Budget proposal to disallow deduction for reinsurance premiums paid to affiliates; other insurance tax provisions

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In brief

President Obama yesterday submitted a Fiscal Year 2014 budget to Congress, including a number of International and insurance industry 'tax reform' proposals estimated to raise $157 billion and $30.5 billion respectively over 10 years. Of specific importance to foreign owned US insurance companies is a provision that limits deductions for reinsurance premiums paid by a US insurance company to its foreign affiliates. The provision is similar to previous budget proposal, as well as to the 'Neal Bill' originally introduced by Congressman Richard Neal (D-MA) in 2009. Under this proposal, a US insurer with an affiliate that is based abroad and not subject to US tax law, could not deduct as an expense reinsurance premiums paid to that affiliate.

In detail

The proposal would (1) deny an insurance company a deduction for reinsurance premiums paid to an affiliated foreign reinsurance company to the extent that the foreign reinsurer (or its parent company) is not subject to US income tax with respect to the premiums received and (2) exclude from the insurance company's income (in the same proportion that the premium deduction was denied) any ceding commissions received or reinsurance recovered with respect to reinsurance policies for which a premium deduction is wholly or partially denied.

A foreign corporation that is paid a premium from an affiliate that would otherwise be denied a deduction under this proposal would be permitted to elect to treat those premiums and the associated investment income as income effectively connected with the conduct of a trade or business in the United States and attributable to a permanent establishment for tax treaty purposes. For foreign tax credit purposes, reinsurance income treated as effectively connected under this rule would be treated as foreign source income and would be placed into a separate category within section 904. This provision would be effective for policies issued in taxable years beginning after December 31, 2013.

In addition, to the reinsurance premiums provision, the budget proposes a number of revenue-raising provisions to be reserved for tax reform legislation, including:

- International 'tax reform' proposals -- including a minimum tax on foreign earnings -- "to prevent companies from shifting profits overseas to avoid US taxes"

- Financial and insurance industry reforms, including a mark-to-market rule for derivatives
- Modification of rules that apply to sales of life insurance contracts
- Modification of proration rules for life insurance company general and separate accounts
- Expand pro rata interest expense disallowance for corporate-owned life insurance.

The takeaway

The current proposal may significantly increase the US tax burden on foreign owned US insurance companies. Consequently, offshore insurance companies and their US affiliates should closely monitor the developments of the current proposal.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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