

# Operational Changes for Implementing FATCA

## Implications for the insurance industry

---

12 June, 2012

**Envisage**

**Martin Straub**

Envisage Wealth Management  
Binzstrasse 18  
8045 Zürich  
Tel. +41 44 455 65 20  
Fax. +41 44 455 65 29  
[martin.straub@envisage.ch](mailto:martin.straub@envisage.ch)  
[www.envisage.ch](http://www.envisage.ch)

## 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

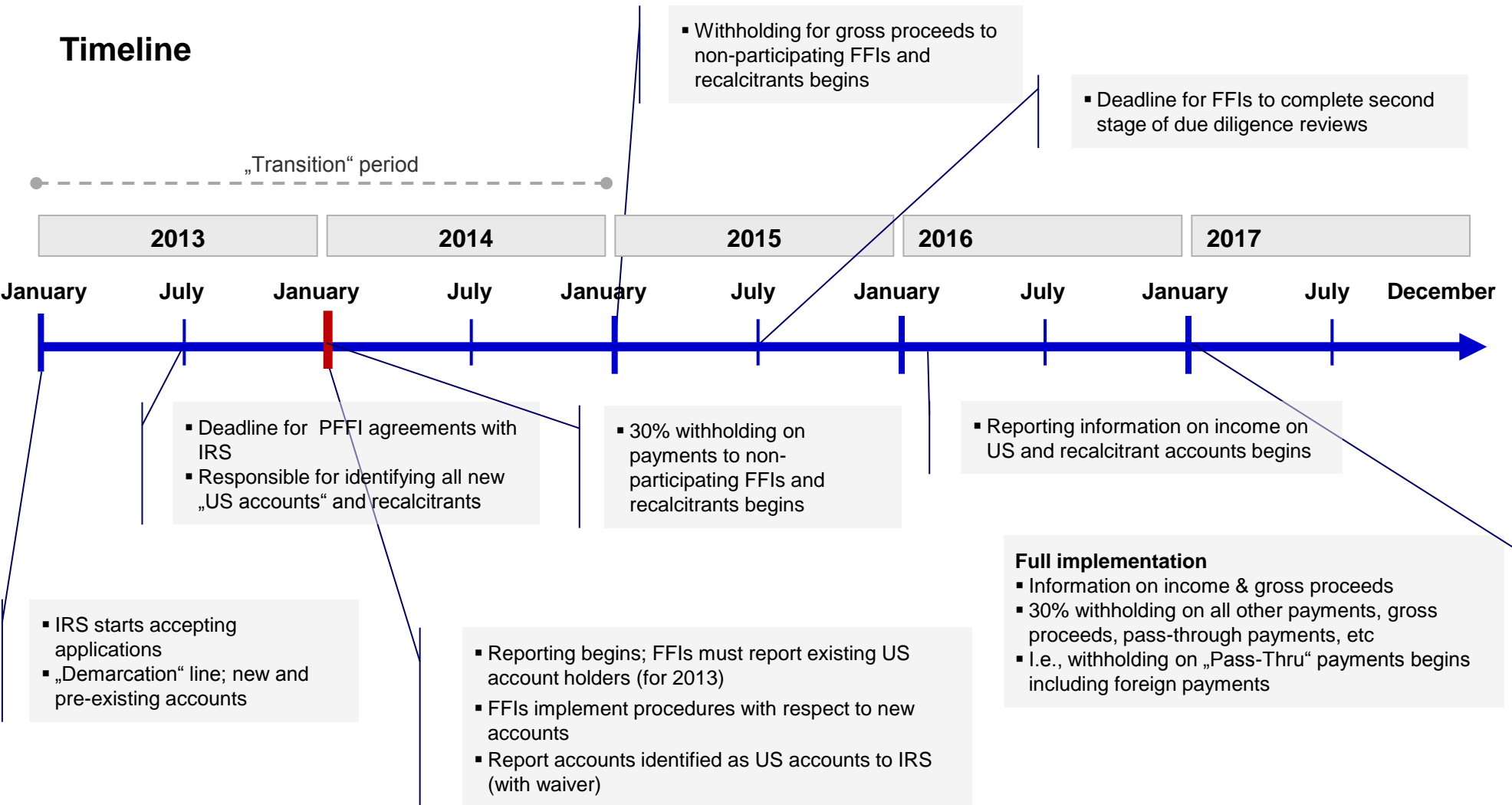
Private Placement Life Insurance;

- 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

„Transition“ period



## 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

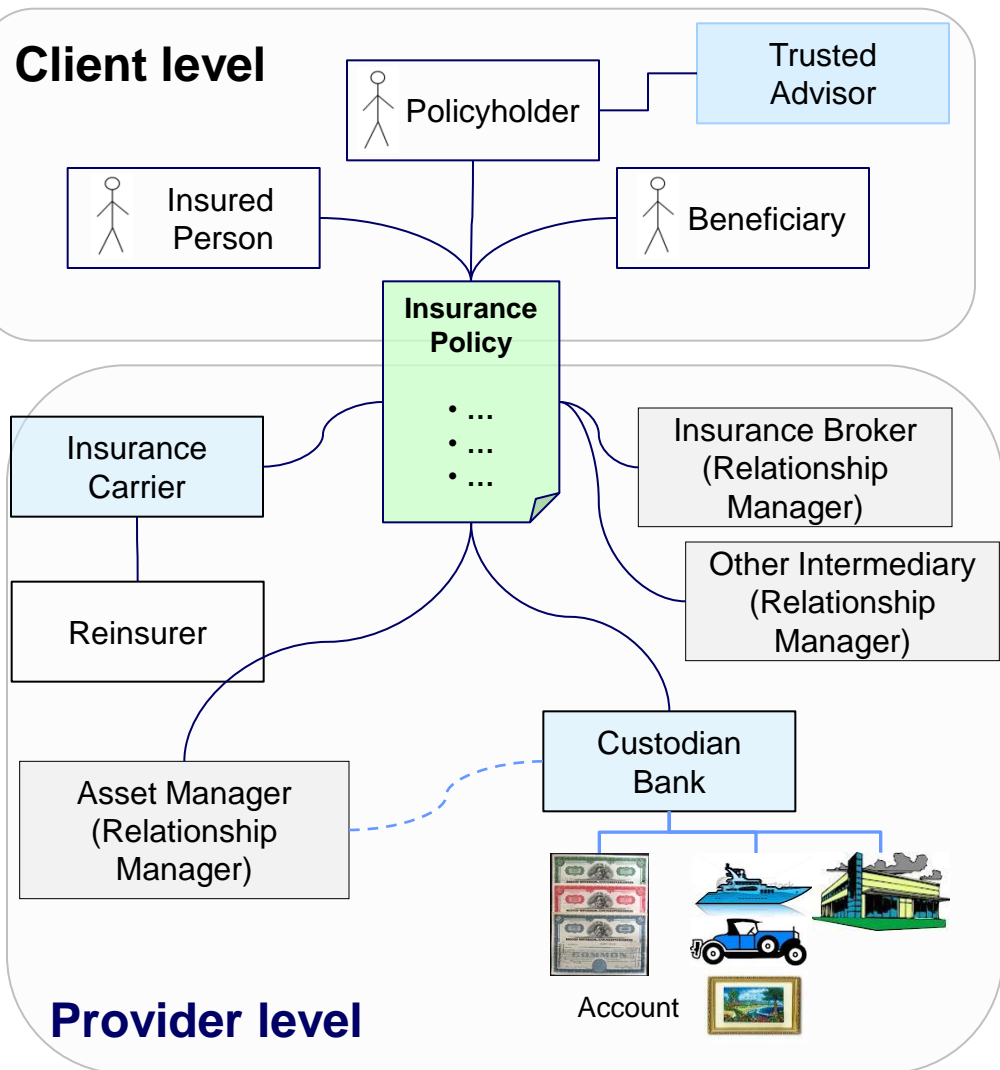
## Tasks for Insurers;

