

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

REG-117307-04

RIN 1545-BD27

Stock Held by Foreign Insurance Companies

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains a proposed regulation relating to the determination of income of foreign insurance companies that is effectively connected with the conduct of a trade or business within the United States. The regulation provides that the exception to the asset-use test for stock shall not apply in determining whether the income, gain, or loss from portfolio stock held by foreign insurance companies constitutes effectively connected income.

DATES: Written or electronic comments and requests for a public hearing must be received by September 23, 2004.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-117307-04), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-117307-04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or sent electronically, via the IRS Internet site at

[www.irs.gov/regs](http://www.irs.gov/regs) or via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (IRS and REG-117307-04).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Sheila Ramaswamy, at (202) 622-3870; concerning submissions and delivery of comments, Robin Jones, 202-622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

### **Background**

In 1992, the Treasury Department and the IRS published proposed regulations under section 864 providing that stock is not treated as an asset used in, or held for use in, the conduct of a trade or business in the United States. Proposed §1.864-4(c)(2)(ii)(C). The notice of proposed rulemaking solicited comments regarding the appropriate treatment of income from portfolio stock investments of insurance companies. The Treasury Department and the IRS published final regulations in 1996 which adopted the general rule in the proposed regulations that stock is not treated as an asset used in, or held for use in, the conduct of a U.S. trade or business. TD 8657(1996-1 C.B. 153). The final regulations reserved on the treatment of stock held by a foreign insurance company. §1.864-4(c)(2)(iii)(b). This proposed regulation sets forth circumstances in which stock held by a foreign insurance company is not subject to the general rule in §1.864-4(c)(2)(iii)(a), which provides that stock is not an asset used in a U.S. trade or business.

### **Explanation of Provisions**

In the case of a foreign corporation engaged in a trade or business within the United States during the taxable year, section 864(c)(2) generally provides rules for determining whether certain fixed or determinable, annual or periodical income from sources within the United States or gain or loss from sources within the United States from sale or exchange of capital assets is income effectively connected with the conduct of a trade or business in the United States. Section 864(c)(2). 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 (the asset-use test), or (b) the activities of such trade or business were a material factor in the realization of such income, gain or loss. Section 864(c)(2). Section 1.864-4(c)(2)(iii)(a) generally provides that stock of a corporation (whether domestic or foreign) is not an asset used in or held for use in the conduct of a trade or business in the United States except as provided in (c)(2)(iii)(b). Section 1.864-4(c)(2)(iii)(b) entitled "Stock Held by Foreign Insurance Companies" is reserved.

Insurance companies hold investment assets, such as stocks and bonds, to fund their obligations to policyholders and to meet their surplus (capital) requirements. Thus, stock held in an investment portfolio may be an asset held for use in the trade or business of a foreign insurance company. By contrast, stock of a subsidiary generally is not held for the purpose of

meeting an insurance company's business needs.

This proposed regulation provides that the general rule excluding stock from the asset-use test does not apply to stock held by a foreign insurance company unless such company owns directly, indirectly, or constructively 10 percent or more of the vote or value of the company's stock. The 10-percent threshold is intended to distinguish portfolio stock held to fund policyholder obligations and surplus requirements from investments in a subsidiary. Comments are requested as to whether this 10-percent threshold provides an appropriate standard for determining whether stock is a portfolio investment for these purposes.

#### **Proposed Effective Date**

This regulation is proposed to apply to taxable periods beginning on or after the date of publication of a Treasury decision adopting this rule as a final regulation in the **Federal Register**.

#### **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter

6) do not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### **Comments and Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for a public hearing will be published in the **Federal Register**.

### **Drafting Information**

The principal author of these proposed regulations is Sheila Ramaswamy, Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

### **List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

### **Proposed Amendment to the Regulations**

Accordingly, 26 CFR part 1 is proposed to be amended as

follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. In §1.864-4, paragraph (c)(2)(iii)(b) is revised to read as follows:

§1.864-4 U.S. source income effectively connected with U.S. business.

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \*

(iii) \* \* \*

(b) Paragraph (c)(2)(iii) of this section shall not apply to stock of a corporation (whether domestic or foreign) held by a foreign insurance company unless the foreign insurance company owns 10 percent or more of the total voting power or value of all classes of stock of such corporation. For purposes of this section, section 318(a) shall be applied in determining ownership, except that in applying section 318(a)(2)(C), the phrase "10 percent" is used instead of the phrase "50 percent."

\* \* \* \* \*

Mark E. Matthews,  
Deputy Commissioner for Services and Enforcement.