



## Statement of Statutory Accounting Principles No. 101, *Income Taxes, a Replacement of SSAP No. 10R and SSAP No. 10*

### Overview

On September 19, 2011, following the recommendation and approval by the National Association of Insurance Commissioners' ("NAIC"), Accounting Practices and Procedures Task Force and the Statutory Accounting Principles Working Group ("SAPWG"), the NAIC Financial Condition (E) Committee approved the adoption of Statement of Statutory Accounting Principles ("SSAP") No. 101, *Income Taxes, a Replacement of SSAP No. 10R and SSAP No. 10*. Effective January 1, 2012, SSAP 101 substantively changes statutory accounting for income taxes in two key areas (1) tax contingencies and (2) the admissibility of deferred tax assets.

Although the standard is not effective until January 1, 2012, insurers should quantify the expected impact of adoption now and plan accordingly.

Key changes and points of interest include the following:

- Federal and foreign income tax contingencies are now determined under a modified version of SSAP No. 5 – Revised, *Liabilities, Contingencies and Impairment of Assets* ("SSAP 5R"). GAAP accounting for tax contingencies (formerly referred to as FIN 48 and codified under ASC 740) is expressly rejected under SSAP 101, along with its two-step recognition and measurement model and most of the required disclosures (other than the "early warning" disclosures).
- The statutory valuation allowance concept continues as the initial step in determining the amount of the admitted DTA.
- Expanded admissibility is no longer elective.
- In the first part of the admissibility test, all filers will be allowed to use a reversal period that corresponds to the tax loss carryback provisions of the Internal Revenue Code (not to exceed three years).
- In the second part of the admissibility test:
  - The reversal period and surplus limitation parameters (one year & 10 percent or three years & 15 percent) are determined based upon risk-based capital ("RBC") levels. Companies not meeting the minimum threshold are prohibited from admitting anything in this part of the admissibility test.
  - Non-RBC reporting entities and financial/mortgage guaranty companies are provided special tables for determining admissibility.
  - For purposes of determining test parameters, calculations of RBC or surplus thresholds will use current reporting period information.
- Disclosure requirements have been modified, but retain the need to disclose the impact of tax planning strategies. SSAP 101 adds required disclosures for tax planning strategies involving reinsurance.



Paragraph 2 clearly outlines the objective of accounting for income taxes under SSAP 101 as follows:

*One objective of accounting for income taxes is to recognize the estimated amount of taxes payable or refundable for the current year as a tax liability or asset. A second objective is to recognize deferred tax liabilities and assets for the future tax consequences of events that have been recognized in a reporting entity's statutory financial statements or tax returns. However, the second objective is realistically constrained because (a) the tax payment or refund that results from a particular tax return is a joint result of all the items included in that return, (b) taxes that will be paid or refunded in future years are the joint result of events of the current or prior years and events of future years, and (c) information available about the future is limited. As a result, financial statements will recognize current and deferred income tax assets and liabilities in accordance with the provisions of this statement based upon estimates and approximations.*

These estimates and approximations are the very essence of what drove the need for changes in accounting and reporting for income taxes.

### Tax Contingencies

Preliminary versions of SSAP 101 released in March of 2011 contained provisions which adopted FIN 48 almost in entirety; however after receiving feedback from comment letters, the SAPWG decided to continue with provisions from SSAP 5R for tax contingencies with modifications for federal and foreign income taxes only as follows (SSAP 101, ¶ 3.a.i, ii and iii):

- The term “more likely than not” (defined as a likelihood of more than 50 percent) replaces the term “probable” as used in SSAP No. 5R for federal and foreign income tax loss contingencies only.
- It is presumed that the reporting entity will be examined by the relevant taxing authority that has full knowledge of all relevant information.
- If the estimated tax loss contingency is greater than 50% of the tax benefit associated with the tax position, the tax loss contingency shall be 100%.
- If the tax loss contingency relates to a temporary difference, the indicated current tax liability and offsetting gross deferred tax asset are not recognized until an “event has occurred that would cause a re-evaluation” of the probability of assessment.

This means that insurers will have to establish a tax loss contingency if, based upon management's best estimate, it is *more likely than not* (“MLTN”) that a tax position will not be sustained. Consistent with the US-GAAP standard, an insurer may be obligated to establish a loss contingency even though the odds of being audited or the position being identified are remote. It is expected that the MLTN recognition threshold will result in earlier recognition of income tax loss contingencies and produce a result roughly equivalent to US-GAAP.

As statutory accounting for income taxes is applied on a separate entity basis, the application of this provision must also be at a separate entity level. This will require that each reporting entity conduct a review of federal and foreign income tax positions and apply the MLTN loss contingency standard.



The following table identifies key differences between statutory accounting for tax contingencies under SSAP 10R and SSAP 101:

SSAP No. 10R	SSAP No. 101
<b>Tax-Loss Contingencies</b>	
<ul style="list-style-type: none"> <li>Based on SSAP No. 5R model using a “probable” and “reasonably estimated” criterion.</li> </ul>	<ul style="list-style-type: none"> <li>Based on a modified SSAP No. 5R model using a “more-likely-than-not” and “reasonably estimated” criterion.</li> </ul>
<b>Recognition and Measurement</b>	
<ul style="list-style-type: none"> <li>Tax benefit was recognized with a liability recorded if the related tax contingency was considered probable and could be reasonably estimated, measured at management’s best estimate.</li> <li>Detection risk not addressed.</li> </ul>	<ul style="list-style-type: none"> <li>Tax benefit is recognized with a liability recorded if the related tax-loss contingency is more-likely-than-not and can be reasonably estimated. The amount of the tax-loss contingency is measured at management’s best estimate; however, if the estimated tax-loss contingency is greater than 50 percent of the tax benefit originally recognized, the tax-loss contingency recorded shall be equal to 100 percent of the original tax benefit recognized.</li> <li>Management presumes that the tax position will be examined by the relevant taxing authority that has full knowledge of all relevant information.</li> </ul>
<b>Tax-Loss Contingency Disclosures</b>	
<ul style="list-style-type: none"> <li>No required disclosures of tax-loss contingencies.</li> </ul>	<ul style="list-style-type: none"> <li>Eliminates FIN 48 disclosures applicable to non-public entities except for disclosures of tax-loss contingencies for which it is reasonably possible that the total liability will significantly increase within 12 months of the reporting date. For such tax-loss contingencies, entities must disclose an estimate of the range of the reasonably possible increase in tax liabilities or state that an estimate of the range cannot be made.</li> </ul>



## Statutory Valuation Allowance

SSAP 101 establishes the concept of an adjusted gross deferred tax asset ("AGDTA"), consistent with SSAP 10R by providing for a statutory valuation allowance (§7.e.). The statutory valuation allowance employs a more likely than not standard, which is applied at the entity level and results in a reduction in the gross DTA, not a separate valuation allowance within the financial statements. This clarifies confusion over the previous application of the valuation allowance under SSAP 10R, where some entities showed the valuation allowance along with the nonadmitted DTA, instead of as a direct reduction of the gross DTA.

Under SSAP 10R, additional DTA admissibility tests were elective; however, under SSAP 10R, all entities are required to perform each test to determine whether or not additional DTAs can be admitted. This will result in first time admissibility elections for many entities who did not go through the process of determining additional admissible DTAs under SSAP 10R (for example many Property and Casualty companies avoided the application of §10.e.i, ii and iii.).

Entities can consider for admissibility, federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse during a timeframe corresponding with IRS tax loss carryback provisions, not to exceed three years. This includes amounts established in accordance with the provision of SSAP No. 5R as described within paragraph 3.a. of SSAP 101 (as discussed above).

The second part of the admissibility test provides reversal periods and adjusted capital and surplus limitations based on the type of insurer. Companies subject to RBC reporting requirements qualify for a 3-year reversal period and a 15% adjusted capital and surplus limitation if the Authorized Control Level ("ACL") RBC computed without admitted DTAs exceeds 300%. If the ACL RBC computed without admitted DTAs falls within the 200% - 300% range, a 1-year reversal period and 10% adjusted capital and surplus limitation will apply. No DTA is admissible under this part of the admissibility test if the ACL RBC computed without admitted DTAs is less than 200%. For interim periods, the Total Adjusted Capital ("TAC") numerator is based upon current period values while the ACL denominator is based on the ACL reported in the most recently filed calendar year. The use of TAC from the current period in SSAP 101 is a deviation from SSAP 10R, which required the used of adjusted capital from the most recently filed statements. This may provide for some confusion since the numerator and denominator will not be from the same period as they were under SSAP 10R.

Mortgage and financial guaranty companies have separate thresholds based upon the ratio of surplus without admitted DTAs over policyholders and contingency reserves. If the reporting entity is not subject to RBC requirements, is not required to file an RBC Report with its domiciliary state, is not a mortgage or financial guaranty insurer and meets the minimum capital and reserve requirements, then the reporting entity uses the *Realization Threshold Limitation Table – Other Non-RBC Reporting Entities*. This table's threshold limitations are contingent upon the ratio of adjusted gross DTA (AGDTA less the amount of DTA admitted under Step 1) to adjusted capital and surplus.

See the admissibility tables sections on page 6 for applicable thresholds for all entities.

The third part of the admissibility test requires that entities consider the character (i.e. ordinary versus capital) of the DTAs and DTLs and the reversal patterns of temporary differences when offsetting DTAs and DTLs, ensuring that offsetting is permitted under existing enacted federal income tax laws and regulations.



The following table identifies key differences between statutory accounting for statutory valuation allowances under SSAP 10R and SSAP 101:

SSAP No. 10R	SSAP No. 101
<b>Admissibility of Deferred Tax Assets</b>	
<b>Step 1</b>	
<ul style="list-style-type: none"> <li>Limited admissibility to recovering income taxes through carrybacks to those that occurred by the end of the subsequent year. If certain RBC levels were achieved, this limit would be increased to three years.</li> </ul>	<ul style="list-style-type: none"> <li>Allows for timeframe which corresponds to IRS tax loss carryback provisions, subject to SSAP 10R's three-year limit without RBC limitations. Includes accruals for tax-loss contingencies along with income taxes paid in prior years in the determination.</li> </ul>
<b>Step 2</b>	
<ul style="list-style-type: none"> <li>Limited the admissibility of deferred tax assets to the lesser of the amount of AGDTAs expected to be realized in one year, or 10 percent of the most recently filed statutory capital and surplus (adjusted to exclude any net deferred tax assets, electronic data processing equipment and operating software, and any net positive goodwill). If certain RBC levels were achieved, it allowed companies to elect to increase those limits to three years or 15 percent.</li> <li>AGDTAs are calculated as gross deferred tax assets reduced by a valuation allowance determined similar to those determined using Statements of Financial Accounting Standards ("SFAS") 109 guidance.</li> </ul>	<ul style="list-style-type: none"> <li>Admissibility limits are either one year and 10 percent or three years and 15 percent.</li> <li>RBC reporting entities refer to a table that only references the Authorized Control Level ("ACL") RBC at the end of the reporting period (excluding any net deferred tax assets). See Table 1 (RBC Reporting Entities) in the Admissibility Tables section.</li> <li>Mortgage and financial guaranty insurers have a table based on the ratio of surplus (excluding any admitted deferred tax assets) over policyholder and contingency reserves. See Table 2 (Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entities) in the Admissibility Tables section.</li> <li>Non-RBC reporting entities that are not mortgage or financial guaranty insurers have a table based on the percentage of adjusted gross deferred tax assets to adjusted capital and surplus. See Table 3 (Other Non-RBC Reporting Entities) in the Admissibility Tables section. Step 3 allows additional deferred tax assets to be admitted to the extent they are offset by deferred tax liabilities of the same tax character under current tax laws.</li> </ul>
<b>Step 3</b>	
<ul style="list-style-type: none"> <li>Allows additional deferred tax assets to be admitted to the extent they are offset by deferred tax liabilities of the same tax character providing the period of reversal between the applicable deferred tax assets and liabilities does not exceed five years.</li> </ul>	<ul style="list-style-type: none"> <li>Adds consideration of the reversal pattern of deferred tax assets and deferred tax liabilities (consistent with the determination of the statutory valuation allowance prior to the admissibility test) and provides guidance similar to U.S. GAAP on the level of detail required in scheduling deferred tax assets and liabilities.</li> </ul>

**Admissibility Tables****Realization Threshold Limitation Table – RBC Reporting Entities**

ACL RBC (Excluding Net DTA)	Limit on Timing of Realization (¶11.b.i.)	Limit Based on Adjusted Capital and Surplus (¶11.b.ii.)
Greater than 300%	3 years	15%
Less than 200%	0 years	0%
200 – 300%	1 year	10%

**Realization Threshold Limitation Table – Financial Guaranty or Mortgage Guaranty Non-RBC Reporting Entities**

Surplus (Excluding Net DTA) / Policyholders and Contingency Reserves	Limit on Timing of Realization (¶11.b.i.)	Limit Based on Adjusted Capital and Surplus (¶11.b.ii.)
Greater than 115%	3 years	15%
100% to 115%	1 year	10%
Less than 100%	0 years	0%

**Realization Threshold Limitation Table – Other Non-RBC Reporting Entities**

AGDTA / Adjusted Capital & Surplus (%)	Limit on Timing of Realization (¶11.b.i.)	Limit Based on Adjusted Capital and Surplus (¶11.b.ii.)
Less than 50%	3 years	15%
50% to 75%	1 year	10%
Greater than 75%	0 years	0%



## Disclosure Requirements Under SSAP 101

As a practical matter, many of the enhanced footnote disclosures required under SSAP 10R remain in effect under SSAP 101; however, there are some exceptions.

Since expanded admissibility is no longer elective, beginning in 2012, the additional surplus realized from electing expanded admissibility under SSAP 10R will no longer be presented in the balance sheet and surplus reconciliation and disclosures related to the benefits from electing expanded admissibility are no longer required.

The disclosure related to tax planning strategies has been expanded. In addition to disclosing the impact of tax planning strategies on AGDTAs and admitted DTAs by percentage and character, entities now must disclose whether they have utilized tax-planning strategies involving reinsurance (§22.f.).

Changes in accounting resulting from the adoption of SSAP 101 are to be accounted for as a change in accounting principle in accordance with SSAP No. 3, *Accounting Changes and Corrections of Errors* ("SSAP 3"), and should be properly disclosed in accordance with SSAP 3.

For more information, please contact your engagement partner, or Kevin Ryals (704.367.7043), or Howard Smith, (404.575.8960) with the firm's Insurance Services Group with any questions.

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