

**Internal Revenue Service**

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Person To Contact:  
, ID No.

Telephone Number:

In Re:

Refer Reply To:  
CC:INTL:B05  
PLR-123739-13  
Date:  
November 12, 2013

X =  
CFC =  
Country A =  
Parent =  
US Sub =  
Agency =  
Month Y =

Dear :

In a letter dated X, you requested rulings allowing CFC to use certain foreign statement insurance reserves in computing its taxable income on grounds that these insurance reserves are an appropriate means of measuring income within the meaning of section 954(i)(4)(B). Specifically, you requested permission to use: (1) the underwriting reserves and loss reserves for life and annuity contracts reported by CFC on its Country A Annual Report; (2) the underwriting reserves and loss reserves for noncancellable and guaranteed renewable accident and health contracts reported by CFC on its Country A Annual Report; and (3) the underwriting reserves and loss reserves and associated asset basis attributable to CFC's separate accounts, as reported on its Country A Annual Report.

The rulings given in this letter are based on facts and representations submitted by Parent and CFC 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 domestic life insurance, asset management, and international life insurance. Parent directly and indirectly owns all the stock of US Sub. US Sub directly and indirectly owns all the stock of CFC. CFC was formed under the laws of Country A and is engaged in the life insurance business in Country A. CFC is a controlled foreign corporation as defined in section 957.

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

CFC is licensed by the Agency to sell life insurance and annuity contracts to residents of Country A and is subject to regulation by the Agency as a life insurance company. CFC is not engaged in any insurance business outside of Country A. CFC derives more than 50 percent of its aggregate net written premiums from its issuance of life insurance and annuity contracts covering risks in connection with the lives or health of residents of Country A and with respect to which no policyholder, insured, annuitant, or beneficiary is a related person as defined in section 954(d)(3). CFC is prohibited by Country A from carrying on non-life insurance businesses other than certain activities which are incidental to the life insurance business. The life insurance and annuity contracts issued by CFC are regulated as life insurance and annuity contracts by the Agency. Parent has represented that CFC would be subject to tax under Subchapter L if it were a domestic corporation.

As part of its insurance business, CFC issues health and personal accident insurance contracts that are noncancellable or guaranteed renewable, cancellable, or are riders to a life insurance contract. For Country A tax and insurance regulatory purposes, CFC (1) treats these policies as life insurance policies, (2) treats its underwriting reserves and loss reserves attributable to these policies as life insurance reserves, and (3) computes the underwriting reserves and loss reserves on these policies using a methodology similar to that of life insurance reserves. CFC's reserves for these policies are reported on the Country A Annual Report required to be filed for regulatory purposes with the Agency.

CFC also issues separate account-type variable life insurance and annuity contracts which are separately identified and maintained and supported by separately identifiable pools of assets. The assets in such pools are marked to market for local regulatory reporting purposes, and the associated reserves follow movements in the

value of assets, with limited exceptions. For Country A tax and insurance regulatory purposes, CFC is required to make asset basis and reserve-related adjustments to its separate accounts.

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

To comply with Country A's insurance laws and regulations, CFC must establish and maintain certain reserves for obligations to holders of their life insurance and annuity contracts and must set forth the amount of such reserves on the Annual Report. These reserves are (1) underwriting reserves (including reserves for variable contracts) and (2) loss reserves. The rules for calculating these reserves are prescribed by insurance laws, regulations and other Agency guidance and are summarized below.

Underwriting reserves must be held to secure the performance of obligations arising in the future from the life insurance and annuity contracts issued by CFC in Country A. Underwriting reserves are comprised of insurance premium interpolated terminal reserves, unearned premium reserves, and risk reserves. The sum of insurance premium reserves and unearned premium reserves (referred to as the "standard valuation reserve") for life insurance and annuity contracts may not be less than the amount calculated in accordance with the designations of the Agency concerning the reserve method, interest rate, mortality rate and other coefficients.

In accordance with required rules for life insurance companies conducting business in Country A, CFC sets forth the computation method for its underwriting reserves on its license application. The computation method must be based on an actuarial calculation, must be reasonable and appropriate, and must conform to any other standards prescribed by the Agency. Any change in the method of calculating such reserves requires advance notice to the Agency and might not be allowed by the Agency.

The Agency requires life insurance reserves to be determined as follows: (1) the prescribed reserve method for life insurance is the net level premium ("NLP") method; (2) the prescribed mortality table is the standard mortality table generated by the institute of actuaries of Country A; and (3) the prescribed standard interest rate assumption is based on 10-year government bonds of Country A. CFC is also required to carry expense adjustments, which are embedded in the underwriting reserve computation.

The Agency requires fixed annuity reserves to be determined using the same assumptions as life insurance reserves except that a different mortality table is prescribed. Under the prescribed rules for variable annuity reserves, the total of amounts credited to the separate accounts for policyholders must be held as premium reserves.

Notwithstanding that the NLP reserve method is the Agency-prescribed reserve method, the Agency has granted CFC approval to use the account value as the reserve on account value products. When the account value is used, CFC's standard valuation reserves may be less than those reserves would be under the NLP reserve method. In such a case, the Agency also requires CFC to maintain additional special risk reserves.

Currently, CFC holds reserves determined under the NLP method. CFC also holds reserves for account value products and special risk reserves comprising both mortality risk reserves and interest rate assumption risk reserves with respect to their account value reserves. The account value reserves and special risk reserves of CFC are less than or equal to the reserve amount that would be computed under the NLP method.

CFC may also hold loss reserves for outstanding claims (including incurred but not reported claims) under life insurance and annuity contracts issued by CFC. CFC calculates the reserves using the company's individual loss experience, in accordance with rules and regulations prescribed by the Agency.

In accordance with required rules for life insurance companies licensed to do business in Country A, CFC has appointed a qualified actuary to be involved in matters prescribed by the Agency as actuarial matters, including the method of calculating reserves. The actuary must have knowledge and experience concerning actuarial matters and must meet requirements prescribed by the Agency. The actuary is required to submit a written opinion to the Board of Directors of the company and to the Agency concerning whether or not the reserves relating to the insurance contracts prescribed by the Agency are established and maintained in accordance with actuarial soundness.

Parent represents that: (1) CFC is not engaged in any insurance business outside of Country A; (2) any difference in the methods under Country A law used to calculate the reserves related to an insurance policy issued by CFC as compared to the methods used to calculate such reserves for the same insurance policy under subchapter L (if CFC were a US insurance company) would not cause a material difference in the measurement of CFC's income during the life of such policy; and (3) the foreign reserve method used to calculate CFC's underwriting reserves and loss reserves is not contrary to the rules and principles applicable to the calculation of reserves under subchapter L, as modified by section 954(i).

## 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. Sec. 951(a). Subpart F income includes, among other types of income, insurance income under section 953 and foreign base company income under section 954. Sec. 952(a)(1) and (2). Section 953(a) 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 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 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 (e.g., interest and dividends) 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”.

In general, section 953(e)(3) defines a “qualifying insurance company” as any controlled foreign corporation which:

(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 Code 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 Code 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(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)). Sec. 954(i)(2)(A). 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. Sec. 954(i)(2)(B).

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).

Sections 953 and 954 do not define the terms “life insurance or annuity contract” or “property, casualty, or health contract.” Section 953(e)(5) generally provides that, for purposes of sections 953 and 954, the determination of whether a contract issued by a CFC is a life insurance or annuity contract shall be made without regard to section 7702 if: (1) such contract is regulated as a life insurance or annuity contract by the corporation’s home country, and (2) no policyholder, insured, annuitant, or beneficiary with respect to the contract is a United States person.

Section 816(a) of the Internal Revenue Code (the “Code”) defines “life insurance company” as “an insurance company which is engaged in the business of issuing life insurance and annuity contracts . . . 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 . . . .”

Section 816(b)(1) defines the term “life insurance reserves” for purposes of Part I of Subchapter L of the Code as amounts:

- (A) which are computed on the basis of recognized mortality or morbidity tables and assumed rates of interest, and
- (B) which 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 954(i)(3) generally provides that income credited under a separate account-type contract is allocable only to such contract.

Section 817(a) provides that, with respect to any variable contract, reserves are adjusted

(1) by subtracting therefrom 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 (whether or not the assets have been disposed of).

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.

For purposes of Part I of Subchapter L, a life insurance company that issues variable contracts “shall separately account for the various income, exclusion, deduction, asset, reserve, and other liability items properly attributed to such variable contracts.” Section 817(c).

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 Code 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.

Code section 954(i)(4)(B)(ii) was enacted by section 614 of the Job Creation and Worker Assistance Act of 2002. The staff of the Joint Committee on Taxation explains this provision 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. In seeking a ruling, the taxpayer is required to provide the IRS with necessary and appropriate information as to the method, interest rate, mortality and morbidity assumptions and other assumptions under the foreign reserve rules so that a comparison can be made to the reserve amount determined by applying the tax reserve method that would apply if the qualifying insurance company were subject to tax under Subchapter L of the Code (with the modifications provided under present law for purposes of these exceptions). The IRS also may issue published guidance indicating its approval.

Staff of the Joint Comm. On Taxation, Technical Explanation of the AJob Creation and Worker Assistance Act of 2002" (JCX-12-02 (March 6, 2002)).

### **Analysis**

CFC is subject to regulation as a life insurance company by Country A. CFC is licensed, authorized, and regulated by the Agency, 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 Code section 954(d)(3)) in Country A. CFC has represented that it derives more than 50 percent of its aggregate net written premiums from its issuance of life insurance and annuity contracts covering risks in connection with the lives or health of residents of Country A and with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in Code section 954(d)(3)). Finally, CFC is engaged in the life insurance business and would be subject to tax under Subchapter L if it was a domestic corporation. Accordingly, CFC is a QIC.

CFC issues life insurance and annuity contracts in connection with the lives and health of residents of Country A, a country other than the U.S. Such contracts are,

therefore, exempt contracts within the meaning of section 953(e)(2). CFC uses the NLP method (and another method that produces reserves not exceeding the NLP method) for computing its foreign statement underwriting reserves and loss reserves. Because the NLP method is a reasonable method for computing reserves, the foreign statement reserves are an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii).

CFC issued noncancellable and guaranteed renewable 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 and loss reserves on these policies using a methodology similar to that used to compute life insurance reserves. Therefore, the foreign statement underwriting reserves and loss reserves for noncancellable and guaranteed renewable accident and health contracts are also an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii).

CFC issued separate account type contracts as part of its life insurance business. For Country A insurance regulatory purposes, CFC is required to mark-to-market its portfolio investment assets held pursuant to its separate account-type contracts, to adjust the basis of its marked portfolio investment assets to fair market value, and to adjust its underwriting reserves and loss reserves to offset any gain/loss attributable to the marked assets. Because these foreign statement insurance reserves are maintained under principles similar to section 817, these reserves are also an appropriate means of measuring insurance income within the meaning of section 954(i)(4)(B)(ii).

### **Rulings**

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

1. The foreign statement underwriting reserves (including risk reserves) and loss 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) .
2. The foreign statement underwriting reserves and loss reserves maintained by CFC for its exempt 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).
3. The foreign statement insurance reserves maintained by CFC with respect to its exempt separate account contracts are an appropriate means of measuring income under section 954(i)(4)(B)(ii).

### **Caveats**

We express no opinion on any provisions of the Code or regulations not specifically covered by the above ruling.

### **Procedural Statements**

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

Parent should attach a copy of this ruling letter to its Federal income tax return for the taxable years to which this letter applies. In accordance with the power of attorney on file in this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Steven Musher  
Associate Chief Counsel  
(International)

By:

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Steven D. Jensen  
Senior Counsel, Branch 5  
Office of Associate Chief Counsel  
(International)