

## Part III - Administrative, Procedural, and Miscellaneous

### Extension of the Transition Period for the Single-Country Exception Under Section 903 of the Internal Revenue Code

Notice 2023-31

#### SECTION 1. PURPOSE

This notice announces that the Department of the Treasury (Treasury Department) and the Internal Revenue Service (IRS) intend to provide a longer transition period for the documentation requirement in proposed § 1.903-1(c)(2)(iv)(D) (the documentation requirement) when the exception to the source-based attribution requirement in proposed § 1.903-1(c)(2)(iii)(B) (the single-country exception) is finalized.<sup>1</sup>

#### SECTION 2. BACKGROUND

Section 901 of the Internal Revenue Code (Code) allows a credit for foreign income, war profits, and excess profits taxes, and section 903 provides that such taxes include a tax in lieu of a generally-imposed foreign income, war profits, or excess profits tax. A foreign tax is a creditable net income tax only if the determination of the foreign tax base conforms in essential respects to the determination of taxable income under

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<sup>1</sup> Unless otherwise specified, all “section” or “§” references are to sections of the Code or the Income Tax Regulations (26 CFR part 1).

the Code. To meet this test, a foreign tax must satisfy the net gain requirement, which comprises the realization requirement, the gross receipts requirement, the cost recovery requirement (formerly the net income requirement), and the attribution requirement.

The attribution requirement in § 1.901-2(b)(5) requires that a foreign tax conform to the concepts of taxing jurisdiction reflected in the Code that define an income tax in the U.S. sense. With respect to a foreign tax imposed on nonresident taxpayers, the attribution requirement limits the scope of gross receipts and costs included in the base of a foreign tax to those that satisfy the activities-based attribution, source-based attribution, or property-based attribution tests. § 1.901-2(b)(5)(i).

Under the source-based attribution requirement in § 1.901-2(b)(5)(i)(B), a foreign tax imposed on the nonresident's income on the basis of source meets the attribution requirement only if the foreign tax law's sourcing rules are reasonably similar to the sourcing rules that apply for Federal income tax purposes. In the case of gross income arising from royalties, § 1.901-2(b)(5)(i)(B)(2) provides that the foreign tax law must source royalties based on the place of use of, or the right to use, the intangible property, consistent with how the Code sources royalty income.

For foreign withholding taxes, § 1.903-1(c)(2)(iii) provides that the foreign withholding tax must meet the source-based attribution requirement in § 1.901-2(b)(5)(i)(B) to qualify as a "covered withholding tax" that may be creditable as a tax in lieu of an income tax. Thus, a withholding tax on a royalty payment is creditable only if the foreign tax law sources royalties based upon the place of use of, or the right to use, the intangible property, consistent with how the Code sources royalty income.

On November 22, 2022, the Treasury Department and the IRS published proposed regulations (REG-112096-22) in the Federal Register (87 FR 71271) (the 2022 FTC proposed regulations). The 2022 FTC proposed regulations provide a limited exception to the source-based attribution requirement for withholding taxes on certain royalty payments. Under proposed § 1.903-1(c)(2)(iii), a tested foreign tax satisfies the source-based attribution requirement if the tax meets either the source-based attribution requirement or the single-country exception. In general, the single-country exception applies if (1) the income subject to the tested foreign tax is characterized as royalty income under the foreign tax law,<sup>2</sup> and (2) the payment giving rise to such income is made pursuant to a single-country license (such license, the required agreement). Proposed § 1.903-1(c)(2)(iii)(B).

Under the documentation requirement, the required agreement pursuant to which the royalty is paid must be executed no later than the date on which the royalty is paid. However, recognizing that the single-country exception is proposed to be applicable to periods preceding the release of the 2022 FTC proposed regulations, proposed § 1.903-1(c)(2)(iv)(D) provides a special transition documentation rule for royalties paid on or before May 17, 2023 (the transition documentation rule). Under the transition documentation rule, the required agreement must be executed no later than May 17, 2023, and the agreement must state (whether in the terms of the agreement or in

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<sup>2</sup> Income from the sale of a copyrighted article (as determined under rules similar to § 1.861-18) is not characterized as royalty income regardless of the characterization of the income under the foreign tax law.

recitals) that royalties paid on or before the execution of the agreement are considered paid pursuant to the terms of the agreement. According to the preamble to the 2022 FTC proposed regulations, taxpayers may choose to rely on the provisions addressing the attribution requirement for royalty payments (proposed § 1.901-2(b)(5)(i)(B)(2) and (d)(1)(iii) and proposed § 1.903-1(c)(2) and (d)(3), (4), and (8) through (11)) for foreign taxes paid in taxable years beginning on or after December 28, 2021, and ending before the effective date of final regulations adopting these rules.

The Treasury Department and the IRS have received comments with respect to the 2022 FTC proposed regulations, including with respect to the documentation requirement for the single-country exception. The Treasury Department and the IRS are considering those comments.

### SECTION 3. EXTENSION OF THE TRANSITION PERIOD FOR THE DOCUMENTATION REQUIREMENT

To allow for an orderly implementation of the requirements of the single-country exception, including for relevant periods before the finalization of the single-country exception, the Treasury Department and the IRS intend to modify the transition documentation rule when the single-country exception in proposed § 1.903-1(c)(2)(iii)(B) is finalized to provide that the required agreement must be executed no later than 180 days after the date final regulations adopting the single-country exception are filed with the Federal Register.

### SECTION 4. TAXPAYER RELIANCE

Consistent with the preamble to the 2022 FTC proposed regulations, taxpayers

may rely on Section 3 of this notice for foreign taxes paid in taxable years beginning on or after December 28, 2021, and ending before the effective date of final regulations adopting the single-country exception, provided that the foreign tax is otherwise eligible for the single-country exception under the 2022 FTC proposed regulations.

#### SECTION 5. DRAFTING INFORMATION

The principal author of this notice is Teisha M. Ruggiero of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Ms. Ruggiero at (646) 259-8116 (not a toll-free call).