

Foreign Insurer: to Elect or Not to Elect (That Is a Question)

By Sheryl Flum, Jean M. Baxley, and Liz Petrie

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Sheryl Flum

Jean M. Baxley

Liz Petrie

Sheryl Flum is a managing director, Jean M. Baxley is a director, and Liz Petrie is a manager in the financial institutions and products group of KPMG LLP's Washington National Tax practice.

In this article, the authors discuss how a controlled foreign insurance subsidiary can make a section 953(d) election for domestic taxation treatment, and they provide insight on technical procedures, potential pitfalls, and solutions for inadvertent errors.

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A U.S. company has a controlled foreign corporation that would qualify as an insurance company under subchapter L of the Internal Revenue Code of 1986. The insurance subsidiary can be a captive (insures related party risks) or a commercial insurance company (sells insurance coverage to third parties). How should the U.S. company account for the CFC's taxable income (or loss)? The choices are to account for the CFC's income or loss using subpart F of the code or to make a section 953(d) election to have the insurance subsidiary be treated as a domestic corporation for U.S. tax purposes. This article focuses on the section 953(d) election.

A. What Is a Section 953(d) Election?

Section 953(d) allows some foreign insurance companies to elect to be treated as domestic corporations for U.S. tax purposes. Premiums paid to an

electing insurance company are not subject to the section 4371 federal excise tax (FET) on premiums paid to foreign insurers and reinsurers.¹

Once an election is complete, the electing corporation must determine the tax due on its income as if it were a domestic corporation subject to part I (life insurance company) or part II (nonlife insurance company) of subchapter L. The electing insurance company must timely file the U.S. tax return that is due when the election becomes effective and must timely pay any U.S. income taxes due, including estimated payments.²

A foreign corporation that makes the election is subject to U.S. income tax on its worldwide income. To be eligible for the section 953(d) election, the foreign corporation must meet the insurance company test in sections 816(a) and 831(c), which means more than half of its business must be the issuing of insurance or annuity contracts or the reinsuring of risks underwritten by insurance companies.

If the following requirements are met, a foreign insurance company may elect to be treated as a domestic corporation³:

- the foreign corporation is a CFC⁴ by substituting "25 percent or more" for "more than 50 percent" and by using the definition of U.S. shareholder under section 953(c)(1)(A);⁵
- the foreign corporation would qualify as an insurance company under part I or part II of subchapter L;⁶
- the foreign corporation meets the requirements to ensure that taxes imposed on the foreign corporation are paid, that is, it either satisfies the office and assets test in Rev. Proc. 2003-47 or enters into a closing agreement and provides security for payment of taxes due; and
- the foreign corporation makes an election to have section 953(d) apply and to waive all benefits granted by the United States under any treaty.

¹Rev. Proc. 2003-47, 2003-2 C.B. 55, section 2.

²See *id.* at section 4.01.

³Section 953(d)(1).

⁴As defined in section 957(a).

⁵Section 951(b) and reg. section 1.951-1(g)(1).

⁶Sections 801-847.

B. Why Would Insurers Elect Section 953(d)?

If a U.S.-controlled foreign insurance company receives U.S.-source premiums, these premiums are subject to the section 4371 FET, which adds 1 percent or 4 percent to the cost of insurance for the U.S. insured. Eliminating the FET can improve an insurance company's competitiveness in the United States.

If, however, a foreign insurance company carries out its insurance business in the United States (directly or indirectly through an agent), it is subject to U.S. income tax (as well as state and local income tax) at the regular corporate income tax rates on its net effectively connected income with the U.S. insurance business.⁷ Also, a foreign insurance company engaged in a U.S. insurance business is subject to a branch profits tax on its effectively connected earnings and profits remitted (or deemed remitted) in a given tax year at a statutory rate of 30 percent.⁸ Thus, a foreign insurance company's net ECI may be subject to federal income tax at an effective tax rate of 54.5 percent. Finally, a foreign insurance company engaged in a U.S. insurance business is obligated to file federal, state, and local income tax returns.

A foreign insurance company that writes U.S. business and takes the position that it is not engaged in a U.S. trade or business or does not have a permanent establishment in the United States is subjecting itself to potential U.S. income tax risk. Voluntarily subjecting a foreign insurer to "net basis" taxation eliminates the risk that it could be subject to income tax on its gross premium income or that its parent company could be required to make Form 5471 filings.

