Operational Changes for Implementing FATCA
Implications for the insurance industry

12 June, 2012
Introduction: Impact on the insurance industry

Proposed Regulations specifically address:
- Insurance companies
- Insurance and annuity contracts

Certain foreign insurance companies will be treated as foreign financial institutions:
- Cash value insurance and annuity contracts issued or maintained by these companies will be treated as foreign financial accounts
- General framework of FATCA will apply to these insurance companies and insurance contracts similarly to other financial providers and their products
- There are unique rules that will affect only the insurance industry
- These rules will have unique consequences

Why is this a big issue?
- Insurance companies were not subject to the rigours of QI
- Much less prepared and (currently) operationally capable of dealing with FATCA than QI banks
Why are cash value insurance products included?

Why – the substance of the transaction

Private Placement Life Insurance;

- Is a wealth planning tool – most cases, substance is not insurance
  - Limited (1% for VUL) or no actual biometric risk shift
- In substance, it is private banking/wealth management strategy

- Eg., Deferred Variable Annuity (DVA)
  - No Risk Shift = Not Insurance (you are not insuring any risk)

- Insurance companies are engaging in private banking
  - Profitable, but carries its own risks and costs
  - „The piper now wants to get paid“

- Will increasingly be treated as private banking/wealth planning tools
  - Which is Ok, so long as they retain the benefits;
    - Tax optimisation
    - Asset protection
    - Investment flexibility
    - Succession planning
Operational milestones and basic requirements; some key dates for the Insurers

Timeline

- Withholding for gross proceeds to non-participating FFIs and recalcitrants begins
- Reporting begins; FFIs must report existing US account holders (for 2013)
- FFIs implement procedures with respect to new accounts
- Report accounts identified as US accounts to IRS (with waiver)
- Deadline for FFIs to complete second stage of due diligence reviews
- Reporting information on income on US and recalcitrant accounts begins
- Full implementation
  - Information on income & gross proceeds
  - 30% withholding on all other payments, gross proceeds, pass-through payments, etc
  - I.e., withholding on „Pass-Thru“ payments begins including foreign payments

„Transition“ period

- Deadline for PFI agreements with IRS
- Responsible for identifying all new „US accounts“ and recalcitrants
- 30% withholding on payments to non-participating FFIs and recalcitrants begins
- Reporting begins; FFIs must report existing US account holders (for 2013)
- FFIs implement procedures with respect to new accounts
- Report accounts identified as US accounts to IRS (with waiver)
- IRS starts accepting applications
- „Demarcation“ line; new and pre-existing accounts
- Reporting information on income on US and recalcitrant accounts begins
- Full implementation
Three main things we need to look at

1. Consequences of classifying insurance companies as FFIs
2. Treatment of cash value insurance and annuity contracts as financial accounts
3. Disclosure and reporting considerations for U.S. persons

Specific: We are interested in insurance companies that issue or are obligated to make payments with respect to a financial account;
- Surrender payments
- Annuity payments
- Death benefits
- Any other payments accessing the cash value of an insurance or annuity contract
Operational Requirements

FATCA says;
Must identify ➔ US Accounts
all Accounts; ➔ Non-US Accounts

➢ Document each account holder
➢ Report on each US account holder
➢ Identify and withhold on each „recalcitrant“ account holder

Impacts All accounts of FFI

Tasks for Insurers;
1. Determine contract holder
2. Determine Chapter 4 status of contract holder:

1. Specified U.S. person
2. Foreign individual
3. Participating FFI
4. Deemed-compliant FFI
5. Exempt beneficial owner
6. Non-participating FFI
7. Territory financial institution
8. QI branch of a U.S. financial institution
9. Excepted NFFE;
10. or a passive NFFE

3. If US person – contact client, ask for the waiver (secrecy)
4. Report
The involved parties to an insurance contract

**Client level**
- **Policyholder**
- **Beneficiary**
- **Insured Person**
- **Trusted Advisor**

**Policyholder may be:**
- Natural person
- Trust
- Company LLC (NFFE)
- Foundation
- etc.

- Have to check for US indicia
- 30% withholding will apply on all payments

**For many old policies:**
- May not know nationality(s) of „Owner(s)“
- May not even know who „Owner“ is
- May not even be able to find out
- Beneficiary may now be „Owner“
- Carrier may have changed

**Multiple possible:**
- Policyholders
- Beneficiaries
- Insured persons

**Underlying Accounts – reporting value:**
- Multiple possible underlying accounts
- Non-bankable assets - how to value?
- Contract „cash value“ may bear no relation to „fair market value“

**Provider level**
- **Account**
- **Asset Manager (Relationship Manager)**
- **Insurance Broker (Relationship Manager)**
- **Custodian Bank**
- **Reinsurer**
- **Insurance Carrier**
Policyholder US person indicia – the same as for the banks

**Indicia**

**Notice 2010-60 lists six indicia of U.S. status:**

1. Indication that the account holder is a U.S. Citizen or resident
2. A U.S. place of birth
3. A U.S. mailing or permanent address
4. An account where the only address is a P.O. Box, in care of address or hold mail address
5. A power of attorney (POA) or signing authority granted to a person with a U.S. address
6. Instructions to send payments to an account in the U.S. or any instructions received from the U.S.

Having one of these indicia does not mean that the account is owned by a U.S. person, only that it must be given closer scrutiny

**Reporting Requirements**

- Name, address, and Taxpayer Identification Number (TIN) of each account holder which is a specified United States person and;
- In the case of any account holder which is a United States owned foreign entity, the name, address, and TIN of each substantial United States owner of such entity
- The account number
- The account balance or value (timing to be clarified by Regulations)
- Gross receipts and gross withdrawals or payments from the account (timing and manner to be clarified by Regulations).

Alternatively, an FFI may make an election to provide full IRS Form 1099 reporting on each account holder that is a specified United States person or United States owned foreign entity as if the holder of the account were a natural person and citizen of the United States.

**Obvious; guidance didn’t bother to mention:**

- US passport, green card, substantial US presence, regular payments to or from a USFI
  - Will trigger US person status
The reporting and withholding rules - Part 1

Reporting rules
Pre-existing contracts less than 250K USD
- Not required to document or report contract to IRS

Accounts that meet this exception as of effective date of insurance company’s agreement is treated as non-reportable until that account reaches USD 1 Mio in any calendar year
- At which point it then becomes reportable

However, multiple accounts attributable to one owner must be aggregated:
- Contracts attributable to one specific US person must be aggregated
- If Aggregate > 250K USD – must be reported

- Electronic Check for contracts with cash value from 250K up to 1 Mio. USD
- Electronic plus Manual Check for contracts with cash value over 1 Mio. USD
### Pre-Existing contracts - before 1. Jan. 2013

#### Checks; Electronic and Manual

<table>
<thead>
<tr>
<th>$$$</th>
<th>Check?</th>
<th>Who to do?</th>
<th>Comments</th>
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| 1 Mio. | Electronic check | Responsible:  - Insurance company  
Necessary:  - Broker  
- Asset Manager  
- Bank  
- Other intermediary | Will have to partner with other participants to insurance structures  
Electronic and manual checks to be done by brokers, asset managers, banks, etc.?  
May be dependent on the intermediaries to get the information  
Carrier may not be permitted to directly contact owner (US resident) |
| 250K | Electronic check | Insurance company  
Others ??? | How detailed is the electronic check?  
Partnering necessary?  
Electronic checks to be done by partner brokers, asset managers, banks, etc? |
| 0 | No Check | | PFFIs will need to report number and aggregate value of accounts held by recalcitrant account holders plus;  
Number and aggregate value of accounts held by related or non-related PFFIs |
Issue – often the insurance company is not permitted to contact the client directly when client resident in the USA

Mediates Policy
• Owns & Controls Client Relationship
• Communications

Broker/Trust Company/
Lawyer/
Other Intermediary

Asset Manager

Custodian Bank

Mediates Policy
• Owns & Controls Client Relationship
• Communications

Policyholder
(Bob)

