

## HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

### INCOME TAX

#### **Rev. Rul. 2000-28, page 1157.**

**Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term exempt rate.** For purposes of sections 1274, 1288, 382, and other sections of the Code, tables set forth the rates for June 2000.

#### **T.D. 8881, page 1158.**

Amendments to final regulations (T.D. 8734, 1997-2 C.B. 109) relate to the withholding of income tax under section 1441 of the Code on certain U.S. source income paid to foreign persons.

#### **T.D. 8882, page 1150.**

Final regulations under section 356 of the Code relate to nonqualified preferred stock and rights to acquire nonqualified preferred stock, as defined in section 351(g)(2).

#### **T.D. 8883, page 1151.**

Final regulations under section 1032 of the Code relate to the treatment of a disposition by a corporation or partnership of the stock of a corporation in a taxable transaction. Rev. Rul. 80-76 obsoleted.

#### **REG-106186-98, page 1226.**

Proposed regulations under section 368 of the Code provide that mergers involving Disregarded Entities do not qualify for

tax-free treatment because the mergers do not result in the combination of the assets and liabilities of two corporations pursuant to the state or federal merger law. A public hearing is scheduled for August 8, 2000.

#### **REG-107644-98, page 1229.**

Proposed regulations under section 472 of the Code relate to the dollar-value last-in, first-out (LIFO) and inventory price index computation (IPIC) methods of accounting for inventories. A public hearing is scheduled for September 15, 2000.

#### **Notice 2000-29, page 1241.**

**Partnership options and convertible instruments.** This notice invites public comment on the federal income tax treatment of the exercise of an option to acquire a partnership interest, the exchange of convertible debt for a partnership interest, and the exchange of a preferred interest in a partnership for a common interest in that partnership.

### ADMINISTRATIVE

#### **Announcement 2000-48, page 1243.**

This announcement provides additional information relating to Rev. Proc. 2000-12 for financial institutions that are considering entering into a qualified intermediary agreement with the Internal Revenue Service.

Actions Relating to Court Decisions is on the page following the Introduction.

Finding Lists begin on page ii.

Announcements of Disbarments and Suspensions begin on page 1244.

Index for January through May begins on page vi.



# The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities

and by applying the tax law with integrity and fairness to all.

## Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and proce-

dures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

### **Part I.—1986 Code.**

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

### **Part II.—Treaties and Tax Legislation.**

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

### **Part III.—Administrative, Procedural, and Miscellaneous.**

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

### **Part IV.—Items of General Interest.**

This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The first Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the first Bulletin of the succeeding semiannual period, respectively.

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## Actions Relating to Decisions of the Tax Court

It is the policy of the Internal Revenue Service to announce at an early date whether it will follow the holdings in certain cases. An Action on Decision is the document making such an announcement. An Action on Decision will be issued at the discretion of the Service only on unappealed issues decided adverse to the government. Generally, an Action on Decision is issued where its guidance would be helpful to Service personnel working with the same or similar issues. Unlike a Treasury Regulation or a Revenue Ruling, an Action on Decision is not an affirmative statement of Service position. It is not intended to serve as public guidance and may not be cited as precedent.

Actions on Decisions shall be relied upon within the Service only as conclusions applying the law to the facts in the particular case at the time the Action on Decision was issued. Caution should be exercised in extending the recommendation of the Action on Decision to similar cases where the facts are different. Moreover, the recommendation in the Action on Decision may be superseded by new legislation, regulations, rulings, cases, or Actions on Decisions.

Prior to 1991, the Service published acquiescence or nonacquiescence only in

certain regular Tax Court opinions. The Service has expanded its acquiescence program to include other civil tax cases where guidance is determined to be helpful. Accordingly, the Service now may acquiesce or nonacquiesce in the holdings of memorandum Tax Court opinions, as well as those of the United States District Courts, Claims Court, and Circuit Courts of Appeal. Regardless of the court deciding the case, the recommendation of any Action on Decision will be published in the Internal Revenue Bulletin.

The recommendation in every Action on Decision will be summarized as acquiescence, acquiescence in result only, or nonacquiescence. Both “acquiescence” and “acquiescence in result only” mean that the Service accepts the holding of the court in a case and that the Service will follow it in disposing of cases with the same controlling facts. However, “acquiescence” indicates neither approval nor disapproval of the reasons assigned by the court for its conclusions; whereas, “acquiescence in result only” indicates disagreement or concern with some or all of those reasons. “Nonacquiescence” signifies that, although no further review was sought, the Service does not agree with the holding of the court and, gener-

ally, will not follow the decision in disposing of cases involving other taxpayers. In reference to an opinion of a circuit court of appeals, a “nonacquiescence” indicates that the Service will not follow the holding on a nationwide basis. However, the Service will recognize the precedential impact of the opinion on cases arising within the venue of the deciding circuit.

The Actions on Decisions published in the weekly Internal Revenue Bulletin are consolidated semiannually and appear in the first Bulletin for July and the Cumulative Bulletin for the first half of the year. A semiannual consolidation also appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in the following decision:

**Diane Fernandez v. Commissioner,**<sup>1</sup>  
114 T.C. No. 21

The Commissioner ACQUIESCES in result only in the following decision:

**Osteopathic Medical Oncology and Hematology, P.C. v. Commissioner,**<sup>2</sup>  
113 T.C. No. 26

<sup>1</sup> Acquiescence relating to whether the Tax Court has jurisdiction to review the Service's determination that a spouse is not entitled to relief under I.R.C. section 6015.

<sup>2</sup> Acquiescence in result only relating to whether the administration of chemotherapy drugs arising from the provision of medical services constitutes the sale of merchandise within the meaning of Treas. Reg. section 1.471-1.

# Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

## Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2000. See Rev. Rul. 2000–28, page 1157.

## Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of June 2000. See Rev. Rul. 2000–28, page 1157.

## Section 356.—Receipt for Additional Consideration

*26 CFR 1.356–6: Rules for treatment of nonqualified preferred stock as other property.*

### T.D. 8882

## DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

## Reorganizations; Nonqualified Preferred Stock

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to nonqualified preferred stock and rights to acquire nonqualified preferred stock. The regulations are necessary to reflect changes to the law concerning these instruments that were made by the Taxpayer Relief Act of 1997. The regulations affect shareholders who receive nonqualified preferred stock, or rights to acquire such stock, in certain corporate reorganizations and divisions.

EFFECTIVE DATE: These regulations are effective May 16, 2000.

FOR FURTHER INFORMATION CONTACT: Michael J. Danbury, (202) 622-7750 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

## Background and Explanation of Provisions

On January 6, 1998, temporary regulation TD 8753 (1998–9 I.R.B. 6 [63 F.R. 411]) was published in the **Federal Register**. A notice of proposed rulemaking (REG–121755–97, 1998–9 I.R.B. 13) cross-referencing the temporary regulation was published in the **Federal Register** (63 F.R. 453) on the same day.

The temporary regulation provided that, notwithstanding contemporaneously issued final regulations treating certain rights to acquire stock as securities that can be received tax-free in corporate reorganizations and divisions, nonqualified preferred stock (as defined in section 351(g)(2) of the Internal Revenue Code) (NQPS), or a right to acquire NQPS, will in some circumstances not be treated as stock or securities for purposes of sections 354, 355, and 356. The temporary regulation added §1.356–6T, and applied to NQPS received in connection with a transaction occurring on or after March 9, 1998 (other than certain recapitalizations of family-owned corporations and transactions described in section 1014(f)(2) of the Taxpayer Relief Act of 1997, Public Law 105–34, 111 Stat. 788, 921). No written comments responding to the notice of proposed rulemaking were received, and no public hearing was requested or held.

The regulation proposed by REG–121755–97 is adopted by this Treasury decision, and the corresponding temporary regulation is removed. Cross-references to the temporary regulation in §§1.354–1(e), 1.355–1(c), and 1.356–3(b) have been removed and replaced with cross-references to the final regulation at §1.356–6.

## 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. Because the regulations do not impose a collection of information on small

entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations 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 Michael J. Danbury of the Office of Assistant Chief Counsel (Corporate). However, other personnel from the IRS and Treasury participated in their development.

\* \* \* \* \*

## Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

### PART 1—INCOME TAXES

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

Authority: 26 U.S.C. 7805 \* \* \* Section 1.356–6 also issued under 26 U.S.C. 351(g)(4). \* \* \*

### §1.354–1 [Amended]

Par. 2. In §1.354–1, paragraph (e), first sentence, the language “§1.356–6T” is removed and “§1.356–6” is added in its place.

### §1.355–1 [Amended]

Par. 3. In §1.355–1, paragraph (c), first sentence, the language “§1.356–6T” is removed and “§1.356–6” is added in its place.

### §1.356–3 [Amended]

Par. 4. In §1.356–3, paragraph (b), first sentence, the language “§1.356–6T” is removed and “§1.356–6” is added in its place.

Par. 5. Section 1.356–6T is redesignated as §1.356–6 and the section heading is revised to read as follows:

*§1.356–6 Rules for treatment of nonqualified preferred stock as other property.*

\* \* \* \* \*

Robert E. Wenzel,  
Deputy Commissioner  
of Internal Revenue.

Approved May 5, 2000.

Jonathan Talisman,  
Deputy Assistant Secretary  
of the Treasury.

### **Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change**

The adjusted applicable federal long-term rate is set forth for the month of June 2000. See Rev. Rul. 2000–28, page 1157.

### **Section 412.—Minimum Funding Standards**

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2000. See Rev. Rul. 2000–28, page 1157.

### **Section 467.—Certain Payments for the Use of Property or Services**

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2000. See Rev. Rul. 2000–28, page 1157.

### **Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs**

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2000. See Rev. Rul. 2000–28, page 1157.

### **Section 482.—Allocation of Income and Deductions Among Taxpayers**

Federal short-term, mid-term, and long-term rates are set forth for the month of June 2000. See Rev. Rul. 2000–28, page 1157.

### **Section 483.—Interest on Certain Deferred Payments**

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2000. See Rev. Rul. 2000–28, page 1157.

### **Section 642.—Special Rules for Credits and Deductions**

Federal short-term, mid-term, and long-term rates are set forth for the month of June 2000. See Rev. Rul. 2000–28, page 1157.

### **Section 807.—Rules for Certain Reserves**

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2000. See Rev. Rul. 2000–28, page 1157.

### **Section 846.—Discounted Unpaid Losses Defined**

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2000. See Rev. Rul. 2000–28, page 1157.

### **Section 1032.—Exchange of Stock for Property**

*26 CFR 1.1032-2: Disposition by a corporation of stock of a controlling corporation in certain triangular reorganizations.*

**T.D. 8883**

### **DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1**

### **Guidance Under Section 1032 Relating to the Treatment of a Disposition by an Acquiring Entity of the Stock of a Corporation in a Taxable Transaction**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Final regulations.

**SUMMARY:** This document contains final regulations relating to the treatment of a disposition by a corporation or partnership (the acquiring entity) of the stock of a corporation (the issuing corporation) in a taxable transaction. The final regulations interpret section 1032 of the Internal Revenue Code. They affect persons engaging in certain taxable transactions, as described in the final regulations, occurring after May 16, 2000.

**EFFECTIVE DATE:** These regulations are effective May 16, 2000.

FOR FURTHER INFORMATION CONTACT: Filiz Serbes, (202) 622-7550 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

### **Background**

On September 23, 1998, the Treasury and the IRS issued a notice of proposed rulemaking in the Federal Register (63 FR 50816), setting forth rules relating to the treatment of a disposition by a corporation (the acquiring corporation) of the stock of another corporation (the issuing corporation) in a taxable transaction. A public hearing regarding these proposed regulations was held on January 7, 1999. Written comments responding to the notice were received. After consideration of all of the comments, the proposed regulations are adopted as revised by this Treasury decision.

### *Explanation of Revisions and Summary of Comments*

### **The Immediacy Requirement**

The proposed regulations adopted a cash purchase model in which certain transactions involving a contribution of issuing corporation stock by an issuing corporation to an acquiring corporation are recast as a contribution of cash by the issuing corporation to the acquiring corporation to purchase issuing corporation stock from the issuing corporation. As a condition for application of the cash purchase model of the proposed regulations, the proposed regulations adopted the requirement of §1.1502-13(f)(6)(ii)(B) that the issuing corporation stock received by the acquiring corporation be immediately transferred to acquire money or other property.

A number of commentators requested that the term “immediately” be explicitly defined. Some suggested replacing the temporal requirement with a transactional approach, requiring only that the stock be disposed of “pursuant to a plan of acquisition.” Others suggested that the immediacy requirement be waived in certain circumstances, such as with respect to a nonqualified deferred compensation arrangement involving a grantor trust (commonly referred to as a “Rabbi Trust”) that is established to provide fu-

ture benefits to the employees of an acquiring corporation and that is funded with issuing corporation stock.

After considering the purposes of section 1032 and issues of administrative burden and technical complexity, the Treasury and the IRS believe that the immediacy requirement should neither be waived nor construed to permit the acquiring corporation to hold issuing corporation stock for a period of time during which the value of the stock could fluctuate.

The Treasury and the IRS believe that, in a case where the issuing corporation contributes its stock to the acquiring corporation and the acquiring corporation does not immediately dispose of that stock, it is not appropriate to increase the basis of either the issuing corporation stock transferred to the acquiring corporation or the stock of the acquiring corporation held by the issuing corporation. In the cases addressed by the proposed regulations, in which the acquiring corporation exchanges the stock immediately for property owned by a third party, the transaction is indistinguishable from one in which the issuing corporation directly exchanges its stock for the property of the third party (an exchange to which section 1032 would apply) and contributes that property to the acquiring corporation, a transaction whose tax result would be the same as the cash purchase model set forth in the proposed regulations. However, in cases where the acquiring corporation's ownership of the issuing corporation stock is more than transitory, there appears to be no comparable transaction which would generate the same tax consequences as the cash purchase model.

Implementation of an approach that waives the immediacy requirement would raise administrative and policy concerns. If the acquiring corporation were to be permitted to hold the issuing corporation stock for a period of time, the regulations would have to adopt one of two alternative approaches. Under the first alternative, the regulations would provide that the cash purchase model would be deemed to apply at the time that the stock is contributed to the acquiring corporation, giving the acquiring corporation a fair market value basis in the stock. However, such an approach would raise at least two concerns. First, in the case that the issuing corporation stock is not pub-

licly traded, such an approach would impose administrative burdens requiring a valuation of the stock at a time when there is no related transaction to assist in such valuation. Thus, there is a potential for the stock to be overvalued, with a result of inflating the basis in both the contributed issuing corporation stock and the acquiring corporation stock held by the issuing corporation.

Second, even if the valuation were accurate, providing for the cash purchase model on the date of the contribution would facilitate selective loss recognition. If the acquiring corporation could receive the stock at a fair market value basis and hold on to it, then if the value of the stock decreased, the subsidiary could sell the stock and recognize a loss. The Treasury and the IRS believe that it is inappropriate to issue regulations facilitating selective loss recognition.

Under the second alternative, the regulations would suspend the operation of the cash purchase model until such time as the acquiring corporation actually disposes of the issuing corporation stock. However, such an approach also would give rise to inappropriate tax results. In addition to precluding gain recognition attributable to the zero basis result, this alternative would allow a subsidiary to avoid recognition of gain attributable to real appreciation in this asset.

Assume, for example, a case where the issuing corporation contributes issuing corporation stock worth \$100 to the acquiring corporation, the acquiring corporation retains that stock while it appreciates to \$300, and then sells the stock for \$300 in cash. Absent an immediacy requirement, under the second alternative, the acquiring corporation would be deemed to have purchased the stock for \$300 in cash contributed by the issuing corporation immediately before the sale of the stock to the third party. As a result, the acquiring corporation would not recognize any gain or loss, and the issuing corporation would increase its basis in the stock of the acquiring corporation by \$300. More than merely avoiding a zero basis result (i.e., taxation on the \$100 value in the stock when contributed to the acquiring corporation), neither the acquiring corporation nor the issuing corporation would ever be taxed on the further \$200 in appreciation of the issuing corpo-

ration stock which occurred while such stock was held by the acquiring corporation. Such a result, which effectively would provide full section 1032 protection for a subsidiary's gain in certain parent stock, would go well beyond addressing the zero basis result, the scope of these regulations.

Because each of those alternatives would be unsatisfactory for the reasons discussed above, the final regulations retain the immediacy requirement without further exception.

Consistent with that determination, and as in the case of any other transaction, the cash purchase model of these regulations applies to arrangements involving Rabbi Trusts only if the immediacy requirement is satisfied. Thus, these regulations do not apply to Rabbi Trust arrangements in which the stock of an issuing corporation is treated for federal tax purposes as owned for a period of time by its subsidiary. However, the Treasury and the IRS have reconsidered certain aspects of Rabbi Trust arrangements and have determined that the fact that trust assets are subject to the claims of creditors of the subsidiary corporation does not necessarily establish that the subsidiary should be treated as a grantor of the trust at the time the trust is funded. Guidance regarding the effects of this reconsideration on existing Rabbi Trusts will be forthcoming. In addition, the final regulations contain a new example describing an arrangement in which the issuing corporation (and not the subsidiary) is treated as the grantor and owner of the Rabbi Trust, with the result that the immediacy requirement is satisfied upon the transfer of issuing corporation stock by the trust to the subsidiary's employees.

Taxpayers could have reasonably anticipated that Rabbi Trust arrangements could not be structured without causing subsidiaries to be treated as grantors and owners of the trust. For that reason and because of the potential ambiguities in interpreting Rev. Rul. 80-76 (1980-1 C.B. 15), the IRS will not challenge a taxpayer's position that no gain is recognized by an acquiring corporation upon the disposition by a Rabbi Trust, established on or before June 15, 2000, of issuing corporation stock if that stock was contributed by the issuing corporation to the Rabbi Trust on or before May 16, 2001.

### Exchanges by the Acquiring Corporation of Stock of the Issuing Corporation for Other Issuing Corporation Stock

Commentators noted that, unlike §1.1502-13(f)(6)(ii), the recast of the proposed regulations applies even where the acquiring corporation exchanges stock of the issuing corporation for other issuing corporation stock. Allowing a subsidiary to receive parent stock it immediately swaps for other parent stock, which it could hold long term with a cost basis, would facilitate selective loss recognition with respect to parent stock by a subsidiary. Accordingly, the final regulations adopt, as a precondition for the recast, a requirement that the issuing corporation stock not be exchanged for other issuing corporation stock.

### Exchanges by the Acquiring Corporation of Stock of the Issuing Corporation for Acquiring Corporation Debt

Commentators contended that it is unclear whether the proposed regulations are applicable when the acquiring corporation uses issuing corporation stock to satisfy acquiring corporation debt. The Treasury and the IRS believe that the regulations do apply to an exchange of issuing corporation stock for acquiring corporation debt. Although section 1032 refers to an exchange for money or other property and does not expressly refer to exchanges of stock for debt, it is generally acknowledged that section 1032 applies to an exchange of a corporation's stock for its debt, subject to sections 61(a)(12) and 108, which provide that a corporation may have income from a cancellation of indebtedness on an exchange of its stock for its own debt (that is, cancellation of indebtedness income can be realized and recognized when debt is satisfied with stock of the debtor corporation, even though no gain is recognized on the issuance of the stock). Similarly, therefore, the requirement set forth in these regulations that the acquiring corporation transfer issuing corporation stock to acquire money or other property is satisfied where the stock is used to satisfy acquiring corporation debt (although the acquiring corporation may be subject to sections 61(a)(12) and 108). No modifications to the language of the final regulations are needed to achieve this result.

Similarly, a commentator expressed concern that the proposed regulations do not expressly apply to an acquiring corporation's exchange of issuing corporation stock for the acquiring corporation's own outstanding acquiring corporation stock held by a shareholder other than the issuing corporation. The Treasury and the IRS believe that the regulations do apply to such an exchange.

### Acquiring Corporation's Use of Issuing Corporation's Debt

Commentators also requested that the regulations be extended to issuing corporation debt instruments used by the acquiring corporation to acquire money or other property from unrelated third parties. Because section 1032 only refers to corporate stock, debt instruments are beyond the scope of these final regulations.

### Reorganizations Coupled with Taxable Transactions

The proposed regulations do not apply if any party to the exchange receives a substituted basis in the issuing corporation stock. Commentators suggested that the final regulations provide that the above rule does not preclude application of the final regulations if a taxable exchange of issuing corporation stock for property accompanies a reorganization.

The Treasury and the IRS believe that a taxable transaction to which the regulations apply can accompany a reorganization, provided that the exchanges are separate and that the assets acquired in the taxable transaction and the assets acquired as part of the reorganization can be identified. If these elements can be established, the substituted basis prohibition should not preclude application of the final regulations to the taxable portion of the exchange. Accordingly, clarifying language has been added to §1.1032-3(c)(3).

### Options Without a Readily Ascertainable Fair Market Value

Several commentators asked how the proposed regulations apply to a compensatory stock option without a readily ascertainable fair market value. Pursuant to section 83(e)(3) and §1.83-7(a), the grant of such options is effectively treated as an open transaction. Section §1.83-7(a) pro-

vides that section 83(a) and (b) applies at the time the option is exercised or is otherwise disposed of. An example has been added to confirm that the final regulations do not apply to such options.

When the option is exercised, section 83(a) and (b) applies to the transfer of stock pursuant to the exercise. If all of the requirements of §1.1032-3 are met, those regulations apply to determine the treatment accorded the issuing corporation and the acquiring corporation upon transfer of the issuing corporation stock to the employee.

### Reversionary Interest in Issuing Corporation Stock

*Examples 4 and 5* of the proposed regulations set forth situations in which either the issuing corporation (*X*) or the acquiring corporation (*Y*) retains a reversionary interest in the issuing corporation stock. One commentator pointed out that the preamble of the proposed regulations does not articulate reasons for concern with reversionary interests.

These facts were included in the examples in the proposed regulations to indicate ownership of the stock for tax purposes. *Example 6* of the final regulations has been modified to state that *X* retains the only reversionary interest in the *X* stock in the event that *A* forfeits the right to the stock.

### Actual Payment for Issuing Corporation Stock

Under the cash purchase model of the proposed regulations, the acquiring corporation is deemed to have purchased the issuing corporation stock from the issuing corporation for fair market value with cash contributed to the acquiring corporation by the issuing corporation. Commentators requested clarification of the tax consequences in cases where the acquiring corporation or another party makes an actual payment to the issuing corporation for issuing corporation stock. Specifically, concern was expressed as to whether any or all of the amounts actually paid to the issuing corporation are treated as a distribution by the acquiring corporation to the issuing corporation. Assume, for example, that the issuing corporation, which owns all the stock of the acquiring corporation, transfers an option for issuing corporation stock to an employee of

the acquiring corporation. At a time when one share of issuing corporation stock has a fair market value of \$100, that employee exercises the option to acquire one share of issuing corporation stock and pays a strike price of \$80 to the issuing corporation. The acquiring corporation pays some or all of the “spread” of \$20 to the issuing corporation.

The Treasury and the IRS do not believe that an actual payment to the issuing corporation for issuing corporation stock should be taxed as a distribution with respect to acquiring corporation stock. Accordingly, the final regulations have been modified to provide that the amount of cash deemed contributed by the issuing corporation to the acquiring corporation in the cash purchase model is equal to the difference between the fair market value of the issuing corporation stock and the fair market value of the money or other property received by the issuing corporation as payment from the employee or the acquiring corporation. An example to such effect has been added to the final regulations.

Although in other contexts partial payments received by a shareholder of an acquiring corporation should be characterized as boot under section 351(b), these final regulations integrate such payments into the cash purchase model described above. Because the property transferred by the issuing corporation to the acquiring corporation in this context is the issuing corporation’s stock (or is deemed to be cash under the recast of these regulations), characterization of the payment as boot in this context would have no effect. No inference should be drawn from the recast in the final regulations to transactions in which a shareholder receives money or other property in exchange for property other than its own stock.

Section 1.83–6 is currently under study. A cross-reference in §1.83–6(d) to these final regulations has been added to indicate that the mechanics of §1.1032–3, rather than the mechanics of §1.83–6(d), apply to a corporate shareholder’s transfer of its own stock to any person in consideration of services performed for another entity where the conditions of the final regulations are satisfied.

#### Applicability of the Final Regulations in the Partnership Context

Consistent with a suggestion by com-

mentators that the regulations be expanded to apply to transactions involving partnerships, the final regulations treat an acquiring partnership’s disposition of the stock of the issuing corporation in the same manner as an acquiring corporation’s disposition of such stock. The regulations also have been expanded to apply to transactions in which the stock of the issuing corporation is obtained indirectly by the acquiring entity in any combination of exchanges under sections 721 and 351.

In certain situations where the recast of the final regulations does not apply to the disposition by a partnership of a corporate partner’s stock (for example, because the immediacy requirement is not satisfied), realized gain or loss that is allocated to that corporate partner may nonetheless not be recognized pursuant to section 1032. See Rev. Rul. 99–57 (1999–51 I.R.B. 678).

#### Status of §1.1502–13(f)(6)(ii)

The Treasury and the IRS believe that the finalization of these §1.1032–3 regulations renders §1.1502–13(f)(6)(ii) superfluous because there should be no cases which would be subject to recast under §1.1502–13(f)(6)(ii), but in which a member would “otherwise recognize gain” as required for §1.1502–13(f)(6)(ii) to apply. Accordingly, the effective date paragraph in the §1.1502–13(f)(6) regulations has been modified to limit the applicability of §1.1502–13(f)(6)(ii) and the last sentence of §1.1502–13(f)(6)(iv)(A) to periods before the effective date of these regulations.

#### Status of Rev. Rul. 80–76

The preamble to the proposed regulations states that Rev. Rul. 80–76 (1980–1 C.B. 15) addresses the same issues as the proposed regulations and that, when finalized, the regulations will render Rev. Rul. 80–76 obsolete. In Rev. Rul. 80–76, a majority shareholder of parent transfers parent stock to an employee of its subsidiary corporation as compensation. The holding of the revenue ruling that the subsidiary does not recognize gain or loss on the transfer of the parent stock is now governed by these regulations. An example has been added to the final regulations to clarify how general tax principles (see *Commissioner v. Fink*, 483 U.S. 89 (1987)) and these final regulations inter-

act when a shareholder of the parent/issuing corporation compensates an employee of the subsidiary/acquiring corporation. With the finalization of these regulations, Rev. Rul. 80–76 is obsolete.

#### Additional Issues and Future Guidance

Since issuance of the proposed regulations, commentators have raised questions regarding the tax treatment of restricted stock and options granted to employees before or in connection with a transaction in which an issuing corporation distributes the stock of the acquiring corporation under section 355 (commonly referred to as a “spin off”). For example, assume that employees of both X corporation and its subsidiary Y corporation have outstanding options to acquire stock in X corporation. In connection with a spin off of the Y stock by X, the employees of both corporations have their outstanding options converted into options to acquire stock of both X and Y, with option terms preserving the overall values of the original options. Commentators have requested guidance on the tax consequences to X when, after the spin off, employees of X exercise options to acquire Y stock and, likewise, the tax consequences to Y when, after the spin off, employees of Y exercise options to acquire X stock. Guidance addressing these issues will be forthcoming.

#### Effective Date

Commentators suggested that taxpayers who engaged in transactions described in these final regulations prior to the effective date should be eligible for the tax treatment prescribed by the regulations. While the final regulations are applicable only prospectively, the IRS will not challenge a taxpayer’s position taken in a prior period that is consistent with the requirements set forth in the final regulations.

For a discussion of transitional relief concerning certain Rabbi Trust arrangements, see the discussion of the immediacy requirement above.

#### Effect on Other Documents

Rev. Rul. 80–76 (1980–1 C.B. 15) is obsolete.

#### Special Analyses

It has been determined that this Treasury decision is not a significant regula-



tory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notices of proposed rulemaking preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

### Drafting Information

The principal author of these final regulations is Filiz A. Serbes of the Office of the Assistant Chief Counsel (Corporate), IRS. However, other personnel from the IRS and the Treasury Department participated in its development.

\* \* \* \* \*

### 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 1.83-6 is amended by adding two sentences to the end of paragraph (d)(1) to read as follows:

*§1.83-6 Deduction by employer.*

\* \* \* \* \*

(d) \* \* \* (1) \* \* \* For special rules that may apply to a corporation's transfer of its own stock to any person in consideration of services performed for another corporation or partnership, see §1.1032-3. The preceding sentence applies to transfers of stock and amounts paid for such stock occurring on or after May 16, 2000.

\* \* \* \* \*

Par. 3. Section 1.1032-2 is amended by:

1. Revising paragraph (e).
2. Adding paragraph (f).

The addition and revision read as follows:

*§1.1032-2 Disposition by a corporation of stock of a controlling corporation in certain triangular reorganizations.*

\* \* \* \* \*

(e) *Stock options.* The rules of this section shall apply to an option to buy or sell P stock issued by P in the same manner as the rules of this section apply to P stock.

(f) *Effective dates.* This section applies to triangular reorganizations occurring on or after December 23, 1994, except for paragraph (e) of this section, which applies to transfers of stock options occurring on or after May 16, 2000.

Par. 4. Section 1.1032-3 is added to read as follows:

*§1.1032-3 Disposition of stock or stock options in certain transactions not qualifying under any other nonrecognition provision.*

(a) *Scope.* This section provides rules for certain transactions in which a corporation or a partnership (the acquiring entity) acquires money or other property (as defined in §1.1032-1) in exchange, in whole or in part, for stock of a corporation (the issuing corporation).

(b) *Nonrecognition of gain or loss—(1) General rule.* In a transaction to which this section applies, no gain or loss is recognized on the disposition of the issuing corporation's stock by the acquiring entity. The transaction is treated as if, immediately before the acquiring entity disposes of the stock of the issuing corporation, the acquiring entity purchased the issuing corporation's stock from the issuing corporation for fair market value with cash contributed to the acquiring entity by the issuing corporation (or, if necessary, through intermediate corporations or partnerships). For rules that may apply in determining the issuing corporation's adjustment to basis in the acquiring entity (or, if necessary, in determining the adjustment to basis in intermediate entities), see sections 358, 722, and the regulations thereunder.

(2) *Special rule for actual payment for stock of the issuing corporation.* If the issuing corporation receives money or other property in payment for its stock, the amount of cash deemed contributed under paragraph (b)(1) of this section is the difference between the fair market value of the issuing corporation stock and the amount of money or the fair market value of other property that the issuing corporation receives as payment.

(c) *Applicability.* The rules of this section apply only if, pursuant to a plan to acquire money or other property—

(1) The acquiring entity acquires stock of the issuing corporation directly or indirectly from the issuing corporation in a transaction in which, but for this section, the basis of the stock of the issuing corporation in the hands of the acquiring entity would be determined, in whole or in part, with respect to the issuing corporation's basis in the issuing corporation's stock under section 362(a) or 723;

(2) The acquiring entity immediately transfers the stock of the issuing corporation to acquire money or other property (from a person other than an entity from which the stock was directly or indirectly acquired);

(3) The party receiving stock of the issuing corporation in the exchange specified in paragraph (c)(2) of this section from the acquiring entity does not receive a substituted basis in the stock of the issuing corporation within the meaning of section 7701(a)(42); and

(4) The issuing corporation stock is not exchanged for stock of the issuing corporation.

(d) *Stock options.* The rules of this section shall apply to an option issued by a corporation to buy or sell its own stock in the same manner as the rules of this section apply to the stock of an issuing corporation.

(e) *Examples.* The following examples illustrate the application of this section:

*Example 1.* (i) X, a corporation, owns all of the stock of Y corporation. Y reaches an agreement with C, an individual, to acquire a truck from C in exchange for 10 shares of X stock with a fair market value of \$100. To effectuate Y's agreement with C, X transfers to Y the X stock in a transaction in which, but for this section, the basis of the X stock in the hands of Y would be determined with respect to X's basis in the X stock under section 362(a). Y immediately transfers the X stock to C to acquire the truck.

(ii) In this *Example 1*, no gain or loss is recognized on the disposition of the X stock by Y. Immediately before Y's disposition of the X stock, Y is treated as purchasing the X stock from X for \$100 of cash contributed to Y by X. Under section 358, X's basis in its Y stock is increased by \$100.

*Example 2.* (i) Assume the same facts as *Example 1*, except that, rather than X stock, X transfers an option with a fair market value of \$100 to purchase X stock.

(ii) In this *Example 2*, no gain or loss is recognized on the disposition of the X stock option by Y. Immediately before Y's disposition of the X stock option, Y is treated as purchasing the X stock option from X for \$100 of cash contributed to Y by X. Under section 358, X's basis in its Y stock is increased by \$100.

*Example 3.* (i) X, a corporation, owns all of the outstanding stock of Y corporation. Y is a partner in partnership Z. Z reaches an agreement with C, an individual, to acquire a truck from C in exchange for 10 shares of X stock with a fair market value of \$100. To effectuate Z's agreement with C, X transfers to Y the X stock in a transaction in which, but for this section, the basis of the X stock in the hands of Y would be determined with respect to X's basis in the X stock under section 362(a). Y immediately transfers the X stock to Z in a transaction in which, but for this section, the basis of the X stock in the hands of Z would be determined under section 723. Z immediately transfers the X stock to C to acquire the truck.

(ii) In this *Example 3*, no gain or loss is recognized on the disposition of the X stock by Z. Immediately before Z's disposition of the X stock, Z is treated as purchasing the X stock from X for \$100 of cash indirectly contributed to Z by X through an intermediate corporation, Y. Under section 722, Y's basis in its Z partnership interest is increased by \$100, and, under section 358, X's basis in its Y stock is increased by \$100.

*Example 4.* (i) X, a corporation, owns all of the outstanding stock of Y corporation. B, an individual, is an employee of Y. Pursuant to an agreement between X and Y to compensate B for services provided to Y, X transfers to B 10 shares of X stock with a fair market value of \$100. Under §1.83-6(d), but for this section, the transfer of X stock by X to B would be treated as a contribution of the X stock by X to the capital of Y, and immediately thereafter, a transfer of the X stock by Y to B. But for this section, the basis of the X stock in the hands of Y would be determined with respect to X's basis in the X stock under section 362(a).

(ii) In this *Example 4*, no gain or loss is recognized on the deemed disposition of the X stock by Y. Immediately before Y's deemed disposition of the X stock, Y is treated as purchasing the X stock from X for \$100 of cash contributed to Y by X. Under section 358, X's basis in its Y stock is increased by \$100.

*Example 5.* (i) X, a corporation, owns all of the outstanding stock of Y corporation. B, an individual, is an employee of Y. To compensate B for services provided to Y, B is offered the opportunity to purchase 10 shares of X stock with a fair market value of \$100 at a reduced price of \$80. B transfers \$80 and Y transfers \$10 to X as partial payment for the X stock.

(ii) In this *Example 5*, no gain or loss is recognized on the deemed disposition of the X stock by Y. Immediately before Y's deemed disposition of the X stock, Y is treated as purchasing the X stock from X for \$100, \$80 of which Y is deemed to have received from B, \$10 of which originated with Y, and \$10 of which is deemed to have been contributed to Y by X. Under section 358, X's basis in its Y stock is increased by \$10.

*Example 6.* (i) X, a corporation, owns stock of Y. To compensate Y's employee, B, for services provided to Y, X issues 10 shares of X stock to B, subject to a substantial risk of forfeiture. B does not have an election under section 83(b) in effect with respect to the X stock. X retains the only reversionary interest in the X stock in the event that B forfeits the right to the stock. Several years after X's transfer of the X shares, the stock vests. At the

time the stock vests, the 10 shares of X stock have a fair market value of \$100. Under §1.83-6(d), but for this section, the transfer of the X stock by X to B would be treated, at the time the stock vests, as a contribution of the X stock by X to the capital of Y, and immediately thereafter, a disposition of the X stock by Y to B. The basis of the X stock in the hands of Y, but for this section, would be determined with respect to X's basis in the X stock under section 362(a).

(ii) In this *Example 6*, no gain or loss is recognized on the deemed disposition of X stock by Y when the stock vests. Immediately before Y's deemed disposition of the X stock, Y is treated as purchasing X's stock from X for \$100 of cash contributed to Y by X. Under section 358, X's basis in its Y stock is increased by \$100.

*Example 7.* (i) Assume the same facts as in *Example 6*, except that Y (rather than X) retains a reversionary interest in the X stock in the event that B forfeits the right to the stock. Several years after X's transfer of the X shares, the stock vests.

(ii) In this *Example 7*, this section does not apply to Y's deemed disposition of the X shares because Y is not deemed to have transferred the X stock to B immediately after receiving the stock from X. For the tax consequences to Y on the deemed disposition of the X stock, see §1.83-6(b).

*Example 8.* (i) X, a corporation, owns all of the outstanding stock of Y corporation. In Year 1, X issues to Y's employee, B, a nonstatutory stock option to purchase 10 shares of X stock as compensation for services provided to Y. The option is exercisable against X and does not have a readily ascertainable fair market value (determined under §1.83-7(b)) at the time the option is granted. In Year 2, B exercises the option by paying X the strike price of \$80 for the X stock, which then has a fair market value of \$100.

(ii) In this *Example 8*, because, under section 83(e)(3), section 83(a) does not apply to the grant of the option, paragraph (d) of this section also does not apply to the grant of the option. Section 83 and §1.1032-3 apply in Year 2 when the option is exercised; thus, no gain or loss is recognized on the deemed disposition of X stock by Y in Year 2. Immediately before Y's deemed disposition of the X stock in Year 2, Y is treated as purchasing the X stock from X for \$100, \$80 of which Y is deemed to have received from B and the remaining \$20 of which is deemed to have been contributed to Y by X. Under section 358, X's basis in its Y stock is increased by \$20.

*Example 9.* (i) A, an individual, owns a majority of the stock of X. X owns stock of Y constituting control of Y within the meaning of section 368(c). A transfers 10 shares of its X stock to B, a key employee of Y. The fair market value of the 10 shares on the date of transfer was \$100.

(ii) In this *Example 9*, A is treated as making a nondeductible contribution of the 10 shares of X to the capital of X, and no gain or loss is recognized by A as a result of this transfer. See *Commissioner v. Fink*, 483 U.S. 89 (1987). A must allocate his basis in the transferred shares to his remaining shares of X stock. No gain or loss is recognized on the deemed disposition of the X stock by Y. Immediately before Y's disposition of the X stock, Y is treated as purchasing the X stock from X for \$100 of cash contributed to Y by X. Under section 358,

X's basis in its Y stock is increased by \$100.

*Example 10.* (i) In Year 1, X, a corporation, forms a trust which will be used to satisfy deferred compensation obligations owed by Y, X's wholly owned subsidiary, to Y's employees. X funds the trust with X stock, which would revert to X upon termination of the trust, subject to the employees' rights to be paid the deferred compensation due to them. The creditors of X can reach all the trust assets upon the insolvency of X. Similarly, Y's creditors can reach all the trust assets upon the insolvency of Y. In Year 5, the trust transfers X stock to the employees of Y in satisfaction of the deferred compensation obligation.

(ii) In this *Example 10*, X is considered to be the grantor of the trust, and, under section 677, X is also the owner of the trust. Any income earned by the trust would be reflected on X's income tax return. Y is not considered a grantor or owner of the trust corpus at the time X transfers X stock to the trust. In Year 5, when employees of Y receive X stock in satisfaction of the deferred compensation obligation, no gain or loss is recognized on the deemed disposition of the X stock by Y. Immediately before Y's deemed disposition of the X stock, Y is treated as purchasing the X stock from X for fair market value using cash contributed to Y by X. Under section 358, X's basis in its Y stock increases by the amount of cash deemed contributed.

(f) *Effective date.* This section applies to transfers of stock or stock options of the issuing corporation occurring on or after May 16, 2000.

Par. 5. In §1.1502-13, paragraph (f)(6)(v) is amended by adding a sentence after the first sentence to read as follows: *§1.1502-13 Intercompany transactions.*

\*\*\*\*\*

(f) \*\*\*

(g) \*\*\*

(v) *Effective date.* \*\*\* However, paragraph (f)(6)(ii) of this section and the last sentence of paragraph (f)(6)(iv)(A) of this section do not apply to dispositions of P stock or options occurring on or after May 16, 2000. \*\*\*

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Robert E. Wenzel,  
Deputy Commissioner  
of Internal Revenue.

Approved May 5, 2000.

Jonathan Talisman,  
Deputy Assistant Secretary  
of the Treasury.

(Filed by the Office of the Federal Register on May 11, 2000, 2:30 p.m., and published in the issue of the Federal Register for May 16, 2000, 65 F.R. 31073)

**Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property**

(Also sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

**Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term exempt rate.** For purposes of sections 1274, 1288, 382, and other sections of the Code, tables set forth the rates for June 2000.

**Rev. Rul. 2000–28**

This revenue ruling provides various prescribed rates for federal income tax purposes for June 2000 (the current month.) Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes

of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2000–28 TABLE 1				
Applicable Federal Rates (AFR) for June 2000				
	<i>Period for Compounding</i>			
	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
<i>Short-Term</i>				
AFR	6.53%	6.43%	6.38%	6.35%
110% AFR	7.19%	7.07%	7.01%	6.97%
120% AFR	7.87%	7.72%	7.65%	7.60%
130% AFR	8.53%	8.36%	8.27%	8.22%
<i>Mid-Term</i>				
AFR	6.62%	6.51%	6.46%	6.42%
110% AFR	7.29%	7.16%	7.10%	7.06%
120% AFR	7.96%	7.81%	7.74%	7.69%
130% AFR	8.64%	8.46%	8.37%	8.31%
150% AFR	10.01%	9.77%	9.65%	9.58%
175% AFR	11.71%	11.39%	11.23%	11.13%
<i>Long-Term</i>				
AFR	6.39%	6.29%	6.24%	6.21%
110% AFR	7.04%	6.92%	6.86%	6.82%
120% AFR	7.69%	7.55%	7.48%	7.43%
130% AFR	8.35%	8.18%	8.10%	8.04%

REV. RUL. 2000–28 TABLE 2				
Adjusted AFR for June 2000				
	<i>Period for Compounding</i>			
	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
Short-term adjusted AFR	4.62%	4.57%	4.54%	4.53%
Mid-term adjusted AFR	5.01%	4.95%	4.92%	4.90%
Long-term adjusted AFR	5.65%	5.57%	5.53%	5.51%

REV. RUL. 2000-28 TABLE 3

Rates Under Section 382 for June 2000

Adjusted federal long-term rate for the current month	5.65%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	5.75%

REV. RUL. 2000-28 TABLE 4

Appropriate Percentages Under Section 42(b)(2)  
for June 2000

Appropriate percentage for the 70% present value low-income housing credit	8.53%
Appropriate percentage for the 30% present value low-income housing credit	3.65%

REV. RUL. 2000-28 TABLE 5

Rate Under Section 7520 for June 2000

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	8.0%
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**Section 1288.—Treatment of Original Issue Discounts on Tax-Exempt Obligations**

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2000. See Rev. Rul. 2000-28, page 1157.

**Section 1441.—Withholding of Tax On Nonresident Aliens**

26 CFR 1.1441-1: Requirements for the deduction and withholding of tax on payments to foreign persons.

**T.D. 8881**

**DEPARTMENT OF THE TREASURY  
Internal Revenue Service  
26 CFR Parts 1 and 31**

**Revisions to Regulations Relating to Withholding of Tax on Certain U.S. Source Income Paid to Foreign Persons and Revisions of Information Reporting Regulations**

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

**SUMMARY:** This document contains amendments to final regulations relating to the withholding of income tax under sections 1441, 1442, and 1443 on certain U.S. source income paid to foreign persons and related requirements governing collection, deposit, refunds, and credits of withheld amounts under sections 1461 through 1463. Additionally, this document contains amendments under sections 6041, 6041A, 6042, 6045, 6049, and 3406. This regulation affects persons making payments of U.S. source income to foreign persons.

**DATES:** These regulations are effective January 1, 2001.

**FOR FURTHER INFORMATION CONTACT:** Carl Cooper, Laurie Hatten-Boyd, or Kate Hwa (202) 622-3840 (not a toll free number).

**SUPPLEMENTARY INFORMATION:**

**Paperwork Reduction Act**

The collections of information in these final regulations 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) under control number 1545 -1484.

Responses to these collections of information are required to obtain a benefit (to claim an exemption to, or a reduction in, withholding), and to facilitate tax compliance (to verify entitlement to an exemption or a reduced rate). The likely respondents are individuals, businesses, and other for-profit organizations.

Comments on the collections 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 **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224.

The estimated average annual burden per respondent and/or recordkeeper are reflected in the burdens of Forms W-8, 1042, 1042-S, 1099, and the income tax return of a foreign person filed for purposes of claiming a refund.

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

In Treasury Decision 8734 (1997–2 C.B. 109 [62 F.R. 53387]), the Treasury Department and the IRS issued comprehensive regulations (final regulations) under chapter 3 (sections 1441–1464) and subpart G of Subchapter A of chapter 61 (sections 6041–6050S) of the Internal Revenue Code. Those final regulations were amended by TD 8804 (1999–12 I.R.B. 5 [63 F.R. 72183]) which delayed the effective date of the final regulations to payments made after December 31, 1999. The effective date of the regulations was again extended by TD 8856 (2000–3 I.R.B. 298 [64 F.R. 73408]) to payments made after December 31, 2000.

## Need for Changes

Since the publication of TD 8734, the IRS and Treasury have received numerous comments relating to technical errors in the regulations and ways to ease compliance while keeping the objectives of the regulations in place. In Notice 99–8 (1999–5 I.R.B. 26), the IRS and Treasury announced amendments that would be made to the regulations. This TD implements Notice 99–8 and contains additional changes made in response to comments as well as the IRS and Treasury's further analysis of the regulations.

## Explanation of Revisions

### A. Changes to §1.1441–1

#### 1. Payments to a U.S. Branch of Certain Foreign Banks or Foreign Insurance Companies.

Generally, a payment to a U.S. branch of a foreign person is a payment to a foreign person. Under §1.1441–1(b)(2)(iv), however, a U.S. branch of certain foreign banks or insurance companies and a withholding agent may agree to treat the U.S. branch as a U.S. person for purposes of chapter 3 of the Internal Revenue Code. The regulation as initially drafted required a withholding agent to treat such a U.S. branch as a U.S. person for all purposes under chapter 3 of the Internal Revenue

Code. The regulation itself, however, does not treat a U.S. branch as a U.S. person for all purposes under chapter 3 of the Internal Revenue Code. For example, a U.S. branch of a foreign bank or insurance company provides a withholding certificate on a Form W-8, which is used only by foreign persons. Further, under §1.1461–1(c), payments to such a branch are reportable as payments to a foreign person on Form 1042-S. Therefore, §1.1441–1(b)(2)(iv) has been amended to state that, notwithstanding the agreement between the withholding agent and a U.S. branch to treat the U.S. branch as a U.S. person, the branch is not treated as a U.S. person for purposes of providing documentation or for reporting payments to the branch.

#### 2. Rules for Reliably Associating a Payment With a Withholding Certificate or Other Appropriate Documentation

Section 1.1441–1(b)(2)(vii) contains rules to determine whether a payment can be reliably associated with valid documentation. A payment that cannot be reliably associated with valid documentation is subject to the presumption rules in §§1.1441–1(b)(3), 1.1441–4(a)(2)(ii) and (3)(i), 1.1441–5(d) and (e)(6), 1.1441–9(b)(3), and 1.6049–5(d). Paragraph (b)(2)(vii) did not adequately address when a payment made to a nonqualified intermediary, a flow-through entity, or a U.S. branch of certain foreign banks and insurance companies (other than a branch that acts as a U.S. person) would be treated as reliably associated with documentation. These entities provide a withholding certificate for themselves and withholding certificates, documentary evidence, or other information for the persons on whose behalf they act. Therefore, the payment must be reliably associated not only with a withholding certificate from the intermediary, flow-through entity, or U.S. branch, but also with documentation from, or information relating to, the payee on whose behalf the entity acts.

Paragraph (b)(2)(vii) has been amended to provide more detailed reliable association rules. For a payment made to a nonqualified intermediary, a flow-through entity, or a U.S. branch, new paragraph (b)(2)(vii)(B) provides that a withholding agent can reliably associate

the payment with valid documentation if, prior to the payment, it has received a valid nonqualified intermediary withholding certificate on Form W-8IMY; it can determine the portion of the payment that relates to valid documentation associated with the Form W-8IMY from a payee (i.e., a person other than a nonqualified intermediary, flow-through entity, or U.S. branch); and the nonqualified intermediary, flow-through entity, or U.S. branch has provided sufficient information for the withholding agent to report the payment on Form 1042-S or Form 1099, if reporting is required.

Paragraph (b)(2)(vii)(C) provides rules for a withholding agent that makes a payment to a qualified intermediary that does not assume primary withholding responsibility under chapter 3 of the Internal Revenue Code or primary Form 1099 reporting and backup withholding responsibility under chapter 61 and section 3406 of the Internal Revenue Code. The payment can be reliably associated with valid documentation if, prior to the payment, the withholding agent receives a valid qualified intermediary withholding certificate on Form W-8IMY and a withholding statement that allocates the payment among withholding rate pools, including withholding rate pools for each U.S. non-exempt recipient for which the qualified intermediary has provided a valid Form W-9 (or other information if a Form W-9 has not been provided).

For a payment made to a qualified intermediary that assumes primary withholding responsibility under chapter 3 of the Internal Revenue Code with respect to the payment, but does not assume primary Form 1099 reporting and backup withholding responsibility under chapter 61 and section 3406 of the Internal Revenue Code, paragraph (b)(2)(vii)(D) provides that a withholding agent can reliably associate the payment with valid documentation if, prior to the payment, it receives a valid Form W-8IMY and the withholding statement associated with the Form W-8IMY allocates the payment between a single withholding rate pool for which the qualified intermediary assumes primary withholding responsibility and separate withholding rate pools for each U.S. non-exempt recipient.

Paragraph (b)(2)(vii)(E) provides rules for a withholding agent that makes a pay-

ment to a qualified intermediary that assumes primary Form 1099 reporting and backup withholding responsibility under chapter 61 and section 3406 of the Internal Revenue Code, but does not assume primary withholding responsibility under chapter 3 of the Internal Revenue Code. The payment can be reliably associated with valid documentation if, prior to the payment, the withholding agent can associate the payment with a valid Form W-8IMY and the withholding statement associated with the Form W-8IMY allocates the payment among the withholding rate pool or pools for which withholding responsibility is not assumed and the portion of payment for which the qualified intermediary assumes Form 1099 reporting and backup withholding responsibility.

Finally, for a payment made to a qualified intermediary that assumes both primary withholding responsibility under chapter 3 of the Internal Revenue Code and primary Form 1099 reporting and backup withholding responsibility under chapter 61 and section 3406 of the Internal Revenue Code, paragraph (b)(2)(vii)(F) provides that a withholding agent can reliably associate the payment with valid documentation if, prior to the payment, it can associate the payment with a valid Form W-8IMY. In this case, no withholding rate pool allocation information is required. This same rule applies for payments made to a withholding foreign partnership.

### 3. Presumptions of Classification as Individual, Corporation, Partnership, etc.

As initially drafted, §1.1441-1(b)(3)(ii) provided a withholding agent with presumption rules to determine a payee's classification (e.g., individual, corporation, partnership) if it could not reliably associate a payment with valid documentation. Paragraph (b)(3)(ii) did not, however, provide a presumption rule if a withholding agent could not reliably associate a payment with documentary evidence (i.e., documentation other than a withholding certificate) from which it could not determine the payee's classification. For example, documentary evidence may indicate that a payee (other than an entity that is treated as a per se corporation under §301.7701-2(b)(8)(i)) is a type of entity that can be organized so that all of its members have limited liability, in which

case it would be treated as an association, or so that one or more of its members have unlimited liability, in which case it would be treated as a partnership. The determination of classification can be critical because if the entity is a flow-through entity, it is not the beneficial owner of the payment and its documentary evidence cannot be relied upon to grant a reduced rate of withholding.

Section 1.1441-1(b)(3)(ii)(C) has been added to permit a withholding agent to treat an entity that has provided documentary evidence as a corporation if the classification of the entity cannot be determined from documentary evidence or by reference to the exempt recipient rules under §1.6049-4(c)(1)(ii). This presumption rule will reduce burdens on withholding agents that are permitted to use documentary evidence, such as foreign intermediaries and flow-through entities, which would otherwise have to request from payees additional information regarding U.S. tax classification. The presumption rule is not, however, intended to allow foreign entities to avoid making the correct determination of their classification and to provide the correct documentation. Thus, a foreign entity must make a determination about its classification and if it determines that it is an intermediary, partnership, foreign simple trust, or foreign grantor trust under U.S. tax law principles, it must provide an intermediary or flow-through withholding certificate on Form W-8IMY together with the appropriate information relating to its customers, partners, beneficiaries, owners, or other payees. Further, a withholding agent cannot treat an entity as a corporation if it knows, or should know, that the entity is a flow-through entity or intermediary. For example, if a particular type of collective investment vehicle provides documentary evidence that does not establish that it is a corporation, partnership, or trust, but the withholding agent knows, or has reason to know, that the investment vehicle is classified as a partnership for U.S. tax purposes, it must request a partnership withholding certificate from the entity.

An entity that is presumed to be a foreign corporation under new paragraph (b)(2)(ii)(C) cannot be treated as the beneficial owner entitled to a reduced rate of withholding to the extent the documen-

tary evidence indicates that it is a bank, broker, custodian, intermediary, or other agent unless the entity provides a statement that it is the beneficial owner of the income. For example, documentary evidence that indicates that the payee is a bank does not permit a withholding agent to apply the portfolio interest exception to payments of interest made to the bank. In addition, even though a foreign entity is treated as a beneficial owner for purposes of the exceptions to withholding under the Internal Revenue Code and regulations, it is not necessarily entitled to claim treaty benefits. Whether treaty benefits may be claimed by an entity depend on whether it meets the requirements under the income tax treaty and section 894.

### 4. Changes to presumption rules

Several simplifying and clarifying changes have been made to the presumption rules in §1.1441-1(b)(3). First, the presumption rule applicable to pensions and annuities contained in §1.1441-1(b)(3)(iii)(C) has been expanded to apply to individual retirement accounts and individual retirement annuities. Second, §1.1441-1(b)(3)(iii)(D), which contains presumption rules applicable to offshore accounts, was revised to state the applicable rule more clearly. In addition, the restriction on applying the presumption rule of paragraph (b)(3)(iii)(D) to amounts that are not subject to withholding has been moved from that paragraph to §1.6049-5(d)(2). This change eliminates a conflict with §1.6049-5(d)(2), as previously drafted, which applied the paragraph (b)(3)(iii)(D) rule to amounts not subject to withholding.

Section 1.1441-1(b)(3)(iv) contains a grace period presumption rule that permits a withholding agent to treat a payee as a foreign person in certain situations where the withholding agent would presume the payee to be a U.S. person. Although the grace period rule generally does not permit a withholding agent to apply any exceptions to withholding, it does permit a withholding agent to apply a reduced rate of withholding for 90 days to a payee that provides a withholding certificate that would have been valid except that it was transmitted by facsimile. One commentator noted that because the facsimile rule applied only to payees that a withholding agent could, "in its discre-

tion” treat as a foreign person, the rule was limited to those situations where the presumption rules would have treated the payee as a U.S. person and the withholding agent was exercising its discretion to treat the payee as foreign. Therefore, the commentator argued, the rule arguably could not be applied to payees that were required to be treated as foreign persons under the presumption rules, e.g., an exempt recipient with indicia of foreign status. The regulation has been modified by removing the phrase “in its discretion” thereby permitting the facsimile rule to apply to payees that are treated as foreign payees under the presumption rules.

Paragraph (b)(3)(v), as promulgated in TD 8734, provided several presumption rules that applied if a withholding agent did not receive from a nonqualified intermediary the withholding certificates or documentary evidence of the persons on whose behalf the nonqualified intermediary acted or did not receive information allocating the payment to each person. Under paragraph (b)(3)(v)(C), if the withholding agent could associate a payment with a group of beneficial owners or payees, it could treat the payment as being made in its entirety to the person in the group that was subject to the highest withholding rate or, if the rates were equal, to the payee in the group with the highest U.S. tax liability. If a nonqualified intermediary grouped persons subject to similar withholding and tax rates together and allocated the payment to the group, the nonqualified intermediary could achieve a reduced rate of withholding for its customers without reliably associating the payment to each of the customers that would be entitled to the payment. Treasury and the IRS stated in Notice 99-8 that affording a reduced rate of withholding under these circumstances was inappropriate. Further, it was inappropriate to report the entire payment as if it were made to a single documented payee who was not entitled to receive the entire amount of income.

Paragraph (b)(3)(v) has been revised so that whenever a payment to a nonqualified intermediary cannot be reliably associated with valid documentation from a specific payee, the payment is treated as made to an undocumented foreign payee and is subject to 30 percent withholding. Under §1.1461-1(c), such payments are

reported to an unknown owner on Form 1042-S. Thus, a payment can no longer be subject to a reduced rate of withholding because it can be allocated to a group of documented payees all of whom are subject to the same reduced rate of withholding. Similar changes have been made to the presumption rules that applied to foreign partnerships under former §1.1441-5(d)(3)(ii).

Paragraph (b)(3)(vi), as originally drafted, was in error. It stated that the presumption rules that applied to foreign intermediaries also applied to U.S. branches of foreign banks and insurance companies that assumed withholding responsibility. The rule should have provided that the intermediary presumption rules also apply to U.S. branches of foreign banks and insurance companies that do not agree to be treated as U.S. persons. Those branches are generally treated in the same manner as nonqualified intermediaries under chapter 3 of the Internal Revenue Code. Therefore, paragraph (b)(3)(vi) has been revised to apply only to those branches that are not treated as U.S. persons. Finally, paragraph (b)(3)(vii), which applies to payments to joint payees, has been amended to clarify the treatment of payments made to joint accounts.

#### 5. Rules for Withholding and Reporting of Payments by a Foreign Intermediary and Certain U.S. Branches

Section 1.1441-1(b)(6) sets forth the withholding obligations of a foreign intermediary and certain U.S. branches. The regulation, as originally drafted, stated that a qualified intermediary, a nonqualified intermediary, or a U.S. branch of a foreign bank or insurance company was deemed to have satisfied any obligation it had to withhold and report an amount it paid if it did not know that the correct amount had not been withheld. The rule did not, however, require a foreign intermediary or U.S. branch to report a payment if it knew that the withholding agent from whom it received the payment had not reported the payment to the persons on whose behalf the foreign intermediary or U.S. branch acted as long as the correct amount was withheld. For example, if a U.S. withholding agent withheld 30 percent from a payment of an amount subject to withholding made to a nonqualified in-

termediary because the nonqualified intermediary failed to provide documentation or allocation information relating to the persons for whom it acted, the rule relieved the nonqualified intermediary from any obligation to report the payment to those persons. Foreign intermediaries and U.S. branches, however, are withholding agents under §1.1441-7(a) and, as stated in Notice 99-8, it is inappropriate to relieve them of any reporting responsibility unless they have provided another withholding agent with all of the information that the withholding agent needs to report amounts paid to the appropriate recipients of the income. In addition, paragraph (b)(6) should not have included qualified intermediaries, because a qualified intermediary has reporting responsibilities whether or not another withholding agent properly reported the payment made to the qualified intermediary.

The regulation has been revised to provide that a nonqualified intermediary or U.S. branch (other than a U.S. branch treated as a U.S. person) is not required to withhold and report if the nonqualified intermediary or U.S. branch (i) has provided a valid nonqualified intermediary or U.S. branch withholding certificate, (ii) has provided all of the information required to be included in a withholding statement associated with its withholding certificate so that another withholding agent can do the required reporting on Form 1042-S or Form 1099, and (iii) does not know, and has no reason to know, that the other withholding agent did not withhold the correct amount or did not report the payment correctly. A qualified intermediary’s obligations to withhold and report are determined in accordance with its qualified intermediary agreement.

#### 6. Definitions

Section 1.1441-1(c) contains the definitions of terms used in the regulations under chapter 3 of the Internal Revenue Code. The section has been significantly expanded and certain definitions have been consolidated in this section. New definitions, or cross-references to definitions, have been provided for the terms beneficial owner, payee, intermediary, nonqualified intermediary, qualified intermediary, withholding certificate, documentary evidence, documentation, payor, exempt recipient, non-exempt recipient,

reportable amounts, flow-through entity, foreign simple trust, foreign complex trust, foreign grantor trust, partnership, nonwithholding foreign partnership, and withholding foreign partnership.

Paragraph (c)(6)(i) has been changed to state specifically that the definition of beneficial owner does not apply in cases where a reduced rate of withholding is being claimed under an income tax treaty. This change has been made to clarify that a person who is a beneficial owner of an item of income for purposes of these regulations would not necessarily beneficially own the item of income for purposes of an income tax treaty.

Paragraph (c)(6), as originally drafted, did not include rules to determine the beneficial owner of a payment made to a foreign trust or estate. In general, the regulations retained the rules for foreign trusts and estates that existed prior to the publication of TD 8734. The paragraph has been revised to provide specific rules for payments to foreign trusts and estates. Generally, the beneficial owners of a payment to a foreign simple trust are the beneficiaries of the trust. The beneficial owners of a payment made to a foreign grantor trust are the owners of the trust. Foreign complex trusts and foreign estates are considered to be the beneficial owners of income paid to such entities.

Paragraph (c)(12) has been added to clarify the term *payee*. It provides cross-references to those sections under which the payee of income is determined, and emphasizes that foreign intermediaries and flow-through entities are generally not considered the payees of income. A qualified intermediary is, however, a payee to the extent it assumes primary withholding responsibility with respect to a payment, and a flow-through entity is a payee if it is receiving income that is, or is treated as, effectively connected with the conduct of a U.S. trade or business.

The definition of a flow-through entity has been moved from §1.1441-1(e)(3)(i) to paragraph (c)(23). The definition has also been expanded and clarified. The term *flow-through entity* refers to any entity which has an obligation to transmit documentation to another withholding agent. Therefore, an entity may be a flow-through entity whether or not the income paid to the entity is includible in the gross income of the entity's owners. A

flow-through entity includes a nonwithholding foreign partnership, a foreign simple trust, a foreign grantor trust, or an entity that is fiscally transparent under section 894 to the extent it provides documentation on behalf of its interest holders. A withholding foreign partnership and a withholding foreign trust are not flow-through entities. The term flow-through entity has replaced the term partnership in numerous places throughout the regulation.

## 7. Withholding Certificates

### a. Forms W-9

Section 1.1441-1(d) contains rules for a payee to establish its status as a U.S. payee. Under paragraph (d), a payee that provides a Form W-9 may be treated as a U.S. payee that is not subject to withholding under section 1441. Commentators have noted that under current law, there is no prohibition against a foreign person providing a Form W-9 to establish status as an exempt recipient. They therefore suggest that the regulations should be clarified to specifically state that providing a Form W-9 serves as a representation of U.S. status and should only be furnished by a U.S. person. In response to these comments, paragraph (d)(2) has been amended to state that furnishing a Form W-9 serves as a statement that the person providing the form is a U.S. person. Therefore, a foreign person, including a U.S. branch of a foreign person, should not provide a Form W-9 to a withholding agent. The instructions to Form W-9 will also be modified to make clear that providing a Form W-9 is a declaration of U.S. status.

Paragraph (d)(3) is revised to eliminate the requirement for a permanent residence address. Permanent residence address is a term defined in §1.1441-1(e)(2)(ii) and is generally the address of a foreign person in the country in which the person is a resident for tax purposes. The term is inapplicable, and potentially misleading, as applied to the address a U.S. person should provide on Form W-9.

Paragraph (d)(4), as originally drafted, provided rules to determine whether a payment was made to a U.S. beneficial owner. Generally, the regulation provided that if a customer of a foreign intermediary provided a Form W-9, the withhold-

ing agent could treat such person as a U.S. beneficial owner. A customer of a foreign intermediary could also be treated as a U.S. beneficial owner if it provided a U.S. branch withholding certificate that evidenced its agreement to be treated as a U.S. person. A Form W-9 and a U.S. branch withholding certificate, however, do not establish beneficial ownership. Further, it is not necessary under the regulations to determine whether a U.S. payee is a beneficial owner because a payment to a U.S. payee is not subject to withholding under chapter 3 of the Internal Revenue Code whether or not the payee is the beneficial owner of the income. Thus, the paragraph has been modified to provide that the withholding agent may treat the payee of a payment made to a foreign intermediary or a flow-through entity as a U.S. payee if the payee provides a Form W-9 or a U.S. branch withholding certificate that evidences the branch's agreement to be treated as a U.S. person.

### b. Intermediary and flow-through withholding certificates

Section 1.1441-1(e)(3)(i) provides definitions for the terms intermediary withholding certificate, flow-through withholding certificate, and U.S. branch withholding certificate. That section originally defined a flow-through withholding certificate as a Form W-8 furnished by a partnership (other than a withholding foreign partnership) or a trust or estate. The paragraph has been revised to conform to the definition of flow-through entity contained in §1.1441-1(c)(23) and the new rules contained in §1.1441-5(e) regarding foreign trusts and foreign estates, discussed in section E of this Explanation of Provisions. Under paragraph (e)(3)(i), as revised, a flow-through withholding certificate is defined as a withholding certificate on Form W-8 furnished by a nonwithholding foreign partnership, a foreign simple trust, a foreign grantor trust, or a foreign entity presenting claims on behalf of its interest holders for a reduced rate of withholding under an income tax treaty. Foreign complex trusts and foreign estates generally provide beneficial owner withholding certificates.

Section 1.1441-1(e)(3)(ii) provides the requirements for a valid withholding certificate provided by a qualified intermediary. The paragraph has been modified to



reflect the procedures applicable to qualified intermediaries as set forth in Rev. Proc. 2000-12 (2004-4 I.R.B. 1).

Section §1.1441-1(e)(3)(iii) provides rules relating to a nonqualified intermediary withholding certificate. Paragraph (e)(3)(iii) generally provided that payee documentation provided with a nonqualified intermediary withholding certificate needed to be attached to the certificate. Similar requirements existed for flow-through withholding certificates and U.S. branch withholding certificates. The regulations have been revised to require that payee documentation be associated with, rather than attached to, a nonqualified intermediary, flow-through, or U.S. branch certificate to obviate the need for a new withholding certificate each time payee documentation is provided to a withholding agent. The regulations do not set forth specific requirements for associating documentation. Any reasonable method may be used to associate documentation with its intermediary withholding certificate.

Paragraph (e)(3)(iii), as originally drafted, required a certification that the withholding certificates or other appropriate documentation attached to a nonqualified intermediary withholding certificate represented all of the persons to whom the intermediary withholding certificate related or that the amounts of income allocable to persons for whom no documentation was provided was separately stated. A similar requirement applied to nonwithholding foreign partnership withholding certificates in §1.1441-5(c)(3)(iii)(D). The requirement for this certification has been eliminated. The persons on whose behalf a nonqualified intermediary acts will frequently change as persons open and close accounts with the intermediary. Thus, any such certification may be true at the time made, but false at a later point, necessitating a new withholding certificate. The elimination of the certification is not an elimination, however, of the requirement to provide payee withholding certificates to a withholding agent prior to a payment. The certification requirement has also been eliminated for nonwithholding foreign partnerships.

Section 1.1441-1(e)(3)(iii) permits a nonqualified intermediary to provide payee documentation either in the form of withholding certificates or in the form of documentary evidence. The withholding

agent is required to derive information from the withholding certificates or other documentary evidence and report payments to each specific payee on whose behalf the nonqualified intermediary acts. However, the regulations were silent on how a withholding agent was to determine the status (U.S. or foreign) or classification (e.g., corporate, partnership, trust, or estate) and other information required to report payments on Form 1042-S from documentary evidence, particularly when that documentary evidence was in a foreign language. Further, although the regulations require a nonqualified intermediary to allocate payments to each payee on whose behalf it acts so that a withholding agent can report payments to each payee on Form 1042-S or Form 1099, the regulations provided no detail on how the allocation information was to be provided.

The regulations have been revised to take these considerations into account. Under §1.1441-1(e)(3)(iv) as revised, a nonqualified intermediary must associate with its nonqualified intermediary withholding certificate a withholding statement which sets forth the information a withholding agent needs to allocate a payment to each payee on whose behalf the nonqualified intermediary acts and to report the payment. Specifically, the withholding statement must contain for each payee the payee's name, address, country of residence, TIN (if any), the payee's recipient type for Form 1042-S reporting, the applicable rate of withholding, the type of withholding exception applied (if any), and the name of any other intermediary or flow-through entity from whom the payee directly receives the income. Additional information is required if a reduced rate of withholding under an income tax treaty is claimed. The withholding statement may be provided in any manner that the withholding agent and nonqualified intermediary agree, including electronically. It must be updated as frequently as necessary to remain accurate prior to each payment. The regulation does not require a nonqualified intermediary to provide information for a payee unless the payee is a U.S. non-exempt recipient. Information regarding U.S. non-exempt recipients must be provided irrespective of any local laws that prohibit disclosure of an account holder or account information. Therefore, a non-

qualified intermediary should obtain waivers from non-disclosure provisions from U.S. non-exempt recipients. To the extent payee information is not provided, whether for a U.S. non-exempt recipient or any other payee, the regulation has been clarified to state explicitly that a withholding agent must withhold under the presumption rules. Further, the nonqualified intermediary remains liable for any tax not withheld by a withholding agent and, unless the nonqualified intermediary itself files information returns, will also be held liable for penalties imposed for failure to file information returns under sections 6721 and 6722.

Many commentators have argued that it is not practical to provide information allocating a payment to each payee prior to each payment because the customers of nonqualified intermediaries are constantly acquiring and disposing of investments. Several commentators made suggestions on how the regulations might ease compliance burdens. One commentator suggested that no allocation information should be required except in the case of income subject to reduced rates of withholding under an income tax treaty and payments made to U.S. non-exempt recipients. This suggestion was rejected. The IRS has provided a mechanism for aggregate reporting of payments in the model qualified intermediary agreement in Rev. Proc. 2000-12 (2000-4 I.R.B. 387). It is inappropriate to extend such treatment to nonqualified intermediaries without the safeguards contained in a qualified intermediary agreement. Other commentators suggested that a withholding agent should withhold the difference between 30 percent of a payment and the claimed reduced rate of withholding in escrow and release the amounts when allocation information is provided. This suggestion was also not accepted. Such a system would leave the escrow funds out of the control of both the IRS and the beneficial owners of the payments. Further, because the nonqualified intermediary would have to provide frequent allocations as soon as possible after the time of payment to have the escrow funds released, it appeared to provide little relief from the pressures inherent in providing allocation information prior to a payment. Other commentators argued that a reduced rate of withholding should be provided at the time of payment

with allocation information to follow after the close of the year with various disincentives provided for failure to furnish the allocation information. The regulations generally adopt this approach.

Paragraph (e)(3)(iv)(D) provides alternative procedures that permit a nonqualified intermediary to provide information allocating reportable amounts to payees (including U.S. exempt recipients) by January 31 of the year following the calendar year of payment. The alternative procedures do not apply to payments made to U.S. non-exempt recipients. Therefore, allocation information for those persons must be provided prior to a payment. Under the alternative procedures, only allocation information may be provided after a payment is made: all other information that is required to be included in a withholding statement and appropriate payee documentation must be provided prior to a payment. The nonqualified intermediary may have reduced rates of withholding apply by identifying pools of income subject to a particular withholding rate (withholding rate pools) and identifying the payees with the appropriate withholding rate pools.

Various penalties apply if a nonqualified intermediary fails to provide information to allocate payments in a withholding rate pool to a withholding agent by January 31. First, the withholding agent must commence withholding on all payments in accordance with the presumption rules. Therefore, 30 percent withholding applies to amounts subject to withholding and 31 percent backup withholding applies to payments of deposit interest and original issue discount on original issue discount obligations of 183 days or less. Under a cure provision, the withheld amounts may be returned, and the alternative procedures may continue to be used, if the nonqualified intermediary provides allocation information by February 14. If the nonqualified intermediary fails to provide allocation information by that date, withholding continues for the taxable year, and all subsequent taxable years, unless the withholding agent provides allocation information prior to a payment. Further, because no allocation information has been provided, the payments are considered never to have been reliably associated with valid documentation and the foreign beneficial owners and

other payees on whose behalf the nonqualified intermediary is acting are not entitled to a reduced rate of withholding. Therefore, the nonqualified intermediary shall remain liable under section 1461 for the difference between the amount, if any, withheld by the withholding agent and the amount that should have been withheld under the presumption rules. Any tax due because of an allocation failure will be assessed against the nonqualified intermediary and, if necessary, collected from the assets that the nonqualified intermediary has with the withholding agent. Interest and penalties may also be assessed against the nonqualified intermediary. In particular, paragraph (e)(3)(iv)(7) states that a failure to provide allocation information will be presumed to be an intentional failure to file information returns and payee statements under sections 6721 and 6722. The IRS will not, however, hold the withholding agent liable for any tax, interest, or penalties, that are due solely to the failure of the nonqualified intermediary to provide allocation information.

The withholding statement rules and alternative allocation procedures have also been made applicable to U.S. branches of certain foreign banks and insurance companies and flow-through entities. This change, together with certain other changes discussed in this Explanation of Provisions, generally results in nonqualified intermediaries, U.S. branches, and flow-through entities being treated similarly.

Paragraph (e)(3)(iv)(E) has been added to permit the IRS to provide a withholding agent with a notice prohibiting the withholding agent from applying the alternative procedures of paragraph (e)(3)(iv)(D) to an identified nonqualified intermediary (or to a flow-through entity or a U.S. branch of a foreign bank or foreign insurance company) thereby requiring allocation information prior to a payment to have a reduced rate of withholding apply. In addition, the IRS may, in appropriate circumstances issue a notice to a withholding agent prohibiting the withholding agent from applying a reduced rate of withholding under any circumstances, even if allocation information is provided prior to a payment. The IRS contemplates issuing these notices in situations where a nonqualified interme-

diary, flow-through entity, or U.S. branch fails to pay a tax due or is not applying the rules of the regulations in good faith.

### c. Reportable amounts

Foreign intermediaries, flow-through entities, and U.S. branches of foreign banks and insurance companies (other than U.S. branches treated as U.S. persons) are required to provide information with respect to reportable amounts, as defined in §1.1441-1(e)(3)(vi). Prior to its revision, paragraph (e)(3)(vi) included in the definition of reportable amounts original issue discount or interest (OID) paid on short-term instruments. This definition appeared to include interest and OID regardless of whether those amounts were paid on the redemption of an obligation or from the sale or exchange of an obligation in a transaction other than a redemption. Under the presumption rules, if a withholding agent makes a payment to a foreign intermediary of interest and OID on a short-term obligation and it lacks documentation for such amounts, it must presume that the payee is a U.S. non-exempt recipient and report the income on Form 1099 and backup withhold on the payment. See §1.6049-5(d)(3)(iii). These rules proved to be impractical for sales of short-term obligations outside the United States. Foreign intermediaries have contended that they do not have the appropriate systems to report gains from sales transactions on Forms 1099 or to provide the proper allocation information to U.S. payors. Moreover, treating the sale or exchange of short-term OID instruments as reportable interest on Form 1099 was inconsistent with rules that treat amounts paid on the sale or exchange, other than redemptions, of such obligations as gross proceeds. See §§1.6045-1(d)(3) and 31.3406(b)(2)-2. Because it is more appropriate to treat sales, other than redemptions, of short-term OID instruments as gross proceeds rather than payments of interest or original issue discount, the regulation has been amended to provide that reportable amounts do not include amounts representing interest or OID on the sale or exchange, other than a redemption, of a short-term OID instrument. Therefore, a foreign intermediary, flow-through entity, or U.S. branch is not required to provide information regarding these transactions to a withholding agent as part of its withholding statement.

#### d. Period of validity

Section 1.1441-1(e)(4)(ii)(A) states that documentary evidence (i.e., documentation other than a withholding certificate) remains valid until “the earlier of the last day of the third calendar year following the year in which the documentary evidence is created . . . .” Commentators have stated that it is not clear if a document is “created” when it comes into being or when it is provided to a withholding agent. They also stated that basing the validity period on the date a document came into being would be more difficult to administer because they would have to calculate the expiration date in every case rather than assuming that it was valid for three years after it had been received by the withholding agent. In response to these comments, the rule has been amended to permit the validity period to be measured from the date documentation is provided to the withholding agent.

Section 1.1441-1(e)(4)(ii)(B) sets forth the circumstances in which a Form W-8 has an indefinite validity period. Paragraph (e)(4)(ii)(B)(I), as originally drafted, provided that a Form W-8 that contained a TIN was valid indefinitely “if the income for which such certificate is furnished is required to be reported” on Form 1042-S. Commentators noted that a strict reading of this language could preclude the indefinite validity of a Form W-8 with respect to income that was not subject to reporting, even though other income paid to the same beneficial owner by the withholding agent was subject to reporting. The regulation has been amended to provide that if there is annual reporting of at least one item of income paid by a withholding agent to a beneficial owner, the Form W-8 remains valid even for payments that are not subject to reporting. However, if a withholding agent has a Form W-8 with a TIN but does not make any payments of an amount subject to withholding, for example the withholding agent pays only deposit interest, the form remains valid only for 3 calendar years after the year of receipt. In addition, paragraph (e)(4)(ii)(B)(8) has been added to provide an indefinite validity period for a withholding certificate provided by a foreign simple trust or foreign grantor trust for the purposes of transmitting

withholding certificates or documentary evidence.

#### e. Electronic transmission of information

These regulations finalize the regulations proposed in REG-107872-97 (1997-2 C.B. 658 [62 F.R. 53504]) relating to the electronic submission of Forms W-8 and make them applicable beginning January 1, 2000. Like the proposed regulations, the final regulations apply only to situations where there is a direct relationship between the withholding agent or payor and the beneficial owner or payee. The final regulations reserve on applicable standards for transmitting forms through tiers of intermediaries. Comments were solicited on this matter in the preamble to the proposed regulations but none were received. The IRS and Treasury recognize the benefits of allowing the electronic transmission of Forms W-8 through one or more intermediaries and continue to solicit comments regarding requirements to ensure the integrity, accuracy, and reliability of electronically transmitted forms through tiers of intermediaries.

#### f. Requirement of taxpayer identifying number

Section 1.1441-1(e)(4)(vii) provides guidance for when a TIN is required on a Form W-8. Paragraph (e)(4)(vii), as originally drafted, required TINs on withholding certificates from all trusts or estates or the fiduciaries thereof. A number of commentators stated that the TIN requirement was burdensome and unreasonable when applied to pension trusts and large investment trusts. In addition, commentators noted that nonwithholding foreign partnerships, which are treated similarly to foreign simple trusts and foreign grantor trusts, are not required to have a TIN. In response to these comments, the regulations have been amended by eliminating the TIN requirement for foreign trusts other than foreign grantor trusts with 5 or fewer owners.

Paragraph (e)(4)(vii) has also been modified to state that a TIN is required on a withholding certificate from a beneficial owner that is claiming an exemption based on its claim of tax exempt status under section 501(c) or private foundation status. This does not represent a change in the requirements for a withholding certificate from

such a beneficial owner. The regulation, as originally drafted, however, contained the requirement only in §1.1441-9. The requirement of a TIN has been repeated in this paragraph for convenience. Finally, commentators noted that there was a conflict between paragraph (e)(4)(vii), which did not require a TIN on a withholding certificate from a nonwithholding foreign partnership, and §1.1441-5(c)(3)(iii)(A), which stated that a TIN was required. It was never intended that a nonwithholding foreign partnership withholding certificate used to transmit documentation and information relating to its partners have a TIN. Section 1.1441-5(c)(3)(iii)(A) has been modified accordingly. TINs are required, however, if the withholding foreign partnership is providing a withholding certificate on which it claims an exemption from withholding because the income is effectively connected with the conduct of a trade or business or when it is entitled to claim treaty benefits under section 894 on income for which a TIN is required under §1.1441-6(b)(1).

#### g. Requirement to furnish certificates for each account

Generally, each withholding agent that makes a payment to a beneficial owner must obtain a separate withholding certificate. In addition, a withholding agent that is a financial institution must obtain withholding certificates or other appropriate documentation on an account-by-account basis from its customers. Under paragraph (e)(4)(ix)(A)(3) of the regulations, a withholding agent may rely on a withholding certificate held at another branch of the same withholding agent or of a person related to the withholding agent if there is a system in place that permits a withholding agent to access data regarding the withholding certificate and to transmit data that affects the validity of the documentation into the system. A commentator noted that the regulations do not contain provisions, however, to let unrelated withholding agents utilize such a system that they maintain in common or that is maintained by another person. New paragraph (e)(4)(ix)(A)(4) has been added to permit unrelated withholding agents to rely on such a system.

#### h. Special rules for brokers

Section 1.1441-1(e)(4)(ix)(C) provided that a withholding agent may rely

on the certification of a broker acting as the agent of a beneficial owner if the broker held a valid beneficial owner withholding certificate or other documentation for that beneficial owner. As originally drafted, the intention of this provision was unclear. It also appeared to be overly broad because it would have permitted a foreign broker to retain beneficial owner documentation and not transmit the documentation to a U.S. withholding agent.

Paragraph (e)(4)(ix)(C) has been redrafted to clarify, and appropriately limit, its application. As redrafted, it applies only to a U.S. broker. It permits such a broker that is acting as an introducing or corresponding broker to provide a clearing broker with a certification that it holds a valid withholding certificate or other appropriate documentation. Without this rule, an introducing or corresponding broker would have to obtain multiple Forms W-8 and provide them to each clearing broker with whom the introducing or corresponding broker executes transactions. In addition, paragraph (e)(4)(ix)(C) has been amended to apply only to readily tradeable instruments, as provided in §31.3406(h)-3(d), on which it is modeled. An example has been added to illustrate the paragraph.

#### 8. Qualified Intermediary Withholding Certificates

Section 1.1441-1(e)(5) provides rules regarding qualified intermediaries. The rules have been redrafted to more closely conform with the model qualified intermediary agreement published as part of Rev. Proc. 2000-12. The regulation, as originally drafted, contained a requirement that a qualified intermediary disclose U.S. non-exempt recipients “irrespective of local secrecy laws.” The model qualified intermediary agreement has specific provisions contained in section 6.04 of the agreement, as well as other sections, that govern the treatment of U.S. persons whenever foreign law, whether or not a “secrecy” provision, may preclude disclosure of a U.S. non-exempt recipient. Very generally, those provisions require a qualified intermediary to disinvest a U.S. non-exempt recipient who does not waive its local law non-disclosure privileges and to collect backup withholding on income and sales proceeds paid to such person. Therefore, the

language stating that disclosure is required “irrespective of local secrecy laws” has been deleted to avoid creating an inconsistency between the model qualified intermediary agreement and the regulation.

The provisions in paragraph (e)(5) regarding the terms of the withholding agreement a qualified intermediary must enter with the IRS have also been changed to more generally conform with the qualified intermediary agreement as set forth in Rev. Proc. 2000-12. The regulation clarifies the consequences of a qualified intermediary’s assumption of primary withholding responsibility. Section 1.1441-1(e)(5)(iv), as originally drafted, stated that a withholding agent making a payment to a qualified intermediary was required to presume full withholding responsibility for that payment unless the qualified intermediary assumed primary withholding responsibility. The regulation was potentially misleading because it could have been interpreted to mean that if a qualified intermediary did not assume primary withholding responsibility, only the U.S. withholding agent was responsible for withholding. Rev. Proc. 2000-12 makes clear, however, that qualified intermediaries are required to withhold in certain circumstances even though they have not assumed primary withholding responsibility. The rule that was initially in paragraph (e)(5)(iv) was intended to relieve a withholding agent making a payment to a qualified intermediary that assumed primary withholding responsibility from the obligation to withhold, not to relieve the qualified intermediary of any withholding requirement. The paragraph has been amended to reflect this intent.

Paragraph (e)(5)(iv) also stated that a qualified intermediary generally would not be permitted to assume withholding and reporting responsibility under section 3406 and chapter 61 of the Internal Revenue Code on a payment made to a U.S. person unless the qualified intermediary was a foreign branch of a U.S. person or a foreign person that had a branch in the United States capable of performing such reporting and withholding. In developing the model qualified intermediary agreement, it became apparent that it was desirable to permit certain qualified intermediaries that did not meet those criteria to

assume reporting and withholding responsibility under chapter 61 of the Internal Revenue Code and section 3406. For example, where payments are made through clearing organizations, it may be impractical to require a qualified intermediary to provide information regarding U.S. non-exempt recipients to a U.S. withholding agent. The language that generally limited the ability to assume reporting and withholding responsibility under chapter 61 of the Internal Revenue Code and section 3406 has been eliminated. Whether a qualified intermediary may assume such responsibility is left to the terms of the qualified intermediary agreement. See section 3 of the model qualified intermediary agreement in Rev. Proc. 2000-12.

Section 1.1441-1(e)(5)(v), as originally drafted, required a qualified intermediary to associate a payment with one of three categories of assets: (i) assets associated with documented foreign persons, (ii) assets associated with documented U.S. payees, and (iii) assets associated with undocumented payees. These three asset categories were subdivided into classes of assets based on withholding rates and reporting requirements. The asset categories did not provide the needed flexibility sought by qualified intermediaries. For example, information regarding U.S. exempt recipient payees, who are not subject to withholding under section 1441, could not be combined with information regarding foreign beneficial owner payees subject to a zero rate of withholding. The model qualified intermediary agreement, as published in Rev. Proc. 2000-12, substituted the withholding rate pool concept for asset classes and this concept has been reflected in the revised regulation. A withholding rate pool is a payment of a single type of income, determined in accordance with the categories of income reported on Form 1042-S or Form 1099, as applicable, that is subject to a single rate of withholding.

Finally, the regulations permit, in accordance with Rev. Proc. 2000-12, a qualified intermediary and a U.S. withholding agent to use a single withholding rate pool for U.S. non-exempt recipients for whom no backup withholding is required and a single withholding rate pool for U.S. non-exempt recipients that are subject to backup withholding provided that the qualified intermediary agreement

permits such an arrangement and sufficient information is provided to the withholding agent no later than January 15 following the year of payment that allocates the reportable payments to each U.S. non-exempt recipient account holder. Failure to provide the allocation information timely may result in penalties imposed on the qualified intermediary and the termination of its qualified intermediary agreement. Unlike qualified intermediaries, nonqualified intermediaries and flow-through entities are not permitted to pool payments to U.S. non-exempt recipients. Therefore, information sufficient to allocate the payment to each U.S. non-exempt recipient must be provided before a payment is made or the withholding agent must treat the payment as made to a U.S. payee that has failed to provide a TIN and impose backup withholding.

## *B. Changes to §1.1441-2*

### 1. Amounts Subject to Withholding

Section 1.1441-2(a) has been amended to exclude from the definition of amount subject to withholding interest paid as part of the purchase price of an obligation sold between interest payment dates (accrued interest) and an amount representing original issue discount (OID) paid as part of the purchase price of an obligation sold in a transaction other than the redemption of such obligation. The exclusions do not apply, however, if the sale of an obligation is part of a plan the principal purpose of which is to avoid tax and the withholding agent has actual knowledge or reason to know of such plan.

The exclusion of accrued interest and amounts representing OID paid as part of the purchase price of an obligation sold in a transaction other than a redemption were made in response to comments received on §1.1441-2(b)(3) of the final regulations and proposed regulation §1.1441-3(b) (REG-114000, [1997-2 C.B. 661, 62 F.R. 53503]). Section 1.1441-2(b)(3), as originally drafted, required withholding on OID to the extent the withholding agent had actual knowledge of the amount of the payment that was taxable to the beneficial owner. A withholding agent was treated as having actual knowledge if it had a direct account relationship with the holder of the obligation. Proposed regulation §1.1441-3(b) would have eliminated the

rule that no withholding was required on accrued interest and replaced it with a rule that conformed with the rule applicable to OID on the theory that, from a withholding perspective, the two payments were equivalent. The withholding rules applicable to OID and accrued interest would have required withholding whenever a payment of interest or OID was not subject to an exception, such as the portfolio interest exception, or a payment of OID or accrued interest was presumed made to a foreign person and the withholding agent could not reliably associate the payment with beneficial owner documentation. Such payments were subject to reporting on Form 1042-S whether or not withholding was imposed.

In Notice 99-8, Treasury and the IRS announced that they would make modifications to the OID and accrued interest rules. The modifications were intended to address criticisms by commentators that the OID and accrued interest rules were unworkable. Commentators argued that debt obligations are often sold in delivery-versus-payment transactions which settle quickly and often involve multiple intermediaries. The requirement to withhold in absence of a beneficial owner withholding certificate would necessarily inhibit the speed with which sales transactions are normally conducted. In addition, they argued that a withholding agent does not necessarily know the amount of OID or accrued interest merely because it has a direct account relationship with the account holder. In addition, custodians stated that sales were often accounted for in systems different from those used to report interest and OID and therefore the reporting requirement of the regulations would require significant systems modifications. They argued that these modifications were not justified because nearly all accrued interest and OID would be from instruments that could qualify for the portfolio interest exception.

Notice 99-8 proposed rules that were intended to require only the withholding agent that had a direct account relationship with a beneficial owner to obtain a Form W-8. Thus, the notice proposed a rule that would require a withholding agent to obtain a withholding certificate only if it received the proceeds from a sale against delivery of the debt obligation or, in the case of a retirement, the withholding agent was the person respon-

sible for paying the owner or crediting its account. The notice would have prevented intermediaries other than the intermediary with the direct account relationship with the beneficial owner from having to obtain a Form W-8 by stating that any withholding agent that effected a transaction for a broker was generally not required to obtain a Form W-8. A broker was defined by reference to §1.6045-1(a) and generally included a person that makes sales of securities for customers in the ordinary course of that person's trade or business. In addition, the notice proposed to eliminate the rule that presumed knowledge of the amount of OID or interest accrued between interest payment dates merely because there was a direct account relationship with the beneficial owner of an obligation.

Commentators criticized the Notice 99-8 proposal. They argued that the multiple broker exception did not always accomplish its intended purpose because certain participants in a transaction for whom a Form W-8 should not be required could not meet the definition of a broker, particularly since that definition does not include non-U.S. payors that effect sales of obligations at an office outside the United States and certain other persons, such as investment advisors, who might participate in the transaction but did not stand ready to effect sales of securities for others. In addition, the Notice did not solve the problem faced by custodians.

In light of these criticisms, Treasury and the IRS have decided to eliminate the requirement for withholding, and reporting, on accrued interest and an amount representing OID paid on the sale of an OID obligation, other than in a redemption. This change has been effected by eliminating those items from the definition of amounts subject to withholding. Withholding is required, however, if the withholding agent knows or has reason to know that a sale is part of a plan to avoid tax. For example, if a holder of a debt obligation that pays interest that does not qualify for the portfolio interest exception sells the instrument immediately prior to an interest payment date and reacquires the same type of security after the interest payment date and the withholding agent knows, or has reason to know, of this pattern of sales, withholding and reporting of accrued interest is required.

Paragraph (a) has also been amended to state that insurance premiums paid on a contract subject to the section 4371 excise tax are not amounts subject to withholding. As previously drafted, these amounts were excluded from the definition of fixed or determinable annual or periodical (FDAP) income under §1.1441-1(b)(2)(ii) and therefore were not included in amounts subject to withholding. Excluding insurance premiums from FDAP is inappropriate, however. Insurance premiums fall within the definition of FDAP provided in paragraph (b)(1). Therefore, the better means for exempting premiums subject to the section 4371 excise tax from withholding is to exclude them from the definition of amounts subject to withholding.

## 2. Fixed or Determinable Annual or Periodical Income

Section 1.1441-2(b)(1)(i) provides the definition of fixed or determinable annual or periodical (FDAP) income. Such income, if from sources within the United States, is generally an amount subject to withholding and therefore also subject to reporting on Form 1042-S if paid to a foreign payee. Paragraph (b)(1)(i) states that amounts that are excluded from gross income under any provision of law “without regard to the identity of the holder” are not FDAP income. This provision was, in part, intended to exclude from FDAP qualified scholarship income under section 117. The language, however, failed to accomplish its intended purpose because the section 117 exclusion is dependent on the identity of the person receiving the income—the recipient must be a candidate for a degree at a certain type of educational organization. The paragraph has been revised to state that amounts that are excluded from gross income without regard to the U.S. or foreign status of the owner of the income is not FDAP. In addition, the paragraph has been changed to clarify that amounts excluded from gross income under sections 892 (income of foreign governments) and 115 (income of a U.S. possession) are not excluded from the definition of FDAP since the foreign status of the owner of the income is determinative of whether the exclusions provided by those sections apply. Amounts subject to the section 892 and section 115 exclusions are, therefore, included in the scope

of amounts subject to withholding and therefore are reportable on Form 1042-S under section 1461 even though not taxable under section 871 or 881.

## 3. Original Issue Discount

Section 1.1441-2(b)(3) provides rules governing the treatment of original issue discount. Paragraph (b)(3)(i) describes the amount of OID subject to taxation in the hands of the owner of an OID obligation. Minor changes have been made to this paragraph to clarify the amount of OID that is taxable to the beneficial owner of the obligation.

Paragraph (b)(3)(ii) describes the amount of OID subject to withholding. To conform paragraph (b)(3)(ii) to the changes discussed in section B. 1 of this Explanation of Provisions, the paragraph has been revised to require a withholding agent to withhold on OID only upon the redemption of the original issue discount obligation or in any case where the withholding agent knows that a sale, other than a redemption, is being made with the principal purpose of avoiding tax on the obligation. A withholding agent is required to withhold on the actual amount of OID includible in the gross income of the owner of an obligation if it has actual knowledge of such amount, or, if actual knowledge is lacking, on the entire amount of OID determined under Publication 1212, “List of Original Issue Discount Instruments” as if the obligation had been held since issuance.

Paragraph (b)(3)(iii) contained a rule that required a withholding agent to withhold on interest and OID paid on an OID obligation even though it did not know the amount of OID subject to taxation if the withholding agent could not reliably associate the payment with valid documentation. The rule was designed to eliminate an exception to withholding that applied if a withholding agent did not have actual knowledge of the amount of OID that accrued to the holder of the obligation up to the date of sale. If the exception were not eliminated, it was feared that the documentation requirement for portfolio interest could be avoided by selling OID obligations through intermediaries that had no knowledge of the accrued amount of OID. The rule is no longer necessary. Under new §1.1441-2(a)(6), withholding is required if a withholding agent knows, or

has reason to know, that an OID obligation is sold with the principal purpose of avoiding tax. Therefore, the rule as originally contained in paragraph (b)(3)(iii) has been removed. New paragraph (b)(3)(iii) contains the transition rule formerly found in paragraph (b)(3)(iv). The rule has been modified, however. As previously drafted, the rule appeared to eliminate any withholding responsibility by the issuer of an OID obligation or its agent, as formerly contained in Rev. Rul. 68-333 (1968-1 C.B. 390). As revised, issuers and their agents are subject to any applicable withholding requirements on obligations issued before or after December 31, 2000. The rule now states, however, that withholding on OID obligations is only required by persons other than issuers or their agents with respect to obligations issued after December 31, 2000.

## C. Changes to §1.1441-3

### 1. Accrued Interest

Section 1.1441-3 provides rules to determine the amount subject to withholding. In accordance with the change made in §1.1441-2(a)(5), which eliminates interest accrued between sales dates from amounts subject to withholding, §1.1441-3(b)(2) has been modified to eliminate the requirement that a withholding agent that pays accrued interest must report that interest on Form 1042-S.

### 2. Coordination With REIT Withholding

As originally drafted, §1.1441-3(c)(4)(i)(C) required withholding under section 1441 on the portion of a Real Estate Investment Trust (REIT) distribution that is not designated as a capital gain dividend or return of basis. Therefore, §1.1441-3(c)(4)(i)(C) inadvertently required withholding under section 1441 on a distribution in excess of basis, which under section 301(c)(3) is capital gain from the sale or exchange of stock and, therefore, not subject to withholding under section 1441. To correct this error, paragraph (c)(4)(i)(C) has been amended to provide that withholding under section 1441 is not required on a distribution in excess of basis. A distribution in excess of basis is, however, subject to withholding under section 1445 unless the interest in the REIT is not a U.S. real property interest (e.g., an interest in a domestically controlled REIT under section 897(h)(2)).

#### D. Changes to §1441-4

##### 1. Notional Principal Contracts

Section 1.1441-4(a)(3)(i) treats a payment of income on a notional principal contract made to a foreign person as income effectively connected with a trade or business within the United States unless the withholding agent can reliably associate a payment with a withholding certificate that certifies that the payment is not effectively connected. This rule is overly broad because it presumes that any notional principal contract payment made to a foreign person is effectively connected even if the foreign person has no nexus to the United States. As a result, §1.1441-4(a)(3)(i) has been amended to limit the presumption that notional principal contract income is effectively connected to a U.S. trade or business to those situations in which the income is either paid to a U.S. qualified business unit of a foreign person or the withholding agent otherwise knows, or has reason to know, that the income is effectively connected with the conduct of a U.S. trade or business. It is not expected that a withholding agent would be considered to have reason to know that a notional principal contract payment is effectively connected with the conduct of a trade or business within the United States solely because the foreign person receiving the payment has a qualified business unit in the United States to which a portion of the payment may be allocated pursuant to proposed regulation §1.863-3(h) (the global dealing regulations).

Section 1.1441-4(a)(3)(ii), as originally drafted, stated that a payment to a financial institution was not treated as effectively connected with the conduct of a trade or business within the United States if the financial institution provided a representation in a master agreement that governs transactions in notional principal contracts between the parties (for example, an International Swaps and Derivatives Association (ISDA) Agreement) or in the confirmation on the particular notional principal contract transaction that the counter party was a U.S. person or a non-U.S. branch of a foreign person.

Commentators requested that the master agreement and confirmation exceptions be expanded to apply to persons other than financial institutions. Section

1.1441-4(a)(3)(ii) has been amended (in the table or corrections at the end of the regulation) to allow any payee, not just a financial institution, to provide in a master agreement or confirmation statement a representation that the payee is a U.S. person or a non-U.S. branch of a foreign person.

##### 2. Withholding on Payments From Individual Retirement Accounts

Section 1.1441-4(b)(1)(ii), as originally drafted, provided that section 1441 applied to distributions from any trust described in section 401(a) made to a non-resident alien individual and to certain other retirement distributions. The result of this rule is that section 1441, rather than section 3405, applies to retirement distributions. This rule considerably eases the burdens that would otherwise apply to retirement distributions.

Commentators noted that the regulations did not provide the same rule for distributions from individual retirement accounts and annuities described in section 408. The regulation has been amended so that those distributions will be subject to section 1441 as well.

#### E. Changes to §1441-5

Section 1.1441-5 of the regulations concerns payments made to partnerships, trusts, and estates. As originally drafted, the regulations contained extensive rules for payments made to U.S. and foreign partnerships, but applied the rules of the regulations prior to the publication of TD 8734 to trusts and estates. The trust and estate rules, however, were inconsistent with the rules contained in TD 8734 and were also incomplete. For example, §1.1441-1(c)(6)(ii)(B) required a withholding agent to determine the beneficial owner of income paid to a trust or estate under §1.1441-3(f) and (g) of the regulations in effect prior to January 1, 2001. That section, however, did not determine the beneficial owner of income paid to a trust. In addition, §1.1441-1(e)(3)(i) stated that a trust or estate was to use a flow-through withholding certificate furnished under §1.1441-5(e), but that section was reserved in the regulation. The regulation has been revised to provide complete trust and estate rules. Except as noted below, the partnership rules remain generally unchanged; however, several changes were made to clarify those rules.

##### 1. Rules Applicable to U.S. Partnerships, Trusts, and Estates

Section 1.1441-5(b), as originally drafted, provided rules regarding payments to U.S. partnerships. The rules of paragraph (b) have been expanded to cover payments to U.S. trusts and U.S. estates as well. Under revised paragraph (b)(1), a payment to a U.S. partnership, U.S. trust, or U.S. estate is treated as a payment to a U.S. person and, therefore, not subject to withholding under chapter 3 of the Internal Revenue Code. United States partnerships, U.S. trusts, and U.S. estates are required, however, to withhold on payments they make to foreign partners, foreign beneficiaries, or, in the case of grantor trusts, foreign owners. Fiduciaries of U.S. trusts and U.S. estates should take particular note that it is the trust or the estate that is the withholding agent, and Forms 1042 and Forms 1042-S must be filed using the name and TIN of the U.S. trust or U.S. estate, not the name and TIN of the fiduciary.

Under paragraph (b)(2), a U.S. partnership is a withholding agent for a foreign partner's distributable share of partnership income that consists of amounts subject to withholding. A U.S. simple trust is a withholding agent for the distributable net income (DNI) includible in the gross income of a foreign beneficiary to the extent the DNI consists of an amount subject to withholding. Similarly, a U.S. complex trust is a withholding agent on DNI includible in the gross income of a foreign beneficiary to the extent the DNI consists of an amount subject to withholding that is, or is required to be, distributed currently. U.S. simple trusts and complex trusts are permitted to make reasonable estimates of the portion of a distribution that constitute DNI consisting of amounts subject to withholding. A U.S. grantor trust must withhold on any income includible in the taxable income of a foreign person that is treated as an owner to the extent the amount includible consists of an amount subject to withholding.

In the case of a partnership, if amounts subject to withholding are not actually distributed, the U.S. partnership must withhold at the earlier of the time the statement required under section 6031(b) (Form K-1) is mailed or otherwise provided to the partner or the due date for furnishing the statement. In addition, if

an amount of income is required to be, but is not actually distributed to the foreign beneficiary of a U.S. simple or complex trust, the U.S. trust must withhold at the time the income is required to be reported on Form 1042-S. A U.S. grantor trust is required to withhold at the time the trust receives the payment or the payment is credited to the trust's account.

## 2. Payments Made to Foreign Partnerships

Section 1.1441-5(c) provides rules for payments made to foreign partnerships. Generally, the payees of a payment made to a nonwithholding foreign partnership are the partners of the partnership. Paragraph (c)(1)(ii), however, contains rules on when the partnership itself will be regarded as the payee of a payment. That paragraph, as originally drafted, permitted a partnership to be treated as the payee of income if the partnership provided a withholding certificate stating that the payment was effectively connected with the conduct of the partnership's U.S. trade or business. A commentator noted that the paragraph did not treat the partnership as the payee, however, to the extent the income was treated as being effectively connected under the presumption rules in the absence of a withholding certificate.

The paragraph has been revised to treat the partnership as the payee if the income is presumed to be effectively connected in the absence of documentation. For example, if a nonwithholding foreign partnership is receiving income on a notional principal contract and the income is treated as effectively connected income under the presumption rule of §1.1441-4(b)(3)(i), the nonwithholding foreign partnership, and not the partners, is treated as the payee. In addition, the example in paragraph (c)(1)(iv) has been replaced with several less complex examples that better illustrate the operation of the rules of paragraph (c)(1).

Section 1.1441-5(c)(2) contains rules relating to withholding foreign partnerships. Section 1.1441-5(c)(2)(ii)(A), together with §1.1461-1(c)(2)(ii)(A), required a withholding foreign partnership to file a Form 1065 and Forms K-1 and exempted the partnership from having to file Form 1042 and Forms 1042-S. The rule was incorrect. A withholding foreign partnership is generally required to with-

hold on payments and therefore must file a Form 1042, which is an income tax return, and not merely report the amounts on Form 1065. Also, because the IRS matches amounts reported on Forms 1042-S with amounts reported on Form 1042, it was incorrect to substitute Forms K-1 for Forms 1042-S. Therefore, the regulation has been amended to require a withholding foreign partnership to file a tax return on Form 1042 and file information returns on Form 1042-S for amounts subject to withholding paid to, or included in the distributive share of, its foreign partners. A withholding foreign partnership may also be required to file a return on Form 1065 and make the statements on Form K-1 under section 6031 for its partners. However, the IRS may agree in the withholding agreement to modify information reporting requirements to avoid double reporting. A rule that was formerly contained in §1.1441-7(a), which permitted a withholding foreign partnership to arrange with a withholding agent to have the withholding agent impose withholding on a payment has been removed because a withholding foreign partnership is required to assume withholding responsibility.

Section 1.1441-5(c)(3) provides rules relating to nonwithholding foreign partnerships. Paragraph (c)(3)(iv) has been revised to require a nonwithholding foreign partnership to provide a withholding statement in the same manner as a non-qualified intermediary. In addition, paragraph (c)(3)(v) has been revised to conform with revised §1.1441-1(b)(6), discussed in section A. 5 of this Explanation of Provisions. Thus, the regulation has been changed to make clear that a nonwithholding foreign partnership has an obligation to report payments even though another withholding agent has withheld the appropriate amount if the nonwithholding partnership has failed to provide adequate information for a withholding agent to report the payments appropriately on Form 1042-S and Form 1099 or the nonwithholding foreign partnership knows, or has reason to know, that the payments were not correctly reported.

Paragraph (d) of §1.1441-5 provides presumption rules that apply to determine the status of a partnership and its partners if a payment cannot be reliably associated

with valid documentation. The rule in paragraph (d)(3)(ii), which permitted a reduced rate of withholding to be applied to a payment to a nonwithholding foreign partnership if the payment could be associated with a group of documented payees all of whom were subject to the same withholding rate has been removed for the reasons stated in connection with the changes made to §1.1441-1(b)(3)(v)(C). See section A. 4, of this Explanation of Provisions. Under the revised rule, any payment of an amount subject to withholding paid to a foreign partnership that has not been allocated to a specific payee is presumed made to an undocumented foreign payee and subject to 30 percent withholding.

## 3. Payments to Foreign Trusts and Estates

Treasury Decision 8734 did not include new provisions regarding withholding on payments by and to foreign trusts and foreign estates. The IRS provided interim guidance in the instructions to Forms W-8BEN and W-8IMY so that withholding agents could replace documentation that was expiring under the withholding regulations with documentation that would meet the requirements of TD 8734. In addition, Notice 99-8 announced that Treasury and the IRS intended to issue regulations that would clarify the withholding obligations of income paid to trusts and estates. Under the instructions and the notice, a payment to a foreign fiduciary was treated as a payment to a foreign intermediary and, therefore, the foreign fiduciary was required to furnish an intermediary withholding certificate on Form W-8IMY. If the trust was a trust described in section 651(a) or a trust, all or a portion of which was treated as owned by the grantor or other persons under sections 671 through 679, the fiduciary was required to attach Forms W-8BEN, Forms W-8EXP, or Forms W-9, from the beneficiaries or owners of the trust. In all other cases, the foreign trustee or executor was required to attach a Form W-8BEN, Form W-8EXP, or if required, Form W-9, completed on behalf of the trust or estate.

Several commentators objected to the requirement that a foreign fiduciary of a complex trust or a foreign estate provide an intermediary withholding certificate. They requested that a withholding certifi-



cate be required only from the trust or estate itself. Requiring documentation from a fiduciary also was not consistent with the rules under chapter 61, which generally require a Form W-9 from a trust or estate and ignore the status of the fiduciary. Finally, Notice 99-8 did not provide any presumption rules for payments to foreign trusts and foreign estates.

The regulations now contain a comprehensive set of rules for payments made to foreign trusts and foreign estates in §1.1441-5(e). A foreign complex trust (as defined in paragraph (c)(25)) and a foreign estate are generally considered beneficial owners of income under §1.1441-1(c)(6). Therefore, under §1.1441-5(e)(2), a foreign complex trust or a foreign estate may provide a beneficial owner withholding certificate or other beneficial owner documentation for payments for which a reduced rate of withholding is not claimed under a treaty. Whether such a trust or estate can provide a beneficial owner withholding certificate to claim a reduced rate of withholding under an income tax treaty will depend on whether the trust or estate can claim to be a resident of a treaty country, whether it derives the income under section 894, and the regulations thereunder, and whether treaty benefits are denied under a limitation on benefits provision.

Foreign simple trusts and foreign grantor trusts are not payees or beneficial owners under §1.1441-5(e)(3), unless the payment is an amount that is treated as effectively connected with the conduct of a U.S. trade or business. The payees of payments to a foreign simple trust or a foreign grantor trust are generally the beneficiaries or owners of the trust. This is similar to the treatment accorded to payments to foreign partnerships, where the partners, rather than the partnership, are generally considered the payees of income paid to the partnership. Therefore, the documentation rules applicable to foreign simple trusts and foreign grantor trusts generally accord with those applicable to foreign partnerships. The trust itself provides a flow-through withholding certificate with which it associates the withholding certificates or, if permitted, documentary evidence of its beneficiaries or owners. The foreign simple trust or foreign grantor trust must also associate with its flow-through withholding certifi-

cate a withholding statement identical to that provided by foreign partnerships and nonqualified intermediaries. The IRS may permit a foreign trust to function as a withholding foreign trust. A withholding foreign trust would generally be subject to the same provisions as a withholding foreign partnership.

Section 1.1441-1(e)(6) provides presumption rules for payments of amounts subject to withholding to foreign trusts and estates. Whether a payee is a trust or estate is determined under the general presumption rules of §1.1441-1(b)(3)(ii). A trust or estate is presumed to be U.S. unless there are indicia of foreign status. If a payee is presumed to be a foreign trust, but its status as a complex, simple, or grantor trust is unknown, it will be treated as a complex trust. If the trust is known to be a foreign simple or grantor trust, its beneficiaries or owners will generally be presumed to be foreign with respect to payments of amounts subject to withholding.

#### *F. Changes to §1441-6*

Section 1.1441-6 contains the provisions for claiming a reduced rate of withholding under an income tax treaty. Section 1.1441-6(b) has been revised to clarify the requirements for claiming treaty benefits. Specifically, the provisions of paragraph (b)(2), as originally drafted, which related to use of documentary evidence, have been moved to newly revised paragraphs (c)(1) and (2) so that all the documentary evidence rules appear in the same paragraph. Paragraph (b)(2) now contains the provisions relating to treaty claims made by interest holders of fiscally transparent entities. Clarifying changes to those rules, which appeared in former paragraph (b)(4), have also been made.

Section 1.1441-6(c)(1) and (2), as originally drafted, required a foreign person to establish residency by obtaining a certified taxpayer identification number (certified TIN) from the IRS. Those provisions required a person claiming a reduced rate of withholding to submit either a certificate of residency or certain other prescribed documentation, plus affidavits regarding compliance with the limitation on benefits provisions of a treaty and with the regulations under section 894. In Notice 99-8, the IRS announced that it

would not implement the procedures for obtaining certified TINs until January 1, 2002.

The certified TIN procedures have been removed. New paragraph (b)(3), however, provides authority for the IRS to issue guidance on requirements that a treaty claimant must follow to establish residency and compliance with other requirements imposed by treaties and the Internal Revenue Code, such as limitation on benefits provisions and the requirement that the claimant derive the income under section 894. Treasury and the IRS fully intend to implement such procedures. However, Treasury and the IRS determined that it was appropriate to delay implementation of the requirement while withholding agents and beneficial owners implement other requirements under the regulation. In addition, the IRS will examine ways to more effectively implement the certified TIN requirement.

Paragraphs (c)(3) and (4) prescribe the types of documentation that can be used to claim treaty benefits for income from marketable instruments paid outside the United States to offshore accounts. Former paragraph (b)(2) stated that documentary evidence could be used, in certain cases, to claim treaty benefits if the documentary evidence was accompanied by the certifications required in paragraph (c)(5). Paragraph (c)(5) contained a requirement that a beneficial owner applying for a certified TIN provide the IRS with certifications, made in an affidavit signed under penalties of perjury, that the beneficial owner was in compliance with any applicable limitation on benefits provisions contained in a treaty and that the beneficial owner derives the income for which treaty benefits will be claimed. It was unclear from the regulations, as drafted, whether the certifications that were provided to withholding agents were required to be made in affidavits signed under penalties of perjury or whether the affidavit requirement only applied to obtaining certified TINs. Although Treasury and the IRS believe it is important that statements regarding compliance with limitation on benefits provisions and section 894 be given in conjunction with documentary evidence provided to a withholding agent, a penalties of perjury requirement would impose a burden that undermines the use of documentary evi-

dence. One reason for permitting use of documentary evidence is to eliminate, as much as possible, the need for a penalties of perjury statement. Thus, the affidavit and penalties of perjury requirements have been eliminated with respect to documentary evidence provided to a withholding agent. The IRS may, however, require an affidavit in connection with the certified TIN procedures that it will establish. The affidavit requirement in paragraph (c)(4), stating that the information on documentary evidence is true and complete, has also been eliminated.

### G. Changes to §1.1441-7

Section 1.1441-7 defines the term *withholding agent* and provides various rules relating to the obligations of withholding agents, including certain due diligence requirements regarding the documentation they receive from payees.

#### 1. Withholding Agent Defined

§1.1441-7(a) provides the definition of a withholding agent as well as a withholding agent's obligation to withhold the appropriate amount of taxes and file returns. The section has been revised by removing language stating that a withholding foreign partnership does not have to file Forms 1042-S for payments made to foreign partners because it is required to provide Forms K-1. The reason for this change is discussed in section E. 2 of this Explanation of Provisions.

Some U.S. withholding agents commented that foreign persons, including U.S. branches of foreign persons, were taking the position that they were not withholding agents for purposes of chapter 3 of the Internal Revenue Code. Any person, whether U.S. or foreign, that pays, or has control, receipt, custody, or disposal of an amount subject to withholding is a withholding agent. In addition, with respect to a single item of income, each person that handles the payment is a withholding agent. Thus, there may be more than one withholding agent with respect to a payment of an amount subject to withholding. Examples have been added in new paragraph (a)(2) to illustrate these principles. In particular, examples were added to emphasize that foreign persons that pay, or have control, receipt, or custody, of amounts subject to withholding are withholding agents, in-

cluding U.S. branches of foreign persons.

#### 2. Reason to Know

Section 1.1441-7(b)(2)(ii), as originally drafted, provided the exclusive rules for determining when a withholding agent that is a financial institution making a payment of income from marketable securities has reason to know that documentation provided to the withholding agent is unreliable. Commentators noted that the language of paragraph (b)(2)(ii) was inconsistent about whether the rules applied only to withholding certificates (i.e., Forms W-8) or also to documentary evidence. In addition, many commentators noted that the rules could not be reasonably applied to documentary evidence received through tiers of intermediaries, because that documentation would often be in a foreign language. They further argued that the rules relating to P.O. box addresses were unreasonable because in some countries P.O. box addresses are standard. Finally, commentators noted that the means for curing otherwise unreliable documentation were, in some instances, too restrictive.

Section 1.1441-7 (b)(3) through (10) have been added to address the comments. Some of the changes made to paragraph (b) reflect rules in the model qualified intermediary agreement contained in Rev. Proc. 2000-12. Paragraphs (b)(4) through (b)(9) relate to the obligations of a withholding agent for account holders that have a direct account relationship with the withholding agent. The rules are limited to direct account relationships because they often rely on account information that will exist only if such a relationship exists. However, under the rules of paragraph (b)(10), which relate to documentation from persons that are not direct account holders, the rules in paragraph (b)(4) through (9) apply to the extent that they rely on information contained on the face of a withholding certificate, documentary evidence, or a withholding statement.

Paragraph (b)(4) contains general rules regarding the reliability of a withholding certificate provided on Form W-8. Paragraph (b)(5) contains rules for when a Form W-8 will be regarded as unreliable to establish a beneficial owner's foreign status and applicable cure provisions. Paragraph (b)(6) contains rules for when a

Form W-8 will be regarded as unreliable to establish a beneficial owner's claim of treaty benefits and applicable cure provisions. Paragraph (b)(7) provides general rules relating to documentary evidence. Paragraphs (b)(8) and (b)(9) contain rules regarding documentary evidence that is unreliable to establish a beneficial owner's status as a foreign person or a resident of a treaty country, respectively.

Paragraph (b)(10) provides rules regarding due diligence standards for documentation from payees received through nonqualified intermediaries, flow-through entities, and certain U.S. branches of foreign banks and insurance companies. Under paragraph (b)(10), a withholding agent is required to review the information contained in a withholding statement provided by those entities and may not rely on the information contained in the withholding statement to the extent it does not support the claims made for the payee. A withholding agent must also review each withholding certificate to verify that they support the claims made and are consistent with the information on the withholding statement. Under a transition rule, this review process does not apply to withholding certificates received before December 31, 2001, if the payment is made prior to that date. If a withholding certificate received before December 31, 2001, is relevant to a payment made after that date, it must be reviewed for accuracy and matched to the information contained in the withholding statement. Finally, a withholding agent must review documentary evidence to determine that there is no obvious indication that the payee is a U.S. non-exempt recipient or no obvious indication that the documentary evidence does not establish the identity of the person who provided the documentation.

### H. Changes to §1.1441-9

Section 1.1441-9 provides the rules for payments made to foreign tax-exempt entities and foreign governments. Paragraph (b)(2) of that section provided that if a tax-exempt organization did not have a determination from the IRS, it could establish its exempt status by attaching to its withholding certificate an opinion of counsel concluding that the organization is described in section 501(c) of the Internal Revenue Code. In addition, if the

opinion concluded that the organization was described in section 501(c)(3) and was not a private foundation, an affidavit regarding the operations and support of the organization was required to be attached to the organization's withholding certificate as well. The opinion of counsel and affidavit was required to be renewed whenever the certificate to which it was attached was required to be renewed.

Commentators stated that the requirement that the opinion of tax-exempt status be provided by an attorney was too narrow and that an opinion from any federally authorized tax practitioner, as defined in section 7525(a)(3), should be permitted. In addition, the requirement that the opinion of counsel and the affidavit be renewed whenever the certificate was required to be renewed was confusing because a withholding certificate from a tax-exempt entity requires a TIN and, provided the income paid is subject to reporting, is valid indefinitely absent a change in circumstances.

Treasury and IRS are currently considering whether an opinion issued by a person other than an attorney authorized to practice before the IRS should suffice. Although the Treasury and IRS have not yet concluded that a person other than an attorney should be permitted to provide the opinion, the regulation has been amended to permit that possibility in future guidance. In addition, the requirement to renew the opinion and affidavit has been clarified by stating that it must be renewed if there is a change in facts or circumstances relevant to the organization's status under section 501(c)(3).

#### *I. Changes to §1.1461-1*

Section 1.1461-1 contains requirements regarding the payment and deposit of tax withheld under chapter 3 of the Internal Revenue Code and the filing of a tax return (Form 1042) and information returns (Forms 1042-S) by withholding agents. Generally, the paragraph has been amended to make a withholding agent's obligations clearer.

Paragraphs (b)(2) and (c)(4), as originally drafted, stated that a withholding agent was not required to file a tax return or information return if another withholding agent had done so. Numerous exceptions to the rule were provided. These

paragraphs were misleading because they implied that the general rule was that a tax return and information returns were not required if there was another withholding agent in the chain of payment required to file a tax return and information returns. The exceptions to the rule, however, required every withholding agent that made payments of an amount subject to withholding to a foreign person to file a tax return and information returns in every situation, except that a nonqualified intermediary or flow-through entity was not required to file a tax return and information returns for payments that it made provided that it furnished to a withholding agent sufficient information for the withholding agent to correctly withhold and report the payment. Section 1.1461-1(b) and (c) have been clarified to state that a withholding agent that makes a payment of an amount subject to reporting to a recipient must file a Form 1042-S and provide a copy to the recipient. The terms recipient and amount subject to reporting are defined in paragraphs (c)(1)(ii) and (c)(2), respectively. A recipient includes a beneficial owner (including a foreign complex trust and estate), a qualified intermediary, a withholding foreign partnership, a withholding foreign trust, an authorized foreign agent, a U.S. branch treated as a U.S. person, a nonwithholding foreign partnership or foreign simple trust receiving income effectively connected with a U.S. trade or business, any payee presumed to be a foreign person, and any other person for whom a Form 1042-S is required by the instructions to the form. A nonqualified intermediary, a disregarded entity, a flow-through entity, and a U.S. branch that is not treated as a U.S. person are not recipients. Amounts paid to such entities are reported as paid to the persons on whose behalf the entity acts or to the interest holders in the entity. The term amount subject to reporting generally means amount subject to withholding as defined under §1.1441-2(a). The regulation has also been clarified by providing a more extensive, but not exhaustive, list of those amounts subject to reporting and those amounts for which there is an exception to reporting. See new §1.1461-1(c)(2). Paragraph (c)(2)(i)(C), as originally drafted, stated that the amount of effectively connected income that was required to be reported

with respect to a notional principal contract was the net income described in §1.446-3(d). Commentators objected to this requirement because their systems are programmed to report cash payments, not accrued amounts. New paragraph (c)(2)(i)(J) now provides that the amount required to be reported is limited to the amount of cash paid from the notional principal contract.

Finally, the section has been clarified by separately stating the reporting requirements of U.S. withholding agents, qualified intermediaries, nonqualified intermediaries, and flow-through entities. Withholding agents should note, in particular, that information regarding nonqualified intermediaries, flow-through entities, and U.S. branches (other than U.S. branches treated as U.S. persons) in which a recipient is an account holder or an interest holder must be included on Form 1042-S. Such information is important to the IRS's efforts to monitor compliance by such entities and branches with the requirements of the regulations.

#### *J. Changes to the regulations under section 6041*

Section 1.6041-1(d) has been revised to require that the amount of a notional principal contract payment reported on Form 1099 is the amount of cash paid on the contract for the calendar year. This change conforms the Form 1099 reporting rule to that under §1.1461-1(c)(2)(i)(J).

Section 1.6041-4(a)(3) states that a nonqualified intermediary, a qualified intermediary, or certain U.S. branches of foreign banks and insurance companies that receive payments reportable under section 6041 (e.g., rents, notional principal contract income, and other fixed or determinable income) are not required to report the payments on Form 1099 when they, in turn, make the payment to their account holders unless they know the payments are required to be reported and were not so reported. Similar exceptions apply to dividends, gross proceeds from sales of securities, and interest under §§1.6042-3(b)(1)(vi), 1.6045-1(g)(v), and 1.6049-5(b)(14), respectively. These provisions have been modified to state that the exception does not apply to a U.S. branch of a foreign bank or insurance company that agrees with a withholding agent to be treated as a U.S. person. The

exception is inappropriate in this case because such branches do not provide payee documentation on Form W-9 (or the name, address, TIN, and information allocating the payment to the payee) to a withholding agent. The exception is also inappropriate if a qualified intermediary assumes Form 1099 reporting responsibility. Therefore, the exception has been changed to exclude qualified intermediaries that assume Form 1099 reporting. Finally, the exceptions have been amended to state that a nonqualified intermediary, qualified intermediary, or U.S. branch is deemed to know the required reporting was not done in any case where the intermediary or branch has failed to provide documentation or other information so that another payor can do the reporting.

#### *K. Changes to §1.6041A-1*

Section 1.6041A-1(d)(3)(i)(C) has been added to provide an exception from reporting remuneration for services as a direct seller paid outside the United States. Prior to this change, remuneration for services was subject to reporting in absence of documentation establishing the direct seller's status as a foreign person because the presumption rules of §§1.6049-5(d)(2) and 1.1441-1(b)(3)(iii) treated a direct seller as a U.S. non-exempt recipient. Commentators stated that the presumption was inaccurate because most direct sellers abroad are foreign persons. They also argued that obtaining documentation from direct sellers to rebut the presumption was overly burdensome.

#### *L. Changes to §1.6045-1*

Section 1.6045-1(g) provides an exception from Form 1099 reporting for a broker if a customer is considered an exempt foreign person under that section. Under §1.6045-1(g)(1)(i), a broker may treat a customer as an exempt foreign person if the broker receives a withholding certificate or documentary evidence that establishes the person's status as a foreign person. As originally drafted, the last sentence of §1.6045-1(g)(1)(i) stated that if a withholding certificate was provided, a withholding agent could rely on the certificate to exempt the customer from reporting only if the certificate included a statement that the beneficial owner had not been, and at the time the certificate

was furnished reasonably expected not to be, present in the United States for a period aggregating 183 days or more during each calendar year. The regulation did not state whether the a statement was required if documentary evidence was provided.

Two clarifying changes have been made to §1.6045-1(g)(1)(i). First, the regulation has been modified to require the statement relating to presence in the United States only from individuals. Second, the regulation states that the statement is not required if documentary evidence is provided. The statement is required on a withholding certificate and not on documentary evidence because a withholding certificate is the documentation required for an account maintained in the United States. Documentary evidence can only be used for amounts paid outside the United States to an offshore account and, therefore, the likelihood that the person may be present in the United States for the relevant period is greatly reduced.

Clarifying changes have also been made to §1.6045-1(g)(3)(iv). The first sentence of that section stated that a broker could treat an intermediary, as defined in §1.1441-1(c)(13), as an exempt recipient except when the broker had actual knowledge or reason to know the intermediary was acting on behalf of a U.S. person. The exception should only apply if the intermediary is acting on behalf of a U.S. person who is subject to reporting on Form 1099, that is, a U.S. non-exempt recipient. The regulation has been amended to make this clear. An erroneous cite to nonwithholding foreign partnerships has also been eliminated.

In paragraph (g)(4) of §1.6045-1, *Example 7* has been amended to reflect the change to the regulations that now generally treats accrued interest as an amount that is not subject to withholding. Under that example, a foreign bank that is a U.S. payor effects a sale of an interest bearing obligation at an office outside the United States on behalf of an undocumented account holder. Under the regulation, as originally drafted, the gross proceeds from the sale, net of accrued interest, were reported on Form 1099 as paid to a payee that was presumed to be a U.S. person. However, because the accrued interest was considered an amount subject to withholding, it was reportable on Form

1042-S. Under the regulation, as revised, accrued interest is treated as an amount that is not subject to withholding. Therefore, both the gross proceeds, net of accrued interest, and the accrued interest are now presumed paid to a U.S. payee and reported on Form 1099 under the presumption rule §1.6049-5(d)(2). Two additional examples have been added to paragraph (g)(4) to illustrate the operation of the presumption rules on a sale of a short-term original issue discount instrument. These examples were added to make clear that a sale of an OID obligation outside the United States is a gross proceeds transaction and, therefore, under the presumption rule of §1.6049-5(d)(2), presumed made to a U.S. person. Whether the gross proceeds are reportable depends on whether the exception of §1.6045-1(a) for sales outside the United States by a non-U.S. payor applies.

#### *M. Changes to §1.6049-5*

Under §1.6049-5(c)(1), a withholding agent or payor may generally rely on documentary evidence from a foreign payee instead of a beneficial owner withholding certificate on Form W-8 if an amount is paid outside the United States to an offshore account. An offshore account is an account maintained at an office or branch of a U.S. or foreign bank or other financial institution at any location outside the United States and outside of a U.S. possession. Under §1.6049-5(e), an amount is considered paid outside the United States if the payor completes the acts necessary to effect payment outside the United States.

The regulations do not specifically address whether partners of a nonwithholding foreign partnership, foreign beneficiaries of a foreign simple trust, or foreign owners of a foreign grantor trust can use documentary evidence to establish their status as foreign payees. Paragraph (c)(1) has been amended to permit the use of documentary evidence by foreign partners, beneficiaries, and owners in these situations. Documentary evidence can also be used for purposes of chapter 3 of the Internal Revenue Code by virtue of the incorporation of §1.6049-5(c)(1) in §1.1441-1(e)(1)(ii)(A)(2). The use of documentary evidence is appropriate because the regulations generally treat payments to foreign nonwithholding foreign

partnerships, foreign simple trusts, and foreign grantor trusts similar to payments made to nonqualified intermediaries, and the latter are permitted to provide documentary evidence on behalf of their account holders.

Section 1.6049-5(c)(4) provides rules that apply to U.S. payors that make payments outside the United States of amounts not subject to withholding (e.g., foreign source income and gross proceeds from the sale of securities) other than deposit interest and interest or OID on short-term OID instruments. Non-U.S. payors are generally exempt from reporting these payments. There were several issues under paragraph (c)(4) as originally drafted. First, the paragraph was internally inconsistent. Paragraph (c)(4)(i) stated that a bank or other financial institution could establish a payee's status as a foreign person by relying on a written declaration made on an account opening statement that the payee was not a U.S. person in two circumstances: (i) if it was not customary in a country to obtain documentary evidence to establish a person's identity, or (ii) if it was customary to obtain documentary evidence but it was not customary to renew it. Paragraph (c)(4)(iv), however, stated that a bank or financial institution could not rely on a declaration if it was customary to obtain documentary evidence but not customary to renew it. Second, paragraph (c)(4)(i) did not permit a bank or financial institution to rely on documentary evidence to establish a person's foreign status if there was indicia of U.S. status, including employment by a U.S.-based multinational organization. A commentator noted that prohibiting use of documentary evidence merely because an account holder worked for a U.S.-based multinational organization was overly broad because such organizations commonly employ local employees and a withholding agent may not know whether a particular multinational is U.S. based. Finally, paragraph (c)(4)(iii) required a bank or financial institution that relied upon a declaration of foreign status or non-renewable documentary evidence to send a negative confirmation statement each year to the account holder stating that the account holder was being treated as a foreign payee and that the account holder was obligated to notify the bank or financial in-

stitution if it became a U.S. citizen or U.S. resident. A commentator argued that the expense of such a requirement was not justified. The commentator argued that if an account holder legitimately establishes foreign status, it is unlikely that the account holder will become a U.S. citizen or resident and that if it does, there are factors, such as a change of address, that will indicate a change in the person's status.

Paragraph (c)(4) has been amended to remove the inconsistency and to take the commentators' comments into account. Under paragraph (c)(4)(ii), as revised, a declaration of foreign status may be used only if it is not customary to obtain documentary evidence. The declaration may be relied upon only if there is no address or other indicia of U.S. status. If it is customary in the country where a bank or financial institution maintains a branch or office to obtain, but not renew, documentary evidence, then the bank or financial institution may rely on the documentary evidence without the need to renew it provided that it may rely on the documentation to establish foreign status under the due diligence rules of §1.1441-7(b)(7) and (8). The restriction on using such documentation in the case of a U.S. based multinational employee has been removed. If, however, the bank or financial institution may rely on the documentary evidence as establishing foreign status even though there are indicia of U.S. status, it can rely on the documentary evidence only for a period of three full calendar years after the calendar year in which it is received. Finally, neither the documentation rule of paragraph (c)(4)(i) nor the declaration rule of paragraph (c)(4)(ii) requires a payor to send a negative confirmation.

Section 1.6049-5(d) contains presumption rules that generally apply for chapter 61 reporting if a payor lacks required documentation from a payee. Paragraph (d)(2) governs payments other than payments to intermediaries or flow-through entities. Paragraph (d)(2)(i) has been clarified to state that the presumption rules of §1.1441-1(b)(3)(iii)(D) (payments to offshore accounts) do not apply to amounts that are not subject to withholding. As originally drafted, paragraph (d)(2)(i) stated that the rules of §1.1441-1(b)(3)(iii) applied to all payments, irrespective of whether they were

subject to withholding. Section 1.1441-1(b)(3)(iii)(D), however, stated that it did not apply to amounts that were not subject to withholding. Revised paragraph (d)(2)(i) eliminates the inconsistency. Therefore, payments of deposit interest, and interest or OID arising from the redemption of an obligation described in section 871(g)(1)(B)(i) paid to an offshore account are presumed paid to a U.S. payee. In addition, gross proceeds, which are not amounts subject to withholding, are also treated as paid to U.S. persons under §1.6045-1(g)(1)(i). Under the exceptions of §§1.6045-1(a)(1) and 1.6045-1(g)(3), however, gross proceeds from the sale of a security by a non-U.S. payor effected outside the United States are not subject to reporting.

The grace period rule in §1.6049-5(d)(2)(ii), as originally drafted, did not cover the same payments as were covered under the grace period rule of §1.1441-1(b)(3)(iv) even though the latter regulation cross-references §1.6049-5(d)(2)(ii). For example, the rule under the 1441 regulations, but not the rule under section 6049, covered dividends from any redeemable security issued by an investment company and amounts paid with respect to loans of securities. Paragraph 5(d)(2)(ii) has been amended to cover the same payments as are covered by the grace period rule of §1.1441-1(b)(3)(iv). In addition, paragraph (d)(2)(ii) prior to amendment stated that the grace period expired on the earlier of the of the 90th day after the grace period began, the date on which documentation is provided, or the last day of the calendar year. Commentators stated that terminating the grace period at the end of a calendar year complicated systems programming because there was a shrinking grace period for payments made within 90 days of the end of the year. The requirement to terminate the grace period as of the close of a calendar year has been eliminated because it is not necessary.

Paragraph (d)(3) provides presumption rules for payments made to foreign intermediaries. With exceptions for deposit interest and interest and OID on short-term obligations, payments to foreign intermediaries are presumed made to foreign payees. Paragraph (d)(4) provided different presumptions for payments to partnerships. Under that paragraph, pay-

ments made to foreign partnerships were generally presumed made to U.S. payees, even if the partnership established its status as a foreign partnership. Commentators argued that the disparate treatment between intermediaries and partnerships was not justified because they are treated similarly for other purposes under the regulations. The differences also complicated payors' information systems. In response to these comments, the presumption rules of paragraph (d)(3) have been revised to apply to payments made to all flow-through entities (non-withholding foreign partnerships, foreign simple trusts, and foreign grantor trusts).

Paragraph (d)(3)(ii) provides rules for payments of amounts that are not subject to withholding (e.g., foreign source income and gross proceeds from the sales of securities) other than deposit interest and interest and OID on short-term obligations paid to foreign intermediaries and flow-through entities. The paragraph required a payor to presume that a payment was made to an exempt recipient unless the payor had actual knowledge that any person for whom the intermediary was collecting the payment was a U.S. non-exempt recipient. In that case, the payment was treated as made to the U.S. non-exempt recipient. The last sentence of the paragraph, however, also appeared to require a payor to presume that a payment was made to a U.S. non-exempt recipient if it appeared that the payment might be collected on behalf of a U.S. non-exempt payee, because, for example, an intermediary provided Forms W-9 for some payees but did not allocate a payment to any particular payee. The application of the last sentence of the paragraph, however, was uncertain.

Paragraph (d)(3)(ii) has been revised to generally reflect the principle that a payment of an amount that is not subject to withholding (other than short-term OID and deposit interest) made to an intermediary should not be subject to Form 1099 reporting by a payor if the payment would not be subject to Form 1099 reporting if made to a U.S. non-exempt recipient by an intermediary that is not a U.S. payor. Thus, the general rule is that a payment covered by the paragraph (i.e., foreign source income or gross proceeds) is presumed paid to an exempt recipient unless the payor has actual knowledge that the

amount is attributable to a U.S. non-exempt recipient.

As originally drafted, §1.6049-5(d)(3)(iii) provided special presumption rules for payments of deposit interest and interest or OID from short-term original issue discount obligations to foreign intermediaries. It was not clear whether the presumption rule of the paragraph applied to the portion of the sale proceeds representing OID from the sale or exchange of short-term OID instrument in a transaction other than a redemption.

Under paragraph (d)(3)(iii) as revised, a payment of deposit interest or interest or OID on the redemption of a short-term original issue discount obligation paid to an intermediary or flow-through entity is presumed paid to a U.S. payee. The paragraph does not apply to sales or exchanges (other than redemption) of short-term OID instruments. Such sales or exchanges are treated as gross proceeds transactions, in conformance with the rules in §§1.6045-1(c) and (d)(3) and 31.3406(b)(2)-2, and are subject to the general presumption rule for payments made to foreign intermediaries under §1.6049-5(d)(3)(ii). Therefore, gross proceeds from the sale or exchange (other than a redemption) of a short-term OID instrument will generally be presumed paid as made to an exempt recipient. Intermediaries that are U.S. payors, however, may themselves be required to report such gross proceeds under §1.6045-1(c) and (1)(g)(i) and the presumption rule of §1.6049-5(d)(2), which applies to payments made to persons other than an intermediary because under that section gross proceeds are generally considered paid to U.S. payees under that section.

Paragraph (d)(3)(iii)(B) contained a presumption rule for payments made to exempt recipients that had not provided documentation that they were acting as intermediaries. The scope and application of this rule were unclear. Paragraph (d)(3)(iii)(B) has been completely revised and now states that a payment made to an exempt recipient that the payor knows, or has reason to know, is acting as an intermediary is subject to the presumptions that apply to intermediaries.

#### *N. Withholding Certificate Transitional Issues*

The changes made by this regulation will require revisions to instructions to the withholding certificates issued on Form W-8 and certain minor changes to the forms themselves. Until Forms W-8, and the instructions, are revised withholding agents may rely on Forms W-8BEN, W-8ECI, W-8EXP, and W-8IMY as currently in effect but should take into account, particularly with respect to Form W-8IMY used by intermediaries and flow-through entities, that the instructions to the form do not reflect the withholding statement requirements contained in this regulation. In particular, withholding agents and providers of Form W-8IMY should furnish a withholding statement in connection with the form that conforms to §1.1441-1(e)(3)(iv).

#### **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. Finally, it has been determined that the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply to these regulations because the regulations do not impose a collection of information on small entities. Pursuant to 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations (61 F.R. 17614) was submitted to the Small Business Administration for comment on its impact on small business.

#### **Drafting Information**

The principal authors of these regulations are Carl Cooper, Laurie Hatten-Boyd, and Kate Hwa of the Office of Associate Chief Counsel (International).

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#### **Adoption of Amendments to Regulations**

Accordingly, 26 CFR parts 1 and 31 are 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. Effective January 1, 2001, §1.1441-0 is amended by:

1. Revising the entry for §1.1441-1(b)(2)(vii).
2. Adding entries for §1.1441-1(b)(2)(vii)(A) through (F).
- 2a. Revising the entry for §1.1441-1(b)(3)(ii).
3. Adding entries for §1.1441-1(b)(3)(ii)(A) through (C).
4. Revising the entry for §1.1441-1(b)(3)(iv).
5. Revising entry for §1.1441-1(b)(3)(v)(B).
6. Revising the entry for §1.1441-1(b)(3)(vi).
7. Adding entries for §1.1441-1(b)(3)(vii)(A) and (B).
8. Adding entries for §1.1441-1(b)(6)(i) and (ii).
9. Revising the entries for §1.1441-1(c)(6)(ii), (c)(6)(ii)(B), (c)(6)(ii)(C), and adding a new entry for §1.1441-1(c)(6)(ii)(D).
10. Adding entries for §1.1441-1(c)(12) through (29).
11. Revising the entry for §1.1441-1(d)(4).
12. Revising the entry for §1.1441-1(e)(3)(iii), (e)(3)(iv), and (e)(3)(iv)(A) through (C).
13. Adding entries for §1.1441-1(e)(3)(iv)(D) and (E).
14. Adding entries for §1.1441-1(e)(4)(iv)(A), (B), and (C).
15. Revising the entries for §1.1441-1(e)(5)(v) and (e)(5)(v)(B) and (C).
16. Revising the entries for §1.1441-2(b)(3)(i) and (ii).
17. Removing the entries for §1.1441-2(b)(3)(iii) and (iv).
18. Revising the entry for §1.1441-5(a).
19. Revising the entries for §1.1441-5(b), (b)(1), (b)(2), and (b)(2)(i), adding entries for §1.1441-5(b)(2)(i)(A) and (b)(2)(i)(B), and revising entries for §1.1441-5(b)(2)(ii), (b)(2)(iii), (b)(2)(iv), and (b)(2)(v).
20. Revising the entry for §1.1441-5(c)(1)(iv).
21. Removing the entries for §1.1441-5(c)(2)(ii)(A) and (B).
21. Revising the entry for §1.1441-5(c)(3).
22. Revising the entries for §1.1441-5(c)(3)(iii).

23. Revising the entries for §1.1441-5(c)(3)(iv) and (v).
  24. Revising the entry for §1.1441-5(d).
  25. Removing the entries for §1.1441-5(d)(3)(i) through (d)(3)(iv).
  26. Revising the entry for §1.1441-5(d)(4).
  27. Revising the entry for §1.1441-5(e).
  28. Adding entries for §1.1441-5(e)(1), (e)(2), (e)(3), (e)(3)(i), (e)(3)(ii), (e)(4), (e)(5), (e)(5)(i), (e)(5)(ii), (e)(5)(iii), (e)(5)(iv), (e)(5)(v), (e)(6), (e)(6)(i), (e)(6)(ii) and (e)(6)(iii).
  29. Revising the entries for §1.1441-6(b)(2), (b)(2)(i) and (b)(2)(ii).
  30. Adding entries for §1.1441-6(b)(2)(iii) and (b)(2)(iv).
  31. Revising the entry for §1.1441-6(b)(3).
  32. Revising the entry for §1.1441-6(b)(4).
  33. Removing the entries for §1.1441-6(b)(4)(i), (b)(4)(ii), (b)(4)(ii)(A), (b)(4)(ii)(B), (b)(4)(iii), and (b)(4)(iv).
  34. Removing the entry for §1.1441-6(b)(5).
  35. Revising the entry for §1.1441-6(c).
  36. Revising the entry for §1.1441-6(c)(2).
  37. Removing the entries for §1.1441-6(c)(2)(i), (c)(2)(ii), and (c)(2)(iii).
  38. Revising the entries for §1.1441-6(c)(5), (c)(5)(i) and (c)(5)(ii).
  39. Revising the entry for §1.1441-6(e).
  40. Adding entries for §1.1441-7(a)(1) and (2).
  41. Removing the entries for §1.1441-7(b)(2)(i) and (b)(2)(ii).
  42. Revising the entry for §1.1441-7(b)(3).
  43. Adding entries for §1.1441-7(b)(4), (b)(4)(i), (b)(4)(ii), and (b)(5) through (b)(11).
- The additions and revisions read as follows.
- §1.1441-0 Outline of regulation provisions for section 1441.*  
\* \* \* \* \*
- §1.1441-1 Requirement for the deduction and withholding of tax on payments to foreign persons.*  
\* \* \* \* \*
- (b) \* \* \*

- (2) \* \* \*
  - (vii) Rules for reliably associating a payment with a withholding certificate or other appropriate documentation.
  - (A) Generally.
  - (B) Special rules applicable to a withholding certificate from a nonqualified intermediary or flow-through entity.
  - (C) Special rules applicable to a withholding certificate provided by a qualified intermediary that does not assume primary withholding responsibility.
  - (D) Special rules applicable to a withholding certificate provided by a qualified intermediary that assumes primary withholding responsibility under chapter 3 of the Internal Revenue Code.
  - (E) Special rules applicable to a withholding certificate provided by a qualified intermediary that assumes primary Form 1099 reporting and backup withholding responsibility but not primary withholding under chapter 3.
  - (F) Special rules applicable to a withholding certificate provided by a qualified intermediary that assumes primary withholding responsibility under chapter 3 and primary Form 1099 reporting and backup withholding responsibility and a withholding certificate provided by a withholding foreign partnership.
- (3) \* \* \*
- (ii) Presumptions of classification as individual, corporation, partnership, etc.
- (A) In general.
  - (B) No documentation provided.
  - (C) Documentary evidence furnished for offshore account.  
\* \* \* \* \*
  - (iv) Grace period.  
(v) \* \* \*
  - (B) Beneficial owner documentation or allocation information is lacking or unreliable.  
\* \* \* \* \*
  - (vi) U.S. branches.
  - (vii) \* \* \*
  - (A) In general.
  - (B) Special rule for offshore accounts.  
\* \* \* \* \*
  - (6) \* \* \*
  - (i) In general.
  - (ii) Example.  
\* \* \* \* \*
  - (c) \* \* \*
  - (6) \* \* \*
  - (ii) Special rules.  
\* \* \* \* \*

(B) Foreign partnerships.  
 (C) Foreign simple trusts and foreign grantor trusts.  
 (D) Other foreign trusts and foreign estates.  
 \* \* \* \* \*

(12) Payee.  
 (13) Intermediary.  
 (14) Nonqualified intermediary.  
 (15) Qualified intermediary.  
 (16) Withholding certificate.  
 (17) Documentary evidence; other appropriate documentation.  
 (18) Documentation.  
 (19) Payor.  
 (20) Exempt recipient.  
 (21) Non-exempt recipient.  
 (22) Reportable amounts.  
 (23) Flow-through entity.  
 (24) Foreign simple trust.  
 (25) Foreign complex trust.  
 (26) Foreign grantor trust.  
 (27) Partnership.  
 (28) Nonwithholding foreign partnership.  
 (29) Withholding foreign partnership.  
 (d) \* \* \*

(4) When a payment to an intermediary or flow-through entity may be treated as made to a U.S. payee.  
 (e) \* \* \*

(3) \* \* \*

(iii) Intermediary withholding certificate from a nonqualified intermediary.  
 (iv) Withholding statement provided by nonqualified Intermediary.  
 (A) In general.  
 (B) General requirements.  
 (C) Content of withholding statement.  
 (D) Alternative procedures.  
 (E) Notice procedures.  
 \* \* \* \* \*

(4) \* \* \*

(iv) \* \* \*

(A) In general.  
 (B) Requirements.  
 (C) Special requirements for transmission of Forms W-8 by an intermediary. [Reserved]  
 \* \* \* \* \*

(5) \* \* \*

(v) Withholding statement.  
 \* \* \* \* \*

(B) Content of withholding statement.  
 (C) Withholding rate pools.  
 \* \* \* \* \*

*§1.1441-2 Amounts subject to withholding.*  
 \* \* \* \* \*

(b) \* \* \*

(3) \* \* \*

(i) Amount subject to tax.  
 (ii) Amounts subject to withholding.  
 \* \* \* \* \*

*§1.1441-5 Withholding on payments to partnerships trusts, and estates.*  
 (a) In general.  
 (b) Rules applicable to U.S. partnerships, trusts, and estates.  
 (1) Payments to U.S. partnerships, trusts, and estates.  
 (2) Withholding by U.S. payees.  
 (i) U.S. partnerships.  
 (A) In general.  
 (B) Effectively connected income of partners.  
 (ii) U.S. simple trusts.  
 (iii) U.S. complex trusts and U.S. estates.  
 (iv) U.S. grantor trusts  
 (v) Subsequent distribution  
 (c) \* \* \*

(1) \* \* \*

(iv) Examples.  
 \* \* \* \* \*

(3) Nonwithholding foreign partnerships.  
 \* \* \* \* \*

(iii) Withholding certificate from a nonwithholding foreign partnership.  
 (iv) Withholding statement provided by nonwithholding foreign partnership.  
 (v) Withholding and reporting by a foreign partnership.  
 (d) Presumption rules.  
 \* \* \* \* \*

(4) Determination by a withholding foreign partnership of the status of its partners.  
 (e) Foreign trusts and estates.  
 (1) In general.  
 (2) Payments to foreign complex trusts and estates.  
 (3) Payees of payments to foreign simple trusts and foreign grantor trusts.  
 (i) Payments for which beneficiaries and owners are payees.  
 (ii) Payments for which trust is payee.  
 (4) Reliance on claim of foreign complex trust or foreign estate status.  
 (5) Foreign simple trust and foreign grantor trust.  
 (i) Reliance on claim of foreign simple trust or foreign grantor trust status.  
 (ii) Reliance on claim of reduced withholding by a foreign simple trust or foreign grantor trust for its beneficiaries or owners.  
 (iii) Withholding certificate from foreign

simple trust or foreign grantor trust.  
 (iv) Withholding statement provided by a foreign simple trust or foreign grantor trust.  
 (v) Withholding foreign trusts.  
 (6) Presumption rules  
 (i) In general  
 (ii) Determination of status as U.S. or foreign trust or estate in the absence of documentation.  
 (iii) Determination of beneficiary or owner's status in the absence of certain documentation.  
 \* \* \* \* \*

*§1.1441-6 Claim of reduced withholding under an income tax treaty.*  
 \* \* \* \* \*

(b) \* \* \*

(2) Payment to fiscally transparent entity.  
 (i) In general.  
 (ii) Certification by qualified intermediary.  
 (iii) Dual treatment.  
 (iv) Examples.  
 (3) Certified TIN.  
 (4) Claim of benefits under an income tax treaty by a U.S. person.  
 (c) Exemption from requirement to furnish a taxpayer identifying number and special documentary evidence rules for certain income.  
 \* \* \* \* \*

(2) Income to which special rules apply.  
 \* \* \* \* \*

(5) Statements regarding entitlement to treaty benefits.  
 (i) Statement regarding conditions under a limitation on benefits provision.  
 (ii) Statement regarding whether the taxpayer derives the income.  
 \* \* \* \* \*

(e) Competent authority.  
 \* \* \* \* \*

*§1.1441-7 General provisions relating to withholding agents.*  
 (a) \* \* \*

(1) In general.  
 (2) Examples.  
 (b) \* \* \*

(3) Financial institutions—limits on reason to know.  
 (4) Rules applicable to withholding certificates.  
 (i) In general.  
 (ii) Examples.  
 (5) Withholding certificate—establishment of foreign status.  
 (6) Withholding certificate—claim of re-



- duced rate of withholding under treaty.
- (7) Documentary evidence.
- (8) Documentary evidence—establishment of foreign status.
- (9) Documentary evidence—claim of reduced rate of withholding under treaty.
- (10) Limits on reason to know—indirect account holders.
- (11) Additional guidance.

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Par. 3. Effective January 1, 2001, section 1.1441-1 is amended by:

1. Revising the first sentence of paragraph (b)(2)(i).
2. Revising paragraphs (b)(2)(iv)(A), (b)(2)(iv)(B)(3), and (b)(2)(iv)(C).
3. Revising paragraphs (b)(2)(v)(A) and (b)(2)(v)(B).
4. Revising paragraph (b)(2)(vii).
5. Revising the first sentence of paragraph (b)(3)(i).
6. Revising paragraph (b)(3)(ii).
7. Revising paragraphs (b)(3)(iii)(C) and (b)(3)(iii)(D).
8. Revising paragraph (b)(3)(iv).
9. Revising paragraph (b)(3)(v).
10. Revising paragraphs (b)(3)(vi) and (b)(3)(vii).
11. Revising paragraph (b)(6).
12. Revising paragraph (c)(2).
13. Revising paragraph (c)(6).
14. Adding paragraphs (c)(12) through (c)(29).
15. Revising paragraphs (d)(2) through (d)(4).
16. Revising paragraphs (e)(1)(ii)(A)(1), (e)(1)(ii)(A)(3), and (e)(1)(ii)(A)(4).
17. Revising paragraph (e)(3).
18. Revising paragraph (e)(4)(ii)(A).
19. Revising paragraphs (e)(4)(ii)(B)(1) through (e)(4)(ii)(B)(4) and (e)(4)(ii)(B)(6), and adding paragraph (e)(4)(ii)(B)(8).
20. Revising paragraph (e)(4)(iv).
21. Revising paragraph (e)(4)(vii).
22. Adding paragraph (e)(4)(ix)(A)(4) and revising paragraph (e)(4)(ix)(C).
23. Revising paragraph (e)(5)(i) and (e)(5)(iii) through (e)(5)(v).

The additions and revisions read as follows:

*§1.1441-1 Requirement for the deduction and withholding of tax on payments to foreign persons.*

\*\*\*\*\*

(b) \*\*\*

(2) *Determination of payee and payee's status*—(i) *In general.* Except as otherwise provided in this paragraph (b)(2) and

§1.1441-5(c)(1) and (e)(3), a payee is the person to whom a payment is made, regardless of whether such person is the beneficial owner of the amount (as defined in paragraph (c)(6) of this section).

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(iv) *Payments to a U.S. branch of certain foreign banks or foreign insurance companies*—(A) *U.S. branch treated as a U.S. person in certain cases.* A payment to a U.S. branch of a foreign person is a payment to a foreign person. However, a U.S. branch described in this paragraph (b)(2)(iv)(A) and a withholding agent (including another U.S. branch described in this paragraph (b)(2)(iv)(A)) may agree to treat the branch as a U.S. person for purposes of withholding on specified payments to the U.S. branch. Notwithstanding the preceding sentence, a withholding agent making a payment to a U.S. branch treated as a U.S. person under this paragraph (b)(2)(iv)(A) shall not treat the branch as a U.S. person for purposes of reporting the payment made to the branch. Therefore, a payment to such U.S. branch shall be reported on Form 1042-S under §1.1461-1(c). Further, a U.S. branch that is treated as a U.S. person under this paragraph (b)(2)(iv)(A) shall not be treated as a U.S. person for purposes of the withholding certificate it may provide to a withholding agent. Therefore, the U.S. branch must furnish a U.S. branch withholding certificate on Form W-8 as provided in paragraph (e)(3)(v) of this section and not a Form W-9. An agreement to treat a U.S. branch as a U.S. person must be evidenced by a U.S. branch withholding certificate described in paragraph (e)(3)(v) of this section furnished by the U.S. branch to the withholding agent. A U.S. branch described in this paragraph (b)(2)(iv)(A) is any U.S. branch of a foreign bank subject to regulatory supervision by the Federal Reserve Board or a U.S. branch of a foreign insurance company required to file an annual statement on a form approved by the National Association of Insurance Commissioners with the Insurance Department of a State, a Territory, or the District of Columbia. The Internal Revenue Service (IRS) may approve a list of U.S. branches that may qualify for treatment as a U.S. person under this paragraph (b)(2)(iv)(A) (see §601.601(d)(2)

of this chapter). See §1.6049-5(c)(5)(vi) for the treatment of U.S. branches as U.S. payors if they make a payment that is subject to reporting under chapter 61 of the Internal Revenue Code. Also see §1.6049-5(d)(1)(ii) for the treatment of U.S. branches as foreign payees under chapter 61 of the Internal Revenue Code.

(B) \*\*\*

(3) As a payment to a foreign person of income that is effectively connected with the conduct of a trade or business in the United States if the withholding agent cannot reliably associate the payment with a withholding certificate from the U.S. branch or any other certificate or other appropriate documentation from another person. See §1.1441-4(a)(2)(ii).

(C) *Consequences to the U.S. branch* A U.S. branch that is treated as a U.S. person under paragraph (b)(2)(iv)(A) of this section shall be treated as a separate person solely for purposes of section 1441(a) and all other provisions of chapter 3 of the Internal Revenue Code and the regulations thereunder (other than for purposes of reporting the payment to the U.S. branch under §1.1461-1(c) or for purposes of the documentation such a branch must furnish under paragraph (e)(3)(v) of this section) for any payment that it receives as such. Thus, the U.S. branch shall be responsible for withholding on the payment in accordance with the provisions under chapter 3 of the Internal Revenue Code and the regulations thereunder and other applicable withholding provisions of the Internal Revenue Code. For this purpose, it shall obtain and retain documentation from payees or beneficial owners of the payments that it receives as a U.S. person in the same manner as if it were a separate entity. For example, if a U.S. branch receives a payment on behalf of its home office and the home office is a qualified intermediary, the U.S. branch must obtain a qualified intermediary withholding certificate described in paragraph (e)(3)(ii) of this section from its home office. In addition, a U.S. branch that has not provided documentation to the withholding agent for a payment that is, in fact, not effectively connected income is a withholding agent with respect to that payment. See paragraph (b)(6) of this section and §1.1441-4(a)(2)(ii).

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(v) *Payments to a foreign*

*intermediary*—(A) *Payments treated as made to persons for whom the intermediary collects the payment.* Except as otherwise provided in paragraph (b)(2)(v)(B) of this section, the payee of a payment to a person that the withholding agent may treat as a foreign intermediary in accordance with the provisions of paragraph (b)(3)(ii)(C) or (b)(3)(v)(A) of this section is the person or persons for whom the intermediary collects the payment. Thus, for example, the payee of a payment that the withholding agent can reliably associate with a withholding certificate from a qualified intermediary (defined in paragraph (e)(5)(ii) of this section) that does not assume primary withholding responsibility or a payment to a nonqualified intermediary are the persons for whom the qualified intermediary or nonqualified intermediary acts and not to the intermediary itself. See paragraph (b)(3)(v) of this section for presumptions that apply if the payment cannot be reliably associated with valid documentation. For similar rules for payments to flow-through entities, see §1.1441-5(c)(1) and (e)(3).

(B) *Payments treated as made to foreign intermediary.* The payee of a payment to a person that the withholding agent may treat as a qualified intermediary is the qualified intermediary to the extent that the qualified intermediary assumes primary withholding responsibility under paragraph (e)(5)(iv) of this section for the payment. For example if a qualified intermediary assumes primary withholding responsibility under chapter 3 of the Internal Revenue Code but does not assume primary reporting or withholding responsibility under chapter 61 or section 3406 of the Internal Revenue Code and therefore provides Forms W-9 for U.S. non-exempt recipients, the qualified intermediary is the payee except to the extent the payment is reliably associated with a Form W-9 from a U.S. non-exempt recipient.

\* \* \* \* \*

(vii) *Rules for reliably associating a payment with a withholding certificate or other appropriate documentation*—(A) *Generally.* The presumption rules of paragraph (b)(3) of this section and §§1.1441-5(d) and (e)(6) and 1.6049-5(d) apply to any payment, or portion of a payment, that a withholding agent cannot reliably associate with valid documentation. Generally, a withholding agent can reli-

ably associate a payment with valid documentation if, prior to the payment, it holds valid documentation (either directly or through an agent), it can reliably determine how much of the payment relates to the valid documentation, and it has no actual knowledge or reason to know that any of the information, certifications, or statements in, or associated with, the documentation are incorrect. Special rules apply for payments made to intermediaries, flow-through entities, and certain U.S. branches. See paragraph (b)(2)(vii)(B) through (F) of this section. The documentation referred to in this paragraph (b)(2)(vii) is documentation described in paragraphs (c)(16) and (17) of this section upon which a withholding agent may rely to treat the payment as a payment made to a payee or beneficial owner, and to ascertain the characteristics of the payee or beneficial owner that are relevant to withholding or reporting under chapter 3 of the Internal Revenue Code and the regulations thereunder. For purposes of this paragraph (b)(2)(vii), documentation also includes the agreement that the withholding agent has in effect with an authorized foreign agent in accordance with §1.1441-7(c)(2)(i). A withholding agent that is not required to obtain documentation with respect to a payment is considered to lack documentation for purposes of this paragraph (b)(2)(vii). For example, a withholding agent paying U.S. source interest to a person that is an exempt recipient, as defined in §1.6049-4(c)(1)(ii), is not required to obtain documentation from that person in order to determine whether an amount paid to that person is reportable under an applicable information reporting provision under chapter 61 of the Internal Revenue Code. The withholding agent must, however, treat the payment as made to an undocumented person for purposes of chapter 3 of the Internal Revenue Code. Therefore, the presumption rules of paragraph (b)(3)(iii) of this section apply to determine whether the person is presumed to be a U.S. person (in which case, no withholding is required under this section), or whether the person is presumed to be a foreign person (in which case 30-percent withholding is required under this section). See paragraph (b)(3)(v) of this section for special reliance rules in the case of a payment to a foreign intermediary and §1.1441-5(d) and (e)(6) for spe-

cial reliance rules in the case of a payment to a flow-through entity.

(B) *Special rules applicable to a withholding certificate from a nonqualified intermediary or flow-through entity.* (1) In the case of a payment made to a nonqualified intermediary, a flow-through entity (as defined in paragraph (c)(23) of this section), and a U.S. branch described in paragraph (b)(2)(iv) of this section (other than a branch that is treated as a U.S. person), a withholding agent can reliably associate the payment with valid documentation only to the extent that, prior to the payment, the withholding agent can allocate the payment to a valid nonqualified intermediary, flow-through, or U.S. branch withholding certificate; the withholding agent can reliably determine how much of the payment relates to valid documentation provided by a payee as determined under paragraph (c)(12) of this section (i.e., a person that is not itself an intermediary, flow-through entity, or U.S. branch); and the withholding agent has sufficient information to report the payment on Form 1042-S or Form 1099, if reporting is required. See paragraph (e)(3)(iii) of this section for the requirements of a nonqualified intermediary withholding certificate, paragraph (e)(3)(v) of this section for the requirements of a U.S. branch certificate, and §§1.1441-5(c)(3)(iii) and (e)(5)(iii) for the requirements of a flow-through withholding certificate. Thus, a payment cannot be reliably associated with valid documentation provided by a payee to the extent such documentation is lacking or unreliable, or to the extent that information required to allocate and report all or a portion of the payment to each payee is lacking or unreliable. If a withholding certificate attached to an intermediary, U.S. branch, or flow-through withholding certificate is another intermediary, U.S. branch, or flow-through withholding certificate, the rules of this paragraph (b)(2)(vii)(B) apply by treating the share of the payment allocable to the other intermediary, U.S. branch, or flow-through entity as if the payment were made directly to such other entity. See paragraph (e)(3)(iv)(D) of this section for rules permitting information allocating a payment to documentation to be received after the payment is made.

(2) The rules of paragraph (b)(2)(vii)(B)(1)

of this section are illustrated by the following examples:

*Example 1.* WH, a withholding agent, makes a payment of U.S. source interest to NQI, an intermediary that is a nonqualified intermediary. NQI provides a valid intermediary withholding certificate under paragraph (e)(3)(iii) of this section. NQI does not, however, provide valid documentation from the persons on whose behalf it receives the interest payment, and, therefore, the interest payment cannot be reliably associated with valid documentation provided by a payee. WH must apply the presumption rules of paragraph (b)(3)(v) of this section to the payment.

*Example 2.* The facts are the same as in *Example 1*, except that NQI does attach valid beneficial owner withholding certificates (as defined in paragraph (e)(2)(i) of this section) from A, B, C, and D establishing their status as foreign persons. NQI does not, however, provide WH with any information allocating the payment among A, B, C, and D and, therefore, WH cannot determine the portion of the payment that relates to each beneficial owner withholding certificate. The interest payment cannot be reliably associated with valid documentation from a payee and WH must apply the presumption rules of paragraph (b)(3)(v) of this section to the payment. See, however, paragraph (e)(3)(iv)(D) of this section providing special rules permitting allocation information to be received after a payment is made.

*Example 3.* The facts are the same as in *Example 2*, except that NQI does provide allocation information associated with its intermediary withholding certificate indicating that 25 percent of the interest payment is allocable to A and 25 percent to B. NQI does not provide any allocation information regarding the remaining 50 percent of the payment. WH may treat 25 percent of the payment as made to A and 25 percent as made to B. The remaining 50 percent of the payment cannot be reliably associated with valid documentation from a payee, however, since NQI did not provide information allocating the payment. Thus, the remaining 50 percent of the payment is subject to the presumption rules of paragraph (b)(3)(v) of this section.

*Example 4.* WH makes a payment of U.S. source interest to NQI1, an intermediary that is not a qualified intermediary. NQI1 provides WH with a valid nonqualified intermediary withholding certificate as well as a valid beneficial owner withholding certificates from A and B and a valid nonqualified intermediary withholding certificate from NQI2. NQI2 has provided valid beneficial owner documentation from C sufficient to establish C's status as a foreign person. Based on information provided by NQI1, WH can allocate 20 percent of the interest payment to A, and 20 percent to B. Based on information that NQI2 provided NQI1 and that NQI1 provides to WH, WH can allocate 60 percent of the payment to NQI 2, but can only allocate one half of that payment (30 percent) to C. Therefore, WH cannot reliably associate 30 percent of the payment made to NQI2 with valid documentation and must apply the presumption rules of paragraph (b)(3)(v) of this section to that portion of the payment.

(C) *Special rules applicable to a withholding certificate provided by a qualified intermediary that does not assume pri-*

*mary withholding responsibility.* (1) If a payment is made to a qualified intermediary that does not assume primary withholding responsibility under chapter 3 of the Internal Revenue Code or primary Form 1099 reporting and backup withholding responsibility under chapter 61 and section 3406 of the Internal Revenue Code for the payment, a withholding agent can reliably associate the payment with valid documentation only to the extent that, prior to the payment, the withholding agent has received a valid qualified intermediary withholding certificate and the withholding agent can reliably determine the portion of the payment that relates to a withholding rate pool, as defined in paragraph (e)(5)(v)(C) of this section. In the case of a withholding rate pool attributable to a U.S. non-exempt recipient, a payment cannot be reliably associated with valid documentation unless, prior to the payment, the qualified intermediary has provided the U.S. person's Form W-9 (or, in the absence of the form, the name, address, and TIN, if available, of the U.S. person) and sufficient information for the withholding agent to report the payment on Form 1099. See paragraph (e)(5)(v)(C)(2) of this section for special rules regarding allocation of payments among U.S. non-exempt recipients.

(2) The rules of this paragraph (b)(2)(vii)(C) are illustrated by the following examples:

*Example 1.* WH, a withholding agent, makes a payment of U.S. source dividends to QI. QI provides WH with a valid qualified intermediary withholding certificate on which it indicates that it does not assume primary withholding responsibility under chapter 3 of the Internal Revenue Code or primary Form 1099 reporting and backup withholding responsibility under chapter 61 and section 3406 of the Internal Revenue Code. QI does not provide any information allocating the dividend to withholding rate pools. WH cannot reliably associate the payment with valid payee documentation and therefore must apply the presumption rules of paragraph (b)(3)(v) of this section.

*Example 2.* WH makes a payment of U.S. source dividends to QI. QI has 5 customers: A, B, C, D, and E. QI has obtained documentation from A and B establishing their entitlement to a 15 percent rate of tax on U.S. source dividends under an income tax treaty. C is a U.S. person that is an exempt recipient as defined in paragraph (c)(20) of this section. D and E are U.S. non-exempt recipients who have provided Forms W-9 to QI. A, B, C, D, and E are each entitled to 20 percent of the dividend payment. QI provides WH with a valid qualified intermediary withholding certificate as described in paragraph (e)(2)(ii) of this section with which it associates the Forms W-9 from D and E. QI associates the follow-

ing allocation information with its qualified intermediary withholding certificate: 40 percent of the payment is allocable to the 15 percent withholding rate pool, and 20 percent is allocable to each of D and E. QI does not provide any allocation information regarding the remaining 20 percent of the payment. WH cannot reliably associate 20 percent of the payment with valid documentation and, therefore, must apply the presumption rules of paragraph (b)(3)(v) of this section to that portion of the payment. The 20 percent of the payment allocable to the 15 percent withholding rate pool, and the portion of the payments allocable to D and E are payments that can be reliably associated with documentation.

(D) *Special rules applicable to a withholding certificate provided by a qualified intermediary that assumes primary withholding responsibility under chapter 3 of the Internal Revenue Code.* (1) In the case of a payment made to a qualified intermediary that assumes primary withholding responsibility under chapter 3 of the Internal Revenue Code with respect to that payment (but does not assume primary Form 1099 reporting and backup withholding responsibility under chapter 61 and section 3406 of the Internal Revenue Code), a withholding agent can reliably associate the payment with valid documentation only to the extent that, prior to the payment, the withholding agent has received a valid qualified intermediary withholding certificate and the withholding agent can reliably determine the portion of the payment that relates to the withholding rate pool for which the qualified intermediary assumes primary withholding responsibility under chapter 3 of the Internal Revenue Code and the portion of the payment attributable to withholding rate pools for each U.S. non-exempt recipient for whom the qualified intermediary has provided a Form W-9 (or, in absence of the form, the name, address, and TIN, if available, of the U.S. non-exempt recipient). See paragraph (e)(5)(v)(C)(2) of this section for alternative allocation procedures for payments made to U.S. persons that are not exempt recipients.

(2) *Examples.* The following examples illustrate the rules of paragraph (b)(2)(vii)(D)(1) of this section:

*Example 1.* WH makes a payment of U.S. source interest to QI, a qualified intermediary. QI provides WH with a withholding certificate that indicates that QI will assume primary withholding responsibility under chapter 3 of the Internal Revenue Code with respect to the payment. In addition, QI attaches a Form W-9 from A, a U.S. non-exempt recipient, as defined in paragraph (c)(21) of this section, and provides the name, address, and TIN of B, a U.S. person

that is also a non-exempt recipient but who has not provided a Form W-9. QI associates a withholding statement with its qualified intermediary withholding certificate indicating that 10 percent of the payment is attributable to A, and 10 percent to B, and that QI will assume primary withholding responsibility with respect to the remaining 80 percent of the payment. WH can reliably associate the entire payment with valid documentation. Although under the presumption rule of paragraph (b)(3)(v) of this section, an undocumented person receiving U.S. source interest is generally presumed to be a foreign person, WH has actual knowledge that B is a U.S. non-exempt recipient and therefore must report the payment on Form 1099 and backup withhold on the interest payment under section 3406.

*Example 2.* The facts are the same as in *Example 1*, except that no Forms W-9 or other information have been provided for the 20 percent of the payment that is allocable to A and B. Thus, QI has accepted withholding responsibility for 80 percent of the payment, but has provided no information for the remaining 20 percent. In this case, 20 percent of the payment cannot be reliably associated with valid documentation, and WH must apply the presumption rule of paragraph (b)(3)(v) of this section.

(E) *Special rules applicable to a withholding certificate provided by a qualified intermediary that assumes primary Form 1099 reporting and backup withholding responsibility but not primary withholding under chapter 3.* (1) If a payment is made to a qualified intermediary that assumes primary Form 1099 reporting and backup withholding responsibility for the payment (but does not assume primary withholding responsibility under chapter 3 of the Internal Revenue Code), a withholding agent can reliably associate the payment with valid documentation only to the extent that, prior to the payment, the withholding agent has received a valid qualified intermediary withholding certificate and the withholding agent can reliably determine the portion of the payment that relates to a withholding rate pool or pools provided as part of the qualified intermediary's withholding statement and the portion of the payment for which the qualified intermediary assumes primary Form 1099 reporting and backup withholding responsibility.

(2) The following example illustrates the rules of paragraph (b)(2)(vii)(D)(1) of this section:

*Example.* WH makes a payment of U.S. source dividends to QI, a qualified intermediary. QI has provided WH with a valid qualified intermediary withholding certificate. QI states on its withholding statement accompanying the certificate that it assumes primary Form 1099 reporting and backup withholding responsibility but does not assume primary withholding responsibility under chapter 3 of the Internal Revenue Code. QI represents that 15

percent of the dividend is subject to a 30 percent rate of withholding, 75 percent of the dividend is subject to a 15 percent rate of withholding, and that QI assumed primary Form 1099 reporting and backup withholding for the remaining 10 percent of the payment. The entire payment can be reliably associated with valid documentation.

(F) *Special rules applicable to a withholding certificate provided by a qualified intermediary that assumes primary withholding responsibility under chapter 3 and primary Form 1099 reporting and backup withholding responsibility and a withholding certificate provided by a withholding foreign partnership.* If a payment is made to a qualified intermediary that assumes both primary withholding responsibility under chapter 3 of the Internal Revenue Code and primary Form 1099 reporting and backup withholding responsibility under chapter 61 and section 3406 of the Internal Revenue Code for the payment, a withholding agent can reliably associate a payment with valid documentation provided that it receives a valid qualified intermediary withholding certificate as described in paragraph (e)(3)(ii) of this section. In the case of a payment made to a withholding foreign partnership, the withholding agent can reliably associate the payment with valid documentation to the extent it can associate the payment with a valid withholding certificate described in §1.1441-5(c)(2)(iv).

(3) *Presumptions regarding payee's status in the absence of documentation—*  
(i) *General rules.* A withholding agent that cannot, prior to the payment, reliably associate (within the meaning of paragraph (b)(2)(vii) of this section) a payment of an amount subject to withholding (as described in §1.1441-2(a)) with valid documentation may rely on the presumptions of this paragraph (b)(3) to determine the status of the payee as a U.S. or a foreign person and the payee's other relevant characteristics (e.g., as an owner or intermediary, as an individual, trust, partnership, or corporation). \* \* \*

(ii) *Presumptions of classification as individual, corporation, partnership, etc.*  
(A) *In general.* A withholding agent that cannot reliably associate a payment with a valid withholding certificate or that has received valid documentary evidence under §§1.1441-1(e)(1)(ii)(2) and 1.6049-5(c)(1) or (4) but cannot determine a payee's classification from the

documentary evidence must apply the rules of this paragraph (b)(3)(ii) to determine the payee's classification as an individual, trust, estate, corporation, or partnership. The fact that a payee is presumed to have a certain status under the provisions of this paragraph (b)(3)(ii) does not mean that it is excused from furnishing documentation if documentation is otherwise required to obtain a reduced rate of withholding under this section. For example, if, for purposes of this paragraph (b)(3)(ii), a payee is presumed to be a tax-exempt organization based on §1.6049-4(c)(1)(ii)(B), the withholding agent cannot rely on this presumption to reduce the rate of withholding on payments to such person (if such person is also presumed to be a foreign person under paragraph (b)(3)(iii)(A) of this section) because a reduction in the rate of withholding for payments to a foreign tax-exempt organization generally requires that a valid Form W-8 described in §1.1441-9(b)(2) be furnished to the withholding agent.

(B) *No documentation provided.* If the withholding agent cannot reliably associate a payment with a valid withholding certificate or valid documentary evidence, it must presume that the payee is an individual, a trust, or an estate, if the payee appears to be such person (e.g., based on the payee's name or other indications). In the absence of reliable indications that the payee is an individual, trust, or an estate, the withholding agent must presume that the payee is a corporation or one of the persons enumerated under §1.6049-4(c)(1)(ii)(B) through (Q) if it can be so treated under §1.6049-4(c)(1)(ii)(A)(1) or any one of the paragraphs under §1.6049-4(c)(1)(ii)(B) through (Q) without the need to furnish documentation. If the withholding agent cannot treat a payee as a person described in §1.6049-4(c)(1)(ii)(A)(1) through (Q), then the payee shall be presumed to be a partnership. If such a partnership is presumed to be foreign, it is not the beneficial owner of the income paid to it. See paragraph (c)(6) of this section. If such a partnership is presumed to be domestic, it is a U.S. non-exempt recipient for purposes of chapter 61 of the Internal Revenue Code.

(C) *Documentary evidence furnished for offshore account.* If the withholding agent receives valid documentary evi-

dence, as described in §1.6049-5(c)(1) or (4), with respect to an offshore account from an entity but the documentary evidence does not establish the entity's classification as a corporation, trust, estate, or partnership, the withholding agent may presume (in the absence of actual knowledge otherwise) that the entity is the type of person enumerated under §1.6049-4(c)(1)(ii)(B) through (Q) if it can be so treated under any one of those paragraphs without the need to furnish documentation. If the withholding agent cannot treat a payee as a person described in §1.6049-4(c)(1)(ii)(B) through (Q), then the payee shall be presumed to be a corporation unless the withholding agent knows, or has reason to know, that the entity is not classified as a corporation for U.S. tax purposes, the withholding agent is required to presume the payee is a U.S. person under paragraph (b)(3)(iii) of this section, or there are indicia of U.S. status. If the withholding agent must presume the payee is a U.S. person, or there are indicia of U.S. status, the withholding agent shall treat the entity as a partnership, and therefore as a U.S. non-exempt recipient for purposes of chapter 61 of the Internal Revenue Code; however backup withholding under section 3406 shall not apply if backup withholding is not required under §31.3406(g)-1(e) of this chapter. Indicia of U.S. status exists if payments are regularly made to a payee in the United States, the payee has an account with the same withholding agent in the United States, or the payee has a U.S. address. If a payee is, or is presumed to be, a corporation under this paragraph (b)(3)(ii)(C) and a foreign person under paragraph (b)(3)(iii) of this section, a withholding agent shall not treat the payee as the beneficial owner of income if the withholding agent knows, or has reason to know, that the payee is not the beneficial owner of the income. For this purpose, a withholding agent shall have reason to know that the payee is not a beneficial owner if the documentary evidence indicates that the payee is a bank, broker, intermediary, custodian, or other agent, or is treated under §1.6049-4(c)(1)(ii)(B) through (Q) as such a person. A withholding agent may, however, treat such a person as a beneficial owner if the foreign person provides a statement, in writing and signed by a per-

son with authority to sign the statement, that is attached to the documentary evidence stating it is the beneficial owner of the income.

(iii) \* \* \*

(C) *Pensions, annuities, etc.* A payment from a trust described in section 401(a), an annuity plan described in section 403(a), a payment with respect to any annuity, custodial account, or retirement income account described in section 403(b), or a payment from an individual retirement account or individual retirement annuity described in section 408 that a withholding agent cannot reliably associate with documentation is presumed to be made to a U.S. person only if the withholding agent has a record of a Social Security number for the payee and relies on a mailing address described in the following sentence. A mailing address is an address used for purposes of information reporting or otherwise communicating with the payee that is an address in the United States or in a foreign country with which the United States has an income tax treaty in effect and the treaty provides that the payee, if an individual resident in that country, would be entitled to an exemption from U.S. tax on amounts described in this paragraph (b)(3)(iii)(C). Any payment described in this paragraph (b)(3)(iii)(C) that is not presumed to be made to a U.S. person is presumed to be made to a foreign person. A withholding agent making a payment to a person presumed to be a foreign person may not reduce the 30-percent amount of withholding required on such payment unless it receives a withholding certificate described in paragraph (e)(2)(i) of this section furnished by the beneficial owner. For reduction in the 30-percent rate, see §§1.1441-4(e) or 1.1441-6(b).

(D) *Certain payments to offshore accounts.* A payment is presumed made to a foreign payee if the payment is made outside the United States (as defined in §1.6049-5(e)) to an offshore account (as defined in §1.6049-5(c)(1)) and the withholding agent does not have actual knowledge that the payee is a U.S. person. See §1.6049-5(d)(2) and (3) for exceptions to this rule.

(iv) *Grace period.* A withholding agent may choose to apply the provisions of §1.6049-5(d)(2)(ii) regarding a 90-day grace period for purposes of this para-

graph (b)(3) (by applying the term withholding agent instead of the term payor) to amounts described in §1.1441-6(c)(2) and to amounts covered by a Form 8233 described in §1.1441-4(b)(2)(ii). Thus, for these amounts, a withholding agent may choose to treat an account holder as a foreign person and withhold under chapter 3 of the Internal Revenue Code (and the regulations thereunder) while awaiting documentation. For purposes of determining the rate of withholding under this section, the withholding agent must withhold at the unreduced 30-percent rate at the time that the amounts are credited to an account. However, a withholding agent who can reliably associate the payment with a withholding certificate that is otherwise valid within the meaning of the applicable provisions except for the fact that it is transmitted by facsimile may rely on that facsimile form for purposes of withholding at the claimed reduced rate. For reporting of amounts credited both before and after the grace period, see §1.1461-1(c)(4)(i)(A). The following adjustments shall be made at the expiration of the grace period:

(A) If, at the end of the grace period, the documentation is not furnished in the manner required under this section and the account holder is presumed to be a U.S. non-exempt recipient, then backup withholding applies to amounts credited to the account after the expiration of the grace period only. Amounts credited to the account during the grace period shall be treated as owned by a foreign payee and adjustments must be made to correct any underwithholding on such amounts in the manner described in §1.1461-2.

(B) If, at the end of the grace period, the documentation is not furnished in the manner required under this section, or if documentation is furnished that does not support the claimed rate reduction, and the account holder is presumed to be a foreign person then adjustments must be made to correct any underwithholding on amounts credited to the account during the grace period, based on the adjustment procedures described in §1.1461-2.

(v) *Special rules applicable to payments to foreign intermediaries—(A) Reliance on claim of status as foreign intermediary.* The presumption rules of paragraph (b)(3)(v)(B) of this section apply to a payment made to an intermedi-

ary (whether the intermediary is a qualified or nonqualified intermediary) that has provided a valid withholding certificate under paragraph (e)(3)(ii) or (iii) of this section (or has provided documentary evidence described in paragraph (b)(3)(ii)(C) of this section that indicates it is a bank, broker, custodian, intermediary, or other agent) to the extent the withholding agent cannot treat the payment as being reliably associated with valid documentation under the rules of paragraph (b)(2)(vii) of this section. For this purpose, a U.S. person's foreign branch that is a qualified intermediary defined in paragraph (e)(5)(ii) of this section shall be treated as a foreign intermediary. A payee that the withholding agent may not reliably treat as a foreign intermediary under this paragraph (b)(3)(v)(A) is presumed to be a payee other than an intermediary whose classification as an individual, corporation, partnership, etc., must be determined in accordance with paragraph (b)(3)(ii) of this section to the extent relevant. In addition, such payee is presumed to be a U.S. or a foreign payee based upon the presumptions described in paragraph (b)(3)(iii) of this section. The provisions of paragraph (b)(3)(v)(B) of this section are not relevant to a withholding agent that can reliably associate a payment with a withholding certificate from a person representing to be a qualified intermediary to the extent the qualified intermediary has assumed primary withholding responsibility in accordance with paragraph (e)(5)(iv) of this section.

(B) *Beneficial owner documentation or allocation information is lacking or unreliable.* Any portion of a payment that the withholding agent may treat as made to a foreign intermediary (whether a nonqualified or a qualified intermediary) but that the withholding agent cannot treat as reliably associated with valid documentation under the rules of paragraph (b)(2)(vii) of this section is presumed made to an unknown, undocumented foreign payee. As a result, a withholding agent must deduct and withhold 30 percent from any payment of an amount subject to withholding. If a withholding certificate attached to an intermediary certificate is another intermediary withholding certificate or a flow-through withholding certificate, the rules of this paragraph (b)(3)(v)(B) (or §1.1441-5(d)(3) or (e)(6)(iii)) apply by

treating the share of the payment allocable to the other intermediary or flow-through entity as if it were made directly to the other intermediary or flow-through entity. Any payment of an amount subject to withholding that is presumed made to an undocumented foreign person must be reported on Form 1042-S. See §1.1461-1(c). See §1.6049-5(d) for payments that are not subject to withholding.

(vi) *U.S. branches.* The rules of paragraph (b)(3)(v)(B) of this section shall apply to payments to a U.S. branch described in paragraph (b)(2)(iv)(A) of this section that has not agreed to be treated as a U.S. person.

(vii) *Joint payees—(A) In general.* Except as provided in paragraph (b)(3)(vii)(B) of this section, if a withholding agent makes a payment to joint payees and cannot reliably associate a payment with valid documentation from all payees, the payment is presumed made to an unidentified U.S. person. However, if one of the joint payees provides a Form W-9 furnished in accordance with the procedures described in §§31.3406(d)-1 through 31.3406(d)-5 of this chapter, the payment shall be treated as made to that payee. See §31.3406(h)-2 of this chapter for rules to determine the relevant payee if more than one Form W-9 is provided. For purposes of applying this paragraph (b)(3), the grace period rules in paragraph (b)(3)(iv) of this section shall apply only if each payee meets the conditions described in paragraph (b)(3)(iv) of this section.

(B) *Special rule for offshore accounts.* If a withholding agent makes a payment to joint payees and cannot reliably associate a payment with valid documentation from all payees, the payment is presumed made to an unknown foreign payee if the payment is made outside the United States (as defined in §1.6059-5(e)) to an offshore account (as defined in §1.6049-5(c)(1)).

\* \* \* \* \*

(6) *Rules of withholding for payments by a foreign intermediary or certain U.S. branches—(i) In general.* A foreign intermediary described in paragraph (e)(3)(i) of this section or a U.S. branch described in paragraph (b)(2)(iv) of this section that receives an amount subject to withholding (as defined in §1.1441-2(a)) shall be required to withhold (if another withholding

agent has not withheld the full amount required) and report such payment under chapter 3 of the Internal Revenue Code and the regulations thereunder except as otherwise provided in this paragraph (b)(6). A nonqualified intermediary or U.S. branch described in paragraph (b)(2)(iv) of this section (other than a branch that is treated as a U.S. person) shall not be required to withhold or report if it has provided a valid nonqualified intermediary withholding certificate or a U.S. branch withholding certificate, it has provided all of the information required by paragraph (e)(3)(iv) of this section (withholding statement), and it does not know, and has no reason to know, that another withholding agent failed to withhold the correct amount or failed to report the payment correctly under §1.1461-1(c). A qualified intermediary's obligations to withhold and report shall be determined in accordance with its qualified intermediary withholding agreement.

