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ACLI UPDATE

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Treasury and IRS released new temporary and revised final and temporary regulations to implement Foreign Account Tax Compliance Act (FATCA) on Feb. 20, 2014.¹ The Temporary and Final Regulations (TD 9657 and 9658) provided additional details and reflect changes made to the final regulations, issued in January 2013 (the “2013 Final Regulations”), to coordinate with the temporary regulations published under chapters 3 and 61 and section 3406 of the Code. These regulations contain modifications to the 2013 Final Regulations to further harmonize them with the Intergovernmental Agreements (IGAs). These regulations also revised certain provisions of the 2013 Final Regulations regarding withholding of tax on certain U.S. source income paid to foreign persons, information reporting and backup withholding with respect to payments made to certain U.S. persons, portfolio interest paid to nonresident alien individuals and foreign corporations.

ACLI had requested certain technical corrections be made to the 2013 Final. The government provided for the following items in the revised and temporary regulations:

CERTAIN FOREIGN INSURANCE COMPANIES TREATED AS U.S. PERSONS

The 2013 Final Regulations treat a foreign insurance company that is not licensed to do business in any State and makes an election under section 953(d) as a foreign person. ACLI requested that section 953(d) companies that had rulings for separate account purposes to be treated as doing business within a state, be exempted from FFI status. Specifically, we recommended that Treas. Reg. §1.1471-1(b)(132) be modified as follows:

(132) U.S. person. The term U.S. person or United States person means a person described in section 7701(a)(30), the United States government (including an agency or instrumentality thereof), a State (including an agency or instrumentality thereof), or the District of Columbia (including an agency or instrumentality thereof). For purposes of the preceding sentence and subject to an exception set forth herein, the

determination of whether an insurance company is a U.S. person is made without regard to an election by a company not licensed to do business in any State to be subject to U.S. income tax as if it were a domestic insurance company. Thus, a foreign insurance company not licensed to do business in any State that elects pursuant to section 953(d) to be subject to U.S. income tax as if it were a U.S. insurance company is not a U.S. person. **However, an insurance company electing pursuant to section 953(d) to be subject to U.S. income tax as if it were a U.S. insurance company will be treated as a U.S. person if it treats life insurance contracts and annuity contracts issued (if any) as commercial annuities within the meaning of section 3405(e)(6) subject to 6047(d) reporting.**

The temporary regulations in TD 9657 modify the definition of U.S. person to include a foreign insurance company that has made an election under section 953(d) and that either is not a specified insurance company or is a specified insurance company that is licensed to do business in any State. In such cases, the foreign insurance company will be required to continue to report on its owners in accordance with its election under section 953(d). The temporary regulations continue to treat a foreign insurance company that has made an election under section 953(d) and that is a specified insurance company that is not licensed to do business in any State as a foreign person for purposes of FATCA.

GRANDFATHERED OBLIGATIONS—DEFINITIONS—MATERIAL MODIFICATION

Section 1.1471-2(b)(2)(ii)(A)(4) of the 2013 Final Regulations grandfathered life insurance contracts from the withholdable payment rules as long as the entire contract value pays out no later than death of the insured. However, section 1.1471-2(b)(2)(ii)(B)(2) eliminates the grandfathered status for life insurance if the contract contains a substitution of insured rider. ACLI asked whether the regulations intended to exclude a population of insurance policies from grandfathering merely because they had a right to substitute the insured. We noted that if the right to substitute the insured were ever exercised, it would constitute a modification and result in a loss of grand-

fathering. Specifically, we recommended that Treas. Reg. § 1.1471-2(b)(2)(ii)(B)(2) and Treas. Reg. § 1.1471-2(b)(2)(iv) respectively be modified as follows:

(ii) Obligation.

(B) An obligation for purposes of this paragraph (b)(2)(ii) does not include any legal agreement or instrument that—

- (1) Is treated as equity for U.S. tax purposes;
- (2) Lacks a stated expiration or term (for example, a savings deposit or demand deposit, ~~a deferred annuity contract, or a life insurance contract or annuity contract that permits a substitution of a new individual as the insured or as the annuitant under the contract~~);

(iv) Material modification. In the case of an obligation that constitutes indebtedness for U.S. tax purposes, a material modification is any significant modification of the debt instrument as defined in §1.1001-3(e). *For life insurance contracts, a material modification includes any change of the insured under the contract.* In all other cases, whether a modification of an obligation is material is determined based on the facts and circumstances.

The temporary regulations in TD 9657 acknowledged our recommendation. Treasury and IRS noted that substitution of insured provisions are prevalent in existing life insurance contracts, and concluded that life insurance contracts that have such a provision should be eligible for grandfathered status until the provision is invoked.

ACLI had also requested that Treasury and IRS modify the rules under sections 6041 and 6049 related to information reporting and documentation applicable to Controlled Foreign Corporations (CFCs) of life insurance companies so they may conform to FATCA. The rules under sections 6041 and 6049 presume that payees are U.S. persons, and placed the extraordinary burden on the CFC of life insurers to collect reliable documentation to overcome that presumption in order to treat the payee as a non-U.S. person.

Treasury and IRS were responsive to ACLI's request, changed the presumption rule for CFCs and applied the chapter 4 standard for CFC chapter 61 reporting. We appreciate this change that removes a significant burden on the CFCs of life insurance companies. Updating the regulations to change the rule that allows for the presumption of individuals to be treated as U.S. only when there is actual knowledge as to accounts sold overseas is sound tax policy, levels in part the playing field for U.S. and non-U.S. owned FFIs, and is consistent with the chapter 3 and chapter 4 conformity rules in the 2013 Final Regulations. We also recommended that foreign life insurance companies that are CFCs be treated as having complied with all their reporting obligations under the Code if they fulfill the requirements of chapter 4 as proposed under FATCA for foreign life insurers. The regulations continue to require CFCs to report under chapter 61 and chapter 4. This duplication in reporting continues to place an extra burden on U.S. CFCs vis à vis their foreign-owned competitors. We continue our dialogue with the government and request clarification that the 1099 reporting rules not apply to life insurance companies prior to the July 1, 2014, effective date for chapter 4 reporting, and that chapter 4 reporting be the sole reporting for such CFCs that are life insurance companies, thus eliminating the need for Form 1099 reporting.

ACLI also submitted a letter in December 2013³ requesting that FATCA's implementation date be delayed by at least an additional six months to Jan. 1, 2015, noting that a July 2014 implementation date was too early a date for government and withholding agents alike. The letter stressed the need for final chapter 4 regulations, conforming chapter 3, 4, and 61 regulations, and final FATCA related forms and instructions before withholding agents are able to fully understand, implement and finalize changes that need to be made to policies, procedures and systems to meet their FATCA obligations.

In April 2014, Treasury and the IRS facilitated compliance with FATCA by releasing Announcement 2014-17⁴, which allowed taxpayers to treat jurisdictions that have reached agreements in substance with the United States on the terms of IGAs to implement FATCA to be treated as having agreements in effect for the remainder of 2014.

While the government did not delay the July 1, 2014 implementation date for FATCA, it provided for transitional relief

CONTINUED ON PAGE 32

in Notice 2014-33. Notice 2014-33 stated that “calendar years 2014 and 2015 will be regarded as a transition period for purposes of IRS enforcement and administration of the due diligence, reporting, and withholding provisions under chapter 4, as well as the provisions under chapters 3 and 61, and section 3406, to the extent those rules were modified by the temporary coordination regulations.” The IRS will take into account the extent to which foreign financial institutions and withholding agents have made “good faith efforts to comply with the requirements of chapter 4 and temporary coordination regulations.” The government made clear in the Notice that entities that have “not made good faith efforts to comply with the new requirements will not be given any relief from IRS enforcement during the transition period.”

The Notice also allows withholding agents and foreign financial institutions “to treat any obligation held by an entity that is issued, opened, or executed on or after July 1, 2014, and before Jan. 1, 2015, as a preexisting obligation for purposes of the due diligence and withholding requirements applicable to preexisting obligations.” ◀

END NOTES

- ¹ The government released its first set of technical corrections to the 2013 Final regulations in September 2013. <http://www.gpo.gov/fdsys/pkg/FR-2013-09-10/pdf/2013-22004.pdf>
They also released Notice 2013-43, which provided a six-month delay, to July 1, 2014, for FATCA withholding requirements. <http://www.irs.gov/pub/irs-drop/n-13-43.pdf>
- ² See, ACLI letters dated November 9, 2001, November 8, 2009, and April 29, 2011.
- ³ https://members.acli.com/Committees/Committees and Informal Groups/Withholding and Information Reporting Task Force/Documents/ACLI_Letter_on_Notice_2013-43_12-26-13.pdf
- ⁴ <http://www.irs.gov/pub/irs-drop/a-14-17.pdf>



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