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PRACTITIONERS' CORNER

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On January 17 Treasury and the IRS released final regulations implementing the Foreign Account Tax Compliance Act provisions enacted in 2010.[1] The proposed regulations[2] included several provisions specific to insurance companies, as well as general provisions, which were of concern to insurance companies, thus provoking comment from hundreds of interested parties and stakeholders. Comments on the proposed regulations were submitted by insurance companies, industry associations, and the Insurance Companies Committee of the American Bar Association Section of Taxation.[3]

We applaud the IRS's and Treasury's willingness to meet with interested parties to hear ideas about refining the proposed regulations and making the FATCA rules administrable. We had the opportunity to discuss the issues raised in the ABA comments with IRS and Treasury officials in various meetings and public forums. The individuals we interacted with truly listened to the issues and concerns we raised, and we acknowledge their dedication and thoughtfulness — even though we didn't agree on all issues.

The preamble to the final regulations outlines the numerous insurance-specific comments and suggestions received. It explains whether specific comments were incorporated into the final regulations and, if not, the rationale for rejecting a particular comment. All in all, the final regulations are exemplary in their responsiveness to commentators, although, as expected, they are not perfectly accommodating in that they do not adopt all of the changes suggested by insurance industry-specific commentators. Indeed, in one area, the entity status of section 953(d) companies, we believe the final regulations flatly contradict the statute and overstep the bounds of permissible regulatory action.

This article provides an overview of the insurance-specific ABA comments, outlines the IRS's and Treasury's responses to those comments, and discusses selected aspects of the final regulations that are relevant to many insurance companies' business and ongoing FATCA compliance activities.

Common-Sense Timing: Reporting Periods

Proposed Regulations

The proposed regulations required a participating foreign financial institution (FFI) to report annually the name, address, account balance, and payments for each

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[1] T.D. 9610.

[2] REG-121647-10.

[3] The authors of this article drafted the ABA comments along with two other attorneys. *See* ''ABA Section of Taxation Comments on Proposed Regulations Under the Foreign Account Tax Compliance Act Offset Provisions of the HIRE Act, P.L. 111-147 Relating to Insurance Issues'' (June 15, 2012).

U.S. account holder.[4] Insurance companies objected that the provision imposed substantial compliance costs that were likely to yield little valuable data after the initial report was filed, and that it would do little to further the statute's goal of preventing tax avoidance. The proposed regulations linked reporting requirements for banks and investment entities to their regular points of contact with customers — monthly and annual reporting of account values.

ABA Comments

The ABA comments recommended that compliance requirements for insurance companies follow the natural points of contact between insurance companies and their policyholders, just as they do for banks. For insurance companies, contacts with customers occur almost exclusively at policy inception, upon a change of circumstances, and at the payment of benefits, withdrawals, or termination amounts. The ABA comments requested that reporting for insurance companies match those contact points. Adopting those points for reporting would ensure that the IRS could track payments that may be taxable in the United States and would still be consistent with reporting requirements in many European companies, so that compliance costs for modifying existing reporting programs would be reduced.

Insurers also requested that the requirement for revalidation of a policyholder's status as a foreign account every three years be suspended for insurance and annuity contracts. Historically, insurance company policyholders have a very low response rate to company mailings. Nonetheless, failure to respond will place an account holder in the ''recalcitrant account'' category and trigger a requirement to close the account or withhold on payments.

Outcome

The final regulations made no changes to the timing of reports by insurance companies. They also retain the three-year rule for refreshing documentation,[5] but they permit several low-risk categories of documentation to remain valid indefinitely, unless the withholding agent has knowledge of a change in circumstances. The many exceptions are based on the type of payee supplying the written statement or documentation,[6] and they are available for certificates regarding all types of financial accounts, including cash value insurance contracts (CVICs) and annuities. The exceptions should cover most account holders of a CVIC or annuity. For example, for a U.S. account, such as a life insurance contract issued by a U.S. company, a withholding certificate from a non-U.S. individual (Form W-8) is valid indefinitely if it is accompanied by documentary evidence establishing foreign status, and the withholding agent does not have a current U.S. residence, mailing address, or telephone number for the account holder. For a non-U.S. obligation, a participating FFI is required to obtain either a withholding certificate or documentary evidence, which would be valid indefinitely as long as there are no current U.S. indicia. Similarly, indefinite validity will apply to a withholding certificate accompanied by documentary evidence that is furnished by a retirement fund, an excepted nonfinancial foreign entity (NFFE), a publicly traded NFFE, an active NFFE not engaged in a financial business, or a nonprofit organization. A withholding statement or written statement will have indefinite validity if provided by a participating FFI or registered deemed-compliant FFI that has furnished a government-issued identification number (GIIN), or the FFI has verified the GIIN on the IRS list of FFIs. Also, a withholding certificate will qualify for indefinite validity if provided by an intermediary, flow-through entity, U.S. branch, foreign government, foreign central bank, or international organization; or if it is documentary evidence that is generally not renewed or amended ''such as a certificate of incorporation.''

While relaxation of the refreshment requirement is helpful, this rule does not alleviate initial documentation requirements. Insurance companies will want to obtain all required documentation from new customers as they are on-boarded and confirm the accuracy of this documentation before making withholdable payments.

'Clarification' or Reiteration?

Proposed Regulations

The proposed regulations provided that the definition of a financial account includes any equity or debt interest (other than interests that are publicly traded) in specified financial institutions, including insurance companies, but ''only if the value of the debt or equity interest is determined, directly or indirectly, primarily by reference to assets that give rise to withholdable payments.''[7]

ABA Comments

The ABA comments noted that the proposed regulations do not define what types of equity and debt instruments are encompassed by this provision. The comments also pointed out that, if applied broadly, this rule could apply to all foreign insurance companies that issue non-publicly traded stock because a primary determinant of the value of an insurance company's stock is the value of the investment assets that the insurance company holds. The ABA comments suggested that the provision be drafted narrowly as an antiavoidance rule that would apply only when it appears the

[4]Prop. reg. section 1.1471-4(d)(3).

[5]Reg. section 1.1471-3(c)(6)(ii)(A).

[6]Reg. section 1.1471-3(c)(6)(ii)(B).

[7]Prop. reg. section 1.1471-5(b)(1)(iii).

primary purpose for the U.S. holder's ownership of the equity or debt instrument is to avoid application of chapter 4. The comments also requested that the final regulations include specific examples illustrating the types of abusive situations the provision was designed to prevent.

Outcome

The final regulations respond to those comments by:

- describing what types of debt and equity interests in an insurance company are financial accounts; and
- including an antiavoidance rule under which an interest that is issued with ''a principal purpose of avoiding the reporting or withholding requirements of chapter 4'' is the type of debt or equity interest that constitutes a financial account.[8]

Reg. section 1.1471-5(b)(3)(v) provides separate rules for debt and equity interests. For an equity interest in a financial institution to constitute a financial account, the amount payable upon redemption must be either secured or determined (if an unsecured interest) primarily by reference to assets that give rise (or could give rise) to withholdable payments, that is, U.S.-source payments of fixed or determinable annual or periodic income or gross proceeds.[9] For a debt interest in a financial institution to constitute a financial account, either:

- it must be convertible into U.S. stock;
- interest payments (or the redemption/retirement price) on the debt must be determined ''primarily by reference to'' profits or assets of a U.S. person; or
- it must be secured by the assets of a U.S. person.[10]

While this clarification narrows the categories of debt and equity interests that might be considered financial accounts, there are still some open questions, and no examples of financial account-type debt and equity are provided. The preamble to the final regulations does clarify, however, that debt or equity interests in holding companies and treasury centers of expanded affiliated groups whose aggregate income is derived primarily from insurance companies are not financial accounts.

Unfortunately, no examples are provided to illustrate a ''principal purpose'' issuance of debt or equity that would be subject to the antiavoidance rule. That omission may allow the IRS and Treasury flexibility to judge each potential avoidance situation on facts and circumstances as it arises — but it also breeds uncertainty regarding how not to run afoul of the rule. Accordingly, insurers will need to consider this somewhat amorphous antiavoidance rule when offering new investments and when undergoing reorganizations or recapitalizations.

Over the next year or so, we would expect Treasury and the IRS to gain experience with the debt-equity issues of concern to them. Once that learning period ends, we would suggest that the IRS publish a notice or revenue ruling that provides examples of both acceptable and problematic arrangements under the antiavoidance rule, with the goal of amplifying the antiavoidance rule to facilitate compliance.

'How Many Tests Does It Take . . . ?'

Proposed Regulations

The proposed regulations define four categories of financial institutions for purposes of FATCA, including ''an insurance company (or the holding company of an insurance company) that issues or is obligated to make payments with respect to a financial account.''[11] Under the proposed regulations, financial accounts included depository accounts, custodial accounts, specified types of equity and debt interest (discussed above), and CVICs and annuity contracts.

The proposed regulations did not specifically address the chapter 4 status of a non-U.S. company licensed and regulated as an insurance company under the laws of its country of domicile that does not meet the definition of an insurance company in prop. reg. section 1.1471-1(b)(33). This might occur, for example, when a company's insurance premiums, reserves, or insurance claims payments for the year that its chapter 4 status is being determined are minimal compared with its investment income, or when a company issues a substantial volume of insurance products that qualify as insurance for non-U.S. purposes but do not qualify as insurance for U.S. federal income tax purposes.

ABA Comments

The ABA comments suggested that a non-U.S. insurance company that does not issue CVICs or annuity contracts should not be treated as an FFI under the non-insurance FFI tests.

Outcome

The final regulations confirm that insurance companies that do not issue CVICs and annuities can be NFFEs.[12]

The final regulations adopt the terminology of the intergovernmental agreements (IGAs) and provide that

[8] Reg. section 1.1471-5(b)(1)(iii)(C)(1)-(2).

[9] Reg. section 1.1471-5(b)(3)(v)(A).

[10] Reg. section 1.1471-5(b)(3)(v)(B).

[11] Prop. reg. section 1.1471-5(e).

[12] We note that a guaranteed investment contract gives rise to a depository account under reg. section 1.1471-5(b)(3)(i), so the issuer of that contract likely has a FATCA reporting duty and possibly a withholding obligation.

a ''specified insurance company'' is an FFI. The final regulations expressly do not adopt the ABA comments' recommendations on the broader point that insurance companies, which have their own FFI category, not be subject to all FFI tests. To the contrary, the preamble provides that ''an insurance company that is not a specified insurance company must independently determine whether it is a depository institution, custodial institution, or investment entity.'' That rule perpetuates the uncertainty of FFI or non-FFI status for some insurance companies that do not issue CVICs or annuities, have minimal underwriting income in a particular year, or are in runoff.

The final regulations provide relief to some insurance companies in that the reserving activities of an insurance company do not alone trigger FFI status.[13] This explanation apparently is designed to address concerns about the status of runoff companies or companies that have little premium income in a particular year. Although the final regulations contain hundreds of definitions specific to FATCA, the term ''reserving activities'' is not defined. It may be that formulating a definition of reserving activities would be next to impossible; indeed, Treasury and the IRS may appreciate additional comments on this point. Because the type and duration of an insurance company's investment activities are directly keyed to its obligations under insurance contracts, the ''reserving'' category likely covers a broad range of activity.

Reinsurance 'in the Clear'?

Proposed Regulations

A reinsurance exception provided in the proposed regulations[14] lacked the clarity sought by the industry. It excluded from the definition of cash value an amount payable under an insurance contract as a ''benefit providing indemnification of an economic loss incurred upon the occurrence of the event insured against.'' Industry tax professionals asked whether this meant that life reinsurance covering cash value insurance or annuity contracts would be excluded. Moreover, IRS officials commented in public forums that the reinsurance exception applied only to indemnity reinsurance but not to assumption reinsurance, in which the assuming reinsurer stands in the shoes of the ceding company, and assumes a direct relationship to policyholders by collecting premiums and paying benefits directly. Assumption reinsurance is rarely used; indemnity reinsurance accounts for the vast majority of reinsurance contracts.

ABA Comments

The ABA comments sought greater clarity in the exception for reinsurance from the definition of cash value contracts treated as financial accounts. In Notice 2010-60, 2010-37 IRB 329, the IRS acknowledged that reinsurance does not present the threat of tax avoidance that is of concern under FATCA: ''Treasury and IRS do not view the issuance of insurance and reinsurance contracts without cash value as implicating the concerns of chapter 4.'' Continuing, the notice said that the regulations will treat ''entities whose business consists solely of issuing such contracts as nonfinancial institutions for purposes of chapter 4.''

The ABA comments noted that a persuasive policy reason exists for creating an exception from the definition of a financial account for reinsurance: Reinsurance is a business-to-business transaction between a ceding insurance company and a reinsurer, and payments under reinsurance contracts depend on the ceding company's underwriting experience, not on the reinsurer's investment experience. There is no direct contractual relationship between the assuming reinsurer and individual policyholders whose risks are covered by the ceding company. Clearly, reinsurance does not present the opportunity for tax avoidance that is the concern of FATCA.

Outcome

The final regulations preserve the exclusion from cash value for the benefits providing indemnification of an economic loss. Also, reg. section 1.1471-5(b)(3)(vii) defines a financial account as an ''insurance contract (*other than an indemnity reinsurance contract* between two insurance companies)'' (emphasis added). A more complete statement of the rule distinguishing between indemnity and assumption reinsurance, or permitting an express exclusion for life reinsurance but not for assumption reinsurance, would have been preferable. For those who know the exception's history, however, the final regulation is effective in clarifying that indemnity reinsurance alone is insufficient to cause a non-U.S. entity to be an FFI.

Cash Value Clarified

Proposed Regulations

The proposed regulations provided an exclusion from cash value for:

> a refund to the policyholder of a previously paid premium under an insurance contract (other than under a life insurance or annuity contract) due to policy cancellation, decrease in risk exposure during the effective period of the insurance contract, or arising from a redetermination of the premium due to correction of posting or other similar error.[15]

This exclusion incorporates the definition of a return premium from reg. section 1.832-4, which applies

[13]Reg. section 1.1471-5(e)(6).

[14]Prop. reg. section 1.1471-5(b)(3)(v)(C)(1).

[15]Prop. reg. section 1.1471-5(b)(3)(v)(C)(2).

to property and casualty insurance companies. This definition, however, does not describe all possible circumstances in which an amount could be paid to a contract holder that is clearly not an investment return or typical cash value.

The IRS had indicated its intent that return premiums on property and casualty and health insurance contracts would not convert what is otherwise pure property and casualty insurance to a CVIC.

ABA Comments

The ABA comments pointed out that some experience rating features of property and casualty contracts, such as retrospective credits and even medical loss ratio rebates, could be construed as cash value despite this exception. The ABA comments suggested that a return of premium under an insurance contract be excluded from cash value, as long as the return premium does not exceed the premiums paid under the contract.

Outcome

The final regulations amend the exclusions from cash value, as follows:

- amounts payable solely by reason of the death of the insured under a life insurance contract are excluded;
- refunds of previously paid premium (net of the cost of insurance) are also excluded; and
- a return of advance premium or a premium deposit is excluded as long as (1) the contract requires annual premiums and (2) the advance premium or deposit does not exceed the next annual premium payable.

Treasury and the IRS ''did not accept comments requesting that return of premium be permitted to the extent it did not exceed the aggregate premiums paid for the contract, without regard to mortality, morbidity, and expense charges,'' and the preamble explained that those instruments ''implicate the policy objectives of chapter 4.'' Nonetheless, with the overlay of the greater-than-$50,000 minimum to qualify as cash value, these clarifications put to rest some of the most troubling questions about specific policy features that do not neatly fit within the return premium definition of reg. section 1.832-4.

Some In-Scope Product Definitions Improved

Proposed Regulations

The proposed regulations defined insurance contracts by incorporating provisions under the code applicable to U.S. insurance contracts.[16] For example, the proposed regulations defined an annuity contract as a contract that would be an annuity under section 72 (without regard to subsections (s) and (u) and section 817(h)), and they defined a life insurance contract as a contract that satisfies section 7702 (without regard to subsections (b), (c), and (d) and sections 101(f) and 817(h)).

ABA Comments

The ABA comments pointed out that the definitions under the regulations must serve as the foundation for the application of the FATCA regime to products issued by foreign insurance companies, which may not be familiar with the tax regime applicable to U.S. tax-compliant products. There was concern that the proposed regulations did not provide clear definitions of insurance contracts that constitute ''financial accounts'' sufficient to allow foreign insurance companies to determine the status of various contracts as financial accounts. The ABA comments suggested a simple, global, and inclusive approach be used in defining products, and they recommended that the definitions of annuity contract and life insurance contract be grounded in the home-country law applicable to those products.

