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United States Senate
COMMITTEE ON FINANCE
WASHINGTON, DC 20510–6200

September 11, 2014

The Honorable Jacob J. Lew
Secretary of the Treasury
1500 Pennsylvania Ave. NW
Washington, D.C. 20220

Dear Secretary Lew:

Thank you for the Department's response to my June 12, 2014 letter concerning the offshore insurance loophole that allows some U.S. taxpayers, primarily hedge fund investors, to defer paying taxes or otherwise avail themselves of preferential tax treatment by setting up off-shore passive investment vehicles masquerading as insurance companies. I'm encouraged that the Treasury Department and the IRS are concerned about this tax loophole and are exploring administrative and legislative remedies to address the practice; however, as I noted in my letter, this has been a long-standing problem and action needs to be taken sooner rather than later to address it. While there may not be a bright line between what constitutes an active insurance company and what constitutes a passive investment vehicle, I am concerned that under current tax administration practices and constraints there isn't any line at all.

Earlier this year, I asked the Joint Committee on Taxation (JCT) to compile background information about the offshore insurance loophole (attached). Using data compiled from publicly available financial reports of insurance companies filed with the Bermuda Monetary Authority (BMA), JCT identified at least two U.S. hedge fund-backed reinsurance companies -- S.A.C.Re, Ltd.[1] and PaCRe, Ltd. — that in 2012 had insurance liability-to-asset ratios on the order of 1% or less.[2] In 2013, PaCRe's insurance liability-to-asset ratio decreased further to 0.6%, according to the company's most recent financial report posted by BMA, indicating this low ratio was not an anomaly.[3] I am skeptical that entities reporting such low ratios of insurance liabilities to total assets can be considered to be predominantly in the reinsurance business under the Internal Revenue Code.

Treasury's response also noted that a lack of foreign reporting requirements for off-shore insurance entities make it more difficult for the IRS to accurately determine whether an offshore insurance company is truly an insurance company or simply a tax-sheltered investment scheme.

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[1] Now operating as hedge fund-linked HamiltonRe.
[2] For 2012, PacRe and SAC Re had insurance liabilities-to-asset ratios of 0.7% and 1.1% respectively.
[3] PaCRe, Ltd. Consolidated Financial Statements, For the year ended December 31, 2013 and for the period from November 18, 2011 (date of incorporation) to December 31, 2012 (expressed in U.S. dollars), http://www.bma.bm/Insurance/Filings/2013%20FULL%20FILINGS%20CLASS%204/PaCRe,%20Ltd.pdf

However, as noted above in the case of Bermuda, some publicly reported information is available for offshore insurance companies. Please identify which jurisdictions do not provide adequate information, accessible to Treasury, necessary to determine U.S. tax compliance for investors in offshore insurance companies and the nature of the information withheld.

In my June letter, I also asked Treasury and the IRS to identify any additional authority needed to end these abuses. In the attached memorandum, JCT has analyzed the impact of two proposals to help close off this loophole—one by Chairman Camp and one by my predecessor, Chairman Baucus. Both are aimed at creating a clearer and more restrictive definition of what would constitute an active insurance business. JCT noted that of the 30 Class 4 insurance companies regulated by Bermuda in 2012, seven would clearly fail the new standard set by these proposals including the two cited above—PaCRe and S.A.C.Re. Please provide the Department's views on the relative merits of the Camp and Baucus proposals as well as any other proposals, including both legislative and administrative options (such as issuance of further guidance), which Treasury believes would be effective in closing this tax loophole.

Please provide your responses no later than October 2, 2014. If you or your staff has questions concerning this matter, please contact Todd Metcalf, Chief Tax Counsel, or David Berick, Chief Investigator, on the Finance Committee majority staff.

Sincerely,

Ron Wyden

Ron Wyden
Chairman

Attachment