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Washington, DC 20224

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Telephone Number:

Refer Reply To:  
CC:INTL:B05  
PLR-129585-15

Date:  
August 19, 2016

In Re:

Legend

A =  
Parent =  
Sub =  
CFC 1 =  
CFC 2 =  
State 1 =  
State 2 =  
Country A =  
Annual Report =  
Insurance Regulator =  
Day X =  
Finance Agency =  
Year 1 =

Dear \_\_\_\_\_ :

In a letter dated A, Parent (together with Sub) requested a ruling that certain reserves for life insurance contracts, as reflected on the Annual Report that CFC 2 is required to file with its Insurance Regulator, are an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii), and, accordingly, the amounts of those reserves may be used for purposes of sections 954(i) in determining CFC 2's Subpart F income.

The ruling given in this letter is based upon the facts and representations submitted by Parent and accompanied by a statement executed under penalty of

perjury by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

### Facts

Parent is a publicly-traded domestic corporation organized under the laws of State 1. Parent is engaged, through its subsidiaries and affiliates, in various lines of business, which include, among others, domestic and international life insurance. Parent is the common parent of an affiliated group of life insurance companies and non-life insurance companies that file a life/non-life consolidated federal income tax return under section 1504(c)(2). As the common parent, Parent reports the group's income on a consolidated return, which is filed on a calendar year basis.

Parent directly owns all of the stock of Sub, a holding company that is organized as a corporation under the laws of State 2. Sub is a member of Parent's U.S. consolidated group, and its income is reported as part of Parent's consolidated return.

Sub owns directly all of the stock of CFC 1, a Country A company treated as a corporation for U.S. federal income tax purposes. CFC 1 owns directly all of the stock of CFC 2. Both CFC1 and CFC 2 are controlled foreign corporations as defined in section 957(a). Both Parent and Sub are U.S. shareholders of CFC 2 within the meaning of section 951(b). As a 100 percent owner of CFC 2, Sub is the controlling domestic shareholder of CFC 2 within the meaning of Treas. Reg. § 1.964-1(c)(5).

CFC 2 is organized and domiciled in Country A and engaged principally in the provision of life insurance products and services in Country A. CFC 2 carries on a life insurance business and a non-life insurance business in Country A. CFC 2 issues life insurance contracts (determined under section 953(e)(5) without regard to sections 72(s), 101(f), 817(h), and 7702) in connection with residents of Country A, a country other than the United States. CFC 2 is not engaged in any insurance business outside of Country A. CFC 2 only had exempt contracts (as defined in section 953(e)(2)) in Year 1. If CFC 2 were a domestic corporation it would be subject to tax as a life insurance company under Part I of Subchapter L.

CFC 2 derives more than 50 percent of its aggregate net written premiums from the issuance of life insurance contracts covering risks of residents of Country A. CFC 2 derives more than 30 percent of its net written premiums from contracts that cover Country A risks.

The laws of Country A regulate all aspects of the insurance business in Country A, including licensing and accounting (including the calculation of reserves). To conduct an insurance business in Country A, an insurance company is required to obtain and

maintain a license from Insurance Regulator, an autarchy created by a Country A decree-law and directly linked to Country A's Finance Agency.

CFC 2 is licensed and subject to regulation by Insurance Regulator. Under applicable regulatory requirements, CFC 2 is required to establish and maintain reserves for obligations to its policyholders and to report the amounts of such reserves on its Annual Report filed with Insurance Regulator. The Annual Report consists of: (1) a detailed description of the operational status and the use of funds, including a balance sheet, profit and loss statement, statement of changes in shareholders' equity cash flow and proposal for allocation of surplus profit or compensation of deficit; (2) a certificate by CFC 2's internal auditor; and (3) an approval of the items in (1) by the CFC 2's Board of Directors.

The reserves covered by this ruling are limited to CFC 2's underwriting reserves, loss reserves, and policyholders' dividend reserves with respect to its life insurance contracts that are exempt contracts within the meaning of section 953(e)(2).

CFC 2 uses two methods to compute its underwriting reserves for its life insurance contracts: (1) the net level premium method for its term life insurance and endowment contracts; and (2) the 2-year Zillmer reserve method for its long duration whole life insurance contracts. CFC 2 calculates its underwriting reserves using (1) either the U.S. Commissioners' Standard Ordinary mortality tables or Country A's experience mortality tables, and (2) an interest rate based upon CFC 2's pricing assumptions and available bond yields, subject to a maximum interest rate of six percent.

CFC 2's loss reserves do not include any amounts for accrued liabilities. CFC 2's policyholder dividends reserves include only amounts described in section 807(c)(4) as dividend accumulation, and other amounts, held at interest in connection with its life insurance.

Parent represents that each contract covered by the rulings requested is a life insurance contract or annuity contract for federal income tax purposes, without regard to sections 72(s), 101(f), 817(h) and 7702.

The reserves covered by this ruling do not include: (1) deficiency reserves; (2) contingency reserves; (3) equalization reserves; (4) excess interest reserves for excess interest credited beyond the end of the taxable year; (5) reserves for administrative expenses (including guarantees intended to cover future expenses associated with the payment of claims such as bank fees or inflation risk); (6) lapse reserves; (7) underwriting or loss reserves for non-cancellable and guaranteed renewable accident and health contracts; (8) reserves for any amount to protect against a future decline in the value of investment assets; or (9) any reserves for accrued liabilities.

## Law

In general, a United States shareholder of a controlled foreign corporation (“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 953(a)(1) defines the term “insurance income” to include any income that is attributable to the issuing or reinsuring of an insurance or annuity contract, and that would be taxed under Subchapter L if such income were the income of a domestic insurance company. Section 953(a)(2) provides that section 953 insurance income does not include “exempt insurance income” derived by a “qualifying insurance company.” Section 953(b)(3) provides that reserves for any insurance or annuity contract are determined in the same manner as under section 954(i).

Section 953(e)(1) defines “exempt insurance income” as income derived by a qualifying insurance company that is attributable to the issuing (or reinsuring) of an “exempt contract” by such company and that is treated as earned by such company in its home country for purposes of such country’s tax laws. An “exempt contract” is defined under section 953(e)(2) to include an insurance or annuity contract issued by a qualifying insurance company in connection with the lives or health of residents of a country other than the United States, but only if such company derives more than 30 percent of its net written premiums from otherwise exempt contracts which cover applicable home country risks and with respect to which no policyholder, insured, annuitant or beneficiary is a related person within the meaning of section 954(d)(3).

In general, section 953(e)(3) defines a “qualifying insurance company” as any CFC that: (A) is subject to regulation as an insurance company by its home country, and is licensed, authorized, or regulated by the applicable insurance regulatory body for its home country to sell insurance 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 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(a)(1) defines the term “foreign base company income” to include, among other types of income, “foreign personal holding company income.” Section 954(c)(1) sets forth the types of income that are considered foreign personal holding company income. Section 954(i)(1) provides that for purposes of section 954(c)(1), foreign personal holding company income does not include “qualified insurance income” of a “qualifying insurance company.”

Section 954(i)(2) defines the term “qualified insurance income” to mean income of a qualifying insurance company falling into two categories. The first category is income received from unrelated persons and derived from investments made by a qualifying insurance company or qualifying insurance company branch (collectively referred to as a “QIC”) either of its reserves allocable to exempt contracts or of 80 percent of its unearned premiums from exempt contracts (as both are determined in accordance with section 954(i)(4)). Sec. 954(i)(2)(A). The second category is income received from unrelated persons and derived from investments made by a QIC of an amount of its assets allocable to exempt contracts equal to: (1) in the case of property, casualty, or health insurance contracts, one-third of the premiums earned on those contracts during such year; and (2) in the case of life insurance or annuity contracts, 10 percent of the reserves described in section 954(i)(2)(A) for such contracts. Sec. 954(i)(2)(B).

Section 954(i)(4)(B)(i) generally provides that in the case of life insurance and annuity contracts, a QIC’s reserves allocable to exempt contracts are equal to the greater of (1) the net surrender value of the contract or (2) the reserve determined under section 954(i)(5). Section 954(i)(4)(B)(ii), however, provides:

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

Section 954(i)(4)(B)(ii) was originally enacted by section 614 of the Job Creation and Worker Assistance Act of 2002. Under the Protecting Americans from Tax Hikes (PATH) Act of 2015 (P.L. 114-113, 12/18/2015), section 954(i) was permanently extended and made effective for taxable years of foreign corporations beginning after December 31, 2014, and for taxable years of U.S. shareholders with or within which such taxable years of such foreign corporations end. In its Technical Explanation to the PATH Act, the staff of the Joint Committee on Taxation explains 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.

Joint Comm. on Taxation, 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)).

### **Analysis**

CFC 2 is licensed, authorized, and regulated as a life insurance company by the Insurance Regulator of Country A. CFC 2 derives more than 50 percent of its aggregate net written premiums from the issuance of life insurance contracts that cover applicable home country risks and with respect to which no policyholder, insured, annuitant, or beneficiary is a related person (as defined in section 954(d)(3)). CFC 2 is engaged in the life insurance business and would be subject to tax under Subchapter L if it were a domestic corporation. Accordingly, CFC 2 is a QIC under section 953(e)(3).

CFC 2 issues life insurance contracts in connection with the lives and health of residents of Country A, a country other than the United States. No policyholder, insured, annuitant, or beneficiary with respect to any life insurance contracts covered by this ruling is a United States person. CFC 2 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 within the meaning of section 954(d)(3). The contracts that are the subject of this ruling, therefore, are exempt contracts within the meaning of section 953(e)(2).

CFC 2 must establish, maintain, and calculate underwriting and policyholder dividend reserves in accordance with the insurance laws and regulations prescribed by Country A. Country A's Insurance Regulator requires a life insurance company to determine the amount of its insurance reserves based upon guidance it provides. CFC 2 must set forth its insurance reserves on the Annual Report, which must be filed annually with the Insurance Regulator. These 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 (whether U.S.-owned, locally owned, or owned by companies headquartered in other foreign countries). The Insurance Regulator requires CFC 2 to hold these reserves for the fulfillment of claims owed to policyholders and beneficiaries. The reserves are not catastrophe, deficiency, equalization, or similar reserves. The rules prescribed by Country A for determining the amount of the insurance reserves that must be reported on the Annual Report, including the method, interest rate, the mortality and morbidity assumptions, and other factors taken into account, provide an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii).

## **Ruling**

Based on the information submitted and the representations made, the underwriting reserves, loss reserves, and policyholder dividend reserves with respect to exempt life insurance contracts (within the meaning of sections 953(e)(2) and 954(i)(4)(B)) issued by CFC 2 and as reflected on the Annual Report that CFC 2 is required to file with Insurance Regulator, are an appropriate means of measuring income within the meaning of section 954(i)(4)(B)(ii). Accordingly, the amounts of those reserves may be used for purposes of sections 954(i) in determining CFC 2's Subpart F income.

## **Caveats**

No opinion is expressed upon any provisions of the Code or regulations not specifically covered by the above ruling. This ruling is subject to revocation if any of the following circumstances occur: (1) a change in the material facts on which this ruling was based; (2) a material change in the business circumstances of CFC 2 which would impact its reserving method; or (3) a change in the applicable law or foreign rules relating to the current reserving method of CFC 2.

## **Procedural Statements**

This ruling is directed only to CFC 2. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, CFC 2s 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.

Sincerely,

D. Peter Merkel  
Senior Technical Reviewer, Branch 5  
Office of Associate Chief Counsel (International)

cc: