

**CAPTIVE INSURANCE COUNCIL
OF THE DISTRICT OF COLUMBIA**

**CURRENT STATE AND FEDERAL
TAX CONSIDERATIONS**

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DIRECT PROCUREMENT TAXES

DIRECT PROCUREMENT TAXES

- **DIRECT PLACEMENT**
 - **INSURED DIRECTLY ACCESSES UNLICENSED UNAPPROVED INSURER**
 - **LIMITATION RE: ACTIVITIES IN STATE**
 - **TAX IMPOSED ON INSURED**
 - **FILINGS**
 - **INSURER NOT CONSIDERED TO BE DOING BUSINESS**

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DIRECT PROCUREMENT TAXES

DIRECT PROCUREMENT TAXES

- INDUSTRIAL INSURED
 - INSURER CAN ACCESS INDUSTRIAL INSURED IN STATE
 - DEFINITION OF INDUSTRIAL INSURED
 - TAX IMPOSED ON INSURED
 - FILINGS
 - INSURER NOT CONSIDERED TO BE DOING BUSINESS IN THE STATE
 - NOTE: FEDERAL INCOME TAX ISSUE

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PRE-DODD FRANK

DIRECT PROCUREMENT TAXES

- APPLICABILITY
 - CAPTIVES
 - FOREIGN
 - ALIEN
 - MULTI-OWNER
 - SINGLE PARENT
 - CELL

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PRE-DODD FRANK

DIRECT PROCUREMENT TAXES

- APPLICABILITY
 - CAPTIVES
 - INDEPENDENTLY INCORPORATED CELL
 - SPONSORED
 - COMMERCIAL
 - BUT, RISK RETENTION GROUP

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PRE-DODD FRANK

DIRECT PROCUREMENT TAXES

- *STATE BOARD OF INSURANCE v. TODD SHIPYARDS CORP.*,
370 U.S. 451 (1962)
- BUT, *ASSOCIATED ELECTRIC & GAS INSURANCE SERVICES,*
LTD. v. CLARK, 676 A.2d 1357 (1996)

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DODD FRANK

- **NONADMITTED AND REINSURANCE REFORM ACT OF 2010 (“NRRA”)**
 - PREEMPTION
 - APPLIES TO NONADMITTED INSURANCE (P&C PLACED DIRECTLY WITH NONADMITTED INSURER)
 - PREMIUM TAX DEFINITION IS BROADLY DEFINED INCLUDING, *e.g.*, TAX, FEE ASSESSMENT, ETC., DIRECTLY OR INDIRECTLY IMPOSED ON ANY PAYMENT OR CONSIDERATION FOR AN INSURANCE CONTRACT

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DODD FRANK

NRRA – DEFINITION OF HOME STATE

- *HOME STATE* MEANS WITH RESPECT TO AN INSURED THE STATE IN WHICH AN INSURED MAINTAINS ITS PRINCIPAL PLACE OF BUSINESS OR, IN THE CASE OF AN INDIVIDUAL, THE INDIVIDUAL'S PRIMARY RESIDENCE; OR

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DODD FRANK

NRRA – DEFINITION OF HOME STATE

- *HOME STATE* MEANS WITH RESPECT TO AN INSURED:
 - IF 100 PERCENT OF THE INSURED RISK IS LOCATED OUT OF THE STATE REFERRED TO IN CLAUSE (I), THE STATE TO WHICH THE GREATEST PERCENTAGE OF THE INSURED'S TAXABLE PREMIUM FOR THAT INSURANCE CONTRACT IS ALLOCATED, **PROVIDED, HOWEVER, IF MORE THAN 1 INSURED FROM AN AFFILIATED GROUP ARE NAMED INSUREDS ON A SINGLE NON-ADMITTED INSURANCE CONTRACT**, THE TERM "HOME STATE" MEANS THE HOME STATE, AS DETERMINED PURSUANT TO SUBPARAGRAPH (A), OF THE MEMBER OF THE AFFILIATED GROUP THAT HAS THE LARGEST PERCENTAGE OF PREMIUM ATTRIBUTED TO IT UNDER SUCH INSURANCE CONTRACT.
- § 527(6)
- NOTE: KEYS IN ON POLICY

