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Internal Revenue Service
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FATCA – Proposed Regulations issued 8 February 2012, German Insurance Association comments

Dear Sir or Madam:

This letter is written on behalf of our 469 member companies. Membership of the German Insurance Association (GDV) is diverse and includes every component of the insurance industry: life, health, property/casualty and reinsurance. Our member companies represent a combined market share of 97 percent in Germany.

Proposed Regulations for FATCA implementation

We refer to your Proposed Regulations issued 8 February 2012 regarding the Foreign Account Tax Compliance Act (FATCA). In view of the wide-ranging impact on the German insurance industry, we appreciate the opportunity to provide you with our comments (primarily on life insurance matters). We acknowledge that this is the first time insurance-specific issues have been addressed and welcome the efforts Treasury and Internal Revenue Service (IRS) have made in addressing these unique issues.

In response to your request, our comments on the Proposed Regulations are arranged – as far as possible – in the order in which they appear and not in the order of their importance.

We provide remarks and recommendations that address the following topics:

- Clarification of grandfathered obligation
- Simplify processes for identifying and reporting U.S. persons
- Responsible officer: No need for further detailed definition

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- Establish a permanent “Limited Foreign Financial Institution (FFI)-Status”
- Exclusion of life insurance products / focusing on private placement products
- Application of de minimis exemption for U.S. accounts (\$ 50,000 threshold) to new life insurance and annuity contracts
- Clarification of definition and exemption of retirement and pension accounts
- Explicit clarification of the exemption for reinsurance, casualty, property and health
- Focus on cash value life insurance and annuity contracts, simplify definitions
- More precise definition of “term life insurance contract”
- Deemed-compliant status / local FFI status possible to foreign life insurers and their branches
- Exclusion of holding companies
- Joint Statement / Intergovernmental Approach

Clarification of grandfathered obligation

The Proposed Regulations define a grandfathered obligation as any legal agreement in existence on January 1, 2013 that produces or could produce a passthru payment. This definition includes a life insurance contract payable on the earlier of attaining a stated age or death and a term certain annuity. However, the current wording is not clear as to whether annuities payable upon death are grandfathered. These types of annuities also have a defined point of termination, i.e. term certain criteria, which the payee’s death. As such, we think they should be subject to grandfathering rules. Please also keep in mind that such contracts do not have a term specified in years. They clearly do have “stated expiration” as death remains an unavoidable event and the remaining length of such a contract can be actuarially determined.

Including all life insurance and annuity contracts under this grandfathering rule would be much easier to handle and better to understand.

Simplify processes for identifying and reporting U.S. persons

The FATCA reporting obligations should take into consideration the unique nature of life insurance and annuity contracts. Therefore, insurers should be permitted to report to the IRS only in the event of a payment according to the reporting schedule outlined in the Proposed Regulations. The long-term nature of life insurance and annuity contracts differs sub-

stantially from banking and asset management. Especially since taxation rules also reflect these differences by generally not taxing the inside build-up of an insurance contract. There is no risk of tax evasion in the build-up / accumulation phase.

Analogously to the reporting requirements, the nature of insurance contracts makes the revalidation requirements of documentary evidence extremely burdensome. Insurance companies do not have frequent contact with their customers after the sale of the product, but customer-contact will of course be necessary in any case at payment. At this point, data must be collected about the ultimate beneficiary. We would like to propose a more practical concept, which would be in line with the reporting upon payment outlined above. Revalidation of documentary evidence every three years is neither practical for the reasons aforementioned nor warranted as there is no payment or income that could lead to tax avoidance. A revalidation of documentary evidence is in the context of insurance contracts only justifiable if the account holder provides the insurer with new information relating to US indicia or in case of a change of the account holder or the beneficiary.

Finally it would reduce the compliance burden to the industry if there was enhanced reliance on anti-money laundering-data (AML-data), based on local regulations. If we can rely on the country-specific AML-requirements and do not have to conduct further inquiries, this appears more workable.

Responsible officer: No need for further detailed definition

The German insurance industry welcomes the consistent terminology of a “responsible officer” in the Proposed Regulations, replacing the terms “chief compliance officer or another equivalent-level officer” or “high-level management employees” used in the previous notices. A consistent terminology assures legal certainty.

According to the Proposed Regulations, the verification process for determining a participating FFI’s compliance with its FFI agreement will require (i) written compliance policies and procedures, (ii) periodic internal reviews of its compliance and (iii) periodically provided certifications to the IRS (pages 38; 226 et seq.). With regard to internal reviews, the German insurance industry rejects any regulatory determination of detailed requirements. As laid down at present, the Proposed Regulations should (if at all) only determine the general requirement of internal reviews, but should not comprise further details concerning scope and content. It should be left to the undertaking’s responsible officer to decide how to establish internal

reviews. Detailed requirements create additional bureaucracy for insurance undertakings. Therefore, the organization of internal reviews must remain within the undertaking's responsibility.

Establish a permanent "Limited Foreign Financial Institution (FFI)-Status"

GDV appreciates the new category of limited FFI that cannot become an FFI under local law. Nevertheless, we are concerned that some countries will not amend their laws or enter into intergovernmental agreements by 1st January 2016. The transition period is not sufficient as a statutory adjustment / change of the legal framework cannot be influenced by the Limited FFI in the respective country. So removing time limits for Limited FFIs would allow an expanded affiliated group to retain its FFI compliant status. Especially the fact that a Limited FFI will be treated as non-participating and will be subject to withholding, proves that Limited FFIs will suffer from non-compliance. From our point of view, a (more) restrictive requirement would be disproportionate.

Exclusion of life insurance products / focusing on private placement products

We fully support the main objective of FATCA, which is to combat tax evasion by US persons who use FFIs to shield their US tax status from the US tax authority. But we have to stress that in general insurance products do not pose a risk of tax evasion.

Life insurance and annuity contracts are primarily designed for a specific purpose, i.e. financial protection for old age and protection against an unforeseen event (e.g. mortality risk, disability etc.), rather than income-generation purposes. Insurance contracts are maintained over a long period of time. The duration can be anything up to 40+ years depending on the profile of the insured. For investment- or savings-related products, which are of more relevance to FATCA, the terms are typically shorter, usually under 5 years. Termination of an annuity contract or withdrawal of a life insurance policy's cash value is subject to termination charges and surrender charges that make these practically unattractive to investors or tax evaders.

For the above stated reason, we strongly believe that German life insurance products should be excluded completely from the scope of FATCA.

We understand that the IRS is mainly concerned about tax evasion by high net-worth individuals. In this respect we think that tax evasion by these individuals could only be addressed by referring to the concept of private placement life insurance products. "Insurance wrappers" (as they are called in Germany) – which may be the subject of this concern – are asset accounts "wrapped" with a contract in the form of an insurance contract, but very little or no insurance risk is involved. In this case the policy holder controls the investment component. Contributions to this contract can be made in monetary form or in the form of other assets. In Germany "insurance wrappers" are not considered as life insurance contracts under the German framework of the Income Tax Act ('Einkommensteuergesetz', section 20, para. 1, no. 6, s. 5) and are not tax benefited. These special products (defined by law) are treated as an asset account for tax purposes.

With regard to the difference made in German regulations concerning life and annuity contracts on the one hand and the "wrappers" on the other hand we think the comments mentioned above are fully in line with the goals of IRS to focus on products with high tax evasion potential while taking low risk products out of scope.

Application of de minimis exemption for U.S. accounts (\$ 50,000 threshold) to new life insurance and annuity contracts

Except for the rules for existing policies, the Proposed Regulations generally do not exempt low-value accounts from treatment as U.S. accounts, even though such accounts logically present a very low risk of tax evasion. The sole exception in those regulations for low-value accounts concerns depository accounts that are owned by individuals and that have a balance of \$ 50,000 or less. This is too restrictive as there is no objective reason for the differentiation. As explained above, the German life insurance products pose no or rather low risk of tax evasion as they are embedded in a strongly regulated environment. For this reason we strongly ask you to consider adding an exemption for new signed life insurance and annuity contracts with a cash value up to \$ 50,000. A \$ 50,000 threshold for cash value insurance and annuity contracts would substantially reduce compliance costs for insurers by eliminating or minimizing costly data collection and reporting, especially for policies that will never exceed the \$50,000 threshold (for example death benefit insurances covering funeral costs).

Clarification of definition and exemption of retirement and pension accounts

It is clear from the Draft Regulations that the IRS intends to exclude retirement and pension accounts. GDV strongly supports the exclusion of foreign retirement and pension accounts (occupational pensions). In Germany it is especially unlikely that occupational pension products could be used for US tax evasion purposes. The risk of tax evasion does not exist as occupational pensions are heavily regulated and are subject to an automated reporting regime. However, the main problem is that the Proposed Regulations will not permit all types of German occupational retirement plans to satisfy these special Proposed Regulations. As there is a large variety in how local governments regulate pension solutions, these rules are too strict. To solve the problem, GDV recommends using the following definition proposal of the American Council of Life Insurers (ACLI, Comments on Proposed Chapter 4 Regulations, April 23, 2012, p.13):

“A retirement plan would comprise a predetermined contractual or legal arrangement to provide a retirement benefit, pension, or regular income to the covered employee when that person is no longer working or has attained an age to receive retirement benefits. A retirement plan may also include provisions for insurance benefits to a disabled covered employee or to a deceased covered employee’s surviving spouse or dependent. A foreign employer or individual retirement plan excluded from FATCA reporting is one which qualifies as a government-sanctioned retirement plan, legal entity, contractual arrangement or investment vehicle operated to provide pension or retirement benefits or earn income for providing such benefits under the laws of the country in which it is established and regulated with respect to contributions, distributions, reporting, sponsorship and taxation.”

Explicit clarification of the exemption for reinsurance, casualty, property and health

The Proposed Regulations exclude insurance contracts that provide pure insurance protection (such as term life, disability, health, property and casualty insurance contracts) from the definition of financial accounts.

- a) Unlike in the previously published notices (especially Notice 2010-60), it is not stated explicitly that **reinsurance** contracts and **reinsurance business** will be excluded from the FATCA rules. The definition of financial accounts arguably excludes reinsurance as a rein-

insurance contract has no cash value that a policyholder is entitled to receive. Reinsurance is an activity which consists of accepting risks passed on by an insurer or another reinsurer. Reinsurance policies indemnify an insurer against all or part of the loss that the insurer may sustain under the original policy or policies it has issued. These are business-to-business transactions sold only to other insurance companies. Reinsurance recoveries are not available to individuals or other non-insurance entities. There is no risk of tax evasion. Therefore, the Final Regulations should explicitly exempt reinsurance from FATCA's scope.

- b) Due to the fact that the definition of financial accounts is limited to cash value insurance and annuity contracts, especially **property and casualty** insurance contracts seem to be excluded. Nevertheless, a clear statement on the complete exemption of these products (next to **disability and health**) from the definition of financial accounts as it is made in the preamble of the Proposed Regulations would simplify FATCA-compliance for insurers significantly.

Focus on cash value life insurance and annuity contracts, simplify definitions

If the IRS follows our line of reasoning above, the FATCA rules for the insurance sector will focus as a maximum on cash value life insurance contracts and annuity contracts. Occupational pension schemes, reinsurance, disability, health, property and casualty will be excluded. We would welcome this clarity in the final regulations. Furthermore we urge IRS/Treasury to declare even more clearly that any life insurance contract and any annuity contract will be excluded if it is tax-favored (for example by means of a special tax relief granted by national (German) tax law – for instance: state allowance, premiums are deductible or tax exempt). The German legislator promotes favorable tax conditions only for products that do not pose the risk of tax evasion.

In this regard, we are pleased that the IRS tried to find an easy-to-use-definition for "**cash value**". From our perspective, the following definition would be even easier to handle and to understand: Cash value should be defined as the net cash available after all fees, penalties for early termination and transaction costs (= net surrender value).

The current definitions for life insurance and annuity contracts are really difficult to understand. They should be revised to provide needed clarity to insurers. Under the Proposed Regulations a term life insurance contract

means a contract that satisfies section 7702 (notwithstanding subsections (b), (c), and (d) and sections 101(f) and 817(h)). A term annuity contract means a contract that would be an annuity under section 72 (notwithstanding subsections (s) and (u) and section 817(h)).

In Section 953(e)(5)(A) of the Code a statement is used, which defines a life insurance contract issued by a controlled foreign corporation under Subpart F as one “regulated as a life insurance or annuity contract by the corporation’s or unit’s home country.” We consider that definition well suited for general application outside the U.S.. Since the intent is that a life insurance and annuity contract should be defined by local law, the Regulation should state that rule clearly and in plain English, as Section 953(e)(5)(A) of the Code has done. Such a definition would be clear, concise and not subject to confusion or misinterpretation.

More precise definition of “term life insurance contract”

The Proposed Regulations provide that term life insurance contracts are excluded from the definition of financial accounts (and therefore from the definition of U.S. accounts). The definition of term life insurance is excessively restrictive because of the requirement of “equal periodic premiums that are payable annually or more frequently during the period the contract is in existence.” Term life contracts provide for increasing, decreasing or otherwise “unequal” premium payments and therefore could not satisfy that definition. Another problem is: In Germany term life insurance covering one or more years may be funded through a single premium. The narrow definition in the Proposed Regulations would exclude a substantial number of contracts that are not investment products simply because of a specific way of payment and do not allow a policyholder to evade U.S. taxation.

We strongly recommend revising the definition of “term life insurance contracts” by removing the requirement “equal periodic premiums payable annually or more frequently during the period the contract is in existence”.

Extend deemed-compliant status / local FFI status to foreign life insurers

As the Draft Regulations currently stand only banks are able to attain a registered deemed-compliant Local FFI status. No German life insurer and none of its branches could be qualified as a registered deemed-compliant Local FFI. We welcome that the Draft Regulations state that the IRS is willing to think about an analogous extension for entities that issue certain

insurance or annuity contracts. There is no persuasive policy reason to prohibit life insurance companies from attaining local FFI treatment. Applying local FFI status to life insurance companies would considerably reduce the administrative burden for the insurance industry, without increasing the risk of tax evasion.

The majority of our member life insurance companies operate within Germany or within Europe. In general they have more than 95 % of all contracts within Europe and they do not solicit account holders outside Europe. Life insurance is an inherently local business providing products tailored for the local market. We would like to point out that for insurers based in the European Economic Area (EEA), "local" often means the entire EEA. Additionally life insurers cannot be forced to terminate a policyholder's contract, as insurance policies are legally enforceable contracts and governed by contract law. Life insurers are not allowed to cancel a contract because of FATCA rules. Furthermore, it appears to be much too restrictive if any member of an expanded affiliated group had to be incorporated or organized in the same country. We cannot understand why for example multinational groups are to be excluded from this exception, especially if the respective group is primarily active in Europe. Therefore, the Final Regulations should make local FFI status also available to affiliated groups which include both, Local FFIs and others operating cross-border.

Exclusion of holding companies

From our perspective, it would be helpful to exclude any holding company from the scope of FATCA if it does not have any financial account or does not sell products to customers. Their investment activities are not comparable to those targeted by FATCA. A risk of tax evasion does not exist.

Joint Statement / Intergovernmental Approach

We appreciate the joint statement by the USA, France, Germany, Italy, Spain and the United Kingdom regarding an intergovernmental approach improving international tax compliance and implementing FATCA. Only with an alternative way it will be possible for our members to facilitate coordination with local law restrictions and improve collaboration in the battle against offshore tax evasion. Otherwise GDV still views German and EU data protection laws as the most significant barrier to compliance. As long as this issue has not been satisfactorily resolved, German and EU insurance companies are unable to report the information required under FATCA without violating national EU member state laws by which the EU Data Protection Directive has been transposed. Therefore, it is necessary

that any local FFI could collect the information required under chapter 4 and could legally report this information to the German government under German law. To reduce cost and effort it is essential to ensure that there will be no double exposure. This means: The FATCA rules should not take effect before the implementation of the bilateral agreements.

We also remain concerned about the tight timeframes within which it is intended that FATCA will be implemented. The Draft Regulations represent the first detailed guidance specifically dealing with the insurance sector, and for example existing insurance contracts will need to be modified in order to facilitate FATCA reporting and withholding; new reporting processes will need to be developed.

If you have any questions, please do not hesitate to ask.

Sincerely,



(Dr. von Fürstenwerth)



(Dr. Schwark)