CCA 202422010

Purported Insurance Premiums Subject to FDAP Tax

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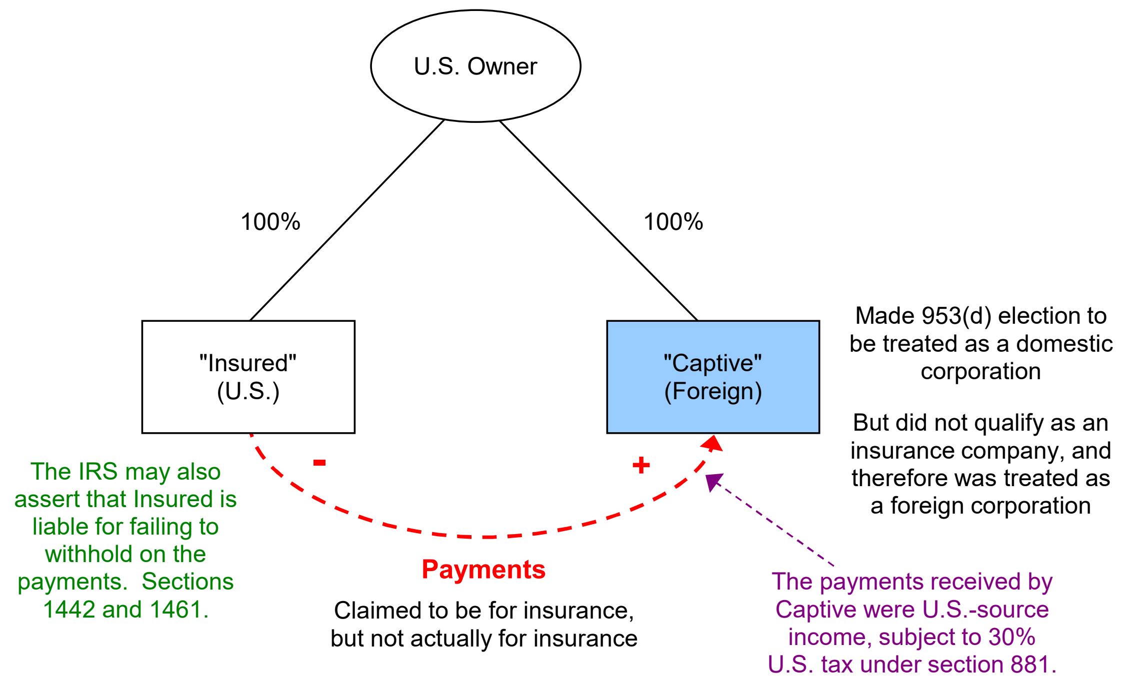
A foreign corporation ("Captive") made a section 953(d) election to be treated as a domestic corporation. A domestic corporation ("Insured") made payments to Captive that were claimed to be deductible insurance premiums. Insured did not deduct or withhold any tax under section 1442 (requiring withholding on payments of fixed or determinable annual or periodical ("FDAP") income) on the payments made to Captive. Captive filed a U.S. Federal income tax return as a domestic insurance company (Form 1120-PC). Captive reported the payments received as income on its tax return and excluded the payments from taxable income under section 831(b).



The IRS determined that the payments to Captive were not insurance premiums (because the arrangement lacked insurance risk, risk distribution, or risk shifting, or was not insurance in its commonly accepted sense) and it denied Insured's claimed deduction. Because the payments to Captive were not for insurance, Captive did not qualify as an insurance company under sections 831(c) and 816(a), and Captive was not eligible to make a section 953(d) election.

Under section 881(a), foreign corporations generally are subject to a 30% tax on amounts of FDAP income received from sources within the U.S. that are not effectively connected with the conduct of a trade or business in the U.S. In *Reserve Mechanical Corp. v. Commr.*, T.C. Memo. 2018-86, *aff'd*, 34 F.4th 881 (10th Cir. 2022), a purported insured made payments to a foreign entity that purported to be a captive and made an election under section 953(d) to be treated as a domestic corporation. The Tax Court found that (1) the captive was not an insurance company, (2) the captive was therefore not eligible to make an election under section 953(d), and (3) the premiums received by the captive were U.S.-source FDAP income taxable under section 881. The facts in the CCA are similar to those in *Reserve Mechanical.*

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