Position Paper

Insurance Europe response to the proposed BEAT Regulations published by the US Treasury and the IRS

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1. Introductory comments

Insurance Europe welcomes the opportunity to comment on the proposed regulations issued by the US Department of the Treasury and the Internal Revenue Service (IRS), implementing the Base Erosion and Anti-abuse Tax (BEAT) under section 59A of the Internal Revenue Code.

While Insurance Europe understands and supports the policy objective behind the BEAT (i.e. to prevent base erosion), the fact is that the BEAT attaches to a far greater amount than could be attributed to any base erosion behaviour on the part of foreign affiliate reinsurers and is therefore extremely punitive and disproportionate.

Insurance Europe also believes that the BEAT is discriminatory towards non-US affiliate reinsurers because it applies to gross premiums paid to foreign affiliate reinsurers but not to premiums paid to US-based affiliate reinsurers for the same type of transaction. The BEAT also results in double taxation for foreign affiliate reinsurers and the proposed regulations do not provide any relief in this respect. Finally, applying the BEAT to gross rather than net reinsurance payments does not reflect the economic substance of a reinsurance contract and goes against the long-established practice of levying taxes on net rather than on gross transactions.

Insurance Europe's views on this matter are also consistent with the conclusions of the OECD BEPS Action Plan, namely that foreign affiliate reinsurance cannot be considered a tax avoidance scheme, as long as it respects a number of criteria (detailed below).

In what follows, Insurance Europe will provide more detailed comments on these issues and others that are raised by the proposed regulations.

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2. Comments on net reinsurance contracts

Under the language of the Tax Cuts and Jobs Act (and as Treasury/IRS point out in the proposed regulation), the BEAT is imposed on the gross amount of transactions with foreign affiliates, so on gross reinsurance premiums in this case.

As a result, in the case of quota share arrangements, for example, the gross amount of reinsurance premium is subject to BEAT, without considering any inbound payments such as reserve adjustments, ceding commissions and claims payments. Similarly, in the case of modified coinsurance or funds withheld coinsurance, the BEAT applies to the whole outbound gross premium as well as to the interest on the funds withheld paid over to the assuming company.

Insurance Europe strongly believes that the base erosion payment (on which the BEAT applies) should be computed net of any related amounts included in taxable income from the same transaction. For reinsurance, this would mean that BEAT would apply to what is left after deducting the loss payment (or return of premium) and the reinsurance commission from the reinsurance premium paid. In other words, the BEAT would in this case apply to net reinsurance payments. This would also be consistent with the usual practice of levying taxes on net (as opposed to gross) amounts. Furthermore, if the reinsurance contract provides for settlement on a net basis, BEAT should apply on that net basis.

Imposing a tax on only one leg of a reinsurance contract is not equitable and does not reflect the economic substance of the contract. Insurance does not stop when a premium is paid to an insurer. Claims payments are made by foreign insurers to US insureds on the occurrence of insurable events which are not controllable by either a related party or unrelated party. But because it applies to gross transactions, the BEAT ends up attaching to a far greater amount than the actual amounts that are believed to be eroding the US tax base (i.e. the underwriting profit made by the reinsurer).

By clearly stating that the BEAT applies to premiums net of any related amounts that are already included in US taxable income from the same transaction (i.e. commissions and claims paid), the proposed regulations could also significantly diminish the impact of double taxation on European companies.

3. Comments on the implications of the BEAT for US insurance capacity

A significant amount of US insurance capacity is provided by European (re)insurers and their affiliates. Because the extremely punitive nature of the BEAT has already led and will probably continue to lead to significant business reorganisations, this will unavoidably result in decreased insurance capacity in the US. If other (re)insurers do not step in to make up for this shortfall in capacity, insurance prices for US consumers will automatically increase. Furthermore, even if the capacity shortfall is in fact filled in large part by US (re)insurers, this will then result in a higher concentration of risk in the US, which would otherwise have been spread globally. Global (re)insurers pool and spread risk across the world, so that there is enough capacity to cover natural disasters wherever they happen. If more of this risk will become concentrated in the US, it will become significantly harder to cover liabilities resulting from high-impact catastrophes.

4. Comments on base erosion

Foreign affiliate reinsurance is not a tax avoidance or a tax base erosion scheme. The OECD considered this very topic as part of its Base Erosion and Profit Shifting (BEPS) Action Plan. The BEPS Action 3 final report discusses tax avoidance concerns that can arise with respect to reinsurance with an affiliate, and identifies three concrete issues:

- The affiliate may be overcapitalised compared to competitors in the market;
- The insured risks and insured parties may be located outside the jurisdiction of the affiliate; or
- The reinsured party may be a related party and may have received a tax deduction for the reinsurance premium.

The final report goes on to state that there was no need for special anti-base erosion rules under Action 3 - *Designing Effective Controlled Foreign Company ("CFC") Rules* - for related party reinsurance, as long as certain conditions are met. These are:

- The reinsurance contract is priced on arms-length terms.
- There is diversification and pooling of risk in the reinsurer.
- The economic capital position of the group has improved because of diversification; therefore, there is a real economic impact for the group as a whole.
- Both the insurer and the reinsurer are regulated entities with broadly similar regulatory regimes and regulators that require evidence of risk transfer and appropriate capital levels.
- The original insurance involves third party risks outside the group.
- The CFC has the requisite skills and experience at its disposal, including employees in the CFC of a related service company with senior underwriting expertise.
- The CFC has a real possibility of suffering losses.

Any foreign affiliate reinsurance that meets these conditions cannot be considered a tax-avoidance scheme. Insurance Europe would therefore respectfully suggest that targeting foreign affiliate reinsurance under the BEAT statute is not justified.

5. Comments on the use of tax loss carry forwards to calculate Modified Taxable Income ("MTI")

In addition to the broader policy concerns expressed above, Insurance Europe would also like to raise two technical issues that arise under the proposed regulations.

Reducing MTI below zero

The first issue relates to the proposed rule limiting the use of net operating loss ("NOL") carry forwards to reduce taxable income below zero for purposes of calculating MTI. Prop. Treas. Reg. § 1.59A-4(b)(1). This rule appears contrary to the statutory language, which states that "modified taxable income" generally means "the taxable income of the taxpayer computed under [Chapter 1 of the Internal Revenue Code] for the taxable year" determined without regard to certain base erosion items. Internal Revenue Code ("IRC") §59A(c)(1). Chapter 1 of the IRC defines "taxable income" generally as gross income minus the deductions allowed by Chapter 1, which encompasses the deduction for NOL carry forwards, and which therefore may result in a taxable income amount below zero. IRC §§63(a), 172(a). Accordingly, under a straightforward reading of the statutory authorities, i) the calculation of MTI begins with taxable income, ii) taxable income includes the deduction for NOL carry forwards, and as a result may be driven below zero, and therefore iii) MTI may also be driven below zero as a result of those same NOL carry forwards.

Insurance Europe understands that US Treasury proposed the NOL carry forward limitation rule to prevent the same carry forwards from being used in multiple years to reduce potential BEAT. If US Treasury believes the proposed rule is a proper and reasonable exercise of its authority under the BEAT statute, and that a tracking system to prevent duplicate use of NOL carry forwards would be too complex and administratively burdensome, Insurance Europe requests that the effective date for the rule be delayed for one or two taxable years. This would provide fair and reasonable relief for taxpayers that took a strict reading of the statutory authority during 2018, prior to publication of the proposed regulations, to calculate, estimate, and plan for potential BEAT liability by including NOL carry forwards without limitation to calculate MTI.

Calculating MTI in the context of life/non-life consolidated returns

The second technical issue Insurance Europe would like to highlight is a concern regarding the calculation of MTI in the context of life/non-life consolidated returns.

As described in the preamble to the proposed regulations, the BEAT statute requires calculating MTI on a "recomputation approach", that is, MTI is determined by recomputing regular taxable income without regard

to BEAT deductions. The proposed regulations, however, require calculating MTI on an "add-back approach", that is, MTI is determined by simply adding back BEAT deductions to regular taxable income. Insurance Europe understands US Treasury's departure from the statutory approach in order to promote i) simplification (recomputation would require tracking of attributes) and ii) ease of current period NOL and IRC §163(j) interest limitation computations. Even so, the US Treasury indicated in the preamble that it welcomes comments on the add-back approach and the practical effects of applying this approach versus the recomputation approach.

In conjunction with the above, the proposed regulations also adopt a "single-taxpayer approach" for consolidated groups, which generally means that all members of a consolidated group are treated as a single taxpayer for purposes of determining MTI.

Under both the single-taxpayer and add-back approaches, consolidated groups first calculate consolidated regular taxable income and then add back to this the sum of BEAT deductions of all group members to arrive at a single consolidated MTI, which can be below zero as a result of current-year losses. This method is fair and reasonable for the majority of consolidated group filers, which do not file life/non-life consolidated returns. However, this method is not fair and reasonable for life/non-life consolidated return filers, as it does not consider the special subgroup rules for computing taxable income under Treas. Reg. §1.1502-47. Under the applicable rules, each subgroup (life and non-life) computes its consolidated taxable income by applying the rules in Treas. Reg. §1.1502-11. See Treas. Reg. § 1.1502-47(h). As part of that calculation, each subgroup is required to use its own NOL carry forward or carry back determined as if the subgroup was the group. See Treas. Reg. § 1.1502-47(h)(2)(iv), -47(k)(5), -47(l)(3). This treatment is required even if the other subgroup has a current year loss because of unique current-period loss absorption rules for life/non-life groups. See, e.g., Treas. Reg. § 1.1502-47(h)(2)(iii) and (v), -47(k)(5)(i) and (ii). For example, the regulations provide for offsets of losses between the subgroups because of the statutory restrictions in section 1503(c)(1) and (2) on the use of non-life subgroup NOLs. Because of these unique rules and the treatment of losses as offsets rather than a single consolidated taxable income calculation, consolidated taxable income as defined in Treas. Reg. § 1.1502-47(g) – and thus MTI – cannot be below zero as a result of current-period losses; thus, life/non-life consolidated group filers are disadvantaged vis-à-vis consolidated filers that do not file as a life/non-life group.

Insurance Europe understands and appreciates that US Treasury is aware of this disparity in treatment and may be working on corrective measures. As a temporary measure, however, we recommend allowing life/non-life consolidated group filers to elect to follow the statute in calculating MTI, (i.e., use a recomputation approach and allow NOLs to increase or create negative taxable income) rather than the alternate, add-back approach in the proposed (or final) regulations. Insurance Europe proposes that the election be permitted until corrective measures are in place to prevent this disparity in treatment.

Insurance Europe is the European insurance and reinsurance federation. Through its 34 member bodies — the national insurance associations — Insurance Europe represents all types of insurance and reinsurance undertakings, eg pan-European companies, monoliners, mutuals and SMEs. Insurance Europe, which is based in Brussels, represents undertakings that account for around 95% of total European premium income. Insurance makes a major contribution to Europe's economic growth and development. European insurers generate premium income of more than €1 200bn, directly employ over 950 000 people and invest over €10 100bn in the economy.