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Internal Revenue Service

P.O. Box 7604

Ben Franklin Station

Washington, DC 20044

Re: Proposed Regulations REG-121647-10, Regulations Relating to Information Reporting by Foreign Financial Institutions and Withholding on Certain Payments to Foreign Financial Institutions and Other Foreign Entities

Dear Madams and Sirs,

On behalf of ACLI<sup>1</sup> and its member companies, we are writing in response to the Proposed Regulations REG-121647-10 ("Proposed Regulations") issued by the Department of Treasury ("Treasury") and Internal Revenue Service ("IRS"), and how these Proposed Regulations to implement Chapter 4<sup>2</sup> will affect life insurance companies. We appreciate the time and effort Treasury and IRS have devoted to devising rules that acknowledge the unique nature of life insurance companies and

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<sup>1</sup> The American Council of Life Insurers represents more than 300 legal reserve life insurer and fraternal benefit society member companies operating in the United States and virtually all internationally. These member companies represent over 90% of the assets and premiums of the U.S. life insurance and annuity industry.

<sup>2</sup> Sections 1471 - 1474 ("Chapter 4"), enacted as part of the Hiring Incentives to Restore Employment Act of 2010, P.L. 111- 147 (the "HIRE") Act).

**American Council of Life Insurers**

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their products worldwide. We sincerely hope our comments will continue to inform and assist/aid Treasury and IRS in crafting the final regulations. The letter provides, in detail, recommendations that identify critical changes to consider in devising life insurance-specific rules. We also request clarification of the life insurance-specific rules and recommend approaches to assist the government and the industry in Chapter 4 enforcement and compliance.

### **Executive Summary**

The following is a summary of our recommendations for changes to the Proposed Regulations and requests for clarification:

- Life insurance companies in jurisdictions where local law prohibits the transmittal of personal information as required by Chapter 4, and for which an Intergovernmental Agreement (“IGA”) is not in place, should be provided an exemption from Chapter 4 until such time as the U.S. government reaches a solution with such foreign government(s) to address the local law prohibitions. (See discussion pp. 17-18)
- The definitions of annuities and life insurance contracts should be clarified to state that for the purposes of Chapter 4, a contract is an annuity or a life insurance contract if it is regulated as an annuity or a life insurance contract in the jurisdiction where the contract is issued. (See discussion pp. 4-6)
- The definition of cash value insurance contracts should be defined as the amount that a policyholder is entitled to receive upon the termination or surrender of the contract. (See discussion pp. 10)
- The scope and definition of term life insurance contracts should include life insurance contracts that provide coverage for a stated duration and the amount paid upon termination cannot exceed aggregate premiums paid for the contract. (See discussion pp. 6-7)
- Indemnity reinsurance contracts should be excluded from the definition of a financial account. The account holder of this type of account is not an individual but rather an insurance company or a reinsurance company engaging in normal risk transfer transactions in the ordinary course of business. This type of contract does not allow for an individual or a non-insurance entity to

invest in the account. We request a clarification that indemnity reinsurance is excluded and request that such contracts expressly be exempted from the definition of a financial account. (See discussion pp. 8-10)

- There should be a \$50,000 de minimis threshold provided for all cash value insurance contracts issued after the date of the Foreign Financial Institution (“FFI”) agreement. This carve-out, currently provided only for depository accounts, would provide relief to many insurance companies that only issue low cash value insurance products. (See discussion pp. 25-26)
- The requirement for review of documentary evidence every three years should be eliminated and replaced by a requirement to review documentary evidence when a change in circumstances revealing objective indicia of U.S. taxpayer status occurs. (See discussion pp. 27-29)
- Life insurance companies that are FFIs should qualify as registered deemed-compliant with the requirements under Chapter 4 if they have procedures in place that prohibit them from selling to, and if they do not market policies to, persons who are not residents in the jurisdictions where they are licensed to operate. The final regulations should include a deemed-compliant category for insurance companies; we provide a list of conditions that would enable an insurance company to qualify as deemed-compliant below. (See discussion pp. 18-22)
- An additional category of deemed-compliant FFIs should be included in the final regulations to address insurance FFIs that exist only to service closed blocks of life insurance and annuity contracts where the companies no longer issue any new policies. (See discussion pp. 22)
- The registered deemed-compliant requirements for retirement funds should be modified to encompass Privatized Government Pension Plans where no single beneficiary has the right to more than 5% of the FFI’s assets or the FFI assets are held solely for a participant in a government designed broad-based pension system. (See discussion pp. 13-15)
- Some restrictions surrounding the exclusion of pension and retirement accounts should be modified or removed to provide meaningful relief for such accounts. The \$50,000 annual contribution limit and the restriction of contributions of earned income to retirement accounts should be removed from the final regulations. (See discussion pp. 15-18)

- Foreign life insurance companies that are classified as Controlled Foreign Corporations (“CFCs”) should be treated as having complied with their reporting obligations under the IRC if they fulfill requirements under Chapter 4. We request that the provisions under 6041 and 6049 related to the current information reporting rules be modified so they conform to the Chapter 4 presumptions of non-U.S. person status unless objective U.S. taxpayer indicia becomes apparent in the ordinary course of business. (See discussion pp. 29-30)
- The definition of life insurance and annuity contracts that qualify as grandfathered obligations should be clarified to indicate that the definitions include life insurance contracts that are payable upon surrender or death and annuity contracts whose term-certain include lifetime payouts. (See discussion pp. 22-23)
- Life insurance and annuity contracts acquired in a merger or acquisition should be classified in the same manner as pre-existing contracts and not subject to Chapter 4 rules retroactively even if the acquiring company has already entered into an FFI agreement. (See discussion pp. 30)

As requested in the preamble, our detailed comments below are based on the order of the Proposed Regulations.

## **I. Definitions**

### **A. Annuity and Life Insurance Contracts**

Sections 1.1471-1 (b)(4) and (35) of the Proposed Regulations define annuity and life insurance contracts with reference to Internal Revenue Code (“IRC”) sections 72 and 7702 respectively.<sup>3</sup> We believe these definitions are intended to define annuity and life insurance contracts by reference to the applicable local law pursuant to which the contract is issued, which in the case of policies issued in the U.S. is the respective U.S. state laws in which the policy is issued. Section 7702(a) expressly defines a life insurance contract to mean “any contract that is a life insurance contract under applicable law”. The Proposed Regulations reference to IRC section 7702 is confusing, as it may read as retaining the reference in section 7702(a) to the cash value accumulation and guideline premium tests. Those two

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<sup>3</sup> Unless otherwise noted, all references are to sections of the Internal Revenue Code of 1986. §1.1471-1 (b)(4): The term annuity contract means a contract that would be an annuity under section 72 (without regard to subsections (s) and (u) and section 817(h)). §1.1471-1 (b)(35): The term life insurance contract means a contract that satisfies section 7702 (without regard to subsections (b), (c), and (d) and sections 101(f) and 817(h)).

quantitative tests are used to define life insurance for U.S. federal tax law purposes and have no correlation to foreign life insurance contracts that may be financial accounts for Chapter 4 purposes.

The reference to section 72 in section 1.1471-1(b)(4) is less clear since there is no definition provided for an annuity contract in IRC section 72 or elsewhere in the Internal Revenue Code or regulations. Section 72 merely describes the tax treatment for the amount distributed from annuity contracts; the term annuity is one defined by state law, custom and practice.

We appreciate that Treasury and IRS have U.S. tax law as a point of reference and may have included such references as shorthand for contracts that are regulated as insurance contracts under local law, as is the case in the U.S. context where a life insurance contract is one that is treated as such under applicable state law. Section 953(e)(5) provides an excellent precedent for defining annuity and life insurance contracts by reference to local law:

For purposes of this section and section 954, the determination of whether a contract issued by a controlled foreign corporation or a qualified business unit (within the meaning of section 989(a)) is a life insurance contract or an annuity contract shall be made without regard to sections 72(s), 101(f), 817(h), and 7702 if—

(A) such contract is regulated as a life insurance or annuity contract by the corporation's or unit's home country . . .

Congress saw fit to define annuity and life insurance contracts by reference to local law for purposes of defining current worldwide income of controlled foreign corporations in section 953 (e)(5). To subject non-U.S. taxpayers to a broader U.S. based concept is clearly beyond the scope and intent of the Foreign Accounts Tax Compliance Act ("FATCA").<sup>4</sup> The use of U.S. tax definition adds tremendous complexity to the administration of the FATCA regime with little or no measurable benefit for FATCA compliance. Annuity and life insurance contracts are sometimes referred to by different names in other countries. Thus, we request that final regulations defining annuity and life insurance contracts clarify that a contract is an annuity or life insurance contract for purposes of Chapter 4 if it is regulated as a life insurance or annuity contract in the jurisdiction where the issuing company is licensed. Final regulations should amend Prop. Treas. Reg. §§1.1471-1 (b)(4) and (35) as follows:

(4) Annuity contract. The term annuity contract means a contract that would be regulated as an annuity contract in the jurisdictions where the issuing company is licensed and under section 72 (without regard to subsections 72(s) and 72(u) and ~~section 817(h)~~).

(35) Life insurance contract. The term life insurance contract means a contract that would be regulated as a life insurance contract in the jurisdiction where the issuing

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<sup>4</sup> FATCA was passed as part of the HIRE act. See, *Supra* note 2.

~~company is licensed and satisfies without regard to sections 7702 (without regard to subsections (b), (c), and (d) and sections 101(f) and 817(h)).~~

Such definitions provide a bright line test that can be understood by non-U.S. insurance companies charged with complying with Chapter 4 as well as those in the IRS charged with enforcing Chapter 4.

## **B. Insurance Contracts Without Cash Value**

### **i. Term Life Insurance Contract**

The Proposed Regulations exclude term life insurance from the definition of a financial account.<sup>5</sup> They define such contracts as “a life insurance contract, other than a contract held by a transferee for value under section 101(a)(2) (determined without regard to section 101(a)(2)(A) or (B)), if equal periodic premiums are payable annually or more frequently during the period the contract is in existence, and the amount payable upon termination of the contract prior to the death of the insured cannot exceed the aggregate premiums paid for the contract, less mortality, morbidity, and expense charges (whether actually imposed or not) for the period or periods of the contract’s existence.”

This definition would exclude only level premium term life insurance policies. Term life insurance policies sold are not limited to those for which premiums are level throughout the term of the contract. In fact, many term life insurance policies have premiums that may change over the life of the policy.<sup>6</sup> Term life insurance is increasingly popular and does not provide a cash value to the policyholder.<sup>7</sup> The definition in the Proposed Regulations should be expanded to include the wide range of term life insurance products that are available and common in the market. Thus, the definition should be modified as follows:

a life insurance contract, other than a contract held by a transferee for value under section 101(a)(2) (determined without regard to section 101(a)(2)(A) or (B)), if ~~equal periodic premiums are payable annually or more frequently during the period the contract~~ provides coverage for a stated duration ~~is in existence,~~ and the amount payable upon termination of the contract prior to the death of the insured cannot exceed the aggregate premiums paid for the contract, ~~less mortality, morbidity, and expense charges (whether actually imposed or not) for the period or periods of the contract’s existence.~~

To satisfy the definition of a term life insurance contract provided in the Proposed Regulations, the amount payable upon termination of the contract prior to the death of the insured cannot exceed the aggregate premiums paid for the contract less various charges. We first note that the definition we have

<sup>5</sup> Prop. Treas. Regs. §1.1471-5(b)(2)(ii).

<sup>6</sup> The Service acknowledges this in its own economic benefit Table 2001 and in its monthly value of group term insurance Table I.

<sup>7</sup> For example, of new individual life policies purchased in the U.S. in 2010, 39 percent, or 3.8 million, were term insurance, totaling \$1.1 trillion, or 69 percent, of the individual life face amount issued.

suggested does not reduce the amount that can be paid upon surrender of a contract by fees and charges. When companies issue return of premium policies to customers, they do not limit the return of premium by fees or charges, as in the common traditional contract the policyholder expects to receive a full return of their premium. Therefore, a contract should not fail the definition of a term contract as a result of returning the full amount of premium paid by the policyholder for the contract. We also note the comparison of the amount of premium paid and returned to the policyholder should be allowed to be made by reference to the local currency in which payments are made; since currency fluctuation should not cause a contract to be subject to FATCA.

We further suggest that any contract for which the policyholder cannot receive more than the premium paid for the contract upon surrender prior to the death of the insured be exempted from FATCA. We would appreciate learning the underlying concerns the government may have with the tax evasion risk presented by return of premium term life insurance policies so that we may assist in crafting the appropriate rule. These products are generally more expensive and should be available to consumers who are willing to pay more for a refund feature.

#### **ii. Annuity Contracts Without Cash Value**

We believe the final regulations should exclude annuity contracts without cash value from the definition of financial account. Prop. Treas. Reg. § 1.1471-5(b)(1)(iv) includes any cash value insurance contract as defined in section 1.1471-5(b)(3)(v) as a financial account. Term life insurance contracts are specifically excluded from the definition of a financial account, but no such corollary exclusion is provided for annuity contracts without cash value. Moreover, the phrase “insurance contract”, one used generically throughout the proposed rules, is not defined. We understand that in U.S. parlance an annuity contract is considered to have a cash value to which an annuity owner can have access, and that is perhaps the reason why an exclusion for annuity contracts without cash value was not provided for in the proposed rules. We have learned from our members who issue annuity contracts overseas that there are annuity contracts to which owners contribute money, but which do not provide access to that cash value by the owners. Nor are owners permitted to take loans against the values in the contracts. Owners instead are only permitted to receive annuity payments in the form of pensions that cannot be bequeathed and terminate upon the death of the owner. These contracts do not pose a tax evasion risk and should be excluded from the final regulations. We therefore suggest that the Prop. Treas. Reg. §1.1471-5(b)(1)(iv) read as follows:

(iv) Any cash value insurance contract (as defined in paragraph (b)(3)(v) of this section) and any cash value annuity contract issued or maintained by a financial institution (as defined in

paragraph (e)(1) of this section).

We recommend that final regulations include a definition for cash value annuity contracts as follows and that a new subsection (iv) be added to Prop. Treas. Reg. §1.1471-5(b)(2) expressly excluding annuity contracts from the definition of financial account:

(4) Cash value annuity contract. The term cash value annuity contract means a contract that would be regulated as an annuity contract in the jurisdictions where the issuing company is licensed and under section 72 (without regard to subsections 72(s) and 72(u) and section 817(h)), with cash value as defined in Prop. Treas. Reg. §1.1471-5(b)(3)(v)(B) to which the owner has access.

Finally, we recognize that the type of annuity contract without cash value we describe may be exempted from Chapter 4 as a retirement account under Prop. Treas. Reg. §1.1471-5(b)(2)(i)(A)(2) since it is designed exclusively to make lifetime payments but recommend the definitions be amended to reflect life insurance products accurately.

### **iii. Reinsurance Contracts**

Prop. Treas. Reg. §1.1471-5(b)(v)(C)(1)-(3) defines amounts that are excluded from cash value for purposes of Chapter 4. In our comments in response to Notices 2010-60 and 2011-34 ACLI requested that life insurance or annuity contracts without cash value be excluded from the definition of financial account under Chapter 4. We included all life reinsurance contracts, term life, return of premium,<sup>8</sup> medical and disability, and other protection insurance policies in this category as they present no tax evasion risk. In Notices 2010-60 and 2011-34 Treasury and IRS indicated that life reinsurance contracts would be excluded from Chapter 4. The Proposed Regulations make no mention of life reinsurance.

We believe Prop. Treas. Reg. §1.471-5(b)(v)(B) defining cash value as an amount that a “policyholder is entitled to receive” or that a “policyholder can borrow under” arguably excludes reinsurance contracts because the term “policyholder” is not used to identify either party to a reinsurance contract. However, it is not clear it was the intention of Treasury and IRS to exclude all reinsurance contracts from the definition of financial account. Therefore, we request that final regulations expressly exclude indemnity life and annuity reinsurance contracts from the definition of financial account for the following reasons:

- Policyholders (as the term is generally understood) are not entitled to receive any amounts under the terms of an indemnity reinsurance contract. The policyholder’s right to receive amounts is

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<sup>8</sup> Contracts may provide for returning of a portion of the premium up to 100 percent of the premium.



defined by the insurance contract without modification by the indemnity reinsurance contract.

- Parties to reinsurance contracts are not individuals or non-insurance entities, but insurance and reinsurance companies.
- In indemnity reinsurance, the reinsurer does not have a direct obligation to an individual/non-insurance entity policyholder and does not receive premium payments from individual/non-insurance entity policyholders. It has a contractual relationship only with the ceding insurer.

In short, a reinsurance contract does not present an opportunity for an individual or entity to make an investment for tax avoidance purposes.

Although one can infer exclusion of reinsurance contracts from the definition of amounts excluded from cash value, good tax administration policy dictates the direct express exclusion of such contracts. We understand further that Treasury and IRS may intend for assumption reinsurance contracts of cash value life insurance and cash value annuities to be treated as cash value contracts, and therefore included in the definition of a “financial account”, because the assuming company stands in the shoes of the original issuer vis à vis the policyholders<sup>9</sup> but the reinsurance payments between insurance companies should be exempted from FATCA.

A clear statement of the rule excluding indemnity reinsurance contracts would provide a bright line test for FFIs in their compliance and the government in its administration of these rules. We also offer the following examples to be included in the final regulations as illustrations of the rule:

Example (A): A U.S. life insurance company ceded a block of business covering cash value life insurance contracts on U.S. citizens and residents to a foreign reinsurer not engaged in a U.S. trade or business. The reinsurance contract with the foreign reinsurer is an indemnity reinsurance contract. The reinsurance contract is not a financial account.

Example (B): The same facts as in example A, except that the indemnity reinsurance contracts cover only life insurance contracts having no cash value and property-casualty insurance contracts. The reinsurance contract is not a financial account.

Example (C): The same facts as in example A, except that the reinsurance contract is an assumption reinsurance contract that obligates policyholders to make payments directly to the

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<sup>9</sup> Many reinsurers view assumption reinsurance as a novation.

foreign reinsurer and obligates the reinsurer to make claims payments directly to policyholders or their beneficiaries. To the extent the contracts assumed were financial accounts, the assumption reinsurer will be viewed as acquiring financial accounts.

### **C. Cash Value Insurance Contracts**

The Proposed Regulations treat annuity and life insurance contracts with any cash value as financial accounts. For this purpose, as well as for purposes of determining which existing annuity and life insurance contracts are excluded from Chapter 4, cash value is defined as “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”.<sup>10</sup>

We believe that a simple administrable definition for cash value is needed for uniform enforcement and compliance of the rules and request that cash value should be defined as follows: “the amount that the policyholder is entitled to receive upon surrender or termination of the contract.”

Such a rule addresses Chapter 4’s concern with the possibility of use of such accounts to evade payment of U.S. taxes and is simple to administer for life insurers across the many jurisdictions in which they operate. The amount to which a policyholder is entitled to receive upon surrender or termination of a contract is a number that is more readily available and tracked by insurance companies’ systems and it would not require additional compliance systems.

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<sup>10</sup> Prop. Treas. Regs. §1.1471-5(b)(3)(v)(B).

Please note that in formulating a definition for “cash value insurance contract,” we emphasize that guidance under FATCA should not give rise to any implication for how the term “cash surrender value” should be construed for purposes of section 7702. (Guidance on the latter term is on Service’s 2011-2012 Priority Guidance Plan, as released on January 25, 2012.) Sections 1471 and 7702 are separate statutes, neither references the other in any way, and there is no indication whatsoever that Congress thought there should be any connection between these statutes. While it is premature to offer comments regarding the meaning of “cash value” under section 7702, we observe that for all purposes the term “cash value” should not include benefits (or the portion of benefits) payable solely upon the occurrence of an insured event. Net amounts at risk payable upon an insured event are not reflective in any way of the investment in a contract and, to our knowledge, have never been considered “cash value” under state insurance law. Nor is there any policy justification for doing so for tax purposes. We further observe that the FATCA Proposed Regulations’ treatment of the return of premium benefits under life insurance contracts as “cash value” is contrary to the clear legislative history of section 7702, and thus it would be improper to apply such a rule in guidance under section 7702. ACLI anticipates offering comprehensive comments on the meaning of “cash value” in the context of section 7702 as part of the guidance process that will be initiated upon issuance of a notice of proposed rulemaking pursuant to the Priority Guidance Plan item.

## **II. Domestic Life Insurance Companies**

U.S. life insurers are considered withholding agents under Chapter 4 as the Proposed Regulations define a withholding agent to be “any person, U.S. or foreign, in whatever capacity acting, that has the control, receipt, custody, disposal, or payment of a withholdable payment”.<sup>11</sup> This means that companies may have withholding obligations related to insurance contracts held by foreign entities that have U.S. owners. Thus, any insurance company making payments for financial services to FFIs and NFFEs will need to establish procedures regarding potential for withholding.

Domestic life insurance companies may also have subsidiaries operating abroad, which, depending upon their business operations, may be categorized as an FFI and subject to withholding if not FATCA compliant. Generally, foreign operations of domestic life insurance companies are localized within a country and are limited to serving the needs of local residents. As a result, these foreign operations are low-risk and should be eligible for the registered or certified deemed-compliant status.

## **III. Foreign Life Insurance Companies**

### **A. Insurance Companies as Foreign Financial Institutions (“FFIs”)**

Prop. Treas. Reg. §1.1471-1(b)(33) defines an insurance company 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”. As noted above in section I. B. ii, above, the term “insurance contract” is not defined. Prop. Treas. Reg. §1.1471-5(e)(iv) define a foreign financial institution to include an insurance company “that issues or is obligated to make payments with respect to a financial account under paragraph (b)(1) of this section”.<sup>12</sup> It is clear from the proposed rules that a company that only issues term life insurance contracts would not be an FFI under these rules as such contracts are excluded from the term financial account. Earlier in this letter, and in our previous submissions, we requested that annuity contracts without cash value, medical and disability insurance, and indemnity reinsurance contracts be expressly excluded from the term financial account. While we believe that language in the Proposed Regulations supports this understanding, such express exclusion would provide clear administrable rules and demystify the complexities of the rules.

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<sup>11</sup> Prop. Treas. Reg. §1.1473-1(d).

<sup>12</sup> Prop. Treas. Reg. §1.1471-5(e)(iv).

## **B. Treatment of Branches**

Prop. Treas. Reg. section 1.1471-4(d)(2)(ii)(C) provides an election allowing FFIs to report its accounts on a branch by branch basis. Furthermore, Prop. Treas. Reg. section 1.1471-4(e)(2) allows FFIs to comply with FATCA even though one or more of its branches are prohibited under local law from reporting or otherwise fulfilling its requirements. This branch treatment is extremely helpful and welcome, especially as many insurance companies do business through branches in countries other than their place of incorporation or domicile. Each branch may find itself, therefore, subject to the jurisdiction of different regulators and tax authorities. By treating each branch as separate under FATCA, the ability to comply with conflicting laws is simplified.

Branch treatment should be extended, especially in consideration of the proposed intergovernmental agreements. We strongly recommend that to clarify and simplify administration of these agreements, an actual or deemed branch of an FFI should be subject to the agreement with the jurisdiction where it is regulated, and not the jurisdiction where the corporate entity is located.

## **IV. Deemed-Compliant – Companies and Accounts**

Prop. Treas. Reg. §1.1471-2(a)(4)(iv) exempts from withholding payments that are made to payees that are “deemed-compliant FFIs in accordance with §1.1471-3(d)(5) through (7)”. These proposed rules set forth two categories of deemed-compliant FFIs, (1) registered deemed-compliant and (2) certified deemed-compliant.

### **A. Retirement Funds and Retirement Accounts**

The proposed rules provide different bases for exemption of retirement funds and exception of retirement accounts. Retirement savings administered by FFIs can be excluded from FATCA if they are personal retirement and pension accounts<sup>13</sup> or if the FFI qualifies as a certified deemed-compliant retirement fund. The Proposed Regulations define personal retirement or pension accounts as those that are

- Tax favored in the jurisdiction,
- All contributions are limited by reference to
  - Earned income and
  - Annual contributions are limited to \$50,000 or less, and
- Withdrawals are restricted.

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<sup>13</sup> Prop. Treas. Regs. §1.1471-5(b)(2)(i).

They also define a certified deemed-compliant retirement funds as those that are

- Tax favored in the jurisdiction,
- All contributions are limited by reference to earned income, and
- No single beneficiary has a right to more than 5%.

We recommended a definition of retirement plans (including both retirement funds and accounts) to be exempted from Chapter 4 in our previous comment letters as follows:

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.

We appreciate the definitions that Treasury and IRS provide for pension and retirement accounts and retirement funds that would be excluded from the definition of financial account in Prop. Treas. Reg. §1.1471-5(b)(2)(i) or treated as certified deemed-compliant in Prop. Treas. Reg. §1.141-5(f)(2)(ii) but believe that some of the restrictions need to be removed in order for the exemption to provide any meaningful relief. It is clear that the statute was designed to provide relief from FATCA's compliance burdens on financial institutions engaged in the provision of retirement or pension benefits. The Proposed Regulations do not entirely accomplish this purpose as provisions prohibit or fail to encompass a wide-variety of low-risk Private Pension Accounts, as well as the insurance companies that administer them. As is explained more fully below, the annual contribution limitations and the restriction of contributions to earned income present the insurmountable hurdles for companies that administer the retirement accounts and pension funds or retirement plans. The problem for most insurance companies is the absence of such legal limitations in the jurisdictions where sanctioned pension funds and retirement plans exist. We request that final regulations be modified to remove the annual contribution limits and the restriction of contributions of earned income to retirement accounts and funds.

#### **i. Certified Deemed-Compliant – Retirement Funds**

The use of private pension systems to provide retirement benefits has grown significantly over the years as many countries have discovered that pay-as-you-go benefits are unsustainable. The transition to private pension systems effectively reduces the public benefit component and converts benefits into a combination of mandatory and/or voluntary private pension accounts (hereinafter collectively "Privatized Government Pension Plans"). Privatized Government Pension Plans are generally

akin to a combination of benefits provided through the United States Social Security (i.e. mandatory pension account) and IRA/401(k) retirement plans (i.e. voluntary pension account). While these Privatized Government Pension Plans may be designed in a variety of ways, they share common restrictions such as local government regulation, participation limitations, as well as funding and distribution limitations. The limitation for funding and distributions include:

- (1) contributions limited to contributions from employee, employer and the government,
- (2) contributions limited by reference to earned income,
- (3) contributions made on a pre-tax basis or otherwise deductible from taxable income, and
- (4) distributions based on accumulated amounts, mortality factors or similar measurements.

With respect to the participation limitations, generally only local country residents earning income in a local country are able to participate in the Privatized Government Pension Plans. Local country residents are subject to stringent documentation requirements to be eligible for participation in Privatized Government Pension Plans. As a result, the use of Privatized Government Pension Plans by U.S. persons is low-risk.

Certain approved entities, including many private insurance companies, operating in foreign jurisdictions (“Private Pension Companies”), are organized to provide products and services to support the Privatized Government Pension Plans. The following examples based on the Chilean Pension System<sup>14</sup> are intended to illustrate the need for the proposed solutions we offer. Note that the Chilean Pension System serves as a model pension system for many Latin American and Eastern European countries.<sup>15</sup> As noted above, the Proposed Regulations define pension or retirement plans as:

- Tax favored in the jurisdiction,
- All contributions are limited by reference to earned income, and
- No single beneficiary has a right to more than 5%.

Foreign pension systems are generally not designed to restrict or otherwise monitor a beneficiary’s percentage ownership in the underlying FFI assets. However, for practical purposes, foreign pension systems have a large number of participants resulting in a small ownership percentage

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<sup>14</sup> Chilean Administradora de Fondos de Pensiones (AFPs).

<sup>15</sup> The Chilean Pension System serves as a model for many other countries, including but not limited to Argentina, Bolivia, Columbia, Costa Rica, Dominican Republic, El Salvador, Mexico, Panama, Peru, Uruguay Hungary, Kazakhstan, Bulgaria, Croatia, Latvia, Estonia, Kosovo, Russia, Slovakia and Romania (citing Next Generation of Individual Account Pension Reforms in Latin America, Social Security Bulletin, Vol. 71 No. 1, 2011). Other examples of government sponsored retirement plans include Canadian Registered Retirement Savings Plans (RRSPs).

per participant. Therefore, it is highly unlikely that any pension participant would ever own more than 5% of any Privatized Government Pension Plan. As a result, application of the requirement that no single beneficiary of a Privatized Government Pension Plan have a right to more than 5% of the FFI assets should be deemed satisfied.

Example:

Approximately 7 million Chilean residents currently contribute to the Chilean pension system. The Chilean residents are required to make mandatory contributions to fund mandatory pension accounts that are managed by one of six Chilean Administradora de Fondos de Pensiones (AFPs). As of September 2011, the percentage of assets held in mandatory pension accounts represented 96.2% of the total assets held in the Chilean pension system. As there are 7 million participants in the Chilean pension system, ownership by any one Chilean resident of any pension fund will be de minimis. Further, as the mandatory pension accounts are subject to participation and contribution limitations, as well as withdrawal restrictions, the low risk nature of the Privatized Government Pension Plan is further demonstrated.

The final regulations should modify the requirements to qualify as a retirement fund under the deemed-compliant FFI to encompass Privatized Government Pension Plans. Specifically, we propose that Treas. Reg. §1.1471-5(f)(2)(ii)(A)(1)(ii) be modified as underlined below:

(ii) No single beneficiary has the right to more than 5% of the FFI's assets or the FFI assets are held solely for a participant in a government designed broad-based pension system.

**ii. Retirement and Pension Accounts**

We request that final regulations be modified to remove the annual contribution limitation of \$50,000 and the restriction of contributions of earned income to retirement accounts. Thus, Prop. Treas. Reg. §1.1471-5(b)(2)(i)(A)(2) should be modified as follows to include pension and retirement accounts in jurisdictions where such limitations do not exist by law:

(2) The account is subject to government regulation as a personal retirement account or is 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, and meets the following requirements—

(i) The account is tax-favored with regard to the jurisdiction in which the account is maintained;

(ii) All of the contributions to the account are employer, government, or employee contributions ~~that are limited by reference to earned income~~ regulated under the law of the jurisdiction in which the account is maintained; and

(iii) Annual contributions (other than transfers from other accounts described in this paragraph (b)(2)(i)(A) or plans described in paragraph (f)(2)(ii) of this section or §1.1471-6(f)) are not limited to ~~\$50,000 or less, and limits or~~ but penalties apply by law of the jurisdiction in which the account is maintained to withdrawals made before reaching a specified retirement age ~~and to annual contributions exceeding \$50,000 (other than transfers from other accounts described in this paragraph (b)(2)(i)(A) or plans described in paragraph (f)(2)(ii) of this section or §1.1471-6(f)).~~

Foreign pension systems provide for different forms of participant distributions. Distributions from mandatory pension accounts may not be taken as a lump sum and generally take the form of (1) periodic payments direct from the Privatized Government Pension Plan and/or (2) conversion of a participant's Privatized Government Pension Plan into an immediate or deferred annuity ("Converted Pension Account"). The Converted Pension Account is effectuated through a direct transfer from the Privatized Government Pension Plan to the Private Pension Company. Participant distributions from the Converted Pension Account are restricted based upon account values and mortality factors. Payout arrangements effectuated through Converted Pension Accounts are an inherent part of the Privatized Government Pension Plan. At this time, it is not clear whether Converted Pension Accounts are viewed as part of the Privatized Government Pension Plan for FATCA purposes. As the Converted Pension Account is only a means of distribution for the Privatized Government Pension Plan, the Converted Pension Accounts should be treated as part of and receive the same treatment as direct distributions from the Privatized Government Pension Plan under Treas. Reg. § 1.1471-5(b)(2)(i)(A).

Example:

In Chile, once a Chilean resident reaches retirement, the Chilean resident may take programmed withdrawals from his or her mandatory pension account or convert some or all of its mandatory pension account into an immediate or deferred annuity. A conversion is effectuated by a direct transfer of the mandatory pension balance (or account) by the AFP to a Chilean Private Pension Company selected through a clearing house system. The Chilean resident cannot receive the cash outright and cannot purchase a pension-related annuity outside the clearing house system. Further, pension-related annuities cannot be subsequently transferred for value. The conversion of the mandatory pension balance (or account) into a pension related annuity is not the creation of an investment, but rather an alternative means to distribute the participant's mandatory pension balance (or account). Accordingly, an annuity funded solely by a Converted Pension Account, and subject to similar withdrawal restrictions as a direct distribution, is and should be, treated for FATCA purposes as part of the retirement or pension fund.



Final regulations should be extended to afford the same treatment to Converted Pension Accounts as to monies transferred directly from mandatory pension accounts. Specifically, we propose that Treas. Reg. §1.1471-5(b)(2)(i)(A)(1) be modified to provide a third category of retirement and pension accounts as identified below:

(3) The account is funded solely with amounts received from a government designed broad-based pension system or any other account that qualifies under paragraph (b)(2)(i)(A)(1) or (2) of this section.

## **B. Additional Categories of Deemed-Compliant FFIs**

### **i. Local Law Prohibitions Absent Intergovernmental Agreements**

Section 1471(b)(1)(F) indicates that Congress anticipated that FATCA's disclosure requirement would conflict with foreign law. We have commented before that as a highly-regulated industry, life insurers may be faced with regulatory penalties, especially with respect to pre-existing accounts if they are compelled to terminate existing policies that fail to provide the required data or waiver. Life insurers will have significant legal exposure concerning pre-existing accounts that may have to be closed due to the unavailability of a waiver.<sup>16</sup> Unilaterally canceling existing policies likely would lead to breach of contract issues, as these policies did not contemplate meeting U.S. tax reporting requirements. Such action could be a breach of the applicable insurance laws to which the FFI is subject and cause the company to be sanctioned by the applicable regulatory body, which could include a requirement for the company to cease new sales. While the most severe of consequences to all life insurers may lie in the insurance and public law responses to the closing of pre-existing contracts, for companies that cannot qualify as registered deemed-compliant pursuant to an IGA, the number of recalcitrant accounts will continue to increase without the prospect of relief on the horizon.

Treasury and IRS acknowledge the bind in which FFIs are placed and has provided for creative solutions to this very real legal and operational problem by devising inter-governmental and multilateral processes. We appreciate that there is an intent to coordinate with foreign governments to provide "an alternative approach to implementation whereby an FFI could satisfy the reporting requirements of Chapter 4 if: (1) the FFI collects the information required under Chapter 4 and reports this information to its residence country government; and (2) the residence country government enters into an agreement to report this information annually to the IRS, as required by Chapter 4, pursuant to an income tax treaty,

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<sup>16</sup> We appreciate that Treasury and IRS have been fully briefed on the intricacies of the hurdles implicated by the European Union's Data Protection rules. We remind that even in jurisdictions with more relaxed privacy laws, at a minimum, consent from policyholders would be required before personal account information required by Chapter 4 may be transmitted by an FFI.

tax information exchange agreement, or other agreement with the United States”.<sup>17</sup> Prop. Treas. Reg. §1.1471-5(f) (1) creates a new category of registered deemed-compliant company for “any FFI that is deemed to comply with the requirements of section 1471(b) pursuant to an agreement between the government of the United States and a foreign government”.<sup>18</sup>

An insurance company is obligated to follow the terms within the four corners of the contract that it has agreed to with its policyholder. Policies in most jurisdictions are not subject to private negotiation, and the local insurance regulators must approve the language in the contract before it may be offered for sale. Insurance contracts cannot be changed once issued, and cannot even be changed for new policies without the consent of the local regulator. In many jurisdictions if the insurance company does not make payments to policyholders as required by the contracts and local regulatory rules to which the insurance company is subject, then the insurance company would be in violation of its private contractual and public regulatory obligations. Such breaches could cause an insurance company to be sanctioned and even prohibited from the future sale of insurance by the local regulator. Insurance companies that do business in countries without an IGA cannot qualify as registered deemed-compliant and would not only end up with recalcitrant accounts but would also negatively impact the expanded affiliated group in which they are a member. To date, Treasury and IRS have not provided a workable solution to this scenario.

We request that insurance companies in jurisdictions where local law prohibits the transmittal of personal information as required by Chapter 4, and for which an IGA is not in place, be deemed-compliant until such time as the U.S. government reaches a solution with such foreign government(s) to address the local law prohibitions. We also request that the qualification of the expanded affiliated group, of which the insurance company so positioned, not be adversely affected for Chapter 4 purposes.

#### **ii. Registered Deemed-Compliant – Insurance Deemed-Compliant Companies**

The Proposed Regulations do not provide rules for how insurance companies may qualify as a deemed-compliant FFI. We have previously recommended that life insurance companies that are FFIs should be deemed-compliant with Chapter 4 requirements under section 1471 (b)(2) if they have

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<sup>17</sup> Preamble, p. 6.

<sup>18</sup> Prop. Treas. Reg. §1.1471-5(f) (1). See also, Prop. Treas. Reg. §1.1471-4(b): Notwithstanding the foregoing, a participating FFI will not be required to withhold pursuant to this section with respect to a payment made to a recalcitrant account holder if so provided under an agreement between the IRS and a foreign government.

procedures in place to prohibit them from

- (1) selling life insurance or annuity contracts to persons who are not residents in the jurisdictions in which they are licensed to operate, or
- (2) marketing life insurance or annuity contracts to U.S. residents.

We suggested that a deemed-compliant life insurance company may be prohibited from marketing outside of its country of incorporation and required to have an officer certify on an annual basis that it has procedures to verify and document that it does not sell to persons who are not residents in the jurisdictions in which they are licensed to operate, and that it does not market policies to U.S. citizens or residents. The final regulations should permit insurance companies and one or more of their branches whose customers are overwhelmingly residents of the jurisdiction in which the insurer is organized or its branches are licensed to become deemed-compliant insurance FFIs.

In addition, insurance companies operating in one of the member states of the European Economic Area (EEA), which consists of the European Union (EU) and certain associated states, are generally permitted to do business in other member states as though organized in such other states. Final regulations should take this into account and treat the EEA as a single jurisdiction for these purposes. Such treatment is consistent with the fact these companies are permitted to operate in all member states. This is consistent with the rule in Prop. Treas. Reg. section 1.1471-5(f)(1)(i)(A)(5) which, for purposes of the local FFI rule, requires that 95% of the accounts maintained by the FFI are held by residents of the country where the FFI is organized, but which effectively treats the European Union as a single jurisdiction.

This deemed-compliant status would apply to stand-alone insurance companies and those insurance companies that are members of an expanded affiliated group, the FFIs of which are each participating or deemed-compliant FFIs, and irrespective of whether each member of the expanded affiliated group is operating within the same country.

We have developed the parameters for how an insurance company may qualify as registered deemed-compliant with our members and recommend that the final regulations include a deemed-compliant “insurance FFI” category designed to permit an insurance company and one or more of its branches to be treated as a registered deemed-compliant FFI under rules similar to those of a “Local FFI” contained in Prop. Reg. § 1.1471-5(f)(1)(i)(A), but modified as described below:

- (1) The FFI must be licensed and regulated under the laws of its country of organization (which

must be FATF-compliant at the time the FFI registers for deemed-compliant status) ~~as a bank or similar organization authorized to accept deposits in the ordinary course of its business, a securities broker or dealer, or a financial planner or investment adviser, but must not qualify as an FFI solely because it is an entity described in paragraph (e)(1)(iii) of this section as an insurance company.~~ For purposes of applying the tests set forth in the preceding sentence and in the following paragraphs (2) through (9), a qualified business unit (within the meaning of section 989(a)) of an FFI should be treated as a separate FFI incorporated or organized under the laws of the country in which it operates.

(2) The FFI ~~must have~~ (taking into account its own operations and not that of any affiliate) has no fixed place of business outside its country of incorporation or organization. However, any fixed place of business in the EEA of an entity incorporated in any EEA country will be deemed to be located in the entity's country of incorporation or organization.

(3) The FFI must not solicit ~~account~~ prospective policyholders outside its country of incorporation or organization. However, any solicitation in the EEA by an entity incorporated in any EEA country will be deemed to occur in the entity's country of incorporation or organization. For this purpose, an FFI will not be considered to have solicited ~~account~~ policyholders outside of its country of organization merely because it operates a website, provided that the website does not specifically state that nonresidents may ~~hold deposit accounts~~ purchase insurance products with the FFI, ~~does not advertise the availability of U.S. dollar denominated deposit accounts or other U.S. dollar denominated investments,~~ and does not target U.S. customers.

(4) The FFI must be required under the tax laws of the country in which the FFI is incorporated or organized to perform either information reporting or withholding of tax with respect to ~~accounts~~ insurance products held by residents.

(5) At least ~~98~~ 95 percent of the ~~accounts~~ insurance products maintained by the FFI must be held by residents (including residents that are entities) of the country in which the FFI is organized. An FFI which is incorporated or organized in an EUEEA member state may treat ~~account~~ policy or annuity holders that are residents (including corporate residents) of other ~~EUEEA~~ member states as residents of the country in which the FFI is incorporated or organized for purposes of this calculation. For purposes of this requirement, the residence calculation is determined prior to the date on which the insurance or annuity contract matures, as a result, if pursuant to Prop. Reg. § 1.1471-5(a)(3)(v) there is deemed to be a change of holder resulting in the beneficiary becoming the holder, the residence of such beneficiary is not taken into account for purposes of determining whether the FFI has satisfied the 95 percent residency test described above.

(6) On or before the date it registers as a deemed-compliant FFI, the FFI must implement policies and procedures to ensure that it does not ~~open~~ issue or maintain accounts for otherwise sell insurance products to any specified U.S. person who is not a resident of the country in which the FFI is organized ~~(including a U.S. person that was a resident when the account was opened but subsequently ceases to be a resident),~~ a nonparticipating FFI, or to any entity controlled or beneficially owned (as determined under the FFI's AML due diligence) by a specified U.S. person ~~that is not a resident of the country in which the FFI is organized.~~

(7) With respect to each ~~account~~insurance product that is held by an individual who is not a resident of the country in which the FFI is organized or by an entity, and that is opened after December 31, 2011, and prior to the date that the FFI implements the policies and procedures described in paragraph (f)(1)(i)(A)(6), the FFI must review those ~~accounts~~products in accordance with the procedures described in §1.1471-4(c) applicable to pre-existing accounts to identify any U.S. account or account held by a nonparticipating FFI, and must certify to the IRS that it did not identify any such account as a result of its review, to the extent it is permitted under the terms of the insurance product or local law, that it has ~~closed~~terminated any such ~~accounts~~insurance product or policy that were identified, or that it agrees to withhold and report on such accounts as would be required under §1.1471-4(b) or (d) if it were a participating FFI.

(8) In the case of an FFI that is a member of an expanded affiliated group, each member of the expanded affiliated group must be ~~incorporated or organized in the same country, must meet the requirements set forth in this paragraph (f)(1)(i)(A), and must meet the procedural requirements of paragraph (f)(1)(ii) of this section.~~ a deemed compliant FFI or a participating FFI.

(9) With respect to insurance products or policies issued after the later of the effective date of the FFI's registered deemed compliant status or January 1, 2016:

(A) The insurance company, itself, or, as delegated to a broker that has the direct relationship with the client, will obtain documentation (certifications or documentary evidence) necessary to identify the client as a U.S. person and will obtain clarification as needed to address the presence of any U.S. indicia identified during the identification procedure.

(i) To the extent that the due diligence collection is delegated to a broker, the broker will agree to comply with the applicable FATCA rules relating to due diligence.

(ii) A broker's failure to satisfy these requirements will be subject to the penalty described below.

(B) Insurance products or policies will not be sold to U.S. persons that are not residents of the jurisdiction in which the FFI is organized.

(C) To the extent that it is determined that a broker or the insurance company has issued a policy to a U.S. person that is not resident in the jurisdiction in which the FFI is organized, the contract with the policy holder (with the approval of local law) will permit the insurance company to cancel the policy and return the premiums paid.

(D) To the extent that it is determined that a change of holder event has resulted in a U.S. person being deemed to be the holder of the policy pursuant to Prop. Reg. §1.1471-5(a)(3)(B), the insurance company or broker shall obtain a validly completed Form W-9 from such U.S. person and an appropriate waiver that would enable the insurance company to conduct information reporting with respect to such person as if the insurance company were a participating FFI and the insurance company shall comply with the applicable information reporting provisions as if it were a participating FFI. If the U.S. person fails to provide a validly completed Form W-9 and an appropriate waiver, the insurance company shall withhold tax from any payment made to such U.S. person as if the insurance company were a participating FFI and the U.S. person is a recalcitrant account holder.

(E) A broker that is determined to have not reasonably and sufficiently complied with its obligations to obtain documentation necessary to identify the client as a U.S. person would be barred from selling policies issued by the insurance company (i.e., the relationship between the broker and the insurance company would end).

We believe that adoption of this new category of deemed-compliant insurance company will create significant efficiencies for both the industry and the IRS and Treasury in complying with and administering FATCA in ways similar to the Local FFI and Restricted Fund registered deemed-compliant FFI categories.

### **iii. Foreign Life Insurance Companies Not Accepting New Business**

Treasury and IRS requested comments on whether additional categories of deemed-compliant FFIs should be included in the final regulations. We recommend the following additional category to address insurance FFIs that pose virtually no risk of U.S. tax evasion, because they exist solely to service closed books of life insurance and annuity contracts. This is to address ACLI members with annuity and life insurance contracts issued through companies that no longer issue policies. In fact, in this category, sales to new policyholders are prohibited and there has been a limited collection of additional premiums on the in-force contracts. The additional category of certified deemed-compliant FFIs could be included as new section 1.1471-5(f)(2)(v) of the Proposed Regulations as follows:

An FFI is described in paragraph (f)(2)(v) if the FFI meets the requirements of paragraphs (f)(2)(v)(A) through (E) of this section.

- (A) The FFI must be an FFI solely because it is described in paragraph (e)(1)(iv) of this section.
- (B) The FFI must have notified its local regulatory authority of its entity's closed status.
- (C) All financial accounts maintained by the FFI were opened prior to the date of enactment of Chapter 4, are standard accounts offered to the public on the same terms, and were not individually negotiated with particular account holders.
- (D) During the period in which the FFI sold financial accounts, the FFI must have had policies and procedures in place prohibiting the sale of such financial accounts to U.S. persons.
- (E) The FFI must maintain policies and procedures to fulfill its information reporting obligations as a U.S. payor (as defined in Treas. Reg. section 1.6049-5(c)(5)).
- (F) The FFI does not have an affiliate that sells insurance in the jurisdiction in which the FFI was or is authorized to sell insurance.

## **V. Grandfathered Obligations**

Section 501 (d)(2) of the HIRE Act provides "that Chapter 4 shall not require any amount to be deducted or withheld from any payment under any obligation outstanding on March 18, 2012, or from the gross proceeds from any disposition of such an obligation."<sup>19</sup> These outstanding obligations were described as legal agreements with a definitive expiration or term. We understand that life insurance

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<sup>19</sup> Hiring Incentives to Restore Employment Act of 2010, P.L. 111- 147 (the "HIRE") Act), section 501 (d)(2).

and annuity contracts can be understood to be included in this category and exempted from withholding because life insurance and annuity contracts are legal agreements with definitive terms, which includes death. However, we believe that there can be uncertainty regarding this understanding, and therefore, request that the regulations make this clear. The terms of both life insurance and annuity contracts are actuarially defined. The scientifically calculated length of an insured's life defines the term of the agreement. In fact, the duration of this term is one of the fundamentals of life insurance and annuity agreements, if the insured dies within a specified time then a death benefit is paid, the annuity owner receives annuity payments for the duration of the measuring life. We ask that Treasury and IRS clarify the definition to include life insurance and annuity contracts.<sup>20</sup> Prop. Treas. Reg. §1.1471-2(b)(2)(ii) provides a non-exclusive list of examples of what the term "obligation" includes for purposes of the grandfather rule in section 501 (d)(2) of the HIRE Act. We recommend the definitions of life insurance and annuity contracts in Prop. Treas. Reg. §1.1471-2(b)(2)(ii)(C) and (D) be modified to properly reflect the fact that all such contracts are legal agreements with definitive terms:

(C) A life insurance contract payable upon the earlier of ~~attaining a stated age~~ surrender or death;

(D) A term certain annuity contract, such term may include the life of the annuitant/measuring life;

The term of any life insurance or annuity contract is actuarially determined and has a definitive expiration. Thus, no withholding tax obligation should apply with respect to pre-existing life insurance contracts and annuities issued on or before January 1, 2013 as life insurance and annuity contracts are legal agreements with definitive terms and could produce withholdable payments under Chapter 4. Any concerns Treasury or IRS may have with respect to life insurance and annuity contracts being exempted from withholding as outstanding obligations is addressed by the material modification rules in the Proposed Regulations which render obligations as "newly issued or executed as of the effective date of such modification".<sup>21</sup> The proposed rules set a facts and circumstances test for determining when a modification of an obligation is material.

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<sup>20</sup> Id., Prop. Treas. Reg. §1.1471-2(b)(2)(i) also extends the effective date for these obligations to any issued prior to January 1, 2013.

<sup>21</sup> Prop. Treas. Reg. §1.1471-2(b)(2)(iii).

## **VI. Due Diligence and Reporting**

### **A. Due Diligence – Pre-existing Accounts**

The Proposed Regulations exclude from the due diligence procedures pre-existing life insurance and annuity contracts with cash values of \$250,000 or less. They provide that

a participating FFI is not required to document a pre-existing individual account that is an account described in §1.1471-5(b)(1)(iv) as a U.S. account or an account held by a recalcitrant account holder if the conditions of paragraphs (c)(4)(iv)(A) and (B) of this section are met. An account that meets this exception as of the effective date of the participating FFI's FFI agreement will be treated as meeting this exception until the account balance or value exceeds \$1,000,000 at the end of any subsequent calendar year.<sup>22</sup>

Treasury and IRS recognize that pre-existing life insurance and annuity contracts pose little or no risk of tax evasion by providing this threshold amount for pre-existing life insurance and annuity contracts with cash values and excluding all below \$250,000 of cash value from the due diligence procedures. We commend Treasury and IRS for recognizing the differences between life insurance industry's products and depository accounts. We also appreciate that the proposed rules dispense with the private banking /private placement life insurance framework previously outlined in Notice 2011-34 and instead require that an electronic and paper review of files of pre-existing accounts with a cash value in excess of \$1,000,000 be conducted for U.S. indicia.<sup>23</sup>

The rules continue to include, as part of this search, an inquiry of the actual knowledge of any relationship manager associated with the account. We would like to remind Treasury and IRS that there is no such analogue in the life insurance company business model and distribution channels. Life insurers do not have relationships with their policyholders similar to those in the banking context; they do not have the close, ongoing business relationships that provide them with detailed knowledge concerning the policyholder. Often a higher cash value is the result of an older contract that has been in place for a long time, for which the life insurance company has likely had little or no contact with the policyholder over the term of the contract. The higher cash value or face amount would not provide the life insurer with additional detailed knowledge concerning the policyholder's tax residence. A life insurance company's files for higher cash value policies would contain only additional data relevant to underwriting the increased risks assumed. Thus, for example, more medical information that would relate to the increased mortality or longevity risk being assumed would be in such files but nothing more.

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<sup>22</sup> Prop. Treas. Regs. §1.1471-4(c)(4)(iv).

<sup>23</sup> Preamble and Prop. Treas. Regs. § 1.1471-4(c)(8).



### **B. Due Diligence - New Accounts**

As discussed above, the Proposed Regulations define financial account to include any life insurance or annuity contract with cash value of more than zero subject to Chapter 4 reporting.<sup>24</sup> Final regulations should provide an exclusion from Chapter 4 for all cash value annuity and life insurance contracts that are issued after the date of the FFI agreement whose values do not exceed \$50,000.

Such an exclusion from the definition of financial account is provided for depository accounts in Prop. Treas. Reg. §1.1471-5(a)(4)(i). ACLI previously requested that the statutory exclusion in IRC section 1471(d)(1)(B) also be made available to insurance companies as a criteria for excluding newly-issued contracts from Chapter 4 requirements. Such a carve-out would provide particularly meaningful relief for some of our members who exclusively issue low cash value life insurance contracts. For example, companies that sell life insurance contracts to pay for funeral and final expenses would be exempted from Chapter 4 altogether as all their contracts would be excluded from the definition of financial account. One member reports that the average face amount (death benefit) of its overseas policies is between \$4,000 to \$7,500, and none of its policies exceed \$40,000 in the face amount. Cash values for these policies typically pay 1/3 of the face amount. Such policies rarely achieve face amounts that are between \$25,000 and \$40,000 and never reach \$50,000 in cash value; the statutory threshold for individual accounts would enable the issuer to predict its Chapter 4 obligations.<sup>25</sup>

Finally, we appreciate that Treasury and IRS might be reluctant to provide for a \$50,000 threshold similar to that provided for depository accounts in the statute because the statute does not make mention of life insurance companies or products. It is understandable that the statute does not explicitly include insurance contracts within the exclusion for accounts for which a value does not exceed \$50,000 since Congress was uncertain as to whether insurance should be within the scope of FATCA.<sup>26</sup> Why would Congress include exclusion for a type of account that they were unsure should be included within the scope of FATCA at all? Thus far, Treasury and IRS have exercised their discretion and included the industry and its products in the absence of any reference to the industry or its products in the

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<sup>24</sup> Prop. Treas. Regs. §1.1471-5(b)(iv). The definition of “custodial accounts” also includes insurance or annuity contract. See, Prop. Treas. Regs. §1.1471-5(b)(3)(ii).

<sup>25</sup> Monetary figures are expressed as U.S. dollars.

<sup>26</sup> In its Technical Explanation of Chapter 4, the Joint Committee on Taxation “anticipated that the Secretary may prescribe special rules addressing the circumstances in which certain categories of companies, such as certain insurance companies, are financial institutions, or the circumstances in which certain contracts or policies, for example annuity contracts or cash value life insurance contracts, are financial accounts or United States accounts for these purposes”. Technical Explanation of the Revenue Provisions Contained in Senate Amendment 3310, the “Hiring Incentives to Restore Employment Act”. JCX-4-10, February 23, 2010. p. 44.

statute. If the Treasury and IRS have the authority to include certain insurance contracts within the scope of Chapter 4, then they clearly have the authority to exclude such low value contracts. Making thresholds and exclusions available for life insurance companies included via regulatory authority constitutes evenhanded tax policy administration and would reflect congressional intent in this area.

### **C. Reliance on Insurance Brokers for Documentation Due Diligence of New Accounts**

As noted in our previous submissions and elsewhere in this letter, life insurers do not have the same manner or frequency of interaction with their policyholders. In fact, an increasing number of insurance companies interact through agents and brokers who serve as intermediaries from inception of the relationship with the policyholder. These intermediaries, often independent third-parties as opposed to agents within the control of the life insurer, initiate and maintain the business relationship and as such obtain the policyholder personal information.

Insurance brokers are not FFIs under Chapter 4. In many jurisdictions, such as throughout the European Union, third-party insurance brokers are regulated and perform the know-your-customer (“KYC”) and anti-money laundering (“AML”) identification procedures. In many countries, the information collected for KYC and AML under insurance requirements is less extensive than required for new life insurance and annuity contracts under the Proposed Regulations.

We request that the broker-based documentation option provided in Prop. Treas. Reg. § 1.1471-3(c)(6)(vi) be amended to include foreign insurance brokers among the parties upon which FFIs may rely for customer documentation collection and retention as follows:

(vi) Documentation to be furnished for each account unless exception applies. Except as otherwise provided in this paragraph (c)(6)(vi), a withholding agent that is a financial institution must obtain withholding certificates or other appropriate documentation on an account-by-account basis. However, the exceptions set forth in §1.1441-1(e)(4)(ix)(A) through (C), that permit withholding agent to rely on documentation held through coordinated account systems, families of mutual funds, and through certain U.S. brokers, or foreign insurance brokers regulated by national insurance regulators apply for purposes of documenting accounts under Chapter 4 of the Internal Revenue Code.

### **VII. Election to Report as a United States Financial Institution**

IRC section 1471(c)(2) permits foreign financial institutions to elect to report “with respect to each United States account maintained by such institution as such institution would be required to

report under sections 6041, 6042, 6045, and 6049.”<sup>27</sup> Prop. Treas. Reg. §1.1471-4(d)(5) provides that a participating FFI may elect under section 1471(c)(2) and “to report with respect to payments to accounts that it is required to treat as U.S. accounts under section 6041, 6042, 6045 and 6049 as if such participating FFI were a U.S. person and each holder of a U.S. account that is a specified U.S. person or U.S. owned foreign entity were a payee who is an individual and citizen of the United States”.<sup>28</sup> The rules expressly exclude “cash value insurance or annuity accounts that are financial accounts described in section 1.1471-5(b)(1)(iv) and that would otherwise be subject to the reporting requirements of section 6047”.<sup>29</sup> Perhaps Treasury and IRS’s exclusion of section 6047 reporting is based on the fact that the same section is absent from those expressly enumerated in IRC section 1471(c)(2). We believe that Treasury and IRS have within their discretionary authority the power to include section 6047 even though it is not expressly included in the enumerated list. The statute does not make mention of life insurance companies or products yet Treasury and IRS have exercised their discretion and included the industry and its products. Making elective options available for life insurance companies included via regulatory authority constitutes evenhanded tax policy administration and reflects fully congressional intent in this area.

