19. (3.25 points)

a. (1 point)

Assume the federal corporate tax rate is 35%. Identify an insurance company's effective tax rate for each of the following:

i. Dividends received from a corporation owned 100% by the insurance company

ii. Tax-exempt municipal bond income

iii. Realized capital gains

iv. Unrealized capital gains

b. (1.5 points)

Other than the treatment of investment income, describe two adjustments made to statutory income to calculate taxable income and briefly explain why the Internal Revenue Service requires these changes.

c. (0.75 point)

An insurance company was formed in 2013. The following schedule shows the company's regular income tax and alternative minimum income tax over the past three years (all figures in thousands of dollars):

Tax Year	Regular Income Tax	Alternative Minimum Income Tax
2013	4,500	4,800
2014	3,900	3,800
2015	4,100	3,800

Determine the income tax paid by the company in 2013, 2014, and 2015.

CONTINUED ON NEXT PAGE

SAMPLE ANSWERS AND EXAMINER'S REPORT

QUESTION 19	
TOTAL POINT VALUE: 3.25	**LEARNING OBJECTIVE: C4**
SAMPLE ANSWERS	

Part a: 1 point

i. Dividends received from corporation owned 100% by insurance company: 0%
ii. Tax-exempt municipal bond income: 35% * 15% = 5.25%
Or
Add 15% of the interest income of tax-exempt municipal bond s to taxable income.
iii. Realized capital gains: 35%
iv. Unrealized capital gains: 0% (UCG are not investment income and therefore not taxable)
Or
35%, but not taxed until realized.
Or
35%, deferred tax asset/liability.

Part b: 1.5 points

- Revenue Offset: 20% of the change in the unearned premium reserve is added to statutory earned premium to account for acquisition expenses.
Or
  - tax basis EP = WP – 0.8 X change in UEPR
  - tax basis EP = Statutory EP + 0.2 X change in UEPR

  This prevents the insurer from claiming a loss due to acquisition expenses by increasing the amount of taxable income.
- Discounting of Loss Reserves: Tax accounting requires the use of discounted loss reserves as opposed to full value reserves in the computation of incurred losses.
Or
  - Tax basis Inc. Losses = Paid Losses + change in discounted reserve.
  - Tax basis Inc. Losses = statutory Inc. Losses - change in reserve discount

  This prevents the IRS from giving a tax refund on what is only a temporary loss until investment income is made.

Part c: 0.75 point

- 2013: Pay AMIT of $4.8M, Minimum tax credit = $0.3M
- 2014: Apply $0.1M of credit to RIT; pay $3.8M, Minimum tax credit = $0.2M
- 2015: Apply $0.2M of credit to RIT; pay $3.9M of income tax

SAMPLE ANSWERS AND EXAMINER'S REPORT

EXAMINER'S REPORT

The candidates were expected to know the basic elements of income tax calculation, difference between statutory income versus taxable income and the alternative minimum tax.

Part a

The candidates were expected to know the basic elements of income tax calculation.

Common mistakes included:

- Answered 15% on part II, assuming proration of tax-exempt municipal bond interest is asked but the question is asking for the effective tax rate.
- Answered only 35% on part IV.

Part b

The candidates were expected to know the difference between statutory incomes versus taxable incomes.

Common mistakes included:

- Listing two reasons, where the second reason was just a restatement of the first reason
- Listing adjustments on investment income. The question clearly stated that "other than the treatment of investment income…
- Only gives the "buzzwords" (e.g., Only "Revenue Offset" or only "Discounting of Loss Reserves") with no additional descriptions.

Part c

The candidates were expected to know the basic of the alternative minimum tax.

A common mistake was making a mistake in calculating tax credit carryforward when tax method changed from year to year. (e.g., RTI in one year and AMTI in next year)