

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:

Telephone Number:

Refer Reply To:
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Date:
August 01, 2016

Legend

A =
CFC =
Country A =
Parent =
US Sub =
Corp A =
Corp B =
Corp C =
Branch 1 =
Branch 2 =
Regulator =
Regulation =
Day X =

Dear _____ :

In a letter dated A, you requested a ruling allowing CFC to use certain foreign statement insurance reserves in computing foreign personal holding company income under section 954 on the grounds that these insurance reserves are an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii). Specifically, you requested permission to use (1) the underwriting reserves, loss reserves, policyholders' dividend reserves, and premiums paid in advance reserves for life insurance and annuity contracts reported by CFC on its Country A Annual Report; (2) the underwriting reserves, loss reserves, and premiums paid in advance reserves attributable to its

noncancellable and guaranteed renewable accident and health (“A&H”) contracts reported by CFC on its Country A Annual Report; and (3) the underwriting reserves, loss reserves, and associated asset bases attributable to CFC’s separate account-type contracts, as reported on the Country A Annual Report.

The rulings given in this letter are based on facts and representations submitted by Parent and accompanied by a statement executed under penalty of perjury by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

Facts

Parent is a publicly-traded domestic corporation that is engaged, through its subsidiaries, in various lines of business, which primarily include life insurance, A&H insurance, credit insurance, annuities, endowment and retirement and savings products. Parent directly and indirectly owns all the stock of US Sub. US Sub owns all of the stock of Corp A. Corp A owns all of the stock of Corp B. Corp B owns all of the stock of Corp C. Corp C owns all of the stock of CFC. Parent represents that CFC is a controlled foreign corporations as defined in section 957. CFC currently has two branches, Branch 1 and Branch 2 (collectively, “Branches”).

CFC is engaged in the life insurance business in Country A and its principal products are traditional life (both term insurance and permanent insurance), variable whole life that employ separate account funds, variable universal whole life, variable universal life savings products with guaranteed death benefits, variable annuities with guaranteed death and living benefits, fixed annuities, interest sensitive life and annuity products, A&H insurance, and retirement insurance for both companies and individuals.

Country A regulates any insurance business conducted in Country A through its insurance laws and regulations. Regulator developed and is responsible for enforcing insurance laws and regulations in Country A. An insurance company must obtain a license from the Regulator to conduct an insurance business in Country A.

CFC is licensed by the Regulator to sell life insurance and annuity contracts to persons in Country A and is subject to regulation by Regulator as a life insurance company. CFC does not carry on business other than life insurance and certain activities that are incidental to the life insurance business. CFC derives greater than 50 percent of its aggregate net written premiums from the issuance of life insurance and annuity contracts covering applicable home country risks. No policyholder, insured, annuitant, or beneficiary to a life insurance or annuity contract that the CFC issues is a related person as defined in section 954(d)(3). Parent has represented that CFC would be subject to tax under Subchapter L if it were a domestic corporation.

Branches are each separate and clearly identified units of the insurance business of CFC that maintain separate books and records. Branches are authorized or licensed by the applicable insurance regulatory body for their home country to sell insurance to persons other than related persons (with the meaning of section 954(d)(3)) in such home country. While each Branch is authorized or licensed by the country in which it is located, each Branch's financial position is overseen by Regulator.

CFC issues health and personal accident insurance contracts that are noncancellable or guaranteed renewable, cancellable, or riders to a life insurance contract. CFC's noncancellable and guaranteed renewable A&H policies create a contingent long-term obligation with an age termination date of age 60 or older, comparable to the obligation created under a whole-life insurance policy. For Country A tax and insurance regulatory purposes, CFC (1) treats its noncancellable and guaranteed renewable A&H policies as life insurance policies; (2) treats its underwriting reserves and loss reserves attributable to noncancellable and guaranteed renewable A&H policies as life insurance reserves; and (3) computes the underwriting reserves and loss reserves on such noncancellable and guaranteed renewable A&H insurance policies using a methodology similar to that of life insurance policy reserves.

CFC also issues separate account-type variable life insurance and annuity contracts, which are separately identified and maintained, and are supported by separately identifiable pools of assets. The assets in the pools are marked to market for local regulatory reporting purposes and the associated reserve follows movements in the value of the assets (with very limited exceptions, such as surrender charges). For Country A tax and insurance regulatory purposes, CFC is required to make asset basis and reserve-related adjustments to its separate accounts (including premiums received but not yet allocated to the separate accounts).

As required by Country A's insurance laws and regulations, CFC files an Annual Report and financial statements with the Regulator. The Annual Report is audited by an external accounting firm in addition to the company's internal auditor. The accounting records of CFC that form the basis for preparing the Annual Report are subject to inspection by the Regulator at any time. The Annual Report is made available to the public. In addition to their use for regulatory purposes, the Annual Report is used for financial purposes, such as Country A credit rating, by lenders, and the public. Day X is the official year-end for life insurance companies operating in Country A.

To comply with Country A's insurance laws, CFC must establish and maintain reserves for its obligations to holders of its life insurance and annuity contracts and must report the amount of such reserves on the Country A Annual Report. The reserves at issue in the ruling request are limited to the underwriting reserves, loss reserves, policyholders' dividend reserves, and premiums paid in advance reserves that CFC maintains on its Country A Annual Report for life insurance or annuity contracts.

CFC has appointed a qualified actuary that satisfies the requirements put forth by Regulator to handle the actuarial matters of the insurance undertaking, including the method of calculating reserves. The actuary has knowledge and experience concerning actuarial matters for a company in Country A engaged in the insurance business.

The reserve system for Country A includes the following requirements as to assumptions and method for underwriting reserves, loss reserves, policyholders' dividend reserves and premiums paid in advance reserves with respect to life insurance and annuity contracts issued by CFC. Underwriting reserves do not follow a prescribed methodology and assumptions, but instead follow the general guidelines of Regulation. Currently, CFC generally holds life insurance reserves determined using the net level premium method or the Zillmer method. For account value-based products, the account value is held. CFC also holds loss reserves for outstanding claims (including claims that have been incurred but not reported) under contracts issued by CFC and calculates the reserves using the company's individual loss experience, in accordance with the rules and regulations prescribed by Regulator. The policyholders' dividend reserves are reserves for dividends that have been declared and that have been paid or credited, and that have not been withdrawn by policyholders. The premiums paid in advance reserves include any premium that had been paid but whose due date falls in the following year.

Parent represents that: (1) CFC is not engaged in any insurance business outside of Country A, except through Branches, and does not carry on non-life insurance business; (2) with regards to A&H policies, the ruling request only applies to "noncancellable life, health, or accident insurance policies" within the meaning of Treas. Reg. § 1.801-3(c) or "guaranteed renewable life, health, and accident insurance policies" within the meaning of Treas. Reg. § 1.801-3(d); and (3) each contract covered by the rulings requested is a life insurance contract or annuity contract for federal income tax purposes, without regard to sections 72(s), 101(f), 817(h) and 7702.

The reserves covered by this ruling do not include: (1) deficiency reserves; (2) contingency reserves; (3) equalization reserves; (4) excess interest reserves for excess interest credited beyond the end of the taxable year; (5) reserves for administrative expenses (including guarantees intended to cover future expenses associated with the payment of claims such as bank fees or inflation risk); (6) reserves for any amount to protect against a future decline in the value of investment assets; or (7) any reserves for accrued liabilities.

Law

In general, a United States shareholder of a controlled foreign corporation ("CFC") must include in gross income its pro rata share of the CFC's Subpart F income for each year. Subpart F income includes, among other types of income, insurance income under section 953 and foreign base company income under section 954.

Section 953(a)(1) defines the term “insurance income” to include any income which is attributable to issuing or reinsuring of an insurance or annuity contract, and which would be taxed under Subchapter L if such income were the income of a domestic insurance company. Section 953(a)(2) provides that section 953 insurance income does not include “exempt insurance income” derived by a “qualifying insurance company.” Section 953(b)(3) provides that reserves for any insurance or annuity contract shall be determined in the same manner as under section 954(i).

Section 953(e)(1) defines exempt insurance income as income derived by a qualifying insurance company which is attributable to the issuing (or reinsuring) of an exempt contract by such company and such income is treated as earned by such company in its home country for purposes of such country’s tax laws. Exempt contracts are defined under section 953(e)(2) to include insurance or annuity contracts issued by a qualifying insurance company in connection with the lives or health of residents of a country other than the U.S. but only if such company derives more than 30 percent of its net written premiums from otherwise exempt contracts which cover applicable home country risks and with respect to which no policyholder, insured, annuitant or beneficiary is a related person within the meaning of section 954(d)(3).

In general, section 953(e)(3) defines a “qualifying insurance company” as any CFC that: (A) is subject to regulation as an insurance company by its home country, and is licensed, authorized, or regulated by the applicable insurance regulatory body for its home country to sell insurance or annuity contracts to persons other than related persons (within the meaning of section 954(d)(3)) in such home country; (B) derives more than 50 percent of its aggregate net written premiums from the issuance by such controlled foreign corporation of contracts covering applicable home country risks of such corporation and with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in section 954(d)(3)); and (C) is engaged in the insurance business and would be subject to tax under Subchapter L if it were a domestic corporation.

Section 954(a)(1) defines the term “foreign base company income” to include, among other types of income, foreign personal holding company income. Section 954(c)(1) sets forth the types of income that are considered to be foreign personal holding company income. Section 954(i)(1) provides that for purposes of section 954(c)(1), foreign personal holding company income does not include “qualified insurance income” of a “qualifying insurance company”.

Section 954(i)(2) defines the term “qualified insurance income” to mean income of a qualifying insurance company falling into two categories. First, income received from unrelated persons and derived from investments made by a qualifying insurance company or qualifying insurance company branch (collectively referred to as a “QIC”) either of its reserves allocable to exempt contracts or of 80 percent of its unearned premiums from exempt contracts (as both are determined in accordance with section 954(i)(4)). Second, income received from unrelated persons and derived from

investments made by a QIC of an amount of its assets allocable to exempt contracts equal to: (1) in the case of property, casualty, or health insurance contracts, one-third of the premiums earned on those contracts during such year; and (2) in the case of life insurance or annuity contracts, 10 percent of the reserves described in section 954(i)(2)(A) for such contracts.

Section 816(a) defines the term “life insurance company” as an insurance company that is engaged in the business of issuing life insurance and annuity contracts (either separately or combined with accident and health insurance), or noncancellable contracts of health and accident insurance, if (1) its life insurance reserves plus (2) unearned premiums, and unpaid losses (whether or not ascertained), on noncancellable life, accident, or health policies not included in life insurance reserves, comprise more than 50 percent of its total reserves. For purposes of the preceding sentence, “insurance company” means any company more than half of the business of which during the taxable year is the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies.

Section 816(b)(1) defines the term “life insurance reserve” as amounts (A) computed or estimated on the basis of recognized mortality or morbidity tables and assumed rates of interest, and (B) that are set aside to mature or liquidate, either by payment or reinsurance, future unaccrued claims arising from life insurance, annuity, and noncancellable accident and health insurance contracts (including life insurance or annuity contracts combined with noncancellable accident and health insurance) involving, at the time with respect to which the reserve is computed, life, accident, or health contingencies.

Section 817 generally provides special rules for certain variable contracts for purposes of Part I of Subchapter L of the Code. Section 817(d) defines a variable contract as any contract that (1) provides for the allocation of all or part of the amounts received under the contract to an account which, pursuant to state law, is segregated from the general asset accounts of the company, and (2) provides for the payment of annuities, is a life insurance contract, or provides funding for insurance on retired lives.

If a contract satisfies the variable contract requirements, and the separate account that funds the variable contract is treated as a segregated asset account, section 817 requires that certain adjustments be made to the insurance company’s asset basis and insurance tax reserves with respect to the segregated asset account. Section 817(a) provides that, with respect to any variable contract, reserves are adjusted (1) by subtracting an amount equal to the sum of the amounts added from time to time (for the taxable year) to the reserves separately accounted for by reason of appreciation in value of assets (whether or not the assets have been disposed of) and (2) by adding thereto an amount equal to the sum of the amounts subtracted from time to time (for the taxable year) from such reserves by reason of depreciation in value of assets.

