

**INTERNAL REVENUE SERVICE**  
**NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM**

June 22, 2001

Number: **200147007**  
Release Date: 11/23/2001  
Index (UIL) No.: 842.01.00  
CASE MIS No.: TAM-119510-01/CC:INTL:B5

Team Coordinator, LMSB NR 1416

Taxpayer's Name:  
Taxpayer's Address:

Taxpayer's Identification No:  
Years Involved:

**LEGEND:**

Taxpayer                =  
State Y                 =  
Country X              =

**ISSUE(S):**

Whether a foreign life insurance company carrying on an insurance business in the U.S. determines the amount of income effectively connected with its U.S. business under section 842(a) of the Internal Revenue Code based exclusively on the amount of income reported by the business on the National Association Insurance Commissioner's ("NAIC") annual statement filed with the state insurance commissioner.

**CONCLUSION:**

A foreign life insurance company doing business in the U.S. is taxable on any income effectively connected with any U.S. trade or business. Sec. 842(a). For this purpose, effectively connected income is determined under section 864(c). The NAIC statement, like any accounting record, is given "due regard" as provided under section 864(c)(2), but is not determinative of the amount of effectively connected income of any U.S. trade or business.

**FACTS:**

Taxpayer is a foreign life insurance company and its business consists of issuing life insurance, annuity, and other insurance contracts in Country X and the United States. Taxpayer conducts its U.S. life insurance business through a U.S. branch. The State of Y is the point of entry of the U.S. branch. The State of Y requires Taxpayer, as a

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foreign life insurance company, to maintain trustee assets and deposits in the United States sufficient to satisfy all potential claims of its U.S. policyholders. In general, under State Y law, the trustee assets must have a value at least equal to a U.S. branch's reserves and other liabilities as well as the minimum capital and surplus required by the state insurance code. The trustee assets are held exclusively for the benefit and protection of U.S. policyholders.

Taxpayer is required to file a NAIC statement with the State of Y and with the insurance departments of each of the states in which it operates. Generally, the NAIC statement is intended to show whether an insurance company has a sufficient amount of assets to meet all liabilities of its U.S. branch operations. The trustee assets held by Taxpayer are required to be included on the NAIC statement. The NAIC statement does not necessary include all assets used in the branch's U.S. trade or business.

In addition to the trustee assets, Taxpayer maintains non-trustee assets in the United States consisting of bonds, stocks, and short-term investments which are managed, maintained, and accounted for in the United States. Non-trustee assets are not reflected in the NAIC statement. The field represents that Taxpayer uses non-trustee assets in its U.S. insurance business.

Taxpayer does not include income derived from its non-trustee assets on its U.S. federal income tax return as effectively connected income. Taxpayer's position is that income attributable to the non-trustee assets is not income effectively connected with the conduct of its U.S. insurance business because this income is not required to be included on the NAIC statement.

#### LAW AND ANALYSIS:

##### A. Controlling Law

Section 842(a), provides in relevant part:

If a foreign company carrying on an insurance business within the United States would qualify under part I...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 income which is from sources within the United States, such a foreign company shall be taxable as provided in section 881.

In general, section 864(c) defines effectively connected income. Under section 864(c)(1), "for purposes of this title," a foreign corporation engaged in a U.S. trade or business during the taxable year determines its effectively connected income under the rules set forth in section 864(c)(2),(3), (4), (6), and (7). Section 864(c)(2) generally provides rules for determining whether periodical income from sources within the U.S.

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or gain or loss from sale or exchange of capital assets are effectively connected to a U.S. trade or business. In making this determination, the factors taken into account include whether (a) the income, gain or loss is derived from assets used in or held for use in the conduct of such trade or business, or (b) the activities of such trade or business were a material factor in the realization of such income, gain or loss. Sec. 864(c)(2); see Treas. Reg. § 1.864-4(c)(2)(application of the asset-use test). For this purpose, due regard is given to whether or not such asset, or income, gain or loss was accounted for through the trade or business. Sec. 864(c)(2); see Treas. Reg. § 1.864-4(c)(4). All other income, gain or loss from source within the U.S. is treated as effectively connected with the conduct of a U.S. trade or business. Sec. 864(c)(3). Section 864(c)(4)(C) provides in the case of a foreign insurance company any income from sources without the U. S. which is attributable to its U.S. business is treated as effectively connected with the conduct of such U.S. trade or business. See Treas. Reg. § 1.864-5(c).

The legislative history of section 842 states:

Your committee believes that foreign insurance companies- life insurance companies and other insurance companies, including both mutual and stock companies- should, in general, be taxed on their investment income in the same manner as other foreign corporations. For this reason, the bill provides that a foreign insurance corporation carrying on an insurance business within the United States is to be taxable in the same manner as domestic companies carrying on a similar business with respect to its income which is effectively connected with the conduct of a trade or business within the United States. . . . For purposes of determining whether or not income of a foreign life insurance company is effectively connected with the conduct of its U.S. life insurance business, the annual statement of its U.S. business on the form approved by the National Association of Insurance Commissioners will usually be followed. It is noted that all the income effectively connected with the foreign life insurance company's U.S. life insurance business, from whatever source derived, comes within the ambit of this provision. This is a continuation of present law which subjects to U.S. tax all the income attributable to the U.S. life insurance business from whatever source derived.

H.R. Rep. No. 1450, 89<sup>th</sup> Cong., 2d Sess. 31, 32 (1966); S. Rep. No. 1707, 89<sup>th</sup> Cong., 2d Sess. 38 (1966)(emphasis added).

In the Omnibus Budget Reconciliation Act of 1987 ("OBRA 1987"), the Conference Committee suggests that regulations exist that apply to life insurance companies which generally look to the NAIC statement to determine effectively connected income. H. Conf. Rep. No. 100-495 at 983 (1987). Regarding these purported regulations, Congress stated: "The conferees believe that those regulations should be reexamined to consider the appropriateness of relying on State insurance rules in determining effectively connected income." H. Conf. Rep. No. 100-495 at 983 (1987). We have been unable to find any such regulations.

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B. Analysis

A foreign insurance company doing business in the U.S. is taxable on any income effectively connected with any U.S. trade or business. Sec. 842(a). For purposes of the Internal Revenue Code, section 864(c) defines income that is effectively connected with a U.S. trade or business. Thus, a foreign insurance company determines income effectively connected to its U.S. trade or business under the rules in section 864(c).

For purposes of this advice, we assume that the non-trusted assets at issue otherwise would constitute assets used in the U.S. life insurance business under the asset-use test of section 864(c)(2)(A) and Treas. Reg. § 1.864-4(c)(2), apart from the question of the relevance of the absence of any reflection of such assets on the NAIC statement.

Taxpayer argues that Congress intended that the NAIC statement was to be determinative of what income is effectively connected to a foreign insurer's U.S. life insurance business, unless a specific statutory or regulatory provision provides otherwise. In support of this argument, Taxpayer refers to the statement in the legislative history providing that "For purposes of determining whether or not income of a foreign life insurance company is effectively connected with the conduct of its U.S. life insurance business, the annual statement of its U.S. business on the form approved by the National Association of Insurance Commissioners will usually be followed." (Emphasis added).

As confirmed by the express language of section 842(a) and the legislative history quoted above, Congress intended that foreign insurance companies should, in general, be taxed on their investment income in the same manner as other foreign corporations on their income which is effectively connected with the conduct of a trade or business within the United States. No special rule was provided besides that in section 864(c)(4)(C) and Treas. Reg. § 1.864-5(c) concerning the foreign source income effectively connected to the conduct of a U.S. trade or business of a foreign insurance company. Thus, Taxpayer's claim that an insurance company specially determines its effectively connected by based on its NAIC statements has no statutory or regulatory basis.

Moreover, the legislative history merely states that NAIC statements will usually be followed. This an acknowledgment that section 864(c)(2) gives "due regard" to accounting records. It does not support Taxpayer's contention that NAIC statements were intended to be a substitute for the rules in section 864(c). In fact, Congress emphasized this very point by noting in the sentence following its discussion of the NAIC statement that "all the income effectively connected with the foreign life insurance company's U.S. life insurance business...comes within the ambit of this provision." Although not reflected in the NAIC statements, the non-trusted assets at issue in this case are managed, maintained, and accounted for in the United States. Such accounting treatment also warrants "due regard" under the statute and regulations.

Accordingly, a foreign life insurance company doing business in the U.S. is taxable on

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any income effectively connected with any U.S. trade or business. Sec. 842(a). For this purpose, effectively connected income is determined under section 864(c). The NAIC statement, like any accounting record, is given “due regard” as provided under section 864(c)(2), but is not determinative of the amount of effectively connected income of any U.S. trade or business.

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.