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ACLI UPDATE
FOREIGN ACCOUNT TAX COMPLIANCE ACT (FATCA)

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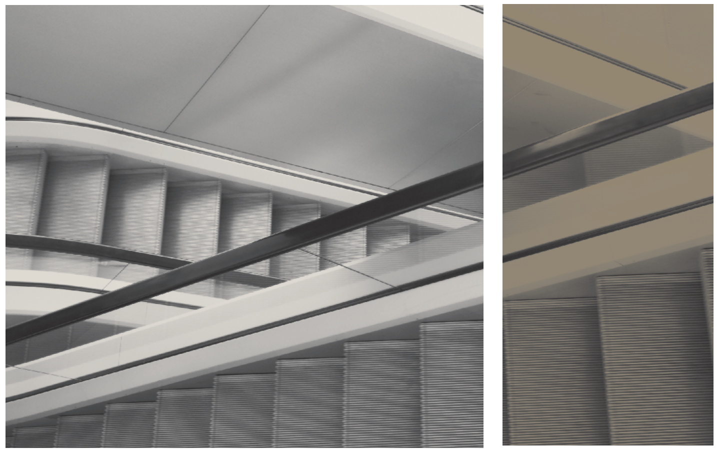

On April 23, 2012, ACLI submitted a comment letter on the proposed regulations to implement the Foreign Account Tax Compliance Act ("FATCA"). The letter provides, in detail, recommendations that identify critical changes for the government to consider in devising life insurance-specific rules; it also requested clarification of the life insurance-specific rules and recommended approaches to assist the government and the industry in Chapter 4 enforcement and compliance. We requested that new categories of deemed-compliant companies be provided so that life insurers could comply with FATCA, and we recommended that the rules for Controlled Foreign Corporations ("CFCs") and retirement funds be modified to address FATCA's purpose and reduce compliance costs. Specifically we requested:

- Life insurance companies in jurisdictions where local law prohibits the transmittal of personal information as required by Chapter 4, and for which an Intergovernmental Agreement ("IGA") is not in place, should be provided an exemption from Chapter 4 until such time as the U.S. government reaches a solution with such foreign government(s) to address the local law prohibitions.
- Life insurance companies that are Foreign Financial Institutions (FFIs) should qualify as registered deemed-compliant with the requirements under Chapter 4 if they have procedures in place that prohibit them from selling to, and if they do not market policies to, persons who are not residents in the jurisdictions where they are licensed to operate. The final regulations should include a deemed-compliant category for insurance companies; we provided a list of conditions that would enable an insurance company to qualify as deemed-compliant.
- An additional category of deemed-compliant FFIs should be included in the final regulations to address insurance FFIs that exist only to service closed blocks of life insurance and annuity contracts where the companies no longer issue any new policies.
- Life insurance and annuity contracts acquired in a merger or acquisition should be classified in the same manner as pre-existing contracts and not subject to Chapter 4 rules retroactively even if the acquiring company has already entered into an FFI agreement.
- Foreign life insurance companies that are classified as CFCs should be treated as having complied with their reporting obligations under the IRC if they fulfill requirements under Chapter 4. We requested that the provisions under 6041 and 6049 related to the current information reporting rules be modified so they conform to the Chapter 4 presumptions of non-U.S. person status unless objective U.S. taxpayer indicia becomes apparent in the ordinary course of business.
- The registered deemed-compliant requirements for retirement funds should be modified to encompass Privatized Government Pension Plans where no single beneficiary has the right to more than 5 percent of the FFI's assets or the FFI assets are held solely for a participant in a government designed broad-based pension system.

We also recommended changes to definitions and guidelines proposed in the rules; in particular we recommended:

- The definitions of annuities and life insurance contracts should be clarified to state that for the purposes of Chapter 4, a contract is an annuity or a life insurance contract if it is regulated as an annuity or a life insurance contract in the jurisdiction where the contract is issued.
- The definition of cash value insurance contracts should be defined as the amount that a policyholder is entitled to receive upon the termination or surrender of the contract.
- The scope and definition of term life insurance contracts should include life insurance contracts that provide coverage for a stated duration and the amount paid upon termination cannot exceed aggregate premiums paid for the contract.
- Indemnity reinsurance contracts should be excluded from the definition of a financial account. The account holder of this type of account is not an individual but rather an insurance company or a reinsurance company engaging in normal risk transfer transactions in the ordinary course of business. This type of contract does not allow for an in-

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dividual or a non-insurance entity to invest in the account. We requested clarification that indemnity reinsurance is excluded and request that such contracts expressly be exempted from the definition of a financial account.
- The definition of life insurance and annuity contracts that qualify as grandfathered obligations should be clarified to indicate that the definitions include life insurance contracts that are payable upon surrender or death and annuity contracts whose term-certain includes lifetime payouts.
- There should be a $50,000 de minimis threshold provided for all cash value insurance contracts issued after the date of the Foreign Financial Institution ("FFI") agreement. This carve-out, currently provided only for depository accounts, would provide relief to many insurance companies that only issue low cash value insurance products.
- The requirement for review of documentary evidence every three years should be eliminated and replaced by a requirement to review documentary evidence when a change in circumstances revealing objective indicia of U.S. taxpayer status occurs.
- Some restrictions surrounding the exclusion of pension and retirement accounts should be modified or removed to provide meaningful relief for such accounts. The $50,000 annual contribution limit and the restriction of contributions of earned income to retirement accounts should be removed from the final regulations.

ACLI and its member company representatives continue to discuss the industry's comments and identify additional topics with the U.S. Department of the Treasury ("Treasury") and Internal Revenue Service ("IRS") officials as the government considers the final rules to adopt in implementing FATCA.

The required minimum distribution rules had the potential to frustrate the use of longevity annuities in qualified plans and IRAs.

PRINCIPLE-BASED RESERVES

In a letter to the Internal Revenue Service and Treasury dated May 1, 2012, the ACLI requested that the Service include on its Guidance Priority List for 2012-2013 numerous items of critical interest to life insurers. One item reflected in the ACLI letter was a request for guidance on tax issues arising under § 807 of the Internal Revenue Code as a result of the adoption by the National Association of Insurance Commissioners ("NAIC") of a principle-based approach to certain life insurance reserves. The ACLI had made a similar request for inclusion of this item on the IRS 2011-2012 Guidance Priority List.

The NAIC's Life Actuarial Task Force vote to expose the NAIC Valuation Manual on June 19, 2012, represented an important step in the NAIC's consideration of PBR and an appropriate juncture for ACLI and Treasury/IRS to continue their dialogue on PBR tax guidance. Discussions will cover further Treasury/IRS consideration of the PBR tax issues first addressed in Notice 2008-18.

ACLI will update *Taxing Times* readers as events unfold.

LONGEVITY ANNUITIES: COMING SOON TO YOUR RETIREMENT PLAN OR IRA

Longevity annuities provide income starting later in retirement. Also known as longevity insurance, payments under these deeply deferred payout or income annuities typically begin on or before age 85 on either a single or joint lives basis. The required minimum distribution rules had the potential to frustrate the use of longevity annuities in qualified plans and IRAs. Under these rules, payments must commence from qualified plans, including 401(k), 403(b), and governmental 457(b) plans, and IRAs starting at age 70½ (or, if later, retirement for most participants in qualified plans). These minimum payments are determined based upon the total account balance held in the plan or IRA(s) as of the prior calendar year-end, including the value of any annuity contracts that are not yet in pay status. Without specific guidance there is a concern that a longevity annuity in qualified plans or IRAs would require greater proportional distributions from the remaining assets that could deplete the plan or IRA account even as annual tax liabilities continue to accrue. ACLI and its members have been seeking additional guidance and legislation to resolve these concerns.

On Feb. 3, 2012, Treasury and IRS proposed regulations to exclude certain annuity contracts from the minimum distribution rules.[1] To qualify for the proposed exclusion, the contract must be a "qualifying" longevity annuity contract or "QLAC." A QLAC is an annuity contract (other than a variable annuity, an equity indexed annuity or similar contract) in which:

- Payments commence no later than age 85.
- The contract satisfies the generally applicable minimum distribution requirements, for example, the limitation on increasing payments.
- The contract does not provide a cash surrender value or similar feature.
- The only benefit payable to a beneficiary is a life annuity.
- The contract states that it is intended to be a QLAC.

Limitations. There is a limit to the amount of QLAC an individual may purchase under the proposed rule. The QLAC exclusion is lost if premiums are in excess of either of these limits:

> Plan/IRA Percentage Limit: Premiums paid may not exceed 25 percent of the individual's account balance on the date of payment (reduced by the amount of any previous QLAC purchased). This limit applies separately to each qualified plan. For traditional IRAs, the limit applies to the aggregate of all of the individual's traditional IRA account balances.
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> Individual Dollar Cap: An individual's total QLAC premiums under qualified plans and IRAs cannot exceed $100,000.

Example: Pat is a participant in a 401(k) plan and also has 2 IRAs. On Dec. 31, 2012, Pat has $100,000 in the 401(k) plan, while each of Pat's IRAs has $20,000. In 2013, Pat may purchase a QLAC with no more than $25,000 under the 401(k) plan (25 percent of $100,000) and a QLAC with no more than $10,000 under an IRA (25 percent of $40,000). These QLAC premiums of $35,000 are less than the $100,000 individual dollar cap.

Treasury and IRS have gathered public comments and held a public hearing on the proposal, and they seem intent on considering changes to make these rules workable for taxpayers, plans and IRA providers. While there may be changes to the limitations in the final rule, expect to see Treasury and IRS retain a percentage limit.

In the preamble to the proposed regulation, Treasury and IRS note that a percentage limitation is necessary in order to be consistent with the pattern of minimum payments required over the life or life expectancy of participants as implemented under the current regulations. They note that the 25 percent limit ensures an overall pattern of payments from the remaining account balance and the longevity annuity that does not provide more deferral than would otherwise be available under the current regulations. Continued efforts on legislative proposals to allow even greater use of longevity annuities is also expected.

END NOTES

[1] For an in-depth discussion of the provisions of the proposed regulation, readers are referred to the article in the May 2012 issue of *Taxing Times*. *See*, Christian DesRochers, Proposed Regulation to Accommodate Longevity Annuities in Retirement Plans, *Taxing Times* (May 2012).

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