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INDIVIDUAL STATE ISSUES

WASHINGTON STATE

- NO DIRECT PLACEMENT OR INDUSTRIAL INSURED STATUTE
- 2% TAX IMPOSED ON INSURER WITH RESPECT TO PREMIUM ON WASHINGTON STATE RISK
- MICROSOFT
- COSTCO
- SELF-REPORTING REQUIREMENT

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INDIVIDUAL STATE ISSUES

WASHINGTON STATE

- ALASKA AIRLINES
- STARBUCKS CORPORATION
- LEGISLATIVE PROPOSALS
- PROCEEDINGS SUSPENDED
- STUDY UNDERTAKEN (NOTE: RFP)
- NEW LEGISLATION 2021

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INDIVIDUAL STATE TAX ISSUES

NEW JERSEY

- ***JOHNSON & JOHNSON v. DIRECTOR***
 - IPT IMPOSED IN N.J. ON PREMIUM PAID TO NON-ADMITTED CAPTIVE. J&J BEGAN PAYING TAX IN 2008 FOR YEARS BEGINNING WITH 2005. PAID ONLY ON N.J. PORTION
 - IN 2011, AFTER NRRA, PAID TAX ON 100% OF PREMIUM

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INDIVIDUAL STATE TAX ISSUES

NEW JERSEY

- ***JOHNSON & JOHNSON v. DIRECTOR***
 - J&J MADE CLAIM FOR APPROXIMATELY \$55,000,000 PLUS INTEREST ASSERTING THAT THE N.J. STATUTE IN RESPONSE TO NRRA WAS INTENDED TO APPLY ONLY TO SURPLUS LINES AS IT ONLY REFERS TO SURPLUS LINES, AND, AS SUCH, THE TAX SHOULD ONLY APPLY TO PREMIUM RELATING TO N.J. RISK
 - COURT CONCLUDED THE LEGISLATION WAS INTENDED TO APPLY TO BOTH SURPLUS LINES AND NON-ADMITTED PREMIUM

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INDIVIDUAL STATE TAX ISSUES

NEW JERSEY

- ***JOHNSON & JOHNSON v. DIRECTOR***
 - ON APPEAL, THE SUPERIOR COURT, APPELLATE DIVISION (“SUPERIOR COURT”) DISAGREED
 - THE SUPERIOR COURT STATED FOLLOWING PRIOR DECISIONS THEY LOOKED TO LANGUAGE OF THE STATUTE, OR IF NOT CLEAR LEGISLATIVE HISTORY, AND GIVEN THERE IS NONE, MUST INTERPRET THE STATUTE TO APPLY ONLY TO SURPLUS LINES TAX

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INDIVIDUAL STATE TAX ISSUES

NEW JERSEY

— *JOHNSON & JOHNSON v. DIRECTOR*

— AS SUCH, THE SUPERIOR COURT HELD THAT THE NEW JERSEY LEGISLATION APPLICABLE BEFORE THE NRRA WAS ENACTED WAS APPLICABLE, AND THAT IT ONLY ALLOWED THE STATE TO COLLECT TAX ON THE PORTION OF PREMIUM APPLICABLE TO NEW JERSEY RISK

— NOTE: APPEAL BY NEW JERSEY

— CHECK OTHER STATES

- COMPARE MINNESOTA STATUTE

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INDIVIDUAL STATE INCOME TAX ISSUES

— GENERAL EXCLUSION FOR INSURANCE COMPANIES

— CASES ADDRESSING EXCLUSION

— *UNITED PARCEL SERVICE, INC. v. INDIANA DEPT. OF STATE REVENUE*, 995 N.E.2d 20 (2013)

— *COSTCO WHOLESALE CORP. v. DEPARTMENT OF REVENUE*, 2012 WL 2992959, 20 Or. 537 (2012)

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INDIVIDUAL STATE INCOME TAX ISSUES

— CASES ADDRESSING EXCLUSION

- *WENDY'S INTERNATIONAL, INC. v. BRIAN HAMER, et al.*, 375 Ill. Dec 194, 996 NE2d 1250 (2013)
- *SCIOTO INSURANCE COMPANY v. OKLAHOMA TAX COMMISSION*, 2012 OK 41, 279 P.3d 782
- *RENT-A-CENTER, INC. & SUBSIDIARIES v. DEPARTMENT OF REVENUE* (2014)

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INDIVIDUAL STATE INCOME TAX ISSUES

— ILLINOIS LEGISLATION TO OVERTURN *WENDY'S* DECISION

— NEW YORK "OVERSTUFFED" RULE

- DEFINITION OF PREMIUM AS BASED ON FEDERAL
- *STEWART SHOPS CORPORATION* (N.Y. DIV. TAX APPEALS)
- *IN RE MOODY'S CORPORATION & SUBSIDIARIES*

- *CONTROLLER v. LEADVILLE INS. CO.* (UNREPORTED IN COURT OF SPECIAL APPEALS OF MD), NO. 2184, SEPTEMBER TERM 2017, MARCH 26, 2019, ON APPEAL

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INTERNATIONAL

- WHAT WILL WE COVER?
 - CONTROLLED FOREIGN CORPORATIONS
 - PASSIVE FOREIGN INVESTMENT COMPANY
 - BASE EROSION AND ANTI-ABUSE TAX
 - FEDERAL EXCISE TAX
 - FOREIGN ACCOUNT TAX COMPLIANCE ACT
 - DOMESTIC ELECTION
- WHY DO YOU CARE?
 - DOMICILE CONSIDERATIONS FOR YOU, YOUR CLIENTS, AND YOUR CONSULTANTS

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WHY CONSIDER A NON-U.S. CAPTIVE

- REGULATORY AND TAX CONSIDERATIONS
 - WHAT IS THE BEST DOMICILE FOR YOUR CAPTIVE FROM A REGULATORY PERSPECTIVE?
 - WHAT ARE THE TAX CONSEQUENCES OF YOUR DOMICILE OPTIONS?
 - IF NON-U.S., ARE THERE DEFERRAL OPPORTUNITIES?
 - SHOULD YOU GO OFFSHORE FROM A REGULATORY PERSPECTIVE BUT ELECT TO COME ONSHORE FOR TAX PURPOSES? IS THIS THE BEST OF BOTH WORLDS?
- DECISION TO FORM OUTSIDE THE U.S. IMPACTS HOW THE CAPTIVE WILL OPERATE – BEYOND BOARD MEETINGS

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TAX MANAGEMENT / NON-U.S. CAPTIVE

- U.S. TRADE OR BUSINESS
 - DIRECT U.S. TAXATION IF CAPTIVE HAS U.S. TAX NEXUS
 - REGULAR AND CONTINUOUS ACTIVITY
 - EMPLOYEES AND AGENTS
 - BRANCH PROFITS TAX – 44.7% EFFECTIVE TAX RATE
- DECISION TO BE NON-U.S. REQUIRES VIGILANCE.

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TAX REGIME FOR NON-U.S. CAPTIVES

- NON-U.S. CAPTIVES ARE SUBJECT TO A SERIES OF U.S. TAX RULES
 - ANTI-DEFERRAL RULES
 - CONTROLLED FOREIGN CORPORATION
 - PASSIVE FOREIGN INVESTMENT COMPANY
 - ANTI-BASE EROSION RULES
 - BASE EROSION ALTERNATIVE TAX
 - COMPLIANCE BURDEN
 - FEDERAL EXCISE TAX
 - FOREIGN ACCOUNT TAX COMPLIANCE ACT
- DECISION IS COMPLEX

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CONTROLLED FOREIGN CORPORATION

—IF THE CAPTIVE IS A CONTROLLED FOREIGN CORPORATION (“CFC”), U.S. SHAREHOLDERS WILL GENERALLY BE TAXED ON THEIR ALLOCABLE SHARE OF THE CFC’S INCOME

- CLASSIC INSURANCE CFC
 - U.S. SHAREHOLDERS INDIVIDUALLY OWNING 10% OR MORE OF THE VOTE OR VALUE OF THE CAPTIVE COLLECTIVELY OWN MORE THAN 25% OF THE VOTE OR VALUE OF THE CAPTIVE, TAKING INTO ACCOUNT ATTRIBUTION
- LIMITED EXCEPTION FOR INSURING RISKS IN CFC’S HOME JURISDICTION
- GENERAL CFC
 - IF NOT WRITING INSURANCE, REQUIREMENT IS 50% (INSTEAD OF 25%)

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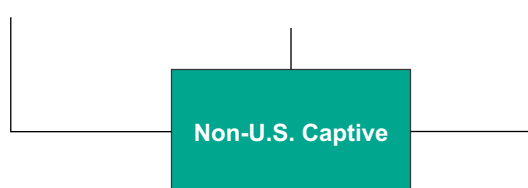
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CONTROLLED FOREIGN CORPORATION

Non-U.S. Shareholders
(Unlimited)

US Shareholders
(10% or more vote or value, and more than 25% aggregate vote or value)

US Shareholders
(Unlimited)
(Less than 10% vote or value)
(but see RPII CFC)



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CONTROLLED FOREIGN CORPORATION

- RELATED PERSON INSURANCE INCOME ("RPII") CFC
 - ADDRESSES THE 11 MEMBER GROUP CAPTIVE, WHERE CAPTIVE INSURES RELATED PARTY RISK, BUT NO U.S. 10% OWNERS
 - RPII IS DEFINED AS UNDERWRITING AND INVESTMENT INCOME ATTRIBUTABLE TO A POLICY OF INSURANCE OR REINSURANCE IF THE INSURED IS: (I) A U.S. SHAREHOLDER OR (II) "RELATED" TO A U.S. SHAREHOLDER (INCLUDES CFC INCOME FROM INSURING NON-U.S. RELATED PERSONS)
 - "RELATED" = >50% OWNERSHIP INTEREST
- U.S. SHAREHOLDERS TAXED ON RPII IF THE U.S. SHAREHOLDERS (*REGARDLESS OF THEIR OWNERSHIP LEVELS*) OWN 25% OR MORE OF THE VOTE OR VALUE OF THE CAPTIVE, IN THE AGGREGATE, TAKING INTO ACCOUNT ATTRIBUTION

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CONTROLLED FOREIGN CORPORATION

- RPII CFC
 - U.S. SHAREHOLDER DOES NOT HAVE TO BE INSURED OR RELATED TO AN INSURED TO RECEIVE A RPII ALLOCATION
 - RPII ALLOCATED FIRST TO U.S. SHAREHOLDERS, UP TO THEIR PROPORTIONATE SHARE OF TOTAL CFC INCOME
 - CFC CAN ELECT TO PAY U.S. TAX RESULTING FROM RPII DIRECTLY, AS U.S. TRADE OR BUSINESS INCOME, RATHER THAN HAVING ITS U.S. SHAREHOLDERS REPORT THE INCOME
 - ELECTION ALSO EXEMPTS U.S. RISK PREMIUMS FROM FEDERAL EXCISE TAX

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CONTROLLED FOREIGN CORPORATION

- RPII CFC
 - EXCEPTIONS TO RPII CFC STATUS
 - DE MINIMIS INCOME EXCEPTION: LESS THAN 20% OF CFC'S GROSS INSURANCE INCOME IS RPII (*I.E.*, INCOME FROM INSURING US SHAREHOLDERS OR PERSONS RELATED TO THE US SHAREHOLDERS)
 - OWNERSHIP EXCEPTION: LESS THAN 20% OF CFC SHARES (VOTE AND VALUE) ARE OWNED BY US INSUREDS OR PERSONS RELATED TO INSUREDS

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PASSIVE FOREIGN INVESTMENT CORPORATION

- IF THE CAPTIVE IS A PFIC, U.S. PERSONS OWNING SHARES ARE TAXED ON EXCESS DISTRIBUTIONS, AND GAINS ON SALE OF STOCK, AS IF EARNED RATABLY OVER OWNERSHIP PERIOD, PLUS INTEREST
 - A NON-U.S. CORPORATION IS A PFIC IF 75% OR MORE OF THE COMPANY'S GROSS INCOME IS PASSIVE, OR
 - 50% OR MORE OF THE COMPANY'S ASSETS ARE HELD FOR PRODUCTION OF PASSIVE INCOME
- SOUNDS LIKE EVERY INSURANCE COMPANY . . . BUT THERE ARE EXCEPTIONS!

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EXCEPTIONS

- PFIC RULES ARE ONEROUS BUT DON'T APPLY TO MANY CAPTIVES
 - PFIC RULES WON'T APPLY TO 10% OR GREATER U.S. SHAREHOLDERS OF A CFC
 - PFIC RULES WON'T APPLY TO INCOME DERIVED BY A FOREIGN CORPORATION IN THE ACTIVE CONDUCT OF AN INSURANCE BUSINESS, PROVIDED THAT THE COMPANY IS A "QUALIFYING INSURANCE COMPANY"
 - U.S. SHAREHOLDERS CAN ELECT OUT OF DEFERRAL
- PFIC EXCEPTIONS ARE MECHANICAL . . . SORT OF

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QUALIFYING INSURANCE COMPANY

- A QUALIFYING INSURANCE COMPANY ("QIC") MUST MEET TRADITIONAL INSURANCE COMPANY TESTS AND MUST MEET A MECHANICAL TEST
 - APPLICABLE INSURANCE LIABILITIES ARE MEASURED AGAINST TOTAL ASSETS
 - 25% SAFE HARBOR
 - 10% FACTS AND CIRCUMSTANCES (AVAILABLE FOR RUNOFF-RELATED OR RATING-RELATED CIRCUMSTANCES)
 - PROPOSED TREASURY REGULATIONS INJECT AMBIGUITY INTO THESE TESTS
- PFICS AND QICS – PROCEED WITH CAUTION!

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BASE EROSION AND ANTI-ABUSE TAX

—THE BEAT IS A NEW CORPORATE ALTERNATIVE MINIMUM TAX THAT RECALCULATES TAX AFTER DISALLOWING CERTAIN DEDUCTIONS

- APPLIES TO TAXPAYERS IN A CONTROLLED GROUP WITH:
 - AVERAGE ANNUAL GROSS RECEIPTS IN EXCESS OF \$500 MILLION OVER THE PRIOR THREE YEARS; AND
 - A GROUP “BASE EROSION PERCENTAGE” (“BEP”) OF 3% OR MORE
- BEP COMPARES DISALLOWED DEDUCTIONS TO ALL DEDUCTIONS (WITH CERTAIN REDUCTIONS)

—THE BEAT IS A CLIFF . . . TAKE CARE TO NOT FALL OFF!

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FEDERAL EXCISE TAX

—APPLIES TO PREMIUMS PAID BY U.S. PERSONS (INCLUDING A U.S. CAPTIVE), TO NON-U.S. INSURERS OR REINSURERS, WITH RESPECT TO A POLICY FOR RISKS WHOLLY OR PARTLY IN THE U.S.

- FET RATE IS 4% FOR DIRECT INSURANCE AND 1% FOR LIFE INSURANCE AND ALL REINSURANCE
 - FET APPLIES TO GROSS PREMIUMS

—FET IS AN EASY AUDIT TARGET!

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FOREIGN ACCOUNT TAX COMPLIANCE ACT

- THE FOREIGN ACCOUNT TAX COMPLIANCE ACT (“FATCA”) PROVISIONS ARE BROADLY DESIGNED TO REQUIRE INFORMATION REPORTING TO PREVENT TAX EVASION BY U.S. INDIVIDUALS THROUGH THE USE OF NON-U.S. ACCOUNTS
 - REQUIRES 30% WITHHOLDING ON “WITHHOLDABLE PAYMENTS” TO FOREIGN FINANCIAL INSTITUTIONS (“FFI”) AND NON-FINANCIAL FOREIGN ENTITIES (“NFFE”) WHEN A W-8BEN-E IS NOT PROVIDED
 - PROPOSED REGULATIONS INDICATE PREMIUM IS NOT A WITHHOLDABLE PAYMENT
- MOST NON-LIFE CAPTIVES WILL BE NFFEs

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DOMESTIC ELECTION – SECTION 953(d)

- CERTAIN NON-U.S. CAPTIVES CAN ELECT TO BE TAXED AS A DOMESTIC CORPORATION UNDER SECTION 953(d)
 - MUST BE AN INSURANCE COMPANY UNDER TRADITIONAL TESTS
 - MUST MET SPECIFIED OWNERSHIP REQUIREMENTS – U.S. SHAREHOLDERS MUST COLLECTIVELY OWN, BY VOTE OR VALUE, 25% OR MORE OF THE SHARES OF THE CAPTIVE
- A SECTION 953(d) CAPTIVE IS TREATED AS A U.S. CORPORATION FOR ALL FEDERAL TAX PURPOSES . . . THERE ARE CONSEQUENCES TO MAKING AND LOSING THE ELECTION

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DOMESTIC ELECTION – SECTION 953(d)

- THERE ARE CONSEQUENCES TO MAKING AND LOSING THE ELECTION
 - MUST WAIVE U.S. TREATY BENEFITS
 - MUST MEET REQUIREMENTS TO PAY TAXES
 - MUST FILE AN ELECTION AND MUST EITHER MAINTAIN AN OFFICE OR POST A LETTER OF CREDIT
 - IF THE CAPTIVE LOSES ITS SECTION 953(d) ELECTION, IT IS AN OUTBOUND TRANSACTION FOR U.S. TAX PURPOSES
- THE SECTION 953(d) ELECTION DOES NOT MEAN THE CAPTIVE IS LICENSED IN THE U.S. . . . THE ELECTION IS A U.S. TAX ELECTION ONLY

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DOMESTIC ELECTION – SECTION 953(d)

- WHY MAKE THE ELECTION? MAY ALREADY BE SUBJECT TO TAX IN THE U.S.
 - AVOID THE BRANCH PROFITS TAX AND THE FET (ON ASSUMED PREMIUM)
 - REGULATORY REGIME
 - DIVIDENDS RECEIVED DEDUCTION (CORPORATE)
 - REDUCED TAX RATE (INDIVIDUAL)
 - AVAILABILITY OF THE SECTION 831(b) ELECTION
 - JOIN CONSOLIDATED GROUP
- TO REPEAT - THE SECTION 953(d) ELECTION DOES NOT MEAN THE CAPTIVE IS LICENSED IN THE U.S.

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INTERNATIONAL . . . WRAPPING IT UP

- THERE ARE BENEFITS TO FORMING A NON-U.S. CAPTIVE, BUT THEY MUST BE WEIGHED CAREFULLY AGAINST THE RISKS
 - THERE MAY BE OPPORTUNITIES TO COVER MORE INSURED AND MORE RISKS
 - THERE MAY BE REDUCED REGULATORY CAPITAL . . . BUT THERE ARE ALWAYS REQUIRED RESERVES TO FIT THE COVERAGE
 - THERE IS AN INCREASED COMPLIANCE BURDEN
 - THERE ARE TAX CONSEQUENCES TO BEING NON-U.S. AT INCEPTION, TO CHANGING FROM U.S. TO NON-U.S. AND VICE-VERSA
 - THERE ARE PERCEPTION CONSIDERATIONS

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