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Global Tax Alert

US proposed regulations on passive foreign investment companies have implications for insurance companies

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Executive summary

On 10 July 2019, the United States (US) Treasury Department (Treasury) and Internal Revenue Service (IRS) issued proposed regulations under the passive foreign investment company (PFIC) rules (Proposed Regulations), providing guidance under Internal Revenue Code Sections 1291, 1297 and 1298.[1] An overview of Sections 1291, 1297 and 1298, and detailed analysis of the Proposed Regulations can be found in EY Global Tax Alert, *US proposed regulations provide guidance on passive foreign investment companies, clarify longstanding PFIC issues and contain both favorable and unfavorable provisions for taxpayers*, dated 18 July 2019 (the General Alert). Accordingly, terms and concepts used but not defined in this Alert generally have the meaning ascribed to them in the General Alert.

This Tax Alert emphasizes aspects of the Proposed Regulations that are relevant for the insurance industry, particularly those concerning the Section 1297(b)(2)(B) exception for insurance companies (PFIC Insurance Exception). The PFIC Insurance Exception rules provide guidance regarding, *inter alia*, whether income of a foreign corporation is excluded from passive income because the income is derived in the active conduct of an insurance business by a qualified insurance corporation (QIC). The Proposed Regulations provide guidance on definitional and computational matters, including:

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- Whether a foreign corporation is a QIC
- The definition of an insurance business
- Whether a QIC is engaged in the active conduct of an insurance business (the active conduct test)
- The determination of a QIC annual amount that is derived from the active conduct of an insurance business and excluded from passive income and passive assets, including a bright-line test for measuring the QIC's active conduct based on expenses (the active conduct percentage)
- The treatment of income and assets of certain look-through subsidiaries and look-through partnerships held by the QIC
- The treatment of income and assets of certain domestic insurance corporations owned by a tested foreign corporation as active for purposes of Section 1297(a), except for purposes of the attribution rule and determining whether a tested foreign corporation is a PFIC
- The prohibition of double counting of any item for purposes of applying the PFIC Insurance Exception rules

Comments to the Proposed Regulations are due on 9 September 2019. The IRS specifically requests comments on several topics included in the PFIC Insurance Exception rules.

Detailed discussion

Exception to passive income for certain foreign insurance companies

For purposes of applying the PFIC Tests to the tested foreign corporation, passive income does not include certain income that is derived in the conduct of an insurance business. Before its amendment by the *Tax Cuts and Jobs Act* (TCJA),[2] former Section 1297(b)(2)(B) provided that passive income generally did not include any income derived in the active conduct of an insurance business by a corporation that is predominantly engaged in an insurance business and would be subject to tax under subchapter L if it were a domestic corporation. On 24 April 2015, proposed regulations were published under former Sections 1297(b)(2)(B) and 1298(g) that addressed the PFIC Insurance Exception and provided guidance on the extent to which a foreign corporation's income and assets producing that income are excluded from passive income and passive assets for purposes of the PFIC Tests.[3]

Section 14501 of the TCJA modified the exception to address Congress's concerns about the lack of clarity and precision regarding how much insurance or reinsurance business a company must do to qualify under the exception. Thus, current Section 1297(b)(2)(B) excludes from the definition of passive income a foreign corporation's income only if (1) the foreign corporation is a QIC, (2) the foreign corporation is engaged in an insurance business, and (3) the income is derived from the active conduct of that insurance business. The 2015 proposed regulations were withdrawn and new provisions on the PFIC Insurance Exception are included in the Proposed Regulations, as amended.

Discussion of the Proposed Regulations is separated into the following parts:

- **Part 1** addresses the qualifying domestic insurance corporation exception and the exclusion of the exception for purposes of the attribution rule when determining whether a lower-tier tested foreign corporation is a PFIC.
- **Part 2** discusses the guidance provided in Prop. Reg. Section 1.1297-4 for determining whether a foreign corporation is a QIC.
- **Part 3** explains the rules in Prop. Reg. Section 1.1297-5 on definitional and computational aspects of applying the exception for passive income under Section 1297(b)(2)(B) for income derived in the active conduct of an insurance business.

Part 1: Qualifying domestic insurance corporation exception

Because of its importance and the impact that it might have on the insurance industry, the qualifying domestic insurance corporation exception and its limited application are addressed first. The Proposed Regulations provide that income of a qualifying domestic insurance corporation is not treated as passive income; similarly, the assets of that corporation are not treated as passive assets for purposes of the PFIC Tests.

A qualifying domestic insurance corporation is defined as a domestic corporation that is subject to tax as an insurance company under subchapter L and is subject to federal income tax on its net income.

The Preamble to the Proposed Regulations (Preamble) clarifies that this rule was intended to address situations in which a tested foreign corporation owns a domestic insurance corporation through a structure to which Section 1298(b)(7) (Domestic Look-Through Rule) does not apply. The Domestic Look-Through Rule would not apply, for example, if a tested foreign corporation owned a domestic insurance company directly, or indirectly through one or more foreign corporations, or two or more domestic corporations.

However, the application of the qualifying domestic insurance corporation exception provided to income or assets of a qualifying domestic insurance corporation would *not* apply in determining whether a tested foreign corporation is a PFIC for purposes of attributing ownership of lower-tier PFIC stock to US persons under the corporate attribution rules of Section 1298(a)(2). Consequently, if a tested foreign corporation would qualify as a PFIC absent application of the qualifying domestic insurance exception, then the attribution rules of Section 1298(a)(2) would generally attribute ownership of any lower-tier PFIC stock held (directly or indirectly) by the tested foreign corporation to a US person owning stock in the tested foreign corporation regardless of the level of ownership by the US person in the tested foreign corporation.

The potential impact of the qualifying domestic insurance corporation is demonstrated by the following example.

Example

Facts: FP is a foreign parent corporation. FP owns D, a US insurance company that meets the definition of a qualifying domestic insurance corporation. FP also owns FS, a foreign corporation.

For the tax year, FS has gross assets of $49, 100% of which are passive. D has gross assets of $51, 50% of which ($25.5) would be passive absent the qualifying domestic insurance corporation exception. FP has no gross assets other than its investment in FS and D.

FS has gross income of $10, 100% of which is passive. D has gross income of $30, 50% of which ($15) would be passive absent the qualifying domestic insurance corporation exception. FP has no gross income.

Result: Under the Asset Test for FP, FP takes into account D's gross assets of $51, 100% of which are non-passive under the qualifying domestic insurance corporation exception. FP also takes into account FS's gross assets of $49, 100% of which are passive. FP's investment in FS and D is not taken into account.[4] FP's Asset Test computation is therefore 49% ($49/$100).

Under the Income Test for FP, FP takes into account D's gross income of $30, 100% of which is non-passive under the qualifying domestic insurance corporation exception. FP also takes into account FS's gross income of $10, 100% of which is passive. FP's Income Test computation is therefore 25% ($10/$40).

Because FP's Asset Test is 49% and Income Test is 25%, FP is not a PFIC.

FS is a PFIC because 100% of its assets and 100% of its gross income are passive. Under Section 1298(a)(2), if FP is not a PFIC generally only US persons that own, directly or indirectly, more than 50% in the value of FP will be treated as owning their proportionate indirect interest in FS. Under the Proposed Regulations, however, the qualifying domestic insurance corporation exception does not apply for purposes of Section 1298(a)(2). Therefore, for attribution purposes, FP must perform its Income Test and Asset Test without applying the qualifying domestic insurance company exception. In this case, FP's passive assets would constitute $74.5 ($49 of FS passive assets and $25.5 of D passive assets). Therefore, for this purpose, FP's Asset Test would be 74.5% ($74.5/$100). As a result, FP would constitute a PFIC *solely for purposes of attributing stock of FS to FP shareholders*. Accordingly, each US person that owns FP stock would be treated as owning their proportionate indirect interest in FS, and would be subject to the PFIC rules with respect to FS.

Implications

The qualifying domestic insurance corporation exception brings a welcome clarification that the PFIC Insurance Exception can apply to the income and assets of a domestic insurance company owned by a tested foreign corporation.

However, foreign-parented groups with domestic insurance company subsidiaries must pay close attention to this rule if they rely on the qualifying domestic insurance corporation exception when determining the PFIC status of the foreign parent corporation. Such companies must reassess their PFIC Tests *without* the exception and analyze whether the foreign parent would be characterized as a PFIC for purposes of attributing ownership to a US person of a lower-tier PFIC owned within the group. Therefore, the qualifying domestic corporation exception included in the Proposed Regulations may burden taxpayers and be hard to administer by subjecting foreign corporations to numerous PFIC analyses and requiring shareholders to obtain information on lower-tier PFICs owned by the tested foreign corporation even when the foreign parent corporation is not a PFIC.

Part 2: Qualifying Insurance Corporation

QIC defined

A QIC is a foreign corporation that is: (1) an insurance company, as defined in Section 816(a), that would be subject to tax under subchapter L if it were a domestic corporation (which generally requires more than half of the corporation's business during the tax year to be the issuing of insurance

or annuity contracts, or the reinsurance of such contracts); and (2) has applicable insurance liabilities that constitute more than 25% of its total assets, determined on the basis of such liabilities and assets as reported on the corporation's applicable financial statement for the last year ending with or within the tax year of the corporation (25% Test).

A foreign corporation may also be treated as a QIC even if it fails to qualify because of the 25% Test, if it satisfies an alternative facts-and-circumstances test and a US person has elected to apply the alternative facts-and-circumstances test (Alternative Facts-and-Circumstances Test).

25% Test

Applicable insurance liabilities

For any life or property and casualty insurance business, the statutory definition of applicable insurance liabilities means: (1) loss and loss adjustment expenses; and (2) reserves (other than deficiency, contingency, or unearned premium reserves) for life and health insurance risks and life and health insurance claims with respect to contracts providing coverage for mortality or morbidity risks.

The Proposed Regulations provide some guidance and include in the definition three components: (i) "occurred" losses for which the foreign corporation has become liable but has not paid before the end of the last annual reporting period ending with or within the tax year (e.g., IBNR for insurable events that have already occurred), including unpaid claims for death benefits, annuity contracts, and health insurance benefits; (ii) unpaid expenses (including reasonable estimates of anticipated expenses) of investigating and adjusted unpaid losses described in (i); and (iii) the aggregate amount of reserves (excluding deficiency, contingency, or unearned premium reserves), held for future, unaccrued health insurance claims and claims with respect to contracts providing coverage for mortality or morbidity risks, including annuity benefits dependent on the life expectancy of one or more individuals.

Implication: The Preamble does not shed more light on the meaning of the undefined non-tax terms used in the Proposed Regulations' definition of applicable insurance liabilities. Because of the important role that applicable insurance liabilities play in measuring whether a foreign corporation is a QIC, taxpayers should consider commenting on the definitional provision and related insurance liabilities that should be included in the final regulations or other published guidance. Further, one might ask whether, to capture the liabilities of an active insurance company, the Treasury and IRS should allow foreign corporations to measure their applicable insurance liabilities during the tax year (without any duplications), rather than at the end of the tax year, to reflect their insurance-related activities throughout the year.

Alternative Facts-and-Circumstances Test

A US person may elect to treat stock in a foreign corporation that fails the 25% Test as stock in a QIC, only if the foreign corporation is predominantly engaged in an insurance business and its applicable insurance liabilities constitute 10% or more of its total assets (10% Test). The election is only available to a US person if the foreign corporation fails the 25% Test solely due to runoff-related or rating-related circumstances involving its insurance business.

Predominantly engaged in an insurance business

The "predominantly engaged" requirement added by Congress as part of the Alternative Facts-and-Circumstances Test is separate from, and in addition to, the requirement that a corporation would be subject to tax under subchapter L if it were a domestic corporation.[5] Specific factors enumerated in the legislative history[6] are incorporated in the Proposed Regulations as part of the analysis of whether a foreign corporation is predominantly engaged in an insurance business. Such factors include claims payment patterns for the current year and prior years; the foreign corporation's loss exposure as calculated for a regulator or a credit rating agency, or if those are not calculated, for internal pricing purposes; and the percentage of gross receipts constituting premiums for the current and prior years, and the number and size of insurance contracts issued. The Proposed Regulations also provide that a small overall number of insured risks with low likelihood but large potential costs, low loss exposure, or the number of employees and agents focused to a greater degree on investment activities may each indicate that a foreign corporation is not predominantly engaged in an insurance business.

Comments are requested on whether the proposed test appropriately determines whether a foreign corporation is predominantly engaged in the insurance business.

Runoff-related circumstances

The Proposed Regulations would require satisfying a three-part test for the failure to meet the 25% Test to be solely due to runoff-related circumstances. First, the foreign corporation must have been actively engaged in the process of terminating its pre-existing active insurance

(or reinsurance) underwriting operations under a plan of liquidation or termination under the supervision of the corporation's applicable insurance regulatory body. Second, the foreign corporation must have not issued or entered into any insurance, annuity, or reinsurance contract (other than contractually obligated renewals of existing insurance or reinsurance contracts pursuant to and consistent with its plan of liquidation or termination of operations). Third, the foreign corporation must have made claim payments during the annual reporting period under insurance, annuity, or reinsurance contracts, and such payments must have caused the corporation to fail to satisfy the 25% Test.

Implication: No guidance is provided on how a foreign corporation would determine whether the payment of claims cause it to fail to satisfy the 25% Test. Further, if claim payments caused a QIC to fail to satisfy the 25% Test in a given year, but claims payments in the following year are not the cause of the failure, would the runoff-related circumstances not exist in the following year? Once the three-part test is satisfied, can the election be made in all future years? Given the importance of runoff-related circumstances to availing the election to US persons holding stock of a QIC that fails to satisfy the 25% Test, taxpayers should consider submitting comments on this issue requesting further guidance and providing the Treasury and IRS with information that would appropriately determine whether runoff-related circumstances occur.

Rating-related circumstances

For the failure to meet the 25% Test to be solely due to rating-related circumstances, the Proposed Regulations would require satisfying a two-part test. First, the failure to meet the 25% Test must result from the specific requirements for capital and surplus that a generally recognized credit rating agency imposes. Second, the foreign corporation must comply with the requirements of the credit rating agency in order to maintain the minimum credit rating required for the foreign corporation to be classified as secure to write new insurance business for the current year.

The Preamble provides that, for this purpose, the proposed rule is intended to apply "to the highest minimum credit rating required to be classified as secure to write new insurance business for any line of insurance business."

Comments were specifically requested on financial guaranty insurance and how the Treasury and IRS should best address such line of business in the context of a rating-related circumstances test.

Election to apply the Alternative Facts-and-Circumstances Test

Generally, providing the Alternative Facts-and-Circumstances Test is met, the election would only be available to a US person that owns stock (directly or indirectly) in a QIC, if that foreign corporation provides certain information to its shareholders that are US persons either by direct statement signed by a responsible officer or an authorized representative of the foreign corporation, or otherwise makes it publicly available through a public filing, disclosure statement, or other notice. The information required includes a statement that the foreign corporation satisfies the Alternative Facts-and-Circumstances Test, the ratio of applicable insurance liabilities to its total assets for the tax year, and a statement indicating whether the failure to satisfy the 25% Test is due to runoff-related or rating-related circumstances, including a brief description of those circumstances.

A US person may make the election by completing the appropriate part of Form 8621 (or successor form) for each year in which the election applies.[7] The US person must attach the form to its timely filed federal income tax return for the tax year to which the election relates (including extensions) and attach the statement provided to it by the foreign corporation. If the foreign corporation makes a publicly available statement instead, the US person must attach a statement incorporating the information provided in such publicly available statement. A US person may not rely on any statement by the foreign corporation if it knows or has reason to know the statement was incorrect.

Currently, there is no protective QIC election available to a US person holding stock (directly or indirectly) in a QIC if the corporation satisfies the 25% Test. One may suggest that the QIC election should be made available to a US person of such corporation if a determination is made in the future that the foreign corporation failed the 25% Test. Perhaps availing the election as a protective measure or allowing it to be made on an amended return should be considered (especially when the election should have been available to the US person but was not made due to circumstances that are outside of the control such US person). Further, the Treasury and IRS should consider allowing a US person to rely upon a statement from the foreign corporation that it meets the 25% Test, unless such person knows or has reason to know that the statement made by the foreign corporation is incorrect, as provided in the Alternative Facts-and-Circumstances Test.

Limitation on the amount of applicable insurance liabilities

Notwithstanding the general definition of applicable insurance liabilities described previously, the amount of applicable insurance liabilities taken into account for purposes of determining whether a foreign corporation satisfies the 25% Test or the 10% Test would be limited under the Proposed Regulations. The amount of applicable insurance liabilities may not exceed the lesser of the amount: (1) shown on the applicable financial statement; (2) required by applicable law or regulation of the jurisdiction of the applicable insurance regulatory body; or (3) shown on the most recent financial statement made on the basis of financial reporting standards (defined as US generally accepted accounting principles (GAAP) or international financial reporting standards (IFRS)), if such financial statement was not prepared for financial reporting purposes.

The Preamble states that this rule is generally aimed to limit the amount to the minimum amount of liabilities required to be reported by an insurance regulator, even if the foreign corporation's regulator would accept a higher liability amount for regulatory purposes.

The Proposed Regulations would require a foreign corporation to discount its applicable insurance liabilities if its applicable financial statement: (1) is not prepared under GAAP or IFRS and (2) does not discount incurred but unpaid losses and loss reserves on an economically reasonable basis. Generally, the foreign corporation would be required to reduce its applicable insurance liabilities to reflect discounting that would apply under either GAAP or IFRS.[8] The Proposed Regulations would allow the foreign corporation to choose whether to apply GAAP principles or IFRS principles to calculate the discounted amount of its applicable insurance liabilities. If the foreign corporation does not choose, GAAP discounting rules would apply.

Implications

The Proposed Regulations provide an unfavorable result for US persons owning shares of a foreign corporation that changed its method of preparing its applicable financial statement by ceasing to prepare it under either GAAP or IFRS. Absent a non-federal tax business purpose, the foreign corporation would have to continue preparing its applicable financial statement under either GAAP or IFRS, otherwise it would be treated as having no applicable insurance liabilities for purposes of the 25% Test or the 10% Test.

Part 3: Exception from the definition of passive income for active insurance income

The Proposed Regulations provide that passive income does not include certain income that a QIC derives in the active conduct of an insurance business and certain income of a qualifying domestic corporation (as discussed in Part 1). Similarly, passive assets do not include, for purposes of the Asset Test, certain QIC assets available to satisfy liabilities related to the QIC's insurance business and certain assets of a qualifying domestic insurance corporation.

Insurance business

For purposes of the PFIC Insurance Exception, the term "insurance business" includes the business of issuing insurance and annuity contracts or reinsuring risks underwritten by other insurance companies (or both), and the investment activities and administrative services required to support (or that are substantially related to) those insurance, annuity, or reinsurance contracts issued or entered into by the QIC. Investment activities are any activities that generate income from assets that the QIC holds to meet its obligations under insurance and annuity contracts issued or reinsured by the QIC.

Active conduct of an insurance business

The Proposed Regulations provide that the term "active conduct" is based on all the facts and circumstances and that, in general, a QIC actively conducts an insurance business only if the officers and employees of the QIC carry out substantial managerial and operational activities. The Preamble provides that active conduct is intended to be interpreted consistently with the active conduct standard in Treas. Reg. Section 1.367(a)-2(d)(5).

In a welcome change from the 2015 proposed regulations, the Proposed Regulations would consider the QIC's officers and employees to include the officers and employees of another corporation, but only if the QIC satisfies a control test with respect to the other corporation. However, the activities of independent contractors are disregarded in determining whether the officers and employees of the QIC carry out substantial managerial and operational activities.

Generally, the Proposed Regulations would require the QIC to satisfy a three-prong control test: (1) the ownership requirement, (2) the control and supervision requirement, and (3) the compensation requirement.

- First, (i) the QIC must either own, directly or indirectly, more than 50% of the other entity's vote and value (if a corporation) or capital and profits interest (if a partnership) or (ii) a common parent must own, directly or indirectly, more than 80% of the vote and value or capital and profits of both the QIC and the other entity performing services for the QIC (the ownership requirement).
- Second, the QIC must exercise regular oversight and supervision over the services performed by the other entity's officers and employees for the QIC (the control and supervision requirement).
- Third, the QIC must either (i) pay directly all the compensation of the other entity's officers and employees attributable to insurance services; (ii) reimburse the other entity for a portion of its expenses, including compensation and related expenses and add a profit markup, as appropriate, for the insurance services performed for the QIC; or (iii) pay arm's-length compensation in accordance with Section 482 on a fee-related basis to the other entity for the insurance services provided (the compensation requirement).

The Proposed Regulations would define the term "insurance services" to mean services performed for the production or acquisition of premiums and investment income on assets held to meet the QIC's obligations under the insurance, annuity, or reinsurance contracts issued or entered into by the QIC.

Active conduct percentage

The Proposed Regulations would require a bright-line, expense-based test to determine the extent of a QIC's active conduct of an insurance business.[9]

The active conduct percentage for the tax year would be calculated by dividing certain insurance related expenses (the numerator) by the sum of those expenses and certain other expenses (the denominator). Specifically, the numerator would equal the aggregate amount of expenses (including compensation or reimbursement of compensation and related expenses) that are:

- For services of the officers and employees of the QIC (or another entity under an arrangement that satisfies the control test)
- Incurred by the QIC
- Related to the production or acquisition of premiums and investment income or assets held to meet the QIC's obligations under the insurance, annuity or reinsurance contracts issued or entered into by the QIC

The denominator would equal the amount included in the numerator, plus "[t]he aggregate amount of all expenses paid for the [tax] year by the QIC to a person other than a person whose services for the QIC are covered by the expenses included in [the numerator] for the production or acquisition of premiums and investment income on assets held to meet obligations under the insurance, annuity, or reinsurance contracts issued or entered into by the QIC."

For purposes of the active conduct percentage ceding commissions are *not* included as an expense in either the numerator or the denominator.

To determine the insurance-related expenses, the Proposed Regulations generally define "the cost of compensation and related expenses" as all costs in cash or in kind, including stock-based compensation, that are directly identified with, or reasonably allocated to, the services of the officers and employees of the insurance company or the related party, as appropriate. Whether the costs are directly identified with, or reasonably allocated to, officers and employees would depend on all the facts and circumstances,

Comments are requested on several aspects of the active conduct percentage determination and approaches taken. As the description of the denominator of the active conduct percentage is unclear, taxpayers may want to consider asking the Treasury and IRS to provide more details on the scope of the expenses to be included in the denominator.

Implications

Due to the important role that the insurance-related expenses play in designating assets and income of a foreign corporation under the PFIC Insurance Exception as either active or passive, determining and supporting the numerator amount would require detailed analysis.

Determination of the amount of income (and assets) derived by a QIC in the active conduct of an insurance business

The annual amount of a QIC's income (or assets) that is derived in the active conduct of an insurance business and excluded from passive income (or passive assets) is

based on an all-or-nothing approach. If the active conduct percentage is 50% or larger, then 100% of the QIC's passive income earned from QIC assets that are available to satisfy liabilities related to the QIC's insurance business would be treated as income that the QIC derives in the active conduct of an insurance business. In contrast, if the active conduct percentage is less than 50%, none of such income would be treated as income that the QIC derives in the active conduct of an insurance business.

Similarly, QIC assets available to satisfy liabilities related to the QIC's insurance business would not be treated as passive assets if the active conduct percentage is 50% or larger.

Certain items of income and assets that are passive in the hands of a look-through subsidiary or look-though partnership (collectively subsidiary entities) may be treated under the Proposed Regulations as active by a QIC when determining the amount of income and assets that are active based on the previous computation. Generally, this rule does not change the character of the items of income or assets from passive to active to the subsidiary entities; rather, the QIC would be treated as if it directly held its proportionate share of the assets and as if it directly received its proportionate share of the income in such subsidiary entities. When determining the amount of income or assets that are otherwise derived by the QIC in an active conduct of an insurance business under this all-or-nothing approach, such assets or income may be treated as active assets/income. For this look-though rule to apply, however, the subsidiary entities must have their assets and liabilities included in the QIC's applicable financial statement for purposes of the 25% Test and the 10% Test.

No double counting

The Proposed Regulations would prohibit an item from being counted more than once for purposes of the PFIC Insurance Exception. For example, an item could not be used to determine a reserve or an applicable insurance liability for purposes of the 25% Test and the 10% Test.

Implication: This general "no double-counting" provision requires careful consideration. For example, it's unclear whether the rule may be read to address back-to-back inter-group transactions. Foreign corporations should consider the application of this rule when determining PFIC status and whether certain items must be eliminated.

Other items of importance

As discussed in the General Alert, the Proposed Regulations would clarify that certain exceptions to FPHCI would apply for PFIC Testing purposes. The Proposed Regulations also expressly provide that certain exceptions to FPHCI and specifically the exception included in Section 954(i) (relating to entities engaged in the active conduct of an insurance business) are not taken into account for PFIC testing purposes. Therefore, if a foreign corporation engaged in the insurance business does not fall within the PFIC Insurance Exception, no other insurance-specific exception to passive income would be available. Further, the exclusion of Section 954(i) for PFIC Testing purposes raises other questions as to how a tested foreign corporation should determine its reserves and gross income (e.g., for purposes of the Income Test or for purposes of meeting the definition of an insurance company). For instance, would other US tax insurance-related requirements applicable in determining gross income or exceptions included in subpart F of subchapter N be allowed (e.g., Section 953(e)(3))? One may ask whether excluding Section 954(i) is necessary in light of the different policy objectives for Section 954(i) and the PFIC Insurance Exception, and whether a company that would meet the requirements of Section 954(i) would not have the characteristics of the types of companies for which the limitations for qualifying for the PFIC Insurance Exception were aimed.

Until the regulations are finalized, taxpayers may choose to apply the Proposed Regulations in their entirety to all open tax years as if they were final regulations, provided that they consistently apply the rules of the Proposed Regulations.

Endnotes

1. All "Section" references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.
2. Pub. L. No. 115-97, 131 Stat. 2234 (2017).
3. 80 FR 22954 (the 2015 proposed regulations).
4. See Prop. Treas. Reg. Section 1.1297-2(c)(1).
5. Specifically, under this requirement, more than half of the corporation's business must be the issuing of insurance or annuity contracts, or the reinsuring of risks underwritten by insurance companies.
6. *See* H.R. Rep. No. 115-466, at 671 (2017) (Conf. Rep.).
7. To make the election before the final regulations are published, a US person must file a limited-information Form 8621 with the box checked regarding the QIC election and must provide identifying information on the shareholder and the foreign corporation. No other part of Form 8621 must be completed if that person is only filing it to make the QIC election under the Alternative Facts-and-Circumstances Test.
8. The Preamble provides further guidance on whether losses are discounted on an economically reasonable basis. Generally, the determination must be made under the relevant facts and circumstances, but specific considerations must be taken into account. For example, discounting must be based on loss and claim payment patterns for either the foreign corporation or insurance companies in similar lines of insurance business. It must also be based on such loss and claim payment patterns of at least the risk-free rate in US dollars or in a foreign currency used in which the foreign corporation conducts some or all of its insurance business.
9. The Preamble provides that the Treasury and IRS determined that the amount of expenses for insurance activities performed by the QUC or by a related party as compared to the total expenses of the QUC indicates the extent to which the QUC conducts the business itself and is actively engages in an insurance business.

For additional information with respect to this Alert, please contact the following:

Ernst & Young LLP, Financial Services Organization – International Tax Services

- Revital Gallen, *Irvine* revital.gallen@ey.com
- Norm Hannawa, *Chicago* norman.hannawa@ey.com
- Chris Ocasal, *Washington, DC* chris.ocasal@ey.com
- John Owsley, *Washington, DC* john.owsley@ey.com

Ernst & Young LLP, Financial Services Office – Insurance

- Mike Shields, *Philadelphia* michael.shields02@ey.com

International Tax and Transaction Services

Global ITTS Co-Leader, **Jeffrey Michalak,** *Detroit*

Global ITTS Co-Leader, **Bridget Walsh,** *London*

ITTS Director, Americas, **Craig Hillier,** *Boston*

ITTS Markets Leader, Americas, **Stephen O'Neil,** *New York*

National ITTS Leader, **Jose Murillo,** *Washington, DC*

ITTS Regional Contacts, Ernst & Young LLP (US)

West
Sadler Nelson, *San Jose*

East
Colleen O'Neill, *New York*

Central
Aaron Topol, *Atlanta*

Financial Services
Chris J Housman, *New York*

Canada – Ernst & Young LLP (Canada)
Warren Pashkowich, *Calgary*

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