
IRS adopts comments from insurers in new FATCA regulations - how will the new rules impact your compliance plans?

March 5, 2014

In brief

The US Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) released on February 20, 2014 two sets of final and temporary regulations. The first set ([Link](#)) contains changes to the provisions of Chapter 4 of the Internal Revenue Code (Code) commonly referred to as the Foreign Account Tax Compliance Act (FATCA Regulations). The second set of regulations ([Link](#)) coordinate the documentation standards, reporting, and withholding rules relating to payments made to non-US and US persons (Chapters 3 and 61 and Section 3406 of the Code) with the FATCA regulations.

According to the Treasury press release ([Link](#)), the new guidance represents the last substantial package of regulations necessary to implement FATCA. As such, the regulations contain numerous changes to the previously issued regulations, with the impact to insurance companies varying dependent on the products, services offered, and onshore or offshore location of activities.

Time is of the essence with less than two months before the April 25 cut-off date in which entities must register to be on the first list of global intermediary identification numbers (GIINs) published by the IRS and less than four months before FATCA withholding begins to apply. Insurers should quickly assess these changes and incorporate any necessary adjustments into their FATCA implementation plans before the approaching FATCA effective dates.

This Insight describes the more notable differences between the final FATCA regulations and temporary regulations that will impact the insurance industry. Please also see an earlier PwC Insight ([Link](#)) released on February 28, 2014 which highlighted many of the updates provided in these final and temporary regulations for all industries.

In detail

The updates to the regulations have been viewed as being generally favorable to the insurance industry and reflect many of the comments made by the industry in the

last few months. The guidance to date has focused on the FATCA requirements such as documentation, withholding, and reporting on life insurance companies and the products they provide. While the new and

temporary regulations do not provide a wholesale exclusion for non-life insurance companies or the associated premiums, the rules continue to focus on the life insurance industry and identifying exceptions and/or exclusions

for non-life insurance companies and products as appropriate.

Offshore payments of US source premium payments

One of the more complicated issues related to the insurance industry was the treatment of an insurance premium related to US risk, but attributable to an offshore obligation and paid via a non-US insurance broker. The final regulations now provide a transitional exception to the definition of a withholdable payment that excludes certain payments of US source fixed, determinable, annual, or periodic (FDAP) income from the definition of a withholdable payment, if the payment was made with respect to an offshore obligation by a person that was not an intermediary.

The temporary regulations also explicitly exclude insurance brokers from the definition of an intermediary for purposes of this exception, which means that the exclusion applies to insurance and reinsurance premiums paid by insureds via non-US insurance brokers.

Observation: While this exclusion only applies to offshore obligations through 2017, this modification will allow insurers, particularly non-life insurers, more time to make the system changes needed to compute the allocation of US risk on 'global policies' and freeing up time to allow them to focus on other areas of their FATCA compliance program.

It should be noted that the definition of an offshore obligation was also updated and currently does not include a payment made by a nonfinancial foreign entity (NFFE). Based on public comments made by the IRS, it appears that was inadvertent and it is expected that the definition of an offshore obligation should be corrected to include payments by NFFEs.

Treatment of US insurance brokers

Under the final regulations issued in January 2013, a withholding agent who makes a payment to a US intermediary or agent of a foreign person would be required to treat the foreign person as the payee if the withholding agent has actual knowledge that the ultimate payee is foreign. This would have effectively required insured persons making payments to US insurance brokers placing a global policy to withhold on their insurance premiums related to US risk. However, the final regulations provide that if the intermediary or agent is a US financial institution or US insurance broker, the withholding agent does not have to withhold unless it has actual knowledge that the US financial institution or US insurance broker will not meet its obligations.

Observation: The conclusion that a withholding agent can treat a US insurance broker, rather than the underlying foreign insurer, as the payee when it is receiving insurance premiums on behalf of a foreign insurance company, is a benefit to the industry. It should reduce the number of Forms 1042-S that an insurance company will expect to receive, and similarly reduce the number of Forms W-8BEN-E that insurance companies will need to provide, since they will only need to document themselves to the insurance broker. Moreover, this will simplify common insurance transactions by consolidating reporting and withholding obligations with the US insurance brokers.

Holding companies

The final regulations from January 2013 provided that the definition of financial institution includes a holding company or treasury center that is part of an expanded affiliated group

(EAG) that includes a depository institution, custodial institution, insurance company, or investment entity. The temporary regulations now specify that the insurance company should be a specified insurance company.

Observation: This clarification confirms that holding companies simply in an EAG with just an insurance company are not FFIs. This clarification should reduce the number of holding company FFIs to the extent their EAG does not include a specified insurance company or other types of FFIs, such as investment entities. Insurance companies should revisit their legal entity analysis, and determine if it is appropriate to reclassify any holding companies previously determined to be FFIs.

US person - Section 953(d)

The final regulations previously provided that an insurance company making a Section 953(d) election is treated as a foreign entity, unless the company is licensed to do business in one of the states in the United States. Under the temporary regulations, such companies are treated as US persons if it is not a specified insurance company or is a specified insurance company that is licensed to do business in any state in the United States. As such, those entities that are specified insurance companies not licensed in the United States will generally be treated as an FFI.

Observation: The temporary regulations confirm a change previously noted in Notice 2013-69.

Grandfathered obligations

The temporary regulations clarify what is a material modification of life insurance and annuity contracts that are otherwise grandfathered obligations. A life insurance contract that contains a provision permitting

the substitution of the insured qualifies for grandfathered status, but annuities that permit substituting the annuitant are excluded from grandfathered status. Further, the temporary regulations indicate that the actual change or substitution of the insured causes a material modification of the obligation and will result in the obligation being treated as newly issued or executed as of the effective date of such modification and subject to withholding.

Observation: *Grandfathered status and the application of material modifications continue to be a challenge for the insurance industry. With the exception of this clarification, the regulations are consistent in their approach that a material modification is determined based on facts and circumstances. Organizations must develop reasonable criteria for identifying when a material modification occurs and establishing this process will be critical for the insurer's implementation plans.*

Nonfinancial group test

The temporary regulations provide additional relief by modifying the way assets are measured for purposes of determining whether an EAG is a

nonfinancial group. The nonfinancial group test requires that for the three-year period ending 12/31, each of the following three conditions must be met:

1. No more than 25% of the gross income of the EAG consists of passive income.
2. No more than 5% of the gross income of the EAG is derived by FFIs in the group.
3. No more than 25% of the value of assets held by the EAG are assets that produce or are held for the production of passive income.

Under the temporary regulations, this third requirement allows the value of assets to be based on either fair market value or book value. Prior to this modification, the requirement only allowed for a computation using fair market value.

Observation: *Many insurance companies struggled with generating a fair market value balance sheet to apply this test. This relief should help primarily non-life groups in making this determination. However, the temporary regulation retains the concept that assets from reserving activity must be considered passive.*

So this relief could be limited in application, as many non-life insurance groups would fail to meet all three tests and be considered a financial group.

The takeaway

Broadly speaking, the recently published guidance provides clarification and relief about what obligations and entities are in scope for purposes of the insurance industry complying with FATCA. The regulatory changes for the insurance industry are significant, and stakeholders should carefully review the regulations to identify their impact on specific situations. Insurance companies that have already begun their FATCA program should revisit their legal entity analysis, implementation plans, and business requirements in order to apply these clarifying points and take full advantage of the regulatory changes.

This regulatory guidance demonstrates the importance of providing the IRS with thoughtful comments as many of the comments were incorporated into the regulations.

Let's talk

For more information on how the above developments and requirements might impact you, please contact a member of the Global Information Reporting Network. To view contacts for over 70 countries worldwide, click [here](#).

For additional information regarding global information reporting and withholding, please click [here](#) for the *Global IRW Newsbrief* and *Tax Insights from Global Information Reporting* archive.