



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

DISTRICT COUNSEL CC:WR:RMD:DEN

FROM: Edward Williams
Senior Technical Reviewer CC:INTL:BR1

SUBJECT:

This Field Service Advice responds to your memorandum dated July 16, 1999. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be used or cited as precedent.

LEGEND:

Corporation A =

Corporation B =

Corporation C =

Country A =

ISSUES:

Issue 1

Whether premiums paid by a Country A corporation on a policy covering risks of its U.S. subsidiary, to a foreign affiliate (e.g., a branch, division or subsidiary) of a domestic insurance company, are exempt from the foreign insurance excise tax imposed under section 4371 of the Code. If not exempt, whether such premiums would be exempt if the foreign insurance company reinsures the policy with an affiliated domestic insurance company.

Issue 2

Whether premiums paid to a controlled foreign corporation, as defined in section §957(b), and included in the gross income of its U.S. shareholders as Subpart F income pursuant to section §951(a), are exempt from the section 4371 excise tax.

Issue 3

Whether premiums paid for policies issued by a foreign insurer which are “signed or countersigned by an officer or agent of the foreign insurer in a State, Territory or the District of Columbia in which the insurer is authorized to do business” are exempt from the excise tax imposed under section 4371.

Issue 4

Whether section 4374 imposes liability for the section 4371 excise tax on the insured where the insured does not make the actual premium payment for the insurance policy.

CONCLUSIONS:

Issue 1

Premiums paid to a wholly owned unincorporated foreign branch (which is a disregarded entity for U.S. tax purposes) of a U.S. insurance company are not subject to the tax imposed by section 4371. However, premiums paid to a foreign subsidiary of a U.S. insurance company will be subject to the tax imposed by section 4371.

If not exempt, such premiums will not become exempt as a result of the foreign insurer reinsuring the policy with an affiliated U.S. insurance company.

Issue 2

Premiums paid to a foreign insurer that is a controlled foreign corporation, and which premiums are included as Subpart F income in the gross income of its U.S. shareholder(s) pursuant to section 951(a), are not generally exempt from the excise tax imposed under section 4371.

Issue 3

Premiums paid for policies issued by a foreign insurer which are “signed or countersigned by an officer or agent of the foreign insurer in a State, Territory or the District of Columbia, in which the insurer is authorized to do business” are not exempt from the excise tax imposed under section 4371 unless the income derived from such activity is effectively connected with a United States trade or business.

Issue 4

Section 4374 of the Code imposes liability for the section 4371 excise tax on an insured as defined in section 4372(d) regardless of whether the insured makes the actual premium payment for the insurance policy.

FACTS:

Corporation B is a Country A corporation that owns 100 percent of the outstanding stock of Corporation A. Corporation A is a domestic manufacturing corporation.

During the years in issue, Corporation B acquired and paid the premiums for various casualty insurance coverage on behalf of Corporation A and Corporation B's other subsidiaries and allocated to each subsidiary a proportionate cost of the insurance plus a markup of approximately 25 percent. All policies of insurance were obtained through and premium payments were made to Corporation C, a Country A insurance brokerage. Corporation C, in turn, remitted the payments to various domestic and foreign insurers.

LAW AND ANALYSIS

Section 4371 imposes a tax on each policy of insurance, indemnity bond, annuity contract or policy of reinsurance issued by any foreign insurer or reinsurer. Pursuant to section 4371(1), the tax is imposed at a rate of four cents on each dollar, or fractional part thereof, of the premium paid on a policy of casualty insurance or indemnity bond, if issued to or for, or in the name of an insured as defined in section 4372(d).

Section 4372(a) of the Code defines the term "foreign insurer" as an insurer who is a nonresident alien individual, a foreign partnership or foreign corporation.

Section 4372(d)(1) of the Code defines the term "insured" as a domestic corporation or partnership, or an individual resident of the United States, against, or with respect to hazards, risks, losses, or liabilities wholly or partly within the United States.

Section 4374 provides that the tax imposed by section 4371 shall be paid, on the basis of a return, by any person who makes, signs, issues or sells any of the documents and instruments subject to the tax, or for whose use or benefit the same are made, signed, issued or sold.

Treas. Reg. § 46.4374-1(a) provides that the tax is to be remitted by the person who makes the payment of the premium to the foreign insurer or to any nonresident agent, solicitor or broker and that such person is that resident person who actually

transfers the money, check or its equivalent to the foreign insurer or to any nonresident agent, solicitor or broker.

Treas. Reg. §46.4374-1(b) provides that the liability for the tax imposed by section 4371 shall attach at the time the premium payment is transferred to the foreign insured or to any nonresident agent, solicitor or broker.

Section 4373(1) generally exempts from the excise tax premiums that are effectively connected with the conduct of a United States trade or business.

While the insurance premium excise tax originated in legislation enacted in 1918, the format of current section 4371 is the result of the Revenue Act of 1942, §502, P.L. 77-753, which amended section 1804 of the 1939 Code, the predecessor of section 4371. The legislative history of the 1942 legislation indicates that, while the tax is a revenue raiser, it will “at the same time eliminate an unwarranted competitive advantage now favoring foreign insurers.” H.R. Rep. No. 2333, 77th Cong., 1st Sess. 61 (1942). The purpose of the insurance excise tax was also explained, as follows, in United States v. Northumberland Ins. Co., Ltd., 521 F.Supp. 70 (D. N.J. 1981):

[t]he competitive imbalance Congress sought to rectify stemmed from the fact that premiums paid to foreign insurance companies not engaged in a trade or business in the United States were not subject to any United States income tax, including withholding tax. [Citations omitted.]

See also The Neptune Mutual Assn., Ltd. of Bermuda v. United States, 87-2 U.S.T.C. par. 16,461 (Cl. Ct. 1987), aff'd, vac'd and rem'd 862 F.2d 1546 (Fed. Cir. 1988), in which the Claims Court states that

[b]efore the enactment of the predecessor statute to section 4371, foreign insurers who did not maintain a domestic agent could write casualty insurance on risks located in the United States without incurring federal tax liability. Conversely, domestic insurers and insurers having domestic agents were subject to federal income tax. This scheme of taxation was changed by the Revenue Act of 1918, which provided that nonresident foreign insurers who were not subject to income tax on their underwriting income, were liable for a three percent stamp tax....The purpose of the 1918 stamp tax...was to equalize the tax burdens of domestic and foreign insurers. [Citations omitted.]

Section 4371 imposes a tax on each policy of insurance, indemnity bond, annuity contract or policy of reinsurance issued by any foreign insurer or reinsurer. Section 4372(a) defines “foreign insurer” as an insurer who is a nonresident alien individual, or a foreign partnership, or a foreign corporation. Section 4371(1) imposes the tax at a rate of four cents on each dollar, or fractional part thereof, of the premium paid on a policy of casualty insurance or indemnity bond, if issued to or for, or in the name of an insured as defined in section 4372(d). Section 4372(d)(1) defines the term “insured” to mean “a domestic corporation or partnership, or an individual resident of the United States, against, or with respect to, hazards, risks, losses, or liabilities wholly or partly within the United States....”

Foreign Branch/Division¹

While not specifically defined in the Code, a wholly owned unincorporated foreign “branch” of a domestic corporation is, for U.S. tax purposes, disregarded as an entity separate from its owner and thus, all tax consequences pass directly through to its domestic “owner”. Treas. Reg. §301.7701-2(c)(2)(i). Section 4371 imposes an excise tax on each policy of insurance issued by any “foreign insurer.” Section 4372(a) of the Code defines “foreign insurer” as an insurer or reinsurer who is a nonresident alien individual, or a foreign partnership, or a foreign corporation. An unincorporated foreign branch is *not* considered an entity separate and distinct from its domestic “owner” and, therefore, will not be considered a “foreign insurer” (as defined in section 4372(a)) if it is wholly owned by a domestic company. The excise tax imposed by section 4371 will not apply to premiums paid to a foreign branch of a U.S. insurance company because the premiums will not be considered paid to a “foreign insurer”.

In addition, imposing an excise tax on a foreign branch of a domestic corporation would be contrary to the legislative purpose of section 4371. Domestic corporations (i.e, those created or organized in the United States, see I.R.C. §7701(a)(4)) are taxed on worldwide income under the rates specified in section 11 of the Code. U.S. income tax is generally paid on any income realized from foreign business or investment activities carried on by a foreign branch of a U.S. corporation. See I.R.C. §§11, 61(a)(2). Thus, the premiums received by a foreign branch of a domestic corporation should not be subject to the section 4371 excise tax because such income is included in the gross income of the domestic corporation and is currently subject to U.S. income tax.

Foreign Subsidiary

¹ For purposes of this discussion, a foreign “division” is deemed to be a segment of the domestic corporation and not a separate entity. As such, the tax treatment of a division would be the same as that of a foreign branch (i.e., pass-through) rather than a foreign subsidiary.

Under the doctrine of Moline Properties, Inc. v. Commissioner, 319 U.S. 436 (1943), federal income tax law usually regards a foreign subsidiary, whether or not controlled by U.S. persons, *as a foreign taxpayer* that is legally distinct from its shareholders. See Treas. Reg. §§1.11-1(a), 1.881-1. A foreign subsidiary of a domestic corporation, therefore, falls squarely within the definition of “foreign insurer” set forth in section 4372(a). Because a foreign subsidiary will be considered a “foreign insurer” for purposes of section 4371, premiums paid to a foreign subsidiary will be subject to the excise tax if the foreign subsidiary issues an insurance policy to or for, or in the name of an “insured” as defined in section 4372(d). I.R.C. §4371(1).

Section 4372(d)(1), in part, defines an “insured” as a “domestic corporation... against, or with respect to, hazards, risks, losses, or liabilities wholly or partly within the United States....” Section 7701(a)(4) defines “domestic,” when applied to a corporation or partnership, as an organization “created or organized in the United States or under the law of the United States or any State....” Corporation A is a domestic corporation. Thus, a foreign subsidiary of a domestic corporation which issues an insurance policy to or for, or in the name of Corporation A, with respect to risks wholly or partly within the United States, will be subject to the excise tax imposed under section 4371.

As reflected in the legislative history, this result is consistent with the purpose of the insurance excise tax provisions; that is, the excise tax is intended to impose a tax on foreign insurers not otherwise conducting a U.S. trade or business the income from which is subject to U.S. income tax. Rev. Rul. 80-222, 1980-2 C.B. 211. A domestic corporation that conducts business through a foreign subsidiary generally is not currently subject to U.S. income tax on the foreign source earnings of the foreign subsidiary until those earnings are repatriated to the United States through distributions or until the stock of the foreign corporation is sold. Such a foreign subsidiary would, therefore, have an advantage over a domestic corporation if it were not subject to the section 4371 excise tax.

If not exempt, whether such premiums would be exempt if the foreign insurance company reinsures the policy with an affiliated U.S. insurance company.

Section 4371(3), in part, imposes a tax “on each policy of...reinsurance issued by any foreign...reinsurer.” Prior to amendment by the Revenue Act of 1942, section 1804 of the 1939 Code, the predecessor of section 4371, exempted reinsurance premiums from the excise tax. Section 1804 of the 1939 Code was amended by section 502 of the Revenue Act of 1942, P.L. 77-753, however, to expressly impose an excise tax on reinsurance premiums paid if the reinsurer is a nonresident alien individual, or a foreign partnership, or a foreign corporation.

Pursuant to section 4371(3), the tax on reinsurance is imposed at a rate of one cent on each dollar, or fractional part thereof, of the premium paid on a policy of reinsurance, if issued [by a foreign reinsurer] to or for, or in the name of a domestic corporation or partnership, or an individual resident of the United States, against, or with respect to hazards, risks, losses, or liabilities wholly or partly within the United States. See Section 4372(d). Section 4372(a) defines a “foreign reinsurer” as a reinsurer who is a nonresident alien individual, or a foreign partnership, or a foreign corporation.

Premiums paid, by a foreign insurer or reinsurer, on a policy of reinsurance issued by a foreign reinsurer will be subject to the excise tax under section 4371(3) if the underlying insurance policy was issued to or for, or in the name of, an insured as defined in section 4372(d). United States v. Northumberland Insurance Co., Ltd., 521 F. Supp. 70 (D. N.J. 1981).

In Northumberland, an Australian insurance company was authorized in 1971 to do business as a surplus lines insurer in New Jersey. In 1971, Northumberland entered into a reinsurance agreement with a Swiss reinsurance company, AIM Reinsurance Co., Ltd. (“AIM RE”). AIM RE had no office in the United States and was not authorized to do business in the United States. Pursuant to agreement, AIM RE agreed to reinsure ninety-percent of the reinsurance written by Northumberland through its U.S. branch for a period of 10 years. Some of the risks that Northumberland ceded to AIM RE had been written by foreign insurance companies and assumed through reinsurance by Northumberland. Almost all of the risks that Northumberland ceded to AIM Re were located in the United States.

Northumberland did not report or pay excise tax on the reinsurance premiums that it paid to AIM RE from 1971 through 1973. The IRS assessed excise tax on the reinsurance premiums that Northumberland paid to AIM RE and Northumberland challenged the imposition of the tax. One of Northumberland’s arguments was

that section 4371(3), which imposes the tax on reinsurance policies, does not apply to policies issued by one foreign insurer to another, and therefore is inapplicable to its reinsurance agreement with AIM RE.

Id. at page 75.

The court rejected Northumberland’s argument and reasoned as follows:

In the case of reinsurance, the “reinsured” need not qualify as an “insured” as defined in section 4372(d). The only requirement is that “the underlying primary policies were issued to “insureds” under section 4372(d).

Id. at page 76. Thus, the excise tax imposed pursuant to section 4371(3) on policies of reinsurance would apply even if the “reinsured” is a foreign entity so long as the underlying policy was issued to an “insured” as defined in section 4372(d).

This view is also supported by Rev. Rul. 58-612 which states

that a policy of reinsurance issued by a foreign insurer covering any of the hazards, risks, losses, or liabilities covered by contracts taxable under section 4371(1) and (2) of the Code is subject to the tax imposed on reinsurance policies by section 4371(3) of the Code, regardless of whether the primary insurer was a domestic or foreign insurer. [Emphasis added.]

Rev. Rul. 58-612, 1958-2 C.B. 850, 851.

Northumberland also argued that section 4371 may not apply to its reinsurance contract with AIM RE because the excise tax was previously imposed on the policies of reinsurance issued by Northumberland on the same underlying risks. Northumberland, 521 F. Supp. fn. at page 78. The court rejected this argument as follows:

To the contrary, the plain language of section 4371 states that the tax is to be imposed on “each” policy of reinsurance issued by any foreign insurer...It applies to policies of reinsurance issued by a foreign insurer “to any person.” [citations omitted.] The only exception provided for is a policy of insurance signed or countersigned...in a state in which the reinsurer is authorized to do business...Had Congress intended to provide an exemption for reinsurance policies issued to foreign reinsureds, “it is reasonable to suppose that Congress would have said so in explicit terms.” [Emphasis added and citation omitted.]

Id. at page 78. As to imposing the reinsurance tax a second time, the court explained, that

[r]eimposing the excise tax on the underlying premium accords with the...legislative intent, namely, eliminating the competitive advantage afforded foreign insurance companies. In the first instance, the excise tax was withheld from the premiums ceded by the direct insurers to Northumberland as reinsurer. This served to equalize Northumberland’s position as a foreign reinsurer. In the second instance, the tax was imposed on the premiums as transferred to AIM RE as a separate foreign reinsurer.... Imposition of the tax to this transaction thus serves to further the legislative policy.

Id. Thus, the court held that the reinsurance premium paid by Northumberland, a foreign reinsurer, to AIM RE, another foreign reinsurer, was subject to the one percent reinsurance excise tax imposed under section 4371(3).

A United States reinsurance company clearly falls outside the definition of “foreign reinsurer” set forth in section 4372(d). Thus, if a foreign insurance company reinsures a policy with an affiliated U.S. insurance company, premiums paid to the U.S. reinsurer will not be subject to the one-percent excise tax imposed on policies of reinsurance under section 4371(3).

However, such an arrangement will not relieve a foreign subsidiary of a U.S. insurer from liability under section 4371(1) with respect to the premiums paid to the subsidiary for the initial insurance policy if such premiums fall within the scope of section 4371(1). The foreign subsidiary is a “foreign insurer” as defined in section 4372(a) and, as such, will be subject to the excise tax if it issues insurance to or for, or in the name of Corporation A, an “insured” as defined in section 4372(d).

Issue 2

Section 951(a)(1)(A) of the Code provides that a U.S. shareholder of a controlled foreign corporation (“CFC”) must include in gross income his pro rata share of the CFC's subpart F income for the year. Section 952(a)(1) defines subpart F income, in the case of a CFC, to include “insurance income” (as defined under section 953).

Section 953(a)(1) provides that, for purposes of section 952(a),

“insurance income” means any income which – (A) is attributable to the issuing (or reinsuring) of an insurance or annuity contract, and (B) would (subject to the modifications provided by subsection (b)) be taxed under subchapter L...if such income were the income of a domestic insurance company.

Premium payments for insurance policies clearly fall within the definition of insurance income as set forth in section 953(a)(1) and are, therefore, subpart F income as defined in section 952(a). Thus, a U.S. shareholder of a controlled foreign insurance corporation must include in gross income his pro rata share of such premium income under section 951(a)(1)(A).

As explained above, section 4371 imposes an excise tax of 4 cents on each dollar of the premium paid on a policy of casualty insurance issued by any foreign insurer if issued to or for, or in the name of, an insured as defined in section 4372(d). Section 4372(d) defines an insured as “a domestic corporation... against, or with respect to hazards, risks, losses or liabilities wholly or partly within the United States....” Section 4373(1) sets forth an exemption from the tax imposed by section

4371 for “any amount which is effectively connected with the conduct of a trade of business within the United States...” [Empahsis added.]

Section 952(b) provides that

[i]n the case of a controlled foreign corporation, subpart F income [which includes insurance income defined under section 953(a)] does not include any item of income from sources within the United States which is effectively connected with the conduct by such corporation of a trade or business within the United States unless such income is exempt from taxation (or is subject to a reduced rate of tax) pursuant to a treaty obligation of the United States. [Emphasis added.]

By definition, subpart F insurance income is not “effectively connected” with the conduct of a U.S. trade or business and, therefore, such income cannot fall within the exemption to section 4371 for “effectively connected income” set forth in section 4373(1). Premiums paid to a controlled foreign corporation and included in gross income by its U.S. shareholders as subpart F income pursuant to section 951(a) are, therefore, subject to the section 4371 excise tax unless specifically exempted by treaty.

While, as a general rule, subpart F insurance income may not be “effectively connected with the conduct of a U.S. trade or business,” section 953(c) provides certain CFCs with the opportunity to make an election to treat certain subpart F income (i.e., related person insurance income) as income effectively connected with the conduct of a U.S. trade or business. I.R.C. §953(c)(3)(C). If such election is made

[t]he tax imposed by section 4371 shall not apply with respect to any related person insurance income treated as effectively connected with the conduct of a trade or business in the United States....

I.R.C. §953(c)(3)(D)(ii).

The legislative history of section 953(c) supports the conclusion that premiums included as subpart F income in the gross income of a U.S. shareholder under section 951(a) remain subject to the section 4371 excise tax. The Conference Report indicates that “[p]remiums received by a captive insurer...like premiums received by an offshore insurer that is subject to present law subpart F, generally remain subject to the excise tax on insurance premiums paid to foreign insurers, absent a treaty provision.” H.R. Rep. No. 99-841, Vol. II, 99th Cong., 2nd Sess. 620 (1986). The Report continues by explaining that

the excise tax does not apply to income treated as effectively connected with the conduct of a U.S. business under the [section 953(c)] “effectively connected” election. This is consistent with the present law exemption from the excise tax generally accorded to premiums that are effectively connected with the conduct of a U.S. trade or business.

Section 953(d) provides that if a controlled foreign corporation (as defined in section 957(a) by substituting “25 percent or more” for “more than 50 percent” and by using the definition of United States shareholder under 953(c)(1)(A)), may make an election to be treated as a domestic corporation if such foreign corporation would qualify under part I or II of Subchapter L for the taxable year if it were a domestic corporation and the foreign corporation meets the requirements prescribed by the Secretary to ensure that the taxes imposed by this chapter on the foreign corporation are paid.

Pursuant to section 953(d), all income of the foreign insurer, including premium payments, are treated as income of a domestic corporation; consequently, the insurer is no longer treated as a foreign entity and thus, the policies it issues are not considered issued by a foreign insurer and are, therefore, not subject to the excise tax imposed under section 4371. Notice 89-79, 1989 C.B. 392.

Absent an election under section 953(c) or (d), there is no specific statutory exemption from the section 4371 excise tax for insurance premiums treated as subpart F income. Thus, if a foreign insurance company is a controlled foreign corporation and does not make an election under either section 953(c) or (d), insurance premiums which are treated as subpart F income pursuant to sections 952(a) and 953(a) will be subject to the foreign insurance excise tax under section 4371.

Issue 3

Section 4373(1) provides an exemption from the excise tax imposed under section 4371 for income that is effectively connected to a United States trade or business unless such income is exempt from the application of section 882(a) under a treaty.

Prior to amendment in 1988, section 4373(1) provided as follows:

The tax imposed by section 4371 shall not apply to—

- (1) Domestic agent. Any policy...signed or countersigned by an officer or agent of the insurer in a State, Territory, or District of the United States, within which such insurer is authorized to do business....

This domestic agent exception did not apply to foreign insurers that were merely engaged in a trade or business, but only to foreign insurers that were “authorized to do business” in a state. See United States v. Northumberland Ins. Co., 521 F.Supp. 70 (D. N.J. 1981). In Northumberland, the Court explained that

the language “authorized to do business” used in section 4373(1) is different from and therefore may carry a separate meaning from the language “engaged in a trade or business.”

Id. at 78.

The Federal Circuit Court of Appeals reviewed the requirements of section 4373(1), prior to its amendment in 1988, in The Neptune Mutual Association, Ltd. of Bermuda v. United States, 13 Cl. Ct. 309 (1987), aff’d 862 F.2d 1546 (Fed. Cir. 1988). Neptune Mutual involved the taxability of insurance premiums paid during quarters ended June 30, 1979 and June 30, 1980. Neptune Mutual, a Bermuda insurance company, received premiums from U.S. insureds and reported them as gross income on a U.S. income tax return. However, the taxpayer deducted nearly the entire amount of the premiums as reinsurance premiums paid to a related company and incurred very little U.S. tax liability.

The IRS took the position that the taxpayer was liable for the excise tax imposed by section 4371 because it was not “authorized to do business” by a state, territory, or district within the United States, and thus, did not qualify for exemption under section 4373(1). The taxpayer paid the amount of excise tax assessed and filed a claim and later a refund suit arguing that it was authorized to do business in the United States and, thus, liable for the income and not the excise tax. The taxpayer relied on section 842 as follows:

If a foreign company carrying on an insurance business within the United States would qualify under part I or II of this subchapter for the taxable year if (without regard to income not effectively connected with the conduct of any trade or business within the United States) it were a domestic corporation, such company shall be taxable under such part on its income effectively connected with its conduct of any trade or business within the United States. With respect to the remainder of its income which is from sources within the United States, such foreign company shall be taxable as provided in section 881.

Section 842 does not contain an exemption from income tax for premiums that have been subject to the excise tax under section 4371. Id. at 1549. The Court of Appeals for the Federal Circuit noted that a literal interpretation of sections 842 and 4371 et seq. could result in premiums received by a foreign insurer engaged in a U.S. trade or business for purposes of section 842, and not exempt from the excise

tax under section 4373(1), being subject to both income and excise taxes on the same premium income. Declining the taxpayer's suggestion to hold that the later enacted income tax provision overruled the excise tax imposed by section 4371, the Federal Circuit, upholding the Commissioner's determination, adopted the rule of statutory construction that favors the more specific provision over a general provision and concluded that "the more specific terms of section 4371 prevail over any conflicting provisions of section 842." Since the court concluded that the taxpayer was not "authorized to do business" in any State, Territory or District of the United States, it held that the taxpayer was not exempt from the excise tax under section 4373(1).

The relationship of sections 842 and 4371 was legislatively resolved by an amendment to section 4373 in P.L. 100-647, §1012(q)(13)(A)(Nov. 10, 1988). Section 4373(1), as applicable to premiums paid on and after December 10, 1988, states that

[t]he tax imposed by section 4371 shall not apply to—

[a]ny amount which is effectively connected with the conduct of a trade or business within the United States unless such amount is exempt from the application of section 882(a) pursuant to a treaty obligation of the United States.

This provision changes the rule applied by the Federal Circuit in Neptune Mutual Association. That is, under the amended section 4373(1), the excise tax applies only if the premium income is not effectively connected with a U.S. trade or business in contrast to the Federal Circuit's rule that the excise tax applied unless the exemption in section 4373, before its amendment, was applicable.

Treasury Regulations §§46.4371-2(a)(1); (b)(1) and (c)(1) have not been changed to reflect the 1988 amendment to section 4373(1) and still refer to an exemption for policies or other instruments "signed or countersigned by an officer or agent of the insurer in a State, Territory, or the District of Columbia in which the insurer is authorized to do business." However, Treasury Regulations will not be sustained if they are plainly inconsistent with the statutes. Bingler v. Johnson, 394 U.S. 741, 749-750 (1969), quoting Commissioner v. South Texas Lumber Co., 333 U.S. 496, 501 (1948). Congress amended section 4373(1) to its current reading to provide exemption from the section 4371 excise tax with respect to amounts which are effectively connected with the conduct of a U.S. trade or business. Therefore, to the extent that section 46.4371-2 of the Regulations is inconsistent with section 4373, as amended by the Tax Reform Act of 1988, the Regulation is no longer effective.

Section 4371(1) imposes a tax, in part, on casualty insurance policies “if issued to or for, or in the name of, an insured as defined in section 4372(d).” [Emphasis added.] Section 4372(d)(1) provides, in part, that the term “insured” means a “domestic corporation...with respect to...risks...wholly or partly within the United States...” Together sections 4371(1) and 4372(d)(1) provide a definition of “insured” that includes Corporation A, a domestic corporation as defined in section 7701(a)(4).

Once it is determined that an insurance policy is subject to the excise tax imposed under section 4371(1), section 4374 establishes liability for payment of the tax. Prior to its amendment in the Tax Reform Act of 1976, P.L. 94-455, §1904(a)(12), section 4374 was as follows:

Any person to or for whom or in whose name any policy...referred to in section 4371 is issued, or any solicitor or broker acting for or on behalf of such person in the procurement of any such instrument, shall affix the proper stamps to such instrument. Notwithstanding the preceding sentence, the Secretary or his delegate may, by regulations, provide that the tax imposed by section 4371 shall be paid on the basis of a return.

The last sentence in section 4374 above, authorizing the Secretary to change the stamp tax to a tax paid by a return, was enacted by P.L. 89-44, §804(a) (June 21, 1965). The Secretary exercised the discretion to require that the tax be paid by return, instead of by stamp, in T.D. 7023 (January 21, 1970). This T.D. promulgated section 46.4374-1(a) of the Regulations, as follows:

the tax imposed by section 4371 shall be paid on the basis of a return. Such tax shall be remitted by the person who makes the payment of the premium to a foreign insurer or reinsurer or to any nonresident agent, solicitor or broker. For purposes of this paragraph, the person who makes payment means that resident person who actually transfers the money, check, or its equivalent to the foreign insurer or reinsurer,...or to any nonresident agent, solicitor or broker....For persons liable for the tax imposed by section 4371, see section 4384 and the regulations thereunder.

This regulation was intended to determine the party responsible for filing the return reporting the tax under Section 4371. The Regulation explicitly provides that liability for the tax is to be determined under section 4384.

Prior to repeal in 1976, section 4384 provided as follows:

The taxes imposed by this chapter shall be paid by any person who makes, signs, issues or sells any of the documents and instruments subject to the

taxes imposed by this chapter, or for whose use or benefit the same are made, signed, issued or sold.... [Emphasis added.]

In the Tax Reform Act of 1976, P.L. 94-455, §1904(a)(12), Congress repealed section 4384 and amended section 4374 to its current reading which requires payment of the tax by return rather than stamp and shifts the determination of liability for the tax, without changing the test for liability, from section 4384 to section 4374. See S. Rep. No. 94-938. 94th Cong., 2d Sess. 526 (June 10, 1986), 1976-3 C.B. Vol. 3, 526, which states the following:

New Code section 4374 corresponds to present Code section 4384 except that it is changed to reflect payment by return rather than by stamp.

Subsequent to its amendment in 1976, section 4374 provides that

[t]he tax imposed by this chapter shall be paid, on the basis of a return, by any person who makes, signs, issues, or sells any of the documents and instruments subject to the tax, or for whose use or benefit the same are made, signed, issued, or sold. [Emphasis added.]

Although section 46.4374-1(a) of the Regulations refers to the actual payment of the premium by the resident person to the foreign insurer, the Regulation was published in 1970 prior to amendment of the statute in 1976. Therefore, to the extent that section 46.4374-1(a) of the Regulations is inconsistent with section 4374, as amended, the Regulation is no longer effective.

Therefore, for purposes of section 4371 et seq., Corporation A, as beneficiary of the insurance, is liable for the excise tax as well as Corporations B and C. An actual payment of premiums on a policy by Corporation A is not necessary to establish liability for the excise tax under section 4374 and the Regulations thereunder, because the liability for the tax is on all makers, signers, issuers and beneficiaries of the insurance subject to tax under section 4371(1). See I.R.C. §4374. Thus, Corporation A is liable for the section 4371 tax on the premiums paid for the insurance.

If you have any further questions, please call (202) 622-3880.

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