

New US withholding and reporting legislation: impact on the insurance industry

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The US Foreign Account Tax Compliance Act (FATCA), enacted on 18 March 2010, will have a substantial impact on certain foreign accounts held at foreign financial institutions (FFIs). The expansive definition of FFIs will have specific significance for the insurance industry. This new legislation is focused on strengthening information reporting and withholding compliance for US persons that invest through or in non-US entities.

The FATCA provisions are effective for payments made after 1 January 2013, subject to certain exceptions. They generally require 30% withholding on any "withholdable payment" (defined as US sourced dividends, US sourced interest and gross proceeds from the sale of assets that could produce US-sourced interest or dividends) made to a FFI (including certain insurance products and/or insurance companies, but also investment vehicles such as hedge funds, private equity funds), if the FFI fails to comply with the new reporting, disclosure and related requirements.

Such requirements encourage FFI to enter into an agreement with the US tax authorities to:

- obtain information from each account holder (and investor) as is necessary to determine which accounts are "US accounts";
- comply with verification and due diligence procedures;
- report annually certain information (incl. name of investor, investment volume, income paid etc.) to the US tax authorities;
- provide US tax authorities with further information upon request; and attempt to obtain a waiver in any case in which foreign (e.g. Luxembourg) law would prevent reporting of such information.

It is important to note that the law introduces an approach under which the direct US owners (it is not yet clear whether that refers to policy holders and/or beneficiaries) and the ultimate US owners are to be identified and disclosed to the US tax authorities.

Many of the implementation aspects of the legislation have been reserved for the US tax authorities (IRS). On 27 August 2010, the IRS therefore issued Announcement 2010-60, which is expected to be the first in a subsequent series of Announcements. The Notice 2010-60 provides the highly-anticipated initial insights into how the FATCA provisions will be implemented and specifically requests comments from the concerned industry by 1 November 2010.

This Notice indicates that the Treasury and IRS do not view the issuance of insurance or reinsurance contracts without cash value as implicating the concerns of the FATCA provisions. They therefore plan on issuing regulations treating entities whose business consists solely of issuing such contracts as non-financial institutions for purposes of FATCA. However, Treasury and IRS are considering entities that issue cash value insurance contracts, annuity contracts or similar arrangements, as entities subject to the new FATCA legislation, as such contracts typically combine insurance protection with an investment component according to them. As a result, in case of non-compliance to this new US legislation, US investments held by insurance companies (either for its own account or for the account of its clients) would be subject to 30% withholding tax, which would have a significant impact on the investment behaviour. It is therefore recommended that the insurance industry considers the impact of such new US legislation and takes the opportunity to comment on the Notice issued by the IRS.

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