Under section 817(b), the basis of each asset in a segregated asset account is increased or decreased by the amount of appreciation or depreciation, respectively, to the extent the reserves or other items referred to in section 817(a) are adjusted. The asset basis and insurance tax reserve adjustments offset any realized gain/loss attributable to such marked assets at the insurance company level.

Section 954(i)(3) imposes separate contract treatment for “separate account-type contracts,” a term which includes contracts not meeting the requirements of section 817. Section 954(i)(3)(A) provides that, for purposes of applying section 954(i) and with respect to any separate account-type contract (including any variable contract not meeting the requirements of section 817), income credited under such contract is allocable only to such contract. Income not allocable to a separate account-type contract is allocated ratably among contracts.

Section 954(i)(4)(B)(i) generally provides that in the case of life insurance and annuity contracts, a QIC’s reserves allocable to exempt contracts are equal to the greater of (1) the net surrender value of the contract or (2) the reserve determined under section 954(i)(5). Section 954(i)(4)(B)(ii), however, provides:

The amount of the reserves under section 954(i)(4)(B)(i) shall be the foreign statement reserve for the contract (less any catastrophe, deficiency, equalization, or similar reserves), if, pursuant to a ruling request submitted by the taxpayer or as provided in published guidance, the Secretary determines that the factors taken into account in determining the foreign statement reserve provide an appropriate means of measuring income.

Section 954(i)(4)(B)(ii) was originally enacted by section 614 of the Job Creation and Worker Assistance Act of 2002. Under the Protecting Americans from Tax Hikes (PATH) Act of 2015 (P.L. 114-113, 12/18/2015), section 954(i) was permanently extended and made effective for taxable years of foreign corporations beginning after December 31, 2014, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end. In its Technical Explanation to the PATH Act, the staff of the Joint Committee on Taxation explains section 954(i)(4)(B)(ii) as follows:

The provision does, however, permit a taxpayer in certain circumstances, subject to approval by the IRS through the ruling process or in published guidance, to establish that the reserve for such contracts is the amount taken into account in determining the foreign statement reserve for the contract (reduced by catastrophe, equalization, or deficiency reserve or any similar reserve). IRS approval is to be based on whether the method, the interest rate, the mortality and morbidity assumptions, and any other factors taken into account in determining foreign statement reserves (taken together or separately) provide an appropriate means of measuring income for Federal income tax purposes.

Joint Comm. on Taxation, Technical Explanation of the Revenue Provisions of the Protecting Americans from Tax Hikes Act of 2015, House Amendment #2 to the Senate Amendment to H.R. 2029 (Rules Committee Print 114-40) (JCX-144-15 (December 17, 2015)).

Analysis

CFC is subject to regulation as a life insurance company by Country A. CFC is licensed, authorized, and regulated by the Regulator, which is the insurance regulatory body for Country A, to sell life insurance and annuity contracts to persons other than related persons within the meaning of section 954(d)(3)) in Country A. Parent has represented that CFC derives more than 50 percent of its aggregate net written premiums from the issuance by CFC and Branches of life insurance and annuity contracts covering applicable home country risks and with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in section 954(d)(3)). Parent has also represented that CFC is engaged in the life insurance business and would be subject to tax under Subchapter L if they were domestic corporations. Branches are qualified business units (within the meaning of section 989(a)) of CFC. Each Branch is authorized or licensed by the applicable insurance regulatory body for its home country to sell insurance to persons other than related persons (within the meaning of section 954(d)(3)) in such home country. Premiums received by Branches are treated as earned by each Branch in its home country for purposes of such country's tax laws. Accordingly, CFC is a QIC under section 953(e)(3) and the Branches are qualifying insurance company branches under section 953(e)(4).

CFC issues life insurance and annuity contracts in connection with the lives and health of residents of Country A, a country other than the United States. The Branches issue life insurance and annuity contracts in connection with the lives and health of resident of their respective home country. CFC derives more than 30 percent of its net written premiums from contracts that cover Country A risks with respect to which no policyholder, insured, annuitant, or beneficiary is a related person within the meaning of section 954(d)(3). Each Branch also derives more than 30 percent of its net written premiums from contracts that cover home country risks with respect to which no policyholder, insured, annuitant, or beneficiary is a related person within the meaning of section 954(d)(3). Life insurance and annuity contracts issued by CFC (including Branches) are therefore exempt contracts within the meaning of section 953(e)(2).