Subject to the life and nonlife consolidated return rules in reg. section 1.1502-47, a section 953(d) company can also join in the filing of a consolidated return with its U.S. affiliates. However, any net operating loss generated by a section 953(d) company must be treated as a dual consolidated loss under section 1503(d) and may not be made available for use by other members of the consolidated group.⁹

C. How Is the Section 953(d) Election Made?¹⁰

A foreign corporation's election under section 953(d) to be taxed as a domestic corporation applies for the year in which the election is made and to all subsequent years unless terminated or revoked

with IRS consent.¹¹ An election is automatically terminated when the corporation fails to meet the election requirements under section 953(d)(1).

The process of making a section 953(d) election must be initiated by filing an original election statement. The electing corporation must attach to its election statement a complete list of all U.S. shareholders (within the meaning of section 953(c)(1)(A)) of the electing corporation as of a date no more than 90 days before the date the election statement is mailed. The list must include each U.S. shareholder's name, address, tax identification number, and ownership percentage. The electing corporation must agree to file an updated list containing that information as of the last day of each tax year. The updated list will be filed with the U.S. tax return reporting the income earned by the electing corporation for each tax year the election is in effect. The electing corporation must also attach to its election statement Form 2848, "Power of Attorney and Declaration of Representative," or Form 8821, "Tax Information Authorization," designating a U.S. representative authorized to receive confidential tax information, including any notice of deficiency, on behalf of the electing corporation. The electing corporation must agree to produce its books and records (or true and accurate copies) in the United States upon request by the IRS.

The election statement must be signed by a duly authorized officer of the electing corporation, within the meaning of section 6062. When the electing corporation files its annual income tax return for the first year for which the election is made, Form 1120-PC, "U.S. Property and Casualty Insurance Company Income Tax Return," or Form 1120-L, "U.S. Life Insurance Company Income Tax Return," it must attach a copy of this election statement (without attachments).

For an election to be effective for a tax year, the original election statement must be filed by the due date prescribed in section 6072(b) (including extensions) for the U.S. income tax return that is due if the election becomes effective. When approved, the election is effective as of the first day of the first tax year (including a short tax year) for which it is made.

When the section 953(d) election is approved, a stamped copy of the election statement and, if applicable, the executed closing agreement will be returned to the electing corporation. If an insured or broker receives a copy of the stamped election statement, he will no longer be liable under section 4374 for the FET imposed under section 4371. The exemption from the FET is effective as of the first

⁷Section 882(a).

⁸Section 884(a).

⁹See generally section 953(d)(3) and reg. section 1.1503(d)-6(a)(3).

¹⁰See Rev. Proc. 2003-47, section 4.04.

¹¹Section 953(d)(2).

day of the first tax year for which the election is made. Any excise taxes that have been paid for periods that the election is effective may be refunded to the person who remitted the taxes. A refund of excise tax (including statutory interest) may be obtained by filing a claim on Form 720X, "Amended Quarterly Federal Excise Tax Return," or Form 843, "Claim for Refund and Request for Abatement."

1. Rev. Proc. 2003-47 mechanics. Rev. Proc. 2003-47 provides the procedure for making a section 953(d) election.¹² The revenue procedure provides that a closing agreement and letter of credit will not be required for an election if the electing corporation:

- maintains an office or other fixed place of business in the United States (office test); and
- owns assets that are physically located in the United States with an adjusted basis equal to 10 percent of its gross income for the base year (asset test).¹³

The base year is the tax year immediately preceding the tax year for which the election is first made. However, if the electing corporation did not receive gross income in the prior tax year, the base year is the first year of the election.

If the electing corporation will be a member of a consolidated group within the meaning of regulation 1.1502-1(h) because of the election, the electing corporation may satisfy the office test and asset test based on the office and assets of a U.S. corporation that is a member of the consolidated group (U.S. affiliate).¹⁴ An electing corporation will satisfy the asset test based on the assets of the U.S. affiliate if the U.S. affiliate owns assets that are physically located in the United States with an adjusted basis equal to 10 percent of the electing corporation's gross income for the base year.

If the electing corporation chooses to satisfy the office test and asset test based on the office and assets of a U.S. affiliate, the U.S. affiliate must enter into a closing agreement with the IRS to agree that, in the event of termination or revocation of the electing corporation's section 953(d) election, the U.S. affiliate will be liable for excise tax imposed under section 4371 (up to a stated amount) that remains unpaid after the electing corporation has been issued a statement of notice and demand for that tax. Information regarding the preparation of this closing agreement will be sent to the electing corporation after it has filed an election statement.

¹²Notice 89-79, 1989 IRB 7, provides the substantive rules for making a section 953(d) election.

