

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

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Person To Contact: _____, ID No.

Telephone Number:

Refer Reply To:
CC:INTL:B05
PLR-129622-15

Date:
August 19, 2016

In Re:

Legend

A =
Parent =
Sub =
CFC =
State 1 =
State 2 =
Country A =
Annual Report =
Insurance Regulator =
Day X =
Year 1 =

Dear _____ :

In a letter dated A, Parent (together with Sub) requested a ruling allowing CFC to use certain foreign statement insurance reserves in computing foreign personal holding company income under section 954(i) 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, and policyholders' dividend reserves for life insurance and annuity contracts reported by CFC on its Annual Report; (2) the underwriting reserves, loss reserves, and policyholder dividend reserves attributable to its non-cancellable and guaranteed renewable accident and health contracts reported by CFC on its Annual Report; and (3) the underwriting reserves, loss reserves, policyholders' dividend reserves, and associated asset bases attributable to CFC's separate account-type contracts, as reported on the Annual Report.

The ruling given in this letter is based upon the 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 organized under the laws of State 1. Parent is engaged, through its subsidiaries and affiliates, in various lines of business, which include, among others, domestic and international life insurance. Parent is the common parent of an affiliated group of life insurance companies and non-life insurance companies that file a life/non-life consolidated federal income tax return under section 1504(c)(2). As the common parent, Parent reports the group's income on a consolidated return, which is filed on a calendar year basis.

Parent directly owns all of the stock of Sub, a holding company that is organized as a corporation under the laws of State 2. Sub is a member of Parent's U.S. consolidated group, and its income is reported as part of Parent's consolidated return.

Sub owns directly all of the stock of CFC, a company that is organized and domiciled in Country A and is treated as a corporation for U.S. federal income tax purposes. CFC is a controlled foreign corporation as defined in section 957(a). Both Parent and Sub are U.S. shareholders of CFC within the meaning of section 951(b). As a 100 percent owner of CFC, Sub is the controlling domestic shareholder of CFC within the meaning of Treas. Reg. § 1.964-1(c)(5).

CFC carries on a life insurance and annuity business in Country A. CFC is not engaged in any insurance business outside of Country A. If CFC were a domestic corporation it would be subject to tax as a life insurance company under Part I of Subchapter L.

CFC issues contracts that are regulated as life insurance and annuity contracts by Insurance Regulator. CFC also issues non-cancellable and guaranteed renewable accident and health insurance contracts. Parent and Sub represent that CFC's non-cancellable and guaranteed renewable accident and health insurance contracts covered under the rulings requested are "non-cancellable life, health, or accident insurance policy" within the meaning of Treas. Reg. § 1.801-3(c). In addition, CFC issues separate account-type contracts, which are separately identified and maintained and are supported by separately identifiable pools of assets.

CFC did not have any non-exempt contracts in Year 1. The reserves covered by this ruling are limited to CFC's underwriting reserves, loss reserves, and policyholders' dividend reserves with respect to its life insurance and annuity contracts that are exempt contracts within the meaning of section 953(e)(2).

CFC derives more than 50 percent of its aggregate net written premiums from the issuance of life insurance and annuity contracts covering risks of residents of Country A. CFC derives more than 30 percent of its net written premiums from otherwise exempt contracts which cover applicable home country risks.

The laws of Country A regulate all aspects of the insurance business in Country A, including licensing and accounting (including the calculation of reserves). To conduct an insurance business in Country A, an insurance company is required to obtain and maintain a license from Insurance Regulator, a bureau within an entity created by Country A's Insurance Act.

CFC is licensed and subject to regulation by Insurance Regulator. Under applicable regulatory requirements, CFC is required to establish and maintain reserves for obligations to its policyholders and to report the amounts of such reserves on its Annual Report filed with Insurance Regulator. The Annual Report consists of: (1) a detailed description of the operational status and the use of funds, including a balance sheet, profit and loss statement, statement of changes in shareholders' equity cash flow and proposal for allocation of surplus profit or compensation of deficit; (2) a certificate by CFC's internal auditor; and (3) an approval of the items described in (1) by CFC's Board of Directors.

CFC uses the following methods to calculate its underwriting reserves (all of which are prescribed by Insurance Regulator): (1) for its life and endowment contracts, the Commissioners' Reserve Valuation Method, modified only to provide the modified net premiums shall not exceed the net level annual premium for a 20-year premium whole life plan at issue age; (2) for its annuity contracts, the net level premium method; (3) for its variable annuity contracts, the Variable Annuity Commissioners' Reserve Valuation Method; and (4) for its long duration accident and health contracts, the 1-year full preliminary term method. For regulatory purposes of Country A, CFC is required to (1) mark-to-market its portfolio investment assets held pursuant to its separate account-type contracts; (2) adjust the bases of its marked portfolio investment assets to fair market value; and (3) adjust its underwriting reserves and loss reserves in order to offset any realized gain or loss attributable to such marked assets.

CFC calculates its underwriting reserves using (1) the standard mortality table applicable to life insurance or annuities that is generated by Insurance Regulator, and (2) an interest rate prescribed by Insurance Regulator based upon Country A's government-issued bond yields. To determine the amount of reserves for accident and health insurance contracts, CFC uses the same morbidity rate tables that it used to determine the premium. CFC does not include future expenses in its reserves.

CFC's loss reserves reflect its unaccrued obligations with respect to its incurred losses. CFC's loss reserves do not include any amounts for accrued liabilities.

CFC's policyholder dividends reserves include only amounts described in section 807(c)(4) as dividend accumulation, and other amounts, held at interest in connection with its life insurance.

Parent and Sub represent that 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) administrative expenses; (6) lapse reserves; (7) a dividend offset reserve; (8) liability adequacy reserves; or (9) 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 that is attributable to the issuing or reinsuring of an insurance or annuity contract, and that 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 are 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 that is attributable to the issuing (or reinsuring) of an "exempt contract" by such company and that is treated as earned by such company in its home country for purposes of such country's tax laws. An "exempt contract" is defined under section 953(e)(2) to include an insurance or annuity contract 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 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 and each of its qualifying insurance branches of contracts—

(i) covering applicable home country risks . . . of such corporation or branch, as the case may be, and

(ii) with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in section 954(d)(3)),

Except that in the case of a branch, such premiums shall only be taken into account to the extent such premiums are treated as earned by such branch in its home country for purposes of such country's tax laws, and

(C) is engaged in the insurance business and would be subject to tax under Subchapter L if it were a domestic corporation.

Section 953(e)(6)(A) provides that “[t]he term “home country” means , with respect to a controlled foreign corporation, the country in which such corporation is created or organized.”

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 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)). 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).

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 non-cancellable contracts of health and accident insurance, if (1) its life insurance reserves plus (2) unearned premiums, and unpaid losses (whether or not ascertained), on non-cancellable 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 non-cancellable accident and health insurance contracts (including life insurance or annuity contracts combined with non-cancellable 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.

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 licensed, authorized, and regulated as a life insurance company by the Insurance Regulator. CFC derives more than 50 percent of its aggregate net written premiums from the issuance of life insurance contracts that cover 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)). CFC is engaged in the life insurance business and would be subject to tax under Subchapter L if it were a domestic corporation. Accordingly, CFC is a QIC under section 953(e)(3). CFC issues life insurance, health insurance, and annuity contracts in connection with the lives and health of residents of Country A, a country other than the United States.

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). The contracts that are the subject of this ruling, therefore, are exempt contracts within the meaning of section 953(e)(2).

CFC issues non-cancellable and guaranteed renewable accident and health (“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 policyholder dividends reserves on these policies using a methodology similar to that used to compute life insurance reserves. The treatment of non-cancellable 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 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).

CFC must establish, maintain, and calculate underwriting, loss and policyholder dividend reserves in accordance with the insurance laws and regulations prescribed of Country A. Insurance Regulator requires a life insurance company to determine the amount of its insurance reserves based upon guidance it provides. CFC must set forth its insurance reserves on Annual Report, which must be filed annually with the Insurance 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 Insurance Regulator requires CFC to hold these reserves for the fulfillment of claims owed to policyholders and beneficiaries. The reserves are not catastrophe, deficiency, equalization, or similar reserves. The rules prescribed by Country A for determining the amount of the insurance reserves that must be reported on the Annual Report, including 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

- (1) Under the facts set forth above, the foreign statement underwriting reserves, loss reserves, and policyholder dividend reserves with respect to exempt life insurance and annuity contracts (within the meaning of sections 953(e)(2) and 954(i)(4)(B)) issued by CFC, are an appropriate means of measuring income under 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 policyholder dividend reserves maintained by CFC for its non-cancellable 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, policyholders' dividend reserves, and associated asset bases attributable to CFC's separate account-type 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

No opinion is expressed upon any provisions of the Code or regulations not specifically covered by the above ruling. This ruling is subject to revocation if any of the following circumstances occur: (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, CFCs 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,

Peter Merkel
Senior Technical Reviewer, Branch 5
Office of Associate Chief Counsel (International)

cc: