Notice of Proposed Rulemaking and Notice of Public Hearing

Exclusions From Gross Income of Foreign Corporations

REG–208280–86

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed rules implementing the portions of section 883(a) and (c) of the Internal Revenue Code (Code) that relate to income derived by foreign corporations from the international operation of a ship or ships or aircraft. The proposed rules reflect changes made by the Tax Reform Act of 1986 and subsequent legislative amendments. The proposed rules provide, in general, that a foreign corporation organized in a qualified foreign country and engaged in the international operation of ships or aircraft shall exclude qualified income from gross income for purposes of United States Federal income taxation, provided that the corporation can satisfy certain ownership and related documentation requirements. The proposed rules explain when a foreign country is a qualified foreign country and what income is considered to be qualified income. The proposed rules specify how a foreign corporation may satisfy the ownership and related documentation requirements. In addition, the proposed rules describe the information that the foreign corporation must include on its United States income tax return in order to claim an exemption. This document provides notice of a public hearing on these proposed rules.

DATES: Written comments must be received by May 8, 2000. Requests to speak and outlines of topics to be discussed at the public hearing scheduled for Thursday, April 27, 2000, at 10 a.m. must be received by Wednesday, April 5, 2000.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–208280–86), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–208280–86), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/tax_regs/regslist.html. The public hearing will be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed rules, Patricia A. Bray, (202) 622-3880; concerning submissions, the hearing, and/or to be placed on the building access list to attend the hearing, Guy Traynor, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the IRS, Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224. Comments on the collection of information should be received by April 10, 2000. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collection of information in this proposed regulation is in §§1.883–1, 1.883–2, 1.883–3, 1.883–4, and 1.883–5. The information required in these sections will enable a foreign corporation to determine if it is eligible to exclude its income from the international operation of a ship or ships or aircraft from gross income on its U.S. Federal income tax return. The information required in these sections will also enable the IRS to monitor compliance with the provisions of the proposed regulations with respect to the stock ownership requirements of §1.883–1(c)(2), and to make a preliminary determination of whether the foreign corporation is eligible to claim such an exemption and is accurately reporting income as required under section 6012.

The collection of information and responses to these collections of information are mandatory. The likely respondents are foreign corporations engaged in the international operation of a ship or ships or aircraft that wish to claim an exemption from U.S. tax under section 883, and certain of their shareholders owning (directly or indirectly) a majority of the value of the shares of such corporations.

Estimated total annual reporting/recordkeeping burden on corporations: 1,400 hours.

The estimated annual burden per respondent varies from 30 minutes to eight hours, depending on the circumstances of the foreign corporation, with an estimated average of one hour.

Estimated number of respondents: 1,400.

Estimated annual frequency of responses: Once.

Estimated total annual reporting burden on shareholders: 22,500 hours.

The estimated annual burden per respondent varies from 15 minutes to eight hours, depending on the circumstances of

the shareholder or intermediary, with an estimated average of 90 minutes.

Estimated number of respondents: 15,000.

Estimated annual frequency of responses: Once.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

Section 883 provides an exemption from gross income for earnings of a foreign corporation derived from the international operation of a ship or ships or aircraft (hereinafter ships or aircraft) if an equivalent exemption from tax is granted by the applicable foreign country to corporations organized in the United States. Section 883 has generally been referred to as the reciprocal exemption provision. Before 1986, section 883 eliminated U.S. tax on earnings from the operation of ships or aircraft derived by foreign persons, including U.S.-controlled foreign corporations, based on whether the country of documentation of the ship or registry of the aircraft provided an exemption to U.S. persons. Section 883 did not require a foreign transportation company to be organized or resident in the country of registration or documentation. Many countries offered various incentives, including no taxation, to non-resident shipping companies that registered ships in that jurisdiction (referred to as flagging-out or documenting ships under flags of convenience). Thus, foreign corporations that documented their ships in such flag of convenience countries could claim a reciprocal exemption from U.S. income tax.

Congress concluded in 1986 that the reciprocal exemption provisions were not meeting their original goal of reserving the right to tax transportation income to the country of residence of the taxpayer (and therefore to eliminate double taxation). In cases where residents of a country with which the United States might desire a reciprocal exemption used vessels or aircraft documented or registered under another flag, the unilateral U.S. concession provided under prior law left the country of residence little incentive to exempt U.S. shippers. Congress was concerned that U.S.-based transportation companies were at a competitive disadvantage because U.S. companies remained potentially subject to tax by the countries in which their foreign competitors were organized and resident.

Congress amended the reciprocal exemption provisions of section 883 to rectify this situation. Tax Reform Act of 1986, section 1212, Public Law 99-514, ((1986–3 C.B. 1) (the 1986 Act)), as amended by the Technical and Miscellaneous Revenue Act of 1988 (TAMRA), Public Law 100–647 (1988–3 C.B. 1), and by the Omnibus Budget Reconciliation Act of 1989, Public Law 101–239 (1990–1 C.B. 210), (the 1986 Act, as amended). It is now irrelevant under section 883 where a ship is documented or an aircraft is registered. Instead, section 883 provides that a foreign corporation may qualify for the reciprocal exemption only if it is organized in a foreign country that grants corporations organized in the United States an equivalent exemption with respect to income derived from the international operation of ships or aircraft. In addition, more than 50 percent of the value of the stock of the foreign corporation must be owned by individuals who are residents of a foreign country that grants corporations organized in the United States an equivalent exemption. The 50 percent ownership requirement generally does not apply if the corporation is either a qualifying controlled foreign corporation (CFC) or if its stock is primarily and regularly traded on an established securities market in a qualified foreign country or the United States.

Since 1986, the United States and more than 30 foreign countries have entered into reciprocal exemption agreements incorporating the statutory amendments of section 883. In addition, more than 60 countries now provide an equivalent exemption through domestic law or an income tax convention. The current regulations under §1.883–1, however, have not been amended to reflect the statutory changes enacted since 1986. This document proposes updated rules reflecting the statutory changes.

Explanation of Provisions

General Rule

Section 1.883–1(a) provides the general rule. A foreign corporation engaged in the international operation of a ship or aircraft shall exclude from its gross income for U.S. Federal income tax purposes any income it derives from the international operation of ships or aircraft if such income is qualified income under paragraph (b) and if the corporation is a qualified foreign corporation under paragraph (c).

Section 1.883–1(b) provides that qualified income is income that is properly includible in an income category described in paragraph (h)(2) of this section and that is the subject of an equivalent exemption granted by the foreign country in which the foreign corporation seeking qualified foreign corporation status is organized.

Section 1.883–1(c)(1) describes the general requirements that a foreign corporation must satisfy to be considered a qualified foreign corporation. A qualified foreign corporation is a corporation, as defined in §§301.7701–2(b) and 301.7701–3, that is engaged in the international operation of ships or aircraft and that is organized in a qualified foreign country. A qualified foreign corporation must also satisfy one of the three stock ownership tests described in paragraph (c)(2) of this section as well as the substantiation and reporting requirements described in paragraph (c)(3) of this section.

Paragraph (c)(2) describes the three stock ownership tests. Generally, a foreign corporation must be able to demonstrate and document that more than fifty percent of the value of its stock is owned by qualified shareholders, as determined under §1.883–4 (qualified shareholder stock ownership test). However, a foreign corporation will not be required to demonstrate that it satisfies the qualified shareholder stock ownership test if it can demonstrate either that its stock is primarily and regularly traded on an established securities market in a qualified foreign country or in the United States, as determined under §1.883–2 (publicly-traded test), or that it is a qualifying controlled foreign corporation as determined under §1.883–3 (CFC test).

To satisfy the substantiation and reporting requirements described in paragraph (c)(3) of this section, a foreign corporation must include the information set out in that paragraph in its Form 1120F, "U.S. Income Tax Return of a Foreign Corporation," in such form and manner as the Form 1120F and its accompanying instructions prescribe. The information to be submitted with the return includes information set out in §§1.883–2(f), 1.883–3(d) and 1.883–4(e), as applicable, relating to information demonstrating that the foreign corporation satisfies one of the three stock ownership tests. Section 1.883–5(c) provides a transition rule that will require such information to be included in a statement attached to the return until the Form 1120F and its instructions are amended to conform to final regulations under this section.

Paragraph (c)(3)(ii) provides that if the Commissioner requests in writing that the foreign corporation substantiate representations made under paragraph (c)(3)(i) of this section, or under §1.883–2(f), 1.882–3(d) or 1.883–4(e), the foreign corporation must provide the supporting documentation or substantiation within 60 days following the written request. If the foreign corporation does not provide all of the information requested within the 60 day period but demonstrates that the failure was due to reasonable cause and not willful neglect, the Commissioner may grant the foreign corporation a 30-day extension to provide the supporting documentation or substantiation. Whether a failure to obtain the documentation or substantiation in a timely manner was due to reasonable cause shall be determined by the Commissioner after considering all the facts and circumstances.

Paragraph (c)(4) contains a rule that allows the Commissioner to retain the right to cure any defects in the documentation where the Commissioner is satisfied that the foreign corporation would otherwise be a qualified foreign corporation.

Paragraph (d) defines a *qualified foreign country* as a foreign country that grants an equivalent exemption to corporations organized in the United States for the relevant category of qualified income earned by the foreign corporation seeking qualified foreign corporation status. A foreign country may be a qualified foreign country with respect to one category of income but not with respect to other categories of income.

Operation of Ships or Aircraft

Section 1.883–1(e) explains what it means to be engaged in the operation of ships or aircraft for purposes of these proposed rules and provides examples of activities that are not treated as the operation of ships or aircraft. Under the general rule, only a corporation that is an owner, lessor, or lessee of an entire ship or aircraft used to carry cargo or persons for hire can be considered engaged in the operation of ships or aircraft.

The term *operation of ships or aircraft*, which includes the operation of a single ship or aircraft, means: the carrying of cargo or passengers for hire; the time or voyage charter of a ship or the wet lease of an aircraft, as those terms are defined in the regulations; and the bareboat charter of a ship or the dry lease of an aircraft, as those terms are defined in the regulations. The term also includes active participation by a corporation that is otherwise engaged in the operation of ships or aircraft in a pool, partnership, strategic alliance, joint operating agreement or code sharing arrangement, or other joint venture that is itself engaged in the operation of ships or aircraft.

Paragraph (e)(2) provides as examples that activities of the following will not be considered *operation of ships or aircraft*: a non-vessel operating common carrier (an NVOCC); a space or slot charterer; a ship management company; a company that obtains ships crews; a ship's agent; a ship or aircraft broker; a freight forwarder; a travel agent; a tour operator; a pure container leasing company; a passive investor in a shipping or aircraft business; or a concessionaire. The proposed rule also provides the definitions of a number of relevant terms.

International Operation of Ships or Aircraft

Section 1.883–1(f) distinguishes international from domestic operation of ships or aircraft. In TAMRA, Congress directed that transportation income derived solely from sources within the United States under section 863(c)(1) should not be granted exemption from U.S. income taxation under section 883. Congress also specified, however, that the reciprocal exemption generally should be available for income from international transport activity that is treated as 50 percent U.S. source income under section 863(c)(2). This is the same type of income on which the gross basis tax of section 887 generally would be imposed. See, S. Rep. No. 100-445, 100th Cong., 2d Sess. 241-242 (1988). However, the reciprocal exemption may not necessarily be available to all types of persons earning that type of income.

To carry out Congress's intent, §1.883–1(f)(1) defines the term *international operation* to mean the operation of ships or aircraft on voyages or flights that begin or end in the United States and correspondingly end or begin in a foreign country, determined on a passenger-by-passenger or cargo-by-cargo basis, as discussed below. The term specifically excludes a "cruise to nowhere" that begins in a U.S. port, travels out into open waters beyond the territorial limits of the United States, and then returns to the U.S. port of origin without touching a foreign port during the voyage. The fact that a ship travels beyond United States territorial limits does not, in itself, constitute international operation of ships or aircraft if there is no stop in a foreign country, as determined under paragraph (f)(2). The same rules apply for aircraft.

Paragraph (f)(2) provides rules for determining the beginning and ending points of a voyage for purposes of the definition of the term *international operation*. Except in the case of a round trip cruise, the carriage of a passenger will be treated as ending at the passenger's final destination even if, en route to the passenger's final destination, a stop is made at a U.S. intermediate point for refueling, maintenance, or other business reasons, provided the passenger does not change aircraft or ships at the U.S. intermediate point. Similarly, carriage of a passenger will be treated as beginning at the passenger's point of origin even if en route to the passenger's final destination, a stop is made at a U.S. intermediate point provided the passenger does not change aircraft or ships at the U.S. intermediate point. Carriage of a passenger will be treated as beginning or ending at a U.S. intermediate point if the passenger changes aircraft or ships at that location. See, H.R. Rep No. 432, 98th Cong., 2d Sess. 1340 (1984); H.R. Rep. No. 861, 98th Cong., 2d Sess. 934 (1984).

The carriage of a passenger on a round trip cruise that begins in the United States and stops at one or more foreign ports for day excursions, maintenance or other business reasons, and returns to the same or another U.S. port will be treated as the international operation of a ship. Pursuant to paragraph (f)(2)(i)(A) such a round trip cruise may also include one or more intermediate stops at a U.S. port or ports for similar purposes.

Carriage of cargo will be treated as ending at the final destination of the cargo even if, en route to that final destination, a stop is made at a U.S. intermediate point, provided that the cargo is transported to its ultimate destination on the same ship or aircraft, or provided the same taxpayer transports the cargo to and from the U.S. intermediate point and the cargo does not pass through customs at the U.S. intermediate point. Similarly, carriage of cargo will be treated as beginning at the cargo's point of origin even if, en route to its final destination, a stop is made at a U.S. intermediate point, provided that the cargo is transported to its ultimate destination on the same ship or aircraft or provided both that the same taxpayer transports the cargo on both legs of the trip and that the cargo does not pass through customs at the U.S. intermediate point. Repackaging, recontainerization, or any other activity involving the unloading of the cargo at the U.S. intermediate point will not change these results. See, H.R. Rep No. 432, 98th Cong., 2d Sess. 1340 (1984); H.R. Rep. No. 861, 98th Cong., 2d Sess. 934 (1984), reprinted in 1984–3 C.B. Vol.2., 1, 188.

Whether income is from international operation is generally to be determined on a passenger-by-passenger and item of cargo-by-item of cargo basis. In the case of income from the bareboat charter of a ship or the dry lease of an aircraft, whether the charter income is derived from international operation is determined by reference to the use of the ship or aircraft by the lowest-tier lessee-operator in the chain of lessees.

A person that is the lessor of a ship under a bareboat charter or of an aircraft under a dry lease will be treated as engaged in the international operation of such ship or aircraft to the extent that the lowest-tier lessee-operator in the chain of ownership uses such ship or aircraft for the international carriage of passengers or cargo for hire during the shorter of the period of the charter or the taxable year. Paragraph (f)(2)(iii) adopts the guidance in section 5.02 of Rev. Proc. 91–12 (1991–1 C.B. 473), for determining the amount of income from the bareboat charter of a ship or the dry lease of an aircraft that is treated as derived from the international operation of the ship or aircraft. The rule provides that a foreign corporation must use a reasonable method for determining the proportion of the charter income that is attributable to such international operation.

One reasonable method, described in §1.883–1(f)(2)(iii)(A), is based on the proportion of the days in the term of the charter or the taxable year, whichever is shorter, that the ship or aircraft is used in international operation by the lowest tier lessee-operator in its chain of lessees. For this purpose, the number of days during which the ship or aircraft is not generating transportation income, within the meaning of section 863(c)(2) (for example, days during which the ship or aircraft is out of service while being repaired or maintained) should not be included in the numerator of the ratio. Another reasonable method described in paragraph (f)(2)(iii)(B) is based on the proportion of the gross income of the lowest tier lessee-operator of the ship or aircraft derived from the international operation of the ship or aircraft during the taxable year. An allocation based on the net income of such lessee-operator will not be considered reasonable for this purpose due to the administrative difficulties involved in determining and verifying the proper allocation of the operator's expenses.

Activities Incidental to International Operations

Some corporations engaged in the operation of ships or aircraft earn income from activities that are so closely related to the primary activity of operation of ships or aircraft that it is appropriate to exclude income from these activities from taxation under section 883 of the Code. By contrast, in cases where the operator's activities are not so closely related to the primary activity of operation of ships or aircraft, it is not appropriate to exclude the income from such activities from taxation.

The purpose of §1.883–1(g) is to provide rules for determining when a closely related activity is incidental to the business of the international operation of ships or aircraft. Paragraph (g)(1) provides examples of activities that will be considered incidental to the international operation of ships or aircraft. For example, where a ship operator contracts for the international carriage of cargo or passengers on a second operator's ship, the activity may be incidental to the international operation of a ship by the first operator. Other examples are: the temporary investment of working capital funds; the sale of tickets for international travel by a ship operator for another ship operator, or by an air carrier for another air carrier; the rental by the operator of a ship or aircraft of containers and related equipment used in connection with the international operation of its ship or aircraft; and bareboat charter of ships or aircraft normally operated on international voyages or flights but currently not needed by the operator, and that are used for international voyages or flights by the lessee/charterer.

If an operator enters into a contract that requires a concessionaire to provide services onboard during the international operation of the operator's ship or aircraft and if the operator receives income from such services, then the income of the operator is appropriately treated as incidental to the operation of the ship or aircraft by the operator.

Paragraph (g)(2) provides examples of activities that are not considered incidental to the international operation of ships or aircraft. These examples include: the sale of or arranging for train travel, bus transfers, land tour packages, or port city hotel accommodations within the United States or a foreign country; and the sale of airline tickets by a cruise ship operator or cruise tickets by an air carrier. Further examples include the sale or rental of U.S. real property; treasury activities involving the investment of excess funds or funds awaiting repatriation generated by the operation of ships or aircraft; rental of containers for a domestic leg of transportation in connection with international carriage of cargo; mere passive investment in an enterprise engaged in the international operation of ships or aircraft; services performed by the operator for parties other than passengers, consignors or consignees; or the carriage of passen-

gers or cargo on ships or aircraft on domestic legs, not treated as international operation, either by the foreign operator or by a U.S. member of a joint operating agreement, such as a code sharing arrangement, pooling or alliance.

Determining Whether a Foreign Country Grants an Equivalent Exemption

Section 1.883–1(h)(1) addresses the conditions under which a foreign country's exemption of certain categories of income from income tax may constitute an "equivalent exemption" within the meaning of section 883 of the Code. A foreign country will be considered to grant an equivalent exemption if: the foreign country generally imposes no tax on income, including income from the international operation of ships or aircraft; the foreign country specifically provides a domestic law exemption from a tax on income from the international operation of ships or aircraft either by statute, decree, or otherwise; or the foreign country provides for a reciprocal exemption by means of an exchange of diplomatic notes or other agreement with the United States. In addition, solely with respect to determining whether a shareholder is a resident of a qualified foreign country in §1.883–4 (for purposes of the qualified shareholder stock ownership test), the foreign country may provide a reciprocal exemption with respect to income from the international operation of ships or aircraft by means of an income tax convention with the United States. Paragraph (h)(3) of this section discusses under what circumstances an income tax convention will be considered to provide an equivalent exemption.

Whether a foreign country provides an equivalent exemption is determined separately with respect to each of the following categories of income—

(A) Income from the carriage of cargo and passengers;

(B) Time or voyage (full) charter income;

(C) Bareboat charter income;

(D) Incidental bareboat charter income;

(E) Incidental container-related income;

(F) Any other income that is incidental to the business of operating ships or aircraft; or

(G) Gains of the operator from the sale, exchange or other disposition of a ship, aircraft, container or related equipment or other moveable property used by that operator in international operation.

If an equivalent exemption is not granted by the foreign country for a category of income, income in that category cannot be exempted from U.S. tax regardless of whether the foreign country grants an equivalent exemption for other categories of income. Furthermore, an equivalent exemption may be available for income derived from the international operation of ships even though income derived from the international operation of aircraft may not be exempt, and vice versa.

Section 1.883–1(h)(3) contains a special rule regarding income tax conventions. If a foreign corporation is organized in a foreign country that provides an equivalent exemption only through an income tax convention with the United States, the foreign corporation may claim benefits under section 894 and the income tax convention, but not under section 883. See, H.R. Rep. No. 841, 99th Cong., 2d Sess., (1986); Staff of joint Comm. on Taxation, 100th Cong., 1st Sess., General Explanation of the Tax Reform Act of 1986, 931 (1987). If, however, the foreign corporation is organized in a country that offers an equivalent exemption under an income tax convention and also by some other means, such as by a diplomatic note, the foreign corporation may choose annually whether it will claim an exemption under section 894 and the income tax convention or under section 883 by means of the diplomatic note. Such an election must be made with respect to all income of the foreign corporation from the international operation of ships or aircraft and cannot be made separately with respect to each category of such income. If a foreign corporation elects to be covered under section 883 rather than under the income tax convention, the foreign corporation must satisfy the requirements of this proposed rule, including demonstrating that it satisfies the stock ownership test of paragraph (c)(2) of this section.

Section 1.883–1(h)(4) describes certain foreign residence-based taxation systems that may not satisfy the equivalent exemption requirements of this section. For example, the exemption granted by a foreign country's law or income tax convention must be a complete exemption and not merely a reduction to a non-zero rate of tax levied against corporations organized in the United States engaged in the international operation of ships or aircraft, except in the case of a reduction to a zero rate for an unlimited period of time. An exemption granted by a foreign country's law that reduces the rate of tax to a zero rate for only a limited period of time, such as in the case of a tax holiday, would not be considered a complete exemption for purposes of this rule.

Similarly, many foreign countries impose tax only on the income of ships or aircraft derived from transporting cargoes into, but not out of, the country or vice versa. Such a foreign country will not be treated as granting an equivalent exemption on the non-taxed income. For example, a foreign country that imposes tax only on the transportation of cargo carried out of the country (outbound freight) will not be treated as granting an equivalent exemption for income from the transporting of cargo into that country (inbound freight). Thus, if a corporation organized in such a country derives U.S. source income from voyages that end in the United States, it cannot claim an exemption on the basis of an equivalent exemption granted by the foreign country for inbound freight income. With respect to the carriage of cargo, the foreign country must provide an exemption from tax for income from transporting cargo both inbound and outbound before it will be considered to grant an equivalent exemption.

An equivalent exemption also does not arise where a foreign country only exempts tax on specific types of cargo. Unless a country exempts income from transporting all types of cargo, it will not be considered to grant an equivalent exemption for purposes of this section.

A foreign country that has a territorial tax system will be considered to grant an equivalent exemption only if the tax system treats income from the international operation of ships or aircraft as 100 percent foreign source, and thereby not subject to tax, even if the income is derived from a voyage or flight that begins or ends in that foreign country.

Pursuant to authority provided in section 883(a)(5) of the Code, these rules provide that if a foreign country generally grants an equivalent exemption to corporations organized in the United States, but

also imposes a residence-based tax on certain corporations organized in the United States, the foreign country may nevertheless be considered to grant an equivalent exemption and to be a qualified foreign country if the residence-based tax is imposed only on a corporation organized in the United States that is treated as a resident of the other country because its place of management or control, or other comparable standard, is in that foreign country. See, H.R. Rep. No. 247, 101st Cong., 1st Sess. 1415 (1989). If instead the residence-based tax is imposed on a corporation organized in the United States that is not managed and controlled in that foreign country, the foreign country would not be treated as a qualified foreign country and would not grant an equivalent exemption for purposes of this section.

Finally, a foreign country must provide an exemption from tax for all income in a category of income, as defined in paragraph (h)(2) of this section. For example, a country that exempts income from the bareboat charter of passenger aircraft but not the bareboat charter of cargo aircraft does not provide an equivalent exemption for income from bareboat charter of aircraft.

Pursuant to section 872(b)(7), the proposed rule explains in §1.883–1(i) that a possession of the United States is considered to be a foreign country for purposes of this proposed rule. Thus, a possession on a mirror system is a qualified foreign country and is considered to grant an equivalent exemption to corporations organized in the United States. The term *mirror system* refers to the general applicability of the Code in the possession with the name of the possession substituted for *United States* in the Code where appropriate. Therefore, a qualified foreign corporation that is organized in a possession on a mirror system, and that operates a transportation business between the possession and the United States, could exclude its income from the international operation of ships or aircraft from its gross income for purposes of U.S. Federal income tax and such income could be exempt from U.S. income tax. In cases where a possession is not on a mirror system, the possession may nevertheless be a qualified foreign country if, for example, it provides for an equivalent exemption through its internal law.

Section 1.883–1(j) confirms the rule of section 265(a)(1). If a qualified foreign corporation derives income from a non-exempt activity as well as qualified income, and both are effectively connected with the conduct of a U.S. trade or business, the foreign corporation may not deduct from any income derived from the non-exempt activity any amount otherwise allowable as a deduction from qualified income that is excluded from gross income and exempt under this proposed rule.

Stock Ownership Tests

As provided in §1.883–1(c)(2), a foreign corporation must satisfy one of three stock ownership tests to be considered a qualified foreign corporation. It must demonstrate that more than fifty percent of the value of its stock is owned by qualified shareholders, as determined under §1.883–4 (qualified shareholder test) or that its stock is primarily and regularly traded on an established securities market in a qualified foreign country or in the United States, as determined under §1.883–2 (publicly-traded test), or that it is a controlled foreign corporation as determined under §1.883–3 (CFC test). Separate reporting and documentation requirements apply to each test. A foreign corporation that satisfies the publicly-traded test or the CFC test and its relevant reporting and documentation requirements does not have to comply with the reporting and documentation requirements of the qualified shareholder test.

The Publicly-Traded Stock Ownership Test

The branch profits tax rules under §1.884–5(d) provide the framework for the publicly traded test due to the strong similarities between the statutory language in sections 883(c) and 884(d)(4)(B) and the fact that both statutes were first enacted as part of the Tax Reform Act of 1986. Section 1.883–2(a) provides that a corporation is a publicly-traded corporation if its stock is primarily and regularly traded on one or more established securities markets in any qualified foreign country or in the United States. The proposed rule generally follows §1.884–5(d)(2) of the branch profits tax regulations in defining the term *established securities market*, except that the proposed rule does not require the foreign securities exchange to be the principal exchange in a country. In addition, the proposed rule follows §1.884–5(d)(3) in defining the term *primarily traded*, except that in the proposed rule the corporation's stock may be traded in any qualified foreign country or the United States and is not limited to trading only in the country where the corporation is organized or the United States.

Similarly, the proposed rule follows §1.884–5(d)(4)(i) in defining the general rule for the term *regularly traded*. Section 1.883–2(d) provides that stock of a foreign corporation is regularly traded if one or more classes of stock of the corporation that, in the aggregate, represent 80 percent or more of the total combined voting power of all classes of stock of such corporation entitled to vote and 80 percent or more of the total value of all classes of stock of such corporation are listed on an established securities market or markets during the taxable year; and, with respect to each class relied on to meet the 80 percent requirement, trades in each such class are effected, other than in de minimis quantities, on such market or markets on at least 60 days during the taxable year (or 1/6 of the number of days in a short taxable year). In addition, the aggregate number of shares in each such class that are traded on such market or markets during the taxable year must be at least 10 percent of the average number of shares outstanding in that class during the taxable year (or, in the case of a short taxable year, a percentage that equals at least 10 percent of the average number of shares outstanding in that class during the short taxable year multiplied by the number of days in the short taxable year, divided by 365).

In addition, if a class of stock of the foreign corporation is traded on an established securities market in the United States, and it is regularly quoted by brokers or dealers making a market in the stock, it can also be treated as meeting the trading requirements, provided that the closely-held exception, described below, does not apply. A broker or dealer makes a market in a stock only if the broker or dealer holds himself out to buy or sell the stock at the quoted price.

A closely-held class of stock, as set out in §1.883– 2(d)(3)(i), cannot be treated as

meeting the trading requirements of the publicly-traded stock ownership test. See, §1.884–5(d)(4)(iii)(A). Section 1.883–2(d)(3)(i) provides that a class of stock is closely held if at any time during the taxable year, one or more 5 percent shareholders own, in the aggregate, 50 percent or more of the value of the outstanding shares of the class of stock at any time during the taxable year. A five percent shareholder is any person who owns at least five percent of the value of the outstanding shares of the class of stock, taking into account stock owned by related persons. See §1.883– 2(d)(3)(iii). See also §1.884–5(d)(4)(iii)(B).

For this purpose, persons will be treated as related if they are related within the meaning of section 267(b). In determining whether two or more corporations are members of the same controlled group under section 267(b)(3), a person is considered to own stock owned directly by such person, stock owned with the application of section 1563(e)(1), and stock owned with the application of section 267(c). Further, in determining whether a corporation is related to a partnership under section 267(b)(10), a person is considered to own the partnership interest owned directly by such person and the partnership interest owned with the application of section 267(e)(3).

The closely-held test in this proposed rule differs in one significant respect from the rule in the branch profits tax regulations. The proposed rule allows the foreign corporation to look through the five percent shareholders of the closely-held class to the ultimate owners and to demonstrate that such owners are qualified shareholders, provided no shares of stock in the chain of ownership are issued in bearer form. In the proposed rule, a class of stock of a foreign corporation that is otherwise regularly traded but is also closely-held will be treated as regularly traded if the foreign corporation demonstrates that more than 50 percent of the value of that class of stock is owned, or is treated as owned by applying the rules of attribution contained in §1.883–4(c), by qualified shareholders for more than half of the days of the taxable year. The requirements for being treated as a qualified shareholder are described in §1.883–4(b). Under this rule, an individual cannot be treated as a qualified shareholder if any corporation in the relevant chain of ownership issues stock in bearer form.

Thus, a foreign corporation with a class of stock that is closely-held may nevertheless count that class as regularly traded provided that the foreign corporation is able to establish that more than 50 percent of the value of the entire class of stock is owned (for example, through a partnership, trust or holding company) by persons who would themselves be qualified shareholders. The branch profits tax regulations do not treat a closely-held class of stock as regularly traded if 50 percent or more of the value of the closely-held block is owned by one or more 5 percent shareholders who are not qualifying shareholders, as defined in §1.884–5(b)(1) and those regulations do not permit the foreign corporation to look beyond the 5 percent shareholders to the owners. The IRS is considering whether to make conforming changes to §1.884–5(d)(4)(iii).

Paragraph (d)(4) is similar to §1.884–5(d)(4)(iv) and provides that trades between related persons described in section 267(b), as modified by §1.883–2(d)(3)(iii), and trades conducted in order to meet the regularly traded requirements are disregarded. A class of stock shall not be treated as meeting the trading requirements if there is a pattern of trades conducted to meet such requirements. For example, trades between two persons that occur several times during the taxable year may be treated as an arrangement or a pattern of trades conducted to meet the trading requirements of paragraph (d) of this section.

Section 1.883–2(d)(5) provides an example to illustrate the application of the rules regarding regularly traded stock and the closely-held exception.

Section 1.883–2(e) provides that a foreign corporation relying on the publicly-traded stock ownership test to establish that it satisfies the stock ownership test of §1.883–1(c)(2) must substantiate that it meets such requirements. The proposed rule requires, for example, that if a class of stock of a foreign corporation is closely-held within the meaning of paragraph (d)(3)(i), then the foreign corporation must obtain an ownership statement from each qualified shareholder upon whom it relies to meet the exception to the closely-held test. The ownership statements are described in §1.883–4(d). In addition, the foreign corporation must maintain and provide to the Commissioner upon request a list of its shareholders of record and any other relevant information.

Section 1.883–2(f) describes the information that the foreign corporation must include in its Form 1120F in order to rely on the publicly-traded stock ownership test to satisfy the stock ownership test of §1.883–1(c)(2).

Controlled Foreign Corporation Stock Ownership Test

Section 1.883–3 provides rules that a foreign corporation must follow if the foreign corporation relies on this section to satisfy the stock ownership test of §1.883–1(c)(2). A controlled foreign corporation (CFC) satisfies the stock ownership test of §1.883–1(c)(2) if it is organized in a qualified foreign country, satisfies the income inclusion test of paragraph (b) of this section, and satisfies the documentation and reporting requirements of paragraphs (c) and (d) of this section, respectively (the CFC test). For purposes of these proposed rules, a CFC that fails the income inclusion test may only satisfy the stock ownership test of §1.883–1(c)(2) if the CFC demonstrates that it meets either the publicly traded test of §1.883–2 or the qualified shareholder test of §1.883–4.

To satisfy the income inclusion test of paragraph (b), the foreign corporation must be a CFC as defined in section 957(a) if such section were applied without regard to section 318(a)(4). In addition, more than 50 percent of the CFC's subpart F income (as defined in section 952) derived from the international operation of ships or aircraft must be included, pursuant to section 951, in the gross income of one or more U.S. citizens, individual residents of the United States or domestic corporations for the taxable years of such persons in which the taxable year of the CFC ends. This additional requirement was included in order to prevent inappropriate extension of benefits under section 883. The rule is illustrated by two examples.

Paragraph (c) provides that a CFC relying on this section to satisfy the stock ownership test of §1.883–1(c)(2) must establish all the facts necessary to satisfy the Commissioner that it qualifies under the CFC stock ownership test. To meet this requirement with respect to the in-

come inclusion test, the CFC must obtain the documentation described in paragraph (c)(2). This documentation includes a copy for the taxable year of the Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations (if otherwise required to be filed) prepared by or on behalf of any U.S. shareholder that is a partnership, estate or trust. In addition, the documentation must include a written statement from each such U.S. shareholder that is a partnership, estate or trust providing the name, address, taxpayer identification number and percentage of interest in the U.S. shareholder held by each partner, beneficiary or other interest owner that is a U.S. citizen, individual resident of the United States or domestic corporation.

Finally, paragraph (d) explains that if a CFC is relying on this section to satisfy the stock ownership test of §1.883–1(c)(2), it must include certain additional information in its Form 1120F for the taxable year, along with the information required to be included in its return by §1.883–1(c)(3). This additional information is set out in paragraph (d) and should be current as of the end of the corporation's taxable year.

Qualified Shareholder Stock Ownership Test

Section 1.883–4(a) provides that a foreign corporation shall satisfy the stock ownership test of §1.883–1(c)(2) if more than 50 percent of its stock (by value) is owned, or treated as owned by applying the attribution rules of paragraph (c) of this section, for at least half of the number of days in the foreign corporation's taxable year by one or more qualified shareholders. In addition, a foreign corporation must meet the substantiation and reporting requirements of paragraphs (d) and (e) of this section (qualified shareholder stock ownership test).

Paragraph (b)(1) of this section explains that a shareholder is a qualified shareholder only if the shareholder meets certain criteria. First, the shareholder must be a resident in a country that offers an equivalent exemption for the same type of income as that earned by the foreign corporation. Second, the shareholder must not own its interest in the foreign corporation through bearer shares either directly or by applying the attribution rules of paragraph (c) of this section. Third, the shareholder must provide to the foreign corporation the documentation required in paragraph (d) of this section and the foreign corporation must meet the reporting requirements of paragraph (e) of this section with respect to such shareholder. Finally, the shareholder must be described in one of the following categories of qualified shareholders—

(A) An individual who is not a beneficiary of a pension fund, as described in paragraph (E), and who is a resident of a qualified foreign country, as determined under paragraph (b)(2);

(B) The government of a qualified foreign country (or a political subdivision or local authority of such country);

(C) A foreign corporation that is organized in a qualified foreign country and meets the publicly traded rules of §1.883–2;

(D) A not-for-profit organization described in paragraph (b)(4) of this section that is not a pension fund as defined in paragraph (b)(5) of this section and that is organized in a qualified foreign country; or

(E) A beneficiary of a pension fund (as defined in paragraph (b)(5)(iv) of this section) administered in or by a qualified foreign country (whose residency is determined under paragraph (d)(3)).

Paragraph (b)(2) of this section explains when an individual is a resident of a qualified foreign country for purposes of this proposed rule. An individual is a resident of a qualified foreign country only if the individual is fully liable to tax as a resident in such country (for example, an individual who is liable to tax only on a remittance basis in a foreign country may not be treated as a resident of that country), and in addition, either: (1) the individual's tax home, within the meaning of paragraph (b)(2)(ii) of this section, is within that qualified foreign country 183 days or more of the taxable year; or (2) the individual is treated as a resident of a qualified foreign country based on special rules pursuant to paragraphs (d)(3) of this section.

Paragraph (b)(2)(ii) explains that for purposes of this section an individual's tax home is considered to be located at the individual's regular or principal (if more than one regular) place of business. If the individual has no regular or principal place of business because of the nature of his business (or lack of a business), then the individual's tax home is located at his regular place of abode in a real and substantial sense. If an individual has no regular or principal place of business and no regular place of abode in a real and substantial sense in a qualified foreign country for 183 days or more of the taxable year, that individual does not have a tax home for purposes of this section and, therefore, is not a qualified shareholder unless either a special rule in paragraphs (d)(3)(ii) through (v) of this section applies or the individual demonstrates that he is fully liable to tax as a resident in such country. If further guidance is needed to determine the tax home of an individual for the purpose of determining whether the individual is a qualified shareholder under this paragraph, the proposed rule anticipates that the foreign corporation would look to published guidance under section 911(d)(3), with the exception of guidance relating to the treatment of itinerants.

Paragraph (b)(3) provides that a shareholder otherwise described in paragraph (b)(1) of this section may be a resident of a foreign country that provides an equivalent exemption for the category of income at issue through an income tax convention with the United States. If the shareholder relies on the convention to demonstrate that the country of residence provides an equivalent exemption and the convention has a requirement in the shipping and air transport article other than residence, such as place of registration or documentation of the ship or aircraft, or in the limitation on benefits article, such as a percentage of resident ownership, the shareholder is not a qualified shareholder unless the corporation seeking qualified foreign corporation status would satisfy any such additional requirement if it were organized in such foreign country. The proposed rule offers two examples to illustrate this rule.

Paragraph (b)(4) explains the requirements for a not-for- profit organization to be a qualified shareholder. This rule generally follows the rules in the first paragraph of §1.884–5(b)(1)(iv) of the branch profits tax regulations. Similarly, paragraph (b)(5) explains the requirements that a pension fund must satisfy in order for its beneficiaries to be qualified shareholders. The proposed rule addresses

both government and non-government pension funds and defines the term beneficiary of a pension fund. This paragraph generally follows §1.884–5(b)(8)(i) through (iii) of the branch profits tax regulations.

Paragraph (c) of this section contains the rules for determining constructive ownership for purposes of applying the stock ownership test of §1.883–1(c)(2) and the qualified shareholder stock ownership test of paragraph (a) of this section. Paragraph (c)(1) provides that stock owned by or for a corporation, partnership, trust, estate, or mutual insurance company or similar entity shall be treated as owned proportionately by its shareholders, partners, beneficiaries, grantors, or other interest holders as provided in paragraphs (c)(2)through (6) of this section. The proportionate interest rules of this paragraph apply successively upward through a chain of ownership, and a person's proportionate interest shall be computed for the relevant days or period that is taken into account in determining whether a foreign corporation satisfies the requirements of paragraph (a) of this section. Stock treated as owned by a person by reason of this paragraph shall be treated as actually owned by such person for purposes of this section. An owner of an interest in an association taxable as a corporation shall be treated as a shareholder of such association for purposes of this paragraph (c).

Paragraph (c)(2) explains that a partner shall be treated as having an interest in stock of a foreign corporation owned by a partnership in proportion to the least of three distributive shares: the partner's percentage distributive share of the partnership's dividend income from the stock; the partner's percentage distributive share of gain from disposition of the stock by the partnership; or the partner's percentage distributive share of the stock (or proceeds from the disposition of the stock) upon liquidation of the partnership. This rule generally follows the constructive ownership rules in §1.884–5(b)(2)(ii) of the branch profits tax regulations. It differs, however, because all qualified shareholders that are partners in a partnership and that are residents of, or organized in, the same qualified foreign country shall be treated as one partner. Thus, the percentage distributive shares of dividend income, gain and liquidation rights of all qualified shareholders that are partners in a partnership and that are residents of, or organized in, the same qualified foreign country are aggregated prior to determining the least of the three percentages set out in paragraph (c)(2)(i) of this section. This divergence was necessary because one country may be a qualified foreign country while another may not and it is necessary for the foreign corporation to identify the value of the stock owned by residents of each country. Several examples illustrate the rules of this paragraph.

Paragraph (c)(3) of this section provides rules for determining the owners of stock owned by or for a trust or estate. These rules generally adopt the rules of §1.884–5(b)(2)(iii) of the branch profits tax regulations. Similarly, paragraphs (c)(4) and (5) provide rules for determining the owners of stock owned by corporations that issue stock and by mutual insurance companies and similar entities, respectively. These rules adopt the rules of §1.884–5(b)(2)(iv) and (v) of the branch profits tax regulations, respectively.

Paragraph (c)(6) explains how to compute the beneficial interests of individuals in non-government pension funds. This rule differs from the rule in §1.884–5(b)(8)(iv) of the branch profits tax regulations in that the proposed rule provides that stock held by a non-government pension fund shall be considered owned by the beneficiaries of the fund equally on a pro-rata basis if certain conditions are met. For example, the trustees, directors or other administrators of the pension fund must have no knowledge, and no reason to know, that a pro-rata allocation of interests of the fund to all beneficiaries would differ significantly from an actuarial allocation of interests in the fund (or, if the beneficiaries' actuarial interest in the stock held directly or indirectly by the pension fund differs from the beneficiaries's actuarial interest in the pension fund, that a pro-rata allocation of interests of the fund to all beneficiaries would differ significantly from the actuarial interests computed by reference to the beneficiaries' actuarial interest in the stock).

The branch profits tax regulations determine such beneficial interests on an actuarial basis. The other conditions that must be satisfied generally follow those set out in §1.884–5(b)(8)(iv).

Paragraph (d)(1) provides that a foreign corporation that relies on this section to satisfy the ownership requirements of §1.883–1(c)(2), must establish all the facts necessary to satisfy the Commissioner that more than 50 percent of the value of its shares is owned, or treated as owned by applying paragraph (c) of this section, by qualified shareholders. A foreign corporation cannot meet this requirement with respect to any stock issued in bearer form. A shareholder that holds shares in the foreign corporation either directly or indirectly in bearer form cannot be a qualified shareholder.

Paragraph (d)(2)(i) provides that, except as provided in paragraph (d)(3), a person may only be a qualified shareholder if for the relevant period, the person completes an ownership statement, which is described in paragraph (d)(4) of this section. In the case of a person owning stock in the foreign corporation indirectly through one or more intermediaries (including mere legal owners or recordholders acting as nominees), each intermediary in the chain of ownership between that person and the foreign corporation seeking qualified foreign corporation status must also complete an intermediary ownership statement, which is described in paragraph (d)(4)(v). In addition, the foreign corporation must receive such ownership statements and retain them with the corporate books and records until the close of statute of limitations for the taxable year to which the statements relate.

The ownership statements required in paragraph (d)(2)(i) remain valid until the earlier of the last day of the third calendar year following the year in which the ownership statement is signed or the day that a change of circumstance occurs that makes any information on the ownership statement incorrect. For example, an ownership statement signed on September 30, 2000, remains valid through December 31, 2003, unless circumstances change that make the information of the statement no longer correct.

Paragraph (d)(3) contains special rules for determining the residence of certain shareholders. These rules are intended to simplify and reduce the effort needed by the foreign corporation and its intermediary shareholders to obtain the documenta-

tion required to substantiate whether the foreign corporation satisfies the qualified shareholder stock ownership test. If one of these special rules applies, the foreign corporation is not required to obtain an ownership statement from the individual owners covered by that rule.

Paragraph (d)(3)(ii) provides a special rule for registered shareholders owning less than one percent of widely-held corporations. This rule is adopted from §1.884–5(b)(3)(iii) of the branch profits tax regulations. A foreign corporation with at least 250 registered individual shareholders, that is not a publicly-traded corporation, as described in §1.883–2, (a widely-held corporation), may not be required to obtain an ownership statement from an individual shareholder owning less than one percent of the widely-held corporation at all times during the taxable year. If such widely-held foreign corporation is the foreign corporation seeking qualified foreign corporation status, or an intermediary that meets the documentation requirements of paragraphs (d)(4)(v)(A) and (B) of this section, relating to ownership statements from widely-held intermediaries with registered shareholders owning less that one percent of such intermediary, the widely-held foreign corporation may treat the address of record in its ownership records as the residence of any less than one percent individual shareholder if the individual's address of record is not a non-residential address, such as a post office box or in care of a financial intermediary or stock transfer agent and the officers and directors of the widely-held corporation neither know nor have reason to know that the individual does not reside at that address.

Paragraph (d)(3)(iii) provides special rules for pension funds. An individual who is a beneficiary of a government pension fund shall be treated as a resident of the country in which the pension fund is administered if the pension fund satisfies the documentation requirements of paragraphs (d)(4)(v)(A) and (C)(*1*) of this section, relating to ownership statements from pension funds. An individual who is a beneficiary of a non-government pension fund having more than 100 beneficiaries shall be treated as a resident of the country of the beneficiary's address as it appears on the records of the fund, provided it is not a nonresidential address, such as a post office box or an address in care of a financial intermediary, and provided none of the trustees, directors or other administrators of the pension fund know, or have reason to know, that the beneficiary is not an individual resident of such foreign country. This rule applies only if the non-government pension fund satisfies the documentation requirements of paragraphs (d)(4)(v)(A) and (C)(*2*) of this section.

Paragraph (d)(3)(iv) provides a special rule for publicly- traded corporations owning a direct or indirect interest in the foreign corporation seeking qualified foreign corporation status. Any stock in a foreign corporation seeking qualified foreign corporation status that is owned by a publicly traded corporation will be treated as owned by a person resident in the country where the publicly traded corporation is organized if the foreign corporation receives the statement described in paragraph (d)(4)(iii) of this section from the publicly-traded shareholder along with copies of any relevant ownership statements that the publicly traded shareholder relies on to satisfy the exception to the closely-held class of stock rule of §1.883–2(d)(3)(ii).

Finally, paragraph (d)(3)(v) provides a special rule for not-for-profit organizations. For purposes of meeting the ownership requirements of paragraph (a) of this section, a not-for-profit organization may rely on the addresses of record of its individual beneficiaries and supporters to determine where such persons are resident, provided that: the addresses of record are not nonresidential addresses such as a post office box or in care of a financial intermediary; the officers, directors or administrators or the organization do not know or have reason to know that the individual beneficiaries or supporters do not reside at that address; and the foreign corporation seeking qualified foreign corporation status receives the statement required in paragraph (d)(4)(iv) of this section from the not-for profit organization.

Paragraph (d)(4) describes the information that must be obtained by a corporation seeking qualified foreign corporation status for each taxable year if the foreign corporation relies on §1.883–4 to meet the stock ownership requirements of §1.883–1(c)(2), or to demonstrate that it is not a closely-held corporation. Treasury and the IRS solicit comments with respect to the appropriateness of these information requirements.

Paragraph (d)(4)(i) provides that an ownership statement from an individual shareholder is a written statement signed under penalties of perjury stating certain general information about a shareholder's ownership interest and country of residence. Paragraph (d)(4)(ii) provides additional information that must be included if the shareholder is a foreign government. Paragraph (d)(4)(iii) provides additional information that must be included if the shareholder is a publicly traded corporation. Paragraph (d)(4)(iv) provides additional information that must be included if the shareholder is a not-for-profit organization.

The foreign corporation seeking qualified foreign corporation status must obtain an intermediary ownership statement from each intermediary standing in the chain of ownership between it and the qualified shareholders upon whom it relies to meet the qualified shareholder stock ownership test. Paragraph (d)(4)(v) provides that an intermediary ownership statement is a written statement signed under penalties of perjury by the intermediary (if the intermediary is an individual) or a person who would be authorized to sign a tax return on behalf of the intermediary (if the intermediary is not an individual) stating certain general information about the intermediary's ownership interest and residence. Paragraph (d)(4)(v)(B) provides additional information that must be included if the shareholder is a widely-held intermediary with registered shareholders owning less than one percent of the widely-held intermediary. Paragraph (d)(4)(v)(C) provides additional information that must be included if the shareholder is a pension fund. This paragraph describes the information to be included in the intermediary ownership statement by both government and non-government pension funds and provides that the determinations required to be made under this paragraph (d)(4)(v)(C) shall be made using information shown on the records of the pension fund for a date during the foreign corporation's taxable year to which the determination is relevant.

Paragraph (d)(5) requires the foreign corporation seeking qualified foreign cor-

poration status to retain the documentation described in paragraphs (d)(3) and (4) of this section until the expiration of the statute of limitations for the taxable year of the foreign corporation to which the documentation relates. Such documentation must be made available for inspection by the Commissioner at such place as the Commissioner may request.

A foreign corporation relying on the ownership requirements of this section to demonstrate that it is a qualified foreign corporation for purposes of §1.883–1(c)(2) must provide the information described in paragraph (e) in addition to the information required in §1.883–1(c)(3) to be included in its Form 1120F for each taxable year. The information should be current as of the end of the corporation's taxable year. This information is to be based on an analysis of the ownership records of the foreign corporation, as well as on the ownership statements and other documentation that are obtained from its shareholders.

Proposed Effective Dates

The effective date provisions for the proposed rule are contained in §1.883–5. The proposed rule applies to taxable years of the foreign corporation ending 30 days or more after the date the proposed rule is published as a final regulation in the **Federal Register**. When the regulation is final, taxpayers may rely on all the provisions of this section for guidance and may elect to apply all such substantive provisions for any open taxable year beginning after December 31, 1986, and ending before the date the final regulation is effective. Such election will be applicable for the year of the election and for all subsequent taxable years. However, in no event will §1.883–1(c)(3) (relating to the substantiation and reporting required to be treated as a qualified foreign corporation) or §§1.883–2(f), 1.883–3(d) and 1.883–4(e) (relating to additional information to be included in the return to demonstrate whether the foreign corporation satisfies one of three stock ownership tests) apply to any taxable years ending prior to the effective date of this regulation.

Section 1.883–1(c)(3) (relating to the substantiation and reporting required to be treated as a qualified foreign corporation) requires that certain information be included in the foreign corporation's Form 1120F, "U.S. tax Return of Foreign Corporation." Sections 1.883–2(f), 1.883–3(d) and 1.883–4(e) (relating to information to be included to demonstrate whether the foreign corporation satisfies one of three stock ownership tests) require that additional information also be included in such return. When this regulation becomes generally applicable, and until the taxable year for which the Form 1120F and its instructions are revised to conform to this regulation and the foreign corporation seeking qualified foreign corporation status is otherwise directed by such instructions, the information required in §1.883–1(c)(3) and §1.883–2(f), 1.883–3(d) or 1.883–4(e), as applicable, must be included in a written statement signed under penalties of perjury by a person authorized to sign the return, attached to the Form 1120F, and filed with the return.

Special Analysis

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business. An initial regulatory flexibility analysis has been prepared as required for the collection of information in this notice of proposed rulemaking under 5 U.S.C. 603. The analysis is set forth in this preamble under the heading "Initial Regulatory Flexibility Analysis."

Initial Regulatory Flexibility Analysis

This initial analysis is prepared pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6). The objective of the proposed regulations is to provide guidance to foreign corporations engaged in the international operation of a ship or ships or aircraft. This guidance will enable the foreign corporation to determine if it is eligible to exclude its income from these activities from gross income for purposes of its United States Federal income tax. The legal basis for these requirements is section 883. The IRS and Treasury are not aware of any Federal rules that duplicate, overlap, or conflict with the proposed regulations.

The documentation and reporting requirements of the proposed regulations enable the IRS to identify those taxpayers that may or may not be eligible to claim a reciprocal exemption. In addition, analysis of the required shareholder documentation will enable the foreign corporation to correctly file its U.S. Federal income tax return.

There are approximately 1,400 foreign corporations that operate a ship or ships or aircraft on voyages or flights to or from the United States annually. These foreign corporations all have an obligation to file a U.S. Federal income tax return, regardless of whether they are entitled to a reciprocal exemption. However, many of those corporations are organized in qualified foreign countries and may be eligible to exempt their income from the international operation of a ship or ships or aircraft from U.S. tax. Because it is impossible to determine at this time which of these foreign corporations satisfies the ownership requirements of the proposed rule, an estimate of the number of small entities that would be affected by these regulations is unavailable. A foreign corporation that complies with the documentation requirements of these proposed rules should have the information necessary to determine with certainty whether it is eligible for an equivalent exemption. This, in turn, is expected to create the additional benefits of increasing compliance with the filing requirements of the Internal Revenue Code and enabling the IRS to confirm whether the foreign corporation is entitled to an exemption.

None of the significant alternatives considered in drafting these regulations would have significantly altered the economic impact of the collections of information on small entities. In considering the significant alternatives that would be permissible under the Code and would enable the IRS to ensure compliance with the Code, the IRS and Treasury concluded that the alternatives generally would impose equal or greater burdens.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8)

copies) that are submitted timely to the IRS. The IRS and Treasury request comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be made available for public inspection and copying.

A public hearing has been scheduled for April 27, 2000, at 10 a.m., in room 2615, Internal Revenue Building, 1111 Constitution Ave., NW., Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to this hearing. Persons who wish to present oral comments at the hearing must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by April 5, 2000. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Patricia A. Bray of the Office of the Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.883–1 is also issued under 26 U.S.C. 883.

Section 1.883–2 is also issued under 26 U.S.C. 883.

Section 1.883–3 is also issued under 26 U.S.C. 883.

Section 1.883–4 is also issued under 26 U.S.C. 883.

Section 1.883–5 is also issued under 26 U.S.C. 883. * * *

Par. 2. Section 1.883–0 is added to read as follows:

§1.883–0 Outline of major topics.

This section lists the major paragraphs contained in §§1.883–1 through 1.883–5.

§1.883–0 Outline of major topics.

§1.883–1 Exclusion of income from the international operation of ships or aircraft.

(a) General rule.
(b) Qualified income.
(c) Qualified foreign corporation.
(1) General rule.
(2) Stock ownership tests.
(3) Substantiation and reporting requirements.
(i) General rule.
(ii) Further documentation.
(4) Commissioner's discretion to cure defects in documentation.
(d) Qualified foreign country.
(e) Operation of ships or aircraft.
(1) General rule.
(2) Activities not considered operation of ships or aircraft.
(3) Definitions.
(i) Full charter.
(ii) Time charter.
(iii) Voyage charter.
(iv) Wet lease.
(v) Bareboat charter.
(vi) Dry lease.
(vii) Space or slot charter.
(viii) Nonvessel operating common carrier (NVOCC).
(ix) Code sharing arrangements.
(f) International operation.
(1) General rule.
(2) Determining whether income is from international operation.
(i) International carriage of passengers.
(A) In general.
(B) Round trip travel on cruise ships.
(ii) International carriage of cargo.
(iii) Bareboat charter of ships or aircraft used in international operations.
(A) Ratio based on use.
(B) Ratio based on gross income.
(g) Activities incidental to the international operation of ships or aircraft.
(1) General rule.
(2) Activities not considered incidental to the international operation of ships or aircraft.
(h) Equivalent exemption.
(1) General rule.
(2) Determining equivalent exemptions for each category of income.
(3) Special rule with respect to income tax conventions.
(4) Exemptions not qualifying as equivalent exemptions. (i) General rule.
(ii) Reduced tax rate or time limited exemption.
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§1.883–5 Effective date.

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(b) Election for retroactive application.
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Par. 3. Section 1.883–1 is revised to read as follows:

§1.883–1 Exclusion of income from the international operation of ships or aircraft.

(a) *General rule*. A foreign corporation shall exclude from its gross income for U.S. tax purposes any income it derives from the international operation of ships or aircraft if such income is qualified income under paragraph (b) of this section and if the corporation is a qualified foreign corporation under paragraph (c) of this section. See paragraph (e) of this section for the definition of the term *operation of ships or aircraft* and see paragraph (f) of this section for the definition of the term *international operation.*

(b) *Qualified income*. Qualified income is income from the international operation of ships or aircraft that—

(1) Is properly includible in any of the income categories described in paragraph (h)(2) of this section; and

(2) Is the subject of an equivalent exemption, as described in paragraph (h) of this section, granted by the qualified foreign country in which the foreign corporation seeking qualified foreign corporation status is organized. See paragraph (d) of this section for the definition of the term *qualified foreign country.*

(c) *Qualified foreign corporation*—(1) *General rule.* A qualified foreign corporation is a corporation, as defined in §§301.7701–2(b) and 301.7701–3 of this chapter, that is engaged in the international operation of ships or aircraft and that is organized in a qualified foreign country. To be a qualified foreign corporation the corporation must also satisfy one of the three stock ownership tests described in paragraph (c)(2) of this section and satisfy the substantiation and reporting requirements described in paragraph (c)(3) of this section. A corporation may be a qualified foreign corporation with respect to one category of qualified income but may not be with respect to another category of income. See paragraph (h)(2) of this section for a discussion of categories of qualified income.

(2) *Stock ownership tests*. To be a qualified foreign corporation the foreign corporation generally must demonstrate and document that more than fifty percent of the value of its stock is owned by qualified shareholders, as determined in §1.883–4 (qualified shareholder stock ownership test). However, a foreign corporation will not be required to demonstrate that it satisfies the qualified shareholder stock ownership test if it can demonstrate either that its stock is primarily and regularly traded on an established securities market in a qualified foreign country or in the United States, as determined under §1.883–2 (publicly-traded test), or that it is a controlled foreign corporation as determined under §1.883–3 (CFC test).

(3) *Substantiation and reporting requirements*—(i) *General rule*. To be a

qualified foreign corporation, a foreign corporation must include the following information in its Form ll20F, "U.S. Income Tax Return of a Foreign Corporation," in the manner that the Form 1120F and its accompanying instructions prescribes—

(A) The corporation's name and address (including mailing code);

(B) The corporation's U.S. taxpayer identification number;

(C) The foreign country in which the corporation is organized;

(D) The applicable authority for an equivalent exemption, (e.g., a citation to either a statute in the country where the corporation is organized or a diplomatic note between the foreign country where the corporation was organized and the United States that provides an equivalent exemption, or to Rev. Rul. 97–31 (1997–1 C.B. 703) (see §601.601(d)(2) of this chapter), if the foreign country is included in Part II or III of the Table of countries that currently provide an equivalent exemption);

(E) The category or categories of qualified income for which an exemption is being claimed;

(F) A reasonable estimate of the amount of each category of U.S. source qualified income for which the exemption is claimed;

(G) Any other information required under §1.883–2(f), 1.883–3(d), or 1.883–4(e); and

(H) Any other specified information.

(ii) *Further documentation*. If the Commissioner requests in writing that the foreign corporation substantiate representations made under paragraph (c)(3)(i) of this section, or under §1.883–2(f), 1.882–3(d) or 1.883–4(e), the foreign corporation must provide the supporting documentation or substantiation within 60 days following the written request. If the foreign corporation does not provide all of the information requested within the 60 day period but demonstrates that the failure was due to reasonable cause and not willful neglect, the Commissioner may grant the foreign corporation a 30-day extension to provide the supporting documentation or substantiation. Whether a failure to obtain the documentation or substantiation in a timely manner was due to reasonable cause shall be determined by the Commissioner after considering all the facts and circumstances.

(4) *Commissioner's discretion to cure defects in documentation*. The Commissioner retains the discretion to cure any defects in the documentation where the Commissioner is satisfied that the foreign corporation would otherwise be a qualified foreign corporation.

(d) *Qualified foreign country*. A qualified foreign country is a foreign country that grants to corporations organized in the United States an equivalent exemption, as described in paragraph (h) of this section, for the category of qualified income earned by the foreign corporation seeking qualified foreign corporation status. A foreign country may be a qualified foreign country with respect to one category of income but not with respect to another category of income, as described in paragraph (h)(2) of this section.

(e) *Operation of ships or aircraft*—(1) *General rule*. Only a corporation that is an owner, lessor or lessee of an entire ship or aircraft used to carry cargo or passengers for hire can be considered engaged in the operation of ships or aircraft. The term *operation of ships or aircraft*, which includes the operation of a single ship or aircraft, means—

(i) Carriage of passengers or cargo for hire;

(ii) Time or voyage charter of a ship, or wet lease of an aircraft (full charter), as defined in paragraph (e)(3) of this section;

(iii) Bareboat charter of a ship, or dry lease of an aircraft, as defined in paragraph (e)(3) of this section; or

(iv) Active participation by a foreign corporation that is otherwise engaged in the operation of ships or aircraft in a pool, partnership, strategic alliance, joint operating agreement, code sharing or other joint venture, that is itself engaged in the operation of ships or aircraft.

(2) *Activities not considered operation of ships or aircraft*. A corporation that is not engaged in any of the activities described in paragraph (e)(1) of this section shall not be considered engaged in the operation of ships or aircraft. Examples of activities that do not constitute activities described in (e)(1) include—

(i) The activities of a nonvessel-operating common carrier (NVOCC), as defined in paragraph (e)(3)(viii) of this section;

(ii) Space or slot charter, as defined in paragraph (e)(3)(vii) of this section;

(iii) Ship management;

(iv) Obtaining crews for ships or aircraft not operated by the corporation;

(v) The activities of a ship's agent;

(vi) Ship or aircraft brokering;

(vii) Freight forwarding;

(viii) The activities of travel agents and tour operators;

(ix) Rental by a container leasing company of containers and related equipment for inland transportation;

(x) Passive investment in an enterprise, including a pool, partnership, strategic alliance, joint operating agreement, or other joint venture, engaged in the international operation of ships or aircraft; or

(xi) The activities of a concessionaire.

(3) *Definitions*—(i) *Full charter*. Full charter (or full rental) means a time charter or a voyage charter of a ship or a wet lease of an aircraft.

(ii) *Time charter*. A time charter is a contract for the use of a ship or aircraft for a specific period of time during which the owner/lessor of the ship or aircraft retains control of the navigation and management of the ship or aircraft (e.g., the owner/lessor continues to be responsible for the crew, supplies, repairs and maintenance, fees and insurance, charges, commissions and other expenses connected with the use of the ship or aircraft).

(iii) *Voyage charter*. A voyage charter is a contract similar to a time charter except that the ship or aircraft is chartered for a specific voyage or flight rather than for a specific period of time.

(iv) *Wet lease*. When a time charter or voyage charter involves an aircraft, it is referred to, in both cases, as a wet lease.

(v) *Bareboat charter*. A bareboat charter is a contract for the use of aircraft whereby the charterer/lessee is in complete possession, control, and command of the ship or aircraft and performs functions normally performed by the owner/lessor of the ship or aircraft. For example, the charterer/lessee is responsible for the navigation and management of the ship or aircraft, the crew, supplies, repairs and maintenance, fees, insurance, charges, commissions and other expenses connected with the use of the ship or aircraft. The owner/lessor of the ship bears none of the expense or responsibility of operation of the ship or aircraft.

(vi) *Dry lease*. When a bareboat char-

ter involves an aircraft, it is referred to as a dry lease.

(vii) *Space or slot charter.* A space or slot charter is a contract for use of a certain amount of space (but less than all of the space) on a ship or aircraft, and may be on a time or voyage basis. When used in connection with passenger aircraft this may be referred to as the sale of block seats.

(viii) *Nonvessel operating common carrier (NVOCC).* A nonvessel operating common carrier is an entity that holds itself out to the public as providing transportation for hire, assumes responsibility or has liability by law for safe transportation of shipments and arranges in its own name with underlying carriers for the performance of such transportation. An NVOCC is distinguishable from a charterer/lessee in that a charterer/lessee hires and has control of all or part of a vessel. An NVOCC is merely a customer of the ocean common carrier. Where an NVOCC consolidates shipments and holds itself out to the public as providing transportation for hire, its services and liabilities are comparable to that of a freight forwarder.

(ix) *Code-sharing arrangements.* Code sharing is an arrangement in which one air carrier puts its identification code on the flight of another carrier. This allows the first carrier to hold itself out as providing service in markets where it does not operate or where it operates infrequently. Code sharing can range from a very limited agreement involving only one market, to alliances between international carriers involving agreements on joint marketing, baggage handling, one-stop check-in service and sharing of frequent flyer awards.

(f) *International operation*—(1) *General rule.* The term *international operation* means operation of ships or aircraft, as defined in paragraph (e) of this section, on voyages or flights that begin or end in the United States, as determined in paragraph (f)(2) of this section, and correspondingly end or begin in a foreign country. The term does not include a voyage or flight that begins and ends in the United States even if the voyage or flight contains a segment extending beyond the territorial limits of the United States with no stop in a foreign country. Operation of ships or aircraft beyond the territorial limits of the United States does not, in itself, constitute international operation of ships or aircraft.

(2) *Determining whether income is from international operation.* Whether income is derived from the international operation of ships or aircraft is determined on a passenger-by-passenger basis (as provided in paragraph (f)(2)(i) of this section) and item of cargo-by-item of cargo basis (as provided in paragraph (f)(2)(ii) of this section). In the case of the bareboat charter of a ship or the dry lease of an aircraft, whether the charter income is derived from international operation is determined by reference to the use of the ship or aircraft by the lowest-tier operator in the chain of lessees (as provided in paragraph (f)(2)(iii) of this section).

(i) *International carriage of passengers*—(A) *In general.* Except in the case of a round trip cruise, income from the carriage of a passenger will be income from the international operation of ships or aircraft if the passenger is carried between a beginning point in the United States and an ending point in a foreign country and vice versa. Carriage of a passenger will be treated as ending at the passenger's final destination even if, en route to the passenger's final destination, a stop is made at an intermediate point for refueling, maintenance, or other business reasons, provided the passenger does not change aircraft or ships at the intermediate point. Similarly, carriage of a passenger will be treated as beginning at the passenger's point of origin even if, en route to the passenger's final destination, a stop is made at an intermediate point and the passenger does not change aircraft or ships at the intermediate point. Carriage of a passenger will be treated as beginning or ending at a U.S. or foreign intermediate point if the passenger changes aircraft or ships at that intermediate point.

(B) *Round trip travel on cruise ships.* In the case of the carriage of a passenger on a round trip cruise that begins in the United States, stops at a foreign intermediate port for shore excursions, refueling, maintenance, or other business reasons, and returns to the same or another U.S. port, the carriage of such passenger on the round trip cruise will be treated as international operation of a ship under paragraph (f)(2)(i)(A) of this section. Such a round trip cruise may also include one or more intermediate stops at a U.S. port or ports for similar purposes.

(ii) *International carriage of cargo.* Income from the carriage of cargo will be income from the international operation of ships or aircraft if the cargo is carried between a beginning point in the United States and an ending point in a foreign country or vice versa. Carriage of cargo will be treated as ending at the final destination of the cargo even if, en route to that final destination, a stop is made at a U.S. intermediate point, provided that the cargo is transported to its ultimate destination on the same ship or aircraft. If the cargo is transferred to another ship or aircraft, the carriage of the cargo may nevertheless be treated as ending at its final destination if the same taxpayer transports the cargo to and from the U.S. intermediate point and the cargo does not pass through customs at the U.S. intermediate point. Similarly, carriage of cargo will be treated as beginning at the cargo's point of origin, even if en route to its final destination, a stop is made at a U.S. intermediate point, provided that the cargo is transported to its ultimate destination on the same ship or aircraft. If the cargo is transferred to another ship or aircraft, the carriage of the cargo may nevertheless be treated as beginning at the point of origin if the same taxpayer transports the cargo to and from the U.S. intermediate point and the cargo does not pass through customs at the U.S. intermediate point. Repackaging, recontainerization, or any other activity involving the unloading of the cargo at the U.S. intermediate point will not change these results if the same taxpayer transports the cargo to and from the U.S. intermediate point and the cargo does not pass through customs at the U.S. intermediate point.

(iii) *Bareboat charter of ships or aircraft used in international operations.* If a qualified foreign corporation bareboat charters a ship or dry leases an aircraft to a lessee and the lowest tier lessee-operator in the chain of ownership uses such ship or aircraft for the international carriage of passengers or cargo for hire, as described in paragraphs (f)(2)(i) and (ii) of this section, the qualified foreign corporation may exclude the proportion of the bareboat charter income attributable to such international operation of the ship

or aircraft. The foreign corporation must use a reasonable method for determining the proportion of the charter income that is attributable to such international operation. Two reasonable methods for determining the amount of charter income attributable to the international operation of the ship or aircraft are the following:

(A) *Ratio based on use.* Multiply the annual charter amount attributable to use of the ship or aircraft by a lessee by a ratio, the numerator of which is the total number of days of uninterrupted travel on voyages or flights of such ship or aircraft between the United States and the farthest point or points where cargo or passengers are loaded en route to, or discharged en route from, the United States, and the denominator of which is the total number of days in the smaller of the taxable year or the particular charter period. For this purpose, the number of days during which the ship or aircraft is not generating transportation income, within the meaning of section 863(c)(2), for example while the ship or aircraft is out of service while being repaired or maintained, should not be included in the numerator of the ratio.

(B) *Ratio based on gross income.* Multiply the annual charter amount attributable to the use of the ship or aircraft by the lessee by a ratio, the numerator of which is the U.S. source gross transportation income (USSGTI as that term is defined in section 887(b)) earned from the operation of the vessel or aircraft by the lowest tier lessee-operator, and the denominator of which is the total gross income of such lessee-operator from the operation of the ship or aircraft during the smaller of the taxable year or the term of the charter, if such information is available. An allocation based on the net income of such lessee-operator will not be considered reasonable for this purpose.

(g) *Activities incidental to the international operation of ships or aircraft*—(1) *General rule.* Certain activities of an operator of ships or aircraft are so closely related to the primary activity of operation of ships or aircraft that they are considered incidental to such operations. Income from these incidental activities is eligible for the reciprocal exemption under this section. Examples of activities of a foreign corporation engaged in the international operation of ships or aircraft that may be considered incidental to such operation include—

(i) Contracting for the international carriage of cargo or passengers, as defined in paragraph (f) of this section, using a space or slot charter, alliance, code sharing or similar arrangement, on ships or aircraft operated by another carrier;

(ii) Temporary investment of working capital funds;

(iii) Sale of tickets for an international voyage by a ship operator for another ship operator;

(iv) Sale of tickets for an international flight by an air carrier for another air carrier;

(v) Rental of containers in connection with the international carriage of goods by sea by the operator of a ship or by air by the operator of an aircraft;

(vi) Contracting with concessionaires for performance of services onboard during the international operation of the operator's ship or aircraft as the case may be; or

(vii) Bareboat charter of ships or aircraft normally used by the operator in international operation but currently not needed, if the ship or aircraft is used by the lessee for international voyages or flights.

(2) *Activities not considered incidental to the international operation of ships or aircraft.* Examples of activities that are not considered to be incidental to the international operation of ships or aircraft by an operator include—

(i) The sale of or arranging for train travel, bus transfers, land tour packages, or port city hotel accommodations within the United States or a foreign country, or the sale of airline tickets by a cruise ship operator or cruise tickets by an air carrier;

(ii) The sale or rental of real property;

(iii) Treasury activities involving the investment of excess funds or funds awaiting repatriation generated by the operation of ships or aircraft;

(iv) Rental of containers for a domestic leg of transportation in connection with international carriage of cargo;

(v) Passive investment in an enterprise engaged in the international operation of ships or aircraft;

(vi) Services performed for parties other than passengers, consignors or consignees, such as ground services at ports or airports or ship or aircraft maintenance; or

(vii) The carriage of passengers or cargo on ships or aircraft on domestic legs, not treated as international operation under paragraph (f) of this section, either by the foreign operator or by a U.S. operator that is a member with the foreign operator in a pool, partnership, strategic alliance, joint operating agreement, code sharing or other joint venture, that is itself engaged in the operation of ships or aircraft.

(h) *Equivalent exemption*—(1) *General rule.* A foreign country grants an equivalent exemption when it exempts from taxation income from the international operation of ships or aircraft derived by corporations organized in the United States. Whether a foreign country provides an equivalent exemption must be determined separately with respect to each category of income, as provided in paragraph (h)(2) of this section. However, an equivalent exemption may be available for income derived from the international operation of ships even though income derived from the international operation of aircraft may not be exempt, and vice versa. For rules regarding shareholders resident in a foreign country that offers an exemption under an income tax convention, see §1.883–4(b)(3). An equivalent exemption may exist where the foreign country—

(i) Generally imposes no tax on income, including income from the international operation of ships or aircraft;

(ii) Specifically provides a domestic law tax exemption for income derived from the international operation of ships or aircraft, either by statute, decree, or otherwise; or

(iii) Exchanges diplomatic notes with the United States, or enters into an agreement with the United States, that provides for a reciprocal exemption under section 883.

(2) *Determining equivalent exemptions for each category of income.* Whether a foreign country grants an equivalent exemption is determined separately with respect to each category of income listed in paragraphs (h)(2)(i) through (vii) of this section and is determined separately with respect to income from the operation of ships and income from the operation of aircraft. Where an exemption is unavailable in the foreign country for a particular category of income, a foreign corporation

organized in that country shall not be permitted to exempt that category of income from U.S. tax under this section, even though the foreign country may grant an equivalent exemption for other categories of income. An equivalent exemption may be available for income derived from the international operation of ships even though income derived from the international operation of aircraft may not be exempt, and vice versa. A separate determination of whether a foreign country grants an equivalent exemption must be made for each of the following categories of income—

(i) Income from the carriage of cargo and passengers (operating income);

(ii) Time or voyage (full) charter income (or full rental);

(iii) Bareboat charter income (or bareboat rental);

(iv) Incidental bareboat charter income (or incidental bareboat rental);

(v) Incidental container-related income;

(vi) Income incidental to the operation of ships or aircraft other than incidental income described in paragraphs (h)(2)(iv) and (v) of this section; and

(vii) Capital gains of the operator from the sale, exchange or other disposition of a ship, aircraft, container or related equipment or other moveable property used by that operator in the international operation of ships or aircraft.

(3) *Special rule with respect to income tax conventions*. If a corporation is organized in a foreign country that provides an equivalent exemption only through an income tax convention with the United States, the foreign corporation must satisfy the terms of that convention before it can receive a benefit under the convention and the foreign corporation may not claim an exemption under section 883. If, however, the corporation is organized in a foreign country that offers an equivalent exemption under an income tax convention and also by some other means, such as by diplomatic note or domestic law, the foreign corporation may choose annually whether it will claim benefits under section 894 and the income tax convention or an exemption under section 883. This choice will apply with respect to all income of the corporation from the international operation of ships or aircraft and the choice cannot be made separately with respect to different categories of such income. If a foreign corporation bases its claim for an exemption on section 883 rather than the income tax convention, the foreign corporation must satisfy all of the requirements under this regulation to qualify for an exemption from U.S. income tax. See §1.883–4(b)(3) for rules regarding shareholders resident in a foreign country that offers an equivalent exemption under a treaty.

(4) *Exemptions not qualifying as equivalent exemptions*—(i) *General rule*. Exemptions provided to corporations organized in the United States by certain foreign countries may not satisfy the equivalent exemption requirements of this section.

(ii) *Reduced tax rate or time limited exemption*. The exemption granted by the foreign country's law or income tax convention must be a complete exemption. The exemption may not constitute merely a reduction to a non-zero rate of tax levied against corporations organized in the United States engaged in the international operation of ships or aircraft or a temporary reduction to a zero rate of tax for only a limited period of time, such as in the case of a tax holiday.

(iii) *Inbound or outbound freight tax*. With respect to the carriage of cargo, the foreign country must provide an exemption from tax for income from transporting freight both inbound and outbound before it will be considered to grant an equivalent exemption. A foreign country that imposes tax only on outbound freight will not be treated as granting an equivalent exemption for income from transporting freight inbound into that country.

(iv) *Exemptions for limited types of cargo*. A foreign country must provide an exemption from tax for income from transporting all categories of cargo before it will be considered to grant an equivalent exemption. For example, if a foreign country were generally to impose tax on income from the international carriage of cargo but to provide a statutory exemption for income from transporting agricultural products, the foreign country would not be considered to grant an equivalent exemption with respect to income from the international carriage of cargo and passengers and would not be a qualified foreign country with respect to that type of income.

(v) *Territorial tax systems*. A foreign country with a territorial tax system will be treated as granting an equivalent exemption if it treats income from the international operation of ships or aircraft derived by a U.S. corporation as 100 percent foreign source and thereby not subject to tax, even if the income is derived from a voyage or flight that begins or ends in that foreign country.

(vi) *Countries that tax on a residence basis*. A foreign country that generally provides an equivalent exemption to corporations organized in the United States but also imposes a residence-based tax on certain corporations organized in the United States, may nevertheless be considered to grant an equivalent exemption if the residence-based tax is imposed only on a corporation organized in the United States that maintains its center of management and control or other comparable attributes in that foreign country. If the residence-based tax is imposed on corporations organized in the United States and engaged in the international operation of ships or aircraft that are not managed and controlled in that foreign country, the foreign country shall not be treated as a qualified foreign country and shall not be considered to grant an equivalent exemption for purposes of this section.

(vii) *Exemptions within categories of income*. A foreign country must provide an exemption from tax for all income in a category of income, as defined in paragraph (h)(2) of this section. For example, a country that exempts income from the bareboat charter of passenger aircraft but not the bareboat charter of cargo aircraft does not provide an equivalent exemption. However, an equivalent exemption may be available for income derived from the international operation of ships even though income derived from the international operation of aircraft may not be exempt, and vice versa.

(i) *Treatment of possessions*. A possession of the United States will be considered to grant an equivalent exemption and will be treated as a qualified foreign country if it is on a mirror system. The term *mirror system* refers to the general applicability in the possession of the Internal Revenue Code of 1986, as amended, with the name of the possession substituted for "United States" where appropriate. If a

possession does not use a mirror system, the possession may nevertheless be a qualified foreign country if, for example, it provides for an equivalent exemption through its internal law.

(j) *Expenses related to exempt income not deductible from non-exempt income*. If a qualified foreign corporation derives income from the international operation of ships or aircraft as well as from a non-exempt activity, and that income is effectively connected with the conduct of a trade or business within the United States, the foreign corporation may not deduct from income derived from a non-exempt activity, any amount otherwise allowable as a deduction from qualified shipping or aircraft income if that income is excluded under this proposed rule. See section 265(a)(1).

Par. 4. Sections 1.883–2 through 1.883–5 are added to read as follows:

§1.883–2 Treatment of publicly-traded corporations.

(a) *General rule*. A foreign corporation shall satisfy the stock ownership test of §1.883–1(c)(2) if it is considered a publicly-traded corporation and satisfies the substantiation and reporting requirements of paragraphs (e) and (f) of this section. To be considered a publicly-traded corporation, the stock of the foreign corporation must be primarily traded and regularly traded on one or more established securities markets, as those terms are defined in paragraphs (b), (c), and (d) of this section, in the United States or any qualified foreign country.

(b) *Established securities market*—(1) *General rule*. For purposes of this section, the term *established securities market* means, for any taxable year—

(i) A foreign securities exchange that is officially recognized, sanctioned, or supervised by a governmental authority of the country in which the market is located, and has an annual value of shares traded on the exchange exceeding $1 billion during each of the three calendar years immediately preceding the beginning of the taxable year;

(ii) A national securities exchange that is registered under section 6 of the Securities Act of 1934 (15 U.S.C. 78f);

(iii) A United States over-the-counter market, as defined in paragraph (b)(4) of this section;

(iv) Any exchange designated under a Limitation On Benefits article in a United States income tax convention; and

(v) Any other exchange that the Secretary may designate by regulation or otherwise.

(2) *Exchanges with multiple tiers*. If an exchange in a foreign country has more than one tier or market level on which stock may be separately listed or traded, each such tier shall be treated as a separate exchange.

(3) *Computation of dollar value of stock traded*. For purposes of paragraph (b)(1)(i) of this section, the value in U.S. dollars of shares traded during a calendar year shall be determined on the basis of the dollar value of such shares traded as reported by the International Federation of Stock Exchanges located in Paris, or, if not so reported, then by converting into U.S. dollars the aggregate value in local currency of the shares traded using an exchange rate equal to the average of the spot rates on the last day of each month of the calendar year.

(4) *Over-the-counter market*. An over-the-counter market is any market reflected by the existence of an interdealer quotation system. An interdealer quotation system is any system of general circulation to brokers and dealers that regularly disseminates quotations of stocks and securities by identified brokers or dealers, other than by quotation sheets that are prepared and distributed by a broker or dealer in the regular course of business and that contain only quotations of such broker or dealer.

(5) *Discretion to determine that an exchange does not qualify as an established securities market*. The Commissioner may determine that a securities exchange that otherwise meets the requirements of this paragraph (b) of this section does not qualify as an established securities market, if—

(i) The exchange does not have adequate listing, financial disclosure, or trading requirements (or does not adequately enforce such requirements); or

(ii) There is not clear and convincing evidence that the exchange ensures the active trading of listed stocks.

(c) *Primarily traded*. For purposes of this section, stock of a corporation is primarily traded on one or more established securities markets, as defined in paragraph (b) of this section, if, with respect to each class of stock described in paragraph (d)(1)(i) of this section (relating to classes of stock relied on to meet the regularly traded test)—

(1) The number of shares in each such class that are traded during the taxable year on all established securities markets in that country exceeds

(2) The number of shares in each such class that are traded during that year on established securities markets in any other single foreign country.

(d) *Regularly traded*—(1) *General rule*. For purposes of this section, stock of a corporation is regularly traded on one or more established securities markets, as defined in paragraph (b) of this section, if—

(i) One or more classes of stock of the corporation that, in the aggregate, represent 80 percent or more of the total combined voting power of all classes of stock of such corporation entitled to vote and of the total value of the stock of such corporation are listed on such market or markets during the taxable year; and

(ii) With respect to each class relied on to meet the 80 percent requirement of paragraph (d)(1)(i) of this section—

(A) Trades in each such class are effected, other than in de minimis quantities, on such market or markets on at least 60 days during the taxable year (or 1/6 of the number of days in a short taxable year); and

(B) The aggregate number of shares in each such class that are traded on such market or markets during the taxable year are at least 10 percent of the average number of shares outstanding in that class during the taxable year (or, in the case of a short taxable year, a percentage that equals at least 10 percent of the average number of shares outstanding in that class during the taxable year multiplied by the number of days in the short taxable year, divided by 365).

(2) *Classes of stock traded on a domestic established securities market treated as meeting trading requirements*. A class of stock that is traded during the taxable year on an established securities market located in the United States shall be considered to meet the trading requirements of paragraph (d)(1)(ii) of this section if the stock is regularly quoted by dealers making a market in the stock. A dealer makes a market in a stock only if the

dealer regularly and actively offers to, and in fact does, purchase the stock from, and sell the stock to, customers who are not related persons (as defined in section 954(d)(3)) with respect to the dealer in the ordinary course of a trade or business.

(3) *Closely-held classes of stock not treated as meeting trading requirement*—(i) *General rule*. Except as provided in paragraph (d)(3)(ii) of this section, a class of stock of a foreign corporation listed on an established securities market or markets and otherwise meeting the trading requirements of paragraph (d)(1)(ii) of this section shall not be treated as meeting the trading requirements of paragraph (d)(1)(ii) of this section (or the requirements of paragraph (d)(2) of this section) for a taxable year if, at any time during the taxable year, one or more persons who own at least 5 percent of the value of the outstanding shares of the class of stock (5 percent shareholders as determined under paragraph (d)(3)(iii) of this section) own, in the aggregate, 50 percent or more of the value of the shares.

(ii) *Exception*. Notwithstanding the general rule of paragraph (d)(3)(i) of this section, a closely-held class of stock that otherwise satisfies the trading requirements of paragraph (d)(1)(ii) of this section may be treated as meeting such trading requirements if the foreign corporation can establish that more than 50 percent of the value of the outstanding shares of the class of stock is owned, or treated as owned under §1.883–4(c), by persons who are qualified shareholders, within the meaning of §1.883–4(b), for more than half the number of days during the taxable year. In addition, such persons may not own their interests in the foreign corporation either directly or by applying the attribution rules of §1.883–4(c) through bearer shares. Further, the foreign corporation must obtain from such persons the relevant documentation described in §1.883–4(d).

(iii) *Treatment of related persons*. Solely for purposes of determining whether a person is a 5 percent shareholder, persons related within the meaning of section 267(b) shall be treated as one person. In determining whether two or more corporations are members of the same controlled group under section 267(b)(3), a person is considered to own stock owned directly by such person, stock owned with the application of section 1563(e)(1), and stock owned with the application of section 267(c). Further, in determining whether a corporation is related to a partnership under section 267(b)(10), a person is considered to own the partnership interest owned directly by such person and the partnership interest owned with the application of section 267(e)(3).

(4) *Anti-abuse rule*. Trades between related persons described in section 267(b), as modified by paragraph (d)(3)(iii) of this section, and trades conducted in order to meet the requirements of paragraph (d)(1) of this section (the trading rule) shall be disregarded. A class of stock shall not be treated as meeting the trading requirements of paragraph (d)(1) of this section if there is a pattern of trades conducted to meet the requirements of paragraph (d)(1) of this section. For example, trades between two persons that occur several times during the taxable year may be treated as an arrangement or a pattern of trades conducted to meet the trading requirements of paragraph (d)(1)(ii) of this section.

(5) *Example*. The closely-held class of stock rule in paragraph (d)(3) is illustrated by the following example:

Example. Closely-held exception—(i) *Facts*. X is a corporation organized in a qualified foreign country. X has one class of stock that is listed and primarily traded on an established securities market in the qualified foreign country. The class of stock of X also meets the trading requirements of paragraph (d)(1)(ii) of this section. However, the founding family owns 60 percent of that class of stock through Hold Co. The remaining 40 percent is not owned by any 5 percent shareholder. Some of the family members are U.S. residents, while the remaining family members are residents of the qualified foreign country. Individuals A and B are members of the founding family and each owns 10 percent of the stock of Hold Co.

(ii) *Analysis*. Because Hold Co owns 60 percent of the class of stock, Hold Co is a 5 percent shareholder and the class of stock will not be regularly traded unless X can prove, applying the attribution rules of §1.883–4(c), that more than 50 percent of the stock of X is owned, or treated as owned under §1.883–4(c), by residents of a qualified foreign country. If X can demonstrate that more than 50 percent of the stock held by Hold Co is owned by qualified shareholders, X can meet this burden and the stock of X will be regularly traded because the exception in paragraph (d)(3)(ii) of this section would apply.

(e) *Substantiation that a foreign corporation is publicly traded*—(1) *In general*. A foreign corporation that relies on the publicly traded test of this section to establish that it is a qualified foreign corporation for purposes of §1.883–1(c)(2) must substantiate that the stock of the foreign corporation is primarily and regularly traded on an established securities market. If one of the classes of stock on which the foreign corporation relies to meet this test is closely-held within the meaning of paragraph (d)(3)(i) of this section, the foreign corporation must obtain an ownership statement described in §1.883–4(d) from each qualified shareholder and intermediary that it relies upon to satisfy the exception to the closely-held class of stock rule, but only to the extent such statement would be required if the foreign corporation were relying on the qualified shareholder test of §1.883–4 with respect to those shares of stock. The foreign corporation must also maintain and provide to the Commissioner upon request a list of its shareholders of record and any other relevant information known to the foreign corporation.

(2) *Availability and retention of documents for inspection*. The documentation described in paragraph (e)(1) of this section must be retained by the corporation seeking qualified foreign corporation status (the foreign corporation) until the expiration of the statute of limitations for the taxable year of the foreign corporation to which the documentation relates. Such documentation must be made available for inspection by the Commissioner at such time and such place as the Commissioner may request in writing.

(f) *Reporting requirements*. A foreign corporation relying on this section to satisfy the stock ownership requirements of §1.883–1(c)(2) must provide the following information that is current as of the end of the corporation's taxable year, in addition to the information required in §1.883–1(c)(3) to be included in its Form 1120F for the taxable year—

(1) The name of the country in which the stock is primarily traded;

(2) The name of the established securities market or markets on which that the stock is listed;

(3) A description of each class of stock relied upon to meet the requirements of paragraph (d) of this section, including the number of shares issued and outstanding as of the close of the taxable year;

(4) For each class of stock relied upon to meet the requirements of paragraph (d) of this section, if one or more 5 percent

shareholders, as defined in paragraph (d)(3)(i) of this section, own in the aggregate 50 percent or more of the value of the outstanding shares of that class of stock at any time during the taxable year, state—

(i) The name and address of each 5 percent shareholder of that class of stock and each related person whose stock is treated as owned by the 5 percent shareholder;

(ii) For each qualified shareholder of the closely-held class of stock upon whom the corporation intends to rely to satisfy the exception to the closely-held class of stock rule of paragraph (d)(3)(ii) of this section—

(A) The name of each such shareholder;

(B) The percentage of the total value of the stock held by each such shareholder;

(C) The address of record of each such shareholder;

(D) The country of residence of each such shareholder, determined under §1.883–4(b)(2)(residence of individual shareholders) or §1.883–4(d)(3)(special rules for residence of certain shareholders);

(E) The portion of the taxable year of the foreign corporation during which the requisite ownership in the closely-held block of stock by qualified shareholders was satisfied;

(5) The percentage of the value of the class of stock represented by the widely-held block of stock; and

(6) Any other specified information.

§1.883–3 Treatment of controlled foreign corporations—(a) *General rule*. A foreign corporation that is a controlled foreign corporation (CFC), as defined in section 954(a), satisfies the stock ownership test of §1.883–1(c)(2) if it meets the income inclusion test in paragraph (b)(1) of this section and satisfies the substantiation and reporting requirements of paragraphs (c) and (d) of this section, respectively (the CFC test). A CFC that fails the income inclusion test of paragraph (b)(1) of this section may not satisfy the stock ownership test of §1.883–1(c)(2) unless the CFC demonstrates that it meets either the publicly traded test of §1.883–2 or the qualified shareholder test of §1.883–4.

(b) *Special rule for CFCs with certain entity shareholders*— (1) *Income inclusion test*. For purposes of these proposed rules, a CFC will not be considered to satisfy the requirements of paragraph (a) of this section unless—

(i) Such corporation would be a CFC as defined in section 957(a) if such section were applied without regard to section 318(a)(4); and

(ii) More than 50 percent of the CFC's subpart F income (as defined in section 952) derived from the international operation of ships or aircraft is includible, pursuant to section 951, in the gross income of one or more U.S. citizens, individual residents of the United States or domestic corporations for the taxable years of such persons in which the taxable year of the CFC ends.

(2) *Examples*. The income inclusion test of this paragraph (b) is illustrated in the following examples:

Example 1. CFC earns U.S. source income from the international operation of aircraft that is not effectively connected with the conduct of a U.S. trade or business. CFC is organized in a qualified foreign country. CFC is not a publicly traded corporation and all of its U.S. shareholders, as defined in section 951(b), are domestic partnerships. All of the partners in those domestic partnerships are citizens and residents of foreign countries. Thus, the CFC fails the income inclusion test of paragraph (b)(1) of this section because no amount of the CFC's relevant subpart F income is includible in the gross income of one or more U.S. citizens, individual residents of the United States or domestic corporations. Therefore the CFC must satisfy the rules of §1.883–4, regarding the qualified shareholder stock ownership test, in order to satisfy the stock ownership test of §1.883–1(c)(2) and be considered a qualified foreign corporation.

Example 2. Ship Co is a CFC organized in a qualified foreign country and is not a publicly traded corporation. Corp A, a domestic corporation, owns 50 percent of the value of the stock of Ship Co. X, a domestic partnership, owns the remaining 50 percent of the value of the stock of Ship Co. A U.S. citizen is a partner owning a 20 percent interest in X. Individual partners owning 80 percent of X are citizens and residents of foreign countries. There are no special allocations of partnership income. Ship Co satisfies the income inclusion test of paragraph (b)(1) of this section because 60 percent (50% + (20% x 50%))of the subpart F income would be includible in the gross income of U.S. citizens or individual residents of the United States or domestic corporations. If Ship Co satisfies the substantiation and reporting requirements of paragraphs (c) and (d) of this section, respectively and the reporting requirements of §1.883–1(c)(3), it will be a qualified foreign corporation.

(c) *Substantiating CFC stock ownership*—(1) *In general*. A CFC relying on this section to satisfy the stock ownership test of §1.883–1(c)(2) must establish all the facts necessary to satisfy the Commissioner that it qualifies under the CFC test. For purposes of the income inclusion test of paragraph (b)(1) of this section, if the CFC has one or more U.S. shareholders that are domestic partnerships, estates, or trusts, the proportionate interest of the subpart F income of the CFC will not be treated as includible in the gross income of any partner, beneficiary or other interest owner of such U.S. shareholder that is a U.S. citizen, resident of the United States or a domestic corporation unless the CFC obtains the documentation described in paragraph (c)(2) of this section.

(2) *Documentation from certain U.S. shareholders*—(i) *In general*. A CFC can only meet the documentation requirements of paragraph (c)(1) of this section if the CFC obtains the following documentation from each U.S. shareholder that is a partnership, estate or trust, with respect to the taxable year of the entity which ends with or within the taxable year of the CFC—

(A) A copy of the Form 5471, "Information Return of U.S. Persons With Respect to Certain Foreign Corporations," if required to be filed with the U.S. shareholder's return and with the Internal Revenue Service Center, Philadelphia PA 19255;

(B) A written statement, signed under penalties of perjury by a person authorized to sign the U.S. Federal tax return of the U.S. shareholder, providing the following information with respect to each U.S. citizen, individual resident of the United States or domestic corporation that is a partner, beneficiary or other interest owner of each such U.S. shareholder and upon whom the CFC intends to rely to satisfy the income inclusion test of paragraph (b)(1) of this section—

(*1*) The name, address (if not a non-residential address, such as a post office box or in care of a financial intermediary or stock transfer agent), and taxpayer identification number;

(*2*) The interest owner's proportionate interest in the U.S. shareholder that reflects that owner's share of subpart F income required to be included in income on such interest owner's U.S. Federal income tax return;

(*3*) The percentage of the vote and the percentage of the value of shares of the CFC owned by each such interest owner; and

(C) Any other specified information.

(ii) *Availability and retention of documents for inspection*. The documentation described in paragraph (c)(2)(i) of this

section must be retained by the corporation seeking qualified foreign corporation status (the CFC) until the expiration of the statute of limitations for the taxable year of the CFC to which the documentation relates. Such documentation must be made available for inspection by the Commissioner at such place as the Commissioner may request in writing.

(d) *Reporting requirements*. A foreign corporation that relies on the CFC test of this section to satisfy the stock ownership test of §1.883–1(c)(2), must provide the following information in addition to the information required in §1.883–1(c)(3) to be included in its Form 1120F for the taxable year. The information must be current as of the end of the corporation's taxable year and must include the following—

(1) The name, address in the corporate records (if that address is not a non-residential address such as a post office box or in care of a financial intermediary or stock transfer agent) and taxpayer identification number of each U.S. shareholder of the CFC;

(2) The percentage of the value of the shares of the CFC that is owned by each U.S. shareholder, as defined in section 957(a) if such section were applied without regard to section 318(a)(4);

(3) If one or more of the U.S. shareholders is a domestic partnership, estate or trust, the name, address, taxpayer identification number and percentage of the vote and the percentage of the value of shares of the CFC owned by each interest owner of each such U.S. shareholder that is a U.S. citizen, individual resident of the United States or a domestic corporation; and

(4) Any other specified information.

§1.883–4 Qualified shareholder stock ownership test .

(a) *General rule*. A foreign corporation shall satisfy the stock ownership test of §1.883–1(c)(2) if more than 50 percent of its stock (by value) is owned, or treated as owned by applying the attribution rules of paragraph (c) of this section, for at least half of the number of days in the foreign corporation's taxable year by one or more qualified shareholders. In addition, a foreign corporation must meet the substantiation and reporting requirements of paragraphs (d) and (e) of this section.

(b) *Qualified shareholder*—(1) *General rule*. A shareholder is a qualified shareholder only if the shareholder—

(i) Is a resident of a country that offers an equivalent exemption for the same type of income (as described in §1.883–1(h)(2)), as that earned by the foreign corporation and for which the foreign corporation is seeking an exemption;

(ii) Does not own its interest in the foreign corporation through bearer shares either directly or by applying the attribution rules of paragraph (c) of this section;

(iii) Provides to the foreign corporation the documentation required in paragraph (d) of this section and the foreign corporation meets the reporting requirements of paragraph (e) of this section with respect to such shareholder; and

(iv) Is described in one of the following categories of qualified shareholders—

(A) An individual not described in paragraph (b)(1)(iv)(E) of this section (whose residency is determined under paragraph (b)(2) of this section);

(B) The government of a qualified foreign country (or a political subdivision or local authority of such country);

(C) A foreign corporation that is organized in a qualified foreign country and meets the publicly traded rules of §1.883–2;

(D) A not-for-profit organization described in paragraph (b)(4) of this section that is not a pension fund as defined in paragraph (b)(5) of this section and that is organized in a qualified foreign country; or

(E) A beneficiary of a pension fund (as defined in paragraph (b)(5)(iv) of this section) administered in or by a qualified foreign country (whose residency is determined under paragraph (d)(3)(iii) of this section).

(2) *Residence of individual shareholders*—(i) *General rule*. An individual not described in paragraph (b)(1)(iv)(E) of this section is a resident of a qualified foreign country only if the individual is fully liable to tax as a resident in such country (e.g., an individual who is liable to tax on a remittance basis in a foreign country will not be treated as a resident of that country) and, in addition—

(A) The individual's tax home, within the meaning of paragraph (b)(2)(ii) of this section, is within that qualified foreign country for 183 days or more of the taxable year; or

(B) The individual is treated as a resident of a qualified foreign country based on special rules pursuant to paragraph (d)(3) of this section.

(ii) *Tax home*. For purposes of this section, an individual's tax home is considered to be located at the individual's regular or principal (if more than one regular) place of business. If the individual has no regular or principal place of business because of the nature of his business (or lack of a business), then the individual's tax home is located at his regular place of abode in a real and substantial sense. If an individual has no regular or principal place of business and no regular place of abode in a real and substantial sense in a qualified foreign country for 183 days or more of the taxable year, that individual does not have a tax home for purposes of this section.

(3) *Certain income tax convention restrictions applied to shareholders*—(i) *Application of restrictions*. A shareholder otherwise described in paragraph (b)(1) of this section may be a resident of a foreign country that provides an equivalent exemption for the category of income at issue through an income tax convention with the United States. If the shareholder relies on the convention to demonstrate that the country of residence provides an equivalent exemption and the convention has a requirement in the shipping and air transport article other than residence, such as place of registration or documentation of the ship or aircraft, or in the limitation on benefits (LOB) article, such as a percentage of resident ownership, the shareholder is not a qualified shareholder unless the corporation seeking qualified foreign corporation status would satisfy any such additional requirement if it were organized in such foreign country.

(ii) *Examples*. The rules of this paragraph (b)(3) are illustrated by the following examples:

Example 1. LOB article requiring additional Country B ownership. Ship Co is organized in Country A. Country A provides an equivalent exemption through a diplomatic note. Eighty percent of the value of the shares of Ship Co is owned by a resident of Country B. Country B provides an equivalent exemption only through an income tax convention with the United States. The limitation on benefits article in the income tax convention between the United States and Country B requires that more than 75 percent of the value of the shares of a Country B corporation must be owned by residents of Country B before such corporation could receive benefits under the income tax convention. In accordance with paragraph (b)(3) of this section, in order for the Country B resident to be a qualified share-

holder, Ship Co must meet the LOB requirements of the United States/Country B income tax convention applied as if Ship Co were a Country B corporation. Because 80 percent of the value of the shares of Ship Co is owned by a resident of Country B, this requirement is satisfied and the Country B shareholder may be a qualified shareholder.

Example 2. Income tax convention requiring registration of ship. Ship Co is organized in Country X and owned entirely by residents of Country Y. Country X's domestic law grants an equivalent exemption to shipping corporations organized in the United States. Country Y grants an equivalent exemption for shipping income through an income tax convention between the United States and Country Y. Article 8 of the income tax convention provides that the exemption will apply only if the ships are registered in the contracting state of the taxpayer's country of residence. Ship Co owns a ship registered in Country Y and a ship registered in Country Z. In accordance with paragraph (b)(3) of this section, in order for the Country Y resident to be a qualified shareholder, Ship Co must meet the flagging requirements of the United States/Country Y income tax convention applied as if Ship Co were a Country Y corporation. Thus, the Country Y shareholders may be qualified shareholders with respect to income earned by the ship registered in Country Y but not with respect to the income earned by the ship registered in Country Z. Thus, if Ship Co otherwise satisfies the requirements of this proposed rule, Ship Co may exclude its income derived from the international operation of the ship registered in Country Y from gross income for purposes of its United States income tax, but may not exclude its income from the international operation of the ship registered in Country Z.

(4) *Not-for-profit organizations.* A not-for-profit organization is a qualified shareholder if it meets the following requirements—

(i) It is a corporation, association taxable as a corporation, trust, fund, foundation, league or other entity operated exclusively for religious, charitable, educational, or recreational purposes, and not organized for profit;

(ii) It is generally exempt from tax in its country of organization by virtue of its not-for-profit status; and

(iii) Either—

(A) More than 50 percent of its annual support is expended on behalf of persons described in paragraph (b)(1)(i) of this section (see paragraph (d)(3)(v) of this section for rules regarding the residence of individual beneficiaries); or

(B) More than 50 percent of its annual support is derived from persons described in paragraph (b)(1)(i) of this section (see paragraph (d)(3)(v) of this section for rules regarding the residence of individual supporters).

(5) *Pension funds*—(i) *Pension fund defined.* The term *pension fund* shall mean a government pension fund or a non- government pension fund, as those terms are defined, respectively, in paragraph (b)(5)(ii) and paragraph (b)(5)(iii) of this section, that is a trust, fund, foundation, or other entity that is established exclusively for the benefit of employees or former employees of one or more employers, the principal purpose of which is to provide retirement, disability, and death benefits to beneficiaries of such entity and persons designated by such beneficiaries in consideration for prior services rendered.

(ii) *Government pension funds.* A government pension fund is a pension fund that is a controlled entity of a foreign sovereign within the principles of §1.892–2T(c)(1) (relating to pension funds established for the benefit of employees or former employees of a foreign government).

(iii) *Non-government pension funds.* A non-government pension fund is a pension fund that—

(A) Is administered in a foreign country and is subject to supervision or regulation by a governmental authority (or other authority delegated to perform such supervision or regulation by a governmental authority) in such country;

(B) Is generally exempt from income taxation in its country of administration;

(C) Has 100 or more beneficiaries; and

(D) The trustees, directors or other administrators of which pension fund provide the documentation required in paragraph (d) of this section.

(iv) *Beneficiary of a pension fund.* The term *beneficiary of a pension fund* shall mean any person who has made contributions to a pension fund, as that term is defined in paragraph (b)(5)(i) of this section, or on whose behalf contributions have been made, and who is currently receiving retirement, disability, or death benefits from the pension fund or can reasonably be expected to receive such benefits in the future, whether or not the person's right to receive benefits from the fund has vested. See paragraph (c)(6) of this section for rules regarding the computation of stock ownership through non-government pension funds.

(c) *Rules for determining constructive ownership*—(1) *General rules for attribution.* For purposes of applying the exception to the closely-held test of §1.883–2(d)(3)(ii) and paragraph (a) of this section, stock owned by or for a corporation, partnership, trust, estate, or mutual insurance company or similar entity shall be treated as owned proportionately by its shareholders, partners, beneficiaries, grantors, or other interest holders as provided in paragraphs (c)(2)through (6) of this section. The proportionate interest rules of this paragraph (c) shall apply successively upward through a chain of ownership, and a person's proportionate interest shall be computed for the relevant days or period that is taken into account in determining whether a foreign corporation satisfies the requirements of paragraph (a) of this section. Stock treated as owned by a person by reason of this paragraph (c) shall be treated as actually owned by such person for purposes of this section. An owner of an interest in an association taxable as a corporation shall be treated as a shareholder of such association for purposes of this paragraph (c).

(2) *Partnerships*—(i) *General rule.* A partner shall be treated as having an interest in stock of a foreign corporation owned by a partnership in proportion to the least of—

(A) The partner's percentage distributive share of the partnership's dividend income from the stock;

(B) The partner's percentage distributive share of gain from disposition of the stock by the partnership; or

(C) The partner's percentage distributive share of the stock (or proceeds from the disposition of the stock) upon liquidation of the partnership.

(ii) *Partners resident in the same country.* For purposes of this paragraph, all qualified shareholders that are partners in a partnership and that are residents of, or organized in, the same qualified foreign country shall be treated as one partner. Thus, the percentage distributive shares of dividend income, gain and liquidation rights of all qualified shareholders that are partners in a partnership and that are residents of, or organized in, the same qualified foreign country are aggregated prior to determining the least of the three percentages set out in paragraph (c)(2)(i) of this section. For the meaning of the term *resident*, see paragraph (b)(2) of this section.

(iii) *Examples.* The rules of paragraph (c)(2)(ii) of this section are illustrated by the following examples:

Example 1. Stock held solely by qualified shareholders through a partnership. Country X grants an equivalent exemption. A and B are individual residents of Country X and are qualified shareholders within the meaning of paragraph (b)(1) of this section. A and B are the sole partners of Partnership P. P's only asset is the stock of Corporation Z, a Country X corporation seeking a reciprocal exemption under this section. A's distributive share of P's income and gain on the disposition of P's assets is 80 percent, but A's distributive share of P's assets (or the proceeds therefrom) on P's liquidation is 20 percent. B's distributive share of P's income and gain is 20 percent and B is entitled to 80 percent of the assets (or proceeds therefrom) on P's liquidation. Under the attribution rules of paragraph (c)(2)(ii) of this section, A and B will be treated as a single partner owning in the aggregate 100 percent of the stock of Z owned by P.

Example 2. Stock held by both qualified and non-qualified shareholders through a partnership. Assume the same facts as in *Example 1* except that C, an individual who is not a resident of a qualified foreign country, is also a partner in P and that C's distributive share of P's income is 60 percent. The distributive shares of A and B are the same as in *Example 1* except that A's distributive share of income is 20 percent. Under the attribution rules of paragraph (c)(2)(ii) of this section, qualified shareholders A and B will be treated as a single partner owning in the aggregate 40 percent of the stock of Z owned by P (i.e., the lowest aggregate percentage of A and B's distributive shares of dividend income (40 percent), gain (100 percent), and liquidation rights (100 percent) with respect to the Z stock). Thus, Z fails to satisfy the ownership requirements of paragraph (a) of this section.

Example 3. Stock held through tiered partnerships. Country X grants an equivalent exemption. A and B are individual residents of Country X and are qualified shareholders within the meaning of paragraph (b)(1) of this section. A and B are the sole partners of Partnership P. P is a partner in Partnership P1, which owns the stock of Corporation Z, a Country X corporation seeking a reciprocal exemption under this section. Assume that P's distributive share of the dividend income, gain and liquidation rights with respect to the Z stock held by P1 is 40 percent. Assume that of the remaining partners of P1 only D is a qualified shareholder. D's distributive share of P1's dividend income and gain is 15 percent; D's distributive share of P1's assets on liquidation is 25 percent. Under the attribution rules of paragraph (c)(2)(ii) of this section, A and B, treated as a single partner, will own 40 percent of the Z stock owned by P1 (100 percent X 40 percent) and D will be treated as owning 15 percent of the Z stock owned by P1 (the least of D's dividend income (15 percent), gain (15 percent), and liquidation rights (25 percent) with respect to the Z stock). Thus, 55 percent of the Z stock owned by P1 is treated as owned by qualified shareholders.

(3) *Trusts and estates*—(i) *Beneficiaries*. In general, an individual shall be treated as having an interest in stock of a foreign corporation owned by a trust or estate in proportion to the individual's actuarial interest in the trust or estate, as provided in section 318(a)(2)(B)(i), except that an income beneficiary's actuarial interest in the trust will be determined as if the trust's only asset were the stock. The interest of a remainder beneficiary in stock will be equal to 100 percent minus the sum of the percentages of any interest in the stock held by income beneficiaries. The ownership of an interest in stock owned by a trust shall not be attributed to any beneficiary whose interest cannot be determined under the preceding sentence, and any such interest, to the extent not attributed by reason of this paragraph (c)(3)(i), shall not be considered owned by a beneficiary unless all potential beneficiaries with respect to the stock are qualified shareholders. In addition, a beneficiary's actuarial interest will be treated as zero to the extent that someone other than the beneficiaries is treated as owning the stock under paragraph (c)(3)(ii) of this section. A substantially separate and independent share of a trust, within the meaning of section 663(c), shall be treated as a separate trust for purposes of this paragraph (c)(3)(i), provided that payment of income, accumulated income or corpus of a share of one beneficiary (or group of beneficiaries) cannot affect the proportionate share of income, accumulated income or corpus of another beneficiary (or group of beneficiaries).

(ii) *Grantor trusts*. A person is treated as the owner of stock of a foreign corporation owned by a trust to the extent that the stock is included in the portion of the trust that is treated as owned by the person under sections 671 through 679 (relating to grantors and others treated as substantial owners).

(4) *Corporations that issue stock*. A shareholder of a corporation that issues stock shall be treated as owning stock of a foreign corporation that is owned by such corporation on any day in a proportion that equals the value of the stock owned by such shareholder to the value of all stock of such corporation. If, however, there is an agreement, express or implied, that a shareholder of a corporation will not receive distributions from the earnings of stock owned by the corporation, the shareholder will not be treated as owning that stock owned by the corporation.

(5) *Mutual insurance companies and similar entities*. Stock held by a mutual insurance company, mutual savings bank, or similar entity (including an association taxable as a corporation that does not issue stock interests) shall be considered owned proportionately by the policy holders, depositors, or other owners in the same proportion that such persons share in the surplus of such entity upon liquidation or dissolution.

(6) *Computation of beneficial interests in non-government pension funds.* Stock held by a pension fund shall be considered owned by the beneficiaries of the fund equally on a pro-rata basis if—

(i) The pension fund meets the requirements of paragraph (b)(5)(iii) of this section;

(ii) The trustees, directors or other administrators of the pension fund have no knowledge, and no reason to know, that a pro-rata allocation of interests of the fund to all beneficiaries would differ significantly from an actuarial allocation of interests in the fund (or, if the beneficiaries' actuarial interest in the stock held directly or indirectly by the pension fund differs from the beneficiaries's actuarial interest in the pension fund, the actuarial interests computed by reference to the beneficiaries' actuarial interest in the stock);

(iii) Either—

(A) Any overfunding of the pension fund would be payable, pursuant to the governing instrument or the laws of the foreign country in which the pension fund is administered, only to, or for the benefit of, one or more corporations that are organized in the country in which the pension fund is administered, individual beneficiaries of the pension fund or their designated beneficiaries, or social or charitable causes (the reduction of the obligation of the sponsoring company or companies to make future contributions to the pension fund by reason of overfunding shall not itself result in such overfunding being deemed to be payable to or for the benefit of such company or companies); or

(B) The foreign country in which the pension fund is administered has laws that are designed to prevent overfunding of a pension fund and the funding of the pension fund is within the guidelines of such laws; or

(C) The pension fund is maintained to provide benefits to employees in a particular industry, profession, or group of industries or professions and employees of at least 10 companies (other than compa-

nies that are owned or controlled, directly or indirectly, by the same interests) contribute to the pension fund or receive benefits from the pension fund; and

(iv) The trustees, directors or other administrators provide the relevant documentation as required in paragraph (d) of this section.

(d) *Substantiation of stock ownership*—(1) *General rule.* A foreign corporation that relies on this section to satisfy the ownership requirements of §1.883–1(c)(2), must establish all the facts necessary to satisfy the Commissioner that more than 50 percent of the value of its shares is owned, or treated as owned applying paragraph (c) of this section, by qualified shareholders. A foreign corporation cannot meet this requirement with respect to any stock that is issued in bearer form. A shareholder that holds shares in the foreign corporation either directly or indirectly in bearer form cannot be a qualified shareholder.

(2) *Application of general rule*—(i) *Ownership statements.* Except as provided in paragraph (d)(3) of this section, a person shall only be treated as a qualified shareholder of a foreign corporation if—

(A) For the relevant period, the person completes an ownership statement described in paragraph (d)(4) of this section or has a valid ownership statement in effect under paragraph (d)(2)(ii) of this section;

(B) In the case of a person owning stock in the foreign corporation indirectly through one or more intermediaries (including mere legal owners or recordholders acting as nominees), each intermediary in the chain of ownership between that person and the foreign corporation seeking qualified foreign corporation status completes an intermediary ownership statement described in paragraph (d)(4)(v) of this section or has a valid intermediary ownership statement in effect under paragraph (d)(2)(ii) of this section; and

(C) The foreign corporation seeking qualified foreign corporation status obtains the statements described in paragraphs (d)(2)(i)(A) and (B) of this section.

(ii) *Three-year period of validity.* The ownership statements required in paragraph (d)(2)(i) of this section shall remain valid until the earlier of the last day of the third calendar year following the year in which the ownership statement is signed, or the day that a change of circumstance occurs that makes any information on the ownership statement incorrect. For example, an ownership statement signed on September 30, 2000, remains valid through December 31, 2003, unless circumstances change that make the information of the statement no longer correct.

(3) *Special rules*—(i) *Determining residence of certain shareholders.* A foreign corporation seeking qualified foreign corporation status or an intermediary that is a direct or indirect shareholder of such foreign corporation may determine the residence of certain shareholders, for purposes of paragraph (b)(2)(i)(B) of this section, under one of the following special rules, in lieu of obtaining the ownership statements required in paragraph (d)(2)(i) of this section from such shareholders.

(ii) *Special rule for registered shareholders owning less than one percent of widely-held corporations.* A foreign corporation with at least 250 registered individual shareholders, that is not a publicly-traded corporation, as described in §1.883–2, (a widely-held corporation), may not be required to obtain an ownership statement from an individual shareholder owning less than one percent of the widely-held corporation at all times during the taxable year. If such widely-held foreign corporation is the foreign corporation seeking qualified foreign corporation status, or an intermediary that meets the documentation requirements of paragraphs (d)(4)(v)(A) and (B) of this section, the widely-held foreign corporation may treat the address of record in its ownership records as the residence of any less than one percent individual shareholder if—

(A) The individual's address of record is not a non-residential address, such as a post office box or in care of a financial intermediary or stock transfer agent; and

(B) The officers and directors of the widely-held corporation neither know nor have reason to know that the individual does not reside at that address.

(iii) *Special rule for beneficiaries of pension funds*—(A) *Government pension fund.* An individual who is a beneficiary of a government pension fund, as defined in paragraph (b)(5)(ii) of this section, shall be treated as a resident of the country in which the pension fund is administered if the pension fund satisfies the documentation requirements of paragraphs (d)(4)(v)(A) and (C)(1) of this section.

(B) *Non-government pension fund.* An individual who is a beneficiary of a non-government pension fund, as described in paragraph (b)(5)(iii) of this section, shall be treated as a resident of the country of the beneficiary's address as it appears on the records of the fund, provided it is not a nonresidential address, such as a post office box or an address in care of a financial intermediary, and provided none of the trustees, directors or other administrators of the pension fund know, or have reason to know, that the beneficiary is not an individual resident of such foreign country. The rules of this paragraph (d)(3)(iii)(B) shall apply only if the non-government pension fund satisfies the documentation requirements of paragraphs (d)(4)(v)(A) and (C)(2) of this section.

(iv) *Special rule for stock owned by publicly-traded corporations.* Any stock in a foreign corporation seeking qualified foreign corporation status that is owned by a publicly- traded corporation will be treated as owned by an individual resident in the country where the publicly-traded corporation is organized if the foreign corporation receives the statement described in paragraph (d)(4)(iii) of this section from the publicly-traded intermediary and copies of any relevant ownership statements from shareholders of the publicly traded corporation relied on to satisfy the exception to the closely-held class of stock rule of §1.883–2(d)(3)(ii) as required in paragraph (d)(2)(i) of this section.

(v) *Special rule for not-for-profit organizations.* For purposes of meeting the ownership requirements of paragraph (a) of this section, a not-for-profit organization may rely on the addresses of record of its individual beneficiaries and supporters to determine the residence of an individual beneficiary or supporter, within the meaning of paragraph (b)(2)(i)(B) of this section, to the extent required under paragraph (b)(4) of this section, provided that—

(A) The addresses of record are not nonresidential addresses such as a post office box or in care of a financial interme-

diary;

(B) The officers, directors or administrators or the organization do not know or have reason to know that the individual beneficiaries or supporters do not reside at that address; and

(C) The foreign corporation seeking qualified foreign corporation status receives the statement required in paragraph (d)(4)(iv) of this section from the not-for-profit organization.

(4) *Ownership statements from shareholders*—(i) *Ownership statements from individuals*. An ownership statement from an individual is a written statement signed by the individual under penalties of perjury stating—

(A) The individual's name, permanent address, and country where the individual is fully liable to tax as a resident, if any;

(B) If the individual was not a resident of the country for the entire taxable year of the foreign corporation seeking qualified foreign corporation status, state each of the foreign countries in which the individual resided and the dates of such residence during the taxable year of such foreign corporation;

(C) If the individual directly owns stock in the corporation seeking qualified foreign corporation status, the name of the corporation, the number of shares in each class of stock of the corporation that are so owned, and the period of time during the taxable year of the foreign corporation during which the individual owned the stock;

(D) If the individual directly owns an interest in a corporation, partnership, trust, estate or other intermediary that directly or indirectly owns stock in the corporation seeking qualified foreign corporation status, the name of the intermediary, the number and class of shares or amount and nature of the interest of the individual in such intermediary, and the period of time during the taxable year of the corporation seeking qualified foreign corporation status during which the individual held such interest;

(E) To the extent known by the individual, a description of the chain of ownership through which the individual owns stock in the corporation seeking qualified foreign corporation status, including the name and address of each intermediary standing between the intermediary described in paragraph (d)(4)(i)(D) of this section and the foreign corporation and whether this interest is owned either directly or indirectly through bearer shares; and

(F) Any other specified information.

(ii) *Ownership statements from foreign governments*. An ownership statement from a government that is a qualified shareholder is a written statement—

(A) Signed by either—

(*1*) An official of the governmental authority, agency or office who has supervisory authority with respect to the government's ownership interest and who is authorized to sign such a statement on behalf of the authority, agency or office; or

(*2*) The competent authority of the foreign country (as defined in the income tax convention between the United States and the foreign country);

(B) That provides—

(*1*) The title of the official signing the statement;

(*2*) The name and address of the government authority, agency or office that has supervisory authority;

(*3*) The information described in paragraphs (d)(4)(i)(C) through (F) of this section (substituting "government" for "individual") with respect to the government's direct or indirect ownership of stock in the corporation seeking qualified resident status; and

(C) Any other specified information.

(iii) *Ownership statements from publicly-traded corporate shareholders*. An ownership statement from a publicly-traded corporation that is a direct or indirect owner of the corporation seeking qualified foreign corporation status is a written statement, signed under penalties of perjury by a person that would be authorized to sign a tax return on behalf of the shareholder corporation containing the following information—

(A) The name of the country in which the stock is primarily traded;

(B) The name of the established securities market or markets on which that the stock is listed;

(C) A description of each class of stock relied upon to meet the requirements of §1.883–2(d)(1), including the number of shares issued and outstanding as of the close of the taxable year;

(D) For each class of stock relied upon to meet the requirements of §1.883–2(d)(1), if one or more 5 percent shareholders, as defined in §1.883–2(d)(3)(i), own in the aggregate 50 percent or more of the value of the outstanding shares of that class of stock at any time during the taxable year, state—

(*1*) The name and address of each 5 percent shareholder and of each related person whose stock is treated as owned by the 5 percent shareholder;

(*2*) For each qualified shareholder upon whom the corporation intends to rely to satisfy the exception to the closely-held class of stock rule of §1.883–2(d)(3)(ii)—

(*i*) The name of each such shareholder;

(*ii*) The percentage of the total outstanding shares of that class owned by such shareholder;

(*iii*) The address of record of such shareholder;

(*iv*) The country of residence of such shareholder, determined under paragraph (b)(2) or (d)(3) of this section; and

(E) The information described in paragraphs (d)(4)(i)(C) through (F) of this section (substituting "publicly-traded corporation" for "individual") with respect to the publicly-traded corporation's direct or indirect ownership of stock in the corporation seeking qualified resident status; and

(F) Any other specified information.

(iv) *Ownership statements from not-for-profit organizations*. An ownership statement from a not-for-profit organization (other than a pension fund as defined in paragraph (b)(5) of this section) is a written statement signed by a person authorized to sign a tax return on behalf of the organization under penalties of perjury stating—

(A) The name, permanent address, and principal location of the activities of the organization (if different from its permanent address);

(B) The information described in paragraphs (d)(4)(i)(C) through (F) of this section (substituting "not-for-profit organization" for "individual");

(C) A representation that the not-for-profit organization satisfies the requirements of paragraph (b)(4) of this section; and

(D) Any other specified information.

(v) *Ownership statements from intermediaries*—(A) *General rule*. The foreign corporation seeking qualified foreign corporation status under the shareholder stock ownership test must obtain an inter-

mediary ownership statement from each intermediary standing in the chain of ownership between it and the qualified shareholders on whom it relies to meet this test. An intermediary ownership statement is a written statement signed under penalties of perjury by the intermediary (if the intermediary is an individual) or a person who would be authorized to sign a tax return on behalf of the intermediary (if the intermediary is not an individual) containing the following information—

(*1*) The name, address, country of residence, and principal place of business (in the case of a corporation or partnership) of the intermediary and, if the intermediary is a trust or estate, the name and permanent address of all trustees or executors (or equivalent under foreign law), or the name and permanent address of place of administration of the intermediary (if a pension fund);

(*2*) The information described in paragraphs (d)(4)(i)(C) through (F) (substituting "intermediary" for "individual");

(*3*) If the intermediary is a nominee for a shareholder or another intermediary, the name and permanent address of the shareholder, or the name and principal place of business of such other intermediary;

(*4*) If the intermediary is not a nominee for a shareholder or another intermediary, the name and country of residence (within the meaning of paragraph (b)(2) of this section) and the proportionate interest in the intermediary of each direct shareholder, partner, beneficiary, grantor, or other interest holder (or if the direct holder is a nominee, of its beneficial shareholder, partner, beneficiary, grantor, or other interest holder) which the foreign corporation seeking qualified foreign corporation status intends to rely on to satisfy the requirements of paragraph (a) of this section, as well as an ownership statement from such person and the period of time during the taxable year for which the interest in the intermediary was owned by the shareholder, partner, beneficiary, grantor or other interest holder. For purposes of this paragraph (d)(4)(v)(A), the proportionate interest of a person in an intermediary is the percentage interest (by value) held by such person, determined using the principles for attributing ownership in paragraph (c) of this section;

(*5*) If the intermediary is a widely-held corporation with registered shareholders owning less than one percent of the stock of such widely-held corporation, the statement set out in paragraph (d)(4)(v)(B) of this section, relating to ownership statements from widely-held intermediaries with registered shareholders owning less than one percent of such widely-held intermediaries;

(*6*) If the intermediary is a pension fund, within the meaning of paragraph (b)(5) of this section, the statement set out in paragraph (d)(4)(v)(C) of this section, relating to ownership statements from pension funds; and

(*7*) Any other specified information.

(B) *Ownership statements from widely-held intermediaries with registered shareholders owning less than one percent of such widely-held intermediary*. An ownership statement from an intermediary that is a corporation with at least 250 individual shareholders, but that is not a publicly-traded corporation within the meaning of §1.883–2, and that relies on paragraph (d)(3)(ii) of this section, relating to the special rule for registered shareholders owning less than one percent of widely-held corporations, must provide the following information in addition to the information required in paragraph (d)(4)(v)(A) of this section—

(*1*) The aggregate proportionate interest by country of residence in the widely-held corporation of such registered shareholders or other interest holders whose address of record is not a non-residential address, such as a post office box or in care of a financial intermediary or stock transfer agent; and

(*2*) A representation that the officers and directors of the widely-held intermediary neither know nor have reason to know that the individual shareholder does not reside at his or her address of record in the corporate records; and

(*3*) Any other specified information.

(C) *Ownership statements from pension funds*—(*1*) *Ownership statements from government pension funds*. A government pension fund (as defined in paragraph (b)(5)(ii) of this section) that relies on paragraph (d)(3)(iii) of this section, relating to the special rules for pension funds, generally must provide the documentation required in paragraph (d)(4)(v)(A) of this section and, in addition, the government pension fund must also provide the following information—

(*i*) The name of the country in which the plan is administered;

(*ii*) A representation that the fund is established exclusively for the benefit of employees or former employees of a foreign government, or employees or former employees of a foreign government and non-governmental employees or former employees that perform or performed governmental or social services;

(*iii*) A representation that the funds that comprise the trust are managed by trustees who are employees of, or persons appointed by, the foreign government;

(*iv*) A representation that the trust forming part of the pension plan provides for retirement, disability, or death benefits in consideration for prior services rendered;

(*v*) A representation that the income of the trust satisfies the obligations of the foreign government to the participants under the plan, rather than inuring to the benefit of a private person; and

(*vi*) Any other specified information.

(*2*) *Ownership statement from non-government pension funds*. The trustees, directors, or other administrators of the non-government pension fund, as defined in paragraph (b)(5)(iii) of this section, that rely on paragraph (d)(3)(iii) of this section, relating to the special rules for pension funds, generally must provide the pension fund's intermediary ownership statement described in paragraphs (d)(4)(v)(A) of this section, and, in addition, the non-government pension fund must also provide the following information—

(*i*) The name of the country in which the pension fund is administered;

(*ii*) A representation that the pension fund is subject to supervision or regulation by a governmental authority (or other authority delegated to perform such supervision or regulation by a governmental authority) in such country, and, if so, the name of the governmental authority (or other authority delegated to perform such supervision or regulation);

(*iii*) A representation that the pension fund is generally exempt from income taxation in its country of administration;

(*iv*) The number of beneficiaries in the pension plan;

(*v*) The aggregate percentage interest of beneficiaries by country of residence based on addresses shown on the books

and records of the fund, provided the addresses are not nonresidential addresses, such as a post office box or an address in care of a financial intermediary, and provided none of the trustees, directors or other administrators of the pension fund know, or have reason to know, that the beneficiary is not a resident of such foreign country;

(*vi*); A representation that the pension fund meets the requirements of paragraph (b)(5)(iii) of this section;

(*vii*) A representation that the trustees, directors or other administrators of the pension fund have no knowledge, and no reason to know, that a pro-rata allocation of interests of the fund to all beneficiaries would differ significantly from an actuarial allocation of interests in the fund (or, if the beneficiaries' actuarial interest in the stock held directly or indirectly by the pension fund differs from the beneficiaries's actuarial interest in the pension fund, the actuarial interests computed by reference to the beneficiaries' actuarial interest in the stock);

(*viii*) Either—

(*A*) Any overfunding of the pension fund would be payable, pursuant to the governing instrument or the laws of the foreign country in which the pension fund is administered, only to, or for the benefit of, one or more corporations that are organized in the country in which the pension fund is administered, individual beneficiaries of the pension fund or their designated beneficiaries, or social or charitable causes (the reduction of the obligation of the sponsoring company or companies to make future contributions to the pension fund by reason of overfunding shall not itself result in such overfunding being deemed to be payable to or for the benefit of such company or companies); or

(*B*) The foreign country in which the pension fund is administered has laws that are designed to prevent overfunding of a pension fund and the funding of the pension fund is within the guidelines of such laws; or

(*C*) The pension fund is maintained to provide benefits to employees in a particular industry, profession, or group of industries or professions and employees of at least 10 companies (other than companies that are owned or controlled, directly or indirectly, by the same interests) contribute to the pension fund or receive benefits from the pension fund; and

(*ix*) Any other specified information.

(*3*) *Time for making determinations*. The determinations required to be made under this paragraph (d)(4)(v)(C) shall be made using information shown on the records of the pension fund for a date during the foreign corporation's taxable year to which the determination is relevant.

(5) *Availability and retention of documents for inspection*. The documentation described in paragraphs (d)(3) and (4) of this section must be retained by the corporation seeking qualified foreign corporation status (the foreign corporation) until the expiration of the statute of limitations for the taxable year of the foreign corporation to which the documentation relates. Such documentation must be made available for inspection by the Commissioner at such time and place as the Commissioner may request in writing.

(e) *Reporting requirements*. A foreign corporation relying on the qualified shareholder test of this section to demonstrate that it is a qualified foreign corporation for purposes of §1.883–1(c)(2) must provide the following information in addition to the information required in §1.883–1(c)(3) to be included in its Form 1120F for each taxable year. The information should be current as of the end of the corporation's taxable year. The information must include the following—

(1) A representation that more than 50 percent of the value of the outstanding shares of the corporation is owned (or treated as owned by reason of paragraph (c) of this section) by qualified shareholders for the category of income for which the exemption is claimed;

(2) With respect to each individual qualified shareholder owning 5 percent or more of the foreign corporation, applying the attribution rules of paragraph (c) of this section, and relied upon to meet the 50 percent ownership test of paragraph (a) of this section, the name and address, as represented on each such individual's ownership statement;

(3) With respect to all qualified shareholders relied upon to satisfy the 50 percent ownership test of paragraph (a) of this section, the total percentage of the value of the outstanding shares owned, applying the attribution rules of paragraph (c) of this section, by all qualified shareholders resident in a qualified foreign country, by country; and

(4) Any other required documentation.

§1.883–5 Effective date.

(a) *General rule*. Sections 1.883–1 through 1.883–4 apply to taxable years of the foreign corporation ending 30 days or more after the date these regulations are published as final regulations in the **Federal Register**.

(b) *Election for retroactive application*. When §§1.883–1 through 1.883–4 become generally applicable, taxpayers may rely on all the provisions of §§1.883–1 through 1.883–4 for guidance and may elect to apply all such substantive provisions for any open taxable year of the foreign corporation beginning after December 31, 1986, and ending less than 30 days after the date these regulations are published as final regulations in the **Federal Register**. However, such election is not required to be applied with respect to §1.883–1(c)(3) (relating to the substantiation and reporting required to be treated as a qualified foreign corporation) or §§1.883–2(f), 1.883–3(d) and 1.883–4(e) (relating to additional information to be included in the return to demonstrate whether the foreign corporation satisfies one of three stock ownership tests). Such election will be applicable for the year of the election and for all subsequent taxable years.

(c) *Transition rule*. For taxable years of the foreign corporation ending 30 days or more after the date these regulations are published as final regulations in the **Federal Register,** and until such time as the Form 1120F and its instructions are revised to conform to §§1.883–1 through 1.883–4, the information required in §1.883–1(c)(3) and §1.883–2(f), 1.883–3(d) or 1.883–4(e), as applicable, must be included on a written statement signed under penalties of perjury by a person authorized to sign the return, attached to the Form 1120F, and filed with the return.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

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