Joint Committee on Taxation
August 17, 1994
JCX-16-94

REVENUE-RELATED PROVISIONS OF H.R. 3800 (SUPERFUND REFORM ACT OF 1994)

Scheduled for Markup by the Committee on Ways and Means on August 18, 1994

I. LEGISLATIVE BACKGROUND

H.R. 3800 ("Superfund Reform Act of 1994"), the Administration's Superfund reauthorization proposal, was introduced (by request) by Messrs. Swift, Dingell, Mineta, Rostenkowski, and Applegate on February 3, 1994. Titles I-VIII of the bill were referred jointly to the Committee on Energy and Commerce and the Committee on Public Works and Transportation. Title IX ("Taxes") was referred to the Committee on Ways and Means.

H.R. 3800 was ordered favorably reported, with an amendment, by Energy and Commerce on May 18, 1994, and the report was filed on June 30, 1994 (H. Rept. 103-582, Part I). Public Works and Transportation marked up H.R. 3800 on July 28, 1994, and ordered the bill favorably reported with amendments.

On May 20, 1994, the Administration separately submitted a proposal for the imposition of two new insurance-related "fees" (drafted to be excise taxes in the Internal Revenue Code -- hereinafter, referred to as excise taxes) on persons issuing or bearing risks under certain commercial insurance policies. This proposal subsequently was modified in a separate transmittal to the Senate Committee on Environment and Public Works. The Administration intended that these new excise taxes, as modified, be incorporated in Title IX of H.R. 3800 as the financing source for a new environmental insurance resolution program created by the bill.

The Committee on Ways and Means held a public hearing on the Superfund revenue proposals on July 25, 1994.[1]

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[1] For a more complete description of the Administration proposal, see Joint Committee on Taxation, "Revenue Related Provisions of H.R.3800", July 22, 1994, JCX-9-94.

II. DESCRIPTION OF PRESENT LAW

1. Current Superfund Taxes and Trust Fund

Four different taxes are imposed under present law to fund the Hazardous Substance Superfund (the "Superfund") program --

(1) A 9.7-cents-per-barrel excise tax on domestic or imported crude oil or refined products;

(2) An excise tax on certain hazardous chemicals, imposed at rates of from $0.22 to $4.87 per ton;

(3) An excise tax on imported substances for which one or more of the hazardous chemicals subject to tax in (2), above have been used as materials in their manufacture or production;[2] and

(4) A corporate environmental income tax equal to 0.12 percent of the amount of modified alternative minimum taxable income in excess of $2 million.

Amounts equivalent to the revenues from these taxes are dedicated to the Superfund Trust Fund, established in the Trust Fund Code of the Internal Revenue Code. Amounts in the Superfund Trust Fund are available for expenditure for the purposes provided in present-law authorizing legislation, as that legislation was enacted in 1986.

These Superfund taxes are scheduled to expire generally after December 31, 1995. Present law provides for an earlier expiration, however, if either of two "dollar caps" is exceeded: (1) if the unobligated balance in the Superfund exceeds $3.5 billion on December 31, 1994, or (2) if the Treasury Department estimates that more than $11.97 billion of revenues from these taxes will be credited to the Superfund before January 1, 1996.

2. Environmental Insurance Resolution Fund and Excise Taxes

Present law does not include any provisions for Federal resolution or funding of claims against insurers by parties potentially responsible for Superfund site cleanup.

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[2] For a complete list of the chemicals and imported substances subject to the taxes described in items (2) and (3), see JCX-9-94.

III. ADMINISTRATION PROPOSAL

1. Current Superfund Taxes and Trust Fund

The Administration proposal would extend the present-law Superfund excise taxes through December 31, 2000, and the corporate environmental income tax through taxable years beginning before January 1, 2001. Conforming amendments would be made to the present-law "dollar caps" to permit collection of these taxes at projected levels during the five-year extension period.

The Administration proposal does not include conforming amendments to the Superfund Trust Fund expenditure authority provisions to reflect proposed authorizing legislation. A technical conforming amendment would update the expenditure purposes of the Superfund Trust Fund to authorize expenditures from the Trust Fund for the purposes provided under the accompanying authorizing legislation (as that legislation becomes effective on the date of enactment of the bill).

2. Environmental Insurance Resolution Fund and Excise Taxes

The Administration proposal would establish a new Environmental Insurance Resolution Fund (the "EIRF") to resolve private litigation about insurance coverage related to cleanup of Superfund sites. The EIRF would process claims against private insurance companies by parties that are potentially liable for cleanup of these sites, and would pay monetary awards to the parties. Upon acceptance of an award, insurance claims would be extinguished. EIRF awards would equal statutory percentages (determined generally by reference to the State in which the sites giving rise to liability are located) of potential claims against insurers.

Awards to parties potentially responsible for cleanup of Superfund sites would cover all sites (past, present, and future) with respect to which the party was found liable. Past unreimbursed costs would be paid in 10 annual installments. Present and future costs would be paid by the EIRF as the costs were incurred.

The EIRF would be established as a new tax-exempt organization, whose members would be appointed by the President. As originally proposed by the Administration, the EIRF would review and process awards for a five-year period, beginning on the date of the bill's enactment. (This five-year period was extended to 10 years in H.R. 3800, as reported by the Committees on Energy and Commerce and Public Works and Transportation.)

The EIRF would be funded by two new excise taxes and a special assessment (imposed in the Internal Revenue Code). These taxes and the special assessment are described in the attached document prepared by the Department of the Treasury.

ADMINISTRATION PROPOSAL FOR FINANCING THE ENVIRONMENTAL INSURANCE RESOLUTION FUND

Overview

To finance the Environmental Insurance Resolution Fund ("the Fund"), the proposal would generate revenue of $8.1 billion at a rate of $810 million per year for ten years. The $8.1 billion would be raised through a combination of excise taxes and resolution user charges assessed by the Fund. In theory, these taxes and user charges are comparable to amounts that otherwise would have been paid by insurers in dealing with claims against them under insurance policies written by the industry prior to 1986.

During the first four years of the Fund, approximately 70 percent of the Fund would be financed prospectively using a retrospective computation basis ("retrospective taxes"), calculated with respect to net premiums written by domestic and foreign insurers and reinsurers for contracts providing certain U.S. commercial liability insurance during the period from 1968 through 1985. Approximately 45 percent would be generated by a retrospective tax on net premiums written by direct writers and approximately 25 percent by a retrospective tax on reinsurance premiums. Approximately 30 percent of the Fund would be financed by a "prospective tax" on direct premiums from certain commercial insurance of U.S. risks currently written by domestic and foreign insurers.

During years five through ten, 65 percent of the Fund's revenues would be raised by the prospective tax on direct premiums from certain commercial insurance of U.S. risks currently written by domestic and foreign insurers. The retrospective tax on reinsurance premiums would continue to generate approximately 25 percent of the Fund's revenues. Approximately 10 percent of the Fund's revenues would be contributed to the Fund by insurers that wrote insurance coverage giving rise to Superfund claims and for which the Fund makes resolutions. These contributions would be resolution user charges based, using a reasonable method, on the resolutions made by the Fund during previous years on behalf of a specific insurer. For example, the resolution user charges could be based on the number and/or dollar amount of resolutions made by the Fund or on the coverage limits of policies submitted to the Fund by persons to whom the Fund make payments. Not more than $81 million per year for six years would be raised by these resolution user charges. The first $81 million in the fifth year would be spread among all insurers for which claims were resolved during the first four years of the Fund.

Under the proposal, no insurer or reinsurer would be allowed to recover under a reinsurance contract on the basis of any payment by the Fund or payment of taxes or resolution user charges.

The annual financing of the Fund would be as follows:

Years	Retrospective Tax on Direct Insurance	Retrospective Tax on Reinsurance	Prospective Tax	Reconciliation Amounts
1-4	$367 (per year)	$200	$243	$-0-
5-10	$-0- (per year)	$200	$529	$81

Tax rates would be determined that would generate this financing for the Fund.

The gross revenues from the prospective and retrospective taxes would be deposited in a newly established trust fund in accordance with the Trust Fund Code of the Internal Revenue Code. The Trust Fund would be administered by the Federal Agency represented by the Fund's chairperson. The Fund's revenues would be managed in a manner similar to that provided for present-law Code trust funds, including expenditure authority provisions consistent with the accompanying authorizing legislation, as effective on the date of the proposal's enactment. The liability to the Federal Government would be limited to amounts equal to gross revenues collected from the Fund's taxes and resolution user charges deposited into the Trust Fund.

Insurers would be entitled to payments from the Fund as indemnification for certain past settlements. These payments could not exceed $350 million during the Fund's existence.

Retrospective taxes

The retrospective taxes would be measured by reference to adjusted base-period commercial premiums, generally defined as net premiums written for contracts or agreements providing insurance or reinsurance with respect to qualified commercial coverage of U.S. risks during the eighteen-year period beginning on January 1, 1968 and ending on December 31, 1985. The taxes would be imposed on both domestic and foreign persons. The rates of retrospective tax would differ for net direct written premiums and reinsurance premiums assumed from unrelated parties. Reinsurance premiums between incorporated, but not unincorporated, insurers under common management would be considered to be between related parties.

Net premiums written for qualified commercial insurance contracts means net premiums written for contracts providing insurance of qualified commercial coverage of U.S. situs risks (defined to include Puerto Rico and possessions and territories) computed on the basis of the annual statement approved by the National Association of Insurance

Commissioners (NAIC). For reinsurance premiums that were not separately allocated and reported on the NAIC annual statement by the line of business to which the underlying coverage relates, the net written premiums for this unallocated reinsurance would be determined by multiplying a reinsurance ratio of 21 percent by the unallocated reinsurance premiums.

For insurers and reinsurers not filing NAIC annual statements, net written premiums should be computed on a basis comparable to that required by the NAIC using reasonable methods (as approved or provided by the Secretary) to approximate comparability where necessary due to inadequate books and records. In addition for these insurers, if necessary a proxy method for determining the allocation of premiums between insurance and reinsurance would be used unless an insurer has adequate books and records to determine the actual insurance and reinsurance premiums. For premiums related to insurance covering risks only partly with the U.S., only the portion of premiums attributable to risks within the U.S. would be subject to the retrospective taxes.

Qualified commercial coverage means insurance coverage that was, or should have been, categorized in the NAIC annual statement in the "commercial multiple peril" or "other liability" lines of business. However, contracts included in the "other liability" line of business that insured only certain types of coverage unrelated to commercial liability (and thus could not generate exposure to environmental insurance claims) would be excluded. For example, medical malpractice insurance would be an excluded coverage. However, commercial property damage insurance, for example, could not be excluded from the commercial multiple peril line of business.

In determining the adjusted base-period commercial premiums written from 1968 through 1985, the net premiums written for each year during the period would be adjusted by an inflation factor. This adjustment would restate all premiums to 1985 dollars.

An exemption amount of $50 million could be deducted from the sum of the inflation-adjusted premiums in determining the adjusted base-period commercial premiums. Aggregation rules would apply so that related persons would be entitled to one $50 million exemption amount. The $50 million exemption would not be available on a per-"Name" or unincorporated-entity basis. Only one $50 million exemption would be allowed for all Underwriters at Lloyd's, London.

Foreign persons not otherwise subject to U.S. income tax would be subject to an alternative "limits" tax equal to 0.5 percent of the maximum limit of liability on all types of property/casualty insurance contracts insuring or reinsuring U.S. risks. However, foreign persons could elect to be subject to the retrospective taxes instead of the limits tax and would be required to enter into a closing agreement with the Treasury Department to ensure collection of a proper amount of tax.

Foreign persons could preliminarily elect, pending execution of a closing agreement,

to be subject to the retrospective taxes in lieu of the limits tax immediately upon enactment of the proposal. Under such an agreement, in place of requiring immediate payment and withholding of the limits tax, the insurer or reinsurer would be required to post adequate security in a designated form with the Treasury for payment of the taxes. If a closing agreement was not executed within a reasonable period of time, the Treasury would be entitled to collect the full amount of limits tax, including the retention of any posted security.

Prospective tax

The prospective tax generally would be imposed on direct premiums written for commercial insurance contracts and would apply in the same manner with respect to commercial insurance contracts written by domestic and foreign insurers of U.S. risks. Because this prospective tax is imposed on direct premiums written, it is not imposed on reinsurance premiums nor is it imposed indirectly on reinsurance premiums as the tax should not be passed through by direct writers in the pricing of reinsurance arrangements.

For premiums related to insurance covering risks only partly within the U.S., the entire premium would be subject to the prospective tax. To avoid such a result, a separate contract could be written for the coverage of the U.S. risks.

The first $5 million of premiums written by an insurer would be exempted from the prospective tax. One $5 million exemption would be available to related persons. The $5 million exemption would not be available on a per-"Name" or unincorporated-entity basis.

Direct premiums written for commercial insurance contracts would mean gross premiums written and other consideration for contracts providing insurance of commercial coverage. Gross premiums written would be computed on the basis of the annual statement approved by the NAIC or on an equivalent basis.

Commercial coverage would mean all commercial lines of insurance except the workers compensation, medical malpractice, and accident and health lines of business. Commercial lines would include premiums of the type that would be categorized in the NAIC annual statement as fire, commercial multiple peril, other liability, product liability, allied lines, multiple peril crop, inland marine, commercial auto no-fault, other commercial auto liability, commercial auto physical damage, farmowners multiple peril, ocean marine, financial guaranty, aircraft, fidelity, surety, glass, burglary and theft, boiler and machinery, and others designated by the Secretary. From the premiums in these commercial lines, premiums for directors and officers liability insurance, professional liability insurance, and fire insurance on residential owner-occupied housing units (including condominiums and cooperatives) should be excluded (with the insurer bearing the burden of proof with respect to the type of insurance coverage).

Effective dates

The prospective and retrospective taxes and resolution user charges generally would be effective on the date of the proposal's enactment and would continue for ten years, unless otherwise provided in the proposal. The prospective tax would apply to direct premiums written after date of enactment. The retrospective taxes would be computed for each calendar year, or part thereof, commencing with the first day of the month beginning after date of enactment. The limits tax on foreign persons would be imposed for insurance coverage periods beginning the first day of a month beginning after the date the Fund becomes operational as described below. The resolution user charges would become payable beginning in the fifth year of the Fund.

The authorizing legislation (H.R. 3800) accompanying this proposal provides that the Fund would not become operative unless at least 85 percent of the parties potentially eligible for awards accepted the Fund's determination of the percentage recoveries for which they potentially were eligible within 150 days of the bill's enactment. To finance the operations of the Fund during the contingency period, start-up filing fees of approximately $1 million would be imposed on insurers by the Fund. These fees would not be creditable against any retrospective or prospective tax imposed under the Internal Revenue Code.

None of the taxes would be collected until it is determined that the Fund has adequate participation ("the contingency period"). This could be for a period up to 150 days after enactment. The retrospective and prospective taxes would accrue during such contingency period but would not be payable during such period.

Within 30 days after the end of the month that includes the end of the contingency period, if adequate participation is achieved, the retrospective and prospective taxes that accrued during the contingency period would become due and payable by insurers.

Once the Fund becomes operational, the retrospective, prospective, and limits taxes would be payable on a monthly basis. Estimated amounts could be paid for months in which premium data is not yet available for calculation of the prospective tax.

Although generally the prospective tax would apply to premiums written after date of enactment but would not become payable by insurers until the contingency period ends, the effective date for imposition of the prospective tax for insurers not otherwise subject to U.S. income tax would be delayed until the contingency period ends. These insurers would be subject to the prospective tax for premiums written after the date the Fund becomes fully operational and before the date that is the number of days in the contingency period beyond the end of the tenth year after date of enactment.

If the Fund does not become operational, any remaining amounts in the Fund would revert to the general revenues of the Treasury.

To finance the Fund's continuing obligations resulting from resolution requests accepted within ten years after date of enactment, reauthorization of the Fund by the Congress would be anticipated. A Treasury study would be conducted in the ninth year of the Fund to make recommendations with respect to the Fund's financing. No inference is intended by the proposed allocation in any year, or combination of years, between retrospective taxes and charges with regard to the structure of any tax or charge that the Congress may find necessary to enact in the future.