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Embassy of Switzerland in the United States of
America

The Honorable Max Baucus
Chairman, Senate Finance Committee
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510-6200

Ref. 461.20 - GHE
Washington D.C., February 20, 2009

Staff Draft on Related Party Reinsurance

Dear Mr. Chairman:

I am writing to express my Government's concern about a draft that was released on December 10, 2008 by the Senate Finance Committee staff on the issue of related party reinsurance. Its intention is to limit the deductibility of reinsurance premiums within related companies. In that regard I would like to bring to your attention some of the Swiss Government's concerns about the draft.

The proposed adjustment would prevent the deduction of any reinsurance premiums paid to affiliated companies located outside the U.S. that are above the amount allowed annually by the U.S. Treasury Department. Reinsurance is a business in an internationalized market where risks are transferred globally. The degree of globalization is higher than in most other industries. The worldwide transfer encompasses not only income and potential profits, but also losses and claims. The proposed draft would not only have a detrimental impact on the business model in this market, but would also have adverse effects on the U.S. economy. Faced with these increased costs, reinsurers would likely either move capital to regions less expensive than the US or increase premiums. Either way, the burden is passed on ultimately to the U.S. consumer in the form of higher insurance premiums since the capital base needed to support US risks would be restricted to that of US insurance and reinsurance companies. International reinsurance companies covered a large amount of the damage caused by the 9/11 terrorist attacks and by major hurricanes such as Katrina and Ike. The staff proposal would severely limit both the availability and affordability of coverage for such disasters in the future.

In our judgment the draft is incompatible with the Double Taxation Convention between the U.S. and Switzerland since the proposal violates the non-discrimination principle stated in Article 24 of the Convention. According to paragraph 2a an affiliate of a Swiss enterprise in the U.S. shall not be taxed more unfavorably than a U.S. enterprise. Paragraph 3 indicates that disbursements to a resident in the other Contracting State shall be deductible for determining the taxable profits to the same extent as disbursements paid to a resident. Therefore, reinsurance premiums ought to be deductible for an insurance company that does business in the U.S. regardless of whether or not the recipient is a related entity as long as the transactions are carried out under similar conditions as if they were independent entities, and regardless of the location of this entity. Finally, paragraph

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4 states that a company the capital of which is wholly or partly owned or controlled by residents of Switzerland shall not be subjected to more burdensome taxation than similar U.S. companies.

I am also concerned that the proposed provisions would constitute a breach of the U.S. obligations under the WTO. Art. XVII (National treatment) of the WTO General Agreement on Trade in Services (GATS) provides for a national treatment obligation for all services for which members have undertaken specific commitments. The US schedule of specific commitments provides for national treatment for the cross-border provision of reinsurance services, except that "a one percent federal excise tax is imposed on all premiums covering US risks that are paid to companies not incorporated under US law, except for premiums that are earned by such companies through an office or dependent agent in the US". Except for this excise duty, the conditions of operation in the U.S. for American and foreign companies should, in law or in fact, be the same. As outlined above, we believe that the proposal, by limiting the ability of insurance companies to reinsure their risk portfolio with related companies abroad, is creating a discrimination against imported reinsurance services.

Article XIV (General exception) provides that "nothing in this agreement shall be construed to prevent the adoption or enforcement by any Member of measures [...] inconsistent with Article XVII, provided that the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or services suppliers of other Members". It is our view that this provision is typically meant to address different procedural measures in the collection of taxes due by non-residents as opposed to resident persons. It is not meant to justify discriminatory treatments between residents and non-residents.

I would like to emphasize my concerns regarding the draft proposal on related party insurance since it would be detrimental to the international conduct of global insurance, it would enhance the cost of insurance coverage for U.S. consumers, it would discriminate against internationally operating companies, and it would conflict with bilateral and multilateral conventions to which the U.S. is a party.

My Government appreciates this opportunity to comment. I stand ready to discuss this matter with you or your staff at any time.

Sincerely,

The Ambassador of Switzerland



Urs Ziswiler

cc: Senator Charles Grassley, Ranking member, Senate Finance Committee