Outcome

The preamble to the final regulations states that in response to comments, references to U.S. tax law rules have been replaced with plain language definitions, and the final regulations incorporate, where appropriate, references to local law definitions and practices. Note, however, that the applicable definitions in the final regulations may be supplanted by the terms of an applicable IGA. The final regulations clarify and expand the definition of annuity contract and clarify the definition of life insurance contract in reg. section 1.1471-1(b)(5), (25), (56), (58), (65), (68), and (69).

Although the final regulations adopt the suggestion that the definitions not incorporate U.S. tax law provisions and strive for plain language definitions, the addition of multiple sub-definitions of types of annuity contracts may complicate matters. Proper application under relevant home-country law may have to be addressed through an applicable IGA for products that don't fit neatly within one of the more specific annuity definitions. The final regulations provide the following definitions applicable to annuity contracts:

- reg. section 1.1471-1(b)(5): annuity contract;
- reg. section 1.1471-1(b)(25): deferred annuity contract;
- reg. section 1.1471-1(b)(56): group annuity contract;
- reg. section 1.1471-1(b)(58): immediate annuity;
- reg. section 1.1471-1(b)(65): investment-linked annuity contract; and
- reg. section 1.1471-1(b)(68): life annuity contract.

The final regulations provide a single definition of life insurance contract at reg. section 1.1471-1(b)(69). Unlike the definition of annuity contract, it does not reference home-country law but similarly clarifies that U.S. tax law definitions are not relevant:

[16]Prop. reg. section 1.1471-1(b)(4) and (b)(35).

> *Life insurance contract.* The term life insurance contract means an insurance contract under which the issuer, in exchange for consideration, agrees to pay an amount upon the death of one or more individuals. That a contract provides one or more payments (for example, for endowment benefits or disability benefits) in addition to a death benefit will not cause the contract to be other than a life insurance contract. For purposes of the preceding sentence, it is immaterial whether a contract satisfies any of the substantive U.S. tax rules (for example, sections 101(f), 817(h), 7702, or investor control prohibition) applicable to the taxation of the contract holder or issuer.

The final regulations are generally consistent with the recommendations made by the ABA comments. Issues may arise concerning alignment of the multiple annuity definitions with specific types of foreign products, but in many instances those issues may be resolved through the terms of an applicable IGA, which would supplant the definitions provided by the final regulations.

Cash Value Insurance Contracts

Proposed Regulations

The proposed regulations define a cash value insurance contract, which is a financial account for FATCA purposes, as an insurance contract that has a cash value of greater than zero.[17] Cash value means the greater of the amount the policyholder is entitled to receive on surrender or termination of the contract (determined without reduction for any surrender charge or policy loan) and the amount the policyholder can borrow under or regarding the contract.[18] The proposed regulations include some exceptions to cash value, including amounts payable as a personal injury or sickness benefit, some premium refunds, and some policyholder dividends (as defined in section 808 but without regard to paragraph (b)(2) of that section). Some term life insurance contracts are excluded from the definition of CVIC.[19]

ABA Comments

The ABA comments noted that the proposed regulations' definition of CVIC is too broad in some places and too narrow in others. Several suggestions were made to assist in narrowing and refining the scope of the contracts that would be captured. First, the ABA comments suggested including a de minimis exception to cash value, which would still allow the IRS and Treasury to obtain relevant information regarding the types of accounts FATCA is meant to target. For purposes of clarification, the ABA comments recommended that the definition of insurance contract be grounded in the home-country law applicable to those products and that the definition of term life insurance contract be revised to encompass all contracts providing traditional term life insurance protection, regardless of whether premiums are payable annually or more frequently while the contract is in force.

Outcome

The final regulations adopt some of the suggestions provided in the ABA comments and reject others. The final regulations provide a $50,000 exception for CVICs by amending the definition of a CVIC to require a minimum cash value greater than $50,000. Aggregation rules apply when determining whether this theshold is met.[20] The final regulations also provide, presumably for administrative convenience, that a participating FFI may elect to disregard the $50,000 threshold by reporting all contracts with a cash value greater than zero.

The final regulations, at reg. section 1.1471-1(b)(61), include a definition of insurance contract for purposes of FATCA:

> *Insurance contract.* The term insurance contract means a contract (other than an annuity contract) under which the issuer in exchange for consideration agrees to pay an amount upon the occurrence of a specified contingency involving mortality, morbidity, accident, liability, or property risk.

The intersection between the definition provided and home-country law will presumably have to be sorted out through IGAs. The final regulations do not broaden the exclusion of term life insurance to include all contracts providing traditional term life insurance protection, although they do narrow the types of contracts being captured under the cash value provisions by excepting both term life insurance contracts and indemnity reinsurance contracts from the CVIC definition.

The relationship between the final regulations' definition of term life insurance and otherwise traditional term life insurance that is apparently targeted for inclusion in the cash value analysis is not immediately evident; it is unclear why any type of term life contracts would be treated as having cash value. However, the final regulations provide that a term life insurance contract must provide for periodic premiums, which do not decrease over time and are payable at least annually during the period the contract is in existence or until the insured reaches age 90, whichever is shorter. The final regulations also impose restrictions on the ability to access contract value without terminating the contract, and they specify that the amount (other than

[17]Prop. reg. section 1.1471-5(b)(3)(v)(A).

[18]Prop. reg. section 1.1471-5(b)(3)(v)(B) and (C).

[19]Prop. reg. section 1.1471-5(b)(2)(ii).

[20]Reg. section 1.471-5(b)(3)(vii) and (b)(4)(iii).

a death benefit) payable upon cancellation or termination of the contract cannot exceed the aggregate premiums paid for the contract, less the sum of mortality, morbidity, and expense charges (whether or not actually imposed) for the period or periods of the contract's existence and any amounts paid before the cancellation or termination of the contract. Finally, a term life insurance contract is not excepted from the definition of cash value insurance contract if it is held by a transferee for value.

With the exception of setting a $50,000 de minimis exclusion for CVICs, the final regulations generally do not adopt the ABA comments. The revised definition of term life insurance contract may preserve some of the U.S.-foreign product disconnect in that products providing traditional term life coverage in foreign jurisdictions but not requiring annual or more frequent premium payments during the term of the policy or to age 90 do not qualify for the term life exception to financial account status.

Currency Translation Clarified

Proposed Regulations

The proposed regulations require FFIs to determine and report account values at the outset of their FFI agreements and as part of their ongoing reporting requirements. For non-U.S. entities, accounts may be kept in U.S. dollars or another country's currency. The rules in the proposed regulations for converting the account values of non-U.S.-dollar-denominated accounts to U.S. dollars are varied. Conversion to U.S. dollars is required for initial due diligence but not necessarily required for other instances in which account value must be calculated.

ABA Comments

The ABA comments recommended that the IRS publish the applicable spot rate used for converting non-U.S.-dollar-denominated account balances to U.S. dollars for preexisting accounts as of an FFI's first year of determination, and periodically thereafter for new FFIs entering the FATCA compliance regime, to facilitate an FFI's implementation of the due diligence and reporting requirements.

Outcome

Rather than implementing a mechanism for publishing spot rates, the final regulations provide generally that the account values may be reported in U.S. dollars or in the currency in which the account is denominated. The final regulations provide rules applicable to the calculation of the account balance or value for determining whether an account meets (or continues to meet) applicable FATCA thresholds. The spot rate to be used is the rate for the date for which the FFI is determining the threshold amount. The spot rate must be determined as of the last day of the calendar year (or, for an annuity, the most recent contract or anniversary date, when applicable) for which the account is being reported or, if the account was closed during the calendar year, the date the account was closed.

Although the final regulations provide more clarity and consistency in connection with calculating account balances and currency conversion, they do not adopt the suggestion that the IRS publish the applicable spot rate in an annual publication.

No Surprise, Disappointment: Premiums

Proposed Regulations

The insurance industry was alarmed by the proposed regulations' classification of insurance premiums as withholdable payments subject to withholding for FATCA purposes. Historically, cross-border outbound insurance and reinsurance premiums have been excepted from withholding for chapter 3 purposes because they generally are subject to the federal excise tax under section 4371.[21] That exception applies to life and annuity, property-casualty, and reinsurance premiums paid to foreign insurers. Under the proposed regulations, however, a withholdable payment includes FDAP income,[22] and FDAP income is defined by reference to reg. section 1.1441-2(b)(1) or -2(c),[23] which includes insurance premiums.

