# Domestic Reinvestment Plans and Other Guidance Under Section 965

## Notice 2005–10

### SECTION 1. OVERVIEW

This notice provides guidance concerning new section 965 of the Internal Revenue Code (Code). It sets forth general principles and specific guidance on domestic reinvestment plans and on investments in the United States described in section 965(b)(4)(B). The Treasury Department and the Internal Revenue Service (IRS) intend to issue additional notices providing guidance concerning section 965, including rules relating to the foreign tax credit and expense allocation, rules for adjusting the calculation of the base period amounts to take into account mergers, acquisitions and spin-offs, and rules regarding controlled groups. The Treasury Department and the IRS expect to issue regulations that incorporate the guidance provided in this and the subsequent notices.

The remainder of this notice is divided into eleven sections. Section 2 provides background information with respect to section 965. Section 3 addresses the meaning of the term "cash dividends." Section 4 sets forth general guidance concerning domestic reinvestment plans. Section 5 lists certain expenditures that, if made pursuant to a domestic reinvestment plan, are investments in the United States described in section 965(b)(4)(B) (permitted investments). Section 6 lists certain expenditures that are not permitted investments. Section 7 describes how a taxpayer elects to apply section 965 to a taxable year. Section 8 provides guidance on reporting requirements and on how a taxpayer may, under the facts and circumstances, establish to the satisfaction of the Commissioner that the dividend proceeds are invested in the United States pursuant to a domestic reinvestment plan, including a safe harbor for making such a demonstration. Section 9 provides transition rules that apply to certain taxpayers that, prior to the issuance of this notice, either adopted a domestic reinvestment plan and received a dividend, or filed a tax return for a taxable year to which section 965 applies. Section 10 provides the effective date of this notice. Section 11 provides information required under the Paperwork Reduction Act of 1995. Finally, section 12 provides drafting information.

This notice provides guidance on several of the requirements for eligibility for the deduction provided under section 965(a). Section 965 contains additional requirements, which are briefly outlined in section 2 of this notice but which are not addressed in detail in this notice, that must be satisfied in order for a cash dividend to be eligible for the deduction provided under section 965(a).

### SECTION 2. BACKGROUND

The American Jobs Creation Act of 2004 (P.L. 108–357) (the Act), enacted on October 22, 2004, added new section 965 to the Code. In general, and subject to limitations discussed below, section 965(a) provides that a corporation that is a U.S. shareholder[1] of a controlled foreign corporation (CFC) may elect, for one taxable year, an 85 percent dividends received deduction (DRD) with respect to certain cash dividends it receives from its CFCs. For this purpose, all U.S. shareholders that are members of an affiliated group filing a consolidated return under section 1501 are treated as one U.S. shareholder. Section 965(c)(5).

For purposes of section 965, the term "dividends" includes cash amounts included in gross income as dividends under sections 302 and 304, but does not include amounts treated as dividends under section 78 or 1248 or, in certain cases, section 367.[2] H.R. Conf. Rep. No. 108–755, at 314–15. For this purpose a cash dividend also includes a cash distribution from a CFC that is excluded from gross income under section 959(a) to the extent of inclusions under section 951(a)(1)(A) as a result of a cash dividend during the election year to: (1) such CFC from another CFC in a section 958(a) chain of ownership; or (2) any other CFC in such chain of ownership to the extent of cash distributions described in section 959(b) made during such year to the CFC from which such U.S. shareholder received such distribution.

The DRD under section 965(a) is subject to several limitations. First, section 965(b)(1) limits the amount of dividends eligible for the deduction to the greatest of the following three amounts: (1) $500 million; (2) the amount shown on the taxpayer's applicable financial statement[3] as earnings permanently reinvested outside the United States; or (3) in the case of an applicable financial statement that does not show a specific amount of earnings permanently reinvested outside the United States and that shows a specific amount of tax liability attributable to such earnings, the amount of such liability divided by 0.35.

Second, section 965(b)(2) limits the amount of dividends eligible for the deduction to the excess (if any) of the dividends received during the taxable year by the U.S. shareholder from CFCs over the annual average for the base period years of: (1) the dividends received during each base period year by such shareholder from CFCs; (2) the amounts includible in such shareholder's gross income for each base period year under section 951(a)(1)(B) with respect to CFCs; and (3) the amounts that would have been included for each base period year but for section 959(a) with respect to CFCs. The base period years are the three taxable years which are among the five most recent taxable

[1] The term U.S. shareholder means, with respect to any foreign corporation, a U.S. person who owns (within the meaning of section 958(a)), or is considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation. Section 951(b).

[2] Dividends resulting from liquidations qualifying under section 332 to which section 367(b) applies qualify as cash dividends to the extent the U.S. shareholder receives cash as part of the liquidation. Section 965(c)(3). A deemed liquidation effectuated through an election under §301.7701–3(c), however, does not result in an actual distribution of cash as required under section 965. See H.R. Conf. Rep. No. 108–755, at 315, footnote 108.

[3] The term "applicable financial statement" means the most recently audited financial statement which is certified on or before June 30, 2003, as being prepared in accordance with generally accepted accounting principles, which is used for the purposes of a statement or report to creditors or shareholders or for any other substantial nontax purpose, and, if the taxpayer is required to file with the SEC, is so filed on or before June 30, 2003. Section 965(c)(1).

years ending on or before June 30, 2003, determined by disregarding the year for which such total amount is highest and the year for which such total amount is lowest among such five years. Section 965(c)(2).

Third, section 965(b)(3) provides that the amount of dividends eligible for the deduction is reduced by any increase in related-party indebtedness of the CFC between October 3, 2004, and the close of the election year. For this purpose, all CFCs with respect to which the taxpayer is a U.S. shareholder are treated as a single CFC.

Finally, section 965(b)(4) provides that the amount of the dividend must be invested in the United States pursuant to a domestic reinvestment plan that is approved by the taxpayer's president, chief executive officer, or comparable official before the payment of the dividend, and that is subsequently approved by the taxpayer's board of directors, management committee, executive committee, or similar body. The domestic reinvestment plan must provide for the investment of the dividend in the United States (other than as a payment for executive compensation), including as a source for the funding of worker hiring and training, infrastructure, research and development, capital investments, or the financial stabilization of the corporation for the purposes of job retention or creation. This list is not intended to be exclusive. H.R. Conf. Rep. No. 108–755, at 316.

Section 965(c) provides definitions and special rules, including rules for adjusting the calculation of the base period amounts to take into account mergers, acquisitions and spin-offs. Sections 965(d) and (e) provide special rules limiting foreign tax credits and expense deductions and limiting the attributes available to offset the nondeductible portion of dividends, respectively.

Section 965(f) provides that taxpayers may elect the application of section 965 for either the taxpayer's last taxable year which begins before October 22, 2004, or the taxpayer's first taxable year which begins during the one-year period beginning on October 22, 2004.

## SECTION 3. CASH DIVIDENDS

### .01 *In General*

The DRD under section 965(a) applies only to cash dividends[4] received by a corporate U.S. shareholder from CFCs with respect to which it is a U.S. shareholder. For this purpose, the term "cash" includes both U.S. dollars and foreign currency. A CFC may effect distributions of cash by wire transfer or check.

The Treasury Department and the IRS anticipate that, in some cases, a CFC will liquidate investments in cash equivalents in order to pay a cash dividend as required under section 965. It is also anticipated that the U.S. shareholder that receives such a cash dividend from the CFC may temporarily invest all or a portion of the dividend proceeds in cash equivalents, which may be similar in nature to those that had been held by the CFC. For purposes of section 965, the mere fact that the CFC held cash equivalents prior to the payment of a cash dividend and the U.S. shareholder holds cash equivalents after the payment of such dividend will not itself cause the Commissioner to recharacterize the dividend as a distribution by the CFC of the cash equivalents (rather than as a required distribution of cash), under the step transaction doctrine, or other similar authorities. For purposes of this paragraph, the term "cash equivalents" has the meaning provided in §1.897–7T(a).

### .02 *Treatment of Distributions to Intermediary Pass-Through Entities*

To qualify as a cash dividend within the meaning of section 965, cash must be distributed from a CFC to the U.S. shareholder in the taxable year for which an election under section 965 applies. For purposes of section 965(a), a cash dividend paid by a CFC to a pass-through entity (a partnership or disregarded entity) that is owned by a U.S. shareholder shall be treated as received by such U.S. shareholder only if and to the extent that such shareholder receives cash in the amount of the CFC dividend during the taxable year for which such election is in effect. In addition, in the case of a partnership, a cash dividend is treated as received by a U.S. shareholder that is a partner in such partnership only if the amount of the dividend is: (i) allocated to the U.S. shareholder-partner under the rules of sections 702 and 704 and the regulations thereunder; and (ii) separately stated to the partner under §1.702–1(a)(8)(ii).

For example, if a U.S. shareholder owns a disregarded entity that, in turn, owns a CFC that pays a cash dividend to the disregarded entity, such dividend will qualify as a cash dividend received by the U.S. shareholder within the meaning of section 965 only to the extent the disregarded entity distributes cash in the amount of the dividend proceeds to the U.S. shareholder during the taxable year to which an election under section 965 applies. A loan of cash from the disregarded entity to the U.S. shareholder would not be considered a distribution of cash for this purpose because, even though the loan would not otherwise be regarded for tax purposes, there would be a legal obligation for the U.S. shareholder to repay the cash to the disregarded entity.

### .03 *Amount of Cash Dividend Not Reduced by Related Deductions or Expenses*

The amount otherwise qualifying as a cash dividend is not reduced by expenses or deductions of the taxpayer related to such cash dividend, including any foreign withholding tax and U.S. federal, state or local income tax imposed thereon. Taxpayers must invest the gross amount of the dividend (not reduced by expenses or deductions related to such dividend) in order for the total cash dividend to qualify under section 965(b)(4). Thus, for example, if a CFC distributes $100x of cash to its U.S. shareholder with respect to its stock that is treated as a dividend, and such distribution is subject to a foreign withholding tax of $5x (such that the U.S. shareholder receives a net amount of $95x), the amount of the cash dividend is $100x. Accordingly, the taxpayer must invest $100x in the United States pursuant to a domestic reinvestment plan in order for the $100x cash dividend to satisfy the requirements of section 965(b)(4).

### .04 *Interaction with Section 959*

Except as provided in section 965(a)(2), the term "dividends" does not include

[4] For purposes of section 965, a cash dividend includes cash amounts treated as a dividend pursuant to section 356(a)(2).

amounts that are not included in gross income pursuant to section 959(a). In other words, distributions by a CFC to its U.S. shareholder with respect to its stock out of its earnings and profits described in section 959(c)(1) and (c)(2) do not qualify as dividends (except to the extent provided in section 965(a)(2)). Thus, for example, if a CFC has earnings and profits described in section 959(c)(1) of 100u and earnings and profits described in section 959(c)(3) of 50u, under the ordering rules of section 959(c) the CFC must distribute 150u to its U.S. shareholder with respect to its stock in order to be considered to have paid a 50u dividend within the meaning of section 965.

## SECTION 4. DOMESTIC REINVESTMENT PLANS

### .01 *In General*

A domestic reinvestment plan is a written plan prepared by the taxpayer that describes the planned investment in the United States of the amount of the dividend otherwise qualifying for the deduction under section 965(a) in reasonable detail and specificity. It may encompass more than one cash dividend from one or more CFCs. A taxpayer may adopt separate domestic reinvestment plans to apply to different cash dividends made during the taxable year to which it elects to apply section 965. Under section 965, amounts invested in the United States pursuant to the domestic reinvestment plan are not required to exceed investments made in prior years or investments that were planned by the taxpayer prior to the enactment of section 965.

