



# WRMarketplace

## An AALU Washington Report

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The *WRMarketplace* is created exclusively for AALU Members by the AALU staff and Greenberg Traurig, one of the nation's leading tax and wealth management law firms. The *WRMarketplace* provides deep insight into trends and events impacting the use of life insurance products, including key take-aways, for AALU members, clients and advisors.

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### **TOPIC: FATCA & U.S. Life Insurance: Should Insurance Advisors Care and Why.**

**MARKET TREND:** The increase in the federal estate tax exemption and the current low rate environment have pushed U.S. life insurers to develop new markets. In that effort, insurers and their producers have decidedly gone global, which necessitates an understanding of the new due diligence, withholding and reporting obligations under the Foreign Account Tax Compliance Act ("FATCA"), as well as the unexpected planning opportunities FATCA may provide.

**SYNOPSIS:** FATCA is a relatively new U.S. law designed to enhance the reporting of, and U.S. tax collection on, U.S. investments in foreign countries. In that regard, FATCA requires foreign financial institutions ("FFIs") to discover and disclose their U.S.-owned account, equity, and debt holders to the IRS. As part of FATCA's implementation through Intergovernmental Agreements ("IGAs"), the U.S. may agree to a reciprocal exchange of financial information with another country regarding U.S. investments (including U.S. life insurance) by the other country's residents. To enforce due diligence and reporting, FATCA also imposes a new 30% withholding tax (in addition to the regular 30% withholding tax) on certain U.S.-source payments payable to FFIs and other foreign entities, unless the foreign recipient has agreed in advance to provide specified information to the IRS regarding their U.S. owners, creditors and investors (in addition to other FATCA requirements). While FATCA mostly targets FFIs, it still generates new obligations for U.S. financial institutions, including U.S. insurance companies, especially with regard to due diligence and withholding.

**TAKE-AWAYS:** For countries with reciprocal FATCA IGAs, U.S. cash value life insurance and annuity contracts may hold more appeal for investment by residents of those countries, since the contracts may require somewhat less FATCA reporting when compared to U.S. bank accounts or similar depository instruments. With regard to the new due diligence and withholding requirements, many U.S. insurers will need to obtain the appropriate IRS Form W-8BEN-E, W-8IMY or Forms W-9 (all recently amended to accommodate FATCA compliance) for all their payees, both foreign and U.S. Advisors will likely find that U.S. carriers are altering their customer onboarding procedures and/or requesting added documentation and updates to accommodate FATCA requirements.

**REFERENCES:** *Internal Revenue Code §§ 1471-1474 and underlying Treasury Regulations, related IRS guidance, and applicable IGAs.*

FATCA has become a recent buzz word in the financial services and insurance industry due to its wide application of financial reporting requirements to both U.S. and foreign financial institutions. Although FATCA generally targets foreign investments by U.S. persons, U.S. financial institutions, including insurance carriers, have found themselves affected by FATCA's broad reach. The following offers a look at how FATCA may impact U.S. insurers and their customers and indicates when and why U.S. life insurance advisors may care.

## **OVERVIEW**

FATCA is a relatively new U.S. law requiring FFIs to discover and disclose their U.S.-owned account, equity, and debt holders to the IRS. To enforce reporting, FATCA imposes a new, additional 30% withholding tax<sup>1</sup> on the U.S.-source income (*e.g.*, interest, dividends, rents, premiums, and annuities from U.S. sources, so-called "**FDAP income**")<sup>2</sup> payable to FFIs (*e.g.*, most banks, funds, depositories and insurance companies) and certain "passive" non-financial foreign entities (including foreign partnerships and certain foreign trusts, generally referred to as "**Passive NFFEs**"), *unless* the foreign recipient has agreed in advance to comply with applicable FATCA requirements, which include providing specified information to the IRS regarding their U.S. owners, creditors and investors.

## **OBLIGATIONS/OPPORTUNITIES FOR U.S. INSURERS**

Despite targeting mostly non-U.S. financial companies, FATCA also generates obligations for U.S. financial institutions, *including U.S. insurance companies*, which involve those discussed below. These obligations, however, *may open up new markets and planning opportunities for non-U.S. clients.*

### **Reporting under IGAs**

To facilitate FATCA's implementation, the U.S. can (and has) entered into IGAs with other countries regarding the specific FATCA reporting and withholding procedures for FFIs in those countries. Depending on the IGA,<sup>3</sup> the United States may agree to a reciprocal exchange of information, which requires certain U.S. financial institutions, *like U.S. insurance companies*, to disclose to the other country's taxing authority the ownership of certain U.S. financial accounts and/or insurance products by the residents of that country. As described below, however, *reporting obligations under reciprocal IGAs may be somewhat less burdensome for certain U.S. life insurance products than for other U.S. investments, like depository accounts.*

Typically, in cases of reciprocal IGAs (as relevant here), the U.S. insurance carriers will need to provide information on the following products, if owned or held by the non-U.S. resident: (1) cash value life insurance policies with cash value exceeding \$50,000 and (2) variable annuity contracts with payouts based on the life of one or more individuals.

The specific information required for disclosure by the U.S. carrier with regard to these insurance products will depend on the applicable IGA, however, typical information includes:

- The name, address, and tax identification number (or equivalent) of any non-U.S. holder
- The account or contract number
- The name and identifying number of the U.S. carrier

- The gross amount of U.S. source dividends and other FDAP income earned on, paid or credited to the contract, but only if and when recognized as U.S. income for U.S. tax purposes (e.g., upon a withdrawal from cash value in excess of policy basis, policy surrender, receipt of payment prior to annuity start date, etc.).

Typically, the disclosure obligations *will not require reporting of the cash value of the insurance or annuity contract* to the other country's tax authority.

Although these disclosure obligations appear significant, they are less burdensome than the reporting obligations imposed by most reciprocal IGAs for so-called "depository accounts" (e.g., commercial, checking, or savings accounts, CDs or similar accounts/instruments maintained in the ordinary course of banking business at a U.S. financial institution). For depository accounts, IGAs often require the reporting U.S. institution to periodically disclose both the U.S. source income as earned (not just when recognized) and the actual account balance.

- ***Why It Matters.*** *From a FATCA perspective, depending on the applicable IGA, U.S. cash value policies and annuities may hold more appeal for investment by non-U.S. residents than through U.S. depository accounts due to the less onerous reporting requirements.* Of course, such investments must address any issues or limitations associated with the issuance by a U.S. insurance carrier of a cash value policy or annuity contract to a non-U.S. person, as well the appropriate ownership structure for such a contract based on tax and/or other issues applicable to the non-U.S. contract holder in both the U.S. and his or her home country.<sup>4</sup>

## **Due Diligence & Withholding**

Under FATCA, the U.S. payor of FDAP payments that are "withholdable payments" to an FFI or Passive NFFE (collectively "**foreign payees**") must determine whether withholding is required and, if so, either (1) obtain from the foreign payee a certification of exemption or appropriate documentation demonstrating that the foreign payee is compliant with FATCA, (2) confirm whether the payment is made under an obligation "grandfathered" from withholding, or (3) withhold the required 30% from the withholdable payment. Failure to comply as provided above can subject a U.S. payor to liability for the taxes not withheld.

For U.S. insurance companies, the payees for FATCA purposes will include: (1) ***policyholders and customers*** (with regard to insurance and annuity contract-specific payments), (2) investors and creditors (with regard to dividends and interest payments), and (3) vendors and service providers (with regard to mostly non-withholdable business-to-business payments for non-financial services and other items).

- ***Why It Matters.*** To meet these FATCA obligations:
  - U.S. insurers that make withholdable payments to foreign payees must collect the appropriate IRS Form W-8-BEN-E<sup>5</sup> or W-8 IMY for intermediates) from foreign payees,<sup>6</sup> and obtain IRS Form W-9 for U.S. payees.
  - U.S. carriers also are altering their customer onboarding procedures and/or requesting additional documentation and updates to accommodate these FATCA requirements.

## TAKE-AWAYS

- As part of FATCA's implementation through IGAs, the U.S. may agree to a reciprocal exchange of financial information with another country regarding U.S. investments by the other country's residents (several reciprocal IGAs have been signed already).
- For countries with reciprocal FATCA IGAs, U.S. cash value life insurance and annuity contracts may hold more appeal for investment by residents of those countries, since the contracts may require somewhat less FATCA reporting, particularly when compared to U.S. bank accounts or similar depository instruments.
- With regard to the new due diligence and withholding requirements, many U.S. insurers will need to obtain the appropriate IRS Form W-8BEN-E, W-8IMY or Forms W-9 (all recently amended to accommodate FATCA compliance) for all their payees, both foreign and U.S.
- Advisors also will likely find that U.S. carriers are altering their customer onboarding procedures and/or requesting added documentation and updates to accommodate FATCA requirements.

## NOTES

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<sup>1</sup> FATCA withholding is in addition to any FDAP withholding, Internal Revenue Code § 1446 partnership withholding and FIRPTA withholding. There also is no reduction provided by a treaty or statutory exemption.

<sup>2</sup> Note that, for sales or dispositions occurring on or after January 1, 2017, gross proceeds from the sale or disposition of property of a type that can produce interest or dividends that is U.S. source FDAP income also are withholdable payments.

<sup>3</sup> In general, an IGA prescribes specific FATCA tax reporting and withholding procedures for financial institutions based in the particular foreign country entering into the IGA with the U.S. Treasury. The Treasury Department has issued two model IGAs. Model 1 requires FFIs to report all FATCA-related information to their own governmental agencies, which then reports it to the IRS. Reciprocal Model 1 IGAs require the U.S. to provide certain information about residents of the Model 1 country to that country in exchange for the information provided to the U.S. by that country regarding U.S. investors. Model 2 requires FFIs to register with, and report information directly to, the IRS.

<sup>4</sup> Although a full discussion of these planning issues is beyond the scope of this article, see *Washington Report #13-34 - Using Life Insurance in U.S. Estate Tax Planning for Non-U.S. Citizens & Residents* for a discussion of some of the U.S. tax and other considerations.

<sup>5</sup> There is some uncertainty about the effective date of the new W-8BEN-E. However, most advisors believe that the form is effective as of the date hereof (considering that, on June 25th, the IRS released the instructions to form W-8BEN-E).

<sup>6</sup> If a W-8 is provided and reflects the recipient's status as a participating FFI, deemed compliant FFI, or another status that exempts the payee from withholding (*e.g.*, territory financial institution, exempt beneficial owner, payee of effectively connected income or any other exempt category under an applicable IGA), no withholding is required. Note that the Treasury Regulations, as well as IGAs, include special rules for reliance on pre-FATCA Forms W-8, and generally follow the current (three-plus year) validity period for Forms W-8. In some situations, payee documentation may remain valid until a "change in circumstances," such as the addition of a U.S. address or phone number.

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