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DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
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The Honorable Alejandro J. Garcia-Padilla  
Governor  
Commonwealth of Puerto Rico  
P.O. Box 9020082  
La Fortaleza, San Juan, PR 00901

Dear Governor Garcia-Padilla:

Thank you for having your representatives meet with us on March 3, 2015. We also thank you for your letter dated December 17, 2014. In your letter, you requested we reconsider the application of section 4371 of the Internal Revenue Code to policies issued by Puerto Rican insurance companies as set forth in Rev. Rul. 79-193, 1979-1 C.B. 359. This ruling holds that "[l]ife insurance policies issued by a Puerto Rican insurance company to any resident person in any state or territory of the United States or the District of Columbia are subject to the tax imposed by section 4371 of the Code." In so holding, it reiterates the holding of Rev. Rul. 59-148, 1959-1 C.B. 446.

You have asked us to reconsider this well-established holding because of Puerto Rico's desire to position itself as an insurance center. In support of this request, we also received a memorandum dated January 13, 2015 from Kirkland & Ellis. The primary argument for why we should reconsider our opinion, as outlined in the Kirkland & Ellis memorandum, centers on the use of the word "territory" in Treasury Regulation section 46.4371-2(b)(1) (issued by T.D. 7023, January 21, 1970) and Rev. Rul. 79-193.

"Territory" as used in the regulation does not include the Commonwealth of Puerto Rico. In the Internal Revenue Code of 1954, "territory" referred to Alaska and Hawaii, which were incorporated into the United States for income tax purposes. Before 1959, "United States" was defined in section 7701(a)(9) to include the "territories of Alaska and Hawaii." Even after Hawaii's statehood, section 7701(a)(4) provided that the term "domestic," when applied to a corporation or partnership, meant created or organized in the United States or under the law of the United States or any state or territory. The section 7701(a)(4) reference to "territory" continued to be to the former incorporated territories, Alaska and Hawaii, and "territory" as used in Treasury Regulation section

46.4371-2 has the same meaning.

The Code and regulations generally referred to Puerto Rico and other unincorporated territories as “possessions.” See section 936(d)(1) and Treas. Reg. section 301.6332-1(a)(2) (T.D. 6746, January 20, 1964). “Territory” was subsequently deleted from several provisions in the Code, including section 7701(a)(4), by section 1906(c) of the Tax Reform Act of 1976 (Pub. L. 94-455) because “there are no longer any United States Territories” (S. Rep. 94-938, at 543 (1976)).

In recent years, the term “territory” as applied to Puerto Rico and other unincorporated territories has become common, beginning with a November 30, 1992 executive order issued by President George H. W. Bush regarding the treatment of Puerto Rico as if it were a state for administrative purposes. Consistent with this change, tax guidance has sometimes used “U.S. territory or possession” to describe Puerto Rico and other unincorporated territories. Compare definition of “U.S. territory or possession” in Treas. Reg. section 1.1471-1(b)(43) (2013) to definition of “possession” in Treas. Reg. section 1.937-1(a)(2)(i) (2006). This recent change in usage does not justify a change in interpretation of “territory” as used in older guidance such as Treas. Reg. section 46.4371-2, issued in 1970, and Rev. Rul. 79-193.

We believe Rev. Rul. 79-183 provides the correct interpretation of “foreign insurer or reinsurer” in section 4371 based upon the definitions of “foreign,” “domestic,” and “United States” in section 7701(a). Section 7701(a)(4) defines the term “domestic” as pertaining to a corporation or partnership created or organized in the United States or under laws of the United States or any state. Section 7701(a)(5) defines the term “foreign,” when applied to a corporation or partnership, as being “not domestic.” Section 7701(a)(9) states that the term “United States,” when used in a geographical sense, includes only the states and the District of Columbia.

The holding of Rev. Rul. 79-183 consistently treats both Puerto Rico insurers and Puerto Rico insureds as foreign because it is not within the United States in a geographic sense, then applies section 4371 accordingly. For the above reasons, we affirm our view that the holding of Rev. Rul. 79-183 correctly interprets section 4371 and the regulation thereunder.

I hope this information is helpful. If you have any questions, please contact me at ( ) , or a member of your staff can contact or at ( ) .

Sincerely,

Marjorie Rollinson  
Deputy Associate Chief Counsel  
(International)

cc: