

Tax Treatment of Overcapitalized Captive Insurance Companies

The Tax Law has been amended concerning the tax treatment of certain captive insurance companies. Chapter 57 of the Laws of 2009 amended the Tax Law to provide that an overcapitalized captive insurance company is excluded from the definition of an insurance corporation that is subject to tax under Article 33. Such corporations are now required to be included in a combined return under either Article 9-A or Article 32 with the closest controlling stockholder.

This TSB-M summarizes the combined reporting rules for an overcapitalized captive insurance company. The provisions described below apply to taxable years beginning on or after January 1, 2009.

General definitions

Section 2 of the Tax Law was amended to define an overcapitalized captive insurance company as an entity that is treated as an association taxable as a corporation under the Internal Revenue Code (IRC) and that also meets all of the following conditions:

- More than 50% of its voting stock is owned or controlled directly or indirectly by a single entity that is treated as an association taxable as a corporation under the IRC and not exempt from federal income tax.
- It is licensed as a captive insurance company under the laws of New York State or another jurisdiction.
- Its business includes providing, directly and indirectly, insurance or reinsurance covering the risks of its parent and/or members of its affiliated group.
- Fifty percent or less of its gross receipts for the taxable year consist of premiums.

The following definitions apply for purposes of the definition of *overcapitalized captive insurance company*:

- *Affiliated group* has the same meaning as that term is given in IRC section 1504, except that the term *common parent corporation* in that section is deemed to mean any person, as defined in IRC section 7701. References to *at least eighty percent* in IRC section 1504 are to be read as *fifty percent or more*. IRC section 1504 is to be read without regard to the exclusion provided for in IRC section 1504(b).
- *Premiums* has the same meaning as that term is given in section 1510(c)(1) of the tax law, except that it includes consideration for annuity contracts and excludes any part of

the consideration for insurance, reinsurance, or annuity contracts that do not provide bona fide insurance, reinsurance, or annuity benefits.

- *Gross receipts* include the amounts included in gross receipts under IRC section 501(c)(15), and all premiums as defined above.

When computing gross receipts for purposes of the definition of overcapitalized captive insurance company, do not consider the gross receipts of members of the same controlled group as the captive insurance company (as referred to in IRC section 501 (c)(15)(B)).

A definition of closest controlling stockholder has been added to Tax Law sections 211.4(a) (Article 9-A), and 1462(f)(2) (Article 32). *Closest controlling stockholder* means the corporation that:

- indirectly owns or controls over 50% of the voting stock of an overcapitalized captive insurance company;
- is subject to tax under Article 9-A or 32 or is otherwise required to be included in a combined return or report under Article 9-A or 32; and
- is the fewest tiers of corporations away in the ownership structure from the overcapitalized captive insurance company.

The commissioner is authorized to prescribe by regulation or published guidance the criteria for determining the closest controlling stockholder.

Combined reporting rules for overcapitalized captive insurance companies

Combined reporting rules under Article 9-A.

The new legislation adds Tax Law section 211.4(a)(7) that requires an overcapitalized captive insurance company to be included in a combined report under Article 9-A if **any** of the following conditions exist:

- a) An overcapitalized captive insurance company must be included in a combined report with the corporation that directly owns or controls over 50% of the voting stock of the overcapitalized captive insurance company if that corporation is subject to tax or required to be included in a combined report under Article 9-A.
- b) If over 50% of the voting stock of an overcapitalized captive insurance company is not directly owned or controlled by a corporation that is subject to tax or required to be included in a combined report under Article 9-A, then the overcapitalized captive insurance company must be included in a combined return or report with the

corporation that is the closest controlling stockholder of the overcapitalized captive insurance company. If the closest controlling stockholder of the overcapitalized captive insurance company is subject to tax or otherwise required to be included in a combined report under Article 9-A, then the overcapitalized captive insurance company must be included in a combined report under Article 9-A.

c) If the corporation that directly owns or controls the voting stock of the overcapitalized captive insurance company is a corporation not permitted to make a combined report as provided in Tax Law section 211.4(a)(2), 211.4(a)(3), or 211.4(a)(5), then the rules in condition (b) above must be applied to determine the corporation in whose combined return or report the overcapitalized captive insurance company should be included. If the corporation that is the closest controlling stockholder of the overcapitalized captive insurance company is a corporation not permitted to make a combined report as described in Tax Law section 211.4(a)(2), 211.4(a)(3), or 211.4(a)(5), then that corporation is deemed to not be in the ownership structure of the overcapitalized captive insurance company, and the closest controlling stockholder is determined without regard to that corporation. The following types of corporations are described in Tax Law sections 211.4(a)(2), 211.4(a)(3), and 211.4(a)(5):

- corporations principally engaged in an aviation business or corporations that are qualified air freight forwarders with respect to an aviation corporation,
- corporations principally engaged in a railroad or trucking business, and
- corporations organized under the laws of a country other than the United States.

d) If an overcapitalized captive insurance company is required by any of the conditions under Tax Law section 211.4(a)(7) to be included in a combined report with another corporation, and that other corporation is also required to be included in a combined report with another related corporation or corporations under Tax Law section 211.4(a), then the overcapitalized captive insurance company must be included in that combined report with those corporations.

If an overcapitalized captive insurance company is not required to be included in a combined report with another corporation under conditions (a) or (b) above, or in a combined return under the provisions of Article 32 (Tax Law section 1462(f)(2)(vi))¹, then the overcapitalized captive insurance company is subject to the opening provisions of Tax Law section 211.4(a) and the provisions of Tax Law section 211.4(a)(4). Under these provisions the

¹ The amendment contained in Section 2 of Part E-1 of Chapter 57 of the Laws of 2009 refers to subparagraph (v) of paragraph 2 of subsection (f) of section 1462 of the Tax Law. This reference to subparagraph (v) is to provisions concerning combination of captive REITs and RICs and credit card banks and is incorrect.

overcapitalized captive insurance company must be included in a combined report under Article 9-A with another corporation if either:

- the substantial intercorporate transaction requirement in the opening provisions of Tax Law section 211.4(a) is satisfied, or
- the intercompany transactions or agreement, understanding, arrangement, or transaction requirement of Tax Law section 211.4(a)(4) is satisfied

and more than 50% of the voting stock of the overcapitalized captive insurance company and substantially all of the capital stock of that other corporation are owned and controlled, directly or indirectly, by the same corporation.

(Tax Law section 211.4(a)(7))

Combined reporting rules under Article 32

Tax Law section 1452(d) has been amended to provide that an overcapitalized captive insurance company that is required to be included in a combined return under the new provisions of Tax Law section 1462(f), as described later, will be subject to tax under Article 32 and will not be subject to tax under Article 9-A. In addition, Tax Law section 1452(m)(4) was amended so that the Gramm-Leach-Bliley (GLB) transitional provisions currently in effect do not apply to an overcapitalized captive insurance company required to be included in a combined return under Article 32.

The new legislation under Tax Law section 1462(f)(2)(vi) requires an overcapitalized captive insurance company to be included in a combined return under Article 32 if **any** of the following conditions exist:

- a) An overcapitalized captive insurance company must be included in a combined return with the banking corporation or bank holding company that directly owns or controls over 50% of the voting stock of the overcapitalized captive insurance company if that banking corporation or bank holding company is subject to tax or required to be included in a combined return under Article 32.
- b) If over 50% of the voting stock of an overcapitalized captive insurance company is not directly owned or controlled by a banking corporation or bank holding company that is subject to tax or required to be included in a combined return under Article 32, then the overcapitalized captive insurance company must be included in a combined return or report with the corporation that is the closest controlling stockholder of the overcapitalized captive insurance company. If the closest controlling stockholder of the overcapitalized captive insurance company is a banking corporation or bank holding company that is subject to tax or required to be included in a combined return under

Article 32, then the overcapitalized captive insurance company must be included in a combined return under Article 32.

c) If the corporation that directly owns or controls the voting stock of the overcapitalized captive insurance company is a corporation not permitted to make a combined return as provided in Tax Law section 1462(f)(4)(ii) or 1462(f)(4)(iv), then the provisions of (b) above must be applied to determine the corporation in whose combined return or report the overcapitalized captive insurance company should be included. If the corporation that is the closest controlling stockholder of the overcapitalized captive insurance company is described in Tax Law section 1462(f)(4)(ii) or 1462(f)(4)(iv) as a corporation not permitted to make a combined return, then that corporation is deemed to not be in the ownership structure of the overcapitalized captive insurance company, and the closest controlling stockholder will be determined without regard to that corporation. The following types of corporations are described in Tax Law sections 1462(f)(4)(ii) and 1462(f)(4)(iv):

- corporations organized under the laws of a country other than the United States; and
- corporations whose greatest tax, computed on a separate basis, is on taxable assets and whose net worth ratio, computed on a separate basis, is less than 5% and whose total assets are comprised of 33% or more of mortgages.

d) If an overcapitalized captive insurance company is required by any of the conditions under Tax Law section 1462(f)(2)(vi) to be included in a combined return with another corporation, and that other corporation is required to be included in a combined return with another corporation under other provisions of Tax Law section 1462(f), the overcapitalized captive insurance company must be included in that combined return with those corporations.

(Tax Law sections 1452(d), 1452(m), 1462(f)(2)(vi))

Computation rules for overcapitalized captive insurance companies that are required to be included in a combined report or return under Articles 9-A or 32

Computation of tax under Article 9-A

In the case of a combined report under Article 9-A, the tax is measured by the combined entire net income, combined minimum taxable income, or combined capital of all the corporations included in the report, including any overcapitalized captive insurance company. However, the tax measured by combined capital may still not exceed the limitation provided for in Tax Law section 210.1(b).

An overcapitalized captive insurance company required to be included in a combined report under Tax Law section 211.4 must compute entire net income as required under Tax Law section 208.9.

(Tax Law section 211.4(b)(1))

Computation of tax under Article 32

In the case of a combined return under Article 32, the tax is measured by the combined entire net income, combined alternative entire net income, or combined taxable assets of all the corporations included in the return, including any overcapitalized captive insurance company.

In the case where an overcapitalized captive insurance company is required under Tax Law section 1462(f) to be included in a combined return, the entire net income of the overcapitalized captive insurance company must be computed as required under Tax Law section 1453.

(Tax Law section 1462(f)(3))

NOTE: A TSB-M is an informational statement of existing department policies or of changes to the law, regulations, or department policies. It is accurate on the date issued. Subsequent changes in the law or regulations, judicial decisions, Tax Appeals Tribunal decisions, or changes in department policies could affect the validity of the information presented in a TSB-M.