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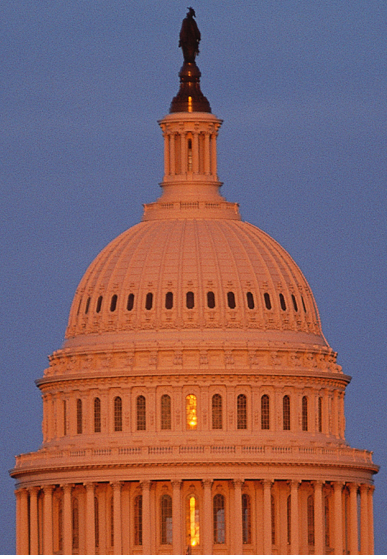

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KPMG report: Foreign tax credit and certain deductions of life insurance companies (final regulations)

Final regulations (T.D. 9959) published today in the Federal Register concern the foreign tax credit and clarify rules relating to foreign-derived intangible income (FDII).

The final regulations also include provisions that address the allocation and apportionment of section 818(f)(1) items of life insurance companies that are members of consolidated groups.

Read the **final regulations** [PDF 1.17 MB] (101 pages as published in the Federal Register on January 4, 2022)

Background

Over the past several years, Treasury and the IRS have issued a series of proposed and final regulations detailing the foreign tax credit and related rules.

More recently, proposed regulations (REG 101657-20) released in November 2020 ("2020 FTC proposed regulations") included guidance relating to the allocation and apportionment of creditable foreign taxes and deductions (including certain deductions for life insurance companies).

T.D. 9959 finalizes certain provisions of the 2020 FTC proposed regulations, including certain deductions of life insurance companies. The following discussion focuses on these insurance provisions.

Final regulations

In T.D. 9959, the final regulations address the allocation and apportionment of section 818(f)(1) items of life insurance companies that are members of consolidated groups.

Under section 818(f), in applying the expense allocation rules to a life insurance company, the deduction for policyholder dividends, reserve adjustments, death benefits, and certain other amounts ("section 818(f) expenses") are treated as items that cannot be definitely allocated to an item or class of gross income. In general, this means that the expenses are apportioned ratably across all the life

insurance company's gross income. However, the statute does not address how to treat consolidated groups and allocation of section 818(f) expenses. Treasury and the IRS outlined several methods that could be used to allocate these expenses in consolidated groups.

In the 2020 FTC proposed regulations, Treasury and the IRS proposed that consolidated life insurance companies allocate expenses based on a single entity approach ("life subgroup method"). The 2020 FTC proposed regulations also included a one-time election for companies to allocate and apportion deductions on a separate company basis.

The IRS requested comments on whether a life subgroup method more accurately reflects the relationship between section 818(f) expenses and the income-producing activities of the life subgroup, and whether the life subgroup method is less susceptible to abuse because it might prevent a consolidated group from inflating its foreign tax credit limitation through intercompany transfers of assets, reinsurance transactions or transfers of section 818(f) expenses.

The comments received supported both the life subgroup method and the separate entity method.
The final regulations finalize the proposed life subgroup method with a one-time election to use the separate entity method. Under the one-time election, a taxpayer may make a binding one-time election to use the separate entity method for all life insurance members in an affiliated group. The election can only be changed with the consent of the Commissioner.

A taxpayer makes the separate entity method election on its federal income tax return filed for its first tax year to which this section applies. This provision applies to tax years beginning on or after December 28, 2021. As a result, most taxpayers will need to decide whether to elect to use the separate entity method on their 2022 tax return.

KPMG observation

The final regulations are estimated to affect approximately 60 taxpayers, namely those entities that have life insurance companies that are a member of a consolidated group. Entities that are affected need to consider modeling their section 818(f) expenses to determine if an election to use the separate entity method into perpetuity would be appropriate, based on how their 818(f) expenses are expected to be generated on a long-term basis.

Also, the decision whether to elect the separate entity method could be critical to many multinational life insurance companies. These companies need to consider modeling the potential implications of the two approaches in order to make informed decisions.

Treasury and the IRS indicated that they may consider future proposed regulations to address any additional anti-abuse concerns (such as under section 845).

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