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ACLI UPDATE
LEGISLATIVE AND REGULATORY DEVELOPMENTS

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As usual, ACLI and its many members have been engaged with regulators and legislators as they have considered new guidance and legislation. On the legislative front, in September, Congress enacted the Small Business Lending Fund Act[1] that contained a provision to treat payments received from the partial annuitization of a non-qualified deferred annuity as payments received as annuity payments. On the regulatory front, the Treasury Department ("Treasury") and the Internal Revenue Service ("IRS") released Rev. Proc. 2010-28[2] with guidance on the applications of sections 7702 and 7702A to life insurance contracts that have mortality guarantees based upon the 2001 Commissioners' Standard Ordinary Mortality Tables ("2001 CSO"), and that may continue in force after the day on which the insured attains age 100. ACLI and its members also engaged Treasury and IRS in discussions about the applicability of the Foreign Account Tax Compliance Act [3]("FATCA") to life insurance companies and products.

PARTIAL ANNUITIZATION AND PARTIAL EXCHANGES OF NON-QUALIFIED DEFERRED ANNUITY CONTRACTS

Partial Annuitization

As noted above, Congress enacted the Small Business Lending Fund Act that contained a provision to treat payments received from the partial annuitization of a non-qualified deferred annuity as annuity payments. This provision applies annuitization rules to partial annuitization for a period of no less than 10 years.

ACLI member companies have been seeking clarification of the rules on partial annuitization for a number of years. This is a very important step in encouraging annuitization. The annuity portion will be treated as a separate contract allowing exclusion ratio treatment. The investment in the contract will be allocated *pro rata* between the annuitized and non-annuitized parts of the contract.

By its terms this provision applies to partial annuitization of life insurance contracts; the merits of partial annuitization of a life insurance contract is under analysis by our members.

Partial Exchanges

The IRS released a Private Letter Ruling on partial exchanges (PLR 201038012) in late September. In the PLR, the taxpayer was 59 ½ before the initial (external) partial exchange of his annuity contract where he instructed the company with whom he had the annuity contract to direct a portion of the cash value to another company to issue a second annuity contract. At a subsequent date, the taxpayer took a withdrawal from the original annuity. The question was whether the subsequent withdrawal invalidated the initial exchange. The IRS ruled that it did not because the taxpayer "met the condition described by Section 72(q)(2)(A): the withdrawal was made on or after the date on which Taxpayer attained age 59 ½ years."

ACLI continues efforts with the Committee of Annuity Insurers to seek guidance.

PREVAILING COMMISSIONERS' STANDARD ORDINARY LIFE VALUATION MORTALITY TABLES

Treasury and IRS issued Rev. Proc. 2010-28 on August 20 on the application of Sections 7702 and 7702A to life insurance contracts that: 1) have mortality guarantees based upon the 2001 CSO Tables; and that 2) may continue in force after the day on which the insured attains age 100. We are pleased to see that Treasury and IRS were responsive to our October 2009 request that the scope of the safe harbors be defined to apply only to contracts issued under 2001 CSO Tables. Moreover, Treasury and IRS were similarly responsive to our requests that:

- the computation rules in the safe harbor be modified consistent with the Society of Actuaries' Tax Section Task Force ("Task Force") recommendations, and
- the proposed 105 percent safe harbor be eliminated.

In Notice 2009-47, Treasury and IRS had also requested comments concerning the applicability of pre-1984 Act case law and the constructive receipt doctrine when a life insurance contract matures, by its terms, while the insured is still alive. ACLI's October 2009 submission argued that Section 7702 addressed any concerns under the *LeGierse* case regarding risk shifting, and that there should be no constructive receipt of inside build-up when an insured attains age 100; the Revenue Procedure did not comment on risk shifting or constructive receipt.

NOTICE 2010-60—APPLICABILITY OF FATCA TO LIFE INSURANCE COMPANIES AND PRODUCTS

FATCA requires increased disclosure of offshore accounts to improve tax compliance and was passed as part of the Hiring Incentives to Restore Employment Act ("HIRE" Act) in March 2010. The provisions of FATCA impose a 30 percent withholding tax on payments to "foreign financial institutions" that do not comply with information reporting requirements with respect to financial accounts U.S. taxpayers have in their institutions.

On August 20, Treasury and IRS issued Notice 2010-60[4] on FATCA; the Notice mentioned that the "definition of 'financial institution' in Section 1471(d)(5) is broad enough to encompass certain insurance companies." ACLI met with IRS and Treasury in August and October to discuss possible application of FATCA to life insurance companies and life insurance products, and submitted a comment letter in response to Notice 2010-60 on November 1. ACLI has also coordinated its efforts with insurance trade representatives internationally to help educate Treasury and IRS on why the nature of life insurance companies and their products does not implicate the potential for tax evasion behind this new reporting (and withholding) regime, and why the distinguishing features of the life insurance companies and the products they issue warrant a substantially different treatment under the FATCA rules.

END NOTES

1 The Small Business Jobs Act of 2010, P.L. 111-240. This new provision is discussed in more detail in this issue at page 1.
2 2010-34 I.R.B. This new provision is discussed in more detail in this issue at page 10.
3 Hiring Incentives to Restore Employment Act of 2010, P.L. 111-147 (the "HIRE") Act.
4 2010-37 I.R.B.

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