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...March 1-4, 2009, Four Seasons, Las Vegas, NV

A Global Gathering for Senior Life Insurance and Reinsurance Executives

ReFocus 2009

March 1-4, 2009

Las Vegas, NV

A4 - Taxes Without Tears

Dennis Allen, Chris DesRochers

Susan Hotine
Moderator

Taxes Without Tears

Susan Hotine, Scribner, Hall & Thompson, LLP

Christian DesRochers, SMART Business Advisory

Dennis Allen, Dewey LeBoeuf LLP

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Inversions and Foreign-Based Insurers: Tax Avoidance?

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Foreign-Based Insurers Viewed as Avoiding U.S. Tax

- U.S. risks transferred to foreign reinsurers, in low-tax or no-tax jurisdictions, through corporate inversions, foreign acquisitions, and reinsurance with foreign insurers
- Foreign-based parent companies may avoid U.S. tax where a U.S. subsidiary reinsures risks with foreign affiliate.
 - Amounts paid to reinsurer deductible by U.S. insurer; ceding commissions taxable
 - Investment income re reserves taxed to reinsurer in low-tax or no-tax jurisdiction
 - Federal excise tax applies, unless exempted by treaty, but does not fully offset arrangement's tax benefits; tax benefit w/o yielding business to third party.
 - Tax benefit perceived to create a *competitive disadvantage* for U.S.-based insurers
- **Contra: Reinsuring U.S. risks with foreign affiliate legitimately provides shifting, distribution and geographic diversification of risk; minimization of regulatory oversight in business-favorable jurisdiction.**

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Current Legislative Proposals: Tax Excess Premiums

- **Senate Finance Committee Staff Discussion Draft (Sen. Max Baucus (D-Mont) - Dec. 2008.**
 - Would disallow any deduction to non-life insurance companies for excess reinsurance premiums paid to affiliated companies for U.S. risks if the premiums are *not Subpart F income or not subject to US income taxation.*
 - Would limit deductions for related-party reinsurance cessions to the average percentage of premium ceded to unrelated reinsurers.
 - Premium limitation would be applied by line of business.
- **H.R. 6969 (Rep. Richard Neal (D - MA)) 110th Congress - September 18, 2008**
 - Similar to Baucus discussion draft, above
 - Except, would disallow a deduction if *premiums are not paid to a CFC or if they are not subject to US income tax.*

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Past Legislative Proposals

- **H.R. 1755, (Rep. Nancy Johnson (R-CT) and Rep. Richard Neal (D – MA)) 107th Congress - May 8, 2001.**
 - Would have denied non-life insurance companies any deduction for premiums paid for direct/indirect reinsurance of U.S. risks with a "related insurer" unless the reinsurance income were subject to U.S. income taxation, or it were established that the income was subject to a greater-than-20% effective income tax rate.
 - However, would have allowed the insurance company to deduct reinsurance recovered from a related insurer to the extent the premium-paid deduction was disallowed under the bill.
- **H.R. 4192 (Rep. Nancy Johnson (R-CT) and Rep. Richard Neal (D - MA))106th Congress - April 5, 2000.**
 - Under an amended section 845, if a domestic person directly/indirectly reinsured U.S. risk with a related foreign reinsurer, then the domestic person's investment income would have been increased each year by an amount equal to the product of the average of the applicable federal mid-term rates and the sum of the reserves and liabilities related to the U.S. risks ceded to the foreign reinsurer.
 - The federal excise tax would not apply to reinsurance premiums paid by such domestic person to such foreign reinsurer.

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Risk Transfer Principles for Tax Accounting Versus for U.S Stat and GAAP Accounting

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Risk Transfer

- A transfer of risk is a necessary component of tax and accounting treatment as insurance.
- Insurer bears the burden
- Risk is transferred if there are plausible scenarios under which a loss can occur.
 - “How much” remains unsettled.

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Tax

- “Insurance” is not defined in the Internal Revenue Code but has evolved through case law.
- Helvering v. LeGierse
 - Supreme Court Case from the 1940’s
 - Risk shifting
 - Risk distribution

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Accounting

- Based on published guidance in both GAAP and statutory accounting
 - FAS 113, IFRS 4, SSAP 61 and 62
 - Determines treatment as insurance or “deposit”
- Key definition: significant loss reasonably possible
- Key challenge: evaluating the possibility of loss

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Risk Analytics

- Develop analytical framework to identify and assess risk.
- Qualitative: “reasonably self evident”
 - Catastrophic risk
- Quantitative: application of a risk metric
 - A single number or index value that quantifies exposure
 - Every metric has an implicit definition of “risk.”

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Risk Metrics

- Value-at Risk (VaR)
 - Amount lost with a specified probability
 - Common in banking
- Tail Value-at-Risk (TVaR)
 - Also called Conditional Tail Expectation (CTE)
 - Weighted average of the worst outcomes
- Insolvency Put Option
 - Expected loss to policyholder on insurer default

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Transfer Pricing for Affiliate Transactions

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Reinsurance with Affiliates

- Offshore reinsurance is seen as creating the potential for tax avoidance.
 - Profits and tax shifted to low tax jurisdictions
 - Reduces overall corporate tax
- Transfer pricing rules intended to prevent “non-arm’s length” transactions
 - Increased tax risk and tax administration costs

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Transfer Pricing

- Price at which goods and services are “sold” within multi- national enterprises (MNEs)
- Can move profits (and taxes) between jurisdictions
 - Tax authorities want to assure the appropriate profit is reported.

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Transfer Pricing Rules

- Tax is governed by transfer pricing rules.
- Internal Revenue Code
 - Section 482
 - Section 845(a)
 - Clear reflection of income
 - “Best method”
- OECD Guidelines
 - Arm’s length method

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Reinsurance Issues

- Has ceding commission been calculated on an arm’s length basis?
- Would the cedant have undertaken the transaction with an independent reinsurer?
- Transfer pricing demonstration:
 - Comparable uncontrolled price
 - Comparable profit method

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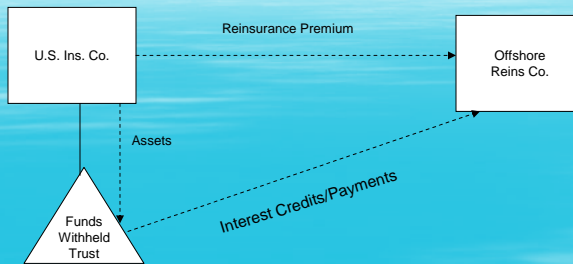


Application of the U.S. Withholding Tax to Offshore Cessions and Cascading U.S. Federal Excise Tax Liability

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Withholding Tax Regime Coinsurance Reinsurance (Funds Withheld)

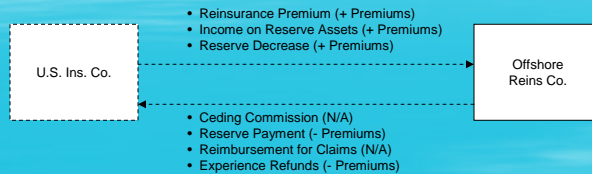


1. **U.S. Federal Excise Tax (FET)**
 - 1% of Reinsurance Premiums Paid
 - Timing of Tax Collection
 - Tax Treaty Relief
2. **U.S. Withholding Tax**
 - 30% of Interest (Reduced Rate under U.S. Tax Treaties)
 - Timing of Tax Collection
 - Portfolio Interest Exception



Withholding Tax Regime

Modified Coinsurance Reinsurance



1. FET Base: Not Reduced by Ceding Commission and Claim Reimbursements
2. U.S. Withholding Tax: Interest Converted to Premium
3. Timing of Tax Collection
4. Tax Treaty Relief

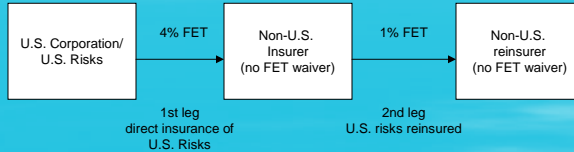


FET: Cascading Liability

- IRS Revenue Ruling 2008-15 -- Issued on March 24, 2008
- IRS concludes U.S. FET applies to reinsurance premiums paid by one foreign insurer to another foreign reinsurer where the premium is for the coverage of U.S. risks

FET Cascading Liability

Scenario 1



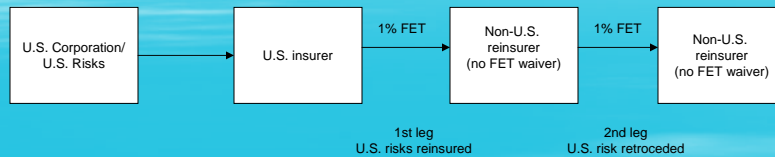
FET applies to:

- (a) premiums the U.S. insured pays the non-U.S. insurer at a 4% rate
- (b) reinsurance premiums the non-U.S. insurer pays to the non-U.S. reinsurer at a 1% rate



FET Cascading Liability

Scenario 2



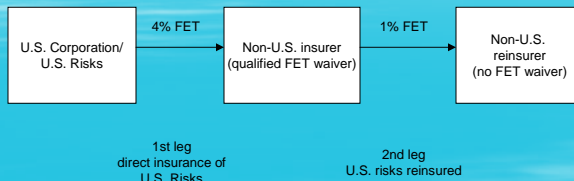
FET applies to:

- (a) reinsurance premiums U.S. insurer pays to the first non-U.S. reinsurer at a 1% rate
- (b) retrocession premiums the first non-U.S. reinsurer pays to the second non-U.S. reinsurer at a 1% rate

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FET Cascading Liability Scenario 3

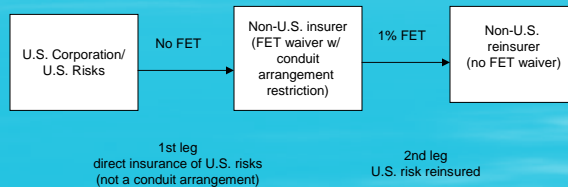


FET applies to:

- (a) premiums the U.S. insured pays to the non-U.S. insurer at a 4% rate (because of subsequent reinsurance to non-U.S. reinsurer with no tax treaty protection)
- (b) reinsurance premiums the non-U.S. insurer pays to the non-U.S. reinsurer at a 1% rate



FET Cascading Liability Scenario 4



FET does *not* apply to premiums the U.S. insured pays to the non-U.S. insurer

FET applies to the reinsurance premiums the non-U.S. insurer pays to the non-U.S. reinsurer at a 1% rate



FET Cascading Liability

IRS Announcement 2008-18

- Voluntary compliance initiative – Relief for past years
 - Avoid cascading FET exposure for periods before October 1, 2008
 - No relief for failure to file return or pay FET on the 1st leg of transaction
- Eligible participants
 - Must timely file FET returns and pay cascading FET for all periods beginning on or after October 1, 2008
 - Or, must timely disclose a treaty-based return position that it is entitled to an exemption with respect to such premiums



FET Cascading Liability

Current Status

- Industry efforts to have IRS Rev. Rul. 2008-15 withdrawn were unsuccessful
- Due date for first FET filing under IRS Announcement 2008-18 was January 31, 2009
- Rev. Rul. 2008-15 is expected to be challenged