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Insurance: PLR again allows use of foreign statement reserves

The IRS has publicly released a private letter ruling* (PLR) that again addresses whether the foreign statement reserves maintained by a wholly owned insurance company (CFC), established under the laws of another country with respect to its exempt annuity contracts, are an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii).

PLR 201718020 [PDF 71 KB] (release date May 5, 2017, and dated February 9, 2017), concludes that the foreign statement underwriting and loss reserves pertaining to exempt life insurance and noncancellable and guaranteed renewable accident and health contracts issued by a CFC are an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii).

PLR 201718020 presents the substantially same scenario and analysis as previously seen in a 2016 letter ruling (described below and also at TaxNewsFlash-United States). More details about the 2017 letter ruling are provided at the end of this report.

*Private letter rulings are taxpayer-specific rulings furnished by the IRS National Office in response to requests made by taxpayers and can only be relied upon by the taxpayer to whom issued. It is important to note that, pursuant to section 6110(k)(3), such items cannot be used or cited as precedent. Nonetheless, such rulings can provide useful information about how the IRS may view certain issues.

KPMG observation

For the past couple of years, the IRS has not approved the utilization of foreign statement reserves as the basis for determining foreign personal holding company income under section 954. With these two PLRs, tax professionals believe there may be a resumption of such approvals.
Several factors provide insight into the IRS’s perspective when evaluating submissions under section 954(i). The IRS emphasizes the underlying actuarial valuation of the annual statement reserves, and requires that the taxpayer represent that the reserves do not include catastrophe, deficiency, equalization, or similar reserves, and that the assets are marked to market consistent with local country rules.

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**Overview—2016 PLR**

Previously, on September 9, 2016, the IRS publicly released PLR 201637005 concluding that the foreign statement reserves maintained by a wholly owned insurance company (CFC A) established under the laws of another country with respect to its exempt annuity contracts are an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii). The IRS ruled that the amount of these reserves may be used in determining CFC A’s foreign personal holding company income under section 954—provided that assets are marked to market consistent with the rules of the country where CFC A is established and that the reserves include only amounts attributable to policyholder benefits.


**Background—2016 PLR**

The taxpayer requested a ruling allowing CFC A to use certain foreign statement insurance reserves in computing the foreign personal holding company income under section 954 because, as the taxpayer asserted, these insurance reserves are an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii) and, accordingly, such reserves may be used in determining foreign personal holding company income under section 954.

CFC A’s operations involve the issuance of payout annuity contracts designed for the Country A defined benefit pension plan market. The contracts issued by CFC A are designed to provide a stream of guaranteed annuity payments to cover an employer’s existing pension obligations for its Country A resident employees. The contracts cover...
obligations to current retirees and active employees. The taxpayer represented that CFC A would be subject to tax under subchapter L if it were a domestic corporation.

In Country A, financial services firms, including insurance companies, are regulated by the Authority. The Authority is an independent, non-governmental body, with certain statutory powers. The Authority requires that each insurance company authorized by the Authority to conduct insurance business in Country A file an annual insurance return. The Annual Return consists of audited financial information and reports of auditors that the Authority uses for supervision. Annual Return requirements include preparation of a revenue account, a balance sheet and profit and loss account for the year; an actuarial investigation every twelve months; an audit of accounts; and the depositing of specific reports with the Authority. The deposited documents are open to public inspection. The taxpayer represented that for purposes of determining foreign personal holding company income, CFC A would follow the Country A mark-to-market method applicable to assets under Country A financial statement rules and would base reserves only on amounts attributable to policyholder benefits if a favorable ruling is granted allowing CFC A to use foreign statement reserves under section 954(i). In addition, taxpayer represented that the reserves CFC A is required to establish under Country A are not catastrophe, deficiency, equalization, or similar reserves.

The taxpayer requested IRS permission to use its Country A financial statement reserves in computing its foreign personal holding company income under section 954.

Discussion of 2016 PLR

Section 954(i)(4)(B)(i) generally provides that, in the case of life insurance and annuity contracts, a qualifying insurance company’s reserves allocable to exempt contracts are equal to the greater of (1) the net surrender value of the contract, or (2) if approved by the IRS, the company’s foreign statement reserves.

Under the Protecting Americans from Tax Hikes (PATH) Act of 2015 (P.L. 114-113, December 18, 2015), section 954(i) was permanently extended and made effective for tax years of foreign corporations beginning after December 31, 2014, and for tax years of U.S. shareholders with or within which such tax years of such foreign corporations.

The IRS quoted the Joint Committee on Taxation (JCT) explanation of section 954(i)(4)(B)(ii), stating:

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.

JCT, *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)).

The IRS found that:

- CFC A issues annuity contracts in connection with the lives and health of residents of Country A.
- CFC A derives more than 30% 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).
- Such contracts are, therefore, exempt contracts within the meaning of section 953(e)(2). Also, CFC A must establish, maintain, and calculate the reserves in accordance with rules prescribed by the Country A authority.
- CFC A must set forth the reserves on the Country A Annual Return, which must be filed annually with the Country A authority.
- The 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 generally (whether U.S.-owned, locally owned, or owned by companies headquartered in other foreign countries).
- The Country A authority requires that CFC A hold reserves for the fulfillment of claims of policyholders and their beneficiaries. The reserves are not catastrophe, deficiency, equalization, or similar reserves.
- Under the rules prescribed by the Country A authority for determining reserves set forth on the Country A annual return, the method, the interest rate, the mortality and morbidity assumptions, and other factors taken into account provide an appropriate means of measuring income for federal income tax purposes.

**Overview—2017 PLR**

**Background—PLR 201718020**

The taxpayer requested a ruling allowing CFC to use certain foreign statement insurance reserves in computing the foreign personal holding company income under section 954 because, as the taxpayer asserted, these insurance reserves are an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii) and, accordingly, such reserves may be used in determining foreign personal holding company income under section 954.

CFC is engaged principally in the underwriting of life insurance contracts and accident and health contracts in Country A. Country A regulates any insurance business conducted in Country A through its insurance laws and regulations. Regulator is
responsible for enforcing insurance laws and regulations in Country A. CFC issues health and personal accident insurance contracts that are noncancellable or guaranteed renewable, cancellable or riders to a life insurance contract. CFC holds reserves with respect to such noncancellable health and personal accident insurance contracts which it treats as life insurance reserves. Generally, CFC does not receive premiums from any insurance contract in connection with the life or health of a resident of the US or from a related party.

Discussion of 2017 PLR

The analysis is the substantially the same as described under PLR 201637005, above.

The IRS found that:

- CFC issues life insurance contracts in connection with the lives and health of residents of Country A.
- CFC derives more than 30% 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).
- Such contracts are, therefore, exempt contracts within the meaning of section 953(e)(2). Also, CFC A must establish, maintain, and calculate the reserves in accordance with rules prescribed by Regulator.
- CFC must set forth its underwriting reserves and loss reserves on the Country A annual report, which must be filed annually with Regulator.
- The 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 generally (whether U.S.-owned, locally owned, or owned by companies headquartered in other foreign countries).
- The Country A authority requires that CFC A hold reserves for the fulfillment of claims of policyholders and their beneficiaries. The reserves are not catastrophe, deficiency, equalization, or similar reserves.
- Under the rules prescribed by Regulator for determining reserves required to be calculated for purposes of the Country A annual report, the method, the interest rate, the mortality and morbidity assumptions, and other factors taken into account provide an appropriate means of measuring income for federal income tax purposes.