

RAB views on US foreign affiliate reinsurance tax proposal

Key concerns

Insurance Europe's Reinsurance Advisory Board (RAB) is significantly concerned by recent developments in the US Congress, reviving past discussions on legislation that would **restrict US insurers' ability to deduct the cost of reinsurance ceded to foreign affiliates** (in a former version referred to as the "Neal bill"). Under existing law, US insurers may deduct the cost of reinsurance (whether from a foreign or domestic carrier and whether underwritten by an affiliated or an unaffiliated reinsurer) as a legitimate business expense.

Denying the deductibility of reinsurance premiums paid to foreign affiliates **would increase costs for domestic carriers, reduce competition and increase the price of insurance for US consumers.**

It is the RAB's understanding that a concrete change to the US tax code to introduce such tax reform proposals may depend on a variety of political and practical factors and is therefore uncertain at this stage. Nevertheless, the introduction of a foreign affiliate reinsurance tax is a real threat and could make its way into a bill that is expected to be published by the end of October or early November. The RAB further holds the view that such tax measures would **undermine the efforts of the bilateral agreement between the EU and US on insurance and reinsurance measures** and put the great achievements made by the negotiating partners at significant risk.

Additional background

This type of restricting measure is not new, given that virtually identical proposals were put forward in recent years by former House of Representatives Ways and Means Committee Chairman Dave Camp (R-MI) and former Senate Finance Committee Chairman Baucus (D-MT), as well as by Representative Richard Neal (D-MA) and Senator Mark Warner (D-VA). On some of those occasions, the European Commission expressed its concerns, for example on the potential US non-compliance with WTO commitments, in writing to the US Congress (copies of the letters are attached).

In a Senate Finance Committee hearing on 27 September, concerns were again raised with respect to the use of premiums paid to foreign affiliate reinsurers by US-based insurers for the purposes of artificially decreasing their US-taxable income. Worryingly, these concerns may be used as justification for a foreign affiliate reinsurance tax, disregarding the fact that the OECD BEPS Action 3 recommendations specifically noted that affiliate reinsurance had a clear business purpose and was not a tax-avoidance scheme, as well as providing a host of data showing the importance of foreign affiliate reinsurance to US-based insurers. The most recent illustration of this importance is that, in the extraordinary 2017 hurricane season, it is estimated that more than 50% of Hurricane Harvey, Irma and Maria insured losses will be paid by global reinsurers (most of which are incorporated in the EU). Early rough estimates are that these three storms alone will generate losses in excess of \$100 billion across US states and territories in the Caribbean.

Denying the deductibility of reinsurance premiums paid to foreign affiliates would increase the cost to domestic carriers, reduce competition and increase the price of insurance for US consumers. Indeed, [a recent study](#) by the Brattle Group found that, if enacted, a tax on foreign affiliate reinsurance would reduce the net supply of reinsurance in the US by an eighth – \$18.3 billion. The same Brattle Group study found that a tax would cause insurance and reinsurance premiums to significantly increase – consumers would have to pay \$5 billion in higher annual costs for the same coverage. Furthermore, this proposal clearly poses the risk of discriminatory treatment of European reinsurers, which would be put at a significant competitive disadvantage to US-based reinsurers.



EUROPEAN UNION
DELEGATION TO THE UNITED STATES OF AMERICA

Acting Head of Delegation

Washington, 10 May 2010
D(2010) 417

The Honorable Timothy F. Geithner
Secretary of the Treasury
U.S. Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

Dear Sir,

I am writing to express the concern of the European Commission about a proposal included in the Administration's budget proposal in relation to affiliated reinsurance. This proposal, if adopted, would deny U.S. tax deductions on reinsurance cessions to affiliated reinsurance companies located outside the U.S.

We believe the proposal is at odds with the principle of a level playing field for all U.S. insurers and reinsurers, by introducing a tax regime that would penalise foreign-owned U.S. insurance companies that reinsure their risks with affiliated foreign companies. This penal tax regime would only apply to foreign-owned insurers; thus it would not result in protecting the U.S. tax base, but in creating a disadvantageous tax environment for foreign insurance providers. This could result in higher premiums for U.S. policy holders or even in the withdrawal of non-US operators from the U.S. reinsurance business, leading to job losses for many U.S. citizens employed by those companies.

Further, as currently drafted, the proposal would clearly capture affiliated reinsurance premium ceded to a foreign affiliate regardless of the tax jurisdiction in which the affiliated foreign company operates. It would thus clearly capture premium ceded to reinsurers incorporated in the European Union, where the average tax burden is approximately 25%. In fact, in the largest EU reinsurance markets, the rate is even higher. Therefore we have doubts whether the primary aim of this provision is tax evasion.

Instead, the main aim of the proposal appears to protect the U.S. insurance and reinsurance industry through a discriminatory treatment of foreign insurers and reinsurers. This would contravene the commitment of G20 leaders to fight protectionism.

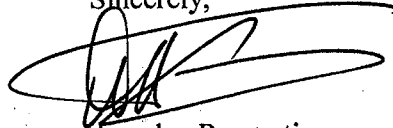
I take the liberty of recalling that the U.S. has specific commitments in insurance services under the WTO General Agreement on Trade in Services (GATS). The U.S. GATS commitments on the cross-border supply of reinsurance services include a reservation regarding the imposition of a Federal Excise Tax of 1%; there are however no limitations

regarding the supply of insurance services within the US, so that a foreign-owned insurer established in the U.S. is entitled to the same treatment as a US-owned insurer. As there is no specific national treatment limitation on the deductibility of reinsurance premiums paid to offshore affiliated reinsurance, any differentiated treatment of the tax deductibility of reinsurers paid to offshore as opposed to onshore affiliates, by foreign-owned rather than US-owned insurers, would contravene the U.S. GATS commitment that reinsurers and insurers of any other WTO member must be treated no less favourably than U.S. suppliers of such services.

A similar letter has been sent to U.S. Trade Representative Ron Kirk and Office of the Management and Budget Director Peter Orszag.

I am grateful for any efforts you may undertake to address this concern.

Sincerely,

A handwritten signature in black ink, appearing to be 'AP', enclosed within a large, loopy oval flourish.

Angelos Pangratis
Acting Head of Delegation

Michel BARNIER
MEMBER OF THE EUROPEAN COMMISSION

Karel DE GUCHT
MEMBER OF THE EUROPEAN COMMISSION

Brussels, 29 SEP. 2011
DL/dcm/Ares link 969870

Reference: Disallowance of reinsurance tax deduction

Dear Congressman Camp,

In July last year we wrote to Congressman Neal to express our concerns about a potential change in the treatment of foreign reinsurance undertakings by the U.S. We are pleased to note that these proposals have not been adopted so far. However, we remain concerned that the proposals may be taken up in the near future, particularly in light of the recommendations set forth in the recent Budget Control Act.

We have restated our main objections to the overall proposal below. In addition, the specific proposals in the U.S. Administration's 2012 Budget (the 2012 proposal) risk having a much larger negative impact on EU undertakings, than the previous 2011 Budget proposals.

It is our understanding that the proposals would deny U.S. tax deductions on reinsurance cessions to affiliated reinsurance companies located outside the U.S. This proposal would penalise foreign-owned U.S. insurance companies, creating an unlevel playing field for U.S. insurers and reinsurers. This is exacerbated by the removal of the 50% total premium threshold and the inclusion of retrocessions (reinsurance of reinsurance) in the 2012 proposal, since this would result in a much greater proportion of the reinsurance premiums paid to affiliated foreign reinsurers being disallowed for tax purposes.

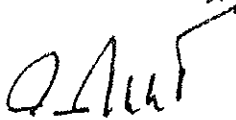
The increased tax burden for foreign insurance providers could eventually result in higher premiums for U.S. policy holders or even the withdrawal of non-U.S. operators from the U.S. reinsurance market. In this context, we observe that, non-U.S. insurers and reinsurers have provided a significant proportion of the cover in relation to several U.S. natural catastrophes in recent years. Availability of insurance and reinsurance cover for catastrophe risk in the U.S. could be significantly reduced were these proposals to be introduced. This could in turn increase the cost of providing such cover and affect the employment situation if the non-U.S. operators who would feel obliged to withdraw from the market.

The Honorable David Camp
Chairman
House Committee on Ways and Means
1139E Longworth House Office Building
USA -- Washington, DC 20515

We understand and share the objective of preventing tax evasion. However, given that the regime applies regardless of the tax jurisdiction in which the affiliated foreign company operates, it also penalises EU reinsurers who are already subject to tax burdens of on average 25%. Therefore, the proposals do not appear to be fit for purpose. Moreover, we would like to again remind you of the U.S. commitments in insurance services under the WTO General Agreement on Trade in Services (GATS) that reinsurers and insurers of any other WTO member must be treated no less favourably than U.S. suppliers of such services.

We understand that each committee of the House of Representatives and the Senate has until 14 October 2011 to transmit to the joint committee its recommendations for changes in law to reduce the US deficit. A similar letter has been sent to Senator Baucus, Chairman of the Senate Finance Committee. At this time where many countries across the world are facing the challenge of reducing budget deficits, we would urge you not to resort to measures that would contravene the commitment of all G20 leaders to fight against protectionism and discrimination.

Yours sincerely,



Michel BARNIER



Karel DE GUCHT

Cc: The Honorable Sander Levin, Ranking Member, House Ways and Means Committee
The Honorable Ron Kirk, United States Trade Representative
The Honorable Timothy F. Geithner, United States Secretary of the Treasury

KAREL DE GUCHT

MEMBER OF THE EUROPEAN COMMISSION

Brussels, 201213
KDG/MVH/CBE/dcm/S(13)4039313

Dear Senator Baucus,

In response to your recent release of the international tax reform staff discussion draft, the European Union would like to take this opportunity to provide feedback on one particular element of the proposed reform, which relates to the tax proposal for reinsurance with affiliated parties.

The potential change in the treatment of foreign insurance undertakings by the United States in the manner proposed in the discussion draft remains a longstanding issue of concern for the European Union. These concerns have been relayed to the Government and the United States Congress on a number of occasions. In particular, the European Union has highlighted the potential for the proposal to lead to the creation of an unequal playing field between American and foreign insurers and reinsurers. We have pointed out that this would not only be detrimental to European Union insurance undertakings, but could also harm American industry and consumers by reducing competition and increasing costs. We are thus very disappointed to note that the most recent proposal maintains the same key elements to which we have objected in the past.

More specifically, it is our understanding that the proposal would deny U.S. tax deductions on reinsurance cessions to foreign-affiliated reinsurance companies located outside the U.S. We consider that this approach would act as a disincentive for U.S.-based insurers to purchase reinsurance from their non-U.S. based affiliates.

*The Honourable Max Baucus
Chairman
Senate Committee on Finance
511 Hart Senate Office Building
Washington, DC 20510
USA*

In our view, this proposal does not recognise the primary risk management function of reinsurance between affiliated companies. Group reinsurance transactions are used to absorb potential losses from an insurance policy and to diversify exposure to extremely large losses from a single source or region, notably with respect to potential catastrophic events. Therefore a measure which interferes with the functioning of risk management practices is likely to result in an increase in the costs of insurance premiums paid by citizens and enterprises. This is particularly relevant in the U.S., where almost 60% of premiums are underwritten by foreign reinsurers and reflected in the large proportion of the coverage provided by non-U.S. reinsurers in relation to several recent U.S. catastrophes. With regard to the 9/11 terrorist attacks, non-U.S. insurers and reinsurers paid 65% of all American claims, and for hurricanes Katrina, Wilma, Rita and Sandy, non-U.S. insurers and reinsurers paid approximately 50% of all related claims.

Secondly, although the proposal provides an option whereby an affiliated foreign reinsurer might elect to be subject to U.S. tax on premiums and other categories of income, and in such cases the tax deduction on reinsurance cessions would continue to apply, this does not ensure that foreign affiliates would effectively receive equal treatment in comparison to U.S. reinsurers. European reinsurers, unlike their U.S. counterparts, would be required to implement complex and costly parallel tax assessment systems. Were European Union reinsurers to elect to be subject to U.S. tax, and as a result to be effectively taxed in the U.S., they would not be entitled to benefit from the various tax relief options available to U.S. companies. In addition, European Union reinsurers would lose their ability to offset profits realised in their operations in the U.S. against tax losses resulting from large insurance claims arising from outside of the U.S., resulting in European Union reinsurers effectively being compelled to pay taxes even under loss-making conditions. Furthermore, delineating income as income effectively connected with and attributable to a permanent establishment in the U.S. would be difficult to achieve in practice, due to different local assessment rules (such as equalisation reserves).

The EU understands and shares your overarching objective of preventing tax evasion. However, European Union reinsurers are subject to tax burdens amounting on average to 25%. We note that the effective tax rate of most competing U.S. groups is substantially below the federal tax rate of 35%. We therefore consider the current proposal to be lacking in its fitness for purpose and fairness in terms of its application to the EU's insurance industry. We remain convinced there are less restrictive and more equitable means to achieve the legitimate goal of preventing tax evasion. Moreover, we continue to express our doubts about the compatibility of the current proposal with the national treatment obligations relating to insurance services taken by the U.S. under the WTO General Agreement on Trade in Services (GATS).

We would thus welcome having an opportunity to enter into a dialogue on how your aims could be achieved in a manner which avoids extraterritorial application and potentially discriminatory treatment, while maintaining a robust reinsurance market for the benefit of U.S. consumers and enterprises.

The EU and the U.S. are currently engaged as partners in the largest trade and investment negotiation ever undertaken, with the ultimate goal of strengthening the competitiveness of both our economies, including in the important area of financial services. Against such an important political backdrop, we trust that our views will merit your fullest attention.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Karel De Gucht', written over a vertical line that extends downwards from the signature.

Karel De Gucht

*Cc: The Honorable Orrin Hatch, Ranking Member, Senate Finance Committee
The Honorable David Camp, Chairman of House Ways and Means Committee,
The Honorable Sander Levin, Ranking Member, House Ways and Means Committee
The Honorable Jacob Lew, United States Secretary of Treasury
The Honorable Michael Froman, United States Trade Representative*