Joint Committee on Taxation
May 8, 2003
JCX-46-03

DESCRIPTION OF ADDITIONAL CHAIRMAN'S MODIFICATIONS TO THE PROVISIONS OF THE "JOBS AND GROWTH TAX ACT OF 2003"

The following additional modifications are made to the provisions of the Jobs and Growth Act of 2003.

I. ADDITIONAL MODIFICATIONS TO THE JOBS AND GROWTH ACT OF 2003

A. Partial Exclusion of Dividend Income from Tax

The exclusion for dividends provided in the Chairman's Modification also includes dividends paid by a foreign corporation, other than other than a foreign corporation whose stock is not regularly traded on an established securities market, a foreign investment company, a passive foreign investment company, or a foreign personal holding company.

B. Temporary State Fiscal Relief Fund

The Chairman's Modification establishes a fund to provide $20 billion, equally divided among State and local governments, to be used for education or job training; health care services, including Medicaid; transportation or other infrastructure; law enforcement or public safety; and other essential government services. The purposes of the fund could include additional measures to ensure that fiduciary attorney fee standards are adequately respected.

II. NEW PROVISIONS

A. Extension of Provision Permitting Qualified Transfers of Excess Pension Assets to Retiree Health Accounts

Present Law

A qualified transfer of excess assets of a defined benefit plan may be made to a separate account within the plan in order to fund retiree health benefits.[1] Excess assets generally means the excess, if any, of the value of the plan's assets[2] over the greater of (1) the lesser of (a) the

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[1] Sec. 420.

[2] The value of plan assets is the lesser of fair market value or actuarial value.

accrued liability under the plan (including normal cost) or (b) 170 percent of the plan's current liability (for 2003),[3] or (2) 125 percent of the plan's current liability.

Excess assets transferred in a qualified transfer may not exceed the amount reasonably estimated to be the amount that the employer will pay out of such account during the taxable year of the transfer for qualified current retiree health liabilities. Amounts transferred in a qualified transfer are not includible in the gross income of the employer and are not subject to the excise tax on reversions of assets in a defined benefit plan. No deduction is allowed to the employer for (1) a qualified transfer or (2) the payment of qualified current retiree health liabilities out of transferred funds (and any income thereon).

In order for the transfer to be qualified, accrued retirement benefits under the pension plan generally must be 100-percent vested as if the plan terminated immediately before the transfer (or in the case of a participant who separated in the one-year period ending on the date of the transfer, immediately before the separation). In addition, at least 60 days before the date of a qualified transfer, the plan administrator must notify each participant and beneficiary under the plan of such transfer.[4] The notice must include information with respect to the amount of excess pension assets, the portion to be transferred, the amount of health benefits liabilities expected to be provided with the assets transferred, and the amount of pension benefits of the participant that will be vested immediately after the transfer. The employer maintaining the plan must also provide advance notice of the transfer to the Department of Labor and the Department of Treasury, and any employee organization representing participants in the plan. A copy of this notice must be available for inspection in the principal office of the administrator.

No qualified transfer may be made after December 31, 2005.

Description of Proposal

The proposal allows qualified transfers of excess defined benefit plan assets through December 31, 2013.

Effective Date

The proposal is effective for transfers made in taxable years beginning after December 31, 2005.

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[3] The current liability full funding limit is repealed for years beginning after 2003. Under the general sunset provision of EGTRRA, the limit is reinstated for years after 2010.

[4] ERISA sec. 101(e).

B. Proration Rules For Life Insurance Business of Property And Casualty Insurance Companies

Present Law

Life insurance company proration rules

A life insurance company is subject to tax on its life insurance company taxable income (LICTI) (sec. 801). LICTI is life insurance gross income reduced by life insurance deductions. For this purpose, a life insurance company includes in gross income any net decrease in reserves, and deducts a net increase in reserves. Because deductible reserve increases might be viewed as being funded proportionately out of taxable and tax-exempt income, the net increase and net decrease in reserves are computed by reducing the ending balance of the reserve items by the policyholders' share of tax-exempt interest (secs. 805(a)(4), 812). Similarly, a life insurance company is allowed a dividends-received deduction for intercorporate dividends from nonaffiliates only in proportion to the company's share of such dividends. Fully deductible dividends from affiliates are excluded from the application of this proration formula, if such dividends are not themselves distributions from tax-exempt interest or from dividend income that would not be fully deductible if received directly by the taxpayer. In addition, the proration rule includes in prorated amounts the increase for the taxable year in policy cash values of life insurance policies and annuity and endowment contracts.

Property and casualty insurance company proration rules

The taxable income of a property and casualty insurance company is determined as the sum of its underwriting income and investment income (as well as gains and other income items), reduced by allowable deductions (sec. 832). Underwriting income means premiums earned during the taxable year less losses incurred and expenses incurred. In calculating its reserve for losses incurred, a property and casualty insurance company must reduce the amount of losses incurred by 15 percent of (1) the insurer's tax-exempt interest, (2) the deductible portion of dividends received (with special rules for dividends from affiliates), and (3) the increase for the taxable year in the cash value of life insurance, endowment or annuity contracts (sec. 832(b)(5)(B)).

This 15-percent proration requirement was enacted in 1986. The reason the provision was adopted was Congress' belief that "it is not appropriate to fund loss reserves on a fully deductible basis out of income which may be, in whole or in part, exempt from tax. The amount of the reserves that is deductible should be reduced by a portion of such tax-exempt income to reflect the fact that reserves are generally funded in part from tax-exempt interest or from wholly or partially deductible dividends." [5]

[5] H. R. Rep. No. 99-426, Report of the Committee on Ways and Means on H.R. 3838, The Tax Reform Act of 1985 (99th Cong., 1st Sess.,), 670.

Property and casualty insurance companies with life insurance reserves

Present law provides that a life insurance company means an insurance company engaged in the business of issuing life insurance, annuity, or noncancellable accident and health insurance, provided its reserves meet a 50-percent threshhold for its reserves (sec. 816). More than 50 percent of its reserves must constitute life insurance reserves or reserves for noncancellable accident and health policies. An insurance company that does not meet this 50-percent threshhold for reserves generally is subject to tax as a property and casualty insurance company. In determining the amount of premiums earned for purposes of calculating its taxable income, a property and casualty insurance company includes in unearned premiums the amount of life insurance reserves determined under the rules applicable to life insurance companies (secs. 832(b)(4), 807).

Description of Proposal

The proposal provides that the life insurance company proration rules, rather than the property and casualty insurance proration rules, apply with respect to life insurance reserves of a property and casualty company.

Effective Date

The proposal is effective for taxable years beginning after December 31, 2003.