#### **VIII. Identification Standards and Presumptions**

##### **A. Documentation - Continued Review of Documentary Evidence Every Three Years**

The Proposed Regulations state that documentary evidence used to identify and determine the Chapter 4 status of a payee, or an account holder is valid “until the earlier of the last day of the third calendar year following the year in which the documentary evidence is provided to the withholding agent”.<sup>30</sup> We believe such re-documentation is neither warranted nor practicable as applied to the life insurance industry.

Life insurers do not have the regularity or frequency of contact with their policyholders that banks and investment funds have. After the commencement of the insurer-insured relationship, contact with policyholders tends to be centered more on events than cycles. Many policyholders plan for premium payments to be made automatically or pay through an agent. Even when policies are paid periodically, there is minimal contact with the policyholder beyond the premium payment process. The non-cyclical

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<sup>27</sup> IRC section 1471(c)(2).

<sup>28</sup> Prop. Treas. Reg. §1.1471-4(d)(5).

<sup>29</sup> Id.

<sup>30</sup> Prop. Treas. Reg. §1.1471-3(c)(6)(ii)(C).

nature of the communication makes efforts at communication a rather fruitless endeavor.<sup>31</sup> To obtain new documentary evidence from affected policyholders would require massive effort and likely result in few if any responses placing the FFI in the precarious position of having expended the resources to comply but have an overwhelming number of recalcitrant accounts after three years.

We request that due diligence based on government-issued identification be treated as not requiring periodic checks unless there are objective indicia of status change. Given the nature of the industry's practices, a better approach would be for the life insurer to re-validate any documentation relevant for a customer's Chapter 4 status when there is: (1) a change in circumstances arising from new information reflecting U.S. indicia or (2) the account holder is changed (for instance, when the policy matures and the obligation to pay the beneficiary becomes fixed). We suggest that Prop. Treas. Reg. §1.1471-3(c)(6)(ii)(D) be modified as follows:

(C) Documentary evidence. As a general rule, documentary evidence is valid until the earlier of the last day of the third calendar year following the year in which the documentary evidence is provided to the withholding agent or the day on which a change in circumstance occurs that makes the information on the documentary evidence incorrect. However, documentary evidence that contains an expiration date will be valid until the end of the expiration period, regardless of whether that expiration date occurs before or after the last day of the third calendar year following the year in which the documentary evidence is provided to the withholding agent. In addition, documentary evidence that is not generally renewed or amended, such as a certificate of incorporation, or those relating to cash value life insurance or cash value annuity contracts may be treated as valid indefinitely until a change in circumstance occurs in the course of normal business operations to indicate that ~~makes~~ the information on the documentary evidence incorrect.

Moreover, the Proposed Regulations point to the principles of Prop. Treas. Reg. § 1.1471-3(c) to determine whether the documentation provided by account holders is acceptable.<sup>32</sup> With respect to individuals, the regulations state "any valid identification issued by an authorized government body (for example, a government or agency thereof, or a municipality), that includes the individual's name and address and is typically used for identification purposes" will be deemed acceptable.<sup>33</sup> We note that many forms of valid identification issued by governments, including for example, US and EU passports do not include an individual's address. Thus, the language in Prop. Treas. Reg. § 1.1471-3(c)(5)(ii) should be changed to

any valid identification issued by an authorized government body (for example, a government or

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<sup>31</sup> Many policyholders simply would not respond due to the nature of the request and inherent infrequency of communication with insureds in the life insurance business. For example, one of our members reports an 8% response to mailings to policyholders in Spain after numerous attempts.

<sup>32</sup> See Prop. Reg. § 1.1471-4(c)(2)(i).

<sup>33</sup> Prop. Treas. Reg. § 1.1471-3(c)(5)(ii).

agency thereof, or a municipality) that ~~includes the individual's name and address and~~ is typically used for identification purposes.

We also request that life insurance companies be allowed to use the same documents that other financial institutions can use pursuant to the Qualified Intermediary ("QI") rules applicable to other financial institutions within the country as basis for the documentary evidence.<sup>34</sup>

#### **B. Treatment of Certain Classes of Entities – Controlled Foreign Corporations (CFCs)**

We appreciate that Treasury and IRS plan to coordinate reporting obligations of CFCs of life insurance companies with any additional obligations they may have to report under Chapter 4. We have previously discussed our proposal for sensible modifications to the reporting requirements for CFCs of U.S. life insurers. Subsequently, Chapter 4 was enacted with potentially new additional requirements for life insurance companies. We recommend that foreign life insurance companies that are CFCs be treated as having complied with all their reporting obligations under the IRC if they fulfill the requirements of Chapter 4 as proposed for foreign life insurers in this submission.

The Proposed Regulations' due diligence rules rely extensively on an FFI's existing customer intake procedures allowing identification of U.S. persons based on information normally collected. If based on this information there are indicia that an account owner is a U.S. taxpayer, the FFI will inquire further to determine if the account holder is a U.S. person. We applaud Treasury and IRS for adopting this approach. Treasury and IRS indicate in the preamble to the Proposed Regulations that they "generally intend to revise the definitions provided in the regulations under Chapter 3 or 61 to conform to the Chapter 4 definitions".<sup>35</sup> We request that Treasury and IRS modify the current provisions under sections 6041 and 6049 related to current information reporting and documentation applicable to CFCs of life insurance companies so they may conform to Chapter 4. The rules currently presume that payees are U.S. persons, and place the extraordinary burden on the CFC of life insurers to collect reliable documentation to overcome that presumption in order to treat the payee as a non-U.S. person. Updating the regulations under IRC section 6041 and 6049 to include the non-U.S. person presumption as to accounts sold overseas and the objective standards for identification of U.S. persons among the accounts is sound tax policy and levels the playing field for U.S. and non-U.S. owned FFIs.

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<sup>34</sup> See *also*, discussion of reliance on insurance brokers for documentation due diligence of new accounts above in section VI.C.

<sup>35</sup> Preamble, p. 29.

Finally, we recognize that the enactment of FATCA has not allowed for the dedication of Treasury and IRS resources to the narrow topic of tax reporting of CFCs of life insurers. We request that in light of the industry's numerous and consistent requests for reasonable and updated guidance with respect to such CFC reporting since the rules were adopted, that it be clarified that the 1099 reporting rules not apply to life insurance companies prior to the January 1, 2013, the effective date for Chapter 4 reporting and that Chapter 4 reporting will replace 1099 reporting for such CFCs that are life insurance companies.<sup>36</sup>

**C. Acquisition of Pre-existing Contracts by an FFI**

A transition or grandfather rule is also needed for life insurance and annuity contracts acquired through an acquisition of such contracts from a life insurance company that does not meet the requirements of section 1471(b) (is a non-participating FFI) or the acquisition of a life insurance company that does not meet the requirements of section 1471(b) (is a non-participating FFI). In such a situation we suggest that contracts existing as of the date of the acquisition be subject to the rules applicable to pre-existing contracts and that the acquiring company be provided a year to establish systems and processes for Chapter 4 compliance. Life insurance and annuity contracts issued one year after the acquisition of a life insurance company would then be subject to the rules for new accounts.

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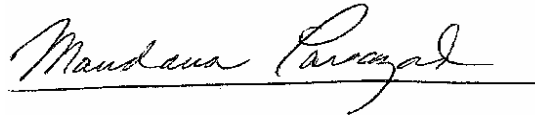
<sup>36</sup> See, ACLI letters dated November 9, 2001, November 8, 2009, and April 29, 2011.

We thank you for your consideration of this request and look forward to meeting with you to discuss the issues that we have presented in this letter. If you have questions or need for additional information, please contact us.

Sincerely,



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