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MEMORANDUM

July 19, 2012

TO: Excess Line Association of New York

FROM: Sutherland Asbill & Brennan LLP

RE: **Federal Insurance Excise Tax Bulletin/Reporting and Treaties**

I. General Discussion of the Federal Insurance Excise Tax

Pursuant to sections 4371 et seq. of the Internal Revenue Code of 1986, as amended (the "Code"), the federal insurance excise tax ("FET") is imposed at a four percent rate on direct (i.e. not reinsurance) placements with non-U.S. insurers of non-life insurance.

Any party to the transaction (including the broker) can be held liable for the tax. The last domestic party in the chain of premium payment, (e.g., the excess line broker) is primarily responsible for remitting the tax to the Internal Revenue Service ("IRS"), although the insured as well as the non-U.S. insurer is also considered liable for the FET.¹

II. Reporting and Payment

A. Reporting

Quarterly FET returns must be filed on a Form 720. This reporting requirement is waived for persons claiming that no FET is due because of a treaty exemption (as discussed below) provided that certain requirements are met.² Such return is due for the first quarter in which an FET liability arises and for all subsequent quarters (whether or not an FET liability

¹ The IRS also takes the position that the FET is applicable to transactions between two non-U.S. insurance companies.

² Generally, the non-U.S. insurer/reinsurer must have entered into a closing agreement with the IRS and such insurer/reinsurer must meet its filing requirement with regard to Form 720.

exists for the quarter).³ The due dates for the returns are April 30th, July 31st, October 31st and January 31st. The return should be filed with the Department of the Treasury, Internal Revenue Service, Cincinnati, OH 45999-0009 and should be mailed so that the postmark is no later than the due date. The U.S. Postal Service, Federal Express, United Parcel Service or DHL Express may be utilized. Written proof of the mailing date should be retained.

B. Payment

Payment of the FET must be made by semimonthly deposits. The deposits must be made by the fourteenth day following the end of the semimonthly period (e.g., for the first semimonthly period, the deposit would be due on the 29th of the month).⁴ The tax liability for the semimonthly period may be computed by either (i) computing the net tax liability for the period, or (ii) computing the net tax liability for the month and dividing it by two provided that this method is used throughout the applicable calendar quarter. Generally, the amount of the deposit must equal at least 95 percent of the tax liability for the period, however, there are certain safe harbor provisions in this regard that, if met, will cause the tax to be treated as deposited for purposes of the penalty provisions.⁵ If the net tax liability for any calendar quarter is \$2,500 or less, no deposit is required for that quarter; rather, the amount due may be paid when the taxpayer files its quarterly FET return (discussed above).

FET deposits must be made under the Electronic Federal Tax Payment System ("EFTPS") (<https://www.eftps.gov/eftps/>). When a Taxpayer identification number ("TIN") is applied for, the taxpayer is automatically enrolled in the EFTPS and will receive instructions on how to activate the enrollment.

C. Treaty Exemptions

Certain tax treaties between the United States and the country in which an insurer is domiciled provide an exemption to the FET on either a qualified or a non-qualified basis. Attached hereto is a list of countries that have tax treaties with the United States that contain an FET exemption.

For example the Tax Treaty between the United States and Switzerland provides for a qualified exemption to the FET; premiums paid pursuant to a policy with a Swiss insurer would be exempt from the FET provided that the risks covered by the premiums are not reinsured with a person not entitled to the benefits of the U.S./Swiss treaty or any other treaty providing for an FET exemption. Additionally, the tax treaty between the United States and the United Kingdom (the "U.K. Treaty") contains a different form of exemption from the FET. Premiums are exempt from the FET provided that the subject policies are not entered into as part of a conduit

³ The IRS District Director has authority under this regulation, however, to require monthly or semimonthly returns if the taxpayer has failed to comply with the return or deposit requirements.

⁴ There are special rules for the September deposit periods. Generally, an additional deposit will be required for the second September semimonthly period, one deposit for the 16th-26th and another for the 27th-30th.

⁵ A safe harbor is available (subject to certain exceptions) if, among other requirements, deposits are timely, each is in an amount of at least 1/6 of the amount due for the previous quarter and any underpayments for a quarter must be paid by the due date of the return.

arrangement. A conduit arrangement means a transaction or series of transactions that is structured in such a way that all or substantially all of the premiums received by the U.K. resident company (that is entitled to the benefits of the U.K. treaty) are paid, directly or indirectly, to another person that is not entitled to the benefits of the U.K. treaty or a treaty with equivalent or more favorable benefits, and that has as its main purpose, or one of its main purposes, the obtaining of the increased benefits of the U.K. treaty. A few older treaties, such as the Treaty with Hungary, contain an unqualified exemption; premiums paid to a Hungarian insurer are exempt without regard to with whom they are reinsured.⁶

In instances in which the applicable treaty provides for an exemption, the policy is treated as exempt if the non-U.S. insurer enters into a closing agreement with the IRS (as required by Revenue Procedure 2003-78).⁷ Revenue Procedure 2003-78 sets forth procedures for establishing exemption from the FET under an applicable U.S. tax treaty. Under the procedures, a non-U.S. insurer or reinsurer may "self certify" that it is entitled to treaty benefits by providing a periodic statement under penalties of perjury that it satisfies both the residency and limitation on benefits provisions of an applicable treaty. This revenue procedure also provides two model forms of closing agreement: an agreement to be used by non-U.S. insurers or reinsurers eligible for the benefits of a treaty that contains a qualified FET waiver, and an agreement to be used by non-U.S. insurers or reinsurers eligible for the benefits of a treaty that contains an FET waiver subject to an anti-conduit arrangement limitation. The FET closing agreements contain provisions similar to those in the closing agreements set forth in prior revenue procedures and require, in relevant part, that a non-U.S. insurer or reinsurer agree to: (i) be liable as a U.S. taxpayer for, and pay, any FET on premiums received from policies that are (a) subsequently reinsured with a reinsurer not entitled to the benefits of a treaty with an FET exemption, or (b) in the case of the U.K. treaty, entered into as part of a "conduit arrangement;" (ii) retain records and make such records available for IRS inspection; (iii) file Form 720 (an FET return) with and make appropriate FET payments to the IRS; and (iv) provide a letter of credit in favor of the IRS.

A broker who has a copy of such a closing agreement in its files, will not be liable for FET should tax be found to be due on the placement.⁸

Non-U.S. insurers or reinsurers wishing to enter into an FET closing agreement with the IRS must submit a request for a closing agreement in accordance with the procedures set forth in Revenue Procedure 2003-78 and Revenue Procedure 2012-1,⁹ along with the applicable user fee (currently, \$8,000) and the following information and documentation:

- A statement signed under penalties of perjury that (i) the non-U.S. insurer or reinsurer is a resident of an applicable treaty country, specifying the name of the

⁶ Please note that a new treaty with Hungary has been signed but is not yet effective.

⁷ Under the terms of such a treaty, provided that an insurance company meets the requirements to be entitled to treaty benefits, the insurance company should be entitled to the FET exemption even though it has not entered into a closing agreement with the IRS.

⁸ The IRS has published a list of companies that have closing agreements; it can be found at <http://www.irs.gov/businesses/international/article/0,,id=246890,00.html> .

⁹ The Revenue Procedure relating to the general requirements for entering into a closing agreement is updated annually, for example the applicable closing agreement for 2011 was Revenue Procedure 2011-1.

treaty country, and (ii) that the non-U.S. insurer or reinsurer qualifies for treaty benefits under the limitation on benefits provision of such treaty, accompanied by an explanation of the basis upon which the non-U.S. insurer or reinsurer so qualifies.

- A letter of credit in favor of the IRS in the amount of \$75,000. (The IRS may require an increased amount under certain circumstances.)
- A completed Form SS-4 in order to request an employer identification number ("EIN") if the non-U.S. insurer or reinsurer does not already have an EIN.
- A list of the position titles of the persons who will be the responsible parties for performance under the FET closing agreement and the names, addresses, and telephone numbers of the persons in such positions as of the date the application is submitted.
- Three copies of a signed FET closing agreement identical to the applicable form of closing agreement appended to Revenue Procedure 2003-78.

Pursuant to Revenue Procedure 2003-78, a non-U.S. insurer or reinsurer that has an existing FET closing agreement obtained under a previous revenue procedure is no longer required to obtain a certificate of residence from the tax authority of its treaty country every three years and/or certify its eligibility for treaty benefits on an annual basis. Instead, such an entity may self certify residency and treaty eligibility every three years by providing the statement signed under penalties of perjury as described above.

An excess line broker may establish that it is appropriate not to withhold FET on a placement with a non-U.S. insurer, if it has knowledge that the non-U.S. insurer has entered into a closing agreement with the IRS for the period in question and that either no portion of the premium will be reinsured to a reinsurer residing in a third country that does not have a treaty exemption, or the non-U.S. insurer will pay the FET on this portion of the original placement.

Country	FET Exemption
CYPRUS	Qualified
FINLAND	Qualified
FRANCE	Qualified
GERMANY	Qualified
HUNGARY ¹⁰	Unqualified
INDIA	Qualified
IRELAND	Qualified
ISRAEL	Qualified
ITALY	Qualified
JAPAN	Qualified
LUXEMBOURG	Qualified, and the FET exemption pertains only to insurance premiums not reinsurance premiums
MEXICO	Qualified
NETHERLANDS	Qualified
ROMANIA	Unqualified
SPAIN	Qualified
SWEDEN	Qualified
SWITZERLAND	Qualified
UNITED KINGDOM	Qualified – (anti-conduit arrangement limitation)
USSR/CIS ¹¹	Qualified and the FET exemption generally only pertains to reinsurance premiums

¹⁰ A new treaty with Hungary has been signed but is not yet effective.

¹¹ The treaty with USSR continues to apply to Armenia, Azerbaijan, Belarus, Georgia, Kyrgyzstan, Moldova, Tajikistan, Turkmenistan and Uzbekistan.