Joint Committee on Taxation
November 15, 2001
JCX-82-01

DESCRIPTION OF CHAIRMAN'S AMENDMENT IN THE NATURE OF A SUBSTITUTE FOR H.R. 3210, THE "TERRORISM RISK PROTECTION ACT"

Background, Present Law and Description of H.R. 3210

Background

H.R. 3210, the "Terrorism Risk Protection Act,", was introduced November 1, 2001, by Mr. Oxley, and referred to the Committee on Financial Services, and in addition to the Committees on Ways and Means, and the Budget. The bill was marked up in the Financial Services Committee of the House on November 7, 2001, and ordered to be reported as amended. The bill includes a provision relating to a tax reserve for terrorism coverage under commercial lines of business that is within the jurisdiction of the Committee on Ways and Means of the House.

Present law

In determining taxable income, a property and casualty insurance company includes its underwriting and investment income or loss. Underwriting income generally means the premiums earned on insurance contracts during the taxable year, reduced by the amount of the deduction allowed for additions to reserves for losses incurred and for expenses incurred. The amount of premiums earned means gross premiums for the year, reduced by the increase in unearned premiums (those which are treated as earned in a future year).[1] The amount of losses incurred includes the amount of losses paid during the taxable year on insurance contracts, and also includes the increase in discounted unpaid losses. Unpaid losses are discounted separately for each line of business, applying tax discounting rules that take account partially of the time value of money during the period the losses remain unpaid. In general, unpaid losses mean the amount of unpaid losses reflected on the annual statement approved by the National Association of Insurance Commissioners that the taxpayer is required to file with insurance regulatory authorities of a State. Generally, this includes losses incurred that have been reported to the company, and also losses that have been incurred but not reported. It does not include losses that have not been incurred.

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[1] A property and casualty insurance company generally is required to reduce its deduction for increases in unearned premiums by 20 percent, to prevent mismatching of income and expenses.

Description of the bill

Non-tax provisions

The bill, as introduced, provides for temporary Federal government cost-sharing for commercial insurers of up to $100 billion, for 90 percent of the amount of insured losses resulting from acts of terrorism in the event of a "triggering determination" during the period from date of enactment to January 1, 2003. The financial assistance is to be repaid through assessments and surcharges. The bill provides for assessments by a Federal government administrator against property and casualty insurers, and surcharges against property and casualty insurance policyholders, following the occurrence of a triggering determination. The triggering determinations include the events that (1) industry-wide terrorism losses exceed $1 billion for the year; and (2) industry-wide losses exceed $100 million for the year and exceed 10 percent of the capital surplus of, and 10 percent of the commercial insurance premiums written by, any single insurer (among other criteria).

Tax provisions

The bill provides a permanent rule allowing an additional deduction to property and casualty insurers for increases in a "terrrorism commercial business reserve." Under the bill, the terrorism commercial business reserve means an amount held in a segregated account (or other separately identifiable arrangement or account) that is set aside to pay or to reinsure future unaccrued claims arising from declared terrorism losses, or to pay other claims if directed by a State insurance commissioner to avoid the company's insolvency. An increase in the reserve for any taxable year is treated as deductible, and a decrease in the reserve for a taxable year is includable in the company's income.

The amount of the reserve allowed to any particular property and casualty insurance company is determined as that company's allocable share of a national limit of $40 billion ($13.34 billion for 2002). The $40 billion amount is a cumulative total, and is increased for inflation after 2002. The company's share of this national limit for any calendar year is determined by the ratio of (1) the company's net written premiums for commercial lines of business that cover declared terrorism losses, to (2) net written premiums for all companies for commercial lines of business that cover declared terrorism losses.

If in any taxable year, a company's deduction exceeds its share of the national limit, then the excess is included in income for the next taxable year. If the excess is distributed out of the account for the reserve, then the excess is not taken into account in determining the opening balance of the reserve for the next year, or the amount of the deduction for the next year.

Under the bill, a declared terrorism loss means the amount of losses and loss adjustment expenses incurred in commercial lines of business, as well as any nonrecoverable assessments, surcharges, or other liabilities that are borne by the company, that are attributable to a declared terrorism event. A declared terrorism event means any event declared by the President to be an act of terrorism against the United States for purposes of this provision.

Effective date.--The tax provisions of the bill are effective for taxable years beginning after December 31, 2001.

Description of Amendment

The amendment would delete the tax provisions of the bill.

The amendment would also require the Secretary of the Treasury to conduct a study of issues relating to permitting property and casualty insurance companies to establish deductible reserves against losses for future acts of terrorism. No later than 4 months after the date of enactment, the Secretary would be required to report to Congress the results of the study, with recommendations for changes to the Internal Revenue Code of 1986 or other appropriate action. The issues to be studied would include

(1) Whether such tax-favored reserves for property and casualty insurance companies would promote insurance coverage of risks of terrorism and the accumulation of additional resources needed to satisfy potential claims resulting from such risks,

(2) The lines of business for which such reserves would be appropriate, including whether the reserves should be applied to personal or commercial lines of business,

(3) How the amount of such reserves would be determined,

(4) How such reserves would be administered,

(5) A comparison of the federal tax treatment of such reserves and of other insurance reserves permitted under present federal tax law,

(6) An analysis of the use of tax-favored reserves for catastrophic events, including acts of terrorism, under the tax laws of foreign countries, and

(7) Whether it would be appropriate to permit similar reserves for other future catastrophic events, such as natural disasters, taking into account the factors under the preceding pargraphs.