ABA Comments

The ABA comments recognized that treating life and annuity premiums as withholdable payments had a sound rationale, because it provided the government leverage in persuading FFIs to register with the IRS to avoid withholding. However, because a property-casualty insurer and a reinsurer write products that are not financial accounts, and therefore would not otherwise be FFIs, the comments argued that an exception should be granted for property-casualty and reinsurance premiums.

Outcome

The preamble to the final regulations states that insurance and reinsurance premiums:

> are exempt under chapter 3, however, because the excise tax under section 4371 is an adequate substitute for tax on the business income of a foreign issuer. In contrast, withholding under chapter 4 is intended as an incentive to FFIs to become participating FFIs, rather than as a proxy for the tax on the income of the issuer. As a result, the policy reasons for the exclusion of such insurance and reinsurance premiums for purposes of chapter 3 withholding are not relevant for chapter 4 withholding. The final regulations therefore do not adopt this comment.

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[21]Reg. section 1.1441-2(a)(7).

[22]Prop. reg. section 1.1473-1(a)(1)(i).

[23]Prop. reg. section 1.1473-1(a)(2)(i)(A).

Given that these premiums would ordinarily be paid as a routine accounts payable function, the inclusion is neither logical (these payments are nonfinancial under the rules) nor functional. Although the preamble does not explain the rationale further, an additional factor may have been the desire to collect the names of any substantial U.S. owners of non-U.S. property-casualty and reinsurance companies. Property-casualty insurers and reinsurers (and life insurers that do not write cash value life insurance and annuity contracts) are NFFEs, which are required to provide the withholding agent the names of their substantial U.S. owners,[24] *unless* they are part of a publicly traded group.[25] The publicly traded exception should cover most large insurers. Nonetheless, agents, brokers, and insurers will be required to determine the FATCA status of foreign insurance companies before transmitting premium payments, and they will need to maintain records of a payee's status to demonstrate their compliance with FATCA.

Does the Code Mean What It Says?

Proposed Regulations

Although it seemed clear to practitioners that a controlled foreign corporation insurance company that elects to be taxed as a U.S. company under section 953(d) (a section 953(d) company) is not an FFI because those companies are treated as domestic corporations for all purposes of the code, the proposed regulations did not specifically address the status of those companies. The code and proposed regulations provided that an FFI is any financial institution that is a foreign entity, and an NFFE is a foreign entity that is not a financial institution. A foreign entity, as defined under the code and proposed regulations, constitutes any entity that is not a U.S. person. A U.S. person, in turn, is defined by section 7701(a)(30) as including a domestic corporation. If a CFC that is an insurance company makes an election under section 953(d)(1), ''for purposes of [Title 26], such corporation shall be treated as a domestic corporation.''

ABA Comments

Noting that although it seemed clear under the code and proposed regulations that a section 953(d) company was not an FFI, the ABA comments recommended that the final regulations explicitly address that point. They requested that a foreign insurance company that is a section 953(d) company be explicitly excluded from the definition of an FFI. The ABA comments suggested that there is no material reason to treat those insurers any differently from domestic insurers, noting that section 953(d) companies are subject to all the reporting obligations of a domestic insurance company.

Outcome

The final regulations reject the suggestion to treat section 953(d) companies as U.S. companies for purposes of FATCA.

Reg. section 1.1471-1(b)(132) defines the term ''U.S. person'' or ''United States person'' as a person described in section 7701(a)(30), the U.S. 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). The regulation further provides that 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 under 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 for FATCA purposes.

The preamble explains why the final regulations' treatment of a section 953(d) company contradicts the plain language of section 953(d), which provides that an electing corporation ''*shall* be treated'' as a domestic insurance company for purposes of Title 26 (emphasis added):

> How a foreign insurance company and its United States shareholders are taxed is immaterial to the need for reporting with regard to insurance or annuity contracts issued by the insurance company to its customers. Therefore, the final regulations provide that the term U.S. person does not include an insurance company that has made an election under section 953(d) if the company is not licensed to do business in any State. However, a foreign insurance company that has made an election under section 953(d) and is licensed to do business in the United States would be considered, for purposes of chapter 4, a U.S. person and, therefore, would remain subject to reporting with respect to its life insurance and annuity contracts under section 6047(d), not chapter 4.

The final regulations provide that for purposes of sections 1471 through 1474 and the regulations thereunder, the term ''U.S. person'' does not include an insurance company that has made an election under section 953(d) if the company is not licensed to do business in any state. In light of the ABA comments and other comments, however, the final regulations permit an insurance company participating FFI that is not licensed in any state to elect to report its chapter 4

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[24] A substantial U.S. owner is any U.S. person owning more than 10 percent of the stock of a corporation by vote or value, or more than 10 percent of the shares of a partnership, or more than 10 percent of the beneficial ownership of a trust. Reg. section 1.1473-1(b)(1).

[25] Reg. section 1.1472-1(c)(1)(i). The publicly traded company must provide a withholding certificate certifying that it is publicly traded and giving the name of the exchange on which its stock is traded.

account information in a manner similar to section 6047(d) reporting.[26] Under the election, an insurance company participating FFI reports the sum of cash value or an annuity contract's account balance or value and any amount paid under the contract as a gross distribution in box 1 of Form 1099-R. The participating FFI can then check box 2b to indicate that the taxable amount is not determined.

While the final regulations appear to provide flexibility to section 953(d) companies, the code's rule that a section 953(d) company is treated as a U.S. insurance company for all purposes of Title 26 trumps the default rule in the final regulations, which would treat them as non-U.S. entities.

Conclusion

Clarity, Overall

The final regulations provide much-needed clarifications of the insurance-specific FATCA definitions that are necessary for U.S. insurers to be able to identify withholdable payments and categorize their payees. The final regulations also provide many insurance-specific definitions and rules that are critical for non-U.S. insurers to be able to determine their FFIs, their NFFEs, and their financial accounts, which, in turn, influence due diligence and reporting requirements. While not all the final rules that emerged were ideal for the industry, the IRS and Treasury were very responsive to the ABA comments specifically, and insurance industry comments generally.

Attempted clarification did not come to fruition, however, concerning the types of debt and equity interests in insurance companies that will constitute financial accounts. Instead, the addition of a blanket anti-avoidance rule without specific examples has muddied this category of potential financial accounts. Hopefully, as the IRS and Treasury gain experience with situations that may be viewed as ''avoidance'' driven, they will provide additional guidance around the blanket antiavoidance rule in the form of a notice or revenue ruling.

The Role of IGAs Should Not Be Underestimated

The IGAs provide some relief from some of the major problems facing global insurance companies, for example, the conflict of laws between European privacy rules and FATCA reporting requirements and the potentially exorbitant cost of searching preexisting financial accounts for U.S. indicia. Importantly, some definitions and concepts in the final regulations may be supplanted by, or refined by, the specific terms of an applicable IGA. This parallel IGA process will allow additional, country-specific clarification and workability to occur without subsequent amendments to the FATCA regulations.

Now, the Grousing

We would suggest that the IRS and Treasury reconsider their position that a section 953(d) company is, for starters, a non-U.S. entity. That position contradicts the plain language of the code, which provides that an electing company is a U.S. person for all purposes of Title 26. Moreover, we believe that categorizing section 953(d) companies differently depending on whether they have a license to conduct business in any state is arbitrary and would not withstand judicial scrutiny. If the IRS and Treasury have specific concerns, such as identifying non-admitted captives or finding offshore separate account products, they should be a bit more transparent in expressing those concerns and work with the industry to address them — rather than attempt to override the code in a Treasury regulation that deals with information reporting.

Next Steps

The final regulations are responsive to insurance industry input, even if companies don't like how the IRS and Treasury came out on some issues. Work remains to be done, however, and hopefully the IRS and Treasury will continue to encourage and engage in ongoing, constructive dialogues with the industry. ◆

[26]Section 6047(d) does not apply to separate account reporting until a distribution occurs. The administration's 2013 budget proposal suggests amending the code to require that reporting. Joint Committee on Taxation, ''Description of Revenue Provisions Contained in the President's Fiscal Year 2013 Budget Proposal,'' JCS-2-12 (June 2012), at 574-576. Similar proposals also were made for fiscal 2001 and for fiscal 2010 through 2012.