

Internal Revenue Service

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Person To Contact: _____, ID No.

Telephone Number:

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X	=	
Parent	=	
US Sub	=	
Taxpayer	=	
Country A	=	
DE	=	
Y	=	
CFC1	=	
Country B	=	
CFC2	=	
Agency	=	
Month Z	=	
Year 1	=	

Dear _____ :

In a letter dated X, you requested a ruling allowing CFC2 to use certain foreign statement insurance reserves in computing 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 the underwriting reserves and loss reserves for life and annuity contracts reported by CFC2 on its Country B Annual Report beginning with the taxable year ending on Year 1.

The ruling given in this letter is based on facts and representations submitted by Taxpayer and CFC2 and accompanied by a penalties of perjury statement executed 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, a domestic corporation, is a mutual insurance holding company that is engaged, through its subsidiaries, in various lines of business, which primarily include domestic life insurance, asset management, and international life insurance. Parent is the common parent of an affiliated group of life insurance companies and non-life insurance companies. Parent directly owns all the stock of US Sub. US Sub is an intermediate holding company that directly owns all of the stock of Taxpayer. Taxpayer is a Country A corporation that reinsures related party risks. Taxpayer reinsures guaranteed minimum death benefits, guaranteed minimum accumulation benefits, guaranteed minimum withdrawal benefits, and guaranteed lifetime withdrawal benefits. Taxpayer elected to be treated as a U.S. corporation pursuant to section 953(d). Taxpayer owns DE, which owns Y% of the stock of CFC1, a Country B corporation, which is a holding company. CFC1 owns Y% of the stock of CFC2. CFC1 and CFC2 are controlled foreign corporations as defined in section 957. CFC2 is engaged in the life insurance business in Country B. Its principal products are individual life insurance, individual annuities, and bank assurance policies.

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

CFC2 is licensed by the Agency to sell life insurance and annuity contracts to residents of Country B and is subject to regulation by the Agency as a life insurance company. CFC2 is prohibited by Country B from carrying on non-life insurance businesses other than certain activities which are incidental to the life insurance business. Taxpayer represents that CFC2 is not engaged in any insurance business outside of Country B. CFC2 derives 100 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 B and with respect to which no policyholder, insured, annuitant, or beneficiary is a related person as defined in section 954(d)(3). Taxpayer has represented that CFC2 would be subject to tax under Subchapter L if it were a domestic corporation.

CFC2 issues life annuities and individual life and bank assurance policies in Country B. CFC2 issues single premium immediate payout annuity products that are primarily designed for the Country B pension market. These annuity contracts are designed to provide a stream of guaranteed annuity payments to cover an employer's existing pension obligations for its Country B resident employees. The annuity contracts are single premium contracts that provide no guaranteed-nonforfeiture benefit, no guaranteed-cash surrender value, and no surrender charge. They have no accumulation value or policyholder fund, and the guarantees are in the form of periodic income streams indexed to an official cost-of-living measure.

As required by Country B's insurance laws and regulations: (i) CFC2 files an Annual Report and financial statements with the Agency; (ii) the Annual Report of CFC2 is audited by an outside accounting auditor in addition to the company's auditor; (iii) the accounting records of CFC2 that form the basis for preparing the Annual Report is subject to inspection by the Agency at any time; and (iv) the Annual Report of CFC2 is made available to the public. CFC2's Annual Report is used for financial purposes in addition to regulatory purposes, such as for credit rating purposes. Month Z is the official year-end for life insurance companies operating in Country B.

To comply with Country B's insurance laws and regulations, CFC2 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 CFC2 in Country B. 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.

The Agency requires life insurance reserves to be determined as follows: (1) the prescribed reserve method for life insurance is identical to the Commissioner's Reserve Valuation Method ("CRVM") as defined in section 807(d)(3); (2) the mortality table is prescribed by Country B ; and (3) the prescribed standard interest rate assumption is 3%. CFC2 is also required to carry expense adjustments, which are embedded in the underwriting reserve computation.

The Agency requires pension annuity reserves to be determined as follows: (1) the prescribed reserve method for pension annuity reserves is the net level premium method ("NLP") method, and (2) the Agency prescribes mortality and interest rate assumptions.

Currently, CFC2 holds life insurance reserves determined using solely the CRVM method and pension annuity reserves determined using solely the NLP method.

CFC2 also holds loss reserves for outstanding claims (including incurred but not reported claims) under life insurance and annuity contracts issued by CFC2. CFC2 calculates the reserves using the company's individual loss experience, in accordance with rules and regulations prescribed by the Agency.

Parent represents that: (1) CFC2 is not engaged in any insurance business outside of Country B; (2) any difference in the methods under Country B law used to calculate the reserves related to an insurance policy issued by CFC2 as compared to the methods used to calculate such reserves for the same insurance policy under subchapter L (if CFC2 were a U.S. insurance company) would not cause a material difference in the measurement of CFC2's income during the life of such policy; and (3) the foreign reserve method used to calculate CFC2'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).

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 "Job Creation and Worker Assistance Act of 2002" (JCX-12-02 (March 6, 2002)).

Analysis

CFC2 is subject to regulation as a life insurance company by Country B. CFC2 is licensed, authorized, and regulated by the Agency, which is the insurance regulatory body for Country B, to sell life insurance and annuity contracts to persons other than related persons (within the meaning of Code section 954(d)(3)) in Country B. CFC2 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 B and with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in Code section 954(d)(3)). Finally, CFC2 is engaged in the life insurance business and would be subject to tax under Subchapter L if it was a domestic corporation. Accordingly, CFC2 is a QIC.

CFC2 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. Moreover, CFC2 derives more than 30 percent of its net written premiums from contracts that cover Country B risks with respect to which no policyholder, insured, annuitant or beneficiary is a related person within the meaning of section 954(d)(3). Such contracts are, therefore, exempt contracts within the meaning of section 953(e)(2).

The foreign statement underwriting reserves and loss reserves held by CFC2 for its exempt contracts that are life insurance contracts and pension annuity contracts

provide an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii) because these reserves are (1) computed using either the CRVM method or NLP method, which are appropriate methods of measuring income, and (2) are not catastrophe, deficiency, equalization, or similar reserves.

Ruling

Based on the information submitted and the representations made, we rule as follows: Under the facts set forth above, the foreign statement underwriting reserves and loss reserves of CFC2 for its exempt contracts that are life insurance and pension annuity contracts are an appropriate means of measuring income within the meaning of section 954(1)(4)(B)(ii) and, accordingly, these reserves may be used in determining its foreign personal holding company income under section 954. This ruling shall apply beginning with the taxable year ending on Year 1.

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 Taxpayer and CFC2. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Taxpayer 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:

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