rul. 2002-6, 2002-1 C.B. 460, to the extent the holdings are inconsistent with the general rules for changing a method of accounting under § 446(e) and § 1.446-1(e).

In addition, this revenue procedure provides guidance on (i) accounting for an adjustment that arose under § 807(f) prior to its amendment by the TCJA and (ii) how a change in basis of computing life insurance reserves must be taken into account for purposes of computing amounts under the transition relief rule of section 13517 of the TCJA.

SECTION 2. BACKGROUND

.01 Section 801(a) imposes a tax on the life insurance company taxable income of a life insurance company. For purposes of computing life insurance company taxable income, §§ 803(a)(2) and 807(a) include in gross income a decrease over the taxable year in reserves described in § 807(c). Sections 805(a)(2) and 807(b) permit a deduction for an increase over the taxable year in such reserves.

.02 Section 831(a) imposes a tax on the taxable income of a nonlife insurance company. For purposes of computing taxable income of a nonlife insurance company, § 832(b)(4) provides that a decrease in unearned premiums over the taxable year increases premiums earned for that year and an increase in unearned premiums over the taxable year reduces premiums earned for that year. The flush language of § 832(b)(4) includes life insurance reserves, as determined under § 807, in unearned premiums for this purpose.

.03 Section 807(c) enumerates items that a life insurance company must account for on a reserve basis and take into account under § 807(a) and (b).

.04 Section 807(c)(1) includes life insurance reserves as an item that is taken into account under § 807(a) and (b). Under § 807(d), the amount of the life insurance reserves for any contract is generally determined based on the tax reserve method applicable to the contract, which is the Commissioners' Reserve Valuation Method (CRVM), Commissioners' Annuity Reserve Valuation Method (CARVM), or other method prescribed by the National Association of Insurance Commissioners (NAIC) that covers the contract as of the date the reserve is determined.

.05 Section 807(f) provides rules for life insurance companies to implement a change in the basis of computing items referred to in § 807(c). Rev. Rul. 65-240, 1965-2 C.B. 236, concludes that because a nonlife insurance company includes life insurance reserves in unearned premiums under § 832(b)(4), a nonlife insurance company likewise should account for a change in basis of computing such reserves under § 810(d)(1) of the Code as it existed then, which was similar to § 807(f)(1) of the Code prior to its amendment by the TCJA.

.06 Prior to amendment by the TCJA, § 807(f)(1) provided that if the amount of a § 807(c) reserve at the close of a taxable year was determined on a basis that differed from the basis for such determination at the close of the preceding taxable year, then 1/10th of the difference between the amount determined at the close of the taxable year under the old basis and the amount determined at the close of the taxable year under the new basis, to the extent attributable to contracts issued before the taxable year, was taken into account for each of the succeeding ten taxable years as a deduction under § 805(a)(2) or as gross income under § 803(a)(2), as appropriate.

.07 Section 13513 of the TCJA amended § 807(f)(1) to treat the adjustments required under § 807(f) as adjustments under § 481 attributable to a change in method of accounting initiated by the taxpayer and made with the consent of the Secretary of the Treasury (Secretary). The § 481 adjustment takes into account only amounts attributable to contracts issued before the taxable year of change. The amendments made by section 13513 are effective for taxable years beginning after December 31, 2017.

.08 To avoid duplication or omission of amounts related to changes that arose under § 807(f) in a year beginning prior to January 1, 2018, a taxpayer must continue the ten-year spread under prior law by taking such amounts into account as described in § 807(f)(1) before its amendment by the TCJA. See § 807(d)(1)(D); § 13513(b) of the TCJA.

.09 Section 13517 of the TCJA, among other things, amends § 807(d) to provide a new method for computing the amount of life insurance reserves, effective for taxable years beginning after December 31, 2017. Section 13517(c)(3) of the TCJA provides a transition relief rule that generally requires the difference between (1) the amount of life insurance reserves with respect to any contract as of the close of the taxable year preceding the first taxable year beginning after December 31, 2017, computed using the method prescribed by the TCJA (the post-TCJA closing balance) and (2) the amount of such reserves computed using the method prior to the amendments by the TCJA (the pre-TCJA closing balance), to be taken into account over the eight succeeding taxable years. To avoid duplication or omission of income, the computation of the pre-TCJA closing balance must take into account any change in basis that is taken into account as required by § 807(f).

.10 A change in basis of computing reserves is a type of change in method of accounting. See Am. Gen. Life & Accident Ins. Co. v. United States, 90-1 USTC (CCH) ¶ 50,010 (M.D. Tenn. 1989). After the amendment of § 807(f) by section 13513 of the TCJA, an insurance company must follow the administrative procedures for a change in method of accounting to change its basis of computing reserves. See H.R. Rep. No. 115-466, at 467 (2017) (Conf. Rep.). Section 13513 of the TCJA, however, does not set forth the administrative procedures for an insurance company to change the basis of computing reserves to comply with § 807(f) and does not specify whether an insurance company is entitled to audit protection or ruling protection.

.11 In general, § 446(e) requires a taxpayer to secure the consent of the Secretary before changing a method of accounting for federal income tax purposes. Section 1.446-1(e)(3)(ii) provides that the Commissioner may prescribe administrative procedures under which a taxpayer will be permitted to change a method of accounting. Except as otherwise provided in § 1.446-1(e)(3)(ii), a taxpayer must file a Form 3115, "Application for Change in Accounting Method," in order to secure the Commissioner's consent to change a method of accounting. Rev. Proc. 2015-13, 2015-5 I.R.B. 419, as clarified and modified by Rev. Proc. 2015-33, 2015-24 I.R.B. 1067, and as modified by Rev. Proc. 2016-1, 2016-1 I.R.B. 1, and Rev. Proc. 2017-59, 2017-48 I.R.B. 543, provides the general procedures by which a taxpayer may obtain automatic consent of the Commissioner to change a method of accounting described in the List of Automatic Changes. Rev. Proc. 2018-31 contains the current List of Automatic Changes.

.12 Section 481(a) provides that in computing the taxpayer's taxable income for any taxable year (referred to as the year of the change), if such computation is under a method of accounting different from the method under which the taxpayer's taxable income for the preceding taxable year was computed, then there shall be taken into account those adjustments that are determined to be necessary solely by reason of the change in order to prevent amounts from being duplicated or omitted.

.13 Section 481(c) provides that in the case of any change described in § 481(a), the taxpayer may, in such manner and subject to such conditions as the Secretary may by regulations prescribe, take the adjustments required by § 481(a) into account in computing the tax imposed by Chapter 1 for the taxable year or years permitted under such regulations.

.14 Section 1.481-1(c)(2) provides that if a change in method of accounting is voluntary (that is, initiated by the taxpayer), then the entire amount of the adjustments required by § 481(a) is generally taken into account in computing taxable income in the taxable year of the change, regardless of whether the adjustments increase or decrease taxable income. Section 1.481-1(c)(2) references §§ 1.446-1(e)(3) and 1.481-4, however, which provide that the Commissioner may prescribe the taxable year or years in which the adjustments are taken into account. Under section 7.03(1) of Rev. Proc. 2015-13, the § 481(a) adjustment period generally is one taxable year (year of change) for a negative § 481(a) adjustment and four taxable years (year of change and next three taxable years) for a positive § 481(a) adjustment.

.15 Under § 1.481-1(c)(1), the reference to "adjustments" as used in § 481 means the net amount of the adjustments required by § 481(a) with regard to a change.

.16 Rev. Rul. 94-74 applies § 807(f) (as it existed then) to several factual situations. Among the holdings of Rev. Rul. 94-74 are (1) there is no requirement under § 446(e) to obtain the Commissioner's consent to change the basis of computing life insurance reserves, (2) the adjustment rule of § 807(f) applies if the recomputation is initiated by the Service, and (3) if a change in basis of computing life insurance reserves is required to correct for an erroneous application of the computation rules of § 807(d)(2) (as it existed then), either the taxpayer or the Service may make the change retroactively by amending (or adjusting) the taxpayer's return (not otherwise barred by the statute of limitations) for periods for which there was an erroneous application of the prescribed rules. Similarly, Rev. Rul. 2002-6 permits a taxpayer to file an amended return for past taxable years to recalculate its life insurance reserves for such years to take into account omitted factors. These holdings of Rev. Rul. 94-74 and Rev. Rul. 2002-6 are inconsistent with the general rules for changing a method of accounting under § 446(e) and § 1.446-1(e). Rev. Rul. 94-74 and Rev. Rul. 2002-6 are modified to the extent they are inconsistent with the general rules for changing a method of accounting under § 446(e) and § 1.446-1(e).

.17 This revenue procedure modifies Rev. Proc. 2018-31 to provide procedures for an insurance company to obtain automatic consent of the Commissioner to change its basis of computing reserves pursuant to § 807(f).