Insurance Policy
- Contract -

Policy
• xxxx
• xxxx

Insurance Carrier

“Offshore” Insurance Carrier
• Potential SEC issues
• State and Federal insurance regulations
  ➢ License to conduct business in USA
• Solicitation rules
• May not contact client directly
• Dependent on Intermediary to communicate with client
Withholding rules
If person is identified as US person;
- US person will be asked to provide waiver of foreign law restrictions to permit reporting by Participating FFI
- If US person fails to provide waiver or other

Will be treated as „Recalcitrant“ account holder
Subject to 30% withholding

Contracts:
- Pre- Jan 2013; „Grandfathered“ → No withholding
- Post Jan 2013 → Withholding

Grandfathering;
1. Deferred Variable Annuities (DVAs) most likely do NOT qualify for grandfathering;
   - Regulations use IRC 1275(a)(1) definition of debt instrument
   - Excludes contracts that qualify under IRC 72, ie. DVA contracts
     ➢ DVAs do not appear to qualify for exclusion from withholding under grandfathering provision
2. DVA conversion to annuity (annuitisation) will most likely be considered „material change to contract“
   ➢ Grandfathering will not apply

Result;
- DVA payouts - surrender and maturity - most likely subject to withholding
- Grandfathering rule will require carriers to;
  ➢ Develop systems and processes to identify contracts as of 1 Jan. 2013
  ➢ Tag them for future reference
- Even where exempted from withholding;
  ➢ May still be subject to due diligence for identification and reporting
Existing contracts - how to do it?

1. Data is In-House
   - Obviously, search algorithms – assuming you have the data
     - Search the client databases
   - Relationship Manager knowledge and search paper files/records

2. Data is external
   - However, may be only the broker (or other intermediary) has - or can get - this information
     - May have a problem
     - He may not be willing (or able) to share it
   - One of big differences between the insurance business and the banking business – „low touch“;
     - Often the broker/intermediary or the asset manager is the Relationship Manager
   - Information requirements were loose for a long time;
     - Carrier now has to get the data
     - May not have it
   - For many policies older than 2006 or so, can get very tricky to work out Chapter 4 status of owner
   - Some owners may have become US persons since taking out policy
   - Example; DVAs are very popular pre-immigration strategy
     - Was holder filed as a US person when they became one?
     - Did they stay in the US?
     - Have they subsequently left?
     - Often, only the broker/intermediary will know
New Contracts - post 1. Jan 2013
Checks; Due diligence, KYC and AML

If US owner of contract (account);
- Obtain secrecy waiver from client
- Report to IRS

Proposed regulations do not exempt low value accounts!
Relatively straightforward;
- For all new insurance contracts written;
  - PFFI required to review information provided at opening of account,
  - identification and other documentation collected under local AML/KYC* rules
  - Establish Chapter 4 status (see slide 6)

If US indicia are identified;
- PFFI must obtain additional documentation
  or
- Treat account as „recalcitrant“

*AML: Anti Money Laundering
KYC: Know Your Customer
Withholding on withholdable and passthru payments

The insurance company is subject to withholding at;

1. The Contract level

   - Person funds contract

   - Insurance Carrier

   - Policy •xxxx •xxxx

   - Withholding applies

2. The Account level

   - Bank

   - Participating FFI

   - Account $$$

   - Withholding applies

   - Insurance company pays out to beneficiary(s):
     - Surrender
     - Death Benefit
     - Annuity

Contract Level; Preventive measure
  ➢ Stops contract being funded in first place

Account level; Punitive measure
  ➢ Penalty on payout

Participating FFI not subject to withholding, but;
  ➢ Will be required to withhold on pass-thru payments to:
    ➢ Recalcitrant account holders - presumably also beneficiaries
    ➢ Non participating FFIs
    ➢ Certain Non-Financial Foreign Entities

Catches Everyone;
including „pure“ European transactions
Identity of holder rules; Who is the owner?  
Half baked???

The Cash Access Rule
- Contract owner is considered owner of contract if;
  - can access the cash value of a contract
  - or;
  - can change the beneficiary(s)

The Maturity Rule
- At the maturity of a life or annuity contract, the beneficiary of the contract is considered the holder of the contract
- Presumably, insurer must obtain account identification information for each beneficiary of a matured insurance contract
  - Before it pays beneficiary(s)
  - Otherwise;
  - Must treat beneficiary as it treated contract owner prior to maturity

Issues:
- Inequitable burden on insurers
- May not be possible to implement in many situations – potentially unworkable
- ??? Understanding of insurance industry on part of IRS/Treasury ???

What to do/How to prepare
- Await further guidance
- Dialogue/negotiation with IRS
- Clarify rules and requirements
Example; Identity of Holder rules: Who is the account owner?

- Settlor has settled an irrevocable trust
- Have three candidates for owner of account – depending on maturity state of contract, your point of view, IRS point of view (and who is still alive):
  - Settlor
  - ILIT Trustee
  - Beneficiary(s)
- GT – Settlor still owner
- ILIT – Settlor no longer owner – trust is irrevocable
- Is this reported as a US owned trust?
- Beneficiaries may now be considered owners
- Carrier will have to decide who is Holder of the contract
  - Maturity Rule…
  - Cash Access Rule….
Implementation - a few overall comments

Be pragmatic

- Very challenging - Insurers to be ready for this in given timeline
  - Capability issues
  - Carriers will need all the help they can get (Brokers, Asset Managers, Intermediaries)
  - Start the conversations now

- Advocate local solutions – Inter Governmental Agreements (IGAs)
  - Local tax authority reporting
  - Get local tax authorities involved – make them aware of the issues
  - Can be key in helping understand what the IRS wants and why - they speak „Tax“!

- Medium to longer term solutions;
  - Consider the private banking approach to dealing with US persons - Quarantine!
  - Separate out and ringfence the US business
  - Set up a separate entity – analogous to banks setting up SEC registered RIAs
  - For insurers there are two options:
    1. Traditional insurer
    2. „953(d)“ insurer
Client Level - Example of what to watch out for – does not work; Disconnects between „what was said“ and „reality“

2008
What was said
- Undeclared Assets
- Paid into policy
- No reporting
- Custodian Bank stays Custodian
- Asset Manager stays Asset Manager
  - Keep the business
- 6 year statute of limitations – Yippee!!

2013
The Reality
- Assets Paid into policy
- Reporting on FBAR
- Reporting on Form 8938
- Potential „Wilful Intent“ in attempted transformation of nature of assets
- Potential criminal liability – tax fraud
- Potential back taxes and penalties for years undeclared
- Investor control doctrine - Bank or Asset Manager may not have direct client contact
- No limit on how far back IRS can go
- Etc.

Voluntary Disclosure - ASAP
What does it look like and mean for the client?

- Back taxes on income and capital gains
- PFIC taxes on investment funds
- Interest on unpaid taxes
- Penalties for non-declaration
- FBAR penalties
- Potential criminal charges – tax fraud

Client comes into possession of assets
- Inheritance
- Offshore income
- Never declared

1998

- Assets put into insurance policy
- "Transformation" of nature of assets
- Insurance policy benefits; tax deferral, protection, no PFIC problem, etc.

2008

- FBAR reporting
- Form 8938 reporting
- Payout potentially subject to 30% withholding (notwithstanding grandfathering?)
- 1% excise tax payable – penalty
- Form 720 filing

2010

- Ok

2013

- Continued liability for previous non-compliance

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Intergovernmental Agreements (IGAs) – the beginning

Under the framework, subject to terms negotiated in each agreement, the applicable country would agree to:

1. Pursue the necessary implementing legislation to require FFIs in its jurisdiction to collect and report to the authorities of the foreign country the information required under FATCA
2. Permit such FFIs that are not otherwise exempt under FATCA to apply necessary diligence to identify their US account holders
3. Automatically transfer the information reported by such FFIs to the United States

The framework would allow the IRS to identify each FFI in the foreign country as a:

- Deemed compliant FFI
- Participating FFI

✓ Removing the need for such FFI to enter into agreement/contract with the IRS to avoid FATCA withholding

But, each FFI still required to register with the IRS, which:

- Requires FFI to receive FATCA identification number

The Carrot; joint statement provides:

“The US will commit to reciprocity with respect to collecting and automatically reporting to tax authorities of FATCA partner countries on the US accounts of that countries residents”
Proposed Framework in “Inter-governmental Approach for Improving International Tax Compliance and Implementing FATCA”

**Financial Institutions**

- UK
- Germany
- France
- Spain
- Italy

**Local tax authorities**

- Client account data

**Policyholders (Account holders – „Bob‘s“)***

- Banks collate account details
- Pass to local tax authorities
- Local tax authorities collate data
- Pass to IRS and Treasury
- IRS and Treasury reciprocate

**Cross Check**

- Exception Report

**Investigations**

- Enquiry
- Request for information
- Audit
- Penalties

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Step 2: Bilateral Agreements (TIEAs)
We are already half-way here

- Banks collate account details
- Pass to local tax authorities
- Tax authorities share data on one-to-one basis
- Cross Check
- Investigations
Step 3: Automatic Information Exchange

- Each country accesses its own residents account data
- Easily scalable to include all OECD countries

- Client account details
- All participating countries

Account Holders → Financial Institutions → Data collection offices → Tax Authorities

- Banks collate account details
- Pass to collection office
- Data is fed into the „tCloud“
- Each countries tax authorities have access to their own countries residents account details
- In each participating country
Industry Level - Possible solution;

Two options:
1. Set up new „Traditional“ carrier
2. Set up „Section 953(d)“ carrier* - US taxpayer corporation

*Section 953(d) of the Internal Revenue Code; a foreign corporation elects to be treated as a US corporation for tax purposes. I.e., reports and is taxed as a US corporation. Becomes a domestic entity for the IRS.
2. Transfer the US book to the new carrier

- Identify all US policies
- Transfer the book

- "Carbon filter" the policies
- Clean the book during transfer
Final stage: full separation of US business

- US Person, US Taxpayer corporation

- Tax transparent
- Full information exchange

- „Deemed Compliant“ FFI for FATCA
- No US accounts

- Achieve full separation of the US business
- Effective „on-shoring“ of US business
- Still no requirement for US insurance license – 953(d) carrier is still offshore

ABC Insurance Carrier

ABC Americas „953(d)“ carrier

The Book

US Book

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Issues with the 953(d) solution;  
Or… there are no perfect solutions

1. Treatment of passive foreign investment companies (PFICs) i.e., foreign investment funds is not clear  
   - 953(d) carrier has potential PFIC tax liability  
     - Or worse – the client has
2. Subject to US federal income tax on earnings  
   - Treated the same as US insurance company  
   - Tax burden must be weighed against benefits
3. Significant U.S. ownership base (25%) required for foreign insurance company making the election  
   - US holding company?  
   - Partner with a US carrier?

There are options, but no easy fixes
Two possible options, some key factors

**Option 1: „Traditional“ Carrier**

- ABC Americas „Traditional“ carrier
  - Submits W8-BEN to custodian bank
  - Located offshore
  - Non-resident

**Factors**
- Reporting issues
- Compliance issues
- FATCA issues
- „Participating Foreign Financial Intermediary (PFFI) for FATCA
- Potential SEC registration requirement for Asset Manager
- 1% excise tax on premium
- Withholding tax on US situs interest and dividends

**Option 2: 953(d) Carrier**

- ABC Americas „953(d)“ carrier
  - Submits W9 to custodian bank
  - Located offshore
  - Non-resident

**US person for the IRS**
- ✓ Tax transparent
- ✓ Full compliance and information exchange with IRS
- ✓ No QI issues for the custodian bank

**Not US person for the SEC**
- ✓ No SEC registration requirement for the asset manager

**Other**
- No federal excise tax on premium
- Is a US Financial Institution - retains duty to identify US payees under FATCA
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