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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

TD 9218

RIN 1545-BE16

Exclusions from Gross Income of Foreign Corporations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final rule; delay of effective date.

SUMMARY: This document amends the applicability date of final regulations under sections 883(a) and (c) (TD 9087) which were published in the **Federal Register** on August 26, 2003 (68 FR 51394). Those final regulations relate to income derived by a foreign corporation from the international operation of ships or aircraft.

DATES: Effective Date: These regulations are effective August 8, 2005.

Applicability Date: These regulations are applicable to taxable years of foreign corporations beginning after September 24, 2004.

FOR FURTHER INFORMATION CONTACT: Patricia Bray, (202) 622-3880 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Sections 883(a)(1) and (a)(2) of the Internal Revenue Code (Code) provide that income derived by a foreign corporation from the international operation of

ships or aircraft may be excluded from gross income.

In 2003, the Treasury Department and the IRS issued final regulations under section 883 applicable to taxable years of a foreign corporation beginning 30 days or more after August 26, 2003. The final regulations 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 U.S. Federal income taxation, provided that the corporation can satisfy certain stock ownership and related documentation requirements.

The regulations provide that a foreign corporation may satisfy the stock ownership requirement if it meets one of three tests under §1.883-1(c)(2). One such test provides that a controlled foreign corporation, as defined in section 957(a) (CFC), satisfies the stock ownership test of §1.883-1(c)(2) if it meets the requirements of §1.883-3, including the income inclusion test of §1.883-3(b). The income inclusion test requires that more than 50 percent of the adjusted net foreign base company income derived by the CFC from the international operation of a ships or aircraft be includible in the gross income of one or more U.S. citizens, individual residents of the United States, or domestic corporations.

Need for Change

Pursuant to section 423 of the American Jobs Creation Act of 2004, 118 Stat. 1418 (2004), Public Law 108-357 (AJCA), the applicability date of the final regulations under section 883 is delayed for one year, so that they apply to taxable years of foreign corporations seeking qualified foreign corporation status

beginning after September 24, 2004. This regulation makes the conforming changes to the final regulations.

Request for Comments

Pursuant to section 415 of AJCA, sections 954(a)(4) and 954(f), relating to foreign base company shipping income, were repealed effective for taxable years of foreign corporations beginning after December, 31, 2004, and for taxable years of U.S. shareholders with or within which such taxable years of the foreign corporations end. Questions have arisen as to the proper interpretation of §1.883-3(b) in light of the statutory amendments to section 954. Foreign corporations have expressed concern that they may no longer satisfy the CFC test if they no longer derive foreign base company income from the international operation of their ships or aircraft as a result of the statutory amendments to sections 954(a)(4) and (f).

The IRS and the Treasury Department believe the better interpretation of §1.883-3(b) is that a CFC that satisfied the CFC test prior to the effective date of the new legislation may continue to satisfy it after the effective date of the new legislation, provided the CFC can demonstrate that had sections 954(a)(4) and (f) not been repealed, more than 50 percent of its current earnings and profits derived from its international operation of ships or aircraft would have been attributable to amounts includible in the gross income of one or more U.S. citizens, individual residents of the United States or domestic corporations (pursuant to section 951(a)(1)(A) or another provision of the Code) for the taxable years of such persons in which the taxable year of the CFC ends.

Conversely, a CFC will not qualify for the exception if it cannot make such a showing.

The IRS and the Treasury Department expect to revise this section of the regulations to clarify this point. Comments are invited on the most appropriate way to accomplish this goal consistent with the principles of the existing regulations and AJCA.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. The collection of information referenced in this rule was previously reviewed by the Office of Management and Budget and approved under control number 1545-1677. The collection of information referenced in these regulations also was previously certified not to have a significant economic impact on a substantial number of small entities. This certification was based upon the fact that these regulations apply to foreign corporations and impose only a limited collection of information burden on shareholders of such corporations, which in some cases may include U. S. small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) was not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations (REG-208280-86; REG-136311-01; 67

FR 50510) was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

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

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

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

Par. 2. Section 1.883-5 is revised to read as follows:

§1.883-5 Effective dates.

(a) General rule. Sections 1.883-1 through 1.883-4 apply to taxable years of a foreign corporation seeking qualified foreign corporation status beginning after September 24, 2004.

(b) Election for retroactive application. Taxpayers may elect to apply §§1.883-1 through 1.883-4 for any open taxable year of the foreign corporation beginning after December 31, 1986, except that the substantiation and reporting requirements of §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 the stock ownership test) will not apply to any year beginning before September 25, 2004. Such election shall apply to the taxable year of the election and to all subsequent taxable years beginning before September 25, 2004.

(c) Transitional information reporting rule. For taxable years of the foreign corporation beginning after September 24, 2004, and until such time as the Form 1120-F, "U.S. Income Tax Return of a Foreign Corporation," or its instructions

are revised to provide otherwise, 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 attached to the Form 1120-F and filed with the return.

Deputy Commissioner for Services and Enforcement.
Mark E. Mathews

Approved: June 24, 2005

Acting Deputy Assistant Secretary of the Treasury (Tax Policy).
Eric Solomon