OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR Robert Stanchik, Supervisory Attorney Group 1116
OP:IN:D:C:EX:1116

FROM: W. Edward Williams, Senior Technical Reviewer, Branch 1
CC:INTL:Br.1

SUBJECT:

This Field Service Advice responds to your memorandum dated February 4, 2000. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND

A =
B =
C =

ISSUES:

1. Does the Excise Tax on foreign reinsurance under I.R.C. § 4371(3) apply to reinsurance covering items shipped outside the United States.

2. Whether a claim for refund may be filed by a reinsurer which did not remit the tax under I.R.C. § 4371 to the Service.

CONCLUSIONS:

1. The tax imposed by I.R.C. § 4371 may not be applied to premiums paid with respect to insurance and reinsurance covering risks associated with goods in actual export from the United States to foreign countries.

2. The claim for refund for taxes under I.R.C. § 4371 should be filed by the domestic
insurance company who remitted the tax to the Service and not by the reinsurer.

FACTS:

United States shippers that ship packages with A, from locations in the United States to locations outside the United States and its possessions, have the option to purchase "excess value" insurance coverage that will pay for damage or loss to the shipment. The insurance premiums were paid by A's customers and remitted by A to one of three unrelated United States insurance companies. The policies issued by the three United States insurance companies state the insurance is to exclusively cover damages in transit of A's mailings with ultimate delivery destinations outside the United States and its possessions. The three insurance policies attach from the time A takes custody of the property and cover continuously thereafter during the course of transportation until delivery to the addressee. This type of insurance coverage is called property and casualty inland marine insurance. A acted as a fiduciary in collecting and remitting the insurance premiums collected from its customers.

B, a corporation formed in, and located in Country C, reinsured the policies of the three United States insurance companies. When the reinsurance contracts were consummated, the three United States insurance companies would remit 99% of the reinsurance premium to B and would withhold 1% of the premium, representing the foreign reinsurance federal excise tax under I.R.C. § 4371(3). The federal excise tax was then remitted to the Internal Revenue Service by the three United States insurance companies.

The Service received a claim filed by B for a refund of federal excise taxes, pursuant to Notice 96-37, 1996-2 C.B. 108. In the claim, dated April 28, 1998, B contended that the tax imposed by I.R.C. § 4371 may not be applied to premiums paid with respect to insurance covering risks associated with goods in export transit from the United States, relying on *United States v. International Business Machines Corp.*, 517 U.S. 843 (1996).

DISCUSSION:

ISSUE 1 Casualty insurance policies are taxable under I.R.C. §§ 4371(1) or 4371(3) if issued by a "foreign insurer or reinsurer" and issued to, for, or in the name of an "insured." A "foreign insurer or reinsurer" is defined in I.R.C. § 4372(a) as an insurer or reinsurer who is *inter alia*, a foreign corporation. An insured is defined in I.R.C. § 4372(d) as:

> (1) a domestic corporation or partnership, or an individual United States resident insured "against, or in respect to, hazards, risks, losses, or liabilities wholly or partly within the United States," or

(2) a foreign corporation or partnership or non-resident alien individual, engaged in a trade or business in the United States insured "against, or in respect to, hazards, risks, losses, or liabilities within the United States."[1]

In *United States v. International Business Machines Corp.*, the United States Supreme Court held that the Export Clause[2] of the United States Constitution prohibits the assessment of nondiscriminatory federal taxes on goods in export transit. 517 U.S. at 863. In doing so, it found that the excise tax under I.R.C. § 4371 as applied to casualty insurance issued by a foreign insurer to cover shipment of IBM's products to its foreign subsidiaries was unconstitutional, as the tax on insurance premiums was equivalent to taxes on the export goods themselves. The Supreme Court refused to overrule its earlier opinion in *Thames & Mersey Marine Insurance Co. v. United States*, 237 U.S. 19 (1915), which had held that the Export Clause, which bars imposition of a "tax or duty" on articles exported from any state, prohibited the tax because casualty insurance is an integral part of exportation.

In *International Business Machines*, the Government had conceded that the Supreme Court ruled in *Thames & Mersey* that the excise tax violated the Export Clause, but asked that the issue be re-examined because its underlying theory had been rejected in the context of the Commerce[3] and Import-Export[4] Clauses and those clauses have historically been interpreted in harmony with the Export Clause. The Supreme Court, however, held that although it had rejected the reasoning behind the early Commerce Clause and Import-Export Clause cases, the differences in the

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[1] Although the April 28, 1998 claim for refund seems to be limited to a constitutional attack based on *United States v. International Business Machines Corp.*, in your request for advice you characterize B's claim as including the contention that it is not "subject to the 1% reinsurance FET, as the insurance coverage was to cover goods in transit with final destinations located outside the United States, and thus did not cover any United States insurable risks." However, under the plain language of I.R.C. § 4372(d)(1), the tax applies to policies insuring risks "wholly or partly within the United States" insuring *domestic corporations, domestic partnerships, and individual United States residents.* For foreign corporations, foreign partnerships and nonresident aliens, I.R.C. § 4371 is limited to policies covering hazards, risks, losses, or liabilities within the United States. See Rev. Rul. 73-362, 1973-2 C.B. 367 (policy issued by foreign insurance company to cover domestic aviation company's aircraft while operated within the U.S. subject to I.R.C. 4371, but doesn't apply to separate policy issued by foreign insurer to cover same aircraft while outside of the U.S.); Rev. Rul. 57-257, 1957-1 C.B. 417 (examples demonstrating applicability of the tax where the risks are wholly or partly in the U.S.); Rev. Rul. 56-505, 1956-2 C.B. 891 (tax applies to foreign policy covering oil drilling operations on submerged Continental Shelf); *United States v. Northumberland Ins. Co. Ltd.*, 521 F. Supp 70, 76 (D.N.J.1981). In *Northumerland*, the Court held that although some of the reinsurance contracts covered non-U.S. risks, the taxpayer had not shown whether the insured were foreign or domestic. Consequently, the taxpayer had not carried its burden of proof, and the tax assessments made by the Service would stand.

[2] U.S. CONST. art. 1, § 9, cl. 5.

[3] U.S. CONST. art. 1, § 8, cl. 3. The Commerce Clause provides "The Congress shall have the Power ... to regulate Commerce with foreign nations, and among the Several States."

[4] U.S. CONST. art. 1, § 10, cl. 2. The Import-Export Clause provides "No State shall ... lay any Imposts or Duties on Imports or Exports."

language of the Export Clause meant that shifts in the Supreme Court's view of the Commerce and Import-Export clauses did not govern the interpretation of the Export Clause. 517 U.S. at 850-853 and 857-61.

The Court observed that while one may question *Thames & Mersey's* finding that a tax on policies insuring exports is functionally the same as a tax on exportation itself, the Government had chosen not to do so in the case. Under the principles that animate *stare decisis*, the Court declined to overrule *Thames & Mersey's* longstanding precedent, on the theory not argued by the parties. 517 U.S. at 854-56.

The dissenting opinion looked to the text and the history of the Export Clause to argue that the Clause makes no mention of and has no bearing on taxes on services like insurance provided to exporters because the "insurance service " is not exported. 517 U.S. at 865, 873. The dissent noted that the debates at the Constitutional Convention focused on taxes on exported goods, such as tobacco, flour and rice, not services. 517 U.S. 874-75. The dissent also noted that the majority's opinion complicates the administration of I.R.C. § 4371 by requiring some accommodation, such as a proration of tax if a foreign insurer's policy covers the domestic leg of a journey for all of a domestic company's shipment of a certain type of merchandise or if a policy is taken out on a single shipment but part of the shipment is delivered in the U.S. and part a broad. 517 U.S. 870-72.

Following the Supreme Court's opinion in *International Business Machines*, the Service issued Notice 96-37, 1996-2 C.B. 208 setting forth procedures for requesting a refund of insurance premium excise taxes based on the holding in *International Business Machines* "that the tax imposed by section 4371(1) of the Internal Revenue Code of 1986 may not be applied to premiums paid with respect to insurance covering risks associated with goods actually in export transit from the U.S."

It could be argued that the facts in *International Business Machines* are distinguishable from the facts in this case. The Supreme Court case involved shipments of products that were manufactured by the taxpayer to its foreign subsidiaries which clearly are goods in export transit. Here, the items shipped could include personal gifts between individuals. Thus, the items here are not items intended to be covered by the founding fathers in the Export Clause, who were concerned with the fear that a Congress controlled by the northern States could strangle the Southern economy by levying an oppressive tax on exports.[5] However, the plain language of the Export Clause broadly prohibits taxes or duties on "Articles exported from any State." The majority in *International Business Machines* noted that it has interpreted that phrase broadly, only limiting that term to permit federal taxation of pre-export goods and services, 517 U.S. at 847, and declining the dissent's invitation to reexamine the debates of the Constitutional Convention to determine the intent of the founding fathers in enacting the Export Clause. See 517 U.S. at 872-73. Moreover, the policies

[5] DAVID M. MESSER, THE HARBOR MAINTENANCE TAX: ALL DREDGED UP AND NO PLACE TO GO, 6 TULSA J. COMP. & INTL. 99, 105 (1998)

involved in *Thames & Mersey* covered "all cargoes which the insured should ship in the foreign trade," 237 U.S. at 22, which undoubtedly included personal noncommercial items, and the Supreme Court refused to overturn *Thames & Mersey.*

Accordingly, we conclude that the tax imposed by I.R.C. § 4371 may not be applied to premiums paid with respect to insurance and reinsurance covering risks associated with goods in actual export from the United States to foreign countries.

ISSUE 2. The claim in this case should have been filed by the three U.S. insurance companies, rather than by B. Notice 96-37, 1996-2 C.B. 208, which "provides the only procedure for claiming a refund," provides that the claim be made by the "taxpayer" without defining that term. I.R.C. § 6402(a), however, provides that the Service has the authority to make the refund to the "person who made the overpayment." Any claim for refund must be filed within the period of limitations for filing a claim "by the taxpayer," a term that, for purposes of the Code, is defined under I.R.C. § 7701(a)(14) as "any person subject to any internal revenue tax." I.R.C. § 6511(a). Therefore, as a matter of statutory interpretation, the proper party to file a refund claim is (1) the person who was subject to any internal revenue tax who (2) made the overpayment. In this case, the payments were made by the three United States insurance companies.

In analogous situations involving refunds under I.R.C. § 4371 , the courts and Service have instructed that claims be filed by the person who remitted the tax. In *Columbia Marine Services, Inc. v. Reffett Ltd.*, 861 F.2d 18, 20 (2d Cir. 1988), the court quoted section 2.06 of Rev. Proc. 81-3, 1981-1 C.B. 618, which states "[t]he treaty provisions exempting policies of insurance from the excise tax and providing for refund of such tax were intended to relieve the person that bore the burden of the tax. However, *the person who remitted the tax must file the claim on behalf of the person who bore the burden of the tax.*" [Emphasis added.] Section 20.6 of Rev. Proc 81-3 continues by stating "[I]n all situations the person who bore the burden of the tax is entitled to the refund and the person who remitted the tax must file the claim on behalf of the person who bore the burden of the tax."

Similarly, in Announcement 81-80, 1981-19 I.R.B. 22, the Service determined that in cases where tax under I.R.C. § 4371 is relieved by treaty, the remitter should file claim on behalf of the person who bore the burden of the tax. In Rev. Rul. 66-197, 1966-2 C.B. 478, the Service determined that where a broker has paid a tax under I.R.C. § 4371 on premiums with respect to an insurance policy which is later canceled, thus resulting in an overpayment of tax, the broker, when filing a subsequent Form 720, may take credit for the tax paid on premiums refunded to the holders of the canceled policy. [6]

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[6] *See, e.g.,* Notice 89-79, 1989-2 C.B. 392, 394 (Any excise taxes imposed by I.R.C. § 4371 that have been paid for periods for which the election is effective may be refunded to the person who remitted the taxes); Notice 87-50, 1987-2 C.B.357, 358 (Any excise taxes that have been paid in any prior quarter of the taxable year with respect to related person insurance income may be refunded to the person who remitted the taxes).

This view is also set forth in the Internal Revenue Manual. IRM Handbook 4.3.3.7.10(2) (7/30/1999), provides "the person who remitted the tax usually files the claim on behalf of the person who bore the burden of the tax, unless the specific treaty with the foreign government permits otherwise." See also IRM 477(10)(2).

Please contact this office if you have any questions regarding this memorandum.

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Branch 1 (International)