



Embassy  
of the Federal Republic of Germany  
Washington

The Honorable  
Max Baucus  
Chairman  
Senate Finance Committee  
United States Senate

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**Subject: Senate Finance Committee Staff Discussion Draft on Tax Treatment of Related Party Reinsurance Premiums**

Dear Senator Baucus,

I am writing you today to express the German Government's concerns over a legislative bill prepared by the staff of the Senate Finance Committee and submitted to the public on December 10, 2008, with the request for comment by February 28, 2009. The bill essentially denies U.S. insurance companies tax deductibility of the reinsurance premiums they pay to related foreign insurance companies if those premiums exceed the industry average of reinsured policies, as more specifically defined in the draft law.

It goes without saying that the German Government respects the independence of the U.S. Congress in writing tax laws and recognizes the need to fight international tax evasion. But, in reference to the request for comment issued by the Senate Finance Committee, it would like, with all due respect, to draw your attention to the law's implications for German-American treaty and economic relations.

In our view, such legislation would not be consistent with generally recognized principles of international tax law, nor would it be in accord with fundamental elements of the German-American double taxation convention. Its consistency with WTO principles is also questionable.

The provision is said to be directed against tax avoidance and evasion by insurance companies, aided by their related companies located in low-tax or non-taxing jurisdictions. Due to the bill's general scope of application, it would, however, also affect companies that reinsure themselves with their related companies headquartered in normal-taxing jurisdictions, such as Germany. This provision would not only lead to a clear disadvantage for U.S. insurance companies related to reinsurance companies in Germany. It would also violate the arms-length principle generally applied in international tax law and the prohibition on discrimination set forth in the German-American double taxation convention, the newest version of which the U.S. Senate only just approved in December 2007.

The arms-length principle is enshrined in Article 9, Section 1 of the German-American double taxation convention. It states that related companies are to be taxed with respect to their mutual business relations and the transactions conducted between them according to the same conditions that would apply to two unrelated third parties. Viewing industry averages as arms length would not be compatible with this principle, because it would disregard individual circumstances that are crucial to price formation. Even OECD guidelines require that individual circumstances be taken into account. The bill's approach of using industry averages is thus incompatible with Article 9, Section 1 of the German-American double taxation convention. The proposed provisions would, in effect, lead to double taxation.

A law similar to the bill would prevent a U.S. insurance company from deducting the reinsurance premiums it pays to a related German insurance company in the same way as it would be able to deduct fees paid to a U.S. insurance company when calculating taxable profits. Such a law would not be consistent with Article 24, Section 3 of the German-American double taxation convention. Furthermore, U.S. insurance companies that are related to German insurance companies in such a way that their capital is wholly or partly owned or controlled, directly or indirectly, by a German insurance company would be subject to taxation in the U.S. that would be more burdensome than the taxation to which other U.S. insurance companies would be subject. Consequently, such a law would not be consistent with Article 24, Section 4 of the German-American double taxation convention.

As a possible remedy, the legislation grants the foreign insurance company the option of avoiding the tax disadvantage arising from the related U.S. insurance company by allowing the foreign company to elect to be treated as a domestic corporation for U.S. tax purposes. Yet this provision also applies U.S. tax law in a manner which is incompatible with the principles laid down in Article 7, Section 1 of the German-American double taxation convention.

The German Government furthermore has concerns about the bill's compatibility with WTO principles, particularly with a view to the obligations related to the General Agreement on Trade in Services (GATS). Specifically, the German Government would like to refer to the relevant obligations concerning national treatment.

I would be grateful if you could take into account the concerns of the German Government in your deliberations as you continue to discuss this legislative bill.

Sincerely,



*copies:*

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