SECTION 3. AUTOMATIC METHOD CHANGE

Rev. Proc. 2018-31 is modified to add new section 26.04 to the List of Automatic Changes to read as follows:

.04 Changes in basis of computing reserves under § 807(f).

(1) Description of change and applicability. This automatic change applies to a change in basis of computing reserves, as described in § 807(f), by a life insurance company or by an insurance company that is not a life insurance company.

(2) Manner of making change.

(a)(i) In general. If the basis of computing any reserves referenced in § 807(c) is changed during a taxable year (year of change), then for purposes of applying § 807(a) and (b) with respect to contracts issued before the year of change, the amount of reserves at the close of the year of change attributable to those contracts is determined on the old basis and the amount of reserves at the opening of the succeeding taxable year attributable to those contracts is determined on the new basis. Reserves attributable to contracts issued during the year of change and thereafter must be computed on the new basis.

(ii) Requirement to file Form 3115. A taxpayer that changes its basis of computing reserves is subject to the procedures that apply to obtain the automatic consent of the Commissioner to change a method of accounting. Under these procedures, (A) the taxpayer must file Form 3115 as provided in this section 26.04, (B) the taxpayer may receive audit protection for taxable years prior to the year of change as provided in section 8.01 of Rev. Proc. 2015-13 in connection with the change, and

(C) the § 481(a) adjustment period generally will be one taxable year (year of change) for a negative § 481(a) adjustment, and four taxable years (year of change and next three taxable years) for a positive § 481(a) adjustment in accordance with section 7.03(1) of Rev. Proc. 2015-13.

(iii) Example. The following example illustrates the rules of sections 26.04(2)(a)(i) and (ii) of this revenue procedure in two situations: (A) the change in basis in computing reserves for contracts issued prior to the year of change results in an increase in the reserves at the end of the year of change (negative § 481(a) adjustment) and (B) the change in basis in computing reserves for contracts issued prior to the year of change results in a decrease in the reserves at the end of the year of change (positive § 481(a) adjustment). The following table summarizes the reserve amounts for contracts issued before the year of change.

	Old Basis	New Basis (Negative § 481(a) Adjustment)	New Basis (Positive § 481(a) Adjustment)
End of Year Prior to Year of Change	100		
End of Year of Change	105	109	101
End of Year Following Year of Change		112	104
Section 481(a) Adjustment		105-109=(4)	105-101=4

Under section 26.04(2)(a)(i) of this revenue procedure, reserves for contracts issued before the year of change are reported under the old basis at the close of the year of change and under the new basis at the beginning of the year following the year of change; reserves for contracts issued during the year of change and thereafter are computed under the new basis. The remainder of this example describes only the deductions and income inclusions relating to reserves for contracts issued before the year of change.

Deduction for a net increase in reserves for the year of change. In both the negative and positive § 481(a) adjustment situations, the company must take $105 of reserves into account (on the old basis) at the end of the year of change, resulting in a $5 increase in reserves ($105 - $100) and a corresponding deduction for a net increase in reserves for the year of change.

Negative § 481 adjustment situation. As described in section 26.04(2)(a)(ii) of this revenue procedure, the negative § 481(a) adjustment of $4 ($109-$105) is taken into account in the year of change, such that the company would recognize a deduction for an increase in reserves under § 807(f) of $4 in the year of change. This results in total deductions in the year of change of $9 ($5 + $4).

At the beginning of the following year, the company must take $109 of reserves into account (new basis) and the deduction for the net increase in reserves for that year is $3 ($112 - $109).

Positive § 481 adjustment situation. As described in section 26.04(2)(a)(ii) of this revenue procedure, the positive § 481(a) adjustment of $4 ($101-$105) is taken into account over four years, such that the company recognizes additional income from a decrease in reserves under § 807(f) of $1 (1/4th of the § 481(a) adjustment) in the year of change. This results in a net reduction in taxable income in the year of change of $4 ($5 - $1).

At the beginning of the following year, the company takes $101 of reserves into account (new basis), and the deduction for the net increase in reserves for that year is $3 ($104 - $101). The company also would recognize another 1/4th of the § 481(a) adjustment, resulting in a $1 increase in income due to a decrease in reserves under § 807(f), and a net reduction in taxable income of $2 ($3 - $1) in that year. The remaining $2 of the § 481 adjustment is recognized as increases in income due to a decrease in reserves under § 807(f) in each of the two remaining years of the § 481 adjustment period.

(b) Section 481(a) adjustment.

(i) Computation of § 481(a) adjustment at end of year. In general, a change in basis of computing reserves under § 807(f) requires an adjustment under

§ 481(a). The § 481(a) adjustment is computed as of the end of the year of change and is only with respect to contracts issued before the year of change.

(ii) Eligibility for additional change within five taxable years. The eligibility rule in section 5.01(1)(f) of Rev. Proc. 2015-13 does not apply to a change under this section 26.04.

(iii) Number of § 481(a) adjustments. Multiple changes during the same taxable year in methods, assumptions, or factors, each of which alone would constitute a change in basis of computing reserves under § 807(f) for the same type of contract (life insurance, annuity, etc.), are considered a single change in basis, and the effects of such multiple changes are netted and treated as a single net negative § 481(a) adjustment or net positive § 481(a) adjustment.

A change in basis of computing the reserve for each type of contract (life insurance, annuity, etc.) is considered a separate change in basis. A separate § 481(a) adjustment must be determined for each type of contract, and each such § 481(a) adjustment must be taken into account separately.

(c) No ruling protection for year of change or subsequent years. The consent granted under section 9 of Rev. Proc. 2015-13 for a change under this section 26.04 is not a determination by the Commissioner that the new basis of computing reserves is a permissible basis of computing reserves and does not create any presumption that the new basis is a permissible basis of computing reserves. The Director may ascertain whether the new method of accounting is a permissible method of accounting. Thus, a taxpayer that changes its basis of computing reserves under this section 26.04 may be required to change or modify that basis of computing reserves for the year of change or any subsequent year if it is determined by the Commissioner that the basis to which the taxpayer changed does not meet the requirements of federal income tax law.

(d) Information required to be furnished.

(i) In view of the amendment of § 807(f) by section 13513 of the Tax Cuts and Jobs Act, Pub. L. No. 115-97 (December 22, 2017) and the information required in section 26.04(2)(d)(ii) of this revenue procedure, the information required under § 1.801-5(c) is not required to be furnished with the taxpayer's return or on Form 3115.

(ii) A taxpayer that files a Form 3115 under this section 26.04 is required to complete or provide only the following information on Form 3115:

- The identification section of page 1 (above Part I);
- The signature section at the bottom of page 1;
- Part I;
- Part II, lines 4, 5, 6a-d, 7a-b, 8a-d, 9, 11a-c, 12, 17, and 18;
- The following information, in lieu of completing Part II, line 14:
    - The item in § 807(c) to which the change in basis relates,
    - The type of contract (e.g., life insurance, annuity) to which the change relates,
    - If a life insurance reserve, a description of the applicable tax reserve method (e.g., Commissioners' Reserve Valuation Method or Commissioners' Annuity Reserve Valuation Method),
    - A description of the change in basis,
    - A description of the reason for the change in basis, including (i) whether the change results from a change in the method prescribed by the National Association of Insurance Commissioners or from another

change (such as a change in assumption for mortality, morbidity, or interest rate), regardless of whether the change is reflected on an annual statement and (ii) whether the change results from a prior incorrect application of federal income tax law and the nature of such incorrect application.

- Part IV. (The taxpayer may indicate that the § 481(a) adjustment is an estimate or is to be determined.)

(e) Concurrent automatic changes. A taxpayer that makes multiple changes in basis under this section 26.04 may file a single Form 3115 that includes all the changes in basis for the year of change. Likewise, a single Form 3115 may be filed for all changes in basis for members of a group filing a consolidated return. The information required by section 26.04(2)(d)(ii) of this revenue procedure is required for each separate change for each member of the group.

(3) Designated automatic accounting method change number. The designated automatic accounting method change number for a change under this section 26.04 is "240."

(4) Contact information. For further information regarding a change under this section, contact Dan Phillips at (202) 317-6995 (not a toll-free call).

SECTION 4. EFFECTIVE DATE

This revenue procedure is effective for taxable years beginning after December 31, 2017.

SECTION 5. EFFECT ON OTHER DOCUMENTS

This revenue procedure modifies Rev. Proc. 2018-31. This revenue procedure also modifies Rev. Rul. 94-74 and Rev. Rul. 2002-6.

SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is Dan Phillips of the Office of the Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue procedure, contact Mr. Phillips at (202) 317-6995 (not a toll-free call).