(ii) *Examples.* The following examples illustrate the rules of paragraph (b)(6)(i) of this section:

*Example 1.* FB, a foreign bank, acts an intermediary for five different persons, A, B, C, D, and E, each of whom owns U.S. securities that generate U.S. source dividends. The dividends are paid by USWA, a U.S. withholding agent. FB furnished USWA with a nonqualified intermediary withholding certificate, described in paragraph (e)(3)(iii) of this section, to which it attached the withholding certificates of each of A, B, C, D, and E. The withholding certificates from A and B claim a 15 percent reduced rate of withholding under an income tax treaty. C, D, and E claim no reduced rate of withholding. FB provides a withholding statement that meets all of the requirements of paragraph (e)(3)(iv) of this section, including information allocating 20 percent of each dividend payment to each of A, B, C, D, and E. FB does not have actual knowledge or reason to know that USWA did not withhold the correct amounts or report the dividends on Forms 1042-S to each of A, B, C, D, and E. FB is not required to withhold or to report the dividends to A, B, C, D, and E.

*Example 2.* The facts are the same as in *Example 1*, except that FB did not provide any information for USWA to determine how much of the dividend payments were made to A, B, C, D, and E. Because USWA could not reliably associate the dividend payments with documentation under paragraph (b)(2)(vii) of this section, USWA applied the presumption rules of paragraph (b)(3)(v) of this section and withheld 30 percent from all dividend payments. In addition, USWA filed a single Form 1042-S reporting the payment to an unknown foreign payee. FB is deemed to know that USWA did not report the payment to A, B, C, D, and E because it did not provide all of the information required on a withholding statement under paragraph (e)(3)(iv) of this section (i.e., allocation information). Although FB is not re-

quired to withhold on the payment because the full 30 percent withholding was imposed by USWA, it is required to report the payments on Forms 1042-S to A, B, C, D, and E. FB's intentional failure to do so will subject it to intentional disregard penalties under sections 6721 and 6722.

\* \* \* \* \*

(c) \* \* \* \*

(2) *Foreign and U.S. person.* The term *foreign person* means a nonresident alien individual, a foreign corporation, a foreign partnership, a foreign trust, a foreign estate, and any other person that is not a U.S. person described in the next sentence. Solely for purposes of the regulations under chapter 3 of the Internal Revenue Code, the term *foreign person* also means, with respect to a payment by a withholding agent, a foreign branch of a U.S. person that furnishes an intermediary withholding certificate described in paragraph (e)(3)(ii) of this section. Such a branch continues to be a U.S. payor for purposes of chapter 61 of the Internal Revenue Code. See §1.6049-5(c)(4). A U.S. person is a person described in section 7701(a)(30), the U.S. government (including an agency or instrumentality thereof), a State (including an agency or instrumentality thereof), or the District of Columbia (including an agency or instrumentality thereof).

\* \* \* \* \*

(6) *Beneficial owner*—(i) *General rule.* This paragraph (c)(6) defines the term beneficial owner for payments of income other than a payment for which a reduced rate of withholding is claimed under an income tax treaty. The term *beneficial owner* means the person who is the owner of the income for tax purposes and who beneficially owns that income. A person shall be treated as the owner of the income to the extent that it is required under U.S. tax principles to include the amount paid in gross income under section 61 (determined without regard to an exclusion or exemption from gross income under the Internal Revenue Code). Beneficial ownership of income is determined under the provisions of section 7701(l) and the regulations under that section and any other applicable general U.S. tax principles, including principles governing the determination of whether a transaction is a conduit transaction. Thus, a person receiving income in a capacity as a nominee, agent, or custodian for another person is not the beneficial owner of the in-

come. In the case of a scholarship, the student receiving the scholarship is the beneficial owner of that scholarship. In the case of a payment of an amount that is not income, the beneficial owner determination shall be made under this paragraph (c)(6) as if the amount were income.

(ii) *Special rules*—(A) *General rule.* The beneficial owners of income paid to an entity described in this paragraph (c)(6)(ii) are those persons described in paragraphs (c)(6)(ii)(B) through (D) of this section.

(B) *Foreign partnerships.* The beneficial owners of income paid to a foreign partnership (whether a nonwithholding or a withholding foreign partnership) are the partners in the partnership, unless they themselves are not the beneficial owners of the income under this paragraph (c)(6). For example, a partnership (first tier) that is a partner in another partnership (second tier) is not the beneficial owner of income paid to the second tier partnership since the first tier partnership is not the owner of the income under U.S. tax principles. Rather, the partners of the first tier partnership are the beneficial owners (to the extent they are not themselves persons that are not beneficial owners under this paragraph (c)(6)). See §1.1441-5(b) for applicable withholding procedures for payments to a domestic partnership. See also §1.1441-5(c)(3)(ii) for applicable withholding procedures for payments to a foreign partnership where one of the partners (at any level in the chain of tiers) is a domestic partnership.

(C) *Foreign simple trusts and foreign grantor trusts.* The beneficial owners of income paid to a foreign simple trust, as described in paragraph (c)(23) of this section, are the beneficiaries of the trust, unless they themselves are not the beneficial owners of the income under this paragraph (c)(6). The beneficial owners of income paid to a foreign grantor trust, as described in paragraph (c)(26) of this section, are the persons treated as the owners of the trust, unless they themselves are not the beneficial owners of the income under this paragraph (c)(6).

(D) *Other foreign trusts and foreign estates.* The beneficial owner of income paid to a foreign complex trust as defined in paragraph (c)(25) of this section or to a foreign estate is the foreign complex trust or estate itself.

\* \* \* \* \*

(12) *Payee.* For purposes of chapter 3 of the Internal Revenue Code, the term *payee* of a payment is determined under paragraph (b)(2) of this section, §1.1441-5(c)(1) (relating to partnerships), and §1.1441-5(e)(2) and (3) (relating to trusts and estates) and includes foreign persons, U.S. exempt recipients, and U.S. non-exempt recipients. A nonqualified intermediary and a qualified intermediary (to the extent it does not assume primary withholding responsibility) are not payees if they are acting as intermediaries and not the beneficial owner of income. In addition, a flow-through entity is not a payee unless the income is (or is deemed to be) effectively connected with the conduct of a trade or business in the United States. See §1.6049-5(d)(1) for rules to determine the payee for purposes of chapter 61 of the Internal Revenue Code. See §§1.1441-1(b)(3), 1.1441-5(d), and (e)(6) and 1.6049-5(d)(3) for presumption rules that apply if a payee's identity cannot be determined on the basis of valid documentation.

(13) *Intermediary.* An *intermediary* means, with respect to a payment that it receives, a person that, for that payment, acts as a custodian, broker, nominee, or otherwise as an agent for another person, regardless of whether such other person is the beneficial owner of the amount paid, a flow-through entity, or another intermediary.

(14) *Nonqualified intermediary.* A *nonqualified intermediary* means any intermediary that is not a qualified intermediary, as defined in paragraph (e)(5)(ii) of this section, or a qualified intermediary that is not acting in its capacity as a qualified intermediary with respect to a payment. For example, to the extent an entity that is a qualified intermediary provides another withholding agent with a foreign beneficial owner withholding certificate as defined in paragraph (e)(2)(i) of this section, the entity is not acting in its capacity as a qualified intermediary. Notwithstanding the preceding sentence, a qualified intermediary is acting as a qualified intermediary to the extent it provides another withholding agent with Forms W-9, or other information regarding U.S. non-exempt recipients pursuant to its qualified intermediary agreement with the IRS.

(15) *Qualified intermediary.* The term

*qualified intermediary* is defined in paragraph (e)(5)(ii) of this section.

(16) *Withholding certificate*. The term withholding certificate means a Form W-8 described in paragraph (e)(2)(i) of this section (relating to foreign beneficial owners), paragraph (e)(3)(i) of this section (relating to foreign intermediaries), §1.1441-5(c)(2)(iv), (c)(3)(iii), and (e)(3)(iv) (relating to flow-through entities), a Form 8233 described in §1.1441-4(b)(2), a Form W-9 as described in paragraph (d) of this section, a statement described in §1.871-14(c)(2)(v) (relating to portfolio interest), or any other certificates that under the Internal Revenue Code or regulations certifies or establishes the status of a payee or beneficial owner as a U.S. or a foreign person.

(17) *Documentary evidence; other appropriate documentation*. The terms *documentary evidence* or *other appropriate documentation* refer to documents other than a withholding certificate that may be provided for payments made outside the United States to offshore accounts or any other evidence that under the Internal Revenue Code or regulations certifies or establishes the status of a payee or beneficial owner as a U.S. or foreign person. See §1.1441-6(b)(2), (c)(3) and (4) (relating to treaty benefits), and 1.6049-5(c)(1) and (4) (relating to chapter 61 reporting). Also see §1.1441-4(a)(3)(ii) regarding documentary evidence for notional principal contracts.

(18) *Documentation*. The term *documentation* refers to both withholding certificates, as defined in paragraph (c)(16) of this section, and documentary evidence or other appropriate documentation, as defined in paragraph (c)(17) of this section.

(19) *Payor*. The term *payor* is defined in §31.3406(a)-2 of this chapter and §1.6049-4(a)(2) and generally includes a withholding agent, as defined in §1.1441-7(a). The term also includes any person that makes a payment to an intermediary, flow-through entity, or U.S. branch that is not treated as a U.S. person to the extent the intermediary, flow-through, or U.S. branch provides a Form W-9 or other appropriate information relating to a payee so that the payment can be reported under chapter 61 of the Internal Revenue Code and, if required, subject to backup withholding under section

3406. This latter rule does not preclude the intermediary, flow-through entity, or U.S. branch from also being a payor.

(20) *Exempt recipient*. The term *exempt recipient* means a person that is exempt from reporting under chapter 61 of the Internal Revenue Code and backup withholding under section 3406 and that is described in §§1.6041-3(q), 1.6045-2(b)(2)(i), and 1.6049-4(c)(1)(ii), and §5f.6045-1(c)(3)(i)(B) of this chapter. Exempt recipients are not exempt from withholding under chapter 3 of the Internal Revenue Code unless they are U.S. persons or foreign persons entitled to an exemption from withholding under chapter 3.

(21) *Non-exempt recipient*. A *non-exempt recipient* is any person that is not an exempt recipient under paragraph (c)(20) of this section.

(22) *Reportable amounts*. *Reportable amounts* are defined in paragraph (e)(3)(vi) of this section.

(23) *Flow-through entity*. A *flow-through entity* means any entity that is described in this paragraph (c)(23) and that may provide documentation on behalf of others to a withholding agent. The entities described in this paragraph are a foreign partnership (other than a withholding foreign partnership), a foreign simple trust (other than a withholding foreign trust) that is described in paragraph (c)(24) of this section, a foreign grantor trust (other than a withholding foreign trust) that is described in paragraph (c)(25) of this section, or, for any payments for which a reduced rate of withholding under an income tax treaty is claimed, any entity to the extent the entity is considered to be fiscally transparent under section 894 with respect to the payment by an interest holder's jurisdiction.

(24) *Foreign simple trust*. A *foreign simple trust* is a foreign trust that is described in section 651(a).

(25) *Foreign complex trust*. A *foreign complex trust* is a foreign trust other than a trust described in section 651(a) or sections 671 through 679.

(26) *Foreign grantor trust*. A *foreign grantor trust* is a foreign trust but only to the extent all or a portion of the income of the trust is treated as owned by the grantor or another person under sections 671 through 679.

(27) *Partnership*. The term *partner-*

*ship* means any entity treated as a partnership under §301.7701-2 or -3 of this chapter.

(28) *Nonwithholding foreign partnership*. A *nonwithholding foreign partnership* is a foreign partnership that is not a withholding foreign partnership, as defined in §1.1441-5(c)(2)(i).

(29) *Withholding foreign partnership*. A withholding foreign partnership is defined in §1.1441-5(c)(2)(i).

(d) \* \* \*

(2) *Payments for which a Form W-9 is otherwise required*. A withholding agent may treat as a U.S. payee any person who is required to furnish a Form W-9 and who furnishes it in accordance with the procedures described in §§31.3406(d)-1 through 31.3406(d)-5 of this chapter (including the requirement that the payee furnish its taxpayer identifying number (TIN)) if the withholding agent meets all the requirements described in §31.3406(h)-3(e) of this chapter regarding reliance by a payor on a Form W-9. Providing a Form W-9 or valid substitute form shall serve as a statement that the person whose name is on the form is a U.S. person. Therefore, a foreign person, including a U.S. branch treated as a U.S. person under paragraph (b)(2)(iv) of this section, shall not provide a Form W-9. A U.S. branch of a foreign person may establish its status as a foreign person exempt from reporting under chapter 61 and backup withholding under section 3406 by providing a withholding certificate on Form W-8.

(3) *Payments for which a Form W-9 is not otherwise required*. In the case of a payee who is not required to furnish a Form W-9 under section 3406 (e.g., a person exempt from reporting under chapter 61 of the Internal Revenue Code), the withholding agent may treat the payee as a U.S. payee if the payee provides the withholding agent with a Form W-9 or a substitute form described in §31.3406(h)-3(c)(2) of this chapter (relating to forms for exempt recipients) that contains the payee's name, address, and TIN. The form must be signed under penalties of perjury by the payee if so required by the form or by §31.3406(h)-3 of this chapter. Providing a Form W-9 or valid substitute form shall serve as a statement that the person whose name is on the certificate is a U.S. person. A Form W-9



or valid substitute form shall not be provided by a foreign person, including any U.S. branch of a foreign person whether or not the branch is treated as a U.S. person under paragraph (b)(2)(iv) of this section. See paragraph (e)(3)(v) of this section for withholding certificates provided by U.S. branches described in paragraph (b)(2)(iv) of this section. The procedures described in §31.3406(h)–2(a) of this chapter shall apply to payments to joint payees. A withholding agent that receives a Form W-9 to satisfy this paragraph (d)(3) must retain the form in accordance with the provisions of §31.3406(h)–3(g) of this chapter, if applicable, or of paragraph (e)(4)(iii) of this section (relating to the retention of withholding certificates) if §31.3406(h)–3(g) of this chapter does not apply. The rules of this paragraph (d)(3) are only intended to provide a method by which a withholding agent may determine that a payee is a U.S. person and do not otherwise impose a requirement that documentation be furnished by a person who is otherwise treated as an exempt recipient for purposes of the applicable information reporting provisions under chapter 61 of the Internal Revenue Code (e.g., §1.6049–4(c)(1)(ii) for payments of interest).

(4) *When a payment to an intermediary or flow-through entity may be treated as made to a U.S. payee.* A withholding agent that makes a payment to an intermediary (whether a qualified intermediary or nonqualified intermediary), a flow-through entity, or a U.S. branch described in paragraph (b)(2)(iv) of this section may treat the payment as made to a U.S. payee to the extent that, prior to the payment, the withholding agent can reliably associate the payment with a Form W-9 described in paragraph (d)(2) or (3) of this section attached to a valid intermediary, flow-through, or U.S. branch withholding certificate described in paragraph (e)(3)(i) of this section or to the extent the withholding agent can reliably associate the payment with a Form W-8 described in paragraph (e)(3)(v) of this section that evidences an agreement to treat a U.S. branch described in paragraph (b)(2)(iv) of this section as a U.S. person. In addition, a withholding agent may treat the payment as made to a U.S. payee only if it complies with the electronic confirmation procedures described in paragraph (e)(4)(v) of this section, if required, and it

has not been notified by the IRS that any of the information on the withholding certificate or other documentation is incorrect or unreliable. In the case of a Form W-9 that is required to be furnished for a reportable payment that may be subject to backup withholding, the withholding agent may be notified in accordance with section 3406(a)(1)(B) and the regulations under that section. See applicable procedures under section 3406(a)(1)(B) and the regulations under that section for payors who have been notified with regard to such a Form W-9. Withholding agents who have been notified in relation to other Forms W-9, including under section 6724(b) pursuant to section 6721, may rely on the withholding certificate or other documentation only to the extent provided under procedures as prescribed by the IRS (see §601.601(d)(2) of this chapter).

- (e) \* \* \* (1) \* \* \*
- (ii) \* \* \* (A) \* \* \*

(1) That the withholding agent can reliably associate the payment with a beneficial owner withholding certificate described in paragraph (e)(2) of this section furnished by the person whose name is on the certificate or attached to a valid foreign intermediary, flow-through, or U.S. branch withholding certificate;

(3) That the withholding agent can reliably associate the payment with a valid qualified intermediary withholding certificate, as described in paragraph (e)(3)(ii) of this section, and the qualified intermediary has provided sufficient information for the withholding agent to allocate the payment to a withholding rate pool other than a withholding rate pool or pools established for U.S. non-exempt recipients;

(4) That the withholding agent can reliably associate the payment with a withholding certificate described in §1.1441–5(c)(3)(iii) or (e)(5)(iii) from a flow-through entity claiming the income is effectively connected income;

(3) *Intermediary, flow-through, or U.S. branch withholding certificate—(i) In general.* An intermediary withholding certificate is a Form W-8 by which a payee represents that it is a foreign person and that it is an intermediary (whether a qualified or nonqualified intermediary)

with respect to a payment and not the beneficial owner. See paragraphs (e)(3)(ii) and (iii) of this section. A flow-through withholding certificate is a Form W-8 used by a flow-through entity as defined in paragraph (c)(23) of this section. See §1.1441–5(c)(3)(iii) (a nonwithholding foreign partnership), §1.1441–5(e)(5)(iii) (a foreign simple trust or foreign grantor trust) or §1.1441–6(b)(2) (foreign entity presenting claims on behalf of its interest holders for a reduced rate of withholding under an income tax treaty). A U.S. branch certificate is a Form W-8 furnished under paragraph (e)(3)(v) of this section by a U.S. branch described in paragraph (b)(2)(iv) of this section. See paragraph (e)(4)(viii) of this section for applicable reliance rules.

(ii) *Intermediary withholding certificate from a qualified intermediary.* A qualified intermediary shall provide a qualified intermediary withholding certificate for reportable amounts received by the qualified intermediary. See paragraph (e)(3)(vi) of this section for the definition of reportable amount. A qualified intermediary withholding certificate is valid only if it is furnished on a Form W-8, an acceptable substitute form, or such other form as the IRS may prescribe, it is signed under penalties of perjury by a person with authority to sign for the qualified intermediary, its validity has not expired, and it contains the following information, statement, and certifications—

(A) The name, permanent residence address (as described in paragraph (e)(2)(ii) of this section), qualified intermediary employer identification number (QI-EIN), and the country under the laws of which the intermediary is created, incorporated, or governed. A qualified intermediary that does not act in its capacity as a qualified intermediary must not use its QI-EIN. Rather the intermediary should provide a nonqualified intermediary withholding certificate, if it is acting as an intermediary, and should use the taxpayer identification number, if any, that it uses for all other purposes;

(B) A certification that, with respect to accounts it identifies on its withholding statement (as described in paragraph (e)(5)(v) of this section), the qualified intermediary is not acting for its own account but is acting as a qualified intermediary;

(C) A certification that the qualified intermediary has provided, or will provide, a withholding statement as required by paragraph (e)(5)(v) of this section; and

(D) Any other information, certifications, or statements as may be required by the form or accompanying instructions in addition to, or in lieu of, the information and certifications described in this paragraph (e)(3)(ii) or paragraph (e)(3)(v) of this section. See paragraph (e)(5)(v) of this section for the requirements of a withholding statement associated with the qualified intermediary withholding certificate.

(iii) *Intermediary withholding certificate from a nonqualified intermediary.* A nonqualified intermediary shall provide a nonqualified intermediary withholding certificate for reportable amounts received by the nonqualified intermediary. See paragraph (e)(3)(vi) of this section for the definition of reportable amount. A nonqualified intermediary withholding certificate is valid only to the extent it is furnished on a Form W-8, an acceptable substitute form, or such other form as the IRS may prescribe, it is signed under penalties of perjury by a person authorized to sign for the nonqualified intermediary, it contains the information, statements, and certifications described in this paragraph (e)(3)(iii) and paragraph (e)(3)(iv) of this section, its validity has not expired, and the withholding certificates and other appropriate documentation for all persons to whom the certificate relates are associated with the certificate. Withholding certificates and other appropriate documentation consist of beneficial owner withholding certificates described in paragraph (e)(2)(i) of this section, intermediary and flow-through withholding certificates described in paragraph (e)(3)(i) of this section, withholding foreign partnership certificates described in §1.1441-5(c)(2)(iv), documentary evidence described in §§1.1441-6(c)(3) or (4) and 1.6049-5(c)(1), and any other documentation or certificates applicable under other provisions of the Internal Revenue Code or regulations that certify or establish the status of the payee or beneficial owner as a U.S. or a foreign person. If a nonqualified intermediary is acting on behalf of another nonqualified intermediary or a flow-through entity, then the nonqualified intermediary must associate with its

own withholding certificate the other nonqualified intermediary withholding certificate or the flow-through withholding certificate and separately identify all of the withholding certificates and other appropriate documentation that are associated with the withholding certificate of the other nonqualified intermediary or flow-through entity. Nothing in this paragraph (e)(3)(iii) shall require an intermediary to furnish original documentation. Copies of certificates or documentary evidence may be transmitted to the U.S. withholding agent, in which case the nonqualified intermediary must retain the original documentation for the same time period that the copy is required to be retained by the withholding agent under paragraph (e)(4)(iii) of this section and must provide it to the withholding agent upon request. For purposes of this paragraph (e)(3)(iii), a valid intermediary withholding certificate also includes a statement described in §1.871-14(c)(2)(v) furnished for interest to qualify as portfolio interest for purposes of sections 871(h) and 881(c). The information and certifications required on a Form W-8 described in this paragraph (e)(3)(iii) are as follows—

(A) The name and permanent resident address (as described in paragraph (e)(2)(ii) of this section) of the nonqualified intermediary, and the country under the laws of which the nonqualified intermediary is created, incorporated, or governed;

(B) A certification that the nonqualified intermediary is not acting for its own account;

(C) If the nonqualified intermediary withholding certificate is used to transmit withholding certificates or other appropriate documentation for more than one person on whose behalf the nonqualified intermediary is acting, a withholding statement associated with the Form W-8 that provides all the information required by paragraph (e)(3)(iv) of this section; and

(D) Any other information, certifications, or statements as may be required by the form or accompanying instructions in addition to, or in lieu of, the information, certifications, and statements described in this paragraph (e)(3)(iii) or paragraph (e)(3)(iv) of this section.

(iv) *Withholding statement provided by nonqualified intermediary—*(A) *In gen-*

*eral.* A nonqualified intermediary shall provide a withholding statement required by this paragraph (e)(3)(iv) to the extent the nonqualified intermediary is required to furnish, or does furnish, documentation for payees on whose behalf it receives reportable amounts (as defined in paragraph (e)(3)(vi) of this section) or to the extent it otherwise provides the documentation of such payees to a withholding agent. A nonqualified intermediary is not required to disclose information regarding persons for whom it collects reportable amounts unless it has actual knowledge that any such person is a U.S. non-exempt recipient as defined in paragraph (c)(21) of this section. Information regarding U.S. non-exempt recipients required under this paragraph (e)(3)(iv) must be provided irrespective of any requirement under foreign law that prohibits the disclosure of the identity of an account holder of a nonqualified intermediary or financial information relating to such account holder. Although a nonqualified intermediary is not required to provide documentation and other information required by this paragraph (e)(3)(iv) for persons other than U.S. non-exempt recipients, a withholding agent that does not receive documentation and such information must apply the presumption rules of paragraph (b) of this section, §§1.1441-5(d) and (e)(6) and 1.6049-5(d) or the withholding agent shall be liable for tax, interest, and penalties. A withholding agent must apply the presumption rules even if it is not required under chapter 61 of the Internal Revenue Code to obtain documentation to treat a payee as an exempt recipient and even though it has actual knowledge that the payee is a U.S. person. For example, if a nonqualified intermediary fails to provide a withholding agent with a Form W-9 for an account holder that is a U.S. exempt recipient, the withholding agent must presume (even if it has actual knowledge that the account holder is a U.S. exempt recipient), that the account holder is an undocumented foreign person with respect to amounts subject to withholding. See paragraph (b)(3)(v) of this section for applicable presumptions. Therefore, the withholding agent must withhold 30 percent from the payment even though if a Form W-9 had been provided, no withholding or reporting on the

payment attributable to a U.S. exempt recipient would apply. Further, a nonqualified intermediary that fails to provide the documentation and the information under this paragraph (e)(3)(iv) for another withholding agent to report the payments on Forms 1042-S and Forms 1099 is not relieved of its responsibility to file information returns. See paragraph (b)(6) of this section. Therefore, unless the nonqualified intermediary itself files such returns and provides copies to the payees, it shall be liable for penalties under sections 6721 (failure to file information returns), and 6722 (failure to furnish payee statements), including the penalties under those sections for intentional failure to file information returns. In addition, failure to provide either the documentation or the information required by this paragraph (e)(3)(iv) results in a payment not being reliably associated with valid documentation. Therefore, the beneficial owners of the payment are not entitled to reduced rates of withholding and if the full amount required to be held under the presumption rules is not withheld by the withholding agent, the nonqualified intermediary must withhold the difference between the amount withheld by the withholding agent and the amount required to be withheld. Failure to withhold shall result in the nonqualified intermediary being liable for tax under section 1461, interest, and penalties, including penalties under section 6656 (failure to deposit) and section 6672 (failure to collect and pay over tax).

(B) *General requirements.* A withholding statement must be provided prior to the payment of a reportable amount and must contain the information specified in paragraph (e)(3)(iv)(C) of this section. The statement must be updated as often as required to keep the information in the withholding statement correct prior to each subsequent payment. The withholding statement forms an integral part of the withholding certificate provided under paragraph (e)(3)(iii) of this section, and the penalties of perjury statement provided on the withholding certificate shall apply to the withholding statement. The withholding statement may be provided in any manner the nonqualified intermediary and the withholding agent mutually agree, including electronically. If the withholding statement is provided electronically,

there must be sufficient safeguards to ensure that the information received by the withholding agent is the information sent by the nonqualified intermediary and all occasions of user access that result in the submission or modification of the withholding statement information must be recorded. In addition, an electronic system must be capable of providing a hard copy of all withholding statements provided by the nonqualified intermediary. A withholding agent will be liable for tax, interest, and penalties in accordance with paragraph (b)(7) of this section to the extent it does not follow the presumption rules of paragraph (b)(3) of this section or §§1.1441-5(d) and (e)(6), and 1.6049-5(d) for any payment of a reportable amount, or portion thereof, for which it does not have a valid withholding statement prior to making a payment.

(C) *Content of withholding statement.* The withholding statement provided by a nonqualified intermediary must contain the information required by this paragraph (e)(3)(iv)(C).

(1) The withholding statement must contain the name, address, TIN (if any) and the type of documentation (documentary evidence, Form W-9, or type of Form W-8) for every person from whom documentation has been received by the nonqualified intermediary to the withholding agent and whether that person is a U.S. exempt recipient, a U.S. non-exempt recipient, or a foreign person. See paragraphs (c)(2), (20), and (21) of this section for the definitions of foreign person, U.S. exempt recipient, and U.S. non-exempt recipient. In the case of a foreign person, the statement must indicate whether the foreign person is a beneficial owner or an intermediary, flow-through entity, or U.S. branch described in paragraph (b)(2)(iv) of this section and include the type of recipient, based on recipient codes used for filing Forms 1042-S, if the foreign person is a recipient as defined in §1.1461-1(c)(1)(ii).

(2) The withholding statement must allocate each payment, by income type, to every payee (including U.S. exempt recipients) for whom documentation has been provided. Any payment that cannot be reliably associated with valid documentation from a payee shall be treated as made to an unknown payee in accordance with the presumption rules of paragraph

(b) of this section and §§1.1441-5(d) and (e)(6) and 1.6049-5(d). For this purpose, a type of income is determined by the types of income required to be reported on Forms 1042-S or 1099, as appropriate. Notwithstanding the preceding sentence, deposit interest (including original issue discount) described in section 871(i)(2)(A) or 881(d) and interest or original issue discount on short-term obligations as described in section 871(g)(1)(B) or 881(e) is only required to be allocated to the extent it is required to be reported on Form 1099 or Form 1042-S. See §1.6049-8 (regarding reporting of bank deposit interest to certain foreign persons). If a payee receives income through another nonqualified intermediary, flow-through entity, or U.S. branch described in paragraph (e)(2)(iv) of this section (other than a U.S. branch treated as a U.S. person), the withholding certificate must also state, with respect to the payee, the name, address, and TIN, if known, of the other nonqualified intermediary or U.S. branch from which the payee directly receives the payment or the flow-through entity in which the payee has a direct ownership interest. If another nonqualified intermediary, flow-through entity, or U.S. branch fails to allocate a payment, the name of the nonqualified intermediary, flow-through entity, or U.S. branch that failed to allocate the payment shall be provided with respect to such payment.

(3) If a payee is identified as a foreign person, the nonqualified intermediary must specify the rate of withholding to which the payee is subject, the payee's country of residence and, if a reduced rate of withholding is claimed, the basis for that reduced rate (e.g., treaty benefit, portfolio interest, exempt under section 501(c)(3), 892, or 895). The allocation statement must also include the taxpayer identification numbers of those foreign persons for whom such a number is required under paragraph (e)(4)(vii) of this section or §1.1441-6(b)(1) (regarding claims for treaty benefits). In the case of a claim of treaty benefits, the nonqualified intermediary's withholding statement must also state whether the limitation on benefits and section 894 statements required by §1.1441-6(c)(5) have been provided, if required, in the beneficial owner's Form W-8 or associated with

such owner's documentary evidence.

(4) The withholding statement must also contain any other information the withholding agent reasonably requests in order to fulfill its obligations under chapter 3, chapter 61 of the Internal Revenue Code, and section 3406.

(D) *Alternative procedures*—(1) *In general.* Under the alternative procedures of this paragraph (e)(3)(iv)(D), a nonqualified intermediary may provide information allocating a payment of a reportable amount to each payee (including U.S. exempt recipients) otherwise required under paragraph (e)(3)(iv)(B)(2) of this section after a payment is made. To use the alternative procedure of this paragraph (e)(3)(iv)(D), the nonqualified intermediary must inform the withholding agent on a statement associated with its nonqualified intermediary withholding certificate that it is using the procedure under this paragraph (e)(3)(iv)(D) and the withholding agent must agree to the procedure. If the requirements of the alternative procedure are met, a withholding agent, including the nonqualified intermediary using the procedures, can treat the payment as reliably associated with documentation and, therefore, the presumption rules of paragraph (b)(3) of this section and §§1.1441-5(d) and (e)(6) and 1.6049-5(d) do not apply even though information allocating the payment to each payee has not been received prior to the payment. See paragraph (e)(3)(iv)(D)(7) of this section, however, for a nonqualified intermediary's liability for tax and penalties if the requirements of this paragraph (e)(3)(iv)(D) are not met. These alternative procedures shall not be used for payments that are allocable to U.S. non-exempt recipients. Therefore, a nonqualified intermediary is required to provide a withholding agent with information allocating payments of reportable amounts to U.S. non-exempt recipients prior to the payment being made by the withholding agent.

(2) *Withholding rate pools.* In place of the information required in paragraph (e)(3)(iv)(B)(2) of this section allocating payments to each payee, the nonqualified intermediary must provide a withholding agent with withholding rate pool information prior to the payment of a reportable amount. The withholding statement must contain all other information required by

paragraph (e)(3)(iv)(B) of this section. Further, each payee listed in the withholding statement must be assigned to an identified withholding rate pool. To the extent a nonqualified intermediary is required to, or does provide, documentation, the alternative procedures do not relieve the nonqualified intermediary from the requirement to provide documentation prior to the payment being made. Therefore, withholding certificates or other appropriate documentation and all information required by paragraph (e)(3)(iv)(B) of this section (other than allocation information) must be provided to a withholding agent before any new payee receives a reportable amount. In addition, the withholding statement must be updated by assigning a new payee to a withholding rate pool prior to the payment of a reportable amount. A withholding rate pool is a payment of a single type of income, determined in accordance with the categories of income used to file Form 1042-S, that is subject to a single rate of withholding. A withholding rate pool may be established by any reasonable method to which the nonqualified intermediary and a withholding agent agree (e.g., by establishing a separate account for a single withholding rate pool, or by dividing a payment made to a single account into portions allocable to each withholding rate pool). The nonqualified intermediary shall determine withholding rate pools based on valid documentation or, to the extent a payment cannot be reliably associated with valid documentation, the presumption rules of paragraph (b)(3) of this section and §§1.1441-5(d) and (e)(6) and 1.6049-5(d).

(3) *Allocation information.* The nonqualified intermediary must provide the withholding agent with sufficient information to allocate the income in each withholding rate pool to each payee (including U.S. non-exempt recipients) within the pool no later than January 31 of the year following the year of payment. Any payments that are not allocated to payees for whom documentation has been provided shall be allocated to an undocumented payee in accordance with the presumption rules of paragraph (b)(3) of this section and §§1.1441-5(d) and (e)(6) and 1.6049-5(d). Notwithstanding the preceding sentence, deposit interest (including original issue discount) described in

section 871(i)(2)(A) or 881(d) and interest or original issue discount on short-term obligations as described in section 871(g)(1)(B) or 881(e) is not required to be allocated to a U.S. exempt recipient or a foreign payee, except as required under §1.6049-8 (regarding reporting of deposit interest paid to certain foreign persons).

(4) *Failure to provide allocation information.* If a nonqualified intermediary fails to provide allocation information, if required, by January 31 for any withholding rate pool, a withholding agent shall not apply the alternative procedures of this paragraph (e)(3)(iv)(D) to any payments of reportable amounts paid after January 31 in the taxable year following the calendar year for which allocation information was not given and any subsequent taxable year. Further, the alternative procedures shall be unavailable for any other withholding rate pool even though allocation information was given for that other pool. Therefore, the withholding agent must withhold on a payment of a reportable amount in accordance with the presumption rules of paragraph (b)(3) of this section, and §§1.1441-5(d) and (e)(6) and 1.6049-5(d), unless the nonqualified intermediary provides all of the information, including information sufficient to allocate the payment to each specific payee, required by paragraph (e)(3)(iv)(A) through (C) of this section prior to the payment. A nonqualified intermediary must allocate at least 90 percent of the income required to be allocated for each withholding rate pool or the nonqualified intermediary will be treated as having failed to provide allocation information for purposes of this paragraph (e)(3)(iv)(D). See paragraph (e)(3)(iv)(D)(7) of this section for liability for tax and penalties if a nonqualified intermediary fails to provide allocation information in whole or in part.

(5) *Cure provision.* A nonqualified intermediary may cure any failure to provide allocation information by providing the required allocation information to the withholding agent no later than February 14 following the calendar year of payment. If the withholding agent receives the allocation information by that date, it may apply the adjustment procedures of §1.1461-2 to any excess withholding for payments made on or after February 1 and

on or before February 14. Any nonqualified intermediary that fails to cure by February 14, may request the ability to use the alternative procedures of this paragraph (e)(3)(iv)(D) by submitting a request, in writing, to the Assistant Commissioner (International). The request must state the reason that the nonqualified intermediary did not comply with the alternative procedures of this paragraph (e)(3)(iv)(D) and steps that the nonqualified intermediary has taken, or will take, to ensure that no failures occur in the future. If the Assistant Commissioner (International) determines that the alternative procedures of this paragraph (e)(3)(iv)(D) may apply, a determination to that effect will be issued by the IRS to the nonqualified intermediary.

(6) *Form 1042-S reporting in case of allocation failure.* If a nonqualified intermediary fails to provide allocation information by February 14 following the year of payment for a withholding rate pool, the withholding agent must file Forms 1042-S for payments made to each payee in that pool (other than U.S. exempt recipients) in the prior calendar year by pro rating the payment to each payee (including U.S. exempt recipients) listed in the withholding statement for that withholding rate pool. If the nonqualified intermediary fails to allocate 10 percent or less of an amount required to be allocated for a withholding rate pool, a withholding agent shall report the unallocated amount as paid to a single unknown payee in accordance with the presumption rules of paragraph (b) of this section and §§1.1441-5(d) and (e)(6) and 1.6049-5(d). The portion of the payment that can be allocated to specific recipients, as defined in §1.1461-1(c)(1)(ii), shall be reported to each recipient in accordance with the rules of §1.1461-1(c).

(7) *Liability for tax, interest, and penalties.* If a nonqualified intermediary fails to provide allocation information by February 14 following the year of payment for all or a portion of the payments made to any withholding rate pool, the withholding agent from whom the nonqualified intermediary received payments of reportable amounts shall not be liable for any tax, interest, or penalties, due solely to the errors or omissions of the nonqualified intermediary. See §1.1441-7(b)(2) through (10) for the due

diligence requirements of a withholding agent. Because failure by the nonqualified intermediary to provide allocation information results in a payment not being reliably associated with valid documentation, the beneficial owners for whom the nonqualified intermediary acts are not entitled to a reduced rate of withholding. Therefore, the nonqualified intermediary, as a withholding agent, shall be liable for any tax not withheld by the withholding agent in accordance with the presumption rules, interest on the under withheld tax if the nonqualified intermediary fails to pay the tax timely, and any applicable penalties, including the penalties under sections 6656 (failure to deposit), 6721 (failure to file information returns) and 6722 (failure to file payee statements). Failure to provide allocation information for more than 10 percent of the payments made to a particular withholding rate pool will be presumed to be an intentional failure within the meaning of sections 6721(e) and 6722(c). The nonqualified intermediary may rebut the presumption.

(8) *Applicability to flow-through entities and certain U.S. branches.* See paragraph (e)(3)(v) of this section and §1.1441-5(c)(3)(iv) and (e)(5)(iv) for the applicability of this paragraph (e)(3)(iv) to U.S. branches described in paragraph (b)(2)(iv) of this section (other than U.S. branches treated as U.S. persons) and flow-through entities.

(E) *Notice procedures.* The IRS may notify a withholding agent that the alternative procedures of paragraph (e)(3)(iv)(D) of this section are not applicable to a specified nonqualified intermediary, a U.S. branch described in paragraph (b)(2)(iv) of this section, or a flow-through entity. If a withholding agent receives such a notice, it must commence withholding in accordance with the presumption rules of paragraph (b)(3) of this section and §§1.1441-5(d) and (e)(6) and 1.6049-5(d) unless the nonqualified intermediary, U.S. branch, or flow-through entity complies with the procedures in paragraphs (e)(3)(iv)(A) through (C) of this section. In addition, the IRS may notify a withholding agent, in appropriate circumstances, that it must apply the presumption rules of paragraph (b)(3) of this section and §§1.1441-5(d) and (e)(6) and 1.6049-5(d) to payments made to a nonqualified intermediary, a

U.S. branch, or a flow-through entity even if the nonqualified intermediary, U.S. branch or flow-through entity provides allocation information prior to the payment. A withholding agent that receives a notice under this paragraph (e)(3)(iv)(E) must commence withholding in accordance with the presumption rules within 30 days of the date of the notice. The IRS may withdraw its prohibition against using the alternative procedures of paragraph (e)(3)(iv)(D) of this section, or its requirement to follow the presumption rules, if the nonqualified intermediary, U.S. branch, or flow-through entity can demonstrate to the satisfaction of the Assistant Commissioner (International) or his delegate that it is capable of complying with the rules under chapter 3 of the Internal Revenue Code and any other conditions required by the Assistant Commissioner (International).

(v) *Withholding certificate from certain U.S. branches.* A U.S. branch certificate is a withholding certificate provided by a U.S. branch described in paragraph (b)(2)(iv) of this section that is not the beneficial owner of the income. The withholding certificate is provided with respect to reportable amounts and must state that such amounts are not effectively connected with the conduct of a trade or business in the United States. The withholding certificate must either transmit the appropriate documentation for the persons for whom the branch receives the payment (i.e., as an intermediary) or be provided as evidence of its agreement with the withholding agent to be treated as a U.S. person with respect to any payment associated with the certificate. A U.S. branch withholding certificate is valid only if it is furnished on a Form W-8, an acceptable substitute form, or such other form as the IRS may prescribe, it is signed under penalties of perjury by a person authorized to sign for the branch, its validity has not expired, and it contains the information, statements, and certifications described in this paragraph (e)(3)(v). If the certificate is furnished to transmit withholding certificates and other documentation, it must contain the information, certifications, and statements described in paragraphs (e)(3)(v)(A) through (C) of this section and in paragraphs (e)(3)(iii) and (iv) (alternative procedures) of this section, applying the term

U.S. branch for the term *nonqualified intermediary*. If the certificate is furnished pursuant to an agreement to treat the U.S. branch as a U.S. person, the information and certifications required on the withholding certificate are limited to the following—

(A) The name of the person of which the branch is a part and the address of the branch in the United States;

(B) A certification that the payments associated with the certificate are not effectively connected with the conduct of its trade or business in the United States; and

(C) Any other information, certifications, or statements as may be required by the form or accompanying instructions in addition to, or in lieu of, the information and certification described in this paragraph (e)(3)(v).

(vi) *Reportable amounts*. For purposes of chapter 3 of the Internal Revenue Code, a nonqualified intermediary, qualified intermediary, flow-through entity, and U.S. branch described in paragraph (b)(2)(iv) of this section (other than a U.S. branch that agrees to be treated as a U.S. person) must provide a withholding certificate and associated documentation and other information with respect to reportable amounts. For purposes of the regulations under chapter 3 of the Internal Revenue Code, the term reportable amount means an amount subject to withholding within the meaning of §1.1441-2(a), bank deposit interest (including original issue discount) and similar types of deposit interest described in section 871(i)(2)(A) or 881(d) that are from sources within the United States, and any amount of interest or original issue discount from sources within the United States on the redemption of certain short-term obligations described in section 871(g)(1)(B) or 881(e). Reportable amounts shall not include amounts received on the sale or exchange (other than a redemption) of an obligation described in section 871(g)(1)(B) or 881(e) that is effected at an office outside the United States. See §1.6045-1(g)(3) to determine whether a sale is effected at an office outside the United States. Reportable amounts also do not include payments with respect to deposits with banks and other financial institutions that remain on deposit for a period of two weeks or less,

to amounts of original issue discount arising from a sale and repurchase transaction that is completed within a period of two weeks or less, or to amounts described in §1.6049-5(b)(7), (10) or (11) (relating to certain obligations issued in bearer form). While short-term OID and bank deposit interest are not subject to withholding under chapter 3 of the Internal Revenue Code, such amounts may be subject to information reporting under section 6049 if paid to a U.S. person who is not an exempt recipient described in §1.6049-4(c)(1)(ii) and to backup withholding under section 3406 in the absence of documentation. See §1.6049-5(d)(3)(iii) for applicable procedures when such amounts are paid to a foreign intermediary.

(4) \* \* \*

(ii) *Period of validity*—(A) *Three-year period*. A withholding certificate described in paragraph (e)(2)(i) of this section, or a certificate described in §1.871-14(c)(2)(v) (furnished to qualify interest as portfolio interest for purposes of sections 871(h) and 881(c)), shall remain valid until the earlier of the last day of the third calendar year following the year in which the withholding certificate is signed or the day that a change in circumstances occurs that makes any information on the certificate incorrect. For example, a withholding certificate signed on September 30, 2001, remains valid through December 31, 2004, unless circumstances change that make the information on the form no longer correct. Documentary evidence described in §§1.1441-6(c)(3) or (4) or 1.6049-5(c)(1) shall remain valid until the earlier of the last day of the third calendar year following the year in which the documentary evidence is provided to the withholding agent or the day that a change in circumstances occurs that makes any information on the documentary evidence incorrect.

(B) \* \* \*

(I) A withholding certificate described in paragraph (e)(2)(ii) of this section that is furnished with a TIN, provided that the withholding agent reports at least one payment annually to the beneficial owner under §1.1461-1(c) or the TIN furnished on the certificate is reported to the IRS under the procedures described in §1.1461-1(d). For example, assume a withholding agent receives a Form W-8 in

2001 from a beneficial owner with respect to an account that contains bonds, the interest on which must be reported on Form 1042-S under §1.1461-1(c). The Form W-8 contains a valid TIN and the withholding agent reports on Forms 1042-S interest to the beneficial owner for 2001 through 2005. In 2005, the beneficial owner sells some of the bonds. For purposes of the exemption from Form 1099 reporting under §1.6045-1(g), the withholding agent may consider the Form W-8 as valid, even though the payment of the sales proceeds is not reportable on Form 1042-S under §1.1461-1(c) and even though the Form W-8 was provided more than three years previously.

(2) A certificate described in paragraph (e)(3)(ii) of this section (a qualified intermediary withholding certificate) but not including the withholding certificates, documentary evidence, statements or other information associated with the certificate.

(3) A certificate described in paragraph (e)(3)(iii) of this section (a nonqualified intermediary certificate), but not including the withholding certificates, documentary evidence, statements or other information associated with the certificate.

(4) A certificate described in paragraph (e)(3)(v) of this section (a U.S. branch withholding certificate), but not including the withholding certificates, documentary evidence, statements or other information associated with the certificate.

\* \* \* \* \*

(6) A certificate described in §1.1441-5(c)(3)(iii) (a withholding certificate from a nonwithholding foreign partnership) but not including the withholding certificates, documentary evidence, statements or other information required to be associated with the certificate.

\* \* \* \* \*

(8) A withholding certificate described in §1.1441-5(e)(5)(iii) provided by a foreign simple trust or a foreign grantor trust to transmit documentation of beneficiaries or owners, but not including the withholding certificates, documentary evidence, statements or other information associated with the certificate.

\* \* \* \* \*

(iv) *Electronic transmission of information*—(A) *In general*. A withholding agent may establish a system for a beneficial owner or payee to electronically fur-

nish a Form W-8, an acceptable substitute Form W-8, or such other form as the Internal Revenue Service may prescribe. The system must meet the requirements described in paragraph (e)(4)(iv)(B) of this section. A withholding agent may accept Forms W-8 that are furnished electronically on or after January 1, 2000, provided the requirements of paragraph (e)(4)(iv)(B) of this section are met.

(B) *Requirements*—(1) *In general*. The electronic system must ensure that the information received is the information sent, and must document all occasions of user access that result in the submission renewal, or modification of a Form W-8. In addition, the design and operation of the electronic system, including access procedures, must make it reasonably certain that the person accessing the system and furnishing Form W-8 is the person named in the Form.

(2) *Same information as paper Form W-8*. The electronic transmission must provide the withholding agent or payor with exactly the same information as the paper Form W-8.

(3) *Perjury statement and signature requirements*. The electronic transmission must contain an electronic signature by the person whose name is on the Form W-8 and the signature must be under penalties of perjury in the manner described in this paragraph (e)(4)(iv)(B)(3).

(i) *Perjury statement*. The perjury statement must contain the language that appears on the paper Form W-8. The electronic system must inform the person whose name is on the Form W-8 that the person must make the declaration contained in the perjury statement and that the declaration is made by signing the Form W-8. The instructions and the language of the perjury statement must immediately follow the person's certifying statements and immediately precede the person's electronic signature.

(ii) *Electronic signature*. The act of the electronic signature must be effected by the person whose name is on the electronic Form W-8. The signature must also authenticate and verify the submission. For this purpose, the terms authenticate and verify have the same meanings as they do when applied to a written signature on a paper Form W-8. An electronic signature can be in any form that satisfies the foregoing requirements. The elec-

tronic signature must be the final entry in the person's Form W-8 submission.

(4) *Requests for electronic Form W-8 data*. Upon request by the Internal Revenue Service during an examination, the withholding agent must supply a hard copy of the electronic Form W-8 and a statement that, to the best of the withholding agent's knowledge, the electronic Form W-8 was filed by the person whose name is on the form. The hard copy of the electronic Form W-8 must provide exactly the same information as, but need not be identical to, the paper Form W-8.

(C) *Special requirements for transmission of Forms W-8 by an intermediary*. [Reserved]  
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(vii) *Requirement of taxpayer identifying number*. A TIN must be stated on a withholding certificate when required by this paragraph (e)(4)(vii). A TIN is required to be stated on—

(A) A withholding certificate on which a beneficial owner is claiming the benefit of a reduced rate under an income tax treaty (other than for amounts described in §1.1441-6(c)(2));

(B) A withholding certificate on which a beneficial owner is claiming exemption from withholding because income is effectively connected with a U.S. trade or business;

(C) A withholding certificate on which a beneficial owner is claiming exemption from withholding under section 871(f) for certain annuities received under qualified plans;

(D) A withholding certificate on which a beneficial owner is claiming an exemption based solely on a foreign organization's claim of tax exempt status under section 501(c) or private foundation status (however, a TIN is not required from a foreign private foundation that is subject to the 4-percent tax under section 4948(a) on income if that income would be exempt from withholding but for section 4948(a) (e.g., portfolio interest));

(E) A withholding certificate from a person representing to be a qualified intermediary described in paragraph (e)(5)(ii) of this section;

(F) A withholding certificate from a person representing to be a withholding foreign partnership described in §1.1441-5(c)(2)(i);

(G) A withholding certificate from a

person representing to be a foreign grantor trust with 5 or fewer grantors;

(H) A withholding certificate provided by a foreign organization that is described in section 501(c);

(I) A withholding certificate from a person representing to be a U.S. branch described in paragraph (b)(2)(iv) of this section.

\*\*\*\*\*

(ix) \*\*\*

(A) \*\*\*

(4) A withholding agent may rely on documentation furnished by a beneficial owner or payee to an agent of the withholding agent. The agent may retain the documentation as part of an information system maintained for a single or multiple withholding agents provided that the system permits any withholding agent that uses the system to easily access data regarding the nature of the documentation, the information contained in the documentation, and its validity, and must allow the withholding agent to easily transmit data into the system regarding any facts of which it becomes aware that may affect the reliability of the documentation. The withholding agent must be able to establish how and when it has accessed the data regarding the documentation and, if applicable, how and when it has transmitted data regarding any facts of which it became aware that may affect the reliability of the documentation. In addition, the withholding agent must be able to establish that any data it has transmitted to the information system has been processed and appropriate due diligence has been exercised regarding the validity of the documentation.

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(C) *Special rule for brokers*—(1) *In general*. A withholding agent may rely on the certification of a broker that the broker holds a valid beneficial owner withholding certificate described in paragraph (e)(2)(i) of this section or other appropriate documentation for that beneficial owner with respect to any readily tradable instrument, as defined in §31.3406(h)-1(d) of this chapter, if the broker is a United States person (including a U.S. branch treated as a U.S. person under paragraph (b)(2)(iv) of this section) that is acting as the agent of a beneficial owner and the U.S. broker has been provided a valid Form W-8 or other appropri-

ate documentation. The certification must be in writing or in electronic form and contain all of the information required of a nonqualified intermediary under paragraphs (e)(3)(iv)(B) and (C) of this section. If a U.S. broker chooses to use this paragraph (e)(4)(ix)(C), that U.S. broker will be solely responsible for applying the rules of §1.1441-7(b) to the withholding certificates or other appropriate documentation. For purposes of this paragraph (c)(4)(ix)(C), the term broker means a person treated as a broker under §1.6045-1(a).

(2) The following example illustrates the rules of this paragraph (e)(4)(ix)(C):

*Example.* SCO is a U.S. securities clearing organization that provides clearing services for correspondent broker, CB, a U.S. corporation. Pursuant to a fully disclosed clearing agreement, CB fully discloses the identity of each of its customers to SCO. Part of SCO's clearing duties include the crediting of income and gross proceeds of readily tradeable instruments (as defined in §31.3406(h)-1(d)) to each customer's account. For each disclosed customer that is a foreign beneficial owner, CB provides SCO with information required under paragraphs (e)(3)(iv)(B) and (C) of this section that is necessary to apply the correct rate of withholding and to file Forms 1042-S. SCO may use the representations and beneficial owner information provided by CB to determine the proper amount of withholding and to file Forms 1042-S. CB is responsible for determining the validity of the withholding certificates or other appropriate documentation under §1.1441-1(b).

\* \* \* \* \*

(5) *Qualified intermediaries*—(i) *General rule.* A qualified intermediary, as defined in paragraph (e)(5)(ii) of this section, may furnish a qualified intermediary withholding certificate to a withholding agent. The withholding certificate provides certifications on behalf of other persons for the purpose of claiming and verifying reduced rates of withholding under section 1441 or 1442 and for the purpose of reporting and withholding under other provisions of the Internal Revenue Code, such as the provisions under chapter 61 and section 3406 (and the regulations under those provisions). Furnishing such a certificate is in lieu of transmitting to a withholding agent withholding certificates or other appropriate documentation for the persons for whom the qualified intermediary receives the payment, including interest holders in a qualified interme-

diary that is fiscally transparent under the regulations under section 894. Although the qualified intermediary is required to obtain withholding certificates or other appropriate documentation from beneficial owners, payees, or interest holders pursuant to its agreement with the IRS, it is generally not required to attach such documentation to the intermediary withholding certificate. Notwithstanding the preceding sentence a qualified intermediary must provide a withholding agent with the Forms W-9, or disclose the names, addresses, and taxpayer identifying numbers, if known, of those U.S. non-exempt recipients for whom the qualified intermediary receives reportable amounts (within the meaning of paragraph (e)(3)(vi) of this section) to the extent required in the qualified intermediary's agreement with the IRS. A person may claim qualified intermediary status before an agreement is executed with the IRS if it has applied for such status and the IRS authorizes such status on an interim basis under such procedures as the IRS may prescribe.

\* \* \* \* \*

(iii) *Withholding agreement*—(A) *In general.* The IRS may, upon request, enter into a withholding agreement with a foreign person described in paragraph (e)(5)(ii) of this section pursuant to such procedures as the IRS may prescribe in published guidance (see §601.601(d)(2) of this chapter). Under the withholding agreement, a qualified intermediary shall generally be subject to the applicable withholding and reporting provisions applicable to withholding agents and payors under chapters 3 and 61 of the Internal Revenue Code, section 3406, the regulations under those provisions, and other withholding provisions of the Internal Revenue Code, except to the extent provided under the agreement.

(B) *Terms of the withholding agreement.* Generally, the agreement shall specify the type of certifications and documentation upon which the qualified intermediary may rely to ascertain the classification (e.g., corporation or partnership) and status (i.e., U.S. or foreign) of beneficial owners and payees who receive payments collected by the qualified intermediary and, if necessary, entitlement to the benefits of a reduced rate under an income tax treaty. The

agreement shall specify if, and to what extent, the qualified intermediary may assume primary withholding responsibility in accordance with paragraph (e)(5)(iv) of this section. It shall also specify the extent to which applicable return filing and information reporting requirements are modified so that, in appropriate cases, the qualified intermediary may report payments to the IRS on an aggregated basis, without having to disclose the identity of beneficial owners and payees. However, the qualified intermediary may be required to provide to the IRS the name and address of those foreign customers who benefit from a reduced rate under an income tax treaty pursuant to the qualified intermediary arrangement for purposes of verifying entitlement to such benefits, particularly under an applicable limitation on benefits provision. Under the agreement, a qualified intermediary may agree to act as an acceptance agent to perform the duties described in §301.6109-1(d)(3)(iv)(A) of this chapter. The agreement may specify the manner in which applicable procedures for adjustments for underwithholding and overwithholding, including refund procedures, apply in the context of a qualified intermediary arrangement and the extent to which applicable procedures may be modified. In particular, a withholding agreement may allow a qualified intermediary to claim refunds of overwithheld amounts. If relevant, the agreement shall specify the manner in which the qualified intermediary may deal with payments to other intermediaries and flow-through entities. In addition, the agreement shall specify the manner in which the IRS will verify compliance with the agreement. In appropriate cases, the IRS may agree to rely on audits performed by an intermediary's approved auditor. In such a case, the IRS's audit may be limited to the audit of the auditor's records (including work papers of the auditor and reports prepared by the auditor indicating the methodology employed to verify the entity's compliance with the agreement). For this purpose, the agreement shall specify the auditor or class of auditors that are approved. Generally, an auditor will not be approved if the auditor is not subject to laws, regulations, or rules that impose sanctions for failure to exercise its independence and to perform the audit compe-



tently. The agreement may include provisions for the assessment and collection of tax in the event that failure to comply with the terms of the agreement results in the failure by the withholding agent or the qualified intermediary to withhold and deposit the required amount of tax. Further, the agreement may specify the procedures by which deposits of amounts withheld are to be deposited, if different from the deposit procedures under the Internal Revenue Code and applicable regulations. To determine whether to enter a qualified intermediary withholding agreement and the terms of any particular withholding agreement, the IRS will consider appropriate factors including whether or not the foreign person agrees to assume primary withholding responsibility, the type of local know-your-customer laws and practices to which it is subject, the extent and nature of supervisory and regulatory control exercised under the laws of the foreign country over the foreign person, the volume of investments in U.S. securities (determined in dollar amounts and number of account holders), the financial condition of the foreign person, and whether the qualified intermediary is a resident of a country with which the United States has an income tax treaty.

(iv) *Assignment of primary withholding responsibility.* Any person who meets the definition of a withholding agent under §1.1441-7(a) (whether a U.S. person or a foreign person) is required to withhold and deposit any amount withheld under §1.1461-1(a) and to make the returns prescribed by §1.1461-1(b) and (c). If permitted by its qualified intermediary agreement, a qualified intermediary agreement may, however, inform a withholding agent from which it receives a payment that it will assume the primary obligation to withhold, deposit, and report amounts under chapter 3 of the Internal Revenue Code and/or under chapter 61 of the Internal Revenue Code and section 3406. If a withholding agent makes a payment of an amount subject to withholding, as defined in §1.1441-2(a), or a reportable payment, as defined in section 3406(b), to a qualified intermediary that represents to the withholding agent that it has assumed primary withholding responsibility for the payment, the withholding agent is not required to withhold on the payment. The withholding agent is not required to deter-

mine that the qualified intermediary agreement actually permits the qualified intermediary to assume primary withholding responsibility. A qualified intermediary that assumes primary withholding responsibility under chapter 3 of the Internal Revenue Code or primary reporting and backup withholding responsibility under chapter 61 and section 3406 is not required to assume primary withholding responsibility for all accounts it has with a withholding agent but must assume primary withholding responsibility for all payments made to any one account that it has with the withholding agent. A qualified intermediary may agree with the withholding agent to assume primary withholding responsibility under chapter 3 and section 3406, only if expressly permitted to do so under its agreement with the IRS.

(v) *Withholding statement—(A) In general.* A qualified intermediary must provide each withholding agent from which it receives reportable amounts, as defined in paragraph (e)(3)(vi) of this section, as a qualified intermediary with a written statement (the withholding statement) containing the information specified in paragraph (e)(5)(v)(B) of this section. A withholding statement is not required, however, if all of the information a withholding agent needs to fulfill its withholding and reporting requirements is contained in the withholding certificate. The qualified intermediary agreement may require, in appropriate circumstances, the qualified intermediary to include information in its withholding statement relating to payments other than payments of reportable amounts. The withholding statement forms an integral part of the qualified intermediary's qualified intermediary withholding certificate and the penalties of perjury statement provided on the withholding certificate shall apply to the withholding statement as well. The withholding statement may be provided in any manner, and in any form, to which qualified intermediary and the withholding agent mutually agree, including electronically. If the withholding statement is provided electronically, there must be sufficient safeguards to ensure that the information received by the withholding agent is the information sent by qualified intermediary and must also document all occasions of user access that result in the

submission or modification of withholding statement information. In addition, the electronic system must be capable of providing a hard copy of all withholding statements provided by the qualified intermediary. The withholding statement shall be updated as often as necessary for the withholding agent to meet its reporting and withholding obligations under chapters 3 and 61 of the Internal Revenue Code and section 3406. A withholding agent will be liable for tax, interest, and penalties in accordance with paragraph (b)(7) of this section to the extent it does not follow the presumption rules of paragraph (b)(3) of this section, §§1.1441-5(d) and (e)(6), and 1.6049-5(d) for any payment, or portion thereof, for which it does not have a valid withholding statement prior to making a payment.

(B) *Content of withholding statement.* The withholding statement must contain sufficient information for a withholding agent to apply the correct rate of withholding on payments from the accounts identified on the statement and to properly report such payments on Forms 1042-S and Forms 1099, as applicable. The withholding statement must—

(1) Designate those accounts for which the qualified intermediary acts as a qualified intermediary;

(2) Designate those accounts for which qualified intermediary assumes primary withholding responsibility under chapter 3 of the Internal Revenue Code and/or primary reporting and backup withholding responsibility under chapter 61 and section 3406; and

(3) Provide information regarding withholding rate pools, as described in paragraph (e)(5)(v)(C) of this section.

(C) *Withholding rate pools—(1) In general.* Except to the extent it has assumed both primary withholding responsibility under chapter 3 of the Internal Revenue Code and primary reporting and backup withholding responsibility under chapter 61 and section 3406 with respect to a payment, a qualified intermediary shall provide as part of its withholding statement the withholding rate pool information that is required for the withholding agent to meet its withholding and reporting obligations under chapters 3 and 61 of the Internal Revenue Code and section 3406. A withholding rate pool is a payment of a single type of income, deter-

mined in accordance with the categories of income reported on Form 1042-S or Form 1099, as applicable, that is subject to a single rate of withholding. A withholding rate pool may be established by any reasonable method on which the qualified intermediary and a withholding agent agree (e.g., by establishing a separate account for a single withholding rate pool, or by dividing a payment made to a single account into portions allocable to each withholding rate pool). To the extent a qualified intermediary does not assume primary reporting and backup withholding responsibility under chapter 61 and section 3406, a qualified intermediary's withholding statement must establish a separate withholding rate pool for each U.S. non-exempt recipient account holder that the qualified intermediary has disclosed to the withholding agent unless the qualified intermediary uses the alternative procedures in paragraph (e)(5)(v)(C)(2) of this section. A qualified intermediary shall determine withholding rate pools based on valid documentation that it obtains under its withholding agreement with the IRS, or if a payment cannot be reliably associated with valid documentation, under the applicable presumption rules. If a qualified intermediary has an account holder that is another intermediary (whether a qualified intermediary or a nonqualified intermediary) or a flow-through entity, the qualified intermediary may combine the account holder information provided by the intermediary or flow-through entity with the qualified intermediary's direct account holder information to determine the qualified intermediary's withholding rate pools.

(2) *Alternative procedure for U.S. non-exempt recipients.* If permitted under its agreement with the IRS, a qualified intermediary may, by mutual agreement with a withholding agent, establish a single withholding rate pool (not subject to backup withholding) for all U.S. non-exempt recipient account holders for whom the qualified intermediary has provided Forms W-9 prior to the withholding agent paying any reportable payments, as defined in section 3406(b), and a separate withholding rate pool (subject to 31-percent withholding) for all U.S. non-exempt recipient account holders for whom a qualified intermediary has not provided Forms W-9 prior to the withholding agent

paying any reportable payments. If a qualified intermediary chooses the alternative procedure of this paragraph (e)(5)(v)(C)(2), the qualified intermediary must provide sufficient information to the withholding agent no later than January 15 of the year following the year in which the reportable payments are paid that allocates the reportable payments to each U.S. non-exempt recipient account holder. Failure to provide such information will result in the application of penalties to the qualified intermediary under sections 6721 and 6722, as well as any other applicable penalties, and may result in the termination of the qualified intermediary's withholding agreement with the IRS. A withholding agent shall not be liable for tax, interest, or penalties for failure to backup withhold or report information under chapter 61 of the Internal Revenue Code due solely to the errors or omissions of the qualified intermediary. If a qualified intermediary fails to provide the allocation information required by this paragraph (e)(5)(v)(C)(2), the withholding agent shall report the entire amount paid from the withholding rate pool to an unknown recipient, or otherwise in accordance with the appropriate Form 1099 and the instructions accompanying the form.

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Par 4. Effective January 1, 2001, §1.1441-2 is amended by:

1. Revising paragraph (a).
2. Revising paragraph (b)(1)(i).
3. Removing paragraph (b)(2)(ii), redesignating paragraph (b)(2)(iii) as paragraph (b)(2)(ii), and adding the word "and" after the semicolon in paragraph (b)(2)(i).
4. Revising paragraph (b)(3).

The revisions read as follows:

§1.1441-2 *Amounts subject to withholding.*

(a) *In general.* For purposes of the regulations under chapter 3 of the Internal Revenue Code, the term *amounts subject to withholding* means amounts from sources within the United States that constitute either fixed or determinable annual or periodical income described in paragraph (b) of this section or other amounts subject to withholding described in paragraph (c) of this section. For purposes of this paragraph (a), an amount shall be treated as being from sources within the

United States if the source of the amount cannot be determined at the time of payment. See §1.1441-3(d)(1) for determining the amount to be withheld from a payment in the absence of information at the time of payment regarding the source of the amount. Amounts subject to withholding include amounts that are not fixed or determinable annual or periodical income and upon which withholding is specifically required under a provision of this section or another section of the regulations under chapter 3 of the Internal Revenue Code (such as corporate distributions upon which withholding is required under §1.1441-3(c)(1) that do not constitute dividend income). Amounts subject to withholding do not include—

(1) Amounts described in §1.1441-1(b)(4)(i) to the extent they involve interest on obligations in bearer form or on foreign-targeted registered obligations (but, in the case of a foreign-targeted registered obligation, only to the extent of those amounts paid to a registered owner that is a financial institution within the meaning of section 871(h)(5)(B) or a member of a clearing organization which member is the beneficial owner of the obligation);

(2) Amounts described in §1.1441-1(b)(4)(ii) (dealing with bank deposit interest and similar types of interest (including original issue discount) described in section 871(i)(2)(A) or 881(d));

(3) Amounts described in §1.1441-1(b)(4)(iv) (dealing with interest or original issue discount on certain short-term obligations described in section 871(g)(1)(B) or 881(e));

(4) Amounts described in §1.1441-1(b)(4)(xx) (dealing with income from certain gambling winnings exempt from tax under section 871(j));

(5) Amounts paid as part of the purchase price of an obligation sold or exchanged between interest payment dates, unless the sale or exchange is part of a plan the principal purpose of which is to avoid tax and the withholding agent has actual knowledge or reason to know of such plan;

(6) Original issue discount paid as part of the purchase price of an obligation sold or exchanged in a transaction other than a redemption of such obligation, unless the purchase is part of a plan the principal purpose of which is to avoid tax and the

withholding agent has actual knowledge or reason to know of such plan; and

(7) Insurance premiums paid with respect to a contract that is subject to the section 4371 excise tax.

(b) *Fixed or determinable annual or periodical income*—(1) *In general*—(i) *Definition*. For purposes of chapter 3 of the Internal Revenue Code and the regulations thereunder, fixed or determinable annual or periodical income includes all income included in gross income under section 61 (including original issue discount) except for the items specified in paragraph (b)(2) of this section. Items of income that are excluded from gross income under a provision of law without regard to the U.S. or foreign status of the owner of the income, such as interest excluded from gross income under section 103(a) or qualified scholarship income under section 117, shall not be treated as fixed or determinable annual or periodical income under chapter 3 of the Internal Revenue Code. Income excluded from gross income under section 892 (income of foreign governments) or section 115 (income of a U.S. possession) is fixed or determinable annual or periodical income since the exclusion from gross income under those sections is dependent on the foreign status of the owner of the income. See §1.306-3(h) for treating income from the disposition of section 306 stock as fixed or determinable annual or periodical income.

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(3) *Original issue discount*—(i) *Amount subject to tax*. An amount representing original issue discount is fixed or determinable annual or periodical income that is subject to tax under sections 871(a)(1)(C) and 881(a)(3) to the extent provided in those sections and this paragraph (b)(3) if not otherwise excluded under paragraph (a) of this section. An amount of original issue discount is subject to tax with respect to a foreign beneficial owner of an obligation carrying original issue discount upon a sale or exchange of the obligation or when a payment is made on such obligation. The amount taxable is the amount of original issue discount that accrued while the foreign person held the obligation up to the time that the obligation is sold or exchanged or that a payment is made on the obligation, reduced by any amount of original issue

discount that was taken into account prior to that time (due to a payment made on the obligation). In the case of a payment made on the obligation, the tax due on the amount of original issue discount may not exceed the amount of the payment reduced by the tax imposed on any portion of the payment that is qualified stated interest.

(ii) *Amounts subject to withholding*. A withholding agent must withhold on the taxable amount of original issue discount paid on the redemption of an original issue discount obligation unless an exception to withholding applies (e.g., portfolio interest or treaty exception). In addition, withholding is required on the taxable amount of original issue discount upon the sale or exchange of an original issue discount obligation, other than in a redemption, to the extent the withholding agent has actual knowledge or reason to know that the sale or exchange is part of a plan the principal purpose of which is to avoid tax. If a withholding agent cannot determine the taxable amount of original issue discount on the redemption of an original issue discount obligation (or on the sale or exchange of such an obligation if the principal purpose of the sale is to avoid tax), then it must withhold on the entire amount of original issue discount accrued from the date of issue until the date of redemption (or the date the obligation is sold or exchanged) determined on the basis of the most recently published “List of Original Issue Discount Instruments” (IRS Publication 1212, available from the IRS Forms Distribution Center) or similar list published by the IRS as if the beneficial owner of the obligation had held the obligation since its original issue.

(iii) *Exceptions to withholding*. To the extent that this paragraph (b)(3) applies to require withholding by a person other than an issuer of an original issue discount obligation, or the issuer’s agent, it shall apply only to obligations issued after December 31, 2000.

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Par. 5. Effective January 1, 2001, §1.1441-3 is amended by:

1. Revising paragraph (b)(2)(i).
2. Revising paragraph (c)(1).
3. Revising paragraph (c)(4)(i)(C).

The revisions read as follows:

§1.1441-3 *Determination of amounts to be withheld*.

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(b) \*\*\*\*\*

(2) *No withholding between interest payment dates*—(i) *In general*. A withholding agent is not required to withhold under §1.1441-1 upon interest accrued on the date of a sale or exchange of a debt obligation when that sale occurs between two interest payment dates (even though the amount is treated as interest under §1.61-7(c) or (d) and is subject to tax under section 871 or 881). See §1.6045-1(c) for reporting requirements by brokers with respect to sale proceeds. See §1.61-7(c) regarding the character of payments received by the acquirer of an obligation subsequent to such acquisition (that is, as a return of capital or interest accrued after the acquisition). Any exemption from withholding pursuant to this paragraph (b)(2)(i) applies without a requirement that documentation be furnished to the withholding agent. However, documentation may have to be furnished for purposes of the information reporting provisions under section 6045 or 6049 and backup withholding under section 3406. The exemption from withholding granted by this paragraph (b)(2) is not a determination that the accrued interest is not fixed or determinable annual or periodical income under section 871(a) or 881(a).

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(c) *Corporate distributions*—(1) *General rule*. A corporation making a distribution with respect to its stock or any intermediary (described in §1.1441-1(c)(13)) making a payment of such a distribution is required to withhold under section 1441, 1442, or 1443 on the entire amount of the distribution, unless it elects to reduce the amount of withholding under the provisions of this paragraph (c). Any exceptions from withholding provided by this paragraph (c) apply without any requirement to furnish documentation to the withholding agent. However, documentation may have to be furnished for purposes of the information reporting provisions under section 6042 or 6045 and backup withholding under section 3406. See §1.1461-1(c) to determine whether amounts excepted from withholding under this section are considered amounts that are subject to reporting.

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(4) \*\*\*\*\* (i) \*\*\*\*\*

(C) *Coordination with REIT withholding.* Withholding is required under section 1441 (or 1442 or 1443) on the portion of a distribution from a REIT that is not designated as a capital gain dividend, a return of basis, or a distribution in excess of a shareholder's adjusted basis in the stock of the REIT that is treated as a capital gain under section 301(c)(3). A distribution in excess of a shareholder's adjusted basis in the stock of the REIT is, however, subject to withholding under section 1445, unless the interest in the REIT is not a U.S. real property interest (e.g., an interest in a domestically controlled REIT under section 897(h)(2)). In addition, withholding is required under section 1445 on the portion of the distribution designated by a REIT as a capital gain dividend. See §1.1445-8.

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Par. 6. Effective January 1, 2001, §1.1441-4 is amended by:

1. Revising paragraph (a)(3)(i).
2. Revising paragraph (b)(1)(ii).

The revisions read as follows:

*§1.1441-4 Exemptions from withholding for certain effectively connected income and other amounts.*

(a) \*\*\*

(3) *Income on notional principal contracts—(i) General rule.* A withholding agent that pays amounts attributable to a notional principal contract described in §1.863-7(a) or 1.988-2(e) shall have no obligation to withhold on the amounts paid under the terms of the notional principal contract regardless of whether a withholding certificate is provided. However, a withholding agent must file returns under §1.1461-1(b) and (c) reporting the income that it must treat as effectively connected with the conduct of a trade or business in the United States under the provisions of this paragraph (a)(3). Except as otherwise provided in paragraph (a)(3)(ii) of this section, a withholding agent must treat the income as effectively connected with the conduct of a U.S. trade or business if the income is paid to, or to the account of, a qualified business unit of a foreign person located in the United States or, if the payment is paid to, or to the account of, a qualified business unit of a foreign person located outside the United States, the withholding agent knows, or has reason to know, the payment is effectively connected with the

conduct of a trade or business within the United States. Income on a notional principal contract does not include the amount characterized as interest under the provisions of §1.446-3(g)(4).

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(b) \*\*\* (1) \*\*\*

(ii) Such compensation would be subject to withholding under section 3402 but for the provisions of section 3401(a) (not including section 3401(a)(6)) and the regulations under that section. This paragraph (b)(1)(ii) does not apply to payments to a nonresident alien individual from any trust described in section 401(a), any annuity plan described in section 403(a), any annuity, custodial account, or retirement income account described in section 403(b), or an individual retirement account or individual retirement annuity described in section 408. Instead, these payments are subject to withholding under this section to the extent they are exempted from the definition of wages under section 3401(a)(12) or to the extent they are from an annuity, custodial account, or retirement income account described in section 403(b), or an individual retirement account or individual retirement annuity described in section 408. Thus, for example, payments to a nonresident alien individual from a trust described in section 401(a) are subject to withholding under section 1441 and not under section 3405 or section 3406.

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Par. 7. Effective January 1, 2001, in §1.1441-5 paragraphs (a) through (e) are revised to read as follows:

*§1.1441-5 Withholding on payments to partnerships, trusts, and estates.*

(a) *In general.* This section describes the rules that apply to payments made to partnerships, trusts, and estates. Paragraph (b) of this section prescribes the rules that apply to a withholding agent making a payment to a U.S. partnership, trust, or estate. It also prescribes the obligations of a U.S. partnership, trust, or estate that makes a payment to a foreign partner, beneficiary, or owner. Paragraph (c) of this section prescribes rules that apply to a withholding agent that makes a payment to a foreign partnership. Paragraph (d) of this section provides presumption rules that apply to payments made to foreign partnerships. Paragraph (e) of this section prescribes rules, includ-

ing presumption rules, that apply to a withholding agent that makes a payment to a foreign trust or foreign estate.

(b) *Rules applicable to U.S. partnerships, trusts, and estates—(1) Payments to U.S. partnerships, trusts, and estates.* No withholding is required under section 1.1441-1(b)(1) on a payment of an amount subject to withholding (as defined in §1.1441-2(a)) that a withholding agent may treat as made to a U.S. payee. Therefore, if a withholding agent can reliably associate (within the meaning of §1.1441-2(b)(vii)) a Form W-9 provided in accordance with §1.1441-1(d)(2) or (4) by a U.S. partnership, U.S. trust, or a U.S. estate the withholding agent may treat the payment as made to a U.S. payee and the payment is not subject to withholding under section 1441 even though the partnership, trust, or estate may have foreign partners, beneficiaries, or owners. A withholding agent is also not required to withhold under section 1441 on a payment it makes to an entity presumed to be a U.S. payee under paragraphs (d)(2) and (e)(6)(ii) of this section.

(2) *Withholding by U.S. payees—(i) U.S. partnerships—(A) In general.* A U.S. partnership is required to withhold under §1.1441-1 as a withholding agent on an amount subject to withholding (as defined in §1.1441-2(a)) that is includible in the gross income of a partner that is a foreign person. Subject to paragraph (b)(2)(v) of this section, a U.S. partnership shall withhold when any distributions that include amounts subject to withholding (including guaranteed payments made by a U.S. partnership) are made. To the extent a foreign partner's distributive share of income subject to withholding has not actually been distributed to the foreign partner, the U.S. partnership must withhold on the foreign partner's distributive share of the income on the earlier of the date that the statement required under section 6031(b) is mailed or otherwise provided to the partner or the due date for furnishing the statement.

(B) *Effectively connected income of partners.* Withholding on items of income that are effectively connected income in the hands of the partners who are foreign persons is governed by section 1446 and not by this section. In such a case, partners in a domestic partnership are not required to furnish a withholding

certificate in order to claim an exemption from withholding under section 1441(c)(1) and §1.1441-4.

(ii) *U.S. simple trusts.* A U.S. trust that is described in section 651(a) (a U.S. simple trust) is required to withhold under chapter 3 of the Internal Revenue Code as a withholding agent on the distributable net income includible in the gross income of a foreign beneficiary to the extent the distributable net income is an amount subject to withholding (as defined in §1.1441-2(a)). A U.S. simple trust shall withhold when a distribution is made to a foreign beneficiary. The U.S. trust may make a reasonable estimate of the portion of the distribution that constitutes distributable net income consisting of an amount subject to withholding and apply the appropriate rate of withholding to the estimated amount. If, at the end of the taxable year in which the distribution is made, the U.S. simple trust determines that it underwithheld under section 1441 or 1442, the trust shall be liable as a withholding agent for the amount under withheld under section 1461. No penalties shall be imposed for failure to withhold and deposit the tax if the U.S. simple trust's estimate was reasonable and the trust pays the underwithheld amount on or before the due date of Form 1042 under section 1461. Any payment of underwithheld amounts by the U.S. simple trust shall not be treated as income subject to additional withholding even if that amount is treated as additional income to the foreign beneficiary, unless the additional amount is income to the foreign beneficiary as a result of a contractual arrangement between the parties regarding the satisfaction of the foreign beneficiary's tax liability. To the extent a U.S. simple trust is required to, but does not, distribute such income to a foreign beneficiary, the U.S. trust must withhold on the foreign beneficiary's allocable share at the time the income is required (without extension) to be reported on Form 1042-S under §1.1461-1(c).

(iii) *U.S. complex trusts and U.S. estates.* A U.S. trust that is not a trust described in section 651(a) (a U.S. complex trust) is required to withhold under chapter 3 of the Internal Revenue Code as a withholding agent on the distributable net income includible in the gross income of a foreign beneficiary to the extent the dis-

tributable net income consists of an amount subject to withholding (as defined in §1.1441-2(a)) that is, or is required to be, distributed currently. The U.S. complex trust shall withhold when a distribution is made to a foreign beneficiary. The trust may use the same procedures regarding an estimate of the amount subject to withholding as a U.S. simple trust under paragraph (b)(2)(ii) of this section. To the extent an amount subject to withholding is required to be, but is not actually distributed, the U.S. complex trust must withhold on the foreign beneficiary's allocable share at the time the income is required to be reported on Form 1042-S under §1.1461-1(c), without extension. A U.S. estate is required to withhold under chapter 3 of the Internal Revenue Code on the distributable net income includible in the gross income of a foreign beneficiary to the extent the distributable net income consists of an amount subject to withholding (as defined in §1.1441-2(a)) that is actually distributed. A U.S. estate may also use the reasonable estimate procedures of paragraph (b)(2)(ii) of this section. However, those procedures apply to an estate that has a taxable year other than a calendar year only if the estate files an amended return on Form 1042 for the calendar year in which the distribution was made and pays the underwithheld tax and interest within 60 days after the close of the taxable year in which the distribution was made.

(iv) *U.S. grantor trusts.* A U.S. trust that is described in section 671 through 679 (a U.S. grantor trust) must withhold on any income includible in the gross income of a foreign person that is treated as an owner of the grantor trust to the extent the amount includible consists of an amount that is subject to withholding (as described in §1.1441-2(a)). The withholding must occur at the time the income is received by, or credited to, the trust.

(v) *Subsequent distribution.* If a U.S. partnership or U.S. trust withholds on a foreign partner, beneficiary, or owner's share of an amount subject to withholding before the amount is actually distributed to the partner, beneficiary, or owner, withholding is not required when the amount is subsequently distributed.

(c) *Foreign partnerships—(1) Determination of payee—(i) Payments treated as made to partners.* Except as otherwise

provided in paragraph (c)(1)(ii) of this section, the payees of a payment to a person that the withholding agent may treat as a nonwithholding foreign partnership under paragraph (c)(3)(i) or (d)(2) of this section are the partners (looking through partners that are foreign intermediaries or flow-through entities) as follows—

(A) If the withholding agent can reliably associate a partner's distributive share of the payment with a valid Form W-9 provided under §1.1441-1(d), the partner is a U.S. payee;

(B) If the withholding agent can reliably associate a partner's distributive share of the payment with a valid Form W-8, or other appropriate documentation, provided under §1.1441-1(e)(1)(ii), the partner is a payee that is a foreign beneficial owner;

(C) If the withholding agent can reliably associate a partner's distributive share of the payment with a qualified intermediary withholding certificate under §1.1441-1(e)(3)(ii), a nonqualified intermediary withholding certificate under §1.1441-1(e)(3)(iii), or a U.S. branch certificate under §1.1441-1(e)(3)(v), then the rules of §1.1441-1(b)(2)(v) shall apply to determine who the payee is in the same manner as if the partner's distributive share of the payment had been paid directly to such intermediary or U.S. branch;

(D) If the withholding agent can reliably associate the partner's distributive share with a withholding foreign partnership certificate under paragraph (c)(2)(iv) of this section or a nonwithholding foreign partnership certificate under paragraph (c)(3)(iii) of this section, then the rules of this paragraph (c)(1)(i) or paragraph (c)(1)(ii) of this section shall apply to determine whether the payment is treated as made to the partners of the higher-tier partnership under this paragraph (c)(1)(i) or to the higher-tier partnership itself (under the rules of paragraph (c)(1)(ii) of this section) in the same manner as if the partner's distributive share of the payment had been paid directly to the higher-tier foreign partnership;

(E) If the withholding agent can reliably associate the partner's distributive share with a withholding certificate described in paragraph (e) of this section regarding a foreign trust or estate, then the

rules of paragraph (e) of this section shall apply to determine who the payees are; and

(F) If the withholding agent cannot reliably associate the partner's distributive share with a withholding certificate or other appropriate documentation, the partners are considered to be the payees and the presumptions described in paragraph (d)(3) of this section shall apply to determine their classification and status.

(ii) *Payments treated as made to the partnership.* A payment to a person that the withholding agent may treat as a foreign partnership is treated as a payment to the foreign partnership and not to its partners only if—

(A) The withholding agent can reliably associate the payment with a withholding certificate described in paragraph (c)(2)(iv) of this section (withholding certificate of a withholding foreign partnership);

(B) The withholding agent can reliably associate the payment with a withholding certificate described in paragraph (c)(3)(iii) of this section (nonwithholding foreign partnership) certifying that the payment is income that is effectively connected with the conduct of a trade or business in the United States; or

(C) The withholding agent can treat the income as effectively connected income under the presumption rules of §1.1441-4(a)(2)(ii) or (3)(i).

(iii) *Rules for reliably associating a payment with documentation.* For rules regarding the reliable association of a payment with documentation, see §1.1441-1(b)(2)(vii). In the absence of documentation, see §§1.1441-1(b)(3) and 1.6049-5(d) and paragraphs (d) and (e)(6) of this section for applicable presumptions.

(iv) *Examples.* The rules of paragraphs (c)(1)(i) and (ii) of this section are illustrated by the following examples:

*Example 1.* FP is a nonwithholding foreign partnership organized in Country X. FP has two partners, FC, a foreign corporation, and USP, a U.S. partnership. USWH, a U.S. withholding agent, makes a payment of U.S. source interest to FP. FP has provided USWH with a valid nonwithholding foreign partnership certificate, as described in paragraph (c)(3)(iii) of this section, with which it associates a beneficial owner withholding certificate from FC and a Form W-9 from USP together with the withholding statement required by paragraph (c)(3)(iv) of this section. USWH can reliably associate the payment of interest with the withholding certificates from FC and USP. Under paragraph

(c)(1)(i) of this section, the payees of the interest payment are FC and USP.

*Example 2.* The facts are the same as in *Example 1*, except that FP1, a nonwithholding foreign partnership, is a partner in FP rather than USP. FP1 has two partners, A and B, both foreign persons. FP provides USWH with a valid nonwithholding foreign partnership certificate, as described in paragraph (c)(3)(iii) of this section, with which it associates a beneficial owner withholding certificate from FC and a nonwithholding foreign partnership certificate from FP1. In addition, foreign beneficial owner withholding certificates from A and B are associated with the nonwithholding foreign partnership withholding certificate from FP1. FP also provides the withholding statement required by paragraph (c)(3)(iv) of this section. USWH can reliably associate the interest payment with the withholding certificates provided by FC, A, and B. Therefore, under paragraph (c)(1)(i) of this section, the payees of the interest payment are FC, A, and B.

*Example 3.* USWH makes a payment of U.S. source dividends to WFP, a withholding foreign partnership. WFP has two partners, FC1 and FC2, both foreign corporations. USWH can reliably associate the payment with a valid withholding foreign partnership withholding certificate from WFP. Therefore, under paragraph (c)(1)(ii)(A) of this section, WFP is the payee of the dividends.

*Example 4.* USWH makes a payment of U.S. source royalties to FP, a foreign partnership. USWH can reliably associate the royalties with a valid withholding certificate from FP on which FP certifies that the income is effectively connected with the conduct of a trade or business in the United States. Therefore, under paragraph (c)(1)(ii)(B) of this section, FP is the payee of the royalties.

(2) *Withholding foreign partnerships—*

(i) *Reliance on claim of withholding foreign partnership status.* A withholding foreign partnership is a foreign partnership that has entered into an agreement with the Internal Revenue Service (IRS), as described in paragraph (c)(2)(ii) of this section, with respect to distributions and guaranteed payments it makes to its partners. A withholding agent that can reliably associate a payment with a certificate described in paragraph (c)(2)(iv) of this section may treat the person to whom it makes the payment as a withholding foreign partnership for purposes of withholding under chapter 3 of the Internal Revenue Code, information reporting under chapter 61 of the Internal Revenue Code, backup withholding under section 3406, and withholding under other provisions of the Internal Revenue Code. Furnishing such a certificate is in lieu of transmitting to a withholding agent withholding certificates or other appropriate documentation for its partners. Although the withholding foreign partnership generally will be required to obtain withholding certifi-

cates or other appropriate documentation from its partners pursuant to its agreement with the IRS, it will generally not be required to attach such documentation to its withholding foreign partnership withholding certificate. A foreign partnership may act as a qualified intermediary under §1.1441-1(e)(5) with respect to payments it makes to persons other than its partners. In addition, the IRS may permit a foreign partnership to act as a qualified intermediary under §1.1441-1(e)(5)(ii)(D) with respect to its partners in appropriate circumstances.

(ii) *Withholding agreement.* The IRS may, upon request, enter into a withholding agreement with a foreign partnership pursuant to such procedures as the IRS may prescribe in published guidance (see §601.601(d)(2) of this chapter). Under the withholding agreement, a foreign partnership shall generally be subject to the applicable withholding and reporting provisions applicable to withholding agents and payors under chapters 3 and 61 of the Internal Revenue Code, section 3406, the regulations under those provisions, and other withholding provisions of the Internal Revenue Code, except to the extent provided under the agreement. Under the agreement, a foreign partnership may agree to act as an acceptance agent to perform the duties described in §301.6109-1(d)(3)(iv)(A) of this chapter. The agreement may specify the manner in which applicable procedures for adjustments for underwithholding and overwithholding, including refund procedures, apply to the withholding foreign partnership and its partners and the extent to which applicable procedures may be modified. In particular, a withholding agreement may allow a withholding foreign partnership to claim refunds of overwithheld amounts on behalf of its customers. In addition, the agreement must specify the manner in which the IRS will audit the foreign partnership's books and records in order to verify the partnership's compliance with its agreement. A withholding foreign partnership must file a return on Form 1042 and information returns on Form 1042-S. The withholding foreign partnership agreement may also require a withholding foreign partnership to file a partnership return under section 6031(a) and partner statements under 6031(b).

(iii) *Withholding responsibility.* A withholding foreign partnership must assume primary withholding responsibility under chapter 3 of the Internal Revenue Code. It is not required to provide information to the withholding agent regarding each partner's distributive share of the payment. The withholding foreign partnership will be responsible for reporting the payments under §1.1461-1(c) and chapter 61 of the Internal Revenue Code. A withholding agent making a payment to a withholding foreign partnership is not required to withhold any amount under chapter 3 of the Internal Revenue Code on a payment to the withholding foreign partnership, unless it has actual knowledge or reason to know that the foreign partnership is not a withholding foreign partnership. The withholding foreign partnership shall withhold the payments under the same procedures and at the same time as prescribed for withholding by a U.S. partnership under paragraph (b)(2) of this section, except that, for purposes of determining the partner's status, the provisions of paragraph (d)(4) of this section shall apply.

(iv) *Withholding certificate from a withholding foreign partnership.* The rules of §1.1441-1(e)(4) shall apply to withholding certificates described in this paragraph (c)(2)(iv). A withholding certificate furnished by a withholding foreign partnership is valid with regard to any partner on whose behalf the certificate is furnished only if it is furnished on a Form W-8, an acceptable substitute form, or such other form as the IRS may prescribe, it is signed under penalties of perjury by a partner with authority to sign for the partnership, its validity has not expired, and it contains the information, statement, and certifications described in this paragraph (c)(2)(iv) as follows—

(A) The name, permanent residence address (as described in §1.1441-1(e)(2)(ii)), and the employer identification number of the partnership, and the country under the laws of which the partnership is created or governed;

(B) A certification that the partnership is a withholding foreign partnership within the meaning of paragraph (c)(2)(i) of this section; and

(C) Any other information, certifications or statements as may be required by the withholding foreign partnership

agreement with the IRS or the form or accompanying instructions in addition to, or in lieu of, the information, statements, and certifications described in this paragraph (c)(2)(iv).

(3) *Nonwithholding foreign partnerships—(i) Reliance on claim of foreign partnership status.* A withholding agent may treat a person as a nonwithholding foreign partnership if it receives from that person a nonwithholding foreign partnership withholding certificate as described in paragraph (c)(3)(iii) of this section. A withholding agent that does not receive a nonwithholding foreign partnership withholding certificate, or does not receive a valid withholding certificate, from an entity it knows, or has reason to know, is a foreign partnership, must apply the presumption rules of §§1.1441-1(b)(3) and 1.6049-5(d) and paragraphs (d) and (e)(6) of this section. In addition, to the extent a withholding agent cannot, prior to a payment, reliably associate the payment with valid documentation from a payee that is associated with the nonwithholding foreign partnership withholding certificate or has insufficient information to report the payment on Form 1042-S or Form 1099, to the extent reporting is required, must also apply the presumption rules. See §1.1441-1(b)(2)(vii)(A) and (B) for rules regarding reliable association. See paragraph (c)(3)(iv) of this section and §1.1441-1(e)(3)(iv) for alternative procedures permitting allocation information to be received after a payment is made.

(ii) *Reliance on claim of reduced withholding by a partnership for its partners.* This paragraph (c)(3)(ii) describes the manner in which a withholding agent may rely on a claim of reduced withholding when making a payment to a nonwithholding foreign partnership. To the extent that a withholding agent treats a payment to a nonwithholding foreign partnership as a payment to the nonwithholding foreign partnership's partners (whether direct or indirect) in accordance with paragraph (c)(1)(i) of this section, it may rely on a claim for reduced withholding by the partner if, prior to the payment, the withholding agent can reliably associate the payment (within the meaning of §1.1441-1(b)(2)(vii)) with a valid withholding certificate or other appropriate documentation from the partner that establishes entitlement to a reduced rate of

withholding. A withholding certificate or other appropriate documentation that establishes entitlement to a reduced rate of withholding is a beneficial owner withholding certificate described in §1.1441-1(e)(2)(i), documentary evidence described in §1.1441-6(c)(3) or (4) or 1.6049-5(c)(1) (for a partner claiming to be a foreign person and a beneficial owner, determined under the provisions of §1.1441-1(c)(6)), a Form W-9 described in §1.1441-1(d) (for a partner claiming to be a U.S. payee), or a withholding foreign partnership withholding certificate described in paragraph (c)(2)(iv) of this section. Unless a nonwithholding foreign partnership withholding certificate is provided for income claimed to be effectively connected with the conduct of a trade or business in the United States, a claim must be presented for each portion of the payment that represents an item of income includible in the distributive share of a partner as required under paragraph (c)(3)(iii)(C) of this section. When making a claim for several partners, the partnership may present a single nonwithholding foreign partnership withholding certificate to which the partners' certificates or other appropriate documentation are associated. Where the nonwithholding foreign partnership withholding certificate is provided for income claimed to be effectively connected with the conduct of a trade or business in the United States under paragraph (c)(3)(iii)(D) of this section, the claim may be presented without having to identify any partner's distributive share of the payment.

(iii) *Withholding certificate from a nonwithholding foreign partnership.* A nonwithholding foreign partnership shall provide a nonwithholding foreign partnership withholding certificate with respect to reportable amounts received by the nonwithholding foreign partnership. A nonwithholding foreign partnership withholding certificate is valid only to the extent it is furnished on a Form W-8 (or an acceptable substitute form or such other form as the IRS may prescribe), it is signed under penalties of perjury by a partner with authority to sign for the partnership, its validity has not expired, and it contains the information, statements, and certifications described in this paragraph (c)(3)(iii) and paragraph (c)(3)(iv) of this

section, and the withholding certificates and other appropriate documentation for all the persons to whom the certificate relates are associated with the certificate. The rules of §1.1441-1(e)(4) shall apply to withholding certificates described in this paragraph (c)(3)(iii). No withholding certificates or other appropriate documentation from persons who derive income through a partnership (whether or not U.S. exempt recipients) are required to be associated with the nonwithholding foreign partnership withholding certificate if the certificate is furnished solely for income claimed to be effectively connected with the conduct of a trade or business in the United States. Withholding certificates and other appropriate documentation that may be associated with the nonwithholding foreign partnership withholding certificate consist of beneficial owner withholding certificates under §1.1441-1(e)(2)(i), intermediary withholding certificates under §1.1441-1(e)(3)(i), withholding foreign partnership withholding certificates under paragraph (c)(2)(iv) of this section, nonwithholding foreign partnership withholding certificates under this paragraph (c)(3)(iii), withholding certificates from foreign trusts or estates under paragraph (e) of this section, documentary evidence described in §1.1441-6(c)(3) or (4) or documentary evidence described in §1.6049-5(c)(1), and any other documentation or certificates applicable under other provisions of the Internal Revenue Code or regulations that certify or establish the status of the payee or beneficial owner as a U.S. or a foreign person. Nothing in this paragraph (c)(3)(iii) shall require a nonwithholding foreign partnership to furnish original documentation. Copies of certificates or documentary evidence may be transmitted to the U.S. withholding agent, in which case the nonwithholding foreign partnership must retain the original documentation for the same time period that the copy is required to be retained by the withholding agent under §1.1441-1(e)(4)(iii) and must provide it to the withholding agent upon request. The information, statement, and certifications required on the withholding certificate are as follows—

(A) The name, permanent residence address (as described in §1.1441-1(e)(2)(ii)), and the employer

identification number of the partnership, if any, and the country under the laws of which the partnership is created or governed;

(B) A certification that the person whose name is on the certificate is a foreign partnership;

(C) A withholding statement associated with the nonwithholding foreign partnership withholding certificate that provides all of the information required by paragraph (c)(3)(iv) of this section and §1.1441-1(e)(3)(iv). No withholding statement is required, however, for a nonwithholding foreign partnership withholding certificate furnished for income claimed to be effectively connected with the conduct of a trade or business in the United States;

(D) A certification that the income is effectively connected with the conduct of a trade or business in the United States, if applicable; and

(E) Any other information, certifications, or statements required by the form or accompanying instructions in addition to, or in lieu of, the information and certifications described in this paragraph (c)(3)(iii).

(iv) *Withholding statement provided by nonwithholding foreign partnership.* The provisions of §1.1441-1(e)(3)(iv) (regarding a withholding statement) shall apply to a nonwithholding foreign partnership by substituting the term nonwithholding foreign partnership for the term nonqualified intermediary.

(v) *Withholding and reporting by a foreign partnership.* A nonwithholding foreign partnership described in this paragraph (c)(3) that receives an amount subject to withholding (as defined in §1.1441-2(a)) shall be required to withhold and report such payment under chapter 3 of the Internal Revenue Code and the regulations thereunder except as otherwise provided in this paragraph (c)(3)(v). A nonwithholding foreign partnership shall not be required to withhold and report if it has provided a valid nonwithholding foreign partnership withholding certificate, it has provided all of the information required by paragraph (c)(3)(iv) of this section (withholding statement), and it does not know, and has no reason to know, that another withholding agent failed to withhold the correct amount or failed to report the payment correctly

under §1.1461-1(c). A withholding foreign partnership's obligations to withhold and report shall be determined in accordance with its withholding foreign partnership agreement.

(d) *Presumption rules—(1) In general.* This paragraph (d) contains the applicable presumptions for a withholding agent (including a partnership) to determine the classification and status of a partnership and its partners in the absence of documentation. The provisions of §1.1441-1(b)(3)(iv) (regarding the 90-day grace period) and §1.1441-1(b)(3)(vii) through (ix) shall apply for purposes of this paragraph (d).

(2) *Determination of partnership status as U.S. or foreign in the absence of documentation.* In the absence of a valid representation of U.S. partnership status in accordance with paragraph (b)(1) of this section or of foreign partnership status in accordance with paragraph (c)(2)(i) or (3)(i) of this section, the withholding agent shall determine the classification of the payee under the presumptions set forth in §1.1441-1(b)(3)(ii). If the withholding agent treats the payee as a partnership under §1.1441-1(b)(3)(ii), the withholding agent shall presume the partnership to be a U.S. partnership unless there are indicia of foreign status. If there are indicia of foreign status, the withholding agent may presume the partnership to be foreign. Indicia of foreign status exist only if the withholding agent has actual knowledge of the payee's employer identification number and that number begins with the two digits "98," the withholding agent's communications with the payee are mailed to an address in a foreign country, or the payment is made outside the United States (as defined in §1.6049-5(e)). For rules regarding reliable association with a withholding certificate from a domestic or a foreign partnership, see §1.1441-1(b)(2)(vii).

(3) *Determination of partners' status in the absence of certain documentation.* If a nonwithholding foreign partnership has provided a nonwithholding foreign partnership withholding certificate under paragraph (c)(3)(iii) of this section that would be valid except that the withholding agent cannot reliably associate all or a portion of the payment with valid documentation from a partner of the partnership, then the withholding agent may



apply the presumption rule of this paragraph (d)(3) with respect to all or a portion of the payment for which documentation has not been received. See §1.1441-1(b)(2)(vii)(A) and (B) for rules regarding reliable association. The presumption rule of this paragraph (d)(3) also applies to a person that is presumed to be a foreign partnership under the rule of paragraph (d)(2) of this section. Any portion of a payment that the withholding agent cannot treat as reliably associated with valid documentation from a partner may be presumed made to a foreign payee. As a result, any payment of an amount subject to withholding is subject to withholding at a rate of 30 percent. Any payment that is presumed to be made to an undocumented foreign payee must be reported on Form 1042-S. See §1.1461-1(c).

(4) *Determination by a withholding foreign partnership of the status of its partners.* A withholding foreign partnership shall determine whether the partners or some other persons are the payees of the partners' distributive shares of any payment made by a withholding foreign partnership by applying the rules of §1.1441-1(b)(2), paragraph (c)(1) of this section (in the case of a partner that is a foreign partnership), and paragraph (e)(3) of this section (in the case of a partner that is a foreign estate or a foreign trust). Further, the provisions of paragraph (d)(3) of this section shall apply to determine the status of partners and the applicable withholding rates to the extent that, at the time the foreign partnership is required to withhold on a payment, it cannot reliably associate the amount with documentation for any one or more of its partners.

(e) *Foreign trusts and estates—(1) In general.* This paragraph (e) provides rules applicable to payments of amounts subject to withholding (as defined in §1.1441-2(a)) that a withholding agent may treat as made to any foreign trust or a foreign estate. For rules relating to payments to a U.S. trust or a U.S. estate, see paragraph (b) of this section. For the definitions of foreign simple trust, foreign complex trust, and foreign grantor trust, see §1.1441-1(c)(24), (25), and (26).

(2) *Payments to foreign complex trusts and foreign estates.* Under §1.1441-1(c)(6)(ii)(D), a foreign complex trust or foreign estate is generally considered to

be the beneficial owner of income paid to the foreign complex trust or foreign estate. See paragraph (e)(4) of this section for rules describing when a withholding agent may treat a payment as made to a foreign complex trust or a foreign estate.

(3) *Payees of payments to foreign simple trusts and foreign grantor trusts—(i) Payments for which beneficiaries and owners are payees.* For purposes of the regulations under chapters 3 and 61 of the Internal Revenue Code and section 3406, a foreign simple trust is not a beneficial owner or a payee of a payment. Also, a foreign grantor trust (or a portion of a trust that is a foreign grantor trust) is not considered a beneficial owner or a payee of a payment. Except as otherwise provided in paragraph (e)(3)(ii) of this section, the payees of a payment made to a person that the withholding agent may treat as a foreign simple trust or a foreign grantor trust (or a portion of a trust that is a foreign grantor trust) are determined under the rules of this paragraph (e)(3)(i). The payees shall be treated as the beneficial owners if they may be so treated under §1.1441-1(c)(6)(ii)(C) and they provide documentation supporting their status as the beneficial owners. The payees of a payment to a foreign simple trust or foreign grantor trust are determined as follows—

(A) If the withholding agent can reliably associate a payment with a valid Form W-9 provided under §1.1441-1(d) from a beneficiary or owner of the foreign trust, then the beneficiary or owner is a U.S. payee;

(B) If the withholding agent can reliably associate a payment with a valid Form W-8, or other appropriate documentation, provided under §1.1441-1(e)(1)(ii) from a beneficiary or owner of the foreign trust, then the beneficiary or owner is a payee that is a foreign beneficial owner;

(C) If the withholding agent can reliably associate a payment with a qualified intermediary withholding certificate under §1.1441-1(e)(3)(ii), a nonqualified intermediary withholding certificate under §1.1441-1(e)(3)(ii), or a U.S. branch withholding certificate under §1.1441-1(e)(3)(v), then the rules of §1.1441-1(b)(2)(v) shall apply to determine the payee in the same manner as if the payment had been paid directly to such intermediary or U.S. branch;

(D) If the withholding agent can reliably associate a payment with a withholding foreign partnership withholding certificate under paragraph (c)(2)(iv) of this section or a nonwithholding foreign partnership withholding certificate under paragraph (c)(3)(iii) of this section, then the rules of paragraph (c)(1)(i) or (ii) of this section shall apply to determine the payee;

(E) If the withholding agent can reliably associate the payment with a foreign simple trust withholding certificate or a foreign grantor trust withholding certificate (both described in paragraph (e)(5)(iii) of this section) from a second or higher-tier foreign simple trust or foreign grantor trust, then the rules of this paragraph (e)(3)(i) or paragraph (e)(3)(ii) of this section shall apply to determine whether the payment is treated as made to a beneficiary or owner of the higher-tier trust or to the trust itself in the same manner as if the payment had been made directly to the higher-tier trust; and

(F) If the withholding agent cannot reliably associate a payment with a withholding certificate or other appropriate documentation, the payees shall be determined by applying the presumptions described in paragraph (e)(6) of this section.

(ii) *Payments for which trust is payee.* A payment to a person that the withholding agent may treat as made to a foreign trust under paragraph (e)(5)(iii) of this section is treated as a payment to the trust, and not to a beneficiary of the trust, only if—

(A) The withholding agent can reliably associate the payment with a foreign complex trust withholding certificate under paragraph (e)(4) of this section;

(B) The withholding agent can reliably associate the payment with a foreign simple trust withholding certificate under paragraph (e)(5)(iii) of this section certifying that the payment is income that is treated as effectively connected with the conduct of a trade or business in the United States; or

(C) The withholding agent can treat the income as effectively connected income under the presumption rules of §1.1441-4(a)(3)(i).

(4) *Reliance on claim of foreign complex trust or foreign estate status.* A withholding agent may treat a payment as made to a foreign complex trust or a for-

eign estate if the withholding agent can reliably associate the payment with a beneficial owner withholding certificate described in §1.1441-1(e)(2)(i) or other documentary evidence under §1.1441-6(c)(3) or (4) (regarding a claim for treaty benefits) or §1.6049-5(c)(1) (regarding documentary evidence to establish foreign status for purposes of chapter 61 of the Internal Revenue Code) that establishes the foreign complex trust or foreign estate's status as a beneficial owner. See paragraph (e)(6) of this section for presumption rules if documentation is lacking.

(5) *Foreign simple trust and foreign grantor trust*—(i) *Reliance on claim of foreign simple trust or foreign grantor trust status.* A withholding agent may treat a person as a foreign simple trust or foreign grantor trust if it receives from that person a foreign simple trust or foreign grantor trust withholding certificate as described in paragraph (e)(5)(iii) of this section. A withholding agent must apply the presumption rules of §§1.1441-1(b)(3) and 1.6049-5(d) and paragraphs (d) and (e)(6) of this section to the extent it cannot, prior to the payment, reliably associate a payment (within the meaning of §1.1441-1(b)(2)(vii)) with a valid foreign simple trust or foreign grantor trust withholding certificate, it cannot reliably determine how much of the payment relates to valid documentation provided by a payee (e.g., a person that is not itself a nonqualified intermediary, flow-through entity, or U.S. branch) associated with the foreign simple trust or foreign grantor trust withholding certificate, or it does not have sufficient information to report the payment on Form 1042-S or Form 1099, if reporting is required. See §1.1441-1(b)(2)(vii)(A) and (B).

(ii) *Reliance on claim of reduced withholding by a foreign simple trust or foreign grantor trust for its beneficiaries or owners.* This paragraph (e)(5)(ii) describes the manner in which a withholding agent may rely on a claim of reduced withholding when making a payment to a foreign simple trust or foreign grantor trust. To the extent that a withholding agent treats a payment to a foreign simple trust or foreign grantor trust as a payment to payees other than the trust in accordance with paragraph (e)(3)(i) of this section, it may rely on a claim for reduced withholding by a beneficiary or owner if,

prior to the payment, the withholding agent can reliably associate the payment (within the meaning of §1.1441-1(b)(2)(vii)) with a valid withholding certificate or other appropriate documentation from a payee or beneficial owner that establishes entitlement to a reduced rate of withholding. A withholding certificate or other appropriate documentation that establishes entitlement to a reduced rate of withholding is a beneficial owner withholding certificate described in §1.1441-1(e)(2)(i) or documentary evidence described in §1.1441-6(c)(3) or (4) or in §1.6049-5(c)(1) (for a beneficiary or owner claiming to be a foreign person and a beneficial owner, determined under the provisions of §1.1441-1(c)(6)), a Form W-9 described in §1.1441-1(d) (for a beneficiary or owner claiming to be a U.S. payee), or a withholding foreign partnership withholding certificate described in paragraph (c)(2)(iv) of this section. Unless a foreign simple trust or foreign grantor trust withholding certificate is provided for income treated as income effectively connected with the conduct of a trade or business in the United States, a claim must be presented for each payee's portion of the payment. When making a claim for several payees, the trust may present a single foreign simple trust or foreign grantor trust withholding certificate with which the payees' certificates or other appropriate documentation are associated. Where the foreign simple trust or foreign grantor trust withholding certificate is provided for income that is treated as effectively connected with the conduct of a trade or business in the United States under paragraph (e)(5)(iii)(D) of this section, the claim may be presented without having to identify any partner's distributive share of the payment.

(iii) *Withholding certificate from foreign simple trust or foreign grantor trust.* A withholding certificate furnished by a foreign simple trust or a foreign grantor trust that is not a withholding foreign trust (within the meaning of paragraph (e)(5)(v) of this section) is valid only if it is furnished on a Form W-8, an acceptable substitute form, or such other form as the IRS may prescribe, it is signed under penalties of perjury by a trustee, its validity has not expired, it contains the information, statements, and certifications required by this paragraph (e)(5)(iii) and

§1.1441-1(e)(3)(iv), and the withholding certificates or other appropriate documentation for all of the payees (as determined under paragraph (e)(3)(i) of this section) to whom the certificate relates are associated with the foreign simple trust or foreign grantor trust withholding certificate. The rules of §1.1441-1(e)(4) shall apply to withholding certificates described in this paragraph (e)(5)(iii). No withholding certificates or other appropriate documentation from persons who derive income through a foreign simple trust or a foreign grantor trust (whether or not U.S. exempt recipients) are required to be associated with the foreign simple trust or foreign grantor trust withholding certificate if the certificate is furnished solely for income that is treated as effectively connected with the conduct of a trade or business in the United States. Withholding certificates and other appropriate documentation (as determined under paragraph (e)(3)(i) of this section) that may be associated with a foreign simple trust or foreign grantor trust withholding certificate consist of beneficial owner withholding certificates under §1.1441-1(e)(2)(i), intermediary withholding certificates under §1.1441-1(e)(3)(i), withholding foreign partnership withholding certificates under paragraph (c)(2)(iv) of this section, non-withholding foreign partnership withholding certificates under paragraph (c)(3)(iii) of this section, withholding certificates from foreign trusts or estates under paragraph (e)(4) or (5)(iii) of this section, documentary evidence described in §§1.1441-6(c)(3) or (4), or 1.6049-5(c)(1), and any other documentation or certificates applicable under other provisions of the Internal Revenue Code or regulations that certify or establish the status of the payee or beneficial owner as a U.S. or a foreign person. Nothing in this paragraph (e)(5)(iii) shall require a foreign simple trust or foreign grantor trust to provide original documentation. Copies of certificates or documentary evidence may be passed up to the U.S. withholding agent, in which case the foreign simple trust or foreign grantor trust must retain the original documentation for the same time period that the copy is required to be retained by the withholding agent under §1.1441-1(e)(4)(iii) and must provide it to the withholding agent upon request. The information, state-

ment, and certifications required on a foreign simple trust or foreign grantor trust withholding certificate are as follows—

(A) The name, permanent residence address (as described in §1.1441-1(e)(2)(ii)), and the employer identification number, if required, of the trust and the country under the laws of which the trust is created;

(B) A certification that the person whose name is on the certificate is a foreign simple trust or a foreign grantor trust;

(C) A withholding statement associated with the foreign simple trust or foreign grantor trust withholding certificate that provides all of the information required by paragraph (e)(5)(iv) of this section. No withholding statement is required, however, for a foreign simple trust withholding certificate furnished for income that is treated as effectively connected with the conduct of a trade or business in the United States;

(D) A certification on a foreign simple trust withholding certificate that the income is treated as effectively connected with the conduct of a trade or business in the United States, if applicable; and

(E) Any other information, certifications, or statements required by the form or accompanying instructions in addition to, or in lieu of, the information, certifications, and statements described in this paragraph (e)(5)(iii);

(iv) *Withholding statement provided by a foreign simple trust or foreign grantor trust.* The provisions of §1.1441-1(e)(3)(iv) (regarding a withholding statement) shall apply to a foreign simple trust or foreign grantor trust by substituting the term foreign simple trust or foreign grantor trust for the term non-qualified intermediary.

(v) *Withholding foreign trusts.* The IRS may enter an agreement with a foreign trust to treat the trust or estate as a withholding foreign trust. Such an agreement shall generally follow the same principles as an agreement with a withholding foreign partnership under paragraph (c)(2)(ii) of this section. A withholding agent may treat a payment to a withholding foreign trust in the same manner the withholding agent would treat a payment to a withholding foreign partnership. The IRS may also enter an agreement to treat a trust as a qualified intermediary in appro-

priate circumstances. See §1.1441-1(e)(5)(ii)(D).

(6) *Presumption rules—(i) In general.* This paragraph (e)(6) contains the applicable presumptions for a withholding agent (including a trust or estate) to determine the classification and status of a trust or estate and its beneficiaries or owners in the absence of valid documentation. The provisions of §1.1441-1(b)(3)(iv) (regarding the 90-day grace period) and §1.1441-1(b)(3)(vii) through (ix) shall apply for purposes of this paragraph (e)(6).

(ii) *Determination of status as U.S. or foreign trust or estate in the absence of documentation.* In the absence of valid documentation that establishes the U.S. status of a trust or estate under paragraph (b)(1) of this section and of documentation that establishes the foreign status of a trust or estate under paragraph (e)(4) or (5)(iii) of this section, the withholding agent shall determine the classification of the payee based upon the presumptions set forth in §1.1441-1(b)(3)(ii). If, based upon those presumptions, the withholding agent classifies the payee as a trust or estate, the trust or estate shall be presumed to be a U.S. trust or U.S. estate unless there are indicia of foreign status, in which case the trust or estate shall be presumed to be foreign. Indicia of foreign status exists if the withholding agent has actual knowledge of the payee's employer identification number and that number begins with the two digits "98," the withholding agent's communications with the payee are mailed to an address in a foreign country, or the payment is made outside the United States (as defined in §1.6049-5(e)). If an undocumented payee is presumed to be a foreign trust it shall be presumed to be a foreign complex trust. If a withholding agent has documentary evidence that establishes that an entity is a foreign trust, but the withholding agent cannot determine whether the foreign trust is a complex trust, a simple trust, or foreign grantor trust, the withholding agent may presume that the trust is a foreign complex trust.

(iii) *Determination of beneficiary or owner's status in the absence of certain documentation.* If a foreign simple trust or foreign grantor trust has provided a foreign simple trust or foreign grantor trust withholding certificate under paragraph

(e)(5)(iii) of this section but the payment to such trust cannot be reliably associated with valid documentation from a specific beneficiary or owner of the trust, then any portion of a payment that a withholding agent cannot treat as reliably associated with valid documentation from a beneficiary or owner may be presumed made to a foreign payee. As a result, any payment of an amount subject to withholding is subject to withholding at a rate of 30 percent. Any such payment that is presumed to be made to an undocumented foreign person must be reported on Form 1042-S. See §1.1461-1(c).

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Par. 8. Effective January 1, 2001, §1.1441-6 is amended by:

1. Revising paragraphs (b)(1), (b)(2), and (b)(3).

2. Removing paragraph (b)(4) and redesignating paragraph (b)(5) as new paragraph (b)(4).

3. Revising paragraphs (c) and (e).

The revisions read as follows:

*§1.1441-6 Claim of reduced withholding under an income tax treaty.*

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(b) *Reliance on claim of reduced withholding under an income tax treaty—(1) In general.* The withholding imposed under section 1441, 1442, or 1443 on any payment to a foreign person is eligible for reduction under the terms of an income tax treaty only to the extent that such payment is treated as derived by a resident of an applicable treaty jurisdiction, such resident is a beneficial owner, and all other requirements for benefits under the treaty are satisfied. See section 894 and the regulations thereunder to determine whether a resident of a treaty country derives the income. Absent actual knowledge or reason to know otherwise, a withholding agent may rely on a claim that a beneficial owner is entitled to a reduced rate of withholding based upon an income tax treaty if, prior to the payment, the withholding agent can reliably associate the payment with a beneficial owner withholding certificate, described in §1.1441-1(e)(2), that contains the information necessary to support the claim, or, in the case of a payment of income described in paragraph (c)(2) of this section made outside the United States with respect to an offshore account, documentary evidence described in paragraphs (c)(3), (4) and (5) of this

section. See §§1.6049-5(e) for the definition of payments made outside the United States and 1.6049-5(c)(1) for the definition of offshore account. For purposes of this paragraph (b)(1), a beneficial owner withholding certificate described in §1.1441-1(e)(2)(i) contains information necessary to support the claim for a treaty benefit only if it includes the beneficial owner's taxpayer identifying number (except as otherwise provided in paragraph (c)(1) of this section) and the representations that the beneficial owner derives the income under section 894 and the regulations thereunder, if required, and meets the limitation on benefits provisions of the treaty, if any. The withholding certificate must also contain any other representations required by this section and any other information, certifications, or statements as may be required by the form or accompanying instructions in addition to, or in place of, the information and certifications described in this section. Absent actual knowledge or reason to know that the claims are incorrect (and subject to the standards of knowledge in §1.1441-7(b)), a withholding agent may rely on the claims made on a withholding certificate or on documentary evidence. A withholding agent may also rely on the information contained in a withholding statement provided under §§1.1441-1(e)(3)(iv) and 1.1441-5(c)(3)(iv) and (e)(5)(iv) to determine whether the appropriate statements regarding section 894 and limitation on benefits have been provided in connection with documentary evidence. If the beneficial owner is a person related to the withholding agent within the meaning of section 482, the withholding certificate must also contain a representation that the beneficial owner will file the statement required under §301.6114-1(d) of this chapter (if applicable). The requirement to file an information statement under section 6114 for income subject to withholding applies only to amounts received during the calendar year that, in the aggregate, exceed \$500,000. See §301.6114-1(d) of this chapter. The Internal Revenue Service (IRS) may apply the provisions of §1.1441-1(e)(1)(ii)(B) to notify the withholding agent that the certificate cannot be relied upon to grant benefits under an income tax treaty. See §1.1441-1(e)(4)(viii) regarding reliance on a withholding certificate by a with-

holding agent. The provisions of §1.1441-1(b)(3)(iv) dealing with a 90-day grace period shall apply for purposes of this section.

(2) *Payment to fiscally transparent entity*—(i) *In general.* If the person claiming a reduced rate of withholding under an income tax treaty is the interest holder of an entity that is considered to be fiscally transparent (as defined in the regulations under section 894) by the interest holder's jurisdiction with respect to an item of income, then, with respect to such income derived by that person through the entity, the entity shall be treated as a flow-through entity and may provide a flow-through withholding certificate with which the withholding certificate or other documentary evidence of the interest holder that supports the claim for treaty benefits is associated. For purposes of the preceding sentence, interest holders do not include any direct or indirect interest holders that are themselves treated as fiscally transparent entities with respect to that income by the interest holder's jurisdiction. See §1.1441-1(c)(23) and (e)(3)(i) for the definition of flow-through entity and flow-through withholding certificate. The entity may provide a beneficial owner withholding certificate, or beneficial owner documentation, with respect to any remaining portion of the income to the extent the entity is receiving income and is not treated as fiscally transparent by its own jurisdiction. Further, the entity may claim a reduced rate of withholding with respect to the portion of a payment for which it is not treated as fiscally transparent if it meets all the requirements to make such a claim and, in the case of treaty benefits, it provides the documentation required by paragraph (b)(1) of this section. If dual claims, as described in paragraph (b)(2)(iii) of this section, are made, multiple withholding certificates may have to be furnished. Multiple withholding certificates may also have to be furnished if the entity receives income for which a reduction of withholding is claimed under a provision of the Internal Revenue Code (e.g., portfolio interest) and income for which a reduction of withholding is claimed under an income tax treaty.

(ii) *Certification by qualified intermediary.* Notwithstanding paragraph (b)(2)(i) of this section, a foreign entity that is fiscally transparent, as defined in the regulations under section 894, that is also a qualified intermediary for purposes

of claiming a reduced rate of withholding under an income tax treaty for its interest holders (who are deriving the income paid to the entity as residents of an applicable treaty jurisdiction) may furnish a single qualified intermediary withholding certificate, as described in §1.1441-1(e)(3)(ii), for amounts for which it claims a reduced rate of withholding under an income tax treaty on behalf of its interest holders.

(iii) *Dual treatment.* Under paragraph (b)(2)(i) of this section, a withholding agent may make a payment to a foreign entity that is simultaneously claiming to be the beneficial owner of a portion of the income (whether or not it is also claiming a reduced rate of tax on its own behalf) and a reduced rate on behalf of persons in their capacity as interest holders in the entity with respect to the same, or a different, portion of the income. If the same portion of a payment may be reliably associated with both the entity's claim and an interest holder's claim, the withholding agent may choose to reject both claims and request new documentation and information allocating the payment among the beneficial owners of the payment or the withholding agent may choose which claim to apply. If the entity and the interest holder's claims are reliably associated with separate portions of the payment, the withholding agent may, at its option, accept such dual claims based on withholding certificates or other appropriate documentation furnished by the entity and its interest holders with respect to their respective shares of the payment even though this will result in the withholding agent treating the entity differently with respect to different portions of the same payment. Alternatively, the withholding agent may choose to apply only the claim made by the entity, provided the entity may be treated as a beneficial owner of the income. If the withholding agent does not accept claims for a reduced rate of withholding presented by any one or more of the interest holders, or by the entity, any interest holder or the entity may subsequently claim a refund or credit of any amount so withheld to the extent the interest holder's or entity's share of such withholding exceeds the amount of tax due.

(iv) *Examples.* The following examples illustrate the rules of this paragraph (b)(2):

*Example 1. (i) Facts.* Entity E is a business organization formed under the laws of country Y. Country Y has an income tax treaty with the United States. The treaty contains a limitation on benefits provision. E receives U.S. source royalties from withholding agent W and claims a reduced rate of withholding under the U.S.-Y tax treaty on its own behalf (rather than on behalf of its interest holders). E furnishes a beneficial owner withholding certificate described in paragraph (b)(1) of this section that represents that E is a resident of country Y (within the meaning of the U.S.-Y tax treaty), is the beneficial owner of the income, derives the income under section 894 and the regulations thereunder, and is not precluded from claiming benefits by the treaty's limitation on benefits provision.

(ii) *Analysis.* Absent actual knowledge or reason to know otherwise, W may rely on the representations made by E to apply a reduced rate of withholding.

*Example 2. (i) Facts.* The facts are the same as under *Example 1*, except that one of E's interest holders, H, is an entity organized in country Z. The U.S.-Z tax treaty reduces the rate on royalties to zero whereas the rate on royalties under the U.S.-Y tax treaty applicable to E is 5 percent. H is not fiscally transparent under country Z's tax law with respect to such income. H furnishes a beneficial owner withholding certificate to E that represents that H derives, within the meaning of section 894 and the regulations thereunder, its share of the royalty income paid to E as a resident of country Z, is the beneficial owner of the royalty income, and is not precluded from claiming treaty benefits by virtue of the limitation on benefits provision in the U.S.-Z treaty. E furnishes to W a flow-through withholding certificate described in §1.1441-1(e)(3)(i) to which it attaches H's beneficial owner withholding certificate and a withholding statement for the portion of the payment that H claims as its distributive share of the royalty income. E also furnishes to W a beneficial owner withholding certificate for itself for the portion of the payment that H does not claim as its distributive share.

(ii) *Analysis.* Absent actual knowledge or reason to know otherwise, W may rely on the documentation furnished by E to treat the royalty payment to a single foreign entity (E) as derived by different residents of tax treaty countries as a result of the claims presented under different treaties. W may, at its option, grant dual treatment, that is, a reduced rate of zero percent under the U.S.-Z treaty on the portion of the royalty payment that H claims to derive as a resident of country Z and a reduced rate of 5 percent under the U.S.-Y treaty for the balance. However, under paragraph (b)(2)(iii) of this section, W may, at its option, treat E as the only relevant person deriving the royalty and grant benefits under the U.S.-Y treaty only.

*Example 3. (i) Facts.* E is a business organization formed under the laws of country X. Country X has an income tax treaty with the United States. E has two interest holders, H1, organized in country Y, and H2, organized in country Z. E receives from W, a U.S. withholding agent, U.S. source royalties and interest that is eligible for the portfolio interest exception under sections 871(h) and 881(c), provided W receives the appropriate beneficial owner statement required under section 871(h)(5). E is classified as a corporation under U.S. tax law principles.

Country X, E's country of organization, treats E as an entity that is not fiscally transparent with respect to items of income under the regulations under section 894. Under the U.S.-X income tax treaty, royalties are subject to 5 percent rate of withholding. Country Y, H1's country of organization, treats E as fiscally transparent with respect to items of income under section 894 and H1 as not fiscally transparent with respect to items of income. Under the country Y-U.S. income tax treaty, royalties are exempt from U.S. tax. Country Z, H2's country of organization, treats E as not fiscally transparent under section 894 with respect to items of income. E provides W with a flow-through beneficial owner withholding certificate with which it associates a beneficial owner withholding certificate from H1. H1's withholding certificate states that H1 is a resident of country Y, derives the royalty income under section 894, meets the applicable limitations on benefits provisions of the U.S.-Y treaty, and is the beneficial owner of the income. The withholding statement attached to E's flow-through withholding certificate allocates one-half of the royalty payment to H1. E also provides W with a beneficial owner withholding certificate for the interest income and the remaining one-half of the royalty income. The withholding certificate states that E is a resident of country X, derives the royalty income under section 894, meets the limitation on benefits provisions of the U.S.-X treaty, and is the beneficial owner of the income.

(ii) *Analysis.* Absent actual knowledge or reason to know that the claims are incorrect, W may treat one-half of the royalty derived by E as subject to a 5 percent withholding rate and one-half of the royalty as derived by H1 and subject to no withholding. Further, it may treat all of the interest as being paid to E and as qualifying for the portfolio interest exception. W can, at its option, treat the entire royalty as paid to E and subject it to withholding at a 5 percent rate of withholding. In that case, H1 would be entitled to claim a refund with respect to its one-half of the royalty.

(3) *Certified TIN.* The IRS may issue guidance requiring a foreign person claiming treaty benefits and for whom a TIN is required to establish with the IRS, at the time the TIN is requested or after the TIN is issued, that the person is a resident in a treaty country and meets other conditions (such as limitation on benefits provisions) of the treaty. See §601.601(d)(2) of this chapter.

\* \* \* \* \*

(c) *Exemption from requirement to furnish a taxpayer identifying number and special documentary evidence rules for certain income—(1) General rule.* In the case of income described in paragraph (c)(2) of this section, a withholding agent may rely on a beneficial owner withholding certificate described in paragraph (b)(1) of this section without regard to the requirement that the withholding certificate include the beneficial owner's taxpayer identifying number. In the case of

payments of income described in paragraph (c)(2) of this section made outside the United States (as defined in §1.6049-5(e)) with respect to an offshore account (as defined in §1.6049-5(c)(1)), a withholding agent may, as an alternative to a withholding certificate described in paragraph (b)(1) of this section, rely on a certificate of residence described in paragraph (c)(3) of this section or documentary evidence described in paragraph (c)(4) of this section, relating to the beneficial owner, that the withholding agent has reviewed and maintains in its records in accordance with §1.1441-1(e)(4)(iii). In the case of a payment to a person other than an individual, the certificate of residence or documentary evidence must be accompanied by the statements described in paragraphs (c)(5)(i) and (ii) of this section regarding limitation on benefits and whether the amount paid is derived by such person or by one of its interest holders. The withholding agent maintains the reviewed documents by retaining either the documents viewed or a photocopy thereof and noting in its records the date on which, and by whom, the documents were received and reviewed. This paragraph (c)(1) shall not apply to amounts that are exempt from withholding based on a claim that the income is effectively connected with the conduct of a trade or business in the United States.

(2) *Income to which special rules apply.* The income to which paragraph (c)(1) of this section applies is dividends and interest from stocks and debt obligations that are actively traded, dividends from any redeemable security issued by an investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1), dividends, interest, or royalties from units of beneficial interest in a unit investment trust that are (or were upon issuance) publicly offered and are registered with the Securities and Exchange Commission under the Securities Act of 1933 (15 U.S.C. 77a) and amounts paid with respect to loans of securities described in this paragraph (c)(2). For purposes of this paragraph (c)(2), a stock or debt obligation is actively traded if it is actively traded within the meaning of section 1092(d) and §1.1092(d)-1 when documentation is provided.

(3) *Certificate of residence.* A certificate of residence referred to in paragraph

(c)(1) of this section is a certification issued by an appropriate tax official of the treaty country of which the taxpayer claims to be a resident that the taxpayer has filed its most recent income tax return as a resident of that country (within the meaning of the applicable tax treaty). The certificate of residence must have been issued by such official within three years prior to its being presented to the withholding agent, or such other period as the IRS may prescribe in published guidance (see §601.601(d)(2) of this chapter). See §1.1441-1(e)(4)(ii)(A) for the period during which a withholding agent may rely on a certificate of residence. The competent authorities may agree to a different procedure for certifying residence, in which case such procedure shall govern for payments made to a person claiming to be a resident of the country with which such an agreement is in effect.

(4) *Documentary evidence establishing residence in the treaty country*—(i) *Individuals*. For an individual, the documentary evidence referred to in paragraph (c)(1) of this section is any documentation that includes the individual's name, address, and photograph, is an official document issued by an authorized governmental body (i.e., a government or agency thereof, or a municipality), and has been issued no more than three years prior to presentation to the withholding agent. A document older than three years may be relied upon as proof of residence only if it is accompanied by additional evidence of the person's residence in the treaty country (e.g., a bank statement, utility bills, or medical bills). Documentary evidence must be in the form of original documents or certified copies thereof.

(ii) *Persons other than individuals*. For a person other than an individual, the documentary evidence referred to in paragraph (c)(1) of this section is any documentation that includes the name of the entity and the address of its principal office in the treaty country, and is an official document issued by an authorized governmental body (e.g., a government or agency thereof, or a municipality).

(5) *Statements regarding entitlement to treaty benefits*—(i) *Statement regarding conditions under a limitation on benefits provision*. In addition to the documentary evidence described in (c)(4)(ii) of this section, a taxpayer that is not an individ-

ual must provide a statement that it meets one or more of the conditions set forth in the limitation on benefits article (if any, or in a similar provision) contained in the applicable tax treaty.

(ii) *Statement regarding whether the taxpayer derives the income*. A taxpayer that is not an individual must also provide, in addition to the documentary evidence and the statement described in paragraph (c)(5)(i) of this section, a statement that any income for which it intends to claim benefits under an applicable income tax treaty is income that will properly be treated as derived by itself as a resident of the applicable treaty jurisdiction within the meaning of section 894 and the regulations thereunder. This requirement does not apply if the taxpayer furnishes a certificate of residence that certifies that fact.

\* \* \* \* \*

(e) *Competent authority*. The procedures described in this section may be modified to the extent the U.S. competent authority may agree with the competent authority of a country with which the United States has an income tax treaty in effect.

\* \* \* \* \*

Par. 9. Effective January 1, 2001, §1.1441-7 is amended by:

1. Revising paragraphs (a), (b)(2) and (b)(3).

2. Adding paragraphs (b)(4) through (b)(11).

The revisions and additions read as follows:

*§1.1441-7 General provisions relating to withholding agents.*

(a) *Withholding agent defined*—(1) *In general*. For purposes of chapter 3 of the Internal Revenue Code and the regulations under such chapter, the term *withholding agent* means any person, U.S. or foreign, that has the control, receipt, custody, disposal, or payment of an item of income of a foreign person subject to withholding, including (but not limited to) a foreign intermediary described in §1.1441-1(e)(3)(i), a foreign partnership, or a U.S. branch described in §1.1441-1(b)(2)(iv)(A) or (E). See §§1.1441-1(b)(2) and (3) and 1.1441-5(c), (d), and (e), for rules to determine whether a payment is considered made to a foreign person. Any person who meets the definition of a withholding agent is required to deposit any tax withheld

under §1.1461-1(a) and to make the returns prescribed by §1.1461-1(b) and (c), except as otherwise may be required by a qualified intermediary withholding agreement, a withholding foreign partnership agreement, or a withholding foreign trust agreement. When several persons qualify as withholding agents with respect to a single payment, only one tax is required to be withheld and deposited. See §1.1461-1. A person who, as a nominee described in §1.6031(c)-1T, has furnished to a partnership all of the information required to be furnished under §1.6031(c)-1T(a) shall not be treated as a withholding agent if it has notified the partnership that it is treating the provision of information to the partnership as a discharge of its obligations as a withholding agent.

(2) *Examples*. The following examples illustrate the rules of paragraph (a)(1) of this section:

*Example 1*. USB is a broker organized in the United States. USB pays U.S. source dividends and interest, which are amounts subject to withholding under §1.1441-2(a), to FC, a foreign corporation that has an investment account with USB. USB is a withholding agent as defined in paragraph (a)(1) of this section.

*Example 2*. USB is a bank organized in the United States. FB is a bank organized in country X. X has an omnibus account with USB through which FB invests in debt and equity instruments that pay amounts subject to withholding as defined in §1.1441-2(a). FB is a nonqualified intermediary, as defined in §1.1441-1(c)(14). Both USB and FB are withholding agents as defined in paragraph (a)(1) of this section.

*Example 3*. The facts are the same as in *Example 2*, except that FB is a qualified intermediary. Both USB and FB are withholding agents as defined in paragraph (a)(1) of this section.

*Example 4*. FB is a bank organized in country X. FB has a branch in the United States. FB's branch has customers that are foreign persons who receive amounts subject to withholding, as defined in §1.1441-2(a). FB is a withholding agent under paragraph (a)(1) of this section and is required to withhold and report payments of amounts subject to withholding in accordance with chapter 3 of the Internal Revenue Code.

*Example 5*. X is a foreign corporation. X pays dividends to shareholders who are foreign persons. Under section 861(a)(2)(B), a portion of the dividends are from sources within the United States and constitute amounts subject to withholding within the meaning of §1.1441-2(a). The dividends are not subject to tax under section 884(a). See 884(e)(3). X is a withholding agent under paragraph (a)(1) of this section.

(b) \* \* \*

(2) *Reason to know*. A withholding agent shall be considered to have reason to know if its knowledge of relevant facts or of statements contained in the with-

holding certificates or other documentation is such that a reasonably prudent person in the position of the withholding agent would question the claims made.

(3) *Financial institutions—limits on reason to know.* For purposes of this paragraph (b)(3) and paragraphs (b)(4) through (b)(10) of this section, the terms *withholding certificate*, *documentary evidence*, and *documentation* are defined in §1.1441-1(c)(16), (17) and (18). Except as otherwise provided in paragraphs (b)(4) through (b)(9) of this section, a withholding agent that is a financial institution (including a regulated investment company) that has a direct account relationship with a beneficial owner (a direct account holder) has a reason to know, with respect to amounts described in §1.1441-6(c)(2), that documentation provided by the direct account holder is unreliable or incorrect only if one or more of the circumstances described in paragraphs (b)(4) through (b)(9) of this section exist. If a direct account holder has provided documentation that is unreliable or incorrect under the rules of paragraph (b)(4) through (b)(9) of this section, the withholding agent may require new documentation. Alternatively, the withholding agent may rely on the documentation originally provided if the rules of paragraphs (b)(4) through (b)(9) of this section permit such reliance based on additional statements and documentation. Paragraph (b)(10) of this section provides limits on reason to know for financial institutions that receive beneficial owner documentation from persons (indirect account holders) that have an account relationship with, or an ownership interest in, a direct account holder. For rules regarding reliance on Form W-9, see §31.3406(g)-3(e)(2) of this chapter.

(4) *Rules applicable to withholding certificates—(i) In general.* A withholding agent has reason to know that a beneficial owner withholding certificate provided by a direct account holder in connection with a payment of an amount described in §1.1441-6(c)(2) is unreliable or incorrect if the withholding certificate is incomplete with respect to any item on the certificate that is relevant to the claims made by the direct account holder, the withholding certificate contains any information that is inconsistent with the direct account holder's claim, the withholding

agent has other account information that is inconsistent with the direct account holder's claim, or the withholding certificate lacks information necessary to establish entitlement to a reduced rate of withholding. A withholding agent shall also treat a withholding certificate as unreliable or incorrect if the name of the person on the withholding certificate indicates that the person is a corporation, partnership, trust, estate, or an individual, and the person's claim of classification (e.g. individual, partnership, corporation) is not consistent with such indication and a difference in classification would result in a different rate of withholding or a difference in the person or persons to whom the payment is reported under §1.1461-1(c) or chapter 61 of the Internal Revenue Code. For purposes of establishing a direct account holder's status as a foreign person or resident of a treaty country a withholding certificate shall be considered unreliable or inconsistent with an account holder's claims only if it is not reliable under the rules of paragraph (b)(5) and (6) of this section. A withholding agent that relies on an agent to review and maintain a withholding certificate is considered to know or have reason to know the facts within the knowledge of the agent.

(ii) *Examples.* The rules of paragraph (b)(4) of this section are illustrated by the following examples:

*Example 1.* F, a foreign person that has a direct account relationship with USB, a bank that is a U.S. person, provides USB with a beneficial owner withholding certificate for the purpose of claiming a reduced rate of withholding on U.S. source dividends. F resides in a treaty country that has a limitation on benefits provision in its income tax treaty with the United States. The withholding certificate, however, does not contain a statement regarding limitations on benefits or deriving the income under section 894 as required by §1.1441-6(b)(1). USB cannot rely on the withholding certificate to grant a reduced rate of withholding because it is incomplete with respect to the claim made by F.

*Example 2.* F, a foreign person that has a direct account relationship with USB, a broker that is a U.S. person, provides USB with a withholding certificate for the purpose of claiming the portfolio interest exception under section 881(c), which applies to foreign corporations. F indicates on its withholding certificate, however, that it is a partnership. USB may not treat F as a beneficial owner of the interest for purposes of the portfolio interest exception because F has indicated on its withholding certificate that it is a foreign partnership, and therefore under §1.1441-1(c)(6)(ii) it is not the beneficial owner of the interest payment.

(5) *Withholding certificate—establish-*

*ment of foreign status.* A withholding agent has reason to know that a beneficial owner withholding certificate (as defined in §1.1441-1(e)(2)) provided by a direct account holder in connection with a payment of an amount described in §1.1441-6(c)(2) is unreliable or incorrect for purposes of establishing the account holder's status as a foreign person if the certificate is described in paragraph (b)(5)(i) or (ii) of this section.

(i) A withholding certificate is unreliable or incorrect if the withholding certificate has a permanent residence address (as defined in §1.1441-1(e)(2)(ii)) in the United States, the withholding certificate has a mailing address in the United States, the withholding agent has a residence or mailing address as part of its account information that is an address in the United States, or the direct account holder notifies the withholding agent of a new residence or mailing address in the United States (whether or not provided on a withholding certificate). A withholding agent may, however, rely on the beneficial owner withholding certificate as establishing the account holder's foreign status if it may do so under the provisions of paragraph (b)(5)(i)(A) or (B) of this section.

(A) A withholding agent may treat a direct account holder as a foreign person if the beneficial owner withholding certificate has been provided by an individual and—

(1) The withholding agent has in its possession or obtains documentary evidence (which does not contain a U.S. address) that is no more than three years old, the documentary evidence supports the claim of foreign status, and the direct account holder provides the withholding agent with a reasonable explanation, in writing, supporting the account holder's foreign status; or

(2) The account is maintained at an office of the withholding agent outside the United States and the withholding agent is required to report annually a payment to the direct account holder on a tax information statement that is filed with the tax authority of the country in which the office is located and that country has an income tax treaty in effect with the United States.

(B) A withholding agent may treat an account holder as a foreign person if the

beneficial owner withholding certificate has been provided by an entity that the withholding agent does not know, or does not have reason to know, is a flow-through entity and—

(1) The withholding agent has in its possession, or obtains, documentation that substantiates that the entity is actually organized or created under the laws of a foreign country; or

(2) The account is maintained at an office of the withholding agent outside the United States and the withholding agent is required to report annually a payment to the direct account holder on a tax information statement that is filed with the tax authority of the country in which the office is located and that country has an income tax treaty in effect with the United States.

(ii) A beneficial owner withholding certificate is unreliable or incorrect if it is provided with respect to an offshore account (as defined in §1.6049-5(c)(1)) and the direct account holder has standing instructions directing the withholding agent to pay amounts from its account to an address or an account maintained in the United States. The withholding agent may treat the direct account holder as a foreign person, however, if the direct account holder provides a reasonable explanation in writing that supports its foreign status.

(6) *Withholding certificate—claim of reduced rate of withholding under treaty.* A withholding agent has reason to know that a withholding certificate (other than Form W-9) provided by a direct account holder in connection with a payment of an amount described in §1.1441-6(c)(2) is unreliable or incorrect for purposes of establishing that the direct account holder is a resident of a country with which the United States has an income tax treaty if it is described in paragraphs (b)(6)(i) through (iii) of this section.

(i) A beneficial owner withholding certificate is unreliable or incorrect if the permanent residence address on the beneficial owner withholding certificate is not in the country whose treaty is invoked, or the direct account holder notifies the withholding agent of a new permanent residence address that is not in the treaty country. A withholding agent may, however, treat a direct account holder as entitled to a reduced rate of withholding

under an income tax treaty if the direct account holder provides a reasonable explanation for the permanent residence address outside the treaty country (e.g., the address is the address of a branch of the beneficial owner located outside the treaty country in which the entity is a resident) or the withholding agent has in its possession, or obtains, documentary evidence that establishes residency in a treaty country.

(ii) A beneficial owner withholding certificate is unreliable or incorrect if the permanent residence address on the withholding certificate is in the applicable treaty country but the withholding certificate contains a mailing address outside the treaty country or the withholding agent has a mailing address as part of its account information that is outside the treaty country. A mailing address that is a P.O. Box, in-care-of address, or address at a financial institution (if the financial institution is not a beneficial owner) shall not preclude a withholding agent from treating the direct account holder as a resident of a treaty country if such address is in the treaty country. If a withholding agent has a mailing address (whether or not contained on the withholding certificate) outside the applicable treaty country, the withholding agent may nevertheless treat a direct account holder as a resident of an applicable treaty country if—

(A) The withholding agent has in its possession, or obtains, additional documentation supporting the direct account holder's claim of residence in the applicable treaty country (and the additional documentation does not contain an address outside the treaty country);

(B) The withholding agent has in its possession, or obtains, documentation that establishes that the direct account holder is an entity organized in a treaty country (or an entity managed and controlled in a treaty country, if the applicable treaty so requires);

(C) The withholding agent knows that the address outside the applicable treaty country (other than a P.O. box, or in-care-of address) is a branch of a bank or insurance company that is a resident of the applicable treaty country; or

(D) The withholding agent obtains a written statement from the direct account holder that reasonably establishes entitle-

ment to treaty benefits.

(iii) A beneficial owner withholding certificate is unreliable or incorrect to establish entitlement to a reduced rate of withholding under an income tax treaty if the direct account holder has standing instructions for the withholding agent to pay amounts from its account to an address or an account outside the treaty country unless the direct account holder provides a reasonable explanation, in writing, establishing the direct account holder's residence in the applicable treaty country.

(7) *Documentary evidence.* A withholding agent shall not treat documentary evidence provided by a direct account holder as valid if the documentary evidence does not reasonably establish the identity of the person presenting the documentary evidence. For example, documentary evidence is not valid if it is provided in person by a direct account holder that is a natural person and the photograph or signature on the documentary evidence, if any, does not match the appearance or signature of the person presenting the document. A withholding agent shall not rely on documentary evidence to reduce the rate of withholding that would otherwise apply under the presumption rules of §§1.1441-1(b)(3), 1.1441-5(d) and (e)(6), and 1.6049-5(d) if the documentary evidence contains information that is inconsistent with the direct account holder's claim of a reduced rate of withholding, the withholding agent has other account information that is inconsistent with the direct account holder's claim, or the documentary evidence lacks information necessary to establish entitlement to a reduced rate of withholding. For example, if a direct account holder provides documentary evidence to claim treaty benefits and the documentary evidence establishes the direct account holder's status as a foreign person and a resident of a treaty country, but the account holder fails to provide the treaty statements required by §1.1441-6(c)(5), the documentary evidence does not establish the direct account holder's entitlement to a reduced rate of withholding. For purposes of establishing a direct account holder's status as a foreign person or resident of a country with which the United States has an income tax treaty with respect to income described in



§1.1441-6(c)(2), documentary evidence shall be considered unreliable or incorrect only if it is not reliable under the rules of paragraph (b)(8) and (9) of this section.

(8) *Documentary evidence—establishment of foreign status.* A withholding agent has reason to know that documentary evidence provided in connection with a payment of an amount described in §1.1441-6(c)(2) is unreliable or incorrect for purposes of establishing the direct account holder's status as a foreign person if the documentary evidence is described in paragraphs (b)(8)(i), (ii), (iii) or (iv) of this section.

(i) A withholding agent shall not treat documentary evidence provided by an account holder after December 31, 2000, as valid for purposes of establishing the direct account holder's foreign status if the only mailing or residence address that is available to the withholding agent is an address at a financial institution (unless the financial institution is a beneficial owner of the income), an in-care-of address, or a P.O. box. In this case, the withholding agent must obtain additional documentation that is sufficient to establish the direct account holder's status as a foreign person. A withholding agent shall not treat documentary evidence provided by an account holder before January 1, 2001, as valid for purposes of establishing a direct account holder's status as a foreign person if it has actual knowledge that the direct account holder is a U.S. person or if it has a mailing or residence address for the direct account holder in the United States. If a withholding agent has an address for the direct account holder in the United States, the withholding agent may nevertheless treat the direct account holder as a foreign person if it can so treat the direct account holder under the rules of paragraph (b)(8)(ii) of this section.

(ii) Documentary evidence is unreliable or incorrect to establish a direct account holder's status as a foreign person if the withholding agent has a mailing or residence address (whether or not on the documentation) for the direct account holder in the United States or if the direct account holder notifies the withholding agent of a new address in the United States. A withholding agent may, however, rely on documentary evidence as establishing the direct account holder's foreign status if it may do so under the

provisions of paragraph (b)(8)(ii)(A) or (B) of this section.

(A) A withholding agent may treat a direct account holder that is an individual as a foreign person even if it has a mailing or residence address for the direct account holder in the United States if the withholding agent—

(1) Has in its possession or obtains additional documentary evidence (which does not contain a U.S. address) supporting the claim of foreign status and a reasonable explanation in writing supporting the account holder's foreign status;

(2) Has in its possession or obtains a valid beneficial owner withholding certificate on Form W-8 and the Form W-8 contains a permanent residence address outside the United States and a mailing address outside the United States (or if a mailing address is inside the United States the direct account holder provides a reasonable explanation in writing supporting the direct account holder's foreign status); or

(3) The account is maintained at an office of the withholding agent outside the United States and the withholding agent is required to report annually a payment to the direct account holder on a tax information statement that is filed with the tax authority of the country in which the office is located and that country has an income tax treaty in effect with the United States.

(B) A withholding agent may treat a direct account holder that is an entity (other than a flow-through entity) as a foreign person even if it has a mailing or residence address for the direct account holder in the United States if the withholding agent—

(1) Has in its possession, or obtains, documentation that substantiates that the entity is actually organized or created under the laws of a foreign country;

(2) Obtains a valid beneficial owner withholding certificate on Form W-8 and the Form W-8 contains a permanent residence address outside the United States and a mailing address outside the United States (or if a mailing address is inside the United States the direct account holder provides additional documentary evidence sufficient to establish the direct account holder's foreign status); or

(3) The account is maintained at an office of the withholding agent outside the

United States and the withholding agent is required to report annually a payment to the direct account holder on a tax information statement that is filed with the tax authority of the country in which the office is located and that country has an income tax treaty in effect with the United States.

(iii) Documentary evidence is unreliable or incorrect if the direct account holder has standing instructions directing the withholding agent to pay amounts from its account to an address or an account maintained in the United States. The withholding agent may treat the direct account holder as a foreign person, however, if the account holder provides a reasonable explanation in writing that supports its foreign status.

(9) *Documentary evidence—claim of reduced rate of withholding under treaty.* A withholding agent has reason to know that documentary evidence provided in connection with a payment of an amount described in §1.1441-6(c)(2) is unreliable or incorrect for purposes of establishing that a direct account holder is a resident of a country with which the United States has an income tax treaty if it is described in paragraph (b)(9)(i) or (ii) of this section.

(i) Documentary evidence is unreliable or incorrect if the withholding agent has a mailing or residence address for the direct account holder (whether or not on the documentary evidence) that is outside the applicable treaty country, or the only address that the withholding agent has (whether in or outside of the applicable treaty country) is a P.O. box, an in-care-of address, or the address of a financial institution (if the financial institution is not the beneficial owner). If a withholding agent has a mailing or residence address for the direct account holder outside the applicable treaty country, the withholding agent may nevertheless treat a direct account holder as a resident of an applicable treaty country if the withholding agent—

(A) Has in its possession, or obtains, additional documentary evidence supporting the direct account holder's claim of residence in the applicable treaty country (and the documentary evidence does not contain an address outside the applicable treaty country, a P.O. box, an in-care-of address, or the address of a financial institution);

(B) Has in its possession, or obtains, documentary evidence that establishes the direct account holder is an entity organized in a treaty country (or an entity managed and controlled in a treaty country, if the applicable treaty so requires); or

(C) Obtains a valid beneficial owner withholding certificate on Form W-8 that contains a permanent residence address and a mailing address in the applicable treaty country.

(ii) Documentary evidence is unreliable or incorrect if the direct account holder has standing instructions directing the withholding agent to pay amounts from its account to an address or an account maintained outside the treaty country unless the direct account holder provides a reasonable explanation, in writing, establishing the direct account holder's residence in the applicable treaty country.

(10) *Limits on reason to know—indirect account holders.* A financial institution that receives documentation from a payee through a nonqualified intermediary, a flow-through entity, or a U.S. branch described in §1.1441-1(b)(2)(iv) (other than a U.S. branch that is treated as a U.S. person) with respect to a payment of an amount described in §1.1441-6(c)(2) has reason to know that the documentation is unreliable or incorrect if a reasonably prudent person in the position of a withholding agent would question the claims made. This standard requires, but is not limited to, a withholding agent's compliance with the rules of paragraphs (b)(10)(i) through (iii).

(i) The withholding agent must review the withholding statement described in §1.1441-1(e)(3)(iv) and may not rely on information in the statement to the extent the information does not support the claims made for any payee. For this purpose, a withholding agent may not treat a payee as a foreign person if an address in the United States is provided for such payee and may not treat a person as a resident of a country with which the United States has an income tax treaty if the address for that person is outside the applicable treaty country. Notwithstanding a U.S. address or an address outside a treaty country, the withholding agent may treat a payee as a foreign person or a foreign person as a resident of a treaty country if a reasonable explanation is provided, in writing, by the nonqualified intermediary,

flow-through entity, or U.S. branch supporting the payee's foreign status or the foreign person's residency in a treaty country.

(ii) The withholding agent must review each withholding certificate in accordance with the requirements of paragraphs (b)(5) and (6) of this section and verify that the information on the withholding certificate is consistent with the information on the withholding statement required under §1.1441-1(e)(3)(iv). If there is a discrepancy between the withholding certificate and the withholding statement, the withholding agent may choose to rely on the withholding certificate, if valid, and instruct the nonqualified intermediary, flow-through entity, or U.S. branch to correct the withholding statement or apply the presumption rules of §§1.1441-1(b), 1.1441-5(d) and (e)(6), and 1.6049-5(d) to the payment allocable to the payee who provided the withholding certificate relates. A withholding agent that receives a withholding certificate before December 31, 2001, is not required to review the information on withholding certificates or determine if it is consistent with the information on the withholding statement until December 31, 2001. A withholding agent may withhold and report in accordance with a withholding statement until December 31, 2001, unless it has actually performed the verification procedures required by this paragraph (b)(10)(ii) and determined that the withholding statement is inaccurate with respect to a particular payee.

(iii) The withholding agent must review the documentary evidence provided by the nonqualified intermediary, flow-through entity, or U.S. branch to determine that there is no obvious indication that the payee is a U.S. non-exempt recipient or that the documentary evidence does not establish the identity of the person who provided the documentation (e.g., the documentary evidence does not appear to be an identification document).

(11) *Additional guidance.* The IRS may prescribe other circumstances for which a withholding certificate or documentary evidence is unreliable or incorrect in addition to the circumstances described in paragraph (b) of this section to establish an account holder's status as a foreign person or a beneficial owner entitled to a reduced rate of withholding in

published guidance (see §601.601(d)(2) of this chapter).

\* \* \* \* \*

Par. 10. Effective January 1, 2001, §1.1441-9 is amended by revising paragraph (b)(2) to read as follows:

*§1.1441-9 Exemption from withholding on exempt income of a foreign tax-exempt organization, including foreign private foundations.*

\* \* \* \* \*

(b) \* \* \*

(2) *Withholding certificate.* A withholding certificate under this paragraph (b)(2) is valid only if it is a Form W-8 and if, in addition to other applicable requirements, the Form W-8 includes the taxpayer identifying number of the organization whose name is on the certificate, and it certifies that the Internal Revenue Service (IRS) has issued a favorable determination letter (and the date thereof) that is currently in effect, what portion, if any, of the amounts paid constitute income includible under section 512 in computing the organization's unrelated business taxable income, and, if the organization is described in section 501(c)(3), whether it is a private foundation described in section 509. Notwithstanding the preceding sentence, if the organization cannot certify that it has been issued a favorable determination letter that is still in effect, its withholding certificate is nevertheless valid under this paragraph (b)(2) if the organization attaches to the withholding certificate an opinion that is acceptable to the withholding agent from a U.S. counsel (or any other person as the IRS may prescribe in published guidance (see §601.601(d)(2) of this chapter)) concluding that the organization is described in section 501(c). If the determination letter or opinion of counsel to which the withholding certificate refers concludes that the organization is described in section 501(c)(3), and the certificate further certifies that the organization is not a private foundation described in section 509, an affidavit of the organization setting forth sufficient facts concerning the operations and support of the organization for the Internal Revenue Service (IRS) to determine that such organization would be likely to qualify as an organization described in section 509(a)(1), (2), (3), or (4) must be attached to the withholding certificate. An organization that provides

an opinion of U.S. counsel or an affidavit may provide the same opinion or affidavit to more than one withholding agent provided that the opinion is acceptable to each withholding agent who receives it in conjunction with a withholding certificate. Any such opinion of counsel or affidavit must be renewed whenever there is a change in facts or circumstances that are relevant to determine the organization's status under section 501(c) or, if relevant, that the organization is or is not a private foundation described in section 509.

\* \* \* \* \*

Par. 12. Effective January 1, 2001, §1.1461-1 is amended by:

1. Removing the last sentence of paragraph (a)(1).

2. Removing paragraphs (b)(2) and (b)(3) and redesignating paragraph (b)(4) as new paragraph (b)(2).

3. Revising paragraphs (c)(1), (c)(2), (c)(3), and (c)(4).

4. Removing paragraphs (c)(5), (c)(6), and (c)(7), and redesignating paragraph (c)(8) as new paragraph (c)(5).

The revisions read as follows:

§1.1461-1 *Payment and returns of tax withheld.*

\* \* \* \* \*

(c) *Information returns*—(1) *Filing requirement*—(i) *In general.* A withholding agent (other than an individual who is not acting in the course of a trade or business with respect to a payment) must make an information return on Form 1042-S (or such other form as the IRS may prescribe) to report the amounts subject to reporting, as defined in paragraph (c)(2) of this section, that were paid during the preceding calendar year. Notwithstanding the preceding sentence, any person that withholds or is required to withhold an amount under sections 1441, 1442, or 1443 must file a Form 1042-S for the payment withheld upon whether or not that person is engaged in a trade or business and whether or not the payment is an amount subject to reporting. A Form 1042-S shall be prepared for each recipient of an amount subject to reporting. The Form 1042-S shall be prepared in such manner as the form and accompanying instructions prescribe. One copy of the Form 1042-S shall be filed with the IRS on or before March 15 of the calendar year following the year in which the amount subject to reporting was paid. It

shall be filed with a transmittal form as provided in the instructions to the Form 1042-S and to the transmittal form. Withholding certificates, documentary evidence, or other statements or documentation provided to a withholding agent are not required to be attached to the form. Another copy of the Form 1042-S must be furnished to the recipient for whom the form is prepared (or any other person, as required under this paragraph (c) or the instructions to the form) on or before March 15 of the calendar year following the year in which the amount subject to reporting was paid. The withholding agent must retain a copy of each Form 1042-S for the statute of limitations on assessment and collection applicable to the Form 1042 to which the Form 1042-S relates.

(ii) *Recipient*—(A) *Defined.* For purposes of this section, the term *recipient* means—

(1) A beneficial owner as defined in paragraph (c)(6) of this section, including a foreign estate or a foreign complex trust, as defined in §1.1441-1(c)(25);

(2) A qualified intermediary as defined in §1.1441-1(e)(5)(ii);

(3) A withholding foreign partnership as defined in §1.1441-5(c)(2) or a withholding foreign trust under §1.1441-5(e)(5)(v);

(4) An authorized foreign agent as defined in §1.1441-7(c);

(5) A U.S. branch that is treated as a U.S. person under §1.1441-1(b)(2)(iv)(A);

(6) A nonwithholding foreign partnership or a foreign simple trust as defined in §1.1441-1(c)(24), but only to the extent the income is (or is treated as) effectively connected with the conduct of a trade or business in the United States by such entity;

(7) A payee, as defined in §1.1441-1(b)(2) that is presumed to be a foreign person under the presumption rules of §1.1441-1(b)(3); 1.1441-5(d) or (e)(6), or 1.6049-5(d); and

(8) Any other person as required on Form 1042-S or the instructions to the form.

(B) *Persons that are not recipients.* A recipient does not include—

(1) A nonqualified intermediary;

(2) A payment to a wholly-owned entity that is disregarded under

§301.7701-2(c)(2) of this chapter as an entity separate from its owner;

(3) A flow-through entity, as defined in §1.1441-1(c)(23) (to the extent it is receiving amounts subject to reporting other than income effectively connected with the conduct of a trade or business in the United States); and

(4) A U.S. branch described in §1.1441-1(b)(2)(iv) that is not treated as a U.S. person under that section.

(2) *Amounts subject to reporting*—(i) *In general.* Subject to the exceptions described in paragraph (c)(2)(ii) of this section, amounts subject to reporting on Form 1042-S are amounts paid to a foreign payee (including persons presumed to be foreign) that are amounts subject to withholding as defined in §1.1441-2(a). Amounts subject to reporting include amounts subject to withholding even if no amount is deducted and withheld from the payment because of a treaty or Internal Revenue Code exception to taxation or because an amount withheld was reimbursed to the payee under the adjustment procedures of §1.1461-2. In addition, amounts subject to reporting include any amounts paid to a foreign payee on which a withholding agent withheld an amount (either under chapter 3 of the Internal Revenue Code or section 3406) whether or not the amount is subject to withholding. Amounts subject to reporting include, but are not limited to, the following items—

(A) The entire amount of a corporate distribution (whether actual or deemed) irrespective of any estimate of the portion of the distribution that represents a taxable dividend;

(B) Interest, including the portion of a notional principal contract payment that is characterized as interest. Interest shall also be reported on Form 1042-S if it is bank deposit interest paid to nonresident alien individuals as required under §1.6049-8;

(C) Rents;

(D) Royalties;

(E) Compensation for dependent and independent personal services performed in the United States;

(F) Annuities;

(G) Pension distributions and other deferred income;

(H) Gambling winnings that are not exempt from tax under section 871(j);

(I) Income from the cancellation of indebtedness unless the withholding agent is unrelated to the debtor and does not have knowledge of the facts that give rise to the payment (see §1.1441-2(d));

(J) Amounts that are (or are presumed to be) effectively connected with the conduct of a trade or business in the United States (including deposit interest as defined in sections 871(i)(2)(A) and 881(d)) even if no withholding certificate is required to be furnished by the payee or beneficial owner. In the case of amounts paid on a notional principal contract described in §1.1441-4(a)(3) that are presumed to be effectively connected with the conduct of a trade or business in the United States, the amount required to be reported is limited to the amount of cash paid from the notional principal contract;

(K) Scholarship, fellowship, or grant income and compensation for personal services that is not excludible from gross income under section 117 (whether or not the taxable scholarship, fellowship, grant income, or compensation for personal services is exempt from tax under an income tax treaty) paid to foreign students, trainees, teachers, or researchers;

(L) Amounts paid to foreign governments, international organizations, or the Bank for International Settlements, whether or not documentation must be provided;

(M) Interest (including original issue discount) paid with respect to foreign-targeted registered obligations described in §1.871-14(e)(2) to the extent the documentation requirements described in §1.871-14(e)(3) and (4) are required to be satisfied (taking into account the provisions of §1.871-14(e)(4)(ii), if applicable); and

(N) Original issue discount paid on the redemption of an OID obligation. The amount to be reported is the amount of OID includible in the gross income of the holder of the obligation, if known, or, if not known, the total amount of original issue discount determined as if the holder held the obligation from its original issuance. A withholding agent may determine the total amount of OID by using the most recently published "List of Original Issue Discount Instruments," (Publication 1212, available from the IRS Forms Distribution Centers).

(ii) *Exceptions to reporting.* The amounts listed in this paragraph (c)(2)(ii)

are not required to be reported on Form 1042-S—

(A) Interest (including original issue discount) that is deposit interest under sections 871(i)(2)(A) and 881(d) and that is not effectively connected with the conduct of a trade or business in the United States, unless reporting is required under §1.6049-8 (regarding payments to certain foreign residents) or is interest that is effectively connected with the conduct of a trade or business in the United States;

(B) Interest or original issue discount on certain short-term obligations, described in section 871(g)(1)(B) or 881(a)(3);

(C) Interest paid on obligations sold between interest payment dates and the portion of the purchase price of an OID obligation that is sold or exchanged in a transaction other than a redemption, unless the sale or exchange is part of a plan, the principal purpose of which is to avoid tax and the withholding agent has actual knowledge or reason to know of such plan (see §1.1441-2(a)(5) and (6));

(D) Any item required to be reported on a Form W-2, including an item required to be shown on Form W-2 solely by reason of §1.6041-2 (relating to return of information for payments to employees) or §1.6052-1 (relating to information regarding payment of wages in the form of group-term life insurance);

(E) Any item required to be reported on Form 1099, and such other forms as are prescribed pursuant to the information reporting provisions of sections 6041 through 6050P and the regulations under those sections;

(F) Amounts paid on a notional principal contract described in §1.1441-4(a)(3)(i) that are not effectively connected with the conduct of a trade or business in the United States (or not treated as effectively connected pursuant to §1.1441-4(a)(3)(ii));

(G) Amounts required to be reported on Form 8288 (U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests) or Form 8804 (Annual Return for Partnership Withholding Tax (section 1446)). A withholding agent that must report a distribution partly on a Form 8288 or 8804 and partly on a Form 1042-S may elect to report the entire amount on a Form 8288 or 8804;

(H) Interest on a registered obligation that is targeted to foreign markets and qualifies as portfolio interest to the extent it is paid to a registered owner that is a financial institution or member of a clearing organization that has provided the proper withholding certificates (see §§1.1441-1(b)(4)(i) and 1.1441-2(a));

(I) Interest on a foreign targeted bearer obligation (see §§1.1441-1(b)(4)(i) and 1.1441-2(a));

(J) Gain described in section 301(c)(3); and

(K) Amounts described in §1.1441-1(b)(4)(xviii) (dealing with certain amounts paid by the U.S. government).

(3) *Required information.* The information required to be furnished under this paragraph (c)(3) shall be based upon the information provided by or on behalf of the recipient of an amount subject to reporting (as corrected and supplemented based on the withholding agent's actual knowledge) or the presumption rules of §§1.1441-1(b)(3), 1.1441-4(a); 1.1441-5(d) and (e); 1.1441-9(b)(3) or 1.6049-5(d). The Form 1042-S must include the following information, if applicable—

(i) The name, address, and taxpayer identifying number of the withholding agent;

(ii) A description of each category of income paid based on the income codes provided on the form (e.g., interest, dividends, royalties, etc.) and the aggregate amount in each category expressed in U.S. dollars;

(iii) The rate of withholding applied or the basis for exempting the payment from withholding (based on exemption codes provided on the form);

(iv) The name and address of the recipient;

(v) The name and address of any non-qualified intermediary, flow-through entity, or U.S. branch as described in §1.1441-1(b)(2)(iv) (other than a branch that is treated as a U.S. person) to which the payment was made;

(vi) The taxpayer identifying number of the recipient if required under §1.1441-1(e)(4)(vii) or if actually known to the withholding agent making the return;

(vii) The taxpayer identifying number of a nonqualified intermediary or flow-through entity (to the extent it is not a recipient) or other flow-through entity to

the extent it is known to the withholding agent;

(viii) The country (based on the country codes provided on the form) of the recipient and of any nonqualified intermediary or flow-through entity the name of which appears on the form; and

(ix) Such information as the form or the instructions may require in addition to, or in lieu of, information required under this paragraph (c)(3).

(4) *Method of reporting*—(i) *Payments by U.S. withholding agents to recipients.* A withholding agent that is a U.S. person (other than a foreign branch of a U.S. person that is a qualified intermediary as defined in §1.1441-1(e)(5)(ii)) and that makes payments of amounts subject to reporting on Form 1042-S must file a separate Form 1042-S for each recipient who receives such amount. For purposes of this paragraph (c)(4), a U.S. person includes a U.S. branch described in §1.1441-1(e)(2)(iv)(A) or (E) that agrees to be treated as a U.S. person. Except as may otherwise be required on Form 1042-S or the instructions to the form, only payments for which the income code, exemption code, withholding rate and recipient code are the same may be reported on a single Form 1042-S. See paragraph (c)(4)(ii) of this section for reporting of payments made to a person that is not a recipient.

(A) *Payments to beneficial owners.* If a U.S. withholding agent makes a payment directly to a beneficial owner it must complete Form 1042-S treating the beneficial owner as the recipient. Under the grace period rule of §1.1441-1(b)(3)(iv), a U.S. withholding agent may, under certain circumstances, treat a payee as a foreign person while the withholding agent awaits a valid withholding certificate. A U.S. withholding agent who relies on the grace period rule to treat a payee as a foreign person must file a Form 1042-S to report all payments on Form 1042-S during the period that person was presumed to be foreign even if that person is later determined to be a U.S. person based on appropriate documentation or is presumed to be a U.S. person after the grace period ends. In the case of joint owners, a withholding agent may provide a single Form 1042-S made out to the owner whose status the U.S. withholding agent relied upon to determine the applicable rate of with-

holding. If, however, any one of the owners requests its own Form 1042-S, the withholding agent must furnish a Form 1042-S to the person who requests it. If more than one Form 1042-S is issued for a single payment, the aggregate amount paid and tax withheld that is reported on all Forms 1042-S cannot exceed the total amounts paid to joint owners and the tax withheld thereon.

(B) *Payments to a qualified intermediary, a withholding foreign partnership, or a withholding foreign trust.* A U.S. withholding agent that makes payments to a qualified intermediary (whether or not the qualified intermediary assumes primary withholding responsibility), a withholding foreign partnership, or a withholding foreign trust shall complete Forms 1042-S treating the qualified intermediary or withholding foreign partnership as the recipient. The U.S. withholding agent must complete a separate Form 1042-S for each withholding rate pool. A withholding rate pool is a payment of a single type of income (determined by the income codes on Form 1042-S) that is subject to a single rate of withholding. A qualified intermediary that does not assume primary withholding responsibility on all payments it receives provides information regarding the proportions of income subject to a particular withholding rate to the withholding agent on a withholding statement associated with a qualified intermediary withholding certificate. A qualified intermediary may provide a U.S. withholding agent with information regarding withholding rate pools for U.S. non-exempt recipients (as defined under §1.1441-1(c)(21)). Amounts paid with respect to such withholding rate pools must be reported on Form 1099 completed for each U.S. non-exempt recipient to the extent they are subject to Form 1099 reporting. These amounts must not be reported on Form 1042-S. In addition, the qualified intermediary may provide the U.S. withholding agent information regarding withholding rate pools for U.S. persons that are exempt recipients as defined under §1.1441-1(c)(20). If such information is provided, a U.S. withholding agent should not report such withholding rate pools on Form 1042-S.

(C) *Amounts paid to U.S. branches treated as U.S. persons.* A U.S. withholding agent making a payment to a U.S.

branch of a foreign person described in §1.1441-1(b)(2)(iv) shall complete Form 1042-S as follows—

(I) If the branch has provided the U.S. withholding agent with a withholding certificate that evidences its agreement with the withholding agent to be treated as a U.S. person, the U.S. withholding agent files Forms 1042-S treating the U.S. branch as the recipient;

(2) If the branch has provided the U.S. withholding agent with a withholding certificate that transmits information regarding beneficial owners, qualified intermediaries, withholding foreign partnerships, or other recipients, the U.S. withholding agent must complete a separate Form 1042-S for each recipient whose documentation is associated with the U.S. branch's withholding certificate; or

(3) If the U.S. withholding agent cannot reliably associate a payment with a valid withholding certificate from the U.S. branch, it shall treat the U.S. branch as the recipient and report the income as effectively connected with the conduct of a trade or business in the United States.

(D) *Amounts paid to an authorized foreign agent.* If a U.S. withholding agent makes a payment to an authorized foreign agent, the withholding agent files Forms 1042-S treating the authorized foreign agent as the recipient, provided that the authorized foreign agent reports the payments on Forms 1042-S to each recipient to which it makes payments. If the authorized foreign agent fails to report the amounts paid on Forms 1042-S for each recipient to which the payment is made, the U.S. withholding agent remains responsible for such reporting.

(E) *Dual Claims.* A U.S. withholding agent may make a payment to a foreign entity that is simultaneously claiming a reduced rate of tax on its own behalf for a portion of the payment and a reduced rate on behalf of persons in their capacity as interest holders in that entity on the remaining portion. See §1.1441-6(b)(2)(iii). If the claims are consistent and the withholding agent accepts the multiple claims, the withholding agent must file a separate Form 1042-S for those payments for which the entity is treated as the beneficial owner and Forms 1042-S for each of the interest holder in the entity for which the interest holder is treated as the recipient. For those payments for which

the interest holder in an entity is treated as the recipient, the U.S. withholding agent shall prepare the Form 1042-S in the same manner as a payment made to a nonqualified intermediary or flow-through entity as set forth in paragraph (c)(4)(ii) of this section. If the claims are consistent but the withholding agent has not chosen to accept the multiple claims, or if the claims are inconsistent, the withholding agent must file a separate Form 1042-S for the person or persons it has chosen to treat as the recipients.

(ii) *Payments made by U.S. withholding agents to persons that are not recipients—(A) Amounts paid to a nonqualified intermediary, a flow-through entity, and certain U.S. branches.* If a U.S. withholding agent makes a payment to a nonqualified intermediary, a flow-through entity, or a U.S. branch described in §1.1441-1(b)(2)(iv) (other than a branch that agrees to be treated as a U.S. person), it must complete a separate Form 1042-S for each recipient to the extent the withholding agent can reliably associate a payment with valid documentation (within the meaning of §1.1441-1(b)(2)(vii)) from the recipient which is associated with the withholding certificate provided by the nonqualified intermediary, flow-through entity, or U.S. branch. If a payment is made through tiers of nonqualified intermediaries or flow-through entities, the withholding agent must nevertheless complete Form 1042-S for the recipients to the extent it can reliably associate the payment with documentation from the recipients. A withholding agent that is completing a Form 1042-S for a recipient that receives a payment through a nonqualified intermediary, a flow-through entity, or a U.S. branch must include on the Form 1042-S the name of the nonqualified intermediary or flow-through entity from which the recipient directly receives the payment. If a U.S. withholding agent cannot reliably associate the payment, or any portion of the payment, with valid documentation from a recipient either because no such documentation has been provided or because the nonqualified intermediary, flow-through entity, or U.S. branch has failed to provide sufficient allocation information so that the withholding agent can associate the payment, or any portion thereof, with valid documentation, then

the withholding agent must report the payments as made to an unknown recipient in accordance with the appropriate presumption rules for that payment. Thus, if under the presumption rules the payment is presumed to be made to a foreign person, the withholding agent must generally withhold 30 percent of the payment and report the payment on Form 1042-S made out to an unknown recipient and shall also include the name of the nonqualified intermediary or flow-through entity that received the payment on behalf of the unknown recipient. If, however, the recipient is presumed to be a U.S. non-exempt recipient (as defined in §1.1441-1(c)(21)), the withholding agent must withhold on the payment as required under section 3406 and report the payment as made to an unknown recipient on the appropriate Form 1099 as required under chapter 61 of the Internal Revenue Code.

(B) *Disregarded entities.* If a U.S. withholding agent makes a payment to a disregarded entity but receives a valid withholding certificate or other documentary evidence from a foreign person that is the single owner of a disregarded entity, the withholding agent must file a Form 1042-S treating the foreign single owner as the recipient. The taxpayer identifying number on the Form 1042-S, if required, must be the foreign single owner's TIN.

(iii) *Reporting by qualified intermediaries, withholding foreign partnerships, and withholding foreign trusts.* A qualified intermediary, a withholding foreign partnership, and a withholding foreign trust shall report payments on Form 1042-S as provided in their agreements with the IRS and the instructions to the form.

(iv) *Reporting by a nonqualified intermediary, flow-through entity, and certain U.S. branches.* A nonqualified intermediary, flow-through entity, or U.S. branch described in §1.1441-1(e)(2)(iv) (other than a U.S. branch that is treated as a U.S. person) is a withholding agent and must file Forms 1042-S for amounts paid to recipients in the same manner as a U.S. withholding agent. A Form 1042-S will not be required, however, if another withholding agent has reported the same amount to the same recipient for which the nonqualified intermediary, flow-through entity, or U.S. branch would be required to file a return and the entire

amount that should be withheld from such payment has been withheld. A nonqualified intermediary, flow-through entity, or U.S. branch must report payments made to recipients to the extent it has failed to provide the appropriate documentation to another withholding agent together with the information required for that withholding agent to reliably associate the payment with the recipient documentation or to the extent it knows, or has reason to know, that less than the required amount has been withheld. A nonqualified intermediary or flow-through entity that is required to report a payment on Form 1042-S must follow the same rules as apply to a U.S. withholding agent under paragraph (c)(4)(i) and (ii) of this section.

(v) *Pro rata reporting for allocation failures.* If a nonqualified intermediary, flow-through entity, or U.S. branch described in §1.1441-1(b)(2)(iv) (other than a branch treated as a U.S. person) that uses the alternative procedures of §1.1441-1(e)(3)(iv)(D) fails to provide information sufficient to allocate the amount subject to reporting paid to a withholding rate pool to the payees identified for that pool, then the withholding agent shall report the payment in accordance with the rule provided in §1.1441-1(e)(3)(iv)(D)(6).

(vi) *Other withholding agents.* Any person that is a withholding agent not described in paragraph (c)(4)(i), (iii), or (iv) of this section (e.g., a foreign person that is not a qualified intermediary, flow-through entity, or U.S. branch) shall file Form 1042-S in the same manner as a U.S. withholding agent and in accordance with the instructions to the form.

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Par. 11. Effective January 1, 2001, §1.6041-1 is amended by revising paragraph (d)(5) to read as follows:

§ 1.6041-1 *Return of information as to payments of \$600 or more.*

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(d) \*\*\*

(5) *Notional principal contracts.* Except as provided in paragraphs (b)(5)(i) and (ii) of this section, amounts paid after December 31, 2000, with respect to notional principal contracts referred to in §1.863-7 or 1.988-2(e) to persons who are not described in §1.6049-4(c)(1)(ii) are required to be reported in returns of

information under this section. The amount required to be reported under this paragraph (d)(5) is limited to the amount of cash paid from the notional principal contract as described in §1.446-3(d). A non-periodic payment is reportable for the year in which an actual payment is made. Any amount of interest determined under the provisions of §1.446-3(g)(4) (dealing with interest in the case of a significant non-periodic payment) is reportable under this paragraph (d)(5) and not under section 6049 (see §1.6049-5(b)(15)). See §1.6041-4(a)(4) for reporting exceptions regarding payments to foreign persons. See, however, §1.1461-1(c)(1) for reporting amounts described under this paragraph (d)(5) that are paid to foreign persons. The provisions of §1.6049-5(d) shall apply for determining whether a payment with respect to a notional principal contract is made to a foreign person. See §1.6049-4(a) for a definition of payor. For purposes of this paragraph (d)(5), a payor includes a middleman defined in §1.6049-4(f)(4).

(i) An amount paid with respect to a notional principal contract is not required to be reported if the payment is made outside the United States (as defined in §1.6049-5(e)) by a non-U.S. payor or a non-U.S. middleman.

(ii) An amount paid with respect to a notional principal contract is not required to be reported if the payment is made outside the United States (as defined in §1.6049-5(e)) by a payor that has no actual knowledge that the payee is a U.S. person, and the payor is—

(A) A U.S. payor or U.S. middleman that is not a U.S. person (such as a controlled foreign corporation defined in section 957(a) or certain foreign corporations or foreign partnerships engaged in a U.S. trade or business); or

(B) A foreign branch of a U.S. bank. See §1.6049-5(c)(5) for a definition of a U.S. payor, a U.S. middleman, a non-U.S. payor, and a non-U.S. middleman.

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Par. 12. Effective January 1, 2001, §1.6041-4 is amended by

1. Revising paragraph (a)(3).
2. Adding paragraph (a)(6).

The revision and addition read as follows:

*§1.6041-4 Foreign-related items and other exceptions.*

(a) \*\*\*

(3) Returns of information are not required for amounts paid by a foreign intermediary described in §1.1441-1(c)(13) that it has received in its capacity as an intermediary and that are associated with a valid withholding certificate described in §1.1441-1(e)(3)(ii) or (iii) and payments made by a U.S. branch of a foreign bank or of a foreign insurance company described in §1.1441-1(b)(2)(iv) (other than a U.S. branch that is treated as a U.S. person) that are associated with a valid withholding certificate described in §1.1441-1(e)(3)(v), which certificate the intermediary or branch has furnished to the payor or middleman from whom it has received the payment, unless, and to the extent, the intermediary or branch knows that the payments are required to be reported under §1.6041-1 and were not so reported. For example, if a foreign intermediary or U.S. branch described in §1.1441-1(b)(2)(iv) fails to provide information regarding U.S. persons that are not exempt from reporting under §1.6041-3(q) to the person from whom the intermediary or U.S. branch receives the payment, the foreign intermediary or U.S. branch must report the payment on an information return. The exception of this paragraph (a)(3) shall not apply to a qualified intermediary that assumes reporting responsibility under chapter 61 of the Internal Revenue Code.

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(6) For rules concerning direct sellers, see §1.6041A-1(d)(3)(i)(C).

\*\*\*\*\*

Par. 13. Effective January 1, 2001, §1.6041A-1 is amended by:

1. Revising paragraph (d)(3)(i)(B).
2. Adding paragraph (d)(3)(i)(C).

The revision and addition read as follows:

*§1.6041A-1 Returns regarding payments of remuneration for services and certain direct sales.*

\*\*\*\*\*

(d) \*\*\*

(3) \*\*\* (i) \*\*\*

(B) Returns of information are not required for payments of remuneration for services from sources outside the United States (determined under the provisions of part I, subchapter N, chapter 1 of the Internal Revenue Code and the regulations under those provisions) if payments

are made outside the United States by a non-U.S. payor or non U.S. middleman. For a definition of non U.S. payor or non-U.S. middleman, see §1.6049-5(c)(5). For circumstances in which a payment is considered to be made outside the United States, see §1.6049-5(e).

(C) Returns of information are not required under sections 6041 or 6041A for amounts paid outside of the United States (within the meaning of §1.6049-5(e)) as remuneration for services as a direct seller (within the meaning of section 3508) performed outside of the United States or for sales described in section 6041A(b) made outside of the United States of consumer products for resale outside of the United States.

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Par. 14. Effective January 1, 2001, §1.6042-3 is amended by revising paragraph (b)(1)(vi) to read as follows:

*§1.6042-3 Dividends subject to reporting.*

\*\*\*\*\*

(b) \*\*\* (1) \*\*\*

(vi) Payments made by a foreign intermediary described in §1.1441-1(c)(13) of amounts that it has received in its capacity as an intermediary and that are associated with a valid withholding certificate described in §1.1441-1(e)(3)(ii) or (iii) and payments made by a U.S. branch of a foreign bank or of a foreign insurance company described in §1.1441-1(b)(2)(iv) (other than a U.S. branch that is treated as a U.S. person) that are associated with a valid withholding certificate described in §1.1441-1(e)(3)(v), which certificate the intermediary or branch has furnished to the payor or middleman from whom it has received the payment, unless, and to the extent, the intermediary or branch knows that the payments are required to be reported under §1.6042-2 and were not so reported. For example, if a foreign intermediary or U.S. branch described in §1.1441-1(b)(2)(iv) fails to provide information regarding U.S. persons that are not exempt from reporting under §1.6049-4(c)(1)(ii) to the person from whom the intermediary or U.S. branch receives the payment, the amount paid by the foreign intermediary or U.S. branch to such person is a dividend. The exception of this paragraph (b)(1)(vi) shall not apply to a qualified intermediary that assumes reporting responsibility under chapter 61 of the Internal Revenue Code.

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Par. 15. Effective January 1, 2001, §1.6045-1 is amended by:

1. Removing the last sentence of paragraph (g)(1)(i) and adding two new sentences in its place.

2. Revising paragraph (g)(3)(iv).

3. Revising paragraph (g)(4), *Example 7*.

4. Adding *Examples 8* and *9* to paragraph (g)(4).

The additions and revisions read as follows:

§1.6045-1 *Returns of information of brokers and barter exchanges.*

\*\*\*\*\*

(g) \*\*\* (1) \*\*\*

(i) \*\*\* For purposes of this paragraph (g)(1)(i), a broker that is required to obtain, or chooses to obtain, a beneficial owner withholding certificate described in §1.1441-1(e)(2)(i) from an individual may rely on the withholding certificate only to the extent the certificate includes a certification that the beneficial owner has not been, and at the time the certificate is furnished, reasonably expects not to be present in the United States for a period aggregating 183 days or more during each calendar year to which the certificate pertains. The certification is not required if a broker receives documentary evidence under §1.6049-5(c)(1) or (4).

\*\*\*\*\*

(3) \*\*\*

(iv) *Special rules where the customer is a foreign intermediary or certain U.S. branches.* A foreign intermediary, as defined in §1.1441-1(c)(13), is an exempt foreign person, except when the broker has actual knowledge or reason to know (within the meaning of §1.6049-5(c)(3)) that the person for whom the intermediary acts is a U.S. person that is not exempt from reporting under §5f.6045-1(c)(3) of this chapter or the broker is required to presume under §1.6049-5(d)(3) that the payee is a U.S. person that is not an exempt recipient. If an intermediary, as defined in §1.1441-1(c)(13), or a U.S. branch described in §1.1441-1(b)(2)(iv) (other than a U.S. branch that is treated as a U.S. person) receives a payment from a payor or middleman, which payment the payor or middleman can associate with a valid withholding certificate described in §1.1441-1(e)(3)(ii), (iii), or (v) furnished by such intermediary or U.S. branch, then

the intermediary or U.S. branch is not required to report such payment when it, in turn, pays the amount to the person whose name is on the certificate furnished by the intermediary or U.S. branch to the payor or middleman, unless, and to the extent, the intermediary or U.S. branch knows that the payment is required to be reported under this section and was not so reported. For example, if a foreign intermediary or U.S. branch fails to provide information regarding U.S. persons that are not exempt from reporting under §5f.6045-1(c)(3) of this chapter to the person from whom the intermediary or U.S. branch receives the payment, the foreign intermediary or U.S. branch must report the payment on an information return. The exception of this paragraph (g)(3)(iv) shall not apply to a qualified intermediary that assumes reporting responsibility under chapter 61 of the Internal Revenue Code.

(4) \*\*\*

*Example 7.* Customer A, an individual, owns U.S. corporate bonds issued in registered form after July 18, 1984 and carrying a stated rate of interest. The bonds are held through an account with foreign bank, X, and are held in street name. X is a wholly-owned subsidiary of a U.S. company and is not a qualified intermediary within the meaning of §1.1441-1(e)(5)(ii). X has no documentation regarding A. A instructs