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In Re:

PLR Request

LEGEND

Taxpayer =

X =

Foreign Partnership =

Country A =

CFC A =

Years =

Foreign Regulator =

Annual Statement =

Act =

Insurance Regulatory Standards =

Date A =

Dear :

This is in response to Taxpayer's request for rulings under section 954(i)(4) of the Internal Revenue Code of 1986, as amended, (the "Code") regarding the reserves for annuity contracts reported by Taxpayer's controlled foreign corporation ("CFC") on the annual financial statement that it files with its foreign insurance regulator.

FACTS

Taxpayer represents the following:

Taxpayer is a life insurance company that is the common parent of an affiliated group of life and non-life insurance companies. Taxpayer owns, through entities disregarded for

U.S. federal income tax purposes, X percent of Foreign Partnership, a company incorporated in Country A that is treated as a partnership for U.S. federal income tax purposes. Foreign Partnership wholly owns CFC A, an insurance company incorporated in Country A. During the Years, CFC A is a controlled foreign corporation (as defined in section 957(a)), and Taxpayer is a U.S. shareholder (as defined in section 951(b)) of CFC A.

CFC A is engaged in the business of underwriting annuity contracts for pension plans in Country A. The annuity contracts issued by CFC A are annuity contracts described in section 954(i)(4)(B), taking into account section 953(e)(5).

CFC A is a qualifying insurance company ("QIC") as defined in section 953(e)(3) and the annuity contracts it issues are exempt contracts within the meaning of section 953(e)(2) based on the following facts as represented by Taxpayer. CFC A issues annuity contracts in connection with the lives and health of residents of Country A, a country other than the United States. CFC A 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 as defined in section 954(d)(3).

Moreover, CFC A derives more than 50 percent of its aggregate net written premiums from the issuance or reinsurance of 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 A would be subject to tax under subchapter L if it were a domestic corporation.

CFC A's insurance operations are located entirely in Country A. CFC A is subject to regulation by multiple Country A regulatory authorities, including Foreign Regulator. Foreign Regulator is delegated regulatory authority under the Act, which includes the authority to license an insurance company to conduct business in Country A and to regulate and supervise on an ongoing basis insurance business conducted in Country A. Foreign Regulator exercises this authority in accordance with Country A's insurance laws, including the Act, and the Foreign Regulator's Insurance Regulatory Standards.

CFC A is licensed and authorized by Foreign Regulator as an insurance company to sell annuity contracts to persons other than related persons in Country A.

Pursuant to the Act and Foreign Regulator's Insurance Regulatory Standards, CFC A submits an Annual Statement, which includes financial reports and metrics prepared in accordance with the Insurance Regulatory Standards, to Foreign Regulator. The financial reports consist of financial information and reports certified by independent auditors. The Annual Statement is publicly available, and Foreign Regulator uses the Annual Statement for insurance supervision purposes.

To comply with Country A's insurance laws and the Insurance Regulatory Standards, CFC A must report and maintain certain insurance contract liabilities associated with CFC A's annuity contracts. CFC A computes the insurance contract liabilities using the methodology prescribed in the Insurance Regulatory Standards—a Solvency II-based methodology—and includes these amounts on its Annual Statement. A certified actuary oversees the computation of the insurance contract liabilities reported in the Annual Statement to ensure that the liabilities are actuarially sound.

The insurance contract liabilities reported on the Annual Statement consist of multiple components, including amounts computed using best estimate assumptions ("best estimate liabilities").¹ The best estimate liabilities portion is a prospective actuarial valuation of discounted projected net cash flows—representing the present value of future benefits and claims, expenses, and future gross premiums—based on up-to-date and credible interest, mortality, morbidity, lapse, and other assumptions that are developed on a best estimate basis. The best estimate liabilities that will be included by CFC A as part of its foreign statement reserve for purposes of section 954(i)(4)(B)(ii) are those associated with CFC A's legal obligations to the policyholders of its annuity contracts. Taxpayer will not include any portion of the best estimate liabilities that are catastrophe, deficiency, equalization, or similar reserves as part of its foreign statement reserve for purposes of section 954(i)(4)(B)(ii). Taxpayer also will not include any portion of the best estimate liabilities that are asset adequacy reserves as part of its foreign statement reserve for purposes of section 954(i)(4)(B)(ii).

CFC A and the reserve methodology that it reported on its annual statements to Foreign Regulator in certain prior years were the subject of a private letter ruling under section 954(i)(4)(B)(ii) issued in 2016.² Under its current method of accounting as described in the prior private letter ruling regarding CFC A, Taxpayer subtracts adjustments for certain investment management expenses, administrative expenses, and maintenance reserves in computing CFC A's U.S. federal income tax reserves under section 954(i)(4)(B)(ii); Taxpayer proposes to continue to do so under the foreign statement reserve method described in this letter.

Taxpayer determines CFC A's income for U.S. federal income tax purposes in accordance with subpart F of the Code, including sections 951A, 953, and 954, and subchapter L, including section 811 (subject to the modifications of section 953(b)).

¹

² Taxpayer seeks a new ruling because of changes to the insurance regulatory and financial reporting regimes in Country A, including changes to the methods of computing reserves.

LAW

In general, a United States shareholder of a 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 952(a). For purposes of determining a CFC's insurance income, the provisions of subchapter L (including, for example, section 811) apply subject to the modifications in section 953(b). Section 953(a). Section 953(b)(3) further provides that reserves for any insurance or annuity contract shall be determined in the same manner as under section 954(i). Section 953(b)(3). A CFC's tested income and tested loss, for purposes of determining a U.S. Shareholder's section 951A inclusion, are also determined by applying the rules of sections 953 and 954(i). Treas. Reg. § 1.951A-2(c)(2).

In general, section 953(e)(3) defines a QIC as any CFC that: (A) is subject to regulation as an insurance (or reinsurance) company by its home country,³ and is licensed, authorized, or regulated by the applicable insurance regulatory body for its home country to sell insurance, reinsurance, 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 or reinsurance by such CFC 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 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)(4)(B)(i) generally provides that in the case of a life insurance or annuity contract, a QIC's reserve for the contract shall be equal to the greater of (1) the net surrender value of the contract or (2) the reserve determined under section 954(i)(5). Generally speaking, section 954(i)(5) determines the amount of the reserve for a contract in the same manner as it would be determined if the QIC were subject to tax under subchapter L, subject to certain adjustments.

Section 954(i)(4)(B)(ii), however, provides:

The amount of the reserve 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

³ 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."

taken into account in determining the foreign statement reserve provide an appropriate means of measuring income.⁴

Section 954(i)(4)(B)(ii) was originally enacted by the Job Creation and Worker Assistance Act of 2002 ("2002 Act"). Pub. L. No. 107-147, sec. 614, 116 Stat. 21, 62. In its Technical Explanation of the 2002 Act, the staff of the Joint Committee on Taxation explained 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. 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 Tax'n, 107th Cong., JCX-12-02, *Technical Explanation of the "Job Creation and Worker Assistance Act of 2002"* 72 (2002).

ANALYSIS

Section 954(i)(4)(B) addresses the amount of the reserve of a QIC for a life insurance or annuity contract. The following facts as represented by Taxpayer relate to certain terms therein.

"Foreign Statement" for Purposes of Section 954(i)(4)

Foreign Regulator is the principal insurance regulator in Country A. The Annual Statement includes the financial statements that CFC A submits to Foreign Regulator for insurance supervision purposes pursuant to the Act and Foreign Regulator's Insurance Regulatory Standards. The insurance contract liabilities associated with CFC A's annuity contracts are reported in the Annual Statement.

⁴ In the absence of published guidance pursuant to section 954(i)(4)(B)(ii), taxpayers may not use their foreign statement reserves if they have not secured a letter ruling granting the Secretary's consent.

Appropriate Means of Measuring Income for Purposes of Section 954(i)(4)(B)(ii)

Foreign Regulator actively and regularly exercises its insurance supervision regulatory authority over CFC A. The Annual Statement, as submitted to Foreign Regulator, is publicly available. The financial reports contained in the Annual Statement consist of financial information and reports certified by independent auditors.

In the Annual Statement, CFC A reports insurance contract liabilities associated with CFC A's annuity contracts. CFC A computes the insurance contract liabilities using the methodology prescribed in the Insurance Regulatory Standards; a certified actuary oversees the computation of the insurance contract liabilities reported in the Annual Statement to ensure the liabilities are actuarially sound.

CFC A must establish, maintain, and calculate its insurance contract liabilities in accordance with the Insurance Regulatory Standards prescribed by Foreign Regulator. The best estimate liabilities measures CFC A's legal obligations to policyholders reported on the Annual Statement (that is, the financial statement used for regulatory purposes by life insurance companies doing business in Country A). Foreign Regulator requires CFC A to hold these reserves for the fulfillment of claims owed to policyholders and beneficiaries. For purposes of section 954(i)(4)(B)(ii), Taxpayer will exclude from its foreign statement reserve the portion of its Annual Statement's best estimate liabilities that are catastrophe, deficiency, equalization, or similar reserves or asset adequacy reserves.

These factors, including a sufficiently rigorous insurance regulatory environment, indicate that the aspects of CFC A's foreign statement reserves that are not adjusted or excluded (as described in the ruling below) can be an appropriate means of measuring income for purposes of section 954(i)(4)(B)(ii).

RULINGS

Based upon Taxpayer's representations, the analysis above, and subject to the caveats below, approval is granted with regard to CFC A's tax years beginning after Date A as follows:

1. CFC A's Annual Statement filed with Foreign Regulator is the foreign statement with respect to the annuity contracts issued by CFC A within the meaning of section 954(i)(4).
2. The best estimate liabilities associated with CFC A's annuity contracts reported on its Annual Statement provide an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii), but only after certain adjustments (as may be applicable) are made to reflect the effect of policies treated as reinsured for U.S. federal income tax purposes and to remove the following subcomponents: catastrophe, deficiency, equalization, or similar reserves; asset

adequacy reserves; and certain other factors (such as maintenance reserves, third party administrative expenses, and investment management expenses).

CAVEATS

This ruling's application is limited to CFC A's foreign statement reserves related to the annuity contracts described herein and the facts, representations, Code sections, and regulations cited herein. The ruling's application is also subject to the terms or conditions in the contemporaneously issued change of accounting method consent agreement. Except as specifically provided otherwise, no opinion is expressed on the federal income tax consequences of any transaction or item discussed or referenced in this letter. For example, no opinion is expressed regarding whether Taxpayer computes CFC A's income (or the treatment of items included therein) properly for U.S. federal income tax purposes or whether the insurance contracts or annuities (or reinsurance thereof) are insurance contracts, annuities, or reinsurance for U.S. federal income tax purposes.

The rulings contained in this letter are based upon information and representations submitted by Taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

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

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers 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.

In accordance with the Powers of Attorney on file with this office, a copy of this letter is being sent to Taxpayer's authorized representatives.

Sincerely,

Je Y. Baik
Senior Technical Reviewer, Branch 5
Office of Associate Chief Counsel
(International)

cc: