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Corporate Insurance Practice

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Foreign Affiliate Reinsurance

New Bill Introduced to Deny Tax Deductions

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Representative Richard Neal (D-Mass.) and Senator Robert Menendez (D-N.J.) introduced last week companion bills (HR 3157; S. 1693) that would disallow a deduction for reinsurance premiums paid by a U.S. insurer to an affiliated reinsurer if the reinsurer is not subject to U.S. tax on the reinsurance premiums (the "Neal Bill"). Congress has considered similar proposals for a number of years and the White House included such a proposal in its budget proposals this year. In addition, Representative Neal previously introduced a bill on this same issue in 2008 and again in 2009. The current Neal Bill differs from prior proposals in a number of respects but appears to be generally consistent with what the White House is proposing.

Under the current Neal Bill, reinsurance premiums paid by U.S. insurers to reinsurers would not be deductible for U.S. federal tax purposes if: 1) such premiums are paid to an affiliated corporation; 2) the reinsurance covers specified risks; and 3) the reinsurance premium in the hands of the reinsurer is not subject to U.S. tax. Disallowance would not apply to premiums paid for reinsurance of life or annuity risks. Thus, the Neal Bill would not apply to life reinsurance. For this purpose, a ceding company would be considered affiliated with a reinsurer if they are both part of the same controlled group of corporations, which very generally would include a parent corporation and subsidiary corporations in which it owns, directly or indirectly, 50 percent or more of their stock.

If a deduction is disallowed for a reinsurance premium, the ceding company would not be taxable on any associated ceding commission it receives or on any subsequent reinsurance recovered. Thus, the detriment to a ceding company from not being able to deduct reinsurance premiums is offset to an extent by the benefit of not having to include in income ceding commissions and reinsurance recovered.

Foreign reinsurers would have the option of electing to treat reinsurance premiums as subject to current U.S. tax. If such an election is made, then the ceding company could deduct the reinsurance premiums it pays. In addition, the foreign insurance excise tax would not apply to such reinsurance premiums.

In the accompanying press release, the Neal Bill is described as closing an unintended loophole and as ending an "unintended tax subsidy for foreign insurance companies." The Bill also is described as generating revenue of $12 billion over 10 years.

To date, proposals like the Neal Bill have been very controversial and have not been able to garner broad Congressional support. It is uncertain what the prospects are for passage of the Neal Bill.

For more information on the matters discussed in this *Locke Lord QuickStudy*, please contact the author:

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