To: NAPSLO Board of Directors
NAPSLO Members

From: Keri A. Kish, Esq., Director of Government Relations

Date: March 24, 2014

Subject: Executive Summary of Foreign Account Tax Compliance Act (FATCA)

On July 1, 2014, the Internal Revenue Service (IRS) regulations for the Foreign Account Tax Compliance Act (FATCA) will become effective. Some of these regulations will impact the surplus lines industry. NAPSLO engaged a tax expert with the law firm of Drinker Biddle & Reath to develop a “Questions and Answers Memorandum” (Q&A Memo) to assist NAPSLO members to better understand their potential new compliance obligations under the regulations. The Q&A Memo provides detailed information on FATCA, the impact to the surplus lines insurance industry and the new responsibilities for the U.S. broker. After reviewing the Q&A Memo, you should understand the following key points regarding your FATCA obligations:

• The purpose of FATCA is to prevent tax evasion. Beginning July 1, 2014, the IRS will require a U.S. broker to confirm the FATCA status of a non-U.S. insurer prior to making payment to them. A U.S. broker forwarding premium to a non-U.S. broker must confirm the FATCA status of both the non-U.S. insurer and the non-U.S. broker prior to making payment to the non-U.S. broker. The Q&A Memo outlines FATCA status in detail.

• A U.S. broker can easily identify the non-U.S. insurer or non-U.S. broker’s FATCA status by requiring the non-U.S. entity to provide IRS Form W-8BEN-E (non-U.S. insurers) or W-8IMY (non-U.S. brokers). We recommend obtaining a copy of the entity’s appropriate form at the time of placement, but certainly prior to accepting the premium. The IRS is also considering developing a database where a non-U.S. entity’s tax status can be immediately verified; however, this is not currently available.

• “Non-U.S. insurers” do include Lloyd’s syndicates.

• If you are provided a W-8BEN-E or W-8IMY from a non-U.S. entity, the Form will clearly indicate the entity’s FATCA status. Asking the non-U.S. entity for the appropriate W-8 form is the best way to ensure both you and the non-U.S. entity are in compliance with FATCA. We recommend you retain
these forms to establish that you verified the non-U.S. entity’s FATCA status in the event the IRS asks you to demonstrate you confirmed the entity’s status.

- If a U.S. broker is unable to determine the non-U.S. entity’s status, FATCA requires you to withhold 30% of the premium. You would be responsible to provide the IRS with the premium you withheld. In the event you do not withhold 30% of the premium and you did not confirm the non-U.S. entity’s tax status, you could be held liable to the IRS for 30% of the premium.

- Upon review of the FATCA regulations, and as explained further in the Q&A Memo, it appears highly unlikely NAPSLO members will place business with a non-U.S. entity that does not qualify as exempt from FATCA. Therefore we do not anticipate you will ever have to withhold premium from one of your non-U.S. partners. However, NAPSLO members nonetheless must confirm the FATCA exempt status of each non-U.S. entity.

- NAPSLO believes after the first time you confirm the FATCA exempt status of a non-U.S. entity, and you can demonstrate how you confirmed their FATCA status, you do not have to obtain the same form for each placement. The W-8BEN-E and W-8IMY forms are valid for 3 years. Unless you have reason to believe there is a change in the non-U.S. entity’s status, you may rely on your initial review until the form expires. However, the non-U.S. entity has a duty to revise their form with the IRS if there are any changes in that three year period.

- The IRS has indicated you will not be required to file an annual Form 1042-S so long as you collect the W-8BEN-E or W-8IMY forms throughout the year. Form 1042-S requires you to report to the IRS the details of your transactions with non-U.S. entities. However, verifying the non-U.S. entity’s FATCA exempt status by obtaining their W-8BEN-E or W-8IMY satisfies this requirement. We recommend you obtain the appropriate forms from the non-U.S. entity at the time of the initial transaction so you can avoid this burdensome report.

- In general, the FATCA confirmation obligation is the responsibility of the last broker in the U.S. broking chain. However, all NAPSLO members should be aware of obligations under FATCA.

**Conclusion**

NAPSLO recommends that each NAPSLO member consider implementing FATCA compliance procedures. As noted above, we believe this should be simple and not overly burdensome. While compliance can be very simple, the importance of compliance should not be underestimated; it is indeed critical that you comply with this new federal regulation. Your non-U.S. partners should be very willing to provide the necessary forms to demonstrate their FATCA status upon your request and hopefully will readily provide them. It would be prudent to simply add this new step into your general checklist of requirements when securing a policy with non-U.S. partners.

NAPSLO continues to monitor requests and discussions with the IRS to exempt the surplus lines/property & casualty industry from the FATCA compliance process. However, as noted in the Q&A Memo, at this time the IRS has declined to provide an exemption. In an effort to reduce the compliance burden on U.S. brokers, the Council of Insurance Agents and Brokers (CIAB) is considering hosting a
clearinghouse or similar assistance for brokers to more readily access W-8BEN-E and W-8IMY forms shared by non-U.S. insurers and brokers. NAPSLO has arranged for NAPSLO members to have access to this solution, if developed. Also, as we mentioned above, the IRS may eventually provide access to the non-U.S. entities’ forms as well.

If you have any questions or need additional assistance related to FATCA, please do not hesitate to contact me at keri@napslo.org or 816.799.0855.
M E M O R A N D U M

TO: NAPSLO Members

FROM: Drinker Biddle & Reath LLP
(Michael Byrne and John W. Weber)

DATE: March 25, 2014

SUBJECT: Foreign Account Tax Compliance Act (FATCA): Questions and Answers

These Questions and Answers do not constitute legal advice and should not be used as a substitute for particularized legal and/or tax advice regarding specific facts or circumstances analyzed in light of applicable laws, regulations and regulatory policies. Neither NAPSLO nor Drinker Biddle & Reath LLP accepts any liability for losses claimed to result from reliance on these Questions & Answers. It is possible that a regulator or taxing authority may take a different position than the guidance expressed herein. Members should obtain their own tax and/or legal counsel for advice on your specific circumstances. You may contact NAPSLO for further guidance or a referral. NAPSLO will provide updates on any further material developments.

Q: What is FATCA?

A: FATCA is the Foreign Account Tax Compliance Act. (It should not be confused with FACTA, the Fair and Accurate Credit Transactions Act, which deals with free credit reports and identity theft.)

Although not primarily concerned with property/casualty or surplus lines insurance, FATCA has potential applicability to all non-U.S. insurers that accept premiums to cover a U.S. source risk and to U.S. brokers placing such business. So as to comply with FATCA - NAPSLO members need to be aware of what the law and implementing regulations require in order to avoid having to withhold 30% of U.S. source premium for placement with a non-U.S. insurer, as described more fully below. A broker who fails to withhold or to acquire proper documentation for such a transaction can be held liable to IRS for the unpaid withholding tax.

Q: When does FATCA become effective?

A: FATCA was passed in 2010 as part of the Hiring Incentives to Restore Employment Act. The U.S. Department of Treasury released final regulations implementing FATCA in January 2013. A new set of
regulations was circulated by Treasury on February 20, 2014. The provisions of these regulations that are potentially relevant to insurance brokers are scheduled to become effective on July 1, 2014.

Q: What is the intent of FATCA?

A: FATCA is a U.S. law aimed at foreign financial institutions (FFIs) and financial intermediaries to prevent tax evasion by U.S. taxpayers through the use of foreign accounts.

Q: What does FATCA require?

A: As noted above, FATCA is aimed at preventing tax evasion. Therefore, FATCA requires FFIs to report to the IRS, details of financial accounts held by U.S. taxpayers or certain foreign entities with U.S. ownership. As a means to enforce this requirement and curb tax evasion, the IRS now requires certain entities to withhold taxes on certain payments from U.S. sources to foreign entities. When and how this happens is explained in more detail below.

Q: What are the consequences of not reporting?

A: Non-U.S. insurers should be prepared to demonstrate to brokers that they are an exempt payee. Exempt payees are more fully explained below. Effective July 1, 2014, a U.S. surplus lines broker, as the last intermediary in the U.S. broking chain could be required to withhold 30% of the premiums covering a U.S. risk paid to a non-U.S. surplus lines insurer (including syndicates at Lloyd’s), unless the broker receives appropriate documentation from the insurer that the insurer is an exempt payee, as discussed below. U.S. source risk generally includes domestic U.S. property/casualty risk and risk related to U.S. residents.

Q: Is FATCA the same as the Federal excise tax?

A: No. The FATCA withholding is separate from and in addition to withholding of Federal excise tax, and certain other withholding obligations.

Q: What do FATCA and its attendant reporting and 30% withholding requirements have to do with property/casualty or surplus lines insurance? Such insurance typically does not involve foreign accounts even when provided by non-U.S. insurers.

A: Although FATCA and the implementing regulations are not primarily concerned with our business, FATCA is remedial legislation and thus the law and regulations are drafted broadly. FATCA’s implementation therefore raises issues for non-U.S. insurers and brokers placing business with them. Industry representatives have warned Treasury (the IRS) of this broad reach and what we perceive to be an unintended consequence. However, brokers are indeed responsible for confirming the non-U.S. insurer is exempt nonetheless. Treasury initially declined a request from the industry for an exemption from the withholding requirement. No such exemption is contained in the recently issued February 20 Regulations.

Generally, property/casualty insurance (and reinsurance) contracts (e.g., a fixed premium for a specified coverage) are not treated as “cash value contracts” that would cause a non-U.S. insurer to be treated as
an FFI. Rather, such property/casualty insurer would be treated as a **non-foreign financial entity (NFFE)**. NFFEs, are **not** subject to FATCA’s more burdensome reporting requirements.

Thus, most non-U.S. property/casualty insurers will not be subject to FATCA’s reporting requirements. However, as will be detailed more fully in the next Question below, U.S. surplus lines broker-payors will still have to take the due diligence to satisfy themselves, and be able to demonstrate to the IRS, that the non-U.S. insurers (and non-U.S. brokers) are within one of the exempt payee categories that would allow the U.S. broker to refrain from FATCA withholding.

**Q: How can non-U.S. insurers and brokers avoid the 30% withholding requirement?**

**A:** Brokers must obtain documentation demonstrating the FATCA-exempt status of the non-U.S. insurer and also, if applicable, the non-U.S. insurance broker. Without this documentation, the broker must withhold 30% of the premium. In order to make compliance with FATCA a bit easier, there are new IRS Forms – Form W-8BEN-E (insurer) and W-8IMY (broker) – to be used by non-U.S. insurers and non-U.S. brokers to provide such documentation to U.S. brokers. A surplus lines broker must validate the FATCA status of the non-U.S. insurer and non-U.S. broker in each placement before premium is settled. The IRS Forms collected from the non-U.S. insurer/broker must be made available to the U.S. surplus lines broker on request. Obtaining these forms will satisfy the broker’s obligation to confirm the non-U.S. insurer (or non-U.S. broker) status.

In addition to obtaining confirmation of the exempt status of the non-U.S. insurer or broker for each transaction, brokers may also be required to submit an annual report to the IRS, on Form 1042-S, detailing those transactions with non-U.S. insurers and brokers with respect to which there was FATCA withholding (if any). The new Regulations indicate that Form 1042-S reporting is not required with respect to premium payments that are covered by Form W-8BEN-E, or other appropriate documentation as discussed below.

The available IRS Forms and instructions are attached as **Exhibit A**.

**Q. How does a non-U.S. insurer or non-U.S. broker achieve FATCA compliance, and how can a U.S. surplus lines broker be certain that premium payments to the non-U.S. insurer or non-U.S. broker are exempt from the 30% withholding requirement?**

**A:** We believe most non-U.S. property/casualty insurers and surplus lines insurers (and brokers and reinsurers) will be determined to be and treated as NFFEs that are not subject to the FATCA reporting requirements. A U.S. surplus lines broker is not required to withhold FATCA tax if it receives from an NFFE a Form W-8BEN-E or some other certificate or form of evidence that indicates that the non-U.S. insurer or broker as the payee has FATCA-exempt status, and the U.S. surplus lines broker does not have reason to question that status.

Exempt payees under FATCA include:

- NFFEs that are publicly-traded on a recognized global exchange, or an affiliate of such NFFEs;
- Active NFFEs (less than 50% of gross income is passive income, and less than 50% of assets are held for the production of passive income); and
Passive NFEs with no substantial (10% or more) U.S. owners, or that have identified their substantial U.S. owners, or have registered with IRS.

We believe a non-U.S. insurer is most likely to be treated as a passive NFFE; and therefore potentially exempt from FATCA withholding. Because of the way that the definitions in the Regulations are drawn, it will be very difficult for a non-U.S. insurer to be deemed Active NFFE status. However, if a non-U.S. insurer does meet the Active NFFE definition, they would also be exempt.

Additionally, a recent IRS Notice and new regulations indicate that certain NFFEs may register and report directly to IRS. If they do so, they would then be listed on the IRS website to more easily demonstrate their exempt status. To potentially reduce some of the burden of confirming the FATCA status, Brokers should check the IRS website to confirm if an insurer is listed with the IRS.

Q: Is there a market-wide solution that would streamline FATCA compliance to make it easy for U.S. brokers to continue to place business with their non-U.S. markets?

A: Cooperation among all surplus lines market participants will be crucial to maximize efficiency and minimize confusion. Non-U.S. insurers and the Council of Insurance Agents and Brokers (CIAB) have considered potential solutions, which may depend on further guidance from the Treasury or IRS. Such solutions could include one or more clearinghouses with secure access to the IRS forms for participating non-U.S. insurers and brokers or providing contact information for obtaining the forms. Such forms could potentially be valid for an extended period (e.g., three years). Should a solution develop, NAPSLO will work to obtain access for NAPSLO members to any such clearinghouses or other solutions. Until such a wider solution becomes available, NAPSLO members should proceed as outlined herein.

In addition, Lloyd’s has current market-wide agreements with IRS in place for other federal income tax and federal excise tax purposes, and thus may be able to agree with IRS on a market-wide approach for FATCA.

Q: What can U.S. surplus lines brokers do to prepare?

A: U.S. surplus lines brokers should consider discussing FATCA and its impact with their non-U.S. insurer and non-U.S. broker partners now. Surplus lines brokers may also wish to begin developing internal processes, systems, protocols and controls and identifying potential areas of high impact to their organizations so as to be ready to comply with the requirements beginning July 1, 2014. As we have tried to convey in the message above, while we believe there will be few, if any, situations in which a broker will ultimately withhold 30% of the premium, the broker will be required to confirm that each and every transaction with a non-U.S. insurer or non-U.S. broker is in fact exempt.

Q. What are the relevant legal authorities and other resources?

A: They include:
  - Internal Revenue Code Sections 1471 through 1474;
  - Treasury Regulations 1.1471-0 through 1.1471-7 and 301.1474-1, including amendments issued on February 20, 2014; and IRS Notices, including Notices 2013-43 (providing extended timelines) and 2013-69 (providing additional guidance and a form FFI Agreement);
• IRS website at http://www.irs.gov/FATCA: and