CFC must establish, maintain, and calculate its underwriting reserves, loss reserves, policyholders' dividend reserves, and premiums paid in advance reserves in accordance with the insurance laws and regulations prescribed by the Regulator. The Regulator generally requires a life insurance company to determine the amount of its underwriting reserves, loss reserves, policyholders' dividend reserves, and premiums paid in advance reserves based on guidance provided by the Regulator. CFC must set forth its underwriting reserves, loss reserves, policyholders' dividend reserves, and premiums

paid in advance reserves on the Country A Annual Report, which must be filed annually with the Regulator. These reserves are the measure of the legal obligations to policyholders on the financial statement used for regulatory purposes by life insurance companies doing business in Country A (whether U.S.-owned, locally owned, or owned by companies headquartered in other foreign countries). The Regulator requires CFC to hold its underwriting reserves, loss reserves, policyholders' dividend reserves, and premiums paid in advance reserves for the fulfillment of claims owed to policyholders and beneficiaries. The reserves are not catastrophe, deficiency, equalization, or similar reserves. Under the rules prescribed by the Regulator for determining reserves required to be calculated for purposes of the Country A Annual Report, the method, interest rate, the mortality and morbidity assumptions and other factors taken into account provide an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii).

CFC issues noncancellable and guaranteed renewable A&H contracts and riders to life insurance contracts as part of its life insurance business. For Country A tax and insurance regulatory purposes, CFC computes the underwriting reserves, loss reserves, and premiums paid in advance reserves on these policies using a methodology similar to that used to compute life insurance reserves. The treatment of noncancellable and guaranteed renewable A&H contracts as life insurance contracts, the reserves for which are computed as life insurance reserves, is consistent with the treatment of such reserves for standard actuarial, local regulatory, local tax, and U.S. GAAP purposes. Under the rules prescribed by the Regulator for determining reserves required to be calculated for purposes of the Country A Annual Report, the method, interest rate, the mortality and morbidity assumptions and other factors taken into account provide an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii). For Country A insurance regulatory purposes, CFC is required (1) to mark to market its portfolio investment assets held pursuant to its separate account-type contracts, (2) to adjust the bases of its marked portfolio investment assets to fair market value, and (3) to adjust its underwriting reserves and loss reserves in order to offset any realized gain or loss attributable to the marked assets. The asset basis and reserve-related adjustments prevent CFC from reporting distortions in the amount and timing of its income on its Country A Annual Report to the Regulator. This method clearly reflects income as does the rules provided by section 817 for domestic insurance companies taxed under subchapter L. Under the rules prescribed by the Regulator for determining reserves required to be calculated for purposes of the Country A Annual Report, the method, interest rate, the mortality and morbidity assumptions and other factors taken into account provide an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii).

Ruling

Based on the information submitted and the representations made, we rule as follows:

(1) Under the facts set forth above, the foreign statement underwriting reserves, loss reserves, policyholders' dividend reserves, and premiums paid in advance reserves maintained by CFC with respect to its exempt life insurance or annuity contracts are an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii) and may be used in determining the foreign personal holding company income of CFC under section 954(i).

(2) Under the facts set forth above, the foreign statement underwriting reserves, loss reserves, and premiums paid in advance reserves maintained by CFC for its noncancellable and guaranteed renewable accident and health contracts are an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii) and may be used in determining the foreign personal holding company income of CFC under section 954(i).

(3) Under the facts set forth above, the foreign statement underwriting reserves, loss reserves, and associated asset bases attributable to CFC's separate account contracts are an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii) and may be used in determining the foreign personal holding company income of CFC under section 954(i).

Caveats

We express no opinion on any provisions of the Code or regulations not specifically covered by the above ruling. This ruling will be subject to revocation if any of the following circumstances occurs: (1) a change in the material facts on which this ruling was based; (2) a material change in the business circumstances of CFC which would impact its reserving method; or (3) a change in the applicable law or foreign rules relating to the current reserving method of CFC.

Procedural Statements

This ruling is directed only to CFC. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Mark E. Erwin
Branch Chief, Branch 5
Office of Associate Chief Counsel (International)

cc: