Proposed FATCA regulations provide specific guidance to insurance companies regarding application and implementation

Background

On 8 February 2012, Treasury and the Internal Revenue Service (IRS) released proposed regulations that were published in the Federal Register on 15 February 2012 to provide guidance on the application and implementation of the information withholding and reporting regime in the Foreign Account Tax Compliance Act (FATCA) provisions of the Hiring Incentives to Restore Employment (HIRE) Act (P.L. 111-147). (See Tax Alert 2010-467.) The proposed regulations are more than 350 pages in length and incorporate, with significant modifications, much of the guidance provided in three notices issued in 2010 and 2011. (See Tax Alerts 2010-1164, 2011-662 and 2011-1185.)

The guidance provided by the proposed regulations specifically related to insurance is the first detailed set of rules issued under FATCA and incorporates many of the topics identified as issue areas in the comment letters received by Treasury from domestic and foreign insurance companies and trade associations during the past two years. This alert focuses on the provisions that apply specifically to insurance companies. Tax Alert 2012-310, published last week, provides a more general description and analysis of the proposed regulations.

It is evident from reading the proposed regulations that Treasury put a lot of thought and effort into drafting them and listened to the comments and attempted to reflect them in the proposed rules. The insurance provisions are a solid start to providing guidance the global insurance industry can rely upon to develop the necessary administrative processes and procedures and make changes to software systems to accumulate, analyze and store the data required to achieve and maintain ongoing compliance with the FATCA rules. There are a number of areas where further dialogue and detailed commentary from the insurance industry to Treasury should help to refine the proposed regulations and further reduce the administrative burdens, including:

- Further refine the definitions of life insurance and annuity contracts to eliminate the need for foreign insurance companies to become proficient in US tax law definitions of these contracts

Get the facts on FATCA!
You can access current FATCA news and thought leadership.
Type into your web browser: www.ey.com/FATCA.
Expand the definition of local foreign financial institutions (FFI) so that insurance companies meeting the requirements can avoid the administrative compliance related to documentation of certain individual accounts.

Clarify the definition of forms of life insurance and annuity contracts eligible for the grandfathered obligations exception to withholding on contracts in force on 1 January 2013.

Provide a definitive statement that indemnity reinsurance not involving administrative services is excluded from the reporting, documentation and withholding rules.

Modify the relationship manager definitions (entity and individual) under the pre-existing contract rules to align the concept with the various distribution system formats utilized to market insurance and annuity contracts around the world.

The proposed regulations extend qualification as a grandfathered obligation (which is not subject to FATCA withholding) to obligations outstanding on 1 January 2013. The proposed regulations also expand the categories of FFIs that will be deemed compliant with FATCA’s requirements. In addition, the proposed regulations provide greater flexibility in the treatment of FFIs in an affiliated group so that barriers to compliance by one affiliate will not taint the whole FFI group.

The proposed regulations reflect a phase-in of dates for FATCA reporting requirements applicable to FFIs as follows:

- The identity of US account holders must be reported starting in 2014 (for the 2013 calendar year).
- Information about income on US accounts must be reported starting in 2016 (for the 2015 calendar year).
- Full information on US accounts, including information about gross proceeds, must be reported starting in 2017 (for the 2016 calendar year).

In addition, the FATCA withholding rules for FFIs will not apply to certain payments made before 1 January 2015, except for payments made to payees with certain indicia that they might in fact be FFIs (prima facie FFIs).

However, non-financial foreign entities (NFFE) remain subject to potential FATCA withholding on US-source fixed or determinable income paid by US financial institutions beginning 1 January 2014 and on gross proceeds beginning 1 January 2015. Furthermore, US financial institutions must still begin to look at new, non-resident alien entity accounts differently, starting 1 January 2013.

The proposed regulations reserve on the definition of foreign “passthrough” payments and provide that withholding will not be required on such payments before 1 January 2017.

In general, for the majority of US insurance companies, which will be considered withholding agents, the proposed regulations contain a demarcation line of 1 January 2013, for purposes of distinguishing between “new” and “pre-existing” accounts. Withholding agents must generally consider all documentation obtained from an account holder for new accounts for know-your-customer/anti-money laundering (KYC/AML) purposes when determining the account holder’s status for FATCA purposes. US withholding agents will be required to withhold on payments of US-source fixed and determinable annual or periodic (FDAP) income paid to new accounts held by non-participating and presumed FFIs (i.e., entity account holders for which appropriate FATCA certifications have not been received) and pre-existing prima facie FFI accounts starting 1 January 2014, and on gross
proceeds paid to non-participating and presumed FFIs starting 1 January 2015. While participating FFIs have a phase-in period for reporting under FATCA, US withholding agents that are not FFIs will apparently be required to begin reporting information about substantial US owners of NFFEs as early as 15 March 2014, for the calendar year 2013, on a form yet to be published.

In addition, the preamble to the proposed regulations indicates that the existing Chapter 3 (i.e., non-resident alien withholding and reporting) and Chapter 61 (i.e., Form 1099 reporting) regulations will be amended effective 1 January 2014 to conform to the FATCA provisions. As a result, in addition to the existing “reasons to know,” withholding agents will be deemed to have reason to know a withholding certificate (e.g., Form W-8BEN) is unreliable if the withholding agent has a US telephone number on file for the account holder, or information indicating that an account holder was born in the United States. In such a case, the withholding agent would be required to obtain additional documentary evidence in order to rely on the Form W-8BEN. Conformity also means that, under the proposed regulations, withholding agents can only rely on a Form W-8 received more than one year after a payment is made if they also obtain documentary evidence of the non-resident alien’s status. Finally, when the IRS conforms the existing regulations under Chapters 3 and 61 to the FATCA provisions after 31 December 2013, a withholding agent will be able to rely on a faxed withholding certificate if the withholding agent confirms that the person furnishing the form is the person named on it. Currently, this is not permitted.

There are a number of aspects of the proposed regulations that have significant impacts on the asset-management activities of insurance companies. Ernst & Young will be issuing a separate Tax Alert regarding the impact of FATCA on asset-management activities.

Next steps

A public hearing on the proposed regulations is scheduled for 15 May 2012. Written comments on the proposed regulations must be submitted April 30. This is a relatively short comment period, and Treasury has recently indicated it still plans to release final regulations by late summer.

At the same time as the proposed regulations were released, Treasury released a joint statement from the United States, France, Germany, Italy, Spain and the United Kingdom announcing an agreement to explore an intergovernmental approach to FATCA implementation that would allow FFIs in each country to provide the information required under FATCA to that country’s tax authorities rather than to the IRS, and generally relieve FFIs in those countries from significant compliance burdens, including the need to sign an FFI agreement. While few details are available today, the development of the intergovernmental approach is clearly a development all companies impacted by FATCA must stay abreast of as it likely will significantly impact how companies approach their compliance obligations over time.

For more background on FATCA and previous related guidance, see Tax Alerts 2010-1164, 2011-662, and 2011-1185.

General description of FATCA’s impacts on US and foreign insurance companies

While the proposed regulations make great strides in providing guidance and reducing administrative burdens, the application of FATCA is still complex. Before launching into a discussion of the provisions specific to insurance companies, the following is intended to provide a quick look at how FATCA applies to US and foreign insurance companies.

US-based insurance companies

- As previously noted, a USFI is no longer a separate category under FATCA; instead, US financial institutions are considered withholding agents under Chapter 4.
- Companies may have withholding obligations related to insurance contracts held by foreign entities that have US owners (regardless of type of contract).
- Indemnity reinsurance assumed, other than transactions where administrative services are transferred, will generally not require the assuming company to perform withholding under FATCA on the underlying contracts even if they would otherwise meet the definition of a financial account.
- Any insurance company making payments for financial services to FFIs and NFFEs will need to establish procedures regarding potential for withholding.
- Investment funds and other non-insurance products offered by the insurance company and/or its affiliates may have FATCA withholding obligations depending upon whether the company maintains records and is handling cash flows or has outsourced those to a third-party vendor to perform.
- Cash-value insurance and annuity contracts funding qualified pension plans are generally out of scope.
Foreign-based insurance companies

- If foreign insurers sell any cash-value insurance or annuity contracts, the company and its holding company will be classified as an FFI.
- FFIs are also withholding agents; however, withholding is generally delayed until 2017 for most payments made by foreign companies.
- Existing cash-value insurance and annuities are “financial accounts” for purposes of FATCA; pure protection contracts such as term, disability, health or property and casualty insurance are out of scope.
- Cash-value insurance and annuity contracts need to be identified; however, contracts in existence prior to 1 January 2013 can generally be treated as foreign accounts if the company has not previously classified the account as a US account and the contract is less than US$250,000. Some aggregation rules may apply.
- Private banking rules no longer apply; however, cash-value insurance and annuity contracts in excess of US$1 million in value as of 1 January 2013 and each calendar year-end thereafter will require a more extensive electronic and manual US indicia search.
- Information collected at the time of account opening largely follows AML/KYC criteria, and the IRS is modifying W-8 and W-9 forms to correspond with FATCA requirements.
- Cash-value insurance and annuity contracts funding foreign pension and savings plans that meet a number of conditions are out of scope.

The remainder of this alert will focus on a number of key issues that have arisen as the global insurance industry has analyzed the provisions of Chapter 4, taking into account the limited guidance provided in the legislative history and Notice 2010-60 for application to insurance companies, their products and the affiliated groups they are members of.

General comment on approach of the proposed regulations

The proposed regulations provide a number of specific rules across Chapter 4 that define insurance companies, and those insurance products that are financial accounts. The proposed regulations also provide guidance on reporting and withholding. For the most part, the proposed regulations rely upon existing insurance-related definitions in Chapter 1 of the Code, such as sections 72, 101(f), 816(a), 817(h) and 7702. While it is helpful in one sense for the proposed regulations to have relied upon these existing rules, in many cases, as will be discussed below, they also create uncertainty and complexity with respect to implementation and administration. Moreover, many of the provisions of the proposed regulations – both insurance and non-insurance specific – will require foreign companies to reach conclusions about how to deal with particular fact patterns based upon a US tax law with which they may be unfamiliar.

For example, under the general definitions, annuities are defined by reference to section 72; however, section 72 has no specific definition of what an annuity contract is. Domestic life insurance companies in the normal course of developing new products sometimes struggle to determine whether new products are annuities and may request a private ruling from the IRS. Application of such rules to a foreign-designed insurance or annuity contract may in many cases prove difficult. Accordingly, although insurance companies, especially those that are based abroad, will find that many of the provisions of the proposed regulations provide welcome guidance, the application of this guidance may not be straightforward. Applying the guidance, which tends to be based on multiple US tax law sections with many exceptions and caveats rather than bright-line tests, will require significant analysis that will then need to be standardized within systems and operational procedures. This will make implementation and ongoing compliance more complex and costly and require extensive knowledge of US tax law and operational activities to address the proposed requirements.

The discussion below summarizes the guidance provided in the proposed regulations related specifically to insurance companies and their products and provides our observations on the business implications. For a more detailed analysis of the general provisions of the proposed regulation provisions, see Tax Alert 2012-310.

Definition of financial institution

Are insurance companies included in the definition of a financial institution?

Proposed regulations: the proposed regulations clarify that an insurance company can be classified as a financial institution for purposes of FATCA. The proposed regulations define an insurance company as a company more than half of whose business activities during the year relate to issuing insurance or annuity contracts or the reinsuring of such contracts. In order for the insurance company to be considered a financial institution, it has to issue a single cash value insurance or annuity policy. Whether an insurance company is a financial institution or not is a seminal question for foreign insurance
companies under the FATCA rules. US insurance companies are not required to make this determination for FATCA purposes.

**Ernst & Young observes**: general insurance and life insurance companies issuing pure protection (term life, disability, health or property and casualty) are excluded from the definition of a financial institution. If an insurance company issues pure protection along with cash-value insurance or annuities, it will be treated as a financial institution; however, as described below, only the cash-value insurance or annuity contracts will be subject to the account reporting and withholding provisions of Chapter 4 (additional withholding rules may go into effect on 1 January 2017 that could result in additional withholding obligations for companies). For now, the burden of Chapter 4 compliance has been focused only on contracts meeting the definition of a financial account.

As an ongoing compliance matter, insurance companies that are not considered financial institutions will need to monitor the development of new products and reinsurance activities to ensure they do not inadvertently issue or reinsure contracts that could cause them to be classified as a financial institution. What may be a problem for some foreign insurance companies that are primarily focused on issuing contracts not meeting the definition of an annuity under section 72 is the company may not qualify as an insurance company for Chapter 4 purposes. In such a case, the company will most likely be considered a depository institution under Chapter 4 since the funds under the contracts would be treated as amounts held at interest by an insurance company. While depository institutions are treated similarly in many respects to insurance companies, the problems arise in the insurance company maintaining administration systems and procedures to track different contracts and their eligibility for a variety of exceptions under the FATCA rules. Accordingly, insurance companies issuing annuity contracts will need to assess their ability to qualify as an insurance company at the effective date of the FFI agreement and in future years.

**How are holding companies of insurance companies classified?**

**Proposed regulations**: the definition of financial institution discussed above also includes a holding company of an insurance company.

**Ernst & Young observes**: the proposed regulations provide a number of exclusions from the definition of a financial institution, including certain non-financial holding companies that have no financial institution subsidiaries. As a result of these rules working in tandem, affiliated groups that include insurance companies may find it advantageous from a compliance perspective to consider realigning the ownership structure, if possible, to minimize the number of holding companies subject to treatment as a financial institution. Any such restructuring alternatives will have to be weighed against the ability of the affiliated group of FFIs to centralize their compliance obligations at the holding company level under Chapter 4 as compared to the cost associated with such a restructuring. For multinational companies, this may be an advantage as it allows the group holding company to be the “lead FFI” for purposes of the group members’ FFI application process.

**Does an insurance company that only issues or reinsures pure protection insurance contracts have any responsibilities under Chapter 4?**

**Proposed regulations**: the definition of financial institution excludes insurance companies that only issue or reinsure pure protection insurance, such as term life, disability, health or property and casualty insurance. Accordingly, these companies are considered non-financial entities and classified as either domestic, with minimal impact from Chapter 4, or an NFFE, which may be subject to the withholding and reporting rules of Chapter 4 related to other payments the company receives. However, exceptions (discussed below), including active business income, may apply.

**Ernst & Young observes**: pure protection insurance contracts are not financial accounts for Chapter 4 purposes; however, the payments under such contracts for premiums and benefits generally fall into the US tax law definition of fixed or determinable annual or periodic income (FDAP) and may qualify as withholdable payments. On the other hand, if premiums paid to a foreign insurance company relate to US risks that are subject to the US excise tax under section 4371, the premiums are not considered FDAP and would not be considered withholdable payments for Chapter 4 purposes. Term life insurance death benefits are also excluded from FDAP as are most insurance settlement payments under property and casualty insurance contracts and health and disability payments since these are reimbursements for a loss and not considered gross income. An NFFE may also be required to perform documentation, reporting and withholding responsibilities on other financial services payments, such as gross proceeds paid on purchasing US financial instruments from other NFFEs or non-participating FFIs. Payments under reinsurance contracts (see discussion below) may also generate obligations under Chapter 4 depending upon the responsibilities of the reinsurer and the cash flows under the reinsurance agreement.
If a company’s primary business activity is to purchase insurance and annuity contracts as investments, how is the company treated under Chapter 4?

**Proposed regulations:** An entity whose primary business is investing in insurance or annuity contracts (a viatical or life-settlement provider), whether directly or through a partnership, will be considered a financial institution. As a result, a non-US entity will be required to enter into an FFI agreement and comply with the other reporting and withholding obligations of Chapter 4. If investing in insurance or annuity contracts combined with other activities would not rise to the level of treating the entity as a financial institution, then the entity will be considered an NFFE if it is non-US. Income from investments in insurance contracts and annuities is considered passive income in determining whether the company meets the active business exception for NFFEs.

**Ernst & Young observes:** Viaticals and other life-settlement investors in cash-value insurance and annuity contracts, including special purpose entities set up in non-US jurisdictions, may find themselves subject to the reporting and withholding compliance requirements as an FFI.

Are foreign affiliates of US-domiciled parent companies, commonly referred to as CFCs, subject to Chapter 4? How are disregarded entities (such as single-member LLCs), branches and US-owned foreign insurance companies electing under section 953(d) treated?

**Proposed regulations:** CFCs are treated as FFIs with no special relief provided in the proposed regulations. The proposed regulations do not address the treatment of section 953(d) companies. Entities that are disregarded for US federal income tax purposes are similarly disregarded for Chapter 4 purposes, and the owner will be considered the entity and payee.

**Ernst & Young observes:** In Notice 2010-60, the Treasury stated that a CFC that is a financial institution is an FFI and this would appear to be the case currently. Under the subpart F rules of US tax law, the income of a CFC may be currently included in the taxable income of the US parent. However, this inclusion of the foreign entity’s income has no effect on the application of Chapter 4. A CFC that is not a financial institution will be treated as an NFFE. Foreign insurance companies that have made section 953(d) elections should be treated as domestic insurance companies since section 953(d) provides such treatment for all purposes of the Code. Accordingly, a section 953(d) company would be treated as a US company and subject to the withholding agent requirements of Chapter 4. In the case of single-member limited liability companies (LLCs), the owner of the LLC, not the LLC, is considered the entity for purposes of classification under Chapter 4. Therefore, the business activities of LLCs need to be considered in determining the primary business activity of their owner. A similar rule applies to branches.

**Proposed regulations:** A limited relief provision is provided for affiliated groups with branches and affiliates located in jurisdictions that will not be able to comply with certain reporting and withholding aspects of FATCA due to conflicts with local country law. The proposed regulations provide FFIs with the ability to become participating FFIs even though they have affiliates and branches with limitations resulting from existing local country laws. The affiliates and branches with limitations must register as “limited FFIs” and “limited branches” for a period of up to two years ending no later than 31 December 2015. During this period, the limited FFIs and limited branches must perform the due diligence requirements of the proposed regulations, as well as agree not to open new US accounts or accounts held by nonparticipating FFIs. In addition, such limited FFIs and limited branches must identify themselves as nonparticipating FFIs to withholding agents.

**Ernst & Young observes:** For insurance companies in jurisdictions that fail to change their laws in a timely manner, the two-year deadline may be problematic as their entire affiliated group will become non-participating at the end of that deadline. As insurance companies will find it difficult to move accounts out of those jurisdictions, close accounts, or withhold on payments relating to insurance contracts to become participating FFIs, this deadline may be particularly problematic. Treasury should consider ways to clarify and eliminate the “cliff” effect if affiliated groups have FFIs in jurisdictions that do not modify their laws in a timely manner.

**Definition of financial account and excluded contracts**

What forms of insurance are considered financial accounts for Chapter 4 purposes?

**Proposed regulations:** Cash-value insurance and annuity contracts are considered financial accounts. Cash-value insurance is defined by reference to section 7702, with modifications that eliminate all of the testing provisions, including section 101(f) and the diversification requirements under section 817(h). Annuities are defined as contracts that meet the requirements of section 72 without regard to subsections (s) and (u) and section 817(h). Term life insurance
is specifically excluded from the definition of financial account if it has equal periodic premiums, and the amount paid upon termination of contract before death cannot exceed premiums paid as adjusted for mortality and expense charges. However, any amount held by an insurance company under an agreement to pay or credit interest thereon is treated as a depository account and included in the definition of financial account.

**Ernst & Young observes**: defining cash-value insurance by reference to section 7702 while eliminating the cash-value accumulation and guideline premium-testing provisions leaves the focus on treatment of the contract as life insurance under local law and treating endowment contracts as life insurance. Though technically, section 7702 does not apply to contracts sold prior to 1984, the inclusion language to disregard section 101(f) makes it more likely the intent of the statute is to cover all life insurance contracts. By defining annuities with reference to section 72, eliminating the required distributions rule under subsection (s) and prohibiting non-natural persons owning annuities under subsection (u), the definition becomes very expansive.

Deferred annuities and payout annuities are all encompassed under section 72; however, neither the Code nor regulations contain a definitive definition of what an annuity contract is. With the proposed regulations’ modifications to section 72, it is likely that many if not most “annuity-like” contracts will qualify as an annuity for purposes of Chapter 4. This is especially true of payout annuities, which generally meet the requirements of an annuity. However, US-based life insurance companies sometimes struggle to determine if new contract forms – especially those with a deferral period involved – will qualify as an annuity under section 72. So it is very likely foreign life insurance companies will face similar challenges in determining if their contracts qualify as annuities. If the contracts do not qualify under section 72 as annuities, such contracts should be classified as amounts held at interest by an insurance company and treated as depository accounts. However, depository contracts are eligible for a lower threshold de minimis rule for due diligence purposes. In either case, the contract should be classified as a financial account for FATCA purposes.

For both cash-value insurance and annuity contracts, the requirements of section 817(h), related to diversification of the investment portfolio of variable contracts, is waived for Chapter 4 purposes. Accordingly, cash-value insurance and annuity contracts issued by foreign insurance companies that are funded by separate accounts will not need to meet the diversification of investments requirements in order to meet the definitions provided in section 7702 or section 72. However, if the owners of the annuity contracts issued by foreign insurance companies have too much control over the underlying assets, the IRS might be inclined to apply the investor control rules to deem the underlying assets as owned by the contract owner. This is just one of many uncertainties that come into play with the current definitions of life insurance and annuity contracts for Chapter 4 purposes. Also, if annuity contracts are used as the funding source for a pension or savings plan, such contracts may qualify for one of the exceptions to reporting and withholding (see discussion below) and avoid the administrative burden of identifying whether the account is owned by a US person.

**What requirements must a contract meet in order to be classified as an annuity under Chapter 4?**

**Proposed regulations**: the definition of an annuity, as discussed above, is linked to section 72, with modifications to eliminate subsections (s) dealing with required distribution rules, (u), which provides a prohibition on non-natural owners, and section 817(h), requiring investments held under variable life or variable annuity contracts to meet certain diversification requirements.

**Ernst & Young observes**: Code section 72(a) provides that “…gross income includes any amount received as an annuity (whether for a period certain or during one or more lives) under an annuity, endowment or life insurance contract…”; however, there is no definition of an annuity contract or “any amount received as an annuity.” The accompanying regulations generally provide contracts will be covered under section 72 in accordance with customary practices of life insurance companies.

In a variety of private letter rulings spanning several decades, the IRS refers to numerous textbook definitions of an annuity, as well as a description from a Senate report in 1982 that described a commercial annuity as “… a promise by a life insurance company to pay the beneficiary a given sum for a specified period, which period may terminate at death. Annuity contracts permit the systematic liquidation of an amount consisting of principal (the policyholder’s investment in the contract) and income ….” The IRS rulings and case law generally focus on the annuitant/owner having an interest in only the periodic payments and not any principal fund or source from which they are derived. However, US courts have distinguished between periodic payments under an annuity vs. periodic payments of interest.

For foreign life insurance companies, in particular, the determination of whether a contract is an annuity or a contract held at interest may not make much difference for Chapter 4 reporting purposes. In determining if a company is an insurance company for Chapter 4 purposes, more than half of the business during the calendar year must be from issuing or reinsuring insurance or annuity contracts. For these purposes, it appears the company must first determine if its contracts meet the
aggregation rules. US$50,000 threshold, taking into account certain
is provided for depository accounts that do not exceed a
an exception to the term US account
Proposed regulations:
apply to cash-value insurance or annuity contracts?
account" maintained by an FFI during a calendar year
Does the depository account exception to the term "US
account" maintained by an FFI during a calendar year
apply to cash-value insurance or annuity contracts?
Proposed regulations: an exception to the term US account
is provided for depository accounts that do not exceed a
US$50,000 threshold, taking into account certain
aggregation rules.

Ernst & Young observes: Cash-value insurance and annuity
contracts are not eligible for this exception; however, contracts
that fail treatment as annuities and are treated as amounts held
at interest by an insurance company are treated as depository
accounts and may take advantage of the exception. As
discussed below, other rules may provide for grandfathering of
certain contracts from reporting and /or withholding.

How is reinsurance treated under Chapter 4?
Proposed regulations: the definition of an insurance company
includes the reinsuring of insurance or annuity contracts
although the term reinsurance is not defined. The definition of a
financial account includes any cash-value insurance or annuity
contract issued or maintained by a financial institution. But it
provides no specific reference to reinsurance. And, as discussed
below, a withholding agent is any person who has control,
custody, disposal or payment of a withholdable payment.

Ernst & Young observes: while Notice 2010-60 referred
specifically to reinsurance, the proposed regulation provides
no guidance related to reinsurance other than to include it in
the definition of an insurance company. Since the definition of
a financial account refers to contracts issued or maintained by
the financial institution, the reference to the latter condition
appears to be a vague reference to reinsurance. As a result,
an assumption reinsurance transaction involving cash-value
insurance or annuity contracts will result in the reinsurer
becoming the withholding agent under Chapter 4 for future
payments to policyholders of the reinsured contracts.

However, indemnity reinsurance contracts covering cash-value
insurance or annuity contracts, although considered financial
accounts, should not cause the reinsurer to have Chapter 4
responsibilities for documenting, reporting or withholding on the
underlying insurance risk reinsured, unless the reinsurer steps
into the shoes of the direct writer for all purposes, including
such administrative tasks as collecting premiums and paying
claims. For many indemnity reinsurance contracts, the reinsurer
is assuming mortality or longevity risk, not the future payment
of cash value. Short of the reinsurance company’s replacing the
direct writer, the reinsurance contract should not be considered a
financial account. In most reinsurance, the reinsuring company’s
obligation is to the ceding insurance company; it has neither the
control over payments to the policyholders nor the information
on the underlying policies to perform any of the Chapter 4
requirements. Treasury should consider adding a definitive
statement to the regulations to clarify treatment of reinsurance in
order to simply compliance efforts.
Are pension and other retirement contracts classified as financial accounts?

Proposed regulations: two broad categories of savings accounts, regardless of the type of financial product used to fund the account, are excluded from the definition of financial account. The first category relates to retirement and pension contracts that are either (i) held by certain retirement or pension funds or (ii) subject to government regulation as a personal retirement account or registered or regulated as an account for the provision of retirement or pension benefits under the laws of the country in which the FFI that maintains the account is established or in which it operates. The second category relates to tax-favored savings vehicles for purposes other than retirement established in the jurisdiction in which the FFI that maintains it is established or in which it operates. Both categories of savings accounts must also meet certain criteria in the jurisdiction in which the account is maintained, including having tax-favored status, contributions limited to earned income, annual contributions not exceeding US$50,000 and penalties applicable to withdrawals made prior to specified age requirements. See the discussion below for certain retirement funds that are deemed to have met the FFI reporting requirements without formally entering into an FFI agreement.

Ernst & Young observes: the definition of retirement-type contracts is very similar to the broad range of tax-favored plans provided under US tax law. It includes separate pension and profit-sharing plans that hold assets and individual retirement accounts where individuals establish accounts to hold tax-deferred contributions and the earnings thereon. Interestingly, the rules do not place limits on the type of funding contract, so cash-value insurance or annuities held in this type of account fall within this exception to the definition of financial account even though there are restrictions on the use of such contracts under US pension plans. While the rules are not clear, we believe this exception should also be available to contracts used to pay a pension benefit. This would be similar to the common practice in the US for retirees to transfer their balance form a pension or other retirement contract into an individual retirement annuity in order to pay benefits.

The second type of exempted program, the non-retirement savings vehicle, seems to have been formulated with products such as UK ISAs or Canadian Government-regulated savings account in mind. It remains to be seen whether the litany of rules established to exempt foreign pension and saving plans from Chapter 4 compliance are flexible enough in practice. For instance, in the UK, the limitation on pension contributions is currently £50,000 which would fail the limitations provided under the exemption.

Is cash value a defined term under Chapter 4?

Proposed regulations: a cash-value insurance contract is defined as an insurance contract with a cash value greater than zero. Cash value is defined as the greater of (i) the amount the policyholder is entitled to receive upon surrender or termination of the contracts without reduction for surrender charges or policy loans or (ii) the amount the policyholder can borrow under the contract. Cash value does not include (i) personal injury or sickness benefits or a benefit providing indemnification of an economic loss incurred upon the occurrence of the event insured; (ii) refunds of premiums to policyholders; or (iii) policyholder dividends other than termination dividends on term insurance, personal injury or sickness or other pure insurance contract.

Ernst & Young observes: ultimately, cash value is an amount that the owner of a policy can get before death. The determination of cash value should be consistent with how most insurance companies maintain their policyholder account or accumulation values related to cash-value insurance and annuity contracts. Companies may be able to simplify the process if they can validate that the loan amount is never greater than the account or accumulation value. The exclusion of return premiums and policyholder dividends also serves as a further clarification of the definition of which insurance products are subject to Chapter 4 documentation and reporting requirements. Likewise, while buried in the definition of cash value, the exclusion for personal injury and indemnification payments on economic loss incurred is a further clarification that disability, health and property and casualty insurance benefits do not constitute cash value and, thus, such insurance contracts are not subject to Chapter 4. However, based upon the rules contained in the proposed regulations, the addition of a return of premium benefit may cause a term insurance contract to be treated as having a cash value and therefore treated as a financial account.

Are insurance companies eligible for any of the deemed-compliant exceptions to registering as participating FFIs?

Proposed regulations: two categories of FFI may be able to qualify as deemed-compliant FFIs and, thus, be exempt from withholding — registered and certified FFIs. Registered deemed-compliant FFIs must register with the IRS to declare their status and attest to certain procedural requirements. Certified deemed-compliant FFIs are not required to register with the IRS, but must certify to withholding agents that they meet the relevant requirements through the use of Form W-8. Registered deemed-compliant FFIs are broken into four sub-categories of which only two may apply to insurance companies — local FFIs and non-reporting members of participating FFI groups. However, the list of entities that can qualify as local FFIs does
Proposed regulations: Do specific rules apply to insurance contracts issued by an FFI agreement?

Proposed regulations: The general FFI agreement rules for determining the status of an account holder and identifying and documenting whether an account is a US account applies to insurance companies and their products. There are several specialized provisions related to the due diligence for pre-existing entity and individual accounts as of 1 January 2013 for cash-value insurance and annuity contracts. In particular, if an entity or individual holds cash-value insurance or annuity contracts issued before the effective date of the FFI Agreement and their aggregate value is less than US$250,000 as of that date, the FFI is not required to document the accounts as a US account subject to review although the insurance company may choose to do so. Accordingly, payments made on these pre-existing accounts are not considered reportable as a US account. However, if the insurance company elects to apply the US$250,000 pre-existing contract exception, it will need to track the cash value of the affected accounts since it is required to document and report the account in the year after its year-end cash value exceeds US$1 million.

To determine these various thresholds, the FFI is required to aggregate all cash-value insurance and annuity contracts maintained by members of an affiliated group or individual, but only to the extent computerized systems link the accounts by reference to a common data element, such as a client number or taxpayer identification number, and allow account values to be aggregated. The FFI will also be required to aggregate accounts held by entities and/or individuals that a relationship manager has the ability to aggregate. The relevant account value is the balance or value of the aggregated accounts as determined for purposes of reporting to the account holder.

Ernst & Young observes: The current deemed-compliant exception for non-reporting members could apply to insurance companies; however, the requirement to transfer accounts identified as US accounts to another FFI is problematic because under most countries insurance laws, it is difficult to quickly terminate a policyholder’s insurance contract. In some instances, the only way to terminate a contract is through a novation or assumption reinsurer of the insurance contracts, which are difficult to implement under regulatory rules – especially cross-border. Even if this were practical, the US$50 million affiliated group asset limitation would severely limit its applicability.

Ernst & Young observes: for insurance companies, the ability to exclude pre-existing contracts from the documentation requirements for both entity and individual accounts is a significant reduction in the administrative burden related to these contracts. The initial threshold of US$250,000 will exclude a significant portion of pre-existing contracts, and the requirement that the status of the account does not change until it reaches US$1 million provides additional relief from the administrative burden although it will require account balance monitoring capabilities to ensure compliance.

The vast majority of affiliated groups of insurance companies generally do not have computer systems that are capable of combining policy-level details across entities and often, due to differences in products or acquisitions, within entities. As a result, the pre-existing account exclusions for insurance companies are likely to be determined on an account-by-account basis; however, some companies may have the ability to aggregate contracts. Accordingly, insurance groups will need to determine their ability to aggregate information and document their findings. Furthermore, these groups must put in place monitoring systems to retest each pre-existing account on subsequent calendar year-end and be able to move an account to reportable status should its value exceed US$1 million.

The requirement for a relationship manager to aggregate contracts may be more difficult to apply. A relationship manager must be an officer or employee of the company who advises account holders on an ongoing basis on matters such as fiduciary, estate planning or philanthropic needs, among others. However, a person is only a relationship manager if, taking into consideration the aggregation rules, the value of the accounts that person works on exceeds US$1 million. For many insurance companies that rely upon third-party agents and brokers to market their products, there may be no relationship managers since those individuals would not be officers or employees of

Reporting requirements

Do specific rules apply to insurance contracts issued or maintained by an insurance company subject to an FFI agreement?

Proposed regulations: the general FFI agreement rules for determining the status of an account holder and identifying and documenting whether an account is a US account applies to insurance companies and their products. There are several specialized provisions related to the due diligence for pre-existing entity and individual accounts as of 1 January 2013 for cash-value insurance and annuity contracts. In particular, if an entity or individual holds cash-value insurance or annuity contracts issued before the effective date of the FFI Agreement and their aggregate value is less than US$250,000 as of that date, the FFI is not required to document the accounts as a US account subject to review although the insurance company may choose to do so. Accordingly, payments made on these pre-existing accounts are not considered reportable as a US account. However, if the insurance company elects to apply the US$250,000 pre-existing contract exception, it will need to
the case of a grantor trust under which an individual is treated as
the holder. Otherwise, the beneficiary is considered the holder. in
access the cash value or change beneficiaries will be considered
owns a cash-value insurance or annuity contract and is able to
account. For cash-value insurance and annuity contracts owned
by an entity, the general ownership rules apply. An individual who
account for purposes of determining if it is a US
institution as owning an account is generally considered the
a person or entity treated by the financial
Proposed regulations:
FFIs, must determine if the owners of a financial
insurance or annuity contract are
persons. For payments to NFFEs, the withholding agent must
determine if there are any substantial US owners of the payee.
Substantial US owner is generally defined as ownership of 10%
or more of the stock, profit interest or capital in a partnership or
a portion of a trust.

Ernst & Young observes: for insurance companies and certain
investment vehicles, the 10% ownership percentage is reduced
to zero so that any US ownership of the stock of a corporation
.vote or value), profits or capital interest in a partnership or any
interest in a trust will require the entity to be considered related
to a substantial US owner. In some ways, this rule simplifies
the analysis for withholding agents as they do not need to
ascertain the level of ownership, only the fact that a US person
or owner has some level of ownership. One area of concern is
that anti-money laundering and know-your-customer rules in
many jurisdictions require entities to disclose owners at a higher
threshold than 10%. Thus, modifications to these processes
may be required in order to capture the information needed to
comply with the FATCA reporting requirements.

How does an FFI determine who is the owner of a cash-
value insurance or annuity contract?

Proposed regulations: a person or entity treated by the financial
institution as owning an account is generally considered the
holder of the account for purposes of determining if it is a US
account. For cash-value insurance and annuity contracts owned
by an entity, the general ownership rules apply. An individual who
owns a cash-value insurance or annuity contract and is able to
access the cash value or change beneficiaries will be considered
the holder. Otherwise, the beneficiary is considered the holder, in
the case of a grantor trust under which an individual is treated as
the owner of the trust, the account will be treated as held by the
owner of the trust.

Ernst & Young observes: as foreign companies develop systems
and procedures to implement the Chapter 4 requirements,
the procedures and documentation related to determining the
holders of financial accounts for purposes of the FFI Agreement
may need to be programmed into administration software to
identify and track the payee on a withholdable payment payable
to an NFFE. For example, while an insurance company may
have on its books and records limitations on the holder of a
policy to the cash value (such as in the case when an irrevocable
beneficiary is named), the trust provisions technically require
the insurance company to make a determination of ownership
applying relevant trust law and US tax law, a difficult matter for
an insurance company located in a different jurisdiction.

How are the general rules for determining a substantial US
owner apply with regard to cash-value insurance and
annuity contracts?

Proposed regulations:

How are the general information reporting requirements
for FFIs and NFFEs modified by any of the specialized
insurance rules?

Proposed regulations: information reporting is required for
financial accounts related to US persons maintained by FFIs and
withholdable payments made to NFFEs with substantial US owners.

Ernst & Young observes: rules related to determining the
holder of cash-value insurance and annuity contracts as
financial accounts, the definition of cash value and the
identification and documentation procedures for pre-existing
accounts related to cash-value insurance and annuity contracts
are all taken into account in applying the general information
reporting requirements for FFIs. In regard to payments to
NFFEs, there are no specialized insurance rules that apply other
than in the determination of the amount of an NFFE’s passive
gross income. Annuity payments, death benefits and amounts
received from a pool of insurance contracts are all taken into
account as passive income. Accordingly, the application of the
information reporting rules should be relatively uniform across
an affiliated group that includes insurance companies.

How are mutual insurance and other non-stock insurance
organizations treated for the exceptions to reporting
for NFFEs?

Proposed regulation: a withholding agent is not required to
withhold on a withholdable payment if the withholding agent can
determine the payee is an excepted NFFE. An excepted NFFE
means a publicly traded corporation on one or more established
securities markets and its affiliated entities, certain territory
entities and certain other specialized entities as well as active
NFFEs. An active NFFE, as discussed above, has less than 50%
of its income from passive sources or less than 50% of its assets
from the production of passive income.
Ernst & Young observes: the global insurance industry has many organizations that are owned by policyholders, such as mutual insurance companies, non-stock health insurance companies and risk retention groups. While these organizations, if not otherwise classified as FFIs, should qualify under the active NFFE exception, it is interesting that organizations that are public by their ownership structure are not included in the definition of a publicly traded company since they do not have stock traded on an established securities market. The burden associated with demonstrating the company’s compliance with the active NFFE rule is more onerous than being exempted due to the ownership structure of the company. Hopefully, Treasury will be willing to consider some form of administrative relief for these types of organizations to further reduce the compliance burden.

Withholdable payments including passthrough payments

How do premiums and benefit payments impact the computation of FDAP used to determine a withholdable payment?

Proposed regulations: the term withholdable payment is defined in the FATCA statute and is a key term in the sections of the proposed regulations related to withholding agents. For instance, a withholding agent must generally withhold on a withholdable payment to an FFI that is not participating, or on withholdable payments to an NFFE that fails to provide the proper documentation on owners or prove its status as excepted. Both situations depend upon the definition of a withholdable payment, which is defined as any payment of US-source FDAP income (fixed or determinable annual or periodic income) and gross proceeds from certain sales and dispositions of property that can produce US-sourced interest or dividend income. FDAP is defined by reference to the regulations under section 1441. If the source of a payment cannot be determined at the time of payment, it must be treated by the withholder as US sourced.

Ernst & Young observes: the definition of FDAP under section 1441 includes premium income; however, certain exclusions under the Code that do not depend upon the US versus foreign status of the payee apply. These include life insurance death benefits under section 101; the return of basis component of annuity payments; and withdrawals from life insurance contracts from the cash value to the extent they do not exceed premiums paid under section 72. FDAP does, however, include the taxable portion of annuity payments or the taxable portion of partial or full surrenders from annuities and life insurance contracts. In addition, FDAP does not include premiums that are subject to the US excise tax under section 4371. While it is hoped that withholding will only be required on a small percentage of what would otherwise be withholdable payments, those payments that are subject to withholding may require the insurance company to compute the amount subject to withholding, which will likely become a manual process due to the infrequency and uniqueness of each payment.

The mere crediting of amounts to cash value by the insurance company should not be considered a withholdable payment as it is not considered a FDAP payment to the policy owner. This suggests that passthrough payment withholding on recalcitrant policy owners can be deferred until payment, when the insurance company should have greater contact with the customer.

Do foreign insurance companies treated as participating FFIs have any withholding obligations prior to 1 January 2017 when the passthrough payment rules become effective?

Proposed regulations: the FFI Agreements treat the company as a US withholding agent and responsible for withholding on withholdable payments and foreign passthrough payments as required under Chapter 4. Withholding on withholdable payments to FFIs is effective 1 January 2014 and on foreign passthrough payments, 1 January 2017. There are certain exceptions to the withholdable payment effective date that may delay withholding until 1 January 2015. Withholding on withholdable payments to an NFFE is required after 31 December 2014.

Ernst & Young observes: generally, participating FFIs (other than custodial institutions, other intermediaries and flow-through entities) will not have to deal with withholding until the passthrough payment rules become effective on 1 January 2017. However, some situations may exist where a foreign insurance company issues cash-value insurance or annuity contracts that are funded directly by investments in assets which generate US-sourced income. In this situation, the participating FFI may have a withholding requirement under Chapter 4 as a withholding agent on a withholdable payment when withdrawals or surrenders are paid since the amounts paid out would be US sourced and considered FDAP.

Are US insurance companies subject to new withholding requirements as a result of FATCA?

Proposed regulations: US insurance companies are treated as withholding agents under FATCA in a manner similar to their role under section 1441. FATCA expands the withholdable payments to include payments by US insurance companies to foreign entities with substantial US owners who do not provide the required documentation and non-participating FFIs. FDAP
payments made with respect to any type of insurance contract to such an entity could be subject to withholding. Under section 1441, only payments to US individuals located outside the US are subject to withholding. The new withholding obligation takes effect for payments made beginning 1 January 2014. US withholding agents will also begin to report information about substantial US owners of NFFEs in 2014 for the 2013 calendar year.

Ernst & Young observes: US insurance companies generally have processes in place to identify life insurance and annuity contracts with individual owners located in a foreign jurisdiction and apply withholding as appropriate on withdrawals and benefit payments. The FATCA expansion will involve companies searching for foreign entities, including trusts, that own contracts and/or to which withholdable payments are made in order to determine if the entities have any US ownership (and then obtaining documentation) or if a financial entity, to determine whether it is a participating FFI. The rules discussed earlier regarding grandfathered obligations apply to exclude payments related to life insurance contracts and term certain annuities outstanding as of 1 January 2013 from the new withholding rules. Insurance companies will need some way to identify within their policy administration systems or manual payment processes contracts that are subject to the grandfather rule.

Do payments made in the ordinary course of business of an insurance company qualify as withholdable payments?

Proposed regulations: payments in the ordinary course of the withholding agent’s business for non-financial services, goods and the use of property are excluded from the definition of withholdable payments. As a result, wages, office equipment leases, awards, prizes and other tangible and intangible non-financial services property are excluded. However, interest and dividends paid, payments for financial services are not considered ordinary course payments. The term “financial services” is not defined.

Ernst & Young observes: In an insurance context, claims payments by the FFI to policyholders should likely be considered non-financial services since they are for reimbursement of an insured event and excluded from FDAP; however, settlement payments under reinsurance contracts are likely to be considered financial services in nature and includible in FDAP. Other types of payments for financial services, such as gross settlements with counterparties, may be withholdable payments if paid to an NFFE or a non-participating FFI. Commissions paid in connection with the sale of cash-value insurance and annuity contracts may also be subject to withholding if they are considered related to a financial service. This is a point that future guidance will presumably clarify.

Are there exceptions to the general withholding rules that eliminate the withholding requirements for categories of insurance contracts?

Proposed regulations: the FFI Agreement generally requires withholding on withholdable payments or passthrough payments when made; however, payments made under grandfathered obligations are excepted from withholding. A grandfathered obligation means any legal agreement that produces or could produce a passthrough payment that is outstanding on 1 January 2013. For purposes of this rule, an obligation includes debt instruments defined in section 1275(a)(1), a life insurance contract payable on the earlier of attaining a stated age or death, or a term certain annuity. However, a grandfathered obligation does not include legal agreements treated as equity or that lack a stated expiration or term, such as a savings deposit, demand deposit, brokerage agreement, custodial agreement or similar agreement to hold financial assets. Any material modification of a grandfathered obligation will result in it being treated as newly issued as of the effective date of such modification.

Ernst & Young observes: the grandfathered obligations provision should allow FFIs to exclude endowments and at least some cash-value life insurance contracts in existence on 1 January 2013 from future withholding obligations. However, the current wording seems to imply that a life insurance contract must be payable at the earlier of death or a stated age, which would appear to exclude life insurance contracts with no fixed maturity date. Thus, a traditional endowment will qualify, as will a life insurance contract that is payable at the earlier of a stated age (i.e., 100) or at death. This leaves in question the treatment of a life insurance contract that does not “force” the payment of the death benefit at the final age covered by the relevant mortality table. While this approach might be superficially consistent with the general requirement that an obligation must have a “stated expiration or term,” it is patently inconsistent with the section’s goal of appropriately easing the administrative burden.

This distinction may significantly increase the administrative burden as most life insurance policy forms will have to be reviewed, and only those containing a stated maturity age will be grandfathered. This issue could be rectified by simply stating that the term “payable at death” is a stated term for purposes of the proposed regulations. While it could, perhaps, be argued that this is currently the case, this issue needs to be clarified. Any concerns relative to the inclusion in the definition of a grandfathered obligation of a life contingency as a stated period should be ameliorated by the fact that life insurance companies are generally considered the only companies allowed to provide a mortality risk benefit.
With regard to annuity contracts, the grandfather provision only applies to term certain annuity contracts, which are a small subset of the larger annuity population. The proposed regulations do not define what is meant by a term certain annuity contract; however, a general industry definition would include contracts in payout status for a specified number of years, such as structured settlements or lottery annuities. This leaves uncertain the proper treatment of payout annuity contracts, for life or a period certain, under the grandfathered obligations provision. The apparent exclusion of many annuities that qualify under section 72 is even more curious given that annuity contracts that do not meet the definition of section 72 (see discussion earlier regarding depository contracts) should qualify for the grandfathering provisions as debt instruments.

The real cause for concern is that, as noted above, the regulation uses the section 1275(a)(1) definition of debt instrument; however; section 1275(a)(1)(B) excludes from the definition of a debt instrument annuity contracts that qualify for section 72 treatment. As a result, deferred annuity contracts and payout annuities for life that are subject to section 72 do not appear to qualify at present for the exclusion from withholding under the grandfathered obligations provision. One could perhaps argue that the intent was that a life annuity is a term certain annuity since the payments will extend for the life of the annuitant, and since this is the only place in the regulations where this distinction is, perhaps inadvertently, made.

The grandfathering rule will require insurance companies to develop systems and processes to identify contracts as of 1 January 2013 and tag them for future reference. In addition, while the contracts may be exempted from withholding, the contract may still be subject to the due diligence procedures for identification and reporting of US owners. Finally, the potential for a grandfathered contract to be treated as a new contract due to a material modification of the contract terms is another example of where the proposed regulations impose complexity upon the insurance company requiring monitoring systems or procedures to identify and properly handle the situations to remain in compliance with FATCA. It is to be hoped that future guidance will help to clarify this provision as it now appears to create rather than reduce the administrative burden.

When a cash-value insurance or deferred annuity contract is converted to a payout annuity, how is the new contract classified for Chapter 4 purposes?

Proposed regulations: if material modifications are made to financial accounts treated as grandfathered obligations for withholding purposes, the contract is considered a new contract as of the effective date of the modifications.

Ernst & Young observes: there are no specific rules related to the conversion of a cash-value insurance or deferred annuity contract to a payout annuity; however, it is likely a material modification of the contract. Accordingly, the grandfathering exception to withholding will not apply to the new contract.

Other matters

Comments requested

Treasury and the IRS continue to seek input from taxpayers on issues that require further clarification. In addition to the requests for comments, the preamble also requests input from taxpayers on issues that include the following:

- Approaches to reduce the burdens related to foreign passthrough payment withholding (e.g., a simplified computation or a safe harbor)
- Additional categories of deemed-compliant FFIs, especially regarding issuers of insurance and annuity products
- Allocation of gross proceeds among partners in a flow-through entity
- Grandfathering of equity interests in certain securitization vehicles that invest solely in debt and similar instruments, if such vehicles will liquidate within a specified time frame

As previously indicated, there is a comment period open until 30 April 2012 and a public hearing scheduled for 15 May 2012. In our observations above, we noted a number of areas where it would be helpful for Treasury to provide clarification in order to further reduce the administrative burden on insurance companies with regard to implementation and ongoing compliance. Several of the key areas for comments include:

- Simplify the definitions of life insurance and annuity contracts that are currently tied to the definitions under US tax law
- Expand the definition of local FFI to include insurance companies
- Clarify treatment of the assuming company’s obligations under FATCA related to indemnity reinsurance
- Provide a definition for a term certain annuity and expand definition to include payout annuities for life

Joint Statement on Intergovernmental Approach to FATCA

At the same time the proposed regulations were issued, Treasury issued an announcement labeled “Joint Statement from the United States, France, Germany, Italy, Spain and the
United Kingdom Regarding an Intergovernmental Approach to Improving International Tax Compliance and Implementing FATCA.” The statement reiterates the policy behind the FATCA provisions, which is to obtain appropriate reporting of US taxpayers’ financial information, and acknowledges that, in certain countries, compliance with FATCA’s reporting, withholding and account closure requirements may be hindered by local legal restrictions. In light of this, the statement provides that the United States is “open to adopting an intergovernmental approach to implement FATCA and improve international tax compliance” and is willing to collect and exchange information automatically and reciprocally on accounts held in US financial institutions by residents of the five EU countries named in the statement. It adds that all those countries recognize the importance of keeping the compliance costs of these efforts as low as possible for financial institutions and other stakeholders.

With this as background, the statement sets out a potential framework for an intergovernmental approach to FATCA compliance, whereby the United States and a partner country would agree to allow FFIs in the partner country to carry out their FATCA obligations by reporting information to the authorities of that country, rather than directly to the IRS. This would eliminate the requirement of each FFI in that country to enter into a separate FFI agreement with the IRS (but might require FFIs to register with the IRS). It would also eliminate FATCA withholding on payments to FFIs in that country by identifying them to other withholding agents as participating or deemed compliant FFIs, and would identify categories of FFIs in that country that would be treated as deemed compliant or presenting a low risk of tax evasion. The United States would, in turn, commit to reciprocity regarding automatic collection and reporting of information on US accounts of residents of the partner country. FFIs in the partner country would not be required to terminate accounts of recalcitrant account holders, impose withholding on passthrough payments to those account holders or impose passthrough payment withholding on payments to other FFIs in the partner country or in other jurisdictions with which the United States has a similar FATCA implementation agreement.

The statement further provides that the US and the partner country would also agree to pursue the legislative changes needed to implement such an approach.

Implications and final observations

The proposed regulations are a solid start to providing guidance to the global insurance industry on how FATCA applies to its products and customers. The focus on the use of definitions under existing US tax law to define life insurance and annuity contracts presents considerable hurdles for foreign insurance companies not familiar with these rules to work through the compliance issues raised. However, it does provide a platform from which the industry can provide detailed comments and proposals to Treasury to refine and focus the rules in order to make the proposed regulations more efficient, clearer and less burdensome.

The key issue for insurance companies continues to be the overall complexity of the task required to be compliant with FATCA. Many insurance companies use a large number of administration systems that generally do not tie together with other systems to manage their in-force contracts. As a result, the burden of searching for US indicia will continue to be a major administrative obstacle. The complexity will carry over to the foreign insurance company’s communications plan to employees, agents and brokers to train them on the administrative and systems changes required by FATCA and the impact to policyholders. The FATCA statute and the new proposed regulations are complex and will require ongoing analysis. We will be issuing additional guidance as we work with industry representatives, and we encourage you to reach out to your Ernst & Young Advisory and Tax service teams for further information.

Proposed FATCA regulations | 15
Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 152,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit www.ey.com.

Ernst & Young is a leader in serving the global financial services marketplace

Nearly 35,000 Ernst & Young financial services professionals around the world provide integrated assurance, tax, transaction and advisory services to our asset management, banking, capital markets and insurance clients.

In the Americas, Ernst & Young is the only public accounting organization with a separate business unit dedicated to the financial services marketplace. Creates in 2000, the Americas Financial Services Office today includes more than 4,000 professionals at member firms in over 50 locations throughout the US, the Caribbean and Latin America.

Ernst & Young professionals in our financial services practices worldwide align with key global industry groups, including Ernst & Young’s Global Asset Management Center, Global Banking & Capital Markets Center, Global Insurance Center and Global Private Equity Center, which act as hubs for sharing industry-focused knowledge on current and emerging trends and regulations in order to help our clients address key issues. Our practitioners span many disciplines and provide a well-rounded understanding of business issues and challenges, as well as integrated services to our clients.

With a global presence and industry-focused advice, Ernst & Young’s financial services professionals provide high-quality assurance, tax, transaction and advisory services, including operations, process improvement, risk and technology, to financial services companies worldwide.

It’s how Ernst & Young makes a difference.

© 2012 EYGM Limited.
All Rights Reserved.

For additional information concerning this alert, please contact:

Insurance Services
New York
Howard Stecker
Ernst & Young LLP
+1 212 773 9723

Chris Karow
Ernst & Young LLP
+1 212 773 4745

John Latham
Ernst & Young LLP
+1 212 773 4078

Hartford
Chris DesRochers
Ernst & Young LLP
+1 860 725 3836

Washington, DC
Terry Jacobs
Ernst & Young LLP
+1 202 327 8705

Greg Stephenson
Ernst & Young LLP
+1 703 757 6437

International Tax Services
Washington, DC
Chris Ocasal
Ernst & Young LLP
+1 202 327 6868

Chicago
Fay Polayes
Ernst & Young LLP
+1 312 879 3012

United Kingdom
Anthony Calabrese
Ernst & Young LLP (UK)
+44 20 7951 5802

Washington Council Ernst & Young
Washington, DC
Jeff Levey
Ernst & Young LLP
+1 202 467 8413

For further information please contact your Ernst & Young professional, or one of the members of our FATCA team:

Americas
New York
Neil Bromberg
Ernst & Young LLP
+1 212 773 9011

Terence Cardew
Ernst & Young LLP
+1 212 773 3628

Asia-Pacific
Darren Rykers
Ernst & Young (Hong Kong) Limited
+852 2629 3011

Rowan Macdonald
Ernst & Young (Hong Kong) Limited
+61 2 9248 4019

Paul Ho
Ernst & Young (Hong Kong) Limited
+852 2849 9564

Europe, Middle East, India, Africa
Julian Skingley
Ernst & Young LLP (UK)
+44 20 7951 7911

Ralf Temporale
Ernst & Young LLP GmbH
+49 89 14331 22191

Japan
Masahiko Okamoto
Ernst & Young ShinNihon LLC
+ 81 3 3503 1100

Takehiro Furukawa
Ernst & Young ShinNihon LLC
+81 3 3506 2411

For additional information concerning this alert, please contact:

Ernst & Young
Assurance | Tax | Transactions | Advisory

About Ernst & Young

Ernst & Young is a global leader in assurance, tax, transaction and advisory services. Worldwide, our 152,000 people are united by our shared values and an unwavering commitment to quality. We make a difference by helping our people, our clients and our wider communities achieve their potential.

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit www.ey.com.

Ernst & Young is a leader in serving the global financial services marketplace

Nearly 35,000 Ernst & Young financial services professionals around the world provide integrated assurance, tax, transaction and advisory services to our asset management, banking, capital markets and insurance clients.

In the Americas, Ernst & Young is the only public accounting organization with a separate business unit dedicated to the financial services marketplace. Created in 2000, the Americas Financial Services Office today includes more than 4,000 professionals at member firms in over 50 locations throughout the US, the Caribbean and Latin America.

Ernst & Young professionals in our financial services practices worldwide align with key global industry groups, including Ernst & Young’s Global Asset Management Center, Global Banking & Capital Markets Center, Global Insurance Center and Global Private Equity Center, which act as hubs for sharing industry-focused knowledge on current and emerging trends and regulations in order to help our clients address key issues. Our practitioners span many disciplines and provide a well-rounded understanding of business issues and challenges, as well as integrated services to our clients.

With a global presence and industry-focused advice, Ernst & Young’s financial services professionals provide high-quality assurance, tax, transaction and advisory services, including operations, process improvement, risk and technology, to financial services companies worldwide.

It’s how Ernst & Young makes a difference.

© 2012 EYGM Limited.
All Rights Reserved.

1112-1316497 NY
EYG No. CK0507

This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither Ernst & Young LLP nor any other member of the global Ernst & Young organization can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.