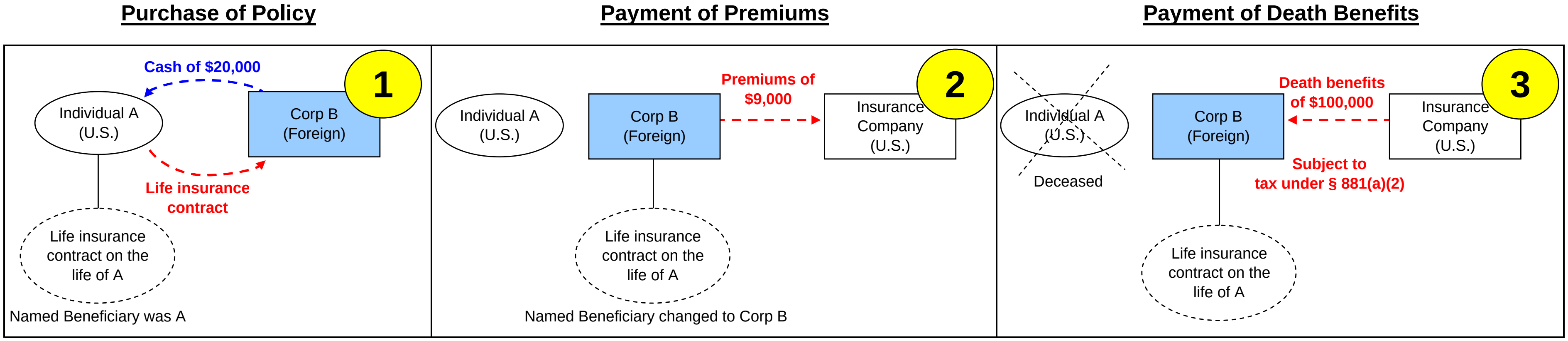
Revenue Ruling 2009-14, Situation 3

Death Benefits Paid to Foreign Corporation Were U.S. Source FDAP



A is a United States citizen residing in the United States. B is a foreign corporation that is not engaged in a trade or business in the U.S. B determines taxable income using the cash method of accounting and files its income tax returns on a calendar year basis. On June 15, 2008, B purchased from A for $20,000 a "life insurance contract" (as defined in §7702) on the life of A. The contract was originally issued by IC, a domestic corporation, to A on January 1, 2001. The contract was a level premium fifteen-year term life insurance contract without cash surrender value. At the time of purchase, the remaining term of the contract was 7.5 years. The monthly premium for the contract was $500, due and payable on the first day of each month. As owner of the contract, B had the right to change the beneficiary and, pursuant to that right, named itself beneficiary under the contract immediately after acquiring the contract. B had no insurable interest in A's life and, except for the purchase of the contract, B had no relationship to A and would suffer no economic loss upon A's death. B purchased the contract with a view to profit. The contract in B's hands was not property described in §1221(a)(1)-(8). The likelihood that B would allow the contract to lapse by failing to pay any of the remaining premiums was remote. On December 31, 2009, A died, and IC paid $100,000 under the life insurance contract to B by reason of A's death. Through that date, B had paid monthly premiums totaling $9,000 to keep the contract in force.

B received $100,000 from IC by reason of the death of A, the insured under the contract. Because B purchased the contract from A in exchange for a purchase price of $20,000, B's acquisition of the contract was a "transfer for a valuable consideration" within the meaning of §101(a)(2). Neither the carryover basis exception of §101(a)(2)(A) nor the exception for transfers involving parties related to the insured under §101(a)(2)(B) applied. Accordingly, §101(a)(1) excludes from B's gross income the amount received by reason of A's death, but §101(a)(2) limits the exclusion to the sum of the actual value of the consideration paid for the transfer ($20,000) and other amounts paid by B ($9,000), or $29,000. B therefore must include in gross income $71,000, which is the difference between the total death benefit received ($100,000) and the amount excluded under §101 ($29,000). The life insurance contract in B's hands was not property described in §1221(a)(1)-(8), and was thus a capital asset in B's hands. Neither the surrender of a life insurance or annuity contract nor the receipt of a death benefit from the issuer under the terms of the contract produces a capital gain. Accordingly, the $71,000 income recognized by B upon the receipt of death benefits under the contract is ordinary income. The Code does not specify the source of income resulting from the payment of death benefits pursuant to a term life insurance contract. Consequently, the source of such income is determined by comparison and analogy to classes of income that are specified within the statute. In the current situation, A is a United States citizen residing in the United States, and IC is a domestic corporation. The ruling concludes that B must recognize $71,000 of ordinary income from sources within the United States, and tax is imposed under §881(a)(1) with respect to this amount.