### .02 *Procedural Requirements*

Pursuant to section 965(b)(4)(A), a domestic reinvestment plan must be approved by the taxpayer's president, chief executive officer, or an official exercising comparable authority over the taxpayer before the cash dividend to which it relates is paid. The taxpayer's board of directors, management committee, executive committee, or the body which exercises similar authority over the taxpayer must subsequently approve the domestic reinvestment plan. Such approval may be granted after the payment of the dividend subject to the domestic reinvestment plan, and no special meeting of the board or other body is required to grant this approval. Where the U.S. shareholder of a CFC is a member of a consolidated group within the meaning of §1.1502–1(h), the domestic reinvestment plan must be approved by the president, chief executive officer, or comparable official, and by the board of directors, management committee, executive committee, or similar body, of the common parent of the consolidated group. In such a case, the domestic reinvestment plan need not be separately approved by other members of the consolidated group, even if such members make permitted investments pursuant to such plan.

### .03 *Specificity*

The domestic reinvestment plan must describe specific anticipated investments in the United States. The Treasury Department and the IRS do not intend to provide a template for a domestic reinvestment plan. The composition of a taxpayer's domestic reinvestment plan may vary depending on the type of permitted investments contemplated by the plan (for example, research and development or capital improvements to plant and facility), the time period over which permitted investments will be made, and whether factors beyond the taxpayer's control could affect its ability to make the contemplated investment. These and other relevant facts and circumstances should be taken into account in applying the reasonable specificity standard set forth in this notice.

In general, the domestic reinvestment plan must provide sufficient detail to enable the taxpayer to demonstrate upon examination that the expenditures that subsequently occur were of the kind that were in fact contemplated at the time of the adoption of such plan. Thus, a domestic reinvestment plan that merely recites the statutory language without further detail, or that merely refers generically to expenditures on whatever uses may be permitted for purposes of section 965, will not be considered to have met the statutory requirements.

The domestic reinvestment plan need not indicate precise dollar amounts expected to be incurred for each specific component of an investment, but must state the total dollar amount that will be invested for each respective principal investment in the United States pursuant to such plan (*e.g.*, a total dollar amount for expenditures for research and development on product lines A, B and C and a total dollar amount for expenditures for advertising for brands D and E). A taxpayer may shift expenditures between investments specified in the plan without amending the plan and, to that extent, the additional amounts spent on one investment would be considered an alternative investment (as described below). For example, if a $100x dividend reinvestment plan calls for expenditures of $30x on research and development and $70x on advertising, and the taxpayer in fact expends $90x on the advertising, the additional $20x expenditures on advertising is an alternative investment.

The domestic reinvestment plan must state a reasonable time period, taking into account the nature of the investments to be made in the United States and other facts and circumstances, during which the taxpayer anticipates completing all such investments pursuant to such plan.

The Treasury Department and the IRS recognize that, after a domestic reinvestment plan is approved, certain investments specified in such plan may no longer be practicable or desirable for various reasons. This may occur, for example, if an investment is dependent on actions of other persons, or upon reasonably anticipated business conditions that subsequently change. For example, a taxpayer's domestic reinvestment plan may contemplate as a principal investment a plant in the United States the construction of which cannot proceed absent certain governmental approvals and, subsequent to the adoption of the plan, the necessary governmental approvals are denied. Accordingly, the domestic reinvestment plan may provide alternative investments, which are themselves permitted investments, for investing the amount of the dividend in the United States in cases where principal investments are subsequently delayed or rejected. Such alternative investments must be described in the domestic reinvestment plan under the same standard of specificity provided above. The domestic reinvestment plan need not, however, set forth the conditions under which the alternative investments will be substituted for the principal investments.

.04 *Amending the Domestic Reinvestment Plan*

In general, the taxpayer is not permitted to modify or amend a domestic reinvestment plan after payment of the dividend to which such plan relates. See section 9.02 of this notice for a special transition rule in the case of certain dividends paid prior to January 13, 2005.

.05 *Tracing or Segregating Funds*

A taxpayer is not required to trace or segregate the specific dividend proceeds it receives to demonstrate that it has properly invested the amount of the dividend in the United States pursuant to the domestic reinvestment plan. Moreover, provided a sufficient amount of funds is properly invested in the United States pursuant to the domestic reinvestment plan (and such plan otherwise satisfies the requirements under section 965(b)(4) and this notice), the fact that other non-permitted investments are made during the period covered by such plan generally will not affect the eligibility of the dividend under section 965.

For example, if, pursuant to a domestic reinvestment plan, a taxpayer plans to invest an amount equal to the dividend in infrastructure over a three-year period, the taxpayer is not required to trace or otherwise account for the specific funds that were distributed to the taxpayer and ensure that the same specific funds are invested in the infrastructure over the three-year period. Rather, the taxpayer must demonstrate to the satisfaction of the Commissioner that an amount equal to the dividend is invested in infrastructure pursuant to the domestic reinvestment plan.

In certain cases, however, the fulfillment of a domestic reinvestment plan may be subject to greater scrutiny by the Commissioner because the plan provides that the investment in the United States will only occur over the course of many years, and during such period the taxpayer also is making expenditures that would not be permitted investments. In that case, a segregated account in the amount of the dividend proceeds, with disbursements from the account expended for the permitted investments described in the domestic reinvestment plan, would be a positive factor in establishing that the requirements of section 965(b)(4) are satisfied.

A domestic reinvestment plan may include an investment that, prior to the adoption of the plan, was anticipated to be made by the taxpayer. This is the case even if, prior to the adoption of the domestic reinvestment plan, such investment was budgeted and expected to be made with other funds.

.06 *Expenditures in Taxable Year of Election*

In general, expenditures made during the taxable year for which the taxpayer elects to apply section 965 may be considered to be made pursuant to the domestic reinvestment plan, regardless of when they are made during such year. Thus, for example, expenditures on permitted investments made in the election year but prior to the payment of the cash dividend described in section 965(a) (or prior to the adoption of the domestic reinvestment plan) may qualify as permitted investments made pursuant to the domestic reinvestment plan. Expenditures made during taxable years prior to the taxable year to which the taxpayer elected section 965 to apply, however, will not qualify as permitted investments made pursuant to the domestic reinvestment plan.

.07 *Partially Completed Domestic Reinvestment Plans*

A cash dividend that would otherwise qualify for the DRD under section 965(a) is considered to qualify pursuant to section 965(b)(4) only to the extent the amount of the dividend is expended on permitted investments pursuant to the domestic reinvestment plan. If the domestic reinvestment plan provides for expenditures on permitted investments of the full amount of the dividend, but the U.S. shareholder in fact expends less than the full amount of the dividend on such permitted investments, the dividend satisfies the requirements of section 965(b)(4) only to the extent of the amount so expended. Thus, for example, assume a CFC pays a cash dividend of $100x to its U.S. shareholder pursuant to a domestic reinvestment plan that properly specifies $100x of permitted investments pursuant to section 4 of this notice (and the dividend otherwise qualifies for the DRD under section 965(a)), but the U.S. shareholder in fact only makes $90x of the permitted investments provided for under the plan. In such a case, $10x of the $100x cash dividend does not qualify for the DRD under section 965(a); the remaining $90x qualifies for the DRD under section 965(a).

SECTION 5. EXPENDITURES THAT ARE INVESTMENTS IN THE UNITED STATES PURSUANT TO SECTION 965(b)(4)

.01 *In General*

(a) *Scope*. Except as provided in sections 5.01(b) and (c) of this notice, expenditures described in section 5 of this notice that are made pursuant to a domestic reinvestment plan, as provided under section 965(b)(4) and this notice, are permitted investments. Because this list of permitted investments is not an exclusive list, other investments in the United States made pursuant to a domestic reinvestment plan may also be permitted investments.

(b) *Payments to Unrelated Persons*. Expenditures described in this section 5 are permitted investments only if they are made to a person that is not related to the taxpayer (within the meaning of section 267(b), other than section 267(b)(8) in the case of an expenditure with respect to a qualified plan pursuant to section 5.02 or 5.05(b)).

(c) *Cash Payments*. In general, permitted investments must be made in the form of cash. If a taxpayer issues a note in payment for what would otherwise be a permitted investment, the permitted investment is considered to be made only as the taxpayer satisfies its obligation under the note in cash.

Stock may not be used to make permitted investments. Thus, for example, if a taxpayer issues stock to acquire a target corporation, such acquisition is not a permitted investment (unless, and only to the extent that, cash also is paid for the target company).[5] Similarly, compensation in the form of stock grants or stock options is not a permitted investment.

[5] This is the case even if the acquisition of the target would qualify, in whole or in part, as a permitted investment under section 5.06 of this notice if cash, rather than taxpayer stock, were used to make the acquisition.

.02 *Funding of Worker Hiring, Training, and Other Compensation*

Expenditures incurred in connection with the funding of worker hiring and training (other than as provided in section 6.02 of this notice) are permitted investments. In general, the funding of worker hiring and training includes expenditures incurred in connection with hiring new workers and training both existing and newly-hired workers and expenditures incurred on compensation and benefits (including the funding of a qualified plan within the meaning of section 401(a)) of existing and newly-hired workers.

Expenditures do not qualify, however, to the extent described in section 6.02 of this notice, related to executive compensation. In addition, expenditures qualify only to the extent attributable to services performed by the workers within the United States. If the services are performed partly within and partly without the United States, the amount of permitted investments shall be determined under the principles of §1.861–4(b)(1). Expenditures in this case may be permitted investments even if the workers are not employees of the taxpayer, provided such expenditures are borne by the taxpayer and the activities are performed in the United States.

In the case of funding a qualified plan, a taxpayer may use a reasonable method to apportion the funding between amounts related to executive compensation and non-executive compensation, and between amounts related to services performed within and without the United States. See also section 5.05(b) of this notice (relating to the qualification of satisfaction of an obligation to fund a qualified plan as financial stabilization for the purposes of job retention or creation in the United States).

.03 *Infrastructure and Capital Investments*

Expenditures incurred in connection with the funding of infrastructure and capital investments are permitted investments. Expenditures for infrastructure and capital investments include physical installations and facilities that support the taxpayer's business, and other assets integral to the conduct of a business, provided that the infrastructure and capital investments are located and used in the United States. Such expenditures also include payments for services performed in the United States that are related to, or provided in connection with, otherwise qualified infrastructure or capital investments described in this section.

Infrastructure and capital investments include plant, property and equipment, communications and distribution systems, computer hardware and software, databases, and supporting equipment. Improvements to the items described above also are qualified expenditures.

Expenditures are incurred for infrastructure and capital investments as described above regardless of whether incurred to construct, develop, purchase, rent, or license such items.

If the infrastructure or capital investment is partly within and partly without the United States, the amount of the expenditure that constitutes a permitted investment with respect to such item is limited to amounts attributable to assets that are located and used within the United States. Similarly, if services related to, or provided in connection with, qualified infrastructure or capital investments are performed partly within and partly without the United States, the amount of the expenditure that constitutes a permitted investment shall be determined under the principles of §1.861–4(b)(1).

.04 *Research and Development*

Expenditures incurred in connection with the funding of research and development are permitted investments. In general, expenditures for research and development are expenditures that are described in §1.174–2, provided that the research and development activities are performed in the United States. In addition, if the research and development is performed partly within and partly without the United States, the amount of the expenditure that constitutes a permitted investment shall be determined under the principles of §1.861–4(b)(1).

Expenditures for research and development constitute a permitted investment only to the extent they are borne by the taxpayer. Thus, for example, expenditures incurred on research and development performed by employees of the taxpayer within the United States are not permitted investments to the extent the taxpayer is reimbursed by another party for such activities pursuant to a cost sharing arrangement under §1.482–7.

Expenditures for research and development may be permitted investments even if the research and development is not performed by employees of the taxpayer, provided such expenditures are borne by the taxpayer and the activities are performed in the United States.

.05 *Financial Stabilization of the Corporation for the Purposes of Job Retention or Creation*

(a) *Repayment of debt*. The repayment by the taxpayer of debt, regardless of whether the lender or holder is a U.S. person, is a permitted investment so long as the repayment contributes to the financial stabilization of the taxpayer for the purposes of job retention or creation in the United States. The repayment of debt ordinarily will be considered to contribute to the financial stabilization of the taxpayer because it improves the taxpayer's debt-equity ratio and reduces the taxpayer's obligations for debt service. An increase in the taxpayer's credit rating due to the debt repayment is not required. Such an increase, however, would be an indication of a contribution to financial stabilization. The requirement that financial stabilization be for the purposes of job retention or creation in the United States is satisfied if, at the time the domestic reinvestment plan is approved by the taxpayer's president, chief executive officer, or comparable official, the taxpayer's reasonable business judgment is that the resulting financial stabilization will be a positive factor in its ability to retain and create jobs in the United States. In this regard, a plan developed by the taxpayer as part of its strategic planning process that evidences expected use of savings attributable to reduced debt service principally for expenditures incurred in connection with permitted investments is one method of demonstrating a purpose of job retention or creation in the United States because such expenditures likely would have direct or indirect positive effects on employment in the United States.

A repayment of debt is not a permitted investment to the extent, at the time of the repayment, the taxpayer has a plan or

intent to incur additional debt on substantially the same terms following the date of the dividend, and the taxpayer in fact incurs such additional debt. In that case, the additional debt, in effect, replaces the repaid debt. Such a temporary or transitory reduction in taxpayer indebtedness is not a permitted investment. The determination of whether the taxpayer had such a plan or intent shall be determined based on all the relevant facts and circumstances, taking into account all relevant provisions and general principles of tax law, including the substance over form doctrine. See, *e.g.*, Rev. Rul. 89–73, 1989–1 C.B. 258.

The taxpayer is not required to demonstrate that there has been a net global reduction in indebtedness of the taxpayer's corporate group in order for the repayment of debt to be a permitted investment. Thus, for example, if a CFC incurs debt (and is treated as the obligor on such debt) to fund a cash dividend it pays to its U.S. shareholder, and the U.S. shareholder uses the dividend proceeds to repay debt owed to an unrelated party, the U.S. shareholder may be able to demonstrate that such repayment is a permitted investment even though the total debt of the taxpayer and its CFCs, taken in the aggregate, is not reduced. If, however, the facts and circumstances are such that, in substance, the taxpayer (rather than the CFC) is the obligor of the debt nominally incurred by the CFC,[6] then the taxpayer simply incurred debt to repay other debt. In such a case, the repayment of the existing debt is transitory and not a permitted investment.

The repayment or acquisition of an intercompany obligation between members of the same consolidated group does not qualify as the repayment of debt for purposes of this section. However, if the consolidated group member receiving funds equal to the repayment or acquisition amount also makes a permitted investment of such amount, such investment may qualify under section 5 of this notice. See section 6.03 of this notice.

(b) *Qualified Plan Funding*. The satisfaction of an obligation to fund a qualified plan (within the meaning of section 401(a)) ordinarily will contribute to the financial stabilization of the taxpayer. The taxpayer is not required to demonstrate the extent to which the plan covers current employees or the extent to which those covered by the plan perform (or performed) services within the United States. The requirement that financial stabilization be for the purposes of job retention or creation in the United States is satisfied if, at the time the domestic reinvestment plan is approved by the taxpayer's president, chief executive officer, or comparable official, the taxpayer's reasonable business judgment is that the resulting financial stabilization will be a positive factor in its ability to retain and create jobs in the United States. See also section 5.02 of this notice (relating to the qualification of expenditures for worker hiring, training and other compensation in the United States as permitted investments).

(c) *Other Expenditures*. Expenditures other than those described in sections 5.05(a) or (b) of this notice also are permitted investments if such expenditures contribute to the financial stabilization of the taxpayer for the purposes of job retention or creation in the United States. Whether such an expenditure contributes to the financial stabilization of the taxpayer for the purposes of job retention or creation in the United States will be determined based on all the facts and circumstances. Such an expenditure generally will be considered to be a permitted investment if the expenditure reduces financial constraints on the taxpayer's U.S. operations and if, at the time the domestic reinvestment plan is approved by the taxpayer's president, chief executive officer, or comparable official, the taxpayer's reasonable business judgment is that such reduction in financial constraints will be a positive factor in its ability to retain and create jobs in the United States.

.06 *Acquisitions of Interests in Business Entities*

(a) *General Rule*. Except as provided in section 5.06(b) of this notice, the acquisition of an ownership interest in a business entity (such as a corporation or a partnership), regardless of whether such entity is domestic or foreign, is a permitted investment to the extent of the percentage of the total value of the assets owned (directly or indirectly) by the business entity that, if acquired directly, would be permitted investments as described in this notice. The direct or indirect acquisition of an interest in a business entity is a permitted investment only if the taxpayer directly or indirectly owns an interest representing at least 10 percent of the value of such business entity after the acquisition. For purposes of determining whether a taxpayer indirectly owns a 10-percent interest in a business entity, and for purposes of determining whether business entities indirectly own interests in other entities, rules similar to the rules of section 267(c) shall apply.

In general, amounts expended to acquire a direct interest in a business entity shall be allocated between permitted and non-permitted investments on the basis of the relative values of the business entity's assets that, if acquired directly, would be permitted or non-permitted investments. If a business entity owns an interest in another business entity in which the taxpayer indirectly owns a 10-percent interest, the assets taken into account for this purpose are the upper-tier entity's share of the assets held by the lower-tier entity, not the upper-tier entity's interest in the lower-tier entity. In valuing assets for this purpose, the taxpayer must use the same methodology under §1.861–9T(g) (*i.e.*, tax book value, alternative tax book value or fair market value) that the taxpayer uses for purposes of allocating and apportioning interest expense for the taxable year under section 864(e). In applying this section 5.06, however, asset amounts shall be characterized as permitted or non-permitted investments based on whether the assets are located and used within the United States, and not on the basis of the source of the income generated by the assets.

(b) *De Minimis Rule* . If a taxpayer acquires an interest in a business entity as described in section 5.06(a) of this notice, and more than 95 percent of such expenditure would be a permitted investment or a non-permitted investment as determined under section 5.06(a) of this notice, the entire acquisition shall be treated as a permitted investment or a non-permitted investment, respectively.

[6] See, *e.g.*, *Plantation Patterns v. Comm'r*, 462 F.2d 712 (5th Cir. 1972), *cert. denied*, 409 U.S. 1076 (1972).

.07 *Advertising and Marketing Expenditures*

Expenditures incurred on advertising or marketing with respect to trademarks, trade names, brand names, or similar intangible property are permitted investments, provided the advertising or marketing activities are performed in the United States. If the advertising or marketing activities are performed partly within and partly without the United States, the amount that constitutes a permitted investment shall be determined under the principles of §1.861–4(b)(1). As is the case with research and development (discussed in section 5.04 of this notice), the advertising or marketing expenditures must be borne by the taxpayer, but the advertising or marketing activities need not be performed by employees of the taxpayer.

.08 *Intangible Property*

Expenditures to acquire the rights to intangible property, through purchase or license, are permitted investments to the extent the rights to the intangible property are used in the United States.

SECTION 6. EXPENDITURES THAT ARE NOT INVESTMENTS IN THE UNITED STATES PURSUANT TO SECTION 965(b)(4)

.01 *In General*

The expenditures described in this section 6 are not permitted investments by the taxpayer in the United States within the meaning of section 965(b)(4). Section 965(b)(4) explicitly provides that executive compensation is not a permitted investment. The other non-permitted investments listed in this section are not reasonably expected to maintain or add to the value of the taxpayer as a going concern. Because this list of non-permitted investments is not an exclusive list, other expenditures may also be non-permitted investments.

.02 *Executive Compensation*

Executive compensation is not a permitted investment. Executive compensation is defined as compensation paid, directly or indirectly, by or on behalf of, the taxpayer, to any employee or former employee, in exchange for services (past, present, or future) performed for the taxpayer, if: (a) the individual is an employee who is subject to the requirements of section 16(a) of the Securities Exchange Act of 1934 with respect to the taxpayer; (b) the individual is an employee who would be subject to such requirements if the taxpayer were an issuer of equity securities referred to in such section; or (c) the individual is a former employee who was described in clauses (a) or (b) of this section 6.02 at the time of his or her severance from employment. A taxpayer may treat the ten employees who received the highest wages in the most recently ended calendar year as being the individuals described in clause (b) of this section 6.02.

.03 *Intercompany Distributions, Obligations, and Transactions*

For purposes of section 965, all U.S. shareholders that are members of an affiliated group filing a consolidated return under section 1501 are treated as one U.S. shareholder. Section 965(c)(5). Therefore, intercompany distributions, intercompany obligations, and intercompany transactions (all as defined in §1.1502–13) between corporations that are members of the same consolidated group are disregarded for purposes of section 965 and cannot be permitted investments under section 5 of this notice. However, if a consolidated group member initially receives a cash dividend from its CFC, an investment of an amount equal to such dividend amount made by another consolidated group member may be a permitted investment under section 5 of this notice.

.04 *Dividends and Other Distributions With Respect to Stock*

Dividends and other distributions made by the taxpayer to its shareholders with respect to its stock, without regard to how such distributions are treated under section 301, are not permitted investments because they do not constitute investments by the taxpayer for purposes of section 965.

Moreover, although intercompany distributions between members of a consolidated group are disregarded for purposes of section 965, a distribution with respect to the stock of a consolidated group member that is held by a person that is not a member of the same consolidated group is not a permitted investment.

.05 *Stock Redemptions*

The redemption of outstanding stock of a taxpayer or, through one or more steps as part of a plan, of a corporation related to the taxpayer (within the meaning of section 267(b)) without regard to whether such redemption is treated as an exchange in part or full payment for the stock under section 302(b), is not a permitted investment. As is the case with dividends, such expenditures do not constitute investments by the taxpayer for purposes of section 965.

Moreover, although an intercompany transaction in which a consolidated group member acquires its own stock from another consolidated group member is disregarded for purposes of section 965, a redemption of shares of stock of a consolidated group member that are held by a person that is not a member of the same consolidated group is not a permitted investment.

.06 *Portfolio Investments in Business Entities*

Except as provided in section 5.06 of this notice, the acquisition of an interest in a business entity is not a permitted investment.

.07 *Debt Instruments or other Evidences of Indebtedness*

The acquisition of a debt instrument or other evidence of indebtedness, including an acquisition of such instrument or indebtedness from the debtor, is not a permitted investment.

.08 *Tax Payments*

Payments of federal, state, local or foreign taxes, and associated interest and penalties, including foreign withholding tax and U.S. federal, state or local income tax imposed on distributions that qualify as cash dividends under section 965(a), are not permitted investments.

SECTION 7. ELECTION TO APPLY SECTION 965 TO A TAXABLE YEAR

In general, a taxpayer elects to apply section 965 to a taxable year by filing Form 8895 with its timely-filed tax return (including extensions) for such taxable year. If, however, a taxpayer files its tax return

for the taxable year to which the taxpayer intends to elect section 965 to apply prior to the issuance of Form 8895, the election must be made on a statement that is attached to its timely-filed tax return (including extensions) for such taxable year. See section 9.03 for a special transition rule for certain tax returns filed prior to January 13, 2005.

SECTION 8. REPORTING AND OTHER ADMINISTRATIVE REQUIREMENTS

.01 *In General*

The determination of whether the dividend has been invested in the United States pursuant to the domestic reinvestment plan as provided under section 965(b)(4) is generally made under the facts and circumstances of the particular taxpayer, as described in section 8.04 of this notice. However, section 8.03 of this notice provides a safe harbor method under which the taxpayer will be considered to have established to the satisfaction of the Commissioner that the amount of the dividend has been invested in the United States pursuant to the domestic reinvestment plan.

Section 8.02 of this notice sets forth reporting and documentation requirements with respect to section 965.

.02 *Reporting and Documentation Requirements*

(a) *Annual Reporting*. The taxpayer shall attach a statement which includes the items described below to its timely-filed tax return (including extensions) for the taxable year to which the taxpayer's election under section 965 applies and for each subsequent taxable year at the beginning of which the taxpayer has not made all investments required to be made under one or more of its domestic reinvestment plans (unless the annual reporting requirement is terminated earlier pursuant to sections 8.03(c)(i) or 8.04(c)(ii) of this notice):

(i) A statement that the document is submitted pursuant to section 965(b)(4) and this notice.

(ii) A general description of any permitted investment made during the taxable year pursuant to the domestic reinvestment plan and a reconciliation over the entire term of such plan through the last day of the taxable year for which the statement is filed of the specific expenditures made with respect to each such investment. The description must include a calculation of the percentage of completion of the domestic reinvestment plan. The percentage of completion of the plan is calculated as the sum of the expenditures made and amounts subject to a binding contract or commitment (as described in section 8.03(b)(i) of this notice) through such last day, divided by the total amount to be invested pursuant to the plan.

(iii) A statement indicating whether any of the permitted investments that have been made pursuant to the domestic reinvestment plan are alternative investments.

(iv) Such additional items, as applicable, pursuant to sections 8.03 and 8.04 of this notice.

(b) *Documentation and Production*. The taxpayer shall, with respect to each of its domestic reinvestment plans, prepare, maintain, and, upon a request by the Commissioner, make available within 30 days of such request, the following:

(i) Records that display in reasonable detail the amount invested in the United States pursuant to the domestic reinvestment plan as required under section 965(b)(4)(B). The documentation must also include an allocation between permitted investments and non-permitted investments and, as relevant, a demonstration that the methodology used is consistent with the principles prescribed in this notice. For example, if the taxpayer acquires a 10-percent interest in a business entity that directly or indirectly owns assets that, if acquired directly, would consist of both permitted and non-permitted investments, an analysis of the allocation of the expenditure between permitted and non-permitted assets under the principles described in section 5.06 of this notice is required.

(ii) A copy of the domestic reinvestment plan and any supporting documents.

(iii) In the case of a cash dividend that is effectuated through an intermediary partnership (as described in section 3.02 of this notice) that is foreign and is not required under section 6031 to file an information return, substantiation that the applicable requirements set forth in section 3.02 of this notice (regarding allocations under sections 702 and 704, and the separate statement of items pursuant to §1.702–1(a)(8)(ii)) were met.

.03 *Safe Harbor*

(a) *In General*. If a taxpayer meets the requirements under sections 8.03(b), 8.03(c), and 8.03(d) of this notice, then the taxpayer will have established to the satisfaction of the Commissioner that the amount of the dividend has been invested in the United States pursuant to the domestic reinvestment plan as required under section 965(b)(4). This safe harbor is not the exclusive method of satisfying the Commissioner. If the safe harbor is not met, the determination will be made under a facts and circumstances analysis described in section 8.04 of this notice.

(b) *Substantive Requirements*. Expenditures comprising at least 60 percent of the amount of total funds with respect to permitted investments to be made pursuant to the domestic reinvestment plan meet both of the following requirements:

(i) Such expenditures have been made, or are the subject of a binding contract or commitment entered into with persons unrelated to the taxpayer (within the meaning of section 267(b), other than section 267(b)(8)), by the end of the second taxable year following the taxable year for which the taxpayer elected to apply section 965; and —

(ii) Such expenditures constitute permitted investments listed in section 5 of this notice (other than investments described in section 5.05(c) of this notice).

(c) *Annual Reporting*. The taxpayer satisfies the reporting requirements of section 8.02(a) of this notice for the taxable year for which the taxpayer elected section 965 to apply and each of the two subsequent taxable years (unless all investments have been made pursuant to the domestic reinvestment plan prior to the beginning of either such taxable year) and includes in such reporting the representations set forth below, as applicable:

(i) In an annual report filed for a taxable year no later than the second taxable year following the taxable year to which the taxpayer elected to apply section 965, representations —

(A) that the requirements of section 8.03(b) of this notice have been met; and

(B) that the taxpayer intends to make the remaining amount of investments, if any, pursuant to the domestic reinvestment plan no later than the end of the fourth taxable year following the taxable year to

which the taxpayer elected to apply section 965.

A taxpayer may cease annual reporting pursuant to section 8.02(a) and this section 8.03(c) after such statement including such representations is filed.

(ii) If the repayment of debt during the taxable year is intended to qualify as a permitted investment pursuant to section 5.05(a) of this notice, representations —

(A) That such repayment of debt contributes to the financial stabilization of the taxpayer in the United States in accordance with section 5.05(a) of this notice;

(B) That at the time the domestic reinvestment plan was approved by the taxpayer's president, chief executive officer, or comparable official, the taxpayer's reasonable business judgment was that the financial stabilization resulting from such repayment of debt will be a positive factor in its ability to retain and create jobs in the United States in accordance with section 5.05(a) of this notice; and

(C) That, at the time of the repayment, the corporation had no plan or intent to incur additional debt under substantially the same terms in accordance with section 5.05(a) of this notice.

(iii) If the satisfaction of an obligation to fund a qualified plan (within the meaning of section 401(a)) is intended to qualify as a permitted investment pursuant to section 5.05(b) of this notice, representations —

(A) That such satisfaction of a qualified plan funding obligation contributes to the financial stabilization of the taxpayer in accordance with section 5.05(b) of this notice; and

(B) That at the time the domestic reinvestment plan was approved by the taxpayer's president, chief executive officer, or comparable official, the taxpayer's reasonable business judgment was that the financial stabilization resulting from such satisfaction of a qualified plan funding obligation will be a positive factor in its ability to retain and create jobs in the United States in accordance with section 5.05(b) of this notice.

(d) *Documentation and Production*. The taxpayer satisfies the documentation and production requirements of section 8.02(b) of this notice.

.04 *Facts and Circumstances*

(a) *In General*. If a taxpayer does not satisfy the safe harbor described in section 8.03 of this notice, the taxpayer must establish to the satisfaction of the Commissioner that, taking into account the facts and circumstances, the amount of the dividend has been, or will be, invested in the United States pursuant to the domestic reinvestment plan as required under section 965(b)(4). The fact that the safe harbor has not been satisfied, however, is not relevant in determining whether the dividend has been invested in the United States pursuant to the domestic reinvestment plan as required under section 965(b)(4). Among the facts and circumstances that may be relevant in establishing to the satisfaction of the Commissioner that the amount of the dividend has been invested in the United States pursuant to the domestic reinvestment plan as required under section 965(b)(4) are those in sections 8.04(b), 8.04(c), and 8.04(d) of this notice.

(b) *Relevant Facts and Circumstances*. Relevant facts and circumstances for purposes of this section 8.04 include:

(i) The time period prescribed in the domestic reinvestment plan, taking into account the nature of the investments to be made in the United States and other facts and circumstances, during which the taxpayer anticipates completing all investments to be made pursuant to the domestic reinvestment plan. See section 4.03 of this notice.

(ii) The degree of specificity used in the domestic reinvestment plan describing anticipated permitted investments. See section 4.03 of this notice.

(iii) The extent to which the taxpayer has completed the investment of the dividend in the United States as required under section 965(b)(4), taking into account the nature of the investments to be made in the United States and other facts and circumstances.

(c) *Annual Reporting*. Relevant facts and circumstances also include the extent to which the taxpayer has complied with the reporting requirements described in section 8.02(a) of this notice, and whether the taxpayer includes in an annual report filed for the taxable year no later than the second taxable year following the taxable year to which the taxpayer elected to apply section 965 the following representations:

(i) that the taxpayer will agree, upon a request by the Commissioner, to enter into an agreement to extend the statute of limitations on assessment and collection with respect to the DRD claimed under section 965(a) for the taxable year to which the taxpayer elected to apply section 965; and

(ii) that the taxpayer will agree, upon a request by the Commissioner, to enter into a multi-year agreement with respect to the taxpayer's completion of the domestic reinvestment plan.

An agreement entered into with the Commissioner may determine the extent of any continuing reporting and documentation requirements pursuant to this section 8.04(c) and section 8.04(d) of this notice.

(d) *Documentation and Production*. Relevant facts and circumstances also include the extent to which the taxpayer satisfies the documentation and production requirements of section 8.02(b) of this notice.

SECTION 9. TRANSITION RULES

.01 *In General*.

All domestic reinvestment plans are subject to the guidance provided in this notice. Thus, for example, expenditures described in Section 6 of this notice are non-permitted investments, even if such expenditures were made prior to the issuance of this notice.

.02 *Dividends Paid Prior to January 13, 2005*.

If a domestic reinvestment plan approved prior to January 13, 2005 is not in conformity with the guidance provided in this notice, the taxpayer may modify such plan to comply with the guidance herein not later than March 14, 2005, even if the dividend (or dividends) to which the plan relates has already been paid. Any domestic reinvestment plan that is so modified must be subsequently approved by the taxpayer's president, chief executive officer, or comparable official, and by the taxpayer's board of directors, management committee, executive committee, or similar body.

.03 *Tax Returns Filed Prior to January 13, 2005*.

A taxpayer that has filed its tax return for the taxable year for which it elects section 965 to apply prior to January 13, 2005, may satisfy the reporting requirements of sections 8.02(a), 8.03(c) or 8.04(c) of this notice on an amended tax return that is filed by the due date (including extensions) of the tax return for such taxable year.

SECTION 10. EFFECTIVE DATE

This notice is effective for the taxable year for which taxpayers have elected section 965 to apply, and subsequent taxable years as relevant.

SECTION 11. PAPERWORK REDUCTION ACT

The collections of information contained in this notice have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–1926.

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.

The collections of information are in sections 7, 8, and 9 of this notice. This information is required to provide the IRS sufficient information to determine whether a taxpayer has properly elected to apply section 965 to a taxable year, to determine whether a dividend has been invested in the United States pursuant to a domestic reinvestment plan under section 965(b)(4), and to determine whether a taxpayer has properly applied certain transition rules. The collections of information are required to obtain the benefit of section 965 for a taxable year. The likely respondents are business corporations.

Estimated total annual reporting and/or recordkeeping burden: 3,750,000 hours.

Estimated average annual burden hours per respondent: 150 hours.

Estimated number of respondents: 25,000.

Estimated annual frequency of responses: on occasion and annually.

The collections of information contained in this notice have 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 collections of information should be received by February 14, 2005. Comments are specifically requested concerning:

Whether the proposed collections of information are 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 collections 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 collections 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.

Comments concerning the accuracy of the burden estimate and suggestions for reducing the burden of the final or temporary regulations 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 **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington DC 20224.

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.

SECTION 12. DRAFTING INFORMATION

The principal author of this notice is Jeffrey L. Vinnik of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in its development. For further information regarding this notice, contact Mr. Vinnik at (202) 622–3840 (not a toll-free call).