1. Determine contract holder
2. Determine Chapter 4 status of contract holder:

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



## 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“

# 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

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

## 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.



# 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

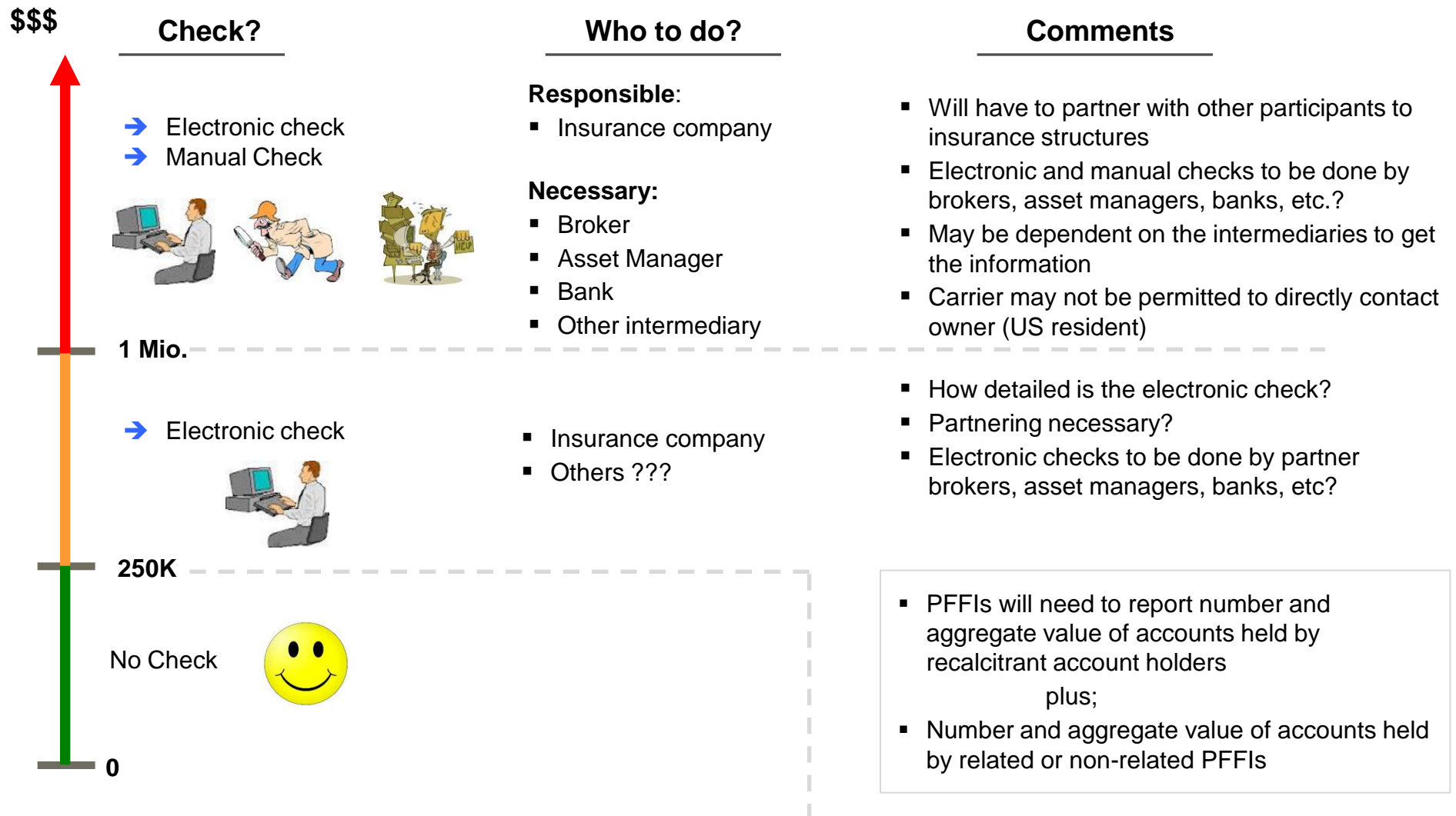
However, multiple accounts attributable to one owner must be aggregated:

- Contracts attributable to one specific US person must be aggregated
- If Aggregate > 250K USD – must be reported

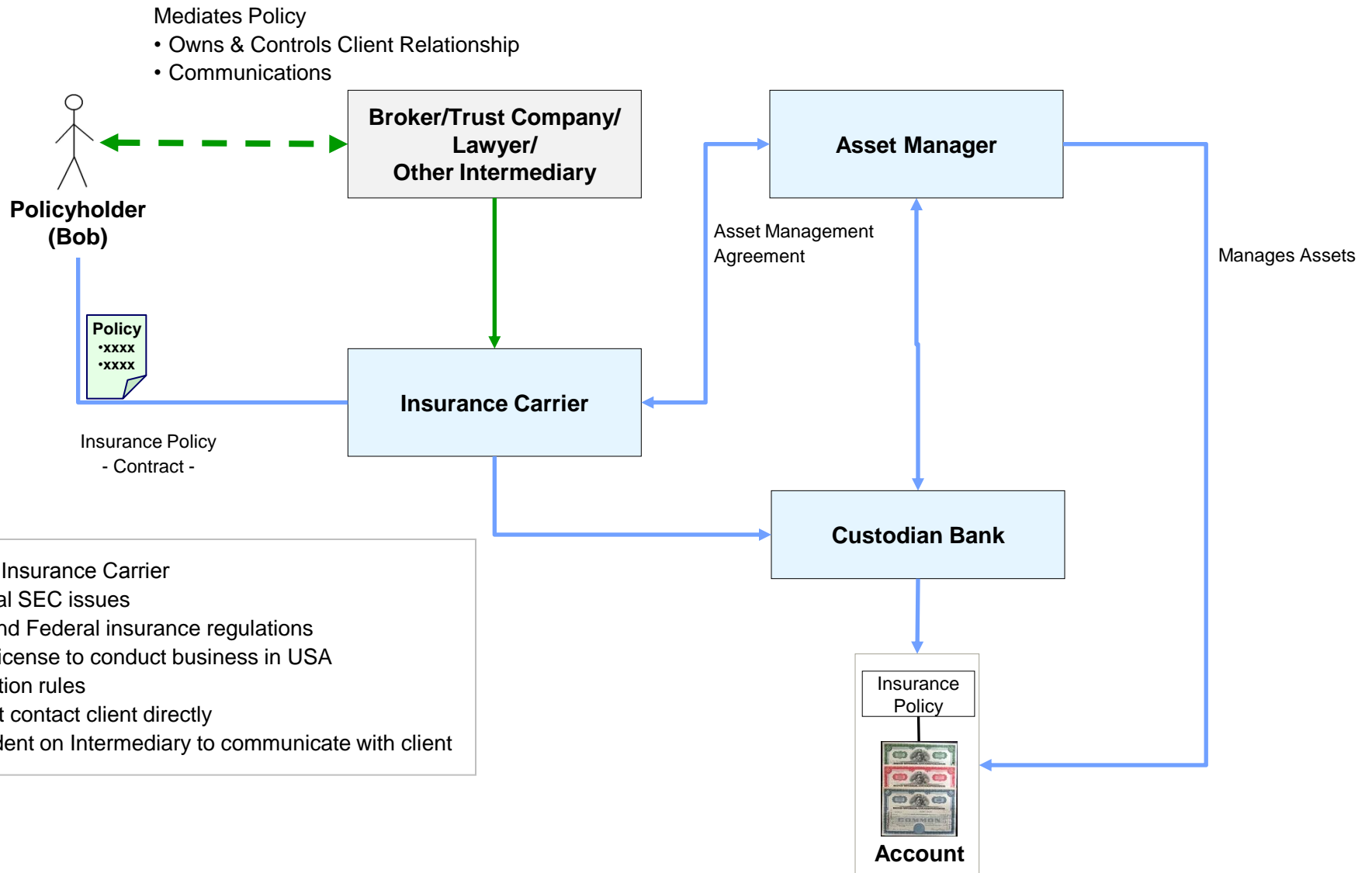
- Electronic Check for contracts with cash value from 250K up to 1 Mio. USD
- Electronic plus Manual Check for contracts with cash value over 1 Mio. USD

# Pre-Existing contracts - before 1. Jan. 2013

## Checks; Electronic and Manual



# Issue – often the insurance company is not permitted to contact the client directly when client resident in the USA



## „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

# The reporting and withholding rules - Part 2

---

## 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)

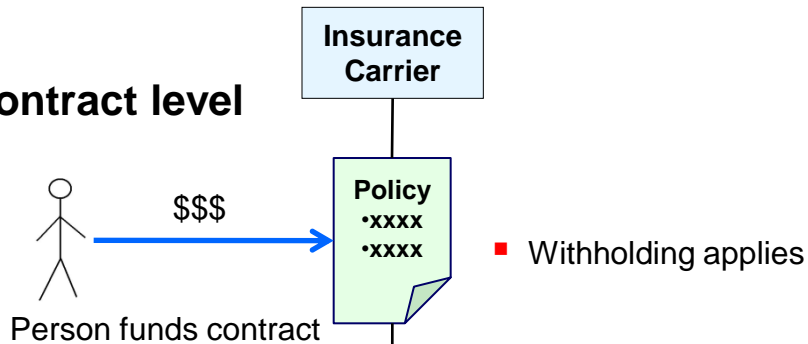
If US indicia are identified;

- PFFI must obtain additional documentation
- or
- Treat account as „recalcitrant“

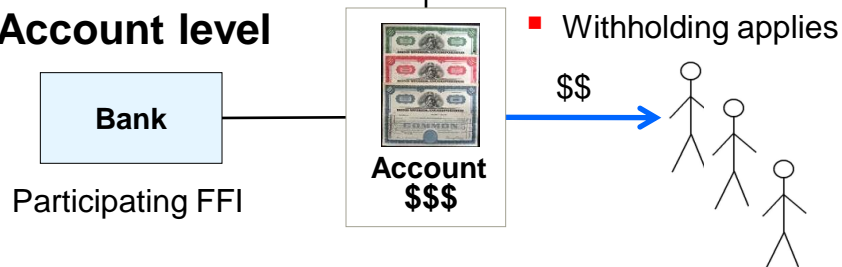
# Withholding on withholdable and passthru payments

The insurance company is subject to withholding at;

## 1. The Contract level



## 2. The Account level



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:**

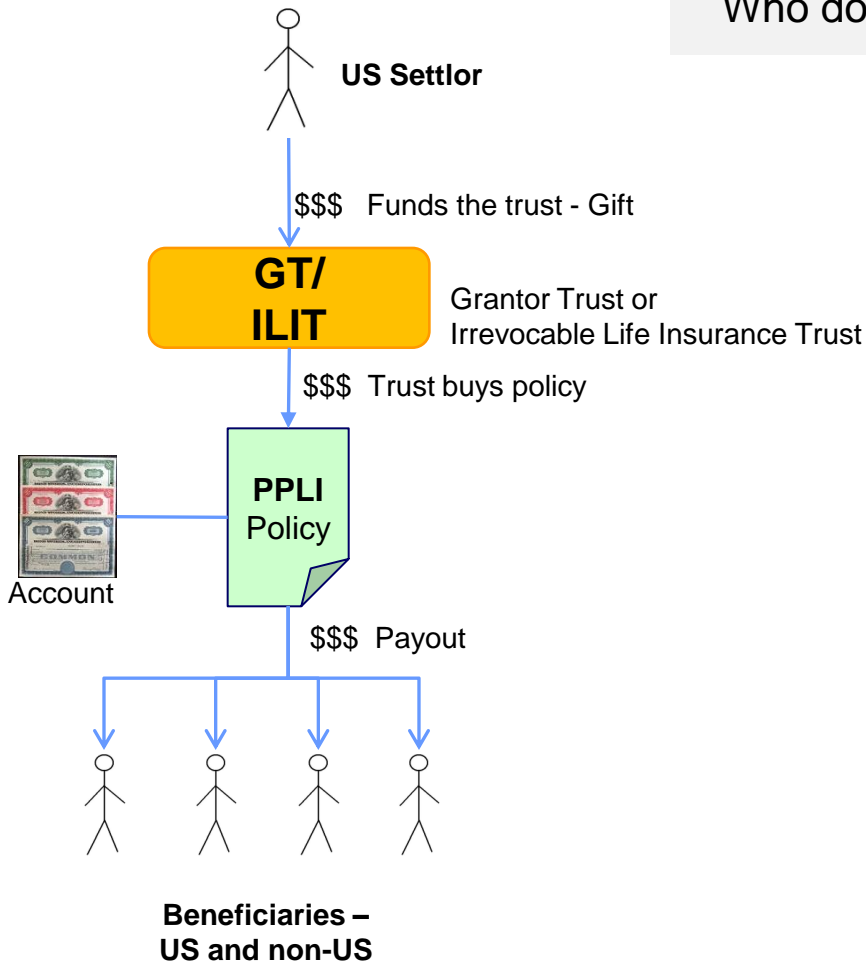
- Inequitable burden on insurers
- May not be possible to implement in many situations – potentially unworkable
- ??? Understanding of insurance industry on part of IRS/Treasury ???

### **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?



Who does the insurance company report as 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 – analagous 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

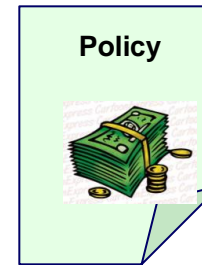
Paid into policy



- No reporting
- Custodian Bank stays Custodian
- Asset Manager stays Asset Manager
  - Keep the business
- 6 year statute of limitations – Yippee!!!

## 2013

The Reality



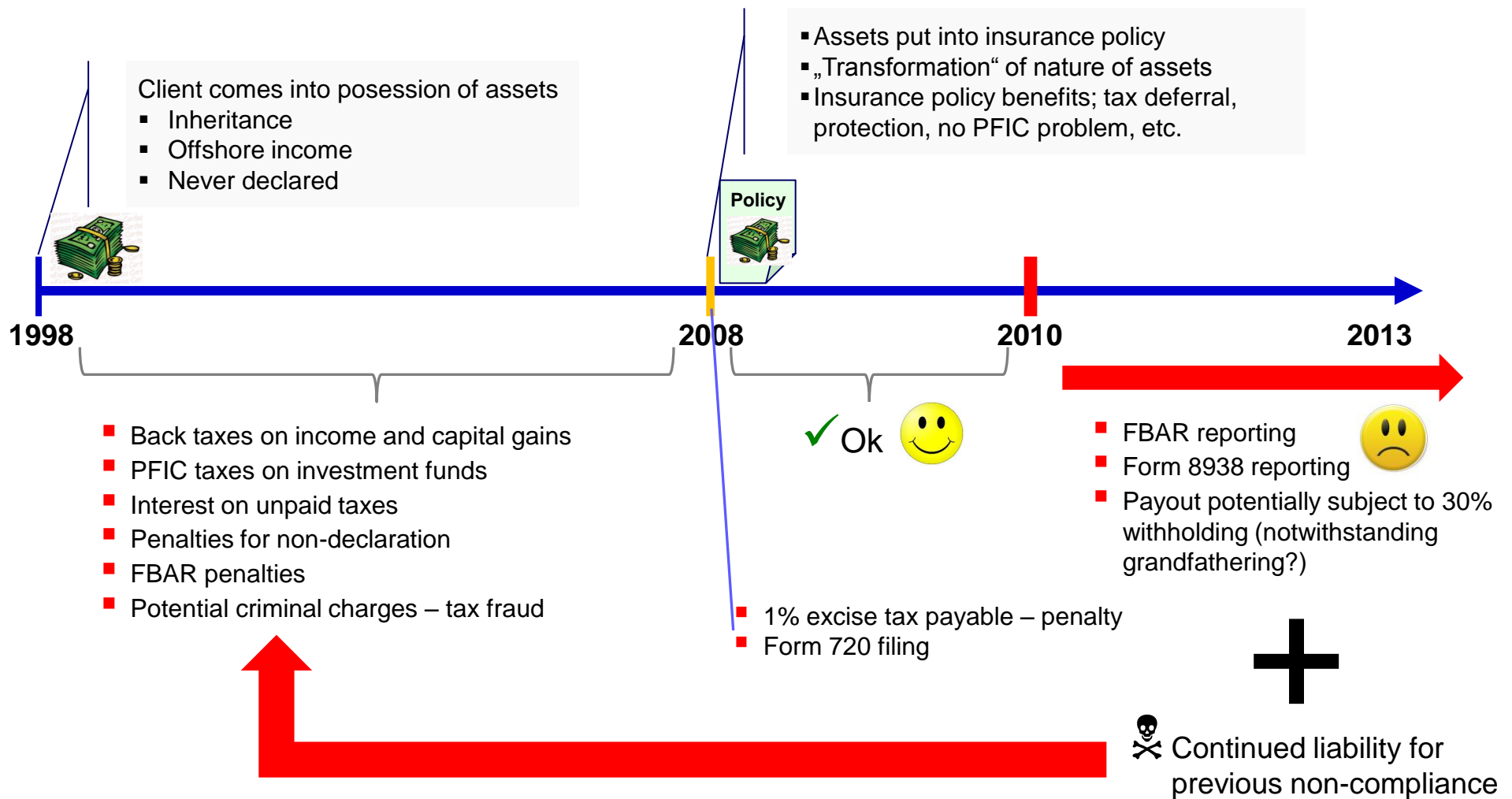
Assets Paid into policy

- ✗ 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?



# Government Level - Joint Statement regarding an Intergovernmental Approach to Improving International Tax Compliance and Implementing FATCA

---

## 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  
or
- Participating FFI

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

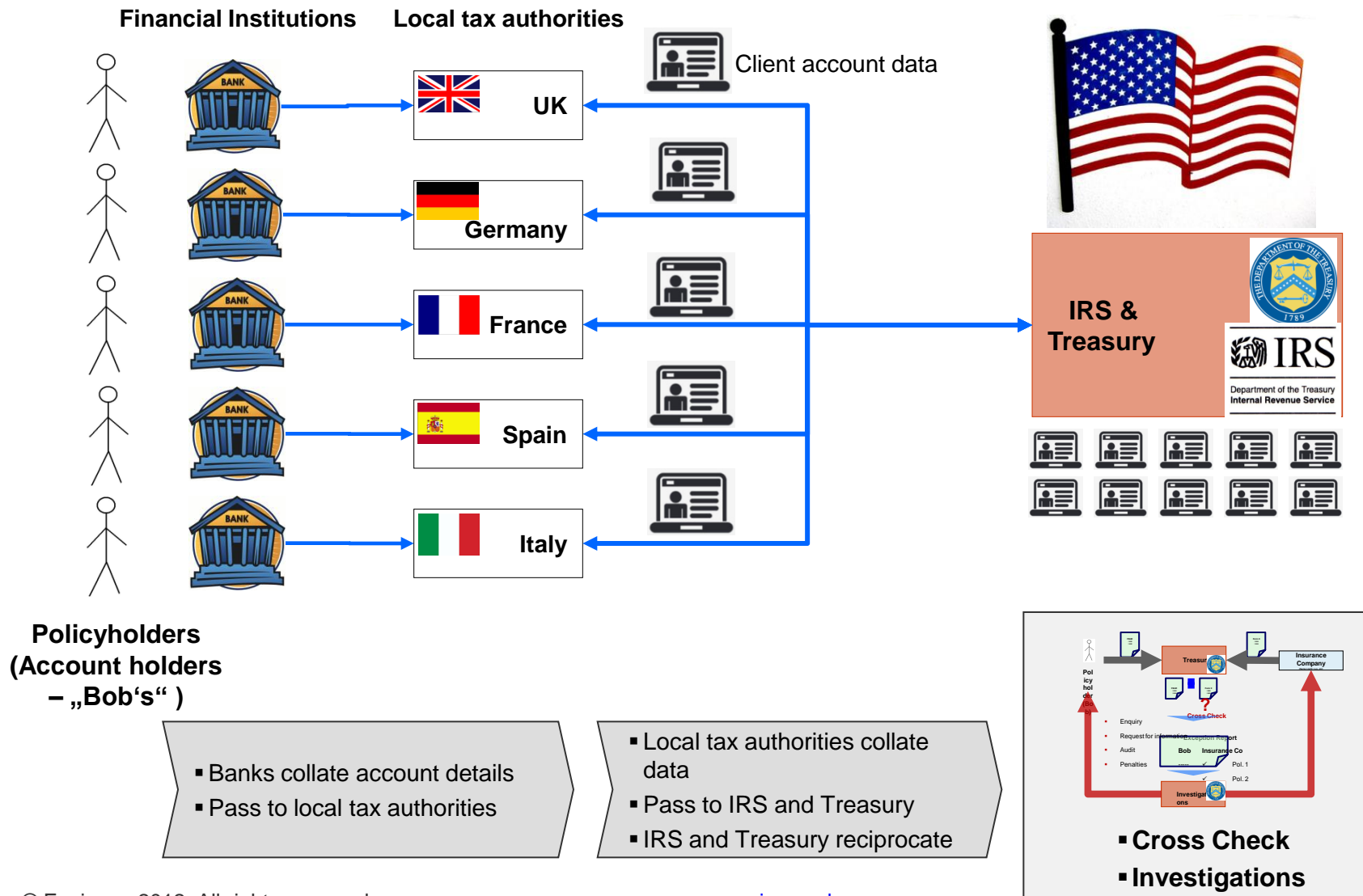
But, each FFI still required to register with the IRS, which:

- Requires FFI to receive FATCA identification number

The Carrot; joint statement provides:

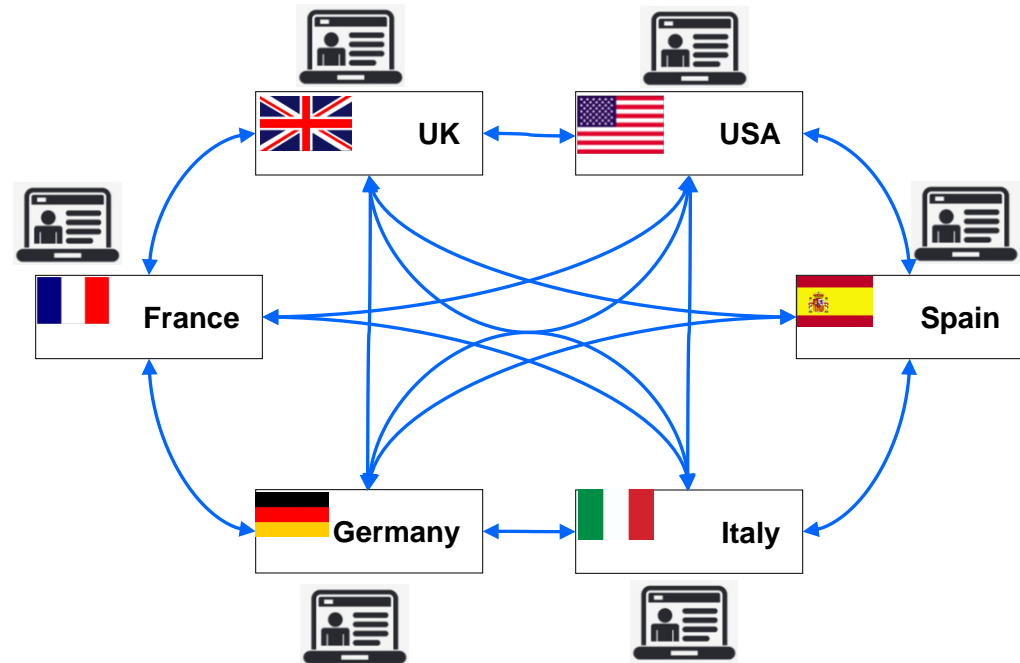
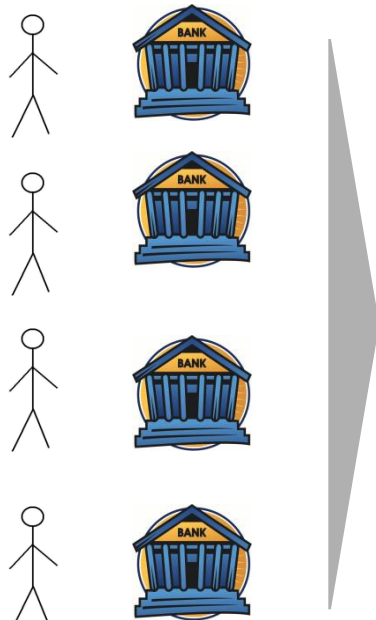
**“The US will commit to reciprocity with respect to collecting and automatically reporting to tax authorities of FATCA partner countries on the US accounts of that countries residents”**

# Proposed Framework in “Inter-governmental Approach for Improving International Tax Compliance and Implementing FATCA”



# Step 2: Bilateral Agreements (TIEAs)

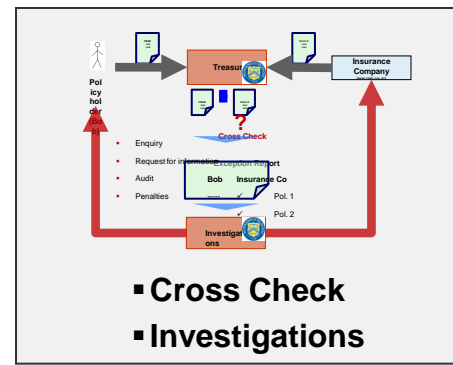
## We are already half-way here



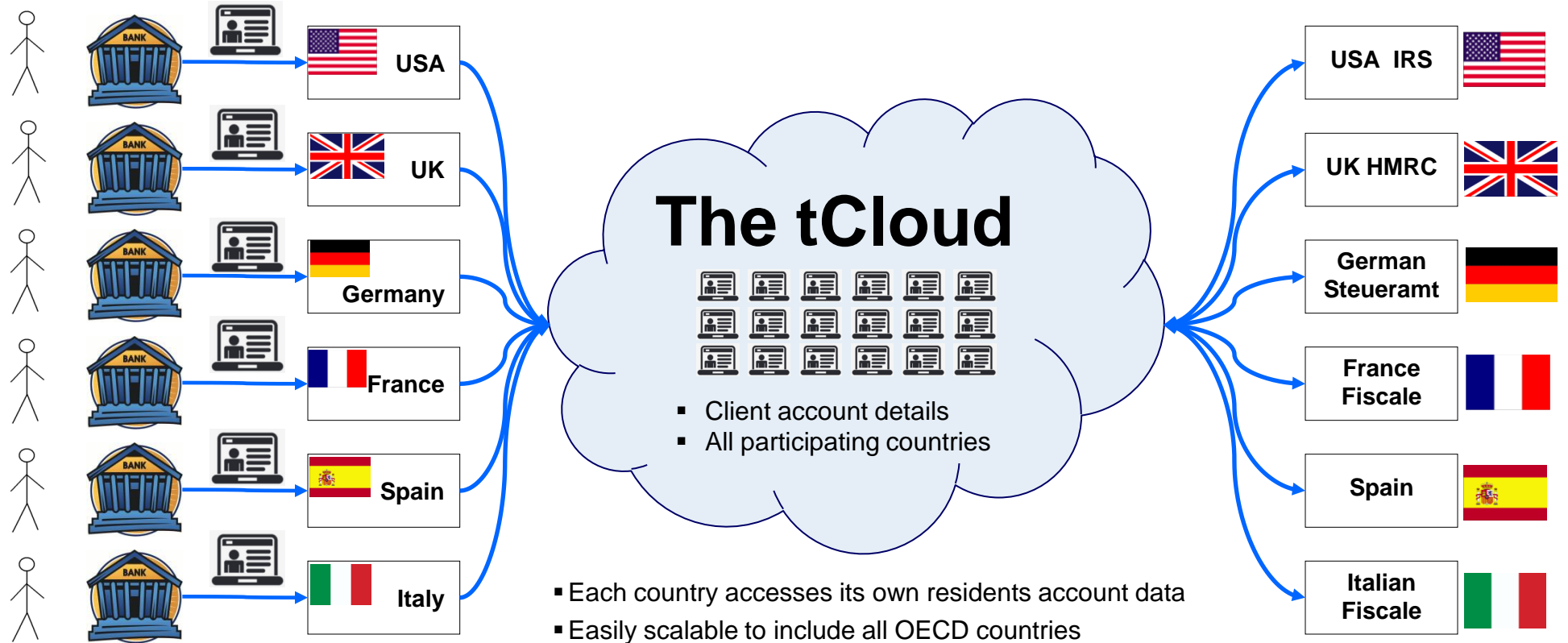
**Policyholders**  
(Account holders  
– „Bob’s“ )

▪ Banks collate account details  
▪ Pass to local tax authorities

▪ Tax authorities share data on one-to-one basis



# Step 3: Automatic Information Exchange



- 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;

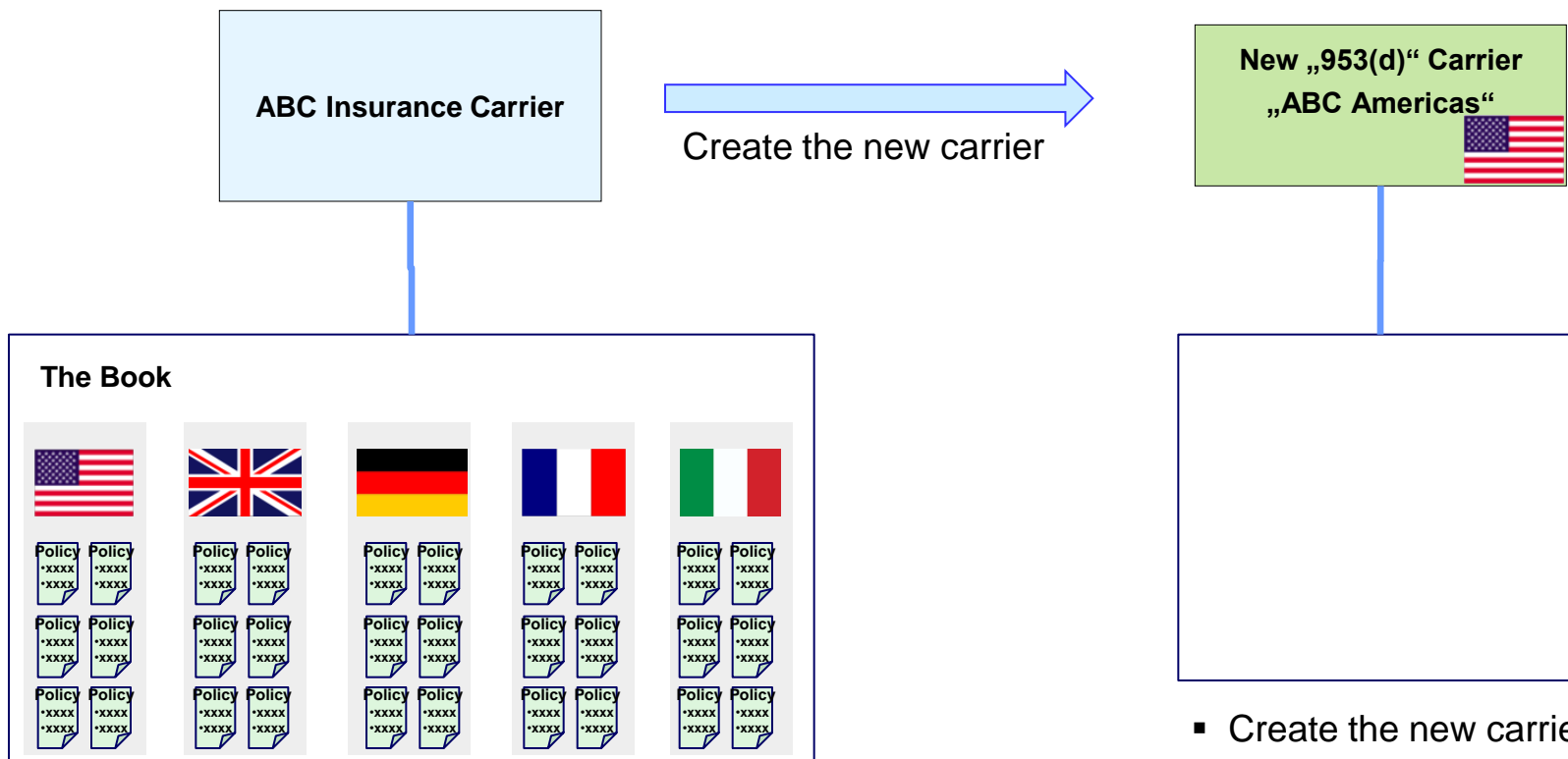
## 1. Create a new carrier for US connections.

### Two options:

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



Example using „953(d)“ solution

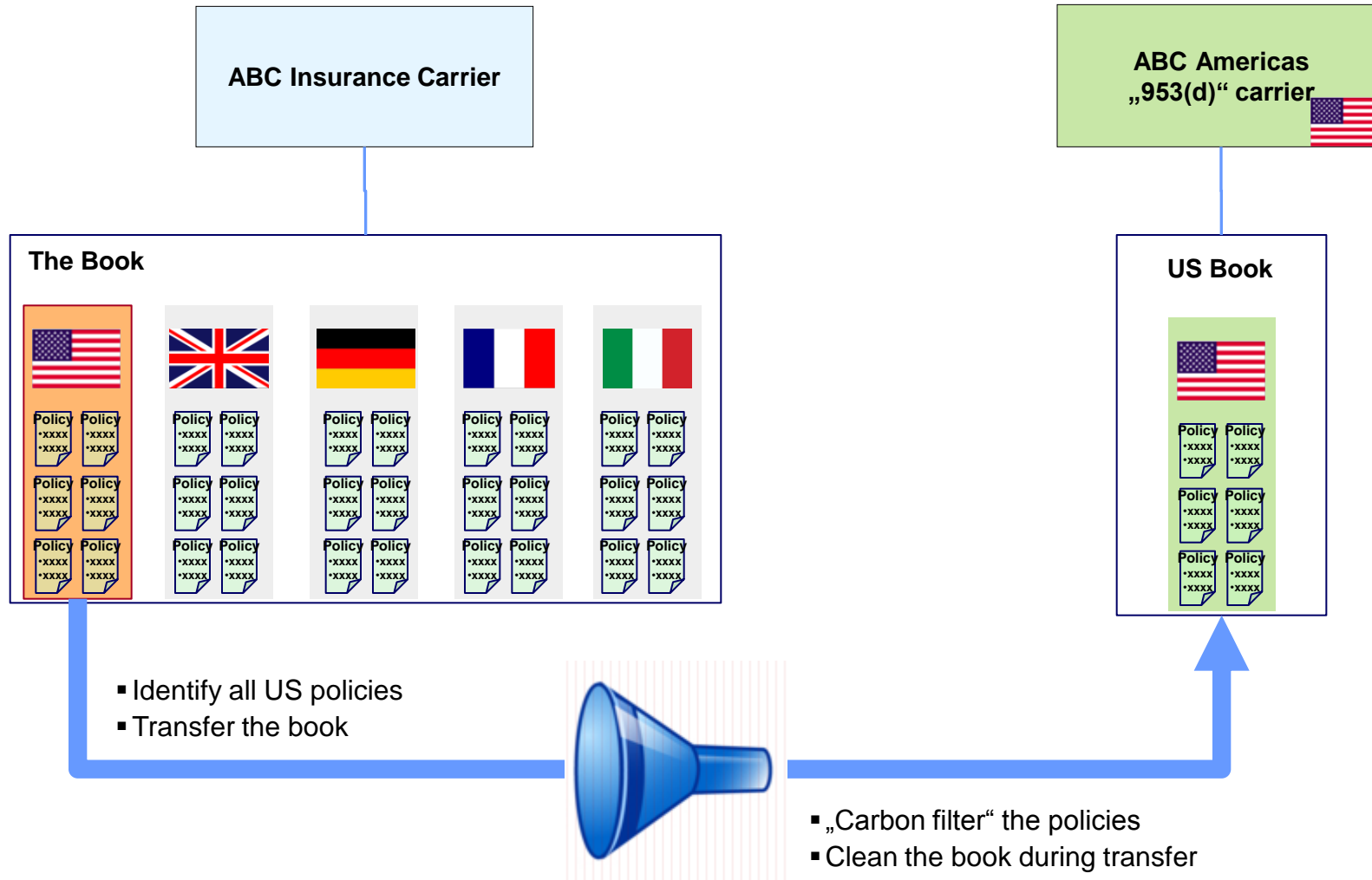


- Mixed Book
- All jurisdictions bundled in one carrier

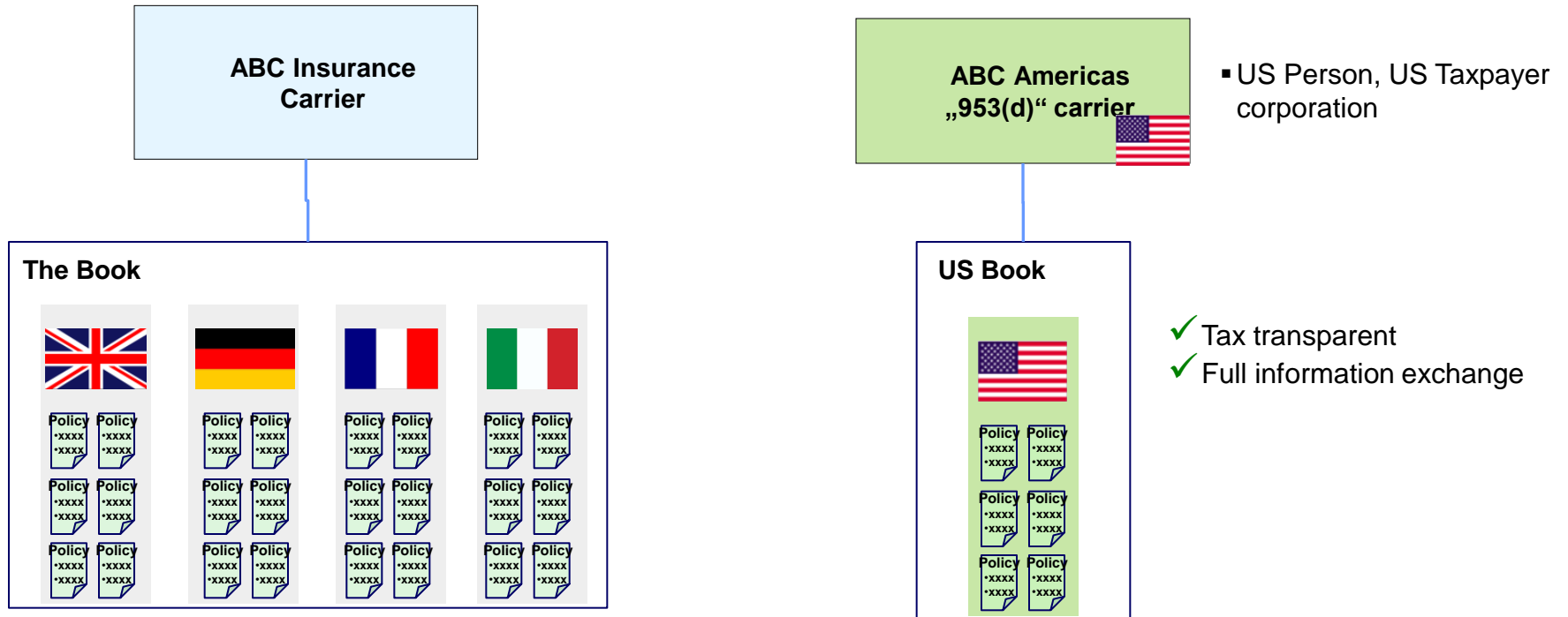
- Create the new carrier
- Clean, empty

\*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



# Final stage: full separation of US business



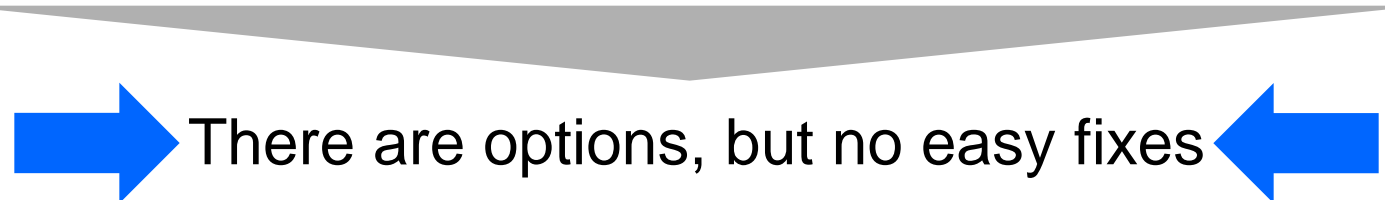
- „Deemed Compliant“ FFI for FATCA
- No US accounts

- 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

## 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

## Option 2: 953(d) Carrier

**ABC Americas**  
**„953(d)“ carrier**

- Submits W9 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

### 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

# Disclaimer

---

This presentation contains information prepared by Envisage GmbH ("Envisage") and is not a direct solicitation by Envisage in any way, form or manner. This information may not be copied, altered, offered, sold or otherwise distributed to any other person by any recipient without the prior written consent of Envisage.

Although all reasonable effort has been made to ensure facts, statements and estimates stated within this presentation are accurate and opinions contained are fair and reasonable, this information is of necessity brief and selective in nature. The material is intended to provide an introduction only. None of the information contained in this presentation constitutes or is intended to constitute legal, financial, investment, tax, accounting or any other advice. Neither Envisage nor any of its directors or employees and advisors, nor any other persons shall have any liability for its accuracy, inaccuracy or liability, loss, damage or harm, however arising, directly or indirectly from the use of information contained within this presentation. Envisage does not recommend or guarantee that information contained within this presentation should be used as a guideline, template or to replace independent investment, legal, tax, accounting, financial or any other professional advice. Furthermore, no statements or comments contained in this presentation are intended to be used for or as investment, tax or legal advice, for the purpose of avoiding any penalties imposed under any countries tax or legal code.