Internal Revenue Service

Number: **200427014**
Release Date: 7/2/04
Index Number: 4371.00-00

Department of the Treasury
Washington, DC 20224

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:INTL:BR1 – PLR-155955-03
Date:
March 26, 2004

TY:

Taxpayer =

Corp X =
Corp Z =
Country A =
Country B =
City C =
City D =
State E =
State F =
Date G =
Date H =
Product J =

Dear :

This responds to your letter dated September 16, 2003, in which you requested a ruling that premiums received by Taxpayer on policies of insurance or reinsurance of U.S. risks are exempt from the insurance excise tax imposed by section 4371 of the Internal Revenue Code of 1986, as amended ("Code"), pursuant to the income tax convention between the United States and Country A (the "Treaty").

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Taxpayer's principal activity is to insure certain non-life insurance risks of its parent company, Corp X, and other operating subsidiaries of Corp X. Taxpayer transacts business through its office in City C in Country A. Independent agents perform audit, taxation, and management functions in Country A for the Taxpayer. A City D-based Corp X affiliate, Corp Y, provides professional services to the Taxpayer.

Taxpayer has entered into an agreement to insure costs incurred by certain Corp X affiliates worldwide, including Corp Z, in connection with the recall of Product J. Corp Z, a State E corporation based in State F, distributes Product J, accessories, and equipment in the United States. The taxpayer plans to issue additional insurance policies with respect to United States insureds or risks within the United States in the future.

Taxpayer was organized in Country A and is fully liable to tax in Country A on its worldwide income. The standard tax rate of % in respect of Taxpayer's income arising from trading activities has applied since Date G.

The Taxpayer bases its eligibility for the § 4371 exemption on its ability to satisfy Article 23(5)(a) of the Treaty.

Section 4371 of the Code imposes an excise tax on premiums paid on insurance policies issued to U.S persons and covering U.S. risks wholly or partly within the United States, and to foreign persons engaged in a U.S. trade or business covering risks within the United States. See section 4372(d). Rev. Proc. 92-39 establishes procedures for entering into a closing agreement to establish an exemption from the section 4371 excise tax when the exemption is claimed under a U.S. income tax treaty.

Article 2 (Taxes Covered), paragraph 1(a) of the Treaty provides that in the United States the Federal excise taxes imposed on insurance premiums paid to foreign insurers is a covered tax. The Treaty shall, however, apply to the Federal excise taxes imposed on insurance premiums paid to foreign insurers only to the extent that the risks covered by such premiums are not reinsured with a person not entitled to the benefits of this or any other convention which provides exemption from these taxes.

Paragraph 2 of the Protocol to the Treaty requires that for the purposes of Article 2, paragraph 1, the Treaty shall not apply to the Federal excise taxes imposed on insurance premiums paid to foreign insurers where such premiums are not subject to the generally applicable tax imposed on insurance corporations in the Contracting State in which such insurers are resident.

Article 23(Limitation on Benefits), paragraph (1) provides that except as otherwise provided in this Article, a resident of a Contracting State that derives income from the other Contracting State shall be entitled to all the benefits of the Treaty only if such resident is a "qualified person" as defined in this Article.

Article 23(2) sets forth several alternative safe harbors for meeting the requirements to be a “qualified person” entitled to all of the benefits of the Treaty. Taxpayer is unable to satisfy these safe harbors. Article 23(5)(a) of the Treaty provides that a company that is a resident of a Contracting State shall also be treated entitled to all of the benefits of the Convention if:

i) at least 95 percent of the aggregate vote and value of all its shares is owned directly or indirectly by seven or fewer qualified persons or persons that are residents of member states of the European Union or of parties to the North American Free Trade Agreement (NAFTA) or any combination thereof; and

ii) such company meets the base reduction test described in subparagraph (c)(ii) of paragraph 2, provided that a resident of a member state of the European Union or a party to NAFTA shall be treated as a qualified person for the purposes of that test.

<u>Article 23(5)(a)(i)</u>

Taxpayer represents that for the Year Ended Date H, 100 percent of the outstanding share capital of the Taxpayer is owned by Corp X, a company registered in Country B**.**

Article 23(8)(e) of the Treaty defines the term “resident of a member state of the European Union” as:

> a person that would be entitled to the benefits of a comprehensive income tax convention in force between any member state of the European Union and the Contracting State from which the benefits of the Convention are claimed, provided that if such convention does not contain a comprehensive Limitation on Benefits article (including provisions similar to those of subparagraphs c) and e) of paragraph 2), the person would be entitled to the benefits of this Convention under the principles of paragraph 2 if such person were a resident of one of the Contracting States under Article 4 (Residence) of this Convention.

Country B is a member of the European Union. Corp X is a resident of Country B because it is incorporated under the laws of Country B and is liable to tax in Country B by reason of its incorporation and place of management. Thus, Corp X is a resident of Country B for purposes of the Treaty. The U.S.- Country B Treaty contains a comprehensive Limitation on Benefits provision (Article 28(d) and (e)) similar to those of

Article 23(2)(c) and (3) of the Treaty. Under Article 28(d) of the U.S.-Country B Treaty, a resident is entitled to the benefits of the treaty if such person is a company in whose principal class of shares there is substantial and regular trading on a recognized stock exchange.

The phrase "substantial and regular trading "is not defined in the U.S.-Country B treaty, its legislative history, or in the Treasury Technical Explanation.

A concept similar to "substantial and regular trading" is found in section 884(e)(4)(B) of the Code. Under that section, a publicly traded corporation may be a resident of a treaty country if—

> (i) the stock of such corporation is primarily and regularly traded on an established securities market in such country….

In applying the "primarily and regularly traded" requirement in section 884(e)(4)(B) of the Code, Treasury Regulations section 1.884-5(d)(4)(i) defines "regularly traded" as follows:

> For purposes of this section, stock of a corporation is "regularly traded" on one or more established securities markets in the foreign corporation's country of residence… for the taxable year if—
>
> (A) One or more classes of stock of the corporation that, in the aggregate, represent 80 percent or more of the total combined voting power of all classes of stock of such corporation entitled to vote and of the total value of the stock of such corporation are listed on such market or markets during the taxable year;
>
> (B) With respect to each class relied on to meet the 80 percent requirement of paragraph (d)(4)(i)(A) of this section –
>
> (1) Trades in each such class are effected, other than in *de minimis* quantities, on such market or markets on at least 60 days during the taxable year…; and
>
> (2) The aggregate number of shares of each such class that is traded on such market or markets during the taxable year is at least 10 percent of the average number of shares outstanding in that class during the taxable year (or, in the case of a short taxable year, a percentage that equals 10 percent of the number of days in the short taxable year divided by 365).

It is represented that Corp X's share capital consisted of one class of registered shares for the fiscal year and that the shares are traded on all Country B stock exchanges and also in Zurich, Paris and City D and that trading in these share satisfies the requirements of Treasury Regulations section 1.884-5(d)(4)(i). Thus, Taxpayer represents that there is substantial and regular trading on a recognized stock exchange of the principal class of shares of Corp X, within the meaning of the U.S.-Country B Treaty.

Article 23(a)(5)(ii)

In addition to satisfying the ownership requirements of Article 23(5)(a)(i) of the Treaty, Taxpayer must meet the base reduction test of Article 23(5)(a)(ii) as described in subparagraph (c)(ii) of paragraph 2. A resident of a member state of the European Union or of a party to NAFTA is treated as a qualified person for the purposes of that test.

Under the base reduction test of paragraph 2(c)(ii), a resident is a qualified person for a fiscal year only if amounts it paid to persons that are neither qualified persons nor residents or citizens of the United States, and that are deductible for income tax purposes in that fiscal year in the payor's State of residence do not exceed 50 percent of the gross income of the payor. Deductible payments do not include arm's length payments in the ordinary course of business for (1) services or tangible property, and (2) payments in respect of financial obligations of a bank.

Section 3.09 of Rev. Proc. 92-39, 1992-1 C.B. 860, contains a base erosion test similar to the test provided in Article 23(5)(a)(ii) of the Treaty. Section 3.09 states that the terms "gross income" and "liabilities" have the same meaning as in section 3.07 of Rev. Proc. 92-39. Section 3.07(1) provides that "gross income" includes investment income attributable to the taxpayer's insurance business but excluding investment income not attributable to its insurance business. Section 3.07(10) also provides that the term "liabilities" refers to amounts that reduce gross premiums or are deductible against gross income, including interest, royalties, and premiums paid in connection with reinsuring risks.

Based on the facts submitted, Taxpayer has represented that Corp X is a qualified person for purposes of the base erosion test of Article 23(2)(c)(ii) of the Treaty**.** After removing the liability accrued with respect to insurance coverage issued to Corp X, the total of the remaining liabilities accrued by the Taxpayer in fiscal year , does not exceed 50 percent of the fiscal year gross income. Thus, Taxpayer satisfies the base erosion test with respect to fiscal year . Taxpayer further represented that it expects to satisfy the base erosion test for and its future fiscal years.

Based on these representations, we conclude that the Taxpayer satisfies the ownership requirements of Article 23(5)(a) and is eligible for benefits under the Treaty.

According to paragraph 8(a) of the Closing Agreement, the liability of the Taxpayer for Federal excise tax, as agreed upon, including liability resulting from reinsurance of U.S. risks with persons not entitled to exemption under the Treaty or another convention, will commence on . The letter of credit required by paragraph 5(a) of the Closing Agreement, in the amount of $, must be in effect with 30 days of the date the agreement is signed on behalf of the Commissioner.

Any person otherwise required to remit the Federal excise tax on foreign insurance or reinsurance premiums issued by the Taxpayer pursuant to section 46.4374-1(a) of the excise tax regulations may rely on a copy of this letter or an executed copy of the Closing Agreement as authority that they may consider premiums paid to the Taxpayer on and after , as exempt under the Treaty from the Federal excise tax.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely,

W. Edward Williams
Special Counsel
Office of Office of the Associate Chief
Counsel
(International)

Enclosures (2)

cc: