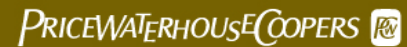


Captive insurance update



President Obama's budget targets affiliated reinsurance

February 2, 2010

Alert 10-03

On February 1, 2010, The Obama Administration released the "General Explanations of the Administration's Fiscal Year 2011 Revenue Proposals", also known as the "Green Book". The proposed budget expects to generate over \$400 billion in business tax increases over the next ten years; \$122 billion is expected to be related to international tax changes. Of particular interest to the (re)insurance industry is a proposal (hereinafter, the "reinsurance proposal") to disallow a deduction for "excess" reinsurance premiums paid to affiliates. The reinsurance proposal is similar to other legislative proposals targeting the non U.S. reinsurance industry (see the Neal Bill – HR 6969).

Under the reinsurance proposal, a U.S. insurance company would be denied a deduction for certain reinsurance premiums that are paid to affiliated foreign reinsurance companies with regard to U.S. risks insured by the insurance company or its U.S. affiliates. The deduction is disallowed to the extent of 1) the foreign reinsurers (or their parent companies) are not subject to U.S. income tax on premiums received and 2) the amount of reinsurance premiums paid (net of ceding commissions) to the foreign reinsurers is greater than 50% of the total insurance premiums received by the U.S. insurance company and its U.S. affiliates for a line of business.

The reinsurance proposal also discusses that a foreign corporation that receives reinsurance premiums from an affiliate can elect to treat those premiums and the associated investment income as Effectively Connected Income ("ECI") of a U.S. trade or business. Reinsurance premiums treated as ECI would not be subject to the disallowance.

Under the proposal the reinsurance premiums are treated as affiliated non-taxed premiums unless they are subpart F income or subject to U.S. tax. It may be noted that such reinsurance premiums may not be subpart F income when a CFC has no earnings and profits under section 952(c). (This provision is similar to the 2009 Neal Bill).

The reinsurance proposal would be effective for taxable years beginning after December 31, 2010.

PwC observation

The reinsurance proposal, in its current form, appears to be more 'taxpayer friendly' when compared to predecessor proposals regarding the reinsurance of U.S. risk to offshore affiliates (e.g., the Neal Bill). The latest proposal targets only "excessive" reinsurance levels and is not jurisdiction-specific (i.e., does not consider the reinsurer's local tax rate or whether the reinsurer is domiciled in a country with a Comprehensive Income Tax Treaty with the United States).

The reinsurance proposal may have a limited impact on captive insurance companies where U.S. domiciled captives cede reinsurance to affiliated captives not subject to U.S. tax.

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