Neal Bill reintroduced: Deduction would be disallowed for non-taxed reinsurance premiums paid to foreign affiliates

May 24, 2013

In brief

On May 20, 2013, Congressman Richard Neal (D-MA), with his co-sponsor Congressman William Pascrell (D-NJ), reintroduced a foreign reinsurance bill, H.R. 2054 (the '2013 Neal Bill'), that would limit deductions for reinsurance premiums paid by a US insurance company to its foreign affiliates. Sen. Robert Menendez (D-NJ) introduced a companion bill, S. 991, in the Senate. The bill reflects Rep. Neal's continued concern that the use of affiliated reinsurers is a means by which US insurance risks migrate to offshore reinsurance markets to avoid US tax.

Rep. Neal has previously introduced three foreign reinsurance tax bills in recent past Congresses – H.R. 3157 (Oct. 12, 2011) (the '2011 Neal Bill'), H.R. 3424 (Jul. 30, 2009) (the '2009 Neal Bill'), and H.R. 6969 (Sep. 18, 2008) (the '2008 Neal Bill'). The 2013 Neal Bill is the same as the 2011 Neal Bill, despite the fact that Rep. Neal said the 2013 Neal Bill addresses concerns raised by tax experts. Similar bills were introduced by Rep. Neal in earlier Congresses. The approach of the 2013 Neal Bill is comparable to that of the Obama Administration Fiscal Year 2014 budget revenue proposal that was explained in the FY 2014 Green Book.

In detail

The 2013 Neal Bill would generally (1) defer the deduction for reinsurance premiums paid to an affiliated foreign reinsurance company, to the extent that the foreign reinsurer is not subject to US income tax with respect to the premiums received, until the insured event occurs; and (2) exclude from the insurance company's income (in the same proportion that the premium deduction was denied) any return premiums, ceding commissions received, reinsurance recovered, or other amounts received with respect to reinsurance policies for which a premium deduction is wholly or partially denied.

Although these provisions would apply to both a life or a non-life insurance company, they would not apply to the reinsurance of risks with respect to which life insurance reserves described in Section 816(b)(1) are established. A corporation would be treated as "affiliated" with an insurance company if both corporations would be members of the same controlled group of corporations under consolidated return rules if those rules were applied by substituting a 50 percent threshold for the 80 percent voting power and total value thresholds that appear in Section 1563, and without regard to certain rules that are specific to insurance companies and foreign corporations.

The bill allows foreign groups to avoid the deduction disallowance by electing to be subject to US tax with respect to the premiums and net investment income from affiliate reinsurance of US risk. If a foreign corporation receives a premium from an affiliate that would otherwise be denied a deduction, the foreign corporation would be permitted to elect to treat those premiums 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. An explanation of the Bill prepared by the Joint Committee of Taxation states that the net investment income associated with the reinsurance is to be computed applying section 842 (relating to deemed investment income) and allowing allocable deductions. To the extent the reinsurance premiums are treated as effectively connected income by reason of the election, the federal insurance excise tax would not apply. 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.

The bill would apply to taxable years beginning after December 31, 2013.

The takeaway

It remains uncertain whether the current Congress will actively consider this legislation. If enacted, the 2013 Neal Bill 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 bill.

Let's talk

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

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