INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM
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CASE MIS No.: TAM-109310-00/CC:INTL:B1

District Director

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No:
Years Involved:
Date of Conference:

LEGEND:

A = .

ISSUE:

Whether the Export Clause of the United States Constitution, art 1, § 9, cl. 5, bars the Internal Revenue Service from imposing the insurance premium excise tax on a policy of insurance providing a mission risk guarantee against failure of a launched satellite.

CONCLUSION:

An insurance policy providing a mission risk guarantee against failure of a launched satellite is not exempt from the tax imposed by I.R.C. § 4371 under the Export Clause of the Constitution, because such policy does not insure "goods in export transit."

FACTS:

A, an insurance broker, arranged for the issuance of several insurance policies by foreign insurers covering the launching of satellites into outer space. A typical satellite launch insurance policy provides for a mission risk guarantee against the partial failure, constructive total failure, or total failure of the launched satellite. The typical policy states that a total failure occurs if the spacecraft does not arrive at its designated orbital location within 90 days after launch, or is completely destroyed, or is otherwise rendered incapable of operation. Constructive total failure occurs if the actual or

projected condition of the launched spacecraft 180 days after launch is such that a performance multiplier is a certain amount or less, or if the satellite is unable to transmit and/or receive in any one of the primary CONUS beams. Partial failure occurs if the actual or projected condition of the launched spacecraft 180 days after launch is such that a performance multiplier is between certain amounts. Coverage is also provided if the launched spacecraft is neither a successfully operating spacecraft nor a total failure, but 180 days after launch has less than a certain number of days of estimated remaining life. Coverage typically begins when the engines of the launch vehicles ignite for purposes of the launch and can continue until the satellite separates from the launch vehicle or up to five years after launch. The typical policy does not allocate premiums between the launch phase and the in-orbit phase. The insured parties are private entities that own the satellite for its entire useful life.

A paid the excise tax for insurance premiums under these policies pursuant to I.R.C. § 4371. A filed a claim for refund of excise taxes paid for the quarters ending 9412-9512, and for quarter 9606. A claims that imposition of the excise tax under I.R.C. § 4371 is unconstitutional based on the United States Supreme Court decision in *United States v. International Business Machines Corp.*, 517 U.S. 843 (1996).[1] A claims that the launching of a satellite is an export for purposes of the Export Clause because an export is any article which leaves the United States, regardless of whether or not the article arrives in a foreign country. A further claims that even assuming that the article must arrive in a foreign country, outer space, which is not under the jurisdiction of any sovereign, should be treated as a foreign country.

LAW AND ANALYSIS:

The Export Clause of the United States Constitution, art. 1, § 9, cl. 5, states that "[n]o Tax or Duty shall be laid on Articles exported from any State."

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. The term "insured" is defined in I.R.C. § 4372(d) as

> (1) a domestic corporation or partnership, or an individual resident of the United States, against, or with respect to, hazards, risks, losses, or

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[1] 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 Court's holding "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." A filed its claim pursuant to Notice 96-37.

liabilities wholly or partly within the United States, or

(2) a foreign corporation, foreign partnership, or nonresident individual, engaged in a trade or business within the United States, against, or with respect to, hazards, risks, losses, or liabilities within the United States.

The insured under the policies in issue are corporations organized in the United States, and, thus, are "insureds" under I.R.C. § 4372(d)(1).

In *United States v. International Business Machines Corp.*, the United States Supreme Court held that the Export Clause 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, the Court found that the excise tax under I.R.C. § 4371 as applied to casualty insurance issued by a foreign insurer to cover shipments 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 prohibits imposition of a stamp tax on policies covering marine risks. In *Thames & Mersey*, the Court concluded that casualty insurance is an integral part of exportation.

In *International Business Machines*, the Government conceded that the Court's opinion in *Thames & Mersey* covered the issue in the case. However, the Government asked that the issue be re-examined, since its underlying premise had been rejected in cases involving the Commerce[2] and Import-Export[3] 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 language of the Export Clause meant that shifts in the Supreme Court's view of the Commerce and Import-Export Clauses did not govern its interpretation of the Export Clause. 517 U.S. at 850-853 and 857-61.

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

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[2] 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."

[3] 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."

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 United States and part abroad. 517 U.S. 870-72.

The issue in *International Business Machines* is distinguishable from the issue in this case. There was no dispute in *International Business Machines* that IBM exported property within the meaning of the Export Clause. In contrast, the issue in this case is whether the launch of a communications satellite and its orbit of the Earth during a period of years constitutes an article "exported from any State." The Supreme Court did not define the term "export" in *International Business Machines*, since neither party to the litigation disputed that the policies covered goods being exported.

Although there are cases that attempt to define the term "export",[4] and whether an article needs to arrive in a foreign country to be exported,[5] none of these cases is directly on point because none of them discuss satellite launches. However, the cases are instructive as to the fundamental requirements of an exportation of property in the Constitutional sense.

Treas. Reg. § 48.0-2(a)(10) defines export for purposes of chapters 31 and 32 of the Code as "the severance of goods from the mass of things belonging to this country with an intention of uniting them to the mass of things belonging to some foreign country".[6] The definition of "export" in section 48.0-2(a)(10) of the Regulations is derived from the Supreme Court's opinion in *Swan & Finch Co. v. United States*, 190 U.S. 143, 144 (1903). This case involved a federal statute that allowed a credit for an import duty when an article subject to such duty are used in the production of an article in the United States and the resulting article is exported from the United States. The issue was whether a lubricating oil, that was produced in part from an imported article on which duty was imposed, was "exported" when such oil was used in connection with the operation of a ship leaving a U.S. port and bound for a foreign port. In concluding that the oil was not exported, the Supreme Court observed the following:

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[4] *See, e.g., Canton R. Co. v. Rogan,* 340 U.S. 511, 515 (1951);*Valley Ice & Fuel Co., Inc. v. United States,* 30 F.3d 635, 639 (5th Cir. 1994); *Carnival Cruise Lines, Inc. v. United States*, 8 F. Supp.2d 877 (Ct. Int'l Trade 1998).

[5] *See, e.g., United States v. Chavez*, 228 U.S. 525 (1913); *United States v. 1903 Obscene Magazines*, 907 F.2d 1338 (2d Cir. 1990);

[6] Note, however, that I.R.C. § 4371 is contained in chapter 34 of the Code.

> the word “export” as used in the Constitution and laws of the United States ... generally means the transportation of goods from this to a foreign country. “As the legal notion of emigrating is a going abroad with an intention of not returning, so that of exportation is a severance of goods from the mass of things belonging to this country with an intention of uniting them to the mass of things belonging to some foreign country or other.” [Citation omitted.]

The issue in *Dooley v. United States*, 183 U.S. 151 (1901), was whether a federal statute imposing a tax on goods imported into Puerto Rico, as applied to goods originating in the United States, is an impermissible tax or duty on exports. The Supreme Court observed the following, at page 154:

> It is not too much to say that, so far as our research has extended, neither the word “export”, “import” or “impost” is to be found in the discussion on this subject ... *in reference other than foreign commerce*, without some special form of words to show that foreign commerce is not meant. ... It follows ... that the word “export” should be ... applied only to goods exported to a foreign country. [Emphasis added.]

In upholding the constitutionality of the tax on goods imported into Puerto Rico from the United States, the Court concluded that such goods were not exported for purposes of the Export Clause, in part, because Puerto Rico is not a foreign country. *See also Fairbank v. United States,* 181 U.S. 283 (1900), in which involved a federal stamp tax imposed on bills of lading for property exported from the United States. In declaring the tax to be an unconstitutional violation of the Export Clause, the Court also reflected its view that an “export” is the shipment of goods from the United States to a foreign country in the normal course of commerce, as follows:

> a bill of lading or some written instrument of the same import is necessarily always associated with every *shipment of articles of commerce from the ports of one country to those of another. The necessities of commerce require it. [Emphasis* added.]

*Fairbank*, at page 294.

The Supreme Court’s definition of the term “export” in *Swan & Finch Co.* was relied on in *United States v. Ehsan*, 163 F.3d 855 (4th Cir. 1998). The latter case involved a federal statute that bans exports to Iran; and the issue was whether a shipment of articles from the United States to a third-country (Dubai), and subsequently to Iran, constituted an export that is banned by the statute. In discussing various interpretations of the term “export”, the Fourth Circuit noted the following:

> These definitions vary in specificity, but all make clear that exportation

> involves the transit of goods from one country to another for the purpose of trade. ... Nearly a century ago the Supreme Court declared that "the word 'export' as used in the Constitution and laws of the United States, generally means the transportation of goods from this to a foreign country." [Citation omitted.] ...
>
> Throughout this history "exportation" has consistently meant *the shipment of goods to a foreign country with the intent to join those goods with the commerce of that country*. [Emphasis added.]

*Ehsan*, at page 858.

Where Congress or a Federal agency has acted on the subject of satellite launches, it has acted to exempt the launching of space vehicles from the definition of an export. The Commercial Space Launch Act, 49 U.S.C. § 70101, explicitly provides that satellite launches are not exports for purposes of the Export Control law. Section 70117(f) of the Act provides:

> **Launch not an export**. – A launch vehicle or payload that is launched is not, because of the launch, an export for purposes of a law controlling exports.

Commerce Department Export Administration regulations at 15 C.F.R. Pt. 772 (1998), similarly define export to exclude "a launch of a launch vehicle and payload for purposes of controlling export." State Department regulations at 22 C.F.R. § 120.17(a)(6), under the Arms Export Control Act, 22 U.S.C. § 2778, state that a "launch vehicle or payload shall not, by reason of the launching of such vehicle, be considered an export." The Tariff Act, 19 U.S.C. § 1484a, states that articles launched from the United States that return from space will "not be considered an importation." Thus, whenever the Congress or a Federal agency has dealt with the issue, it has determined that a satellite launch is not an export.

Moreover, the facts in *International Business Machines* are distinguishable from the facts in this case. *International Business Machines* involved policies insuring shipments of products that were manufactured by the taxpayer to its foreign subsidiaries. The products in *International Business Machines* were clearly goods in export transit; title changed after the goods cleared customs in the foreign country. The policies in this case provide for a mission risk guarantee against the failure of a launched satellite during its launch and in-orbit phases in outer space, which may continue up to five years after launch. Title to the satellite does not change hands; the insured parties are private entities that own the satellite for its entire useful life. This case is more akin to insuring a ship, or a truck on its way from the United States to another destination and its continued performance, rather than insuring "goods in export transit."

Imposition of the federal premium excise tax on an insurance policy covering the launch and subsequent orbit of a communications satellite does not, in our view, violate the Export Clause of the Constitution. Neither a launch rocket nor a satellite is an article being exported from the United States, since neither is entering the stream of commerce where they will be severed from the mass of goods belonging to the United States and transferred to the mass of goods belonging to a foreign country. At no time is there a transfer of title to, or ownership of, the rocket or satellite. Thus, the issue in this case is distinguishable from the issue in *International Business Machines* where it was not disputed that goods were being exported from the United States. Moreover, imposition of the federal premium excise tax on an insurance policy covering the launch and subsequent orbit of a communications satellite does not impinge on the purposes advanced by the Founding Fathers for 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.[7]

As stated in *Canton R. Co. v. Rogan*, 340 U.S. 511, 514 (1951):

> [W]hen the tax is on activities connected with the export or import the range of immunity cannot be so wide. The broader definition which appellant tenders distorts the ordinary meaning of the terms ... and create a zone of tax immunity never before imagined.

We conclude that premiums on insurance providing a mission risk guarantee against failure of a launched satellite is not exempt from tax under I.R.C. § 4371, because the policy does not insure “goods in export transit” for purposes of the Export Clause.

CAVEAT:

No opinion is expressed on as to whether the launching of a satellite constitutes the export of property or use of property without the United States under any other federal tax provision.

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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