

Texas FINREP 2022

Let's Get Technical: Statutory and GAAP
Income Tax Provision Essentials



TOPICS

- ▲ Accounting for Income Taxes
(GAAP Basis - ASC 740)
- ▲ Accounting for Income Taxes
(Statutory Basis - SSAP 101)
- ▲ Tax Legislation Updates

ACCOUNTING FOR INCOME TAXES (ASC 740)

GAAP BASIS OF ACCOUNTING

OVERVIEW OF ASC 740 (CONT.)

Accounting Research
Bulletin (ARB) 43

- Business Expense
- Year: 1953

Accounting Principles
Board (APB) 11

- Income Statement Approach
- Year: 1967

Financial Acct.
Standards Board (FASB)
109

- Balance Sheet Approach
- Year: 1992

Accounting
Standards
Codification
(ASC) 740

- Current guidance
- Year: 2009

OVERVIEW OF ASC 740 (CONT.)

▲ ASC 740 (cont.)

▲ Applies to “income taxes” that are **based on income** (ASC 740-10-20)

▲ “Excess of taxable revenues over tax deductible expenses and exemptions”

▲ Does not apply to gross receipts taxes or franchise taxes that are **based on capital** or withholding taxes

▲ Margin Tax

OVERVIEW OF ASC 740 (CONT.)

▲ ASC 740 (cont.)

- ▲ Recognize **estimated taxes payable or refundable** for the current year as a liability or asset. Change is **current tax expense (benefit)**.
- ▲ Recognize a **deferred tax asset (DTA) or liability (DTL)** for the estimated future tax effects from reversing temporary differences and carryforwards. Change is **deferred tax expense (benefit)**.

ASC 740 – CURRENT INCOME TAXES

▶ Current income tax provision

- ▶ Current year estimated taxes payable or refundable based on current year activity.

Book Income

+/- Permanent Book / Tax Differences

+/- Temporary Book / Tax Differences

Taxable Income

x Enacted Tax Rate (Federal: 21%)

Current Income Tax Provision

ASC 740 – CURRENT INCOME TAXES (CONT.)

PERMANENT DIFFERENCES

- ▶ Meals Expense
- ▶ Entertainment Expense
- ▶ Political & Lobbying Expense
- ▶ Tax-Exempt Interest Income
- ▶ Dividends Received Deduction

TEMPORARY DIFFERENCES

- ▶ Depreciation / Amortization
- ▶ Discounting of Unpaid Losses & LAE
- ▶ Unearned Premiums Reserve
- ▶ Accrued Expenses
- ▶ Prepaid Expenses

ASC 740 – CURRENT INCOME TAXES (CONT.)

DEFERRED TAX ASSET (DTA)

- ▶ Temp differences which upon reversal will generate a future tax benefit
- ▶ Book deductions are greater than tax deductions in the early years

DEFERRED TAX LIABILITY (DTL)

- ▶ Temp differences which upon reversal will generate a future tax liability
- ▶ Tax deductions are greater than book deductions in the early years

ACCOUNTING FOR INCOME TAXES (SSAP 101)

STATUTORY BASIS OF ACCOUNTING

OVERVIEW OF SSAP 101

- ▶ Current codified statutory guidance (effective 1/1/2012)
- ▶ **Adopts GAAP**, with modifications for:
 - ▶ Exclusion of state income taxes
 - ▶ Reporting of Change in Deferred Tax Assets (DTA)
 - ▶ Realization of Deferred Tax Assets (DTA)

➤ DEFERRED TAX ASSET (DTA) ADMISSIBILITY

▸ Modification – Realization of Deferred Tax Asset

▸ SSAP 101, Paragraph 11a – Previous Years

- Admit DTA relative to taxes paid in prior years

- Carryback of DTAs expected to reverse in next 2 years

- Standalone vs. consolidated return groups

➤ DEFERRED TAX ASSET (DTA) ADMISSIBILITY

▢ Modification – Realization of Deferred Tax Asset

▢ SSAP 101, Paragraph 11a – Previous Years

SSAP 101, Paragraph 11a - Example

Current Taxable Year: 2022

Deferred Tax Asset 100,000 Year 1 - Expected to Reverse in 2023 (Receive Tax Benefit)
 Deferred Tax Asset 52,380 Year 2 - Expected to Reverse in 2024 (Receive Tax Benefit)

| | 2021 | W/ Carryback 2021 | 2022 | W/ Carryback 2022 |
|---|---------|----------------------|---------|----------------------|
| Taxable Income (Loss) | 100,000 | 100,000 | 100,000 | 100,000 |
| Less: Carryback | - | (100,000) | - | (52,380) |
| Adj. Taxable Income (Loss) | 100,000 | - | 100,000 | 47,620 |
| Enacted Rate | 21% | 21% | 21% | 21% |
| Tax Expense | 21,000 | - | 21,000 | 10,000 |
| Decrease in Tax | | (21,000) | | (11,000) |
| Total Decrease in Tax / DTA Admitted under Paragraph 11a | | | | (32,000) |

DEFERRED TAX ASSET (DTA) ADMISSIBILITY (CONT.)

▀ Modification – Realization of Deferred Tax Asset

▀ Paragraph 11b – Future Years

▀ Based on the ratio of adjusted surplus (Surplus ExDTA) to authorized control level (ACL):

▀ Admit DTAs expected to reverse in zero years, one year, or three years.

▀ Admit DTAs up to 0%, 10%, or 15% of adjusted surplus.

▀ Reduced by DTA admitted under Paragraph 11a.

DEFERRED TAX ASSET (DTA) ADMISSIBILITY (CONT.)

Modification – Realization of Deferred Tax Asset

Paragraph 11b – Future Years

Realization Threshold Limitation Table – RBC Reporting Entities

| ExDTA ACL RBC (%) | 11.b.i. | 11.b.ii. |
|-------------------|---------|----------|
| Greater than 300% | 3 years | 15% |
| 200 – 300% | 1 year | 10% |
| Less than 200% | 0 years | 0% |

DEFERRED TAX ASSET (DTA) ADMISSIBILITY (CONT.)

Modification – Realization of Deferred Tax Asset

Paragraph 11b – Future Years

| Deferred Tax Assets: | | Gross DTA | DTA's @ 21% | 1st Year reversal | 2nd Year reversal | 3rd Year reversal | 4+ Year reversal |
|----------------------------------|------|--------------|----------------|----------------------|----------------------|----------------------|---------------------|
| Loss Reserve Discount | | | | | | | |
| 1st year turn | 60% | 3,146,628 | 660,792 | 396,475 | 132,158 | 66,079 | 66,080 |
| 2nd year turn | 20% | | | | | | |
| 3rd year turn | 10% | | | | | | |
| Charitable Contributions | | | | | | | |
| Average one year turn | 100% | 1,000 | 210 | 210 | - | - | - |
| Unrealized Losses FAS 115 | | | | | | | |
| Average one year turn | 0% | 20,383 | 4,280 | - | - | - | 4,280 |
| Net operating loss | | | | | | | |
| 1st year turn | 100% | 944,706 | 198,388 | 198,388 | - | - | - |
| 2nd year turn | 0% | | | | | | |
| 3rd year turn | 0% | | | | | | |
| Non-admitted assets | | | | | | | |
| Average one year turn | 100% | 473,607 | 99,457 | 99,457 | - | - | - |
| | | 4,586,324 | 963,127 | 694,530 | 132,158 | 66,079 | 70,360 |

DEFERRED TAX ASSET (DTA) ADMISSIBILITY (CONT.)

Modification – Realization of Deferred Tax Asset

Paragraph 11b – Future Years

| ExDTA ACL RBC Ratio | Three Years | 455% | INCLUDE 2023 | | INCLUDE 2024 | | INCLUDE 2025 | |
|--|-------------|------|--|--|---|--|---|--|
| | | | With Reversing Temporary Benefits | Without Reversing Temporary Benefits | With Reversing Temporary Benefits | Without Reversing Temporary Benefits | With Reversing Temporary Benefits | Without Reversing Temporary Benefits |
| Temporary ordinary benefits reversing in one year | 450,000 | | | | | | | |
| Temporary capital benefits reversing in one year | - | | | | | | | |
| Temporary ordinary benefits reversing in two years | 200,000 | | | | | | | |
| Temporary capital benefits reversing in two years | - | | | | | | | |
| Temporary ordinary benefits reversing in three years | 499,095 | | | | | | | |
| Temporary capital benefits reversing in three years | - | | | | | | | |
| Estimated Taxable Income - Ordinary | | | 9,067,805 | 9,067,805 | 9,067,805 | 9,067,805 | 9,067,805 | 9,067,805 |
| Estimated Taxable Income - Capital | | | - | - | - | - | - | - |
| Reversing Temporary Differences - Ordinary | | | | 450,000 | | 200,000 | | 499,095 |
| Reversing Temporary Differences - Capital | | | | - | | - | | - |
| Projected Taxable Income - Ordinary | | | 9,067,805 | 9,517,805 | 9,067,805 | 9,267,805 | 9,067,805 | 9,566,900 |
| Projected Taxable Income - Capital | | | - | - | - | - | - | - |
| Tax @ 21% | | | 21% | 21% | 21% | 21% | 21% | 21% |
| Estimated Income Tax - Ordinary | | | 1,904,239 | 1,998,739 | 1,904,239 | 1,946,239 | 1,904,239 | 2,009,049 |
| Estimated Income Tax - Capital | | | - | - | - | - | - | - |
| Benefit of Reversing DTAs - Ordinary | | | | 94,500 | | 42,000 | | 104,810 |
| Benefit of Reversing DTAs - Capital | | | | - | | - | | - |
| Total remaining DTA's that will be realized @ 12/31/2022 | | | | | | | | 241,310 |

DEFERRED TAX ASSET (DTA) ADMISSIBILITY (CONT.)

- ▶ Modification – Realization of Deferred Tax Assets (DTA)
- ▶ Paragraph 11c – Deferred Tax Liabilities
 - ▶ Admit any remaining DTAs to the extent of DTLs
 - ▶ Reduced by DTA admitted under 11a and 11b

➤ FOOTNOTE 9 – INCOME TAXES DISCLOSURE

Note 9 – Income Taxes

A. The components of the net deferred tax asset/(liability) at December 31, 2021 are as follows:

1.

| | December 31, 2021 | | | December 31, 2020 | | |
|---|-------------------|---------|------------|-------------------|---------|------------|
| | Ordinary | Capital | Total | Ordinary | Capital | Total |
| (a) Gross deferred tax assets | \$ 673,253 | \$ - | \$ 673,253 | \$ 504,439 | \$ - | \$ 504,439 |
| (b) Statutory valuation allowance adjustments | - | - | - | - | - | - |
| (c) Adjusted gross deferred tax assets (1a - 1b) | 673,253 | - | 673,253 | 504,439 | - | 504,439 |
| (d) Deferred Tax Assets Nonadmitted | - | - | - | - | - | - |
| (e) Subtotal Net Admitted Deferred Tax Asset (1c - 1d) | 673,253 | - | 673,253 | 504,439 | - | 504,439 |
| (f) Deferred Tax Liabilities | 47,183 | - | 47,183 | 13,409 | - | 13,409 |
| (g) Net admitted deferred tax asset/(Net Deferred Tax Liability) (1e - 1f) | \$ 626,070 | \$ - | \$ 626,070 | \$ 491,030 | \$ - | \$ 491,030 |

➤ FOOTNOTE 9 – INCOME TAXES DISCLOSURE

2.

| SSAP 101, paragraphs 11.a., 11.b., and 11.c.: | December 31, 2021 | | | December 31, 2020 | | |
|---|-------------------|---------|------------|-------------------|---------|------------|
| | Ordinary | Capital | Total | Ordinary | Capital | Total |
| (a) Federal Income Taxes Paid in Prior Years Recoverable Through Loss Carrybacks | \$ 369,003 | \$ - | \$ 369,003 | \$ 486,243 | \$ - | \$ 486,243 |
| (b) Adjusted Gross Deferred Tax Assets Expected to be Realized (Excluding The Amount of Deferred Tax Assets From 2(a) above) After Application of the Threshold Limitation. (The Lesser of 2(b)1 and 2(b)2 Below) | 294,858 | - | 294,858 | 18,196 | - | 18,196 |
| 1. Adjusted Gross Deferred Tax Assets Expected to be Realized Following the Balance Sheet Date | 294,858 | - | 294,858 | 18,196 | - | 18,196 |
| 2. Adjusted Gross Deferred Tax Assets Allowed per Limitation Threshold | | | 1,828,214 | | | 1,815,308 |
| (c) Adjusted Gross Deferred Tax Assets (Excluding the Amount of Deferred Tax Assets From 2(a) and 2(b) above) Offset by Gross Deferred Tax Liabilities | 9,392 | - | 9,392 | - | - | - |
| (d) Deferred Tax Assets Admitted as the Result of Application of SSAP No. 101 Total (2(a) + 2(b) + 2(c)) | \$ 673,253 | \$ - | \$ 673,253 | \$ 504,439 | \$ - | \$ 504,439 |

3.

| | 2021 Percentage | 2020 Percentage |
|--|--------------------|--------------------|
| (a) Ratio Percentage Used to Determine Recovery Period and Threshold Limitation Amount | 529% | 308% |
| (b) Amount of Adjusted Capital and Surplus Used to Determine Recovery Period and Threshold Limitation in 2(b)2 Above | 12,188,093 | 12,102,054 |

➤ FOOTNOTE 9 – INCOME TAXES DISCLOSURE

C. Current Tax and Change in Deferred Tax

1. Current income tax:

| | 2021 | 2020 | Change |
|--|------------|------------|-------------|
| (a) Federal | \$ 191,467 | \$ 175,195 | \$ 16,272 |
| (b) Foreign | | | |
| (c) Subtotal | 191,467 | 175,195 | 16,272 |
| (d) Federal income tax on net capital gains | 2,039 | - | 2,039 |
| (e) Utilization of capital loss carryforward | - | - | - |
| (f) Other | 301 | 38,884 | (38,583) |
| Federal and foreign income taxes incurred | \$ 193,807 | \$ 214,079 | \$ (20,272) |

➤ FOOTNOTE 9 – INCOME TAXES DISCLOSURE

2. Deferred tax assets:

| | 2021 | 2020 | Change |
|---|------------|------------|------------|
| (a) Ordinary: | | | |
| (1) Discounting of unpaid losses | \$ 42,217 | \$ 43,201 | \$ (984) |
| (2) Unearned premium reserve | 585,491 | 308,499 | 276,992 |
| (3) Policyholder reserves | - | - | - |
| (4) Investments | - | - | - |
| (5) Deferred acquisition costs | - | - | - |
| (6) Policyholder dividends accrual | - | - | - |
| (7) Fixed assets | - | - | - |
| (8) Compensation and benefits accrual | - | - | - |
| (9) Pension accrual | - | - | - |
| (10) Receivables - nonadmitted | 31,571 | 138,466 | (106,895) |
| (11) Net operating loss carry-forward | - | - | - |
| (12) Tax credit carry-forward | - | - | - |
| (13) Other (including items <5% of total ordinary tax assets) | 13,974 | 14,273 | (299) |
| (14) Other assets - nonadmitted | - | - | - |
| (99) Subtotal | 673,253 | 504,439 | 168,814 |
| (b) Statutory valuation allowance adjustment | - | - | - |
| (c) Nonadmitted | - | - | - |
| (d) Admitted ordinary deferred tax assets (2a99-2b-2c) | 673,253 | 504,439 | 168,814 |
| (e) Capital | | | |
| (1) Investments | - | - | - |
| (2) Net capital loss carry-forward | - | - | - |
| (3) Real estate | - | - | - |
| (4) Other (including items <5% of total capital tax assets) | - | - | - |
| (99) Subtotal | - | - | - |
| (f) Statutory valuation allowance adjustment | - | - | - |
| (g) Nonadmitted | - | - | - |
| (h) Admitted capital deferred tax assets (2e99-2f-2g) | - | - | - |
| (i) Admitted deferred tax assets (2d+2h) | \$ 673,253 | \$ 504,439 | \$ 168,814 |

➤ FOOTNOTE 9 – INCOME TAXES DISCLOSURE

3. Deferred tax liabilities:

| | 2021 | 2020 | Change |
|---|-----------|-----------|------------|
| (a) Ordinary: | | | |
| (1) Investments | \$ 408 | \$ 1,429 | \$ (1,021) |
| (2) Fixed assets | - | - | - |
| (3) Deferred and uncollected premiums | - | - | - |
| (4) Policyholder reserves | - | - | - |
| (5) Other (including items <5% of total ordinary tax liabilities) | 46,775 | 11,980 | 34,795 |
| (6) Additional acquisition costs-installment premiums | - | - | - |
| (7) Discount of accrued salvage and subrogation | - | - | - |
| (8) Guaranty funds receivable | - | - | - |
| (99) Subtotal | 47,183 | 13,409 | 33,774 |
| (b) Capital | | | |
| (1) Investments | - | - | - |
| (2) Real estate | - | - | - |
| (3) Other (including items <5% of total capital tax liabilities) | - | - | - |
| (99) Subtotal | - | - | - |
| (c) Deferred tax liabilities (3a99+3b99) | \$ 47,183 | \$ 13,409 | \$ 33,774 |

4. Net deferred tax assets/liabilities (2i-3c)

626,070

491,030

135,040

➤ FOOTNOTE 9 – INCOME TAXES DISCLOSURE

D. Reconciliation of Federal Income Tax Rate to Actual Effective Rate

| | December 31, 2021 | Effective Tax Rate |
|---|-------------------|--------------------|
| Permanent Differences: | | |
| Provision computed at statutory rate | \$ (48,128) | 21.0% |
| Proration of tax exempt investment income | - | 0.0% |
| Tax exempt income deduction | - | 0.0% |
| Dividends received deduction | - | 0.0% |
| Disallowed travel and entertainment | - | 0.0% |
| Other permanent differences | - | 0.0% |
| Temporary Differences: | | |
| Total ordinary DTAs | 106,895 | -46.6% |
| Total ordinary DTLs | - | 0.0% |
| Total capital DTAs | - | 0.0% |
| Total capital DTLs | - | 0.0% |
| Other | | |
| Statutory valuation allowance adjustment | - | 0.0% |
| Accrual adjustment - prior year | - | 0.0% |
| Other | - | 0.0% |
| Totals | 58,767 | -25.6% |
| Federal and foreign income taxes incurred | 193,807 | -84.6% |
| Realized capital gains (losses) tax | - | 0.0% |
| Change in net deferred income taxes | (135,040) | 58.9% |
| | \$ 58,767 | -25.7% |

➤ FOOTNOTE 9 – INCOME TAXES DISCLOSURE

E. Operating Loss and Tax Credit Carryforwards

- (1) The amounts, origination dates, and expiration dates of operating loss and tax credit carry forwards available for tax purposes:

| Description (Operating Loss or Tax Credit Carry Forward) | Amounts | Origination Dates | Expiration Dates |
|--|---------|-------------------|------------------|
| -- | \$ - | --- | --- |

- (2) The following is income tax expense for 2021 and 2020 that is available for recoupment in the event of future net losses:

| Year | Amount |
|------|------------|
| 2021 | \$ 193,506 |
| 2020 | \$ 175,497 |

- (3) The Company did not have any protective tax deposits under Section 6603 of the Internal Revenue Code.

F. Consolidated Federal Income Tax Return

- (1) The Company's federal income tax return is consolidated with the following entities:
Not Applicable
- (2) Not Applicable

G. Federal or Foreign Federal Income Tax Loss Contingencies

The Company has no tax loss contingencies for which it is reasonably possible that the total liability will significantly increase within twelve months of the reporting date.

FIN 48 – VALUATION ALLOWANCE

Valuation Allowance Adjustment

- ▲ For the DTA to be subject to adjustment, it must be more likely than not that the DTA will not be realized
 - ▲ More likely than not is “a likelihood of more than 50 percent”
- ▲ Tax planning strategies

Gross Deferred Tax Asset
Less: Valuation Allowance
Adjusted Gross Deferred Tax Asset

TAX LEGISLATION UPDATE

EMPLOYEE RETENTION CREDIT

- Qualification for ERC
- Employees and Gross Receipts analysis at aggregate level
- Claiming the credit – must be on amended form 941-X
- ERC credit must be shown on the tax return for the year in which they were generated

SECTION 174 CAPITALIZATION

- Sec. 174 expenses include direct research expenses, wages and supplies, certain indirect research expenses
- Historically could be deducted in the year they occurred
- Due to TCJA, now must capitalize over a five-year period
- Some Sec. 174 expenses may qualify for R&D tax credits

BUSINESS INTEREST EXPENSE LIMITATION

TAX YEAR 2021

Taxable Income

+ Interest Expense

+ Depreciation

+ Amortization

Adjusted Taxable Income

x 30%

Deductible Interest Expense 2021

TAX YEAR 2022

Taxable Income

+ Interest Expense

~~+ Depreciation~~

~~+ Amortization~~

Adjusted Taxable Income

x 30%

Deductible Interest Expense 2022

INFLATION REDUCTION ACT

- New 15% Corporate Alternative Minimum Tax
- New Excise tax on certain stock buybacks
- Expanded IRS funding

OTHER TAX ITEMS

- Meals Deduction 100% for restaurants in 2021 & 2022
- State tax entity-level tax elections
- Net Operating Loss utilization

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Questions?