

# *Global FS Tax Newsflash*

## How do the proposed FATCA regulations impact Insurers?

*February 20, 2012*



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On February 8th, the highly anticipated proposed regulations were issued, providing guidance on the various provisions under the Foreign Account Tax Compliance Act (“FATCA”), which was enacted as part of the Hiring Incentives to Restore Employment Act of 2010. The proposed regulations provide specific guidance on a number of implementation issues relevant to the insurance industry, and appear to have incorporated a number of comments received from the insurance industry. The proposed regulations generally do not delay most of the existing effective dates for FATCA compliance.

***PwC Observation:** Among the concerns addressed by the proposed regulations were the expansion of the definition related to grandfathered obligations and the clarified definitions around financial account and account holder.*

*Although these regulations are only proposed, they appear to provide sufficient guidance for insurers to determine what products are in scope, the process and system changes which will need to be made, and enable insurers to develop a communication plan with customers and distribution networks in order to address the looming effective dates of these rules.*

Simultaneously with the issuance of the proposed regulations, the governments of the United States, France, Germany, Italy, Spain, and the United Kingdom released a joint statement providing that they are exploring a common approach to FATCA implementation through foreign financial institutions disclosing their FATCA information to the tax authority in their country of residence (rather than directly to the US government). The joint statement also emphasizes the willingness of the United States to reciprocate by automatically collecting and exchanging information on accounts held in US Financial Institutions by residents of each of the respective countries.

***PwC Observation:** The joint statement addresses many of the privacy law concerns raised by insurers and other industries. It does not, however, necessarily reduce the amount of information that must be gathered from a FATCA perspective. Depending on how the reciprocal provisions are drafted, US insurance companies may in some cases need to increase the reporting for non US clients.*

## **1) Insurance terminology now included in many FATCA definitions**

As the previous guidance was written primarily for banking institutions, the insurance industry faced a significant amount of uncertainty leading up to the release of the proposed regulations regarding the applicability and impact of FATCA. As hoped, the proposed regulations do provide clarity around several terms that allow the insurance industry to appropriately address FATCA’s requirements. Specifically, the proposed regulations clarify the intended party identified as an “account holder”, as well as provide additional guidance around the definitions of “cash value”, and “insurance company”, and address circumstances in which certain insurance or annuity contracts are included or excluded from the definition of financial account.

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### *Account Holder*

For insurance and annuity contract accounts which qualify as financial accounts (as defined below), the account holder is deemed to be the person who can access the cash value of the contract or change the beneficiary, or, if there is no such person, the account holder is the beneficiary.

### *Financial Account*

Insurance contracts that include an investment component – namely cash value insurance contracts and annuity contracts are included in the definition of “financial account.” Insurance contracts without a cash value component, such as term life, disability, health, and property and casualty are excluded from the definition of financial account.

### *Cash Value*

A cash value insurance contract is an insurance contract that has a cash value greater than zero. Moreover, cash value is the greater of:

1. The amount that the policyholder is entitled to receive upon surrender or termination of the contract (determined without reduction for any surrender charge or policy loan), and
2. The amount the policyholder can borrow under or with regard to the contract.

### *Cash Value Exclusions*

In addition to the definition of cash value, the following items are specifically excluded from the definition of cash value:

1. A refund to the policyholder of a previously paid premium under an insurance contract (other than under a life insurance or annuity contract) due to policy cancellation, decrease in risk exposure during the effective period of the insurance contract, or arising from a redetermination of the premium due to correction of posting or other similar error; or
2. Certain policyholder dividends, provided such dividends are not termination dividends, which relate to either a term life insurance contract or an insurance contract under which the only benefit payable is providing indemnification of an economic loss incurred upon the occurrence of the event insured against, such as personal injury or a sickness benefit.

### *Insurance Company*

The term insurance company is defined as a company more than half of the business of which during the calendar year is issuing (or being obligated to make payments with respect to) insurance or annuity contracts or the reinsuring of such contracts.

***PwC Observation:*** *The definitions as provided in the proposed regulations provide for clarity needed to apply the appropriate due diligence processes, as well as to define reporting requirements under FATCA. In addition, cash value exclusions clarify the intent of application of a refund to the policyholder of a previously paid premium under an insurance contract as out of scope for purposes of FATCA.*

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## 2) Pension Contracts

Certain savings accounts (including retirement & pension accounts & nonretirement savings accounts) that meet specific requirements are excluded from the definition of a financial account. In general, such accounts must be held by certain retirement plans or be subject to tax and regulatory requirements.

Additionally, an FFI that is organized for the provision of retirement or pension benefits under the law of the country in which it is established or in which it operates and meets certain requirements may qualify as a deemed-compliant FFI.

***PwC Observation:** FATCA excludes certain pension contracts. However, due diligence procedures must be applied to identify potential risk exposures.*

## 3) Modification of Due Diligence Procedures for the Identification of Accounts / De minimus Exception

The proposed regulations reduce the administrative burden imposed by FATCA associated with reviewing records of pre-existing accounts to determine US status by:

- a) At the option of the FFI, individual accounts with a balance or value of \$50,000 or less and certain cash value insurance and annuity contracts with a value of \$250,000 or less, are excluded from the due diligence procedures (effectively a de minimus exception);
- b) Providing a \$250,000 de minimus rule for pre-existing entity accounts;
- c) extending the reliance on information collected during a “know your customer” or “anti-money laundering” process (KYC/AML)
- d) Increasing the threshold for manual reviews to \$1,000,000 for pre-existing individual accounts (a “high value account”);
- e) Providing guidance on the scope of a “diligent review” of paper account records (e.g., paper search);
- f) Eliminating the special rules in the prior guidance for so-called “private banking accounts” and replacing this concept with the aforementioned “high value” account concept.

***PwC Observation:** While the majority of insurance contracts meet the grandfathered obligation requirements described below, there still remains an impact on insurers to review and report on pre-existing accounts and/or policies identified as a US account. Unless the participating FFI elects otherwise, a participating FFI is, however not required to document pre-existing cash value insurance or annuity contracts of individual account holders that have an aggregate value or balance of \$250,000 or less.*

The proposed regulations require that all account balances be aggregated, but only to the extent that computerized systems are able to link accounts by reference to a data element such as a client number or taxpayer identification number that would allow account balances to be aggregated. In addition, relationship managers of high value accounts are also required to aggregate all accounts that the relationship manager knows or has reason to know are directly or indirectly owned, controlled or established by the same person.

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**PwC Observation:** Computerized systems for insurance are often specific to a particular product that is not linked to the other computerized systems for other products. Therefore, it may not be possible to link all of an individual account holder's accounts.

#### 4) Grandfathered Obligations

The proposed regulations modify and expand upon the guidance provided in previous notices regarding the scope of grandfathered obligations by expanding the term to include obligations outstanding on January 1, 2013. The proposed guidance also indicates that any material modification of an outstanding obligation will result in the obligation being treated as newly issued or executed as of the effective date of such modification, and thus no longer included as a grandfathered obligation. Insurance companies with grandfathered obligations that do not qualify for the de minimus exclusion will have to conduct proper due diligence procedures to identify any withholdable payments made which are subject to reporting and have the processes in place to report on such payment.

Additionally, the proposed regulations identify certain obligations (including life insurance contracts payable upon the earlier of attaining a stated age or death and term certain annuity contracts) as eligible for grandfathered status.

**PwC Observation:** The expansion of "grandfathered obligations" provides relief to the insurance industry with regard to withholding; however insurance companies are still required to perform due diligence procedures to identify any withholdable payments made which are subject to reporting.

The proposed regulations define a material modification as it relates to debt securities. For all other obligations, a material modification is based on "all relevant facts and circumstances". Therefore, it remains unclear how material modifications will apply to insurance contracts. For example, whether it includes a change in the face amount of the policy or a change in the beneficiary may be an area where more guidance is needed from the IRS.

#### 5) Additional Categories of Deemed-Compliant FFIs

The proposed regulations expand on previous guidance and provide additional categories of deemed-compliant foreign financial institutions. This expansion is in an effort to reduce the compliance burdens on entities for whom entering into an FFI agreement is not necessary to carry out the provisions of FATCA. The categories of deemed-compliant FFIs are broader than those described in previous guidance, and include categories for registered-deemed compliant FFIs and certified-deemed compliant FFIs. The additions focus on the nature of the investors (e.g., retirement plans, participating FFIs or exempt beneficial owners), investment contribution (e.g., employer, government or employee contribution), as well as the nature of the distribution relationship (e.g., limited to local banks or distributors restricted from distribution outside of the country of residence).

**PwC Observation:** Deemed-compliant status is an alternative to FATCA exemption that the IRS and Treasury have offered for certain institutions, including certain local FFIs and retirement plans that present a low risk of tax evasion. Although these rules may make it easier for some entities to be deemed-compliant, they will not eliminate the administrative burden associated with FATCA. For example, entities

*seeking registered deemed-compliant status will be required to register for deemed-compliant FFI status, enter into an FFI agreement, complete a required certification, and potentially, obtain an FFI-Entity Identification Number. As a payor, entities face additional due diligence requirements (e.g., looking to obtain appropriate withholding certificates for additional categories of deemed-compliant FFI). Finally, a registered deemed-compliant entity will still have certain on-going information gathering and monitoring requirements in order to certify its “deemed-compliant” status every three years.*

*In the FATCA notices, the IRS discussed potentially granting exceptions from FATCA for insurance companies issuing solely property & casualty and reinsurance contracts. In the proposed regulations, there is no deemed compliant status for such companies. However, the proposed regulations only include insurance contracts that include an investment component – namely cash value insurance contracts and annuity contracts are included in the definition of ‘financial account’. Insurance contracts without a cash value component, such as term life, disability, health, and property and casualty, and indemnity reinsurance are excluded from the definition of financial account. It seems that any property & casualty or reinsurance company with just one financial account will still need to register as participating FFIs. As the Treasury Department and the IRS have requested comments regarding whether there should be additional categories of deemed-compliant FFIs not addressed in the proposed regulations, consideration should be given, to providing a category of deemed-compliant FFIs for entities that issue a de minimus number of financial accounts, such as cash value insurance or annuity contracts.*

## **6) Guidance on Procedures Required to Verify Compliance**

The proposed regulations modify the guidance provided in the previous notices by providing that the responsible officer of an FFI will be expected to periodically certify that the FFI complied with the terms of the FFI agreement, which will include, among other items, adopting written policies and procedures, and conducting periodic reviews of the FFI’s compliance with these aforementioned policies and procedures. While verification of compliance through a third-party audit is not required of FFIs, the IRS may choose to perform an audit of the FFI in instances of suspected trends of compliance failures.

***PwC Observation:** This confirms that a responsible officer will be ultimately accountable for FATCA compliance. As such, the responsible officer will need to be satisfied that all of the necessary due diligence, withholding and reporting procedures are sufficiently completed by providing such certifications. It is important to be mindful that many insurance companies also own asset management operations with a number of functions being performed by a third-party service provider (e.g. the due diligence, withholding and reporting functions). In these cases, the responsible officer would still need to be satisfied that all of the procedures are sufficiently completed by providing such certifications.*

As noted above, the proposed regulations provide a great deal of detailed guidance relative to the prior guidance. However, a good deal of guidance is expected in the upcoming months in the form of the draft documents, i.e., FFI Agreement, modified withholding certificates (e.g., Forms W-8) and modified information returns (e.g., Forms 1042-S).

A public hearing has been scheduled for May 15, 2012. The IRS has requested that comments be submitted by April 30, 2012.

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On February 21, 2012, PwC will host a webcast on the proposed regulations in general. A link to the registration site will be open on Friday, February 10, 2012, and can be found at <http://www.pwc.com/us/fatca>.

In addition, various PwC offices in USA will be hosting a series of roundtables and seminars over the course of the next month to discuss the implications of the regulations on the Insurance industry.

***PwC Observation:** It has been suggested that the proposed regulations have either delayed FATCA or that the efforts around compliance for the insurance industry have been substantially mitigated. It seems in fact there is still a substantial amount of work to be done by insurance companies. Given that the regulations have provided details on how these rules may ultimately work, insurers should have sufficient direction to begin assessing and developing a plan to implement the requirements of FATCA into their business processes and procedures.*

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Included below are links to the guidance released today as well as the press release and the joint statement.

Link to release:

<http://www.treasury.gov/press-center/press-releases/Pages/tg1412.aspx>

Link to statement:

<http://www.treasury.gov/press-center/press-releases/Documents/020712%20Treasury%20IRS%20FATCA%20Joint%20Statement.pdf>

Link to regulations

The proposed rules are available at :

[http://www.ofr.gov/OFRUpload/OFRData/2012-02979\\_PI.pdf](http://www.ofr.gov/OFRUpload/OFRData/2012-02979_PI.pdf)

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