¹³Rev. Proc. 2003-47, section 4.04(4).

¹⁴*Id.* section 4.04(4)(e).

The revenue procedure provides an asset calculation sheet and requires an electing corporation or its U.S. affiliate to provide a calculation demonstrating that the electing corporation meets those two tests.

2. Closing agreement process.¹⁵ An electing corporation that does not satisfy the office test and asset test must enter into a closing agreement and provide a letter of credit to secure payment of any taxes due. The electing corporation first must file a statement indicating that it does not satisfy these tests. After filing the statement, the electing insurance company will be given instructions for completing the election process and will be notified when it must submit a letter of credit. The insurance company's election will not be approved until a sufficient letter of credit has been provided.

When the section 953(d) election is approved, the IRS will return a stamped copy of the election statement and, if applicable, the executed closing agreement to the electing insurance company.¹⁶ Once approved, a section 953(d) election generally remains effective for each subsequent tax year in which the requirements of section 953(d) and Rev. Proc. 2003-47 are satisfied.

D. Special Situations and Considerations

1. Incomplete elections. Once a taxpayer files a section 953(d) election, it is important to follow up with the IRS to see the process through and confirm that the election is granted. The election is not final until the electing taxpayer receives a stamped copy of the election statement and, if applicable, the executed closing agreement.

More than one office in the IRS is responsible for finalizing the election. The Plantation, Florida, advisory office reviews the election as an initial matter, and the IRS Office of Chief Counsel (International) is responsible for drafting the closing agreement as appropriate; the two offices collaborate on the letter of credit. We generally recommend that the taxpayer or its representative periodically check with the IRS regarding the status of a taxpayer's election.

2. Late elections section 9100 relief. If a foreign insurance company wishes to pursue a section 953(d) election but misses the filing date for the election or does not receive a final, approved election, reg. sections 301.9100-1 and 301.9100-3 allow a taxpayer to be granted an extension of time to make the election (section 9100 relief).

For purposes of determining whether an election is late so that section 9100 relief would apply, a U.S.

¹⁵*See id.* at section 3.03.

¹⁶*Id.* at section 4.04(5).

taxpayer that keeps its books and records outside the United States may have an extension until June 15 both to file a return and to pay the taxes reflected on the return.¹⁷ That rule also applies to a foreign corporation with an office or place of business in the United States.¹⁸ A taxpayer that files an extension between March 15 and June 15 can still be considered to have filed the election in a timely manner.

Reg. section 301.9100-1 provides standards to be used by the IRS commissioner in determining whether relief should be granted to allow an extension to make a regulatory election. Reg. section 301.9100-3 indicates that relief will be granted if the taxpayer provides evidence establishing that the taxpayer acted reasonably and in good faith and granting relief will not prejudice the government's interests.

Reg. section 301.9100-3(b)(1) indicates that a taxpayer will be deemed to have acted reasonably and in good faith if the taxpayer applies for relief before the IRS discovers the failure to make the election unless: (1) the taxpayer seeks to alter a return position for which an accuracy-related penalty has been or could be imposed under section 6662, and the new position requires or permits a regulatory election for which relief is requested; (2) the taxpayer was fully informed of the required election and related tax consequences and chose not to file the election; or (3) the taxpayer uses hindsight in requesting relief.

Reg. section 301.9100-3(c)(1)(i) indicates that the interests of the government are prejudiced if granting relief will result in a taxpayer having a lower tax liability in the aggregate for all years to which the election applies than the taxpayer would have had if the election had been timely. Accordingly, the taxpayer seeking section 9100 relief should be prepared to demonstrate that granting a late election will not result in a lower aggregate tax liability. Reg. section 301.9100-3(c)(1)(ii) provides that relief ordinarily will not be granted if the tax year in which the regulatory election should have been made or any tax year that would have been affected by the election had it been timely made is closed by the statute of limitations on assessment before the taxpayer's receipt of the ruling granting section 9100 relief.

Also, relief ordinarily will not be granted if the tax year in which the regulatory election should have been made or any tax year that would have been affected by the election had it been timely made is closed by the statute of limitations on assessment before the taxpayer's receipt of section

9100 relief.¹⁹ Further, a request for relief does not suspend the period of limitations on assessment under section 6501(a). Thus, for relief to be granted, the IRS may require the taxpayer to consent under section 6501(c)(4) to an extension of the period of limitations on assessment for the tax year in which the regulatory election should have been made and any tax years that would have been affected by the election had it been timely made.²⁰

To obtain section 9100 relief, the taxpayer must file a private letter ruling request with the IRS National Office. Extensions of time for making a section 953(d) election have been granted in numerous instances.²¹

If section 9100 relief is granted, it will be retroactive to the year in which relief is requested and granted. Once relief is granted, taxpayers that paid premiums to the section 953(d) insurance company for which FET was remitted are entitled to a refund of the FET. The electing company should notify the relevant insureds, ceding companies, or insurance and reinsurance brokers of the retroactive, approved section 953(d) election so customers can claim their FET refunds for open calendar quarters. The IRS maintains a listing of insurance companies that have closing agreements and, thus, can receive U.S. insurance and reinsurance premiums that are not subject to FET.

3. Captives and cell company structures. If a non-U.S. captive qualifies as an insurance company for U.S. tax purposes under sections 816(a) and 831(c), it is eligible for the section 953(d) election. Some captives, both in the United States and in foreign jurisdictions, are formed as series organizations under local law. In this organizational form, the "sponsor" is itself a series organization, and each captive is a separate series, or cell, of the overall organization.

In September 2010 Treasury regulations were proposed that would clarify that a cell, or series, of an insurance series organization (U.S. or foreign) would be treated as an entity for tax purposes.²² Under the proposed regulations, a captive cell of a series organization can make a section 953(d) election again, assuming it qualifies as an insurance company for U.S. income tax purposes, that is, the requirements of insurance risk, risk shifting, and risk distribution are met, and the cell provides insurance in its commonly accepted sense. For new cell captives that meet the insurance requirements,

¹⁹Reg. section 301.9100-3(c)(1)(ii).

²⁰Reg. section 301.9100-3(d)(2).

²¹See, e.g., LTR 201612007; LTR 201451012; LTR 201351010; LTR 201303005; LTR 201119010; LTR 201037021; LTR 201037018; LTR 201028025; and LTR 201017010.

²²Prop. reg. section 301.7701-1.

¹⁷Reg. section 1.6081-5(a)(2).

¹⁸Reg. section 1.6081-5(a)(3).

the proposed regulations provide a welcome rule. Cell captives that were established before exposure of the proposed regulations and were claiming single-entity status, however, faced a decision regarding whether and how to apply the proposed regulations to their existing arrangement.

The proposed regulations contain a consistency rule that requires either all or none of the cells to be treated as separate entities. The proposed regulations do not contemplate a hybrid model — when some cells are combined and treated as a single entity and others are separate — although if a particular cell doesn't qualify as an insurance company, it is presumably combined with the other non-insurance cells.

E. Revoking Section 953(d) Election

Once approved, the election remains effective for each subsequent tax year that the foreign corporation meets the requirements of section 953(d). The electing corporation may revoke the section 953(d) election with the commissioner's consent. The IRS can terminate the section 953(d) election if the electing corporation fails to timely file a return, pay the tax due as stated on the return, or comply with any other requirement for making the election. A termination or revocation of the election is effective on the first day of the first tax year following the year in which the requirements of section 953(d) are not satisfied.²³ If an election is terminated or revoked, the foreign corporation and any successors

²³Section 953(d)(2)(B).

must obtain the IRS's consent to make another election under section 953(d).²⁴

When a section 953(d) election is revoked or terminated, the U.S. shareholders of the CFC may be liable for subpart F income inclusions. Also, any premiums paid to the CFC on U.S. risks will be subject to the section 4371 FET. Further, termination of a section 953(d) election will be subject to section 367(a) and will result in a deemed transfer of the domestic corporation's assets to a foreign corporation, that is, a deemed outbound reorganization.²⁵ Finally, U.S. shareholders of a CFC must file Form 5471. If a company's section 953(d) election is terminated by the IRS, it will not be considered to have filed the proper return (the return filed must be Form 5471 rather than Form 1120-PC or 1120-L). The statute of limitations for the entire return of the U.S. company will be held open until three years after the Form 5471 is filed. During that extended statute of limitations, the IRS can assess *any* additional tax against the U.S. company.²⁶

F. Conclusion

There can be benefits to electing domestic taxation treatment for a CFC that qualifies as an insurance company. The rules and procedures for making the election are specific and can be tricky. Close attention should be paid to ensure that the election is properly made and is approved by the IRS. The consequences for failing to appropriately make the election can cause significant tax compliance issues for the CFC's U.S. shareholders. ■

²⁴Rev. Proc. 2003-47, section 4.02(1).

²⁵Section 953(d)(5).

²⁶AM 2014-002.

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