
Insurance Industry Unhappy About New Identified Mixed Straddle Regs.

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Peter J. Bautz of the American Council of Life Insurers and Jeffrey Maddrey of PricewaterhouseCoopers LLP commented on the new regulations' adverse effect on the insurance industry, particularly the asymmetrical tax treatment for bond holders.

Maddrey said he believes the existing regulations, which have been in place since 1985, allow insurance companies to use expiring loss carryforwards. "We continue to believe these transactions are entirely appropriate under current law, especially considering the context of the way insurance companies operate their business," he said.

A mixed straddle exists when one leg of the straddle is marked to market while the other leg is not. Insurers use an IMS when they have expiring loss carryforwards; the IMS preserves an insurer's ownership in the bond but allows it to recognize gain to offset the expiring losses. The proposed and temporary regulations eliminate a taxpayer's ability to recognize gain on an IMS, freezing the gains when the taxpayer enters the mixed straddle and recognizing the gains only when the position is ultimately disposed.

Bautz conceded that there are other ways for insurers to recognize gains, such as by selling appreciated bonds and buying similar ones from the market. However, he said, those alternatives significantly increase transaction costs.

The commentators noted that asymmetrical bond treatment affects the insurance industry in particular because the industry's investment portfolios are generally all bonds. Asymmetry exists in bond taxation because gain is generally ordinary while losses are capital. The industry uses the identified straddle rules to trigger gain that offsets expiring bad debt capital losses. According to Maddrey, taxpayers trigger gain when interest rates are declining, thus increasing the value of the bonds. He argued that "buy and hold" investors need a way to trigger gain when they have expiring capital losses and that the existing regulations provide just that.

Maddrey also said that while other types of investors have the luxury of a diversified portfolio with various liquid assets, insurance companies generally purchase bonds with the intention of holding them to maturity. That means that other investors are able to trigger gain more easily to offset expiring losses.

Treasury initially released the proposed and temporary regs on August 2 and made them immediately effective. However, commentators raised concerns regarding an immediate effective date, and Treasury later delayed the applicability until final regulations are released. The final regs are expected to be released by the end of June 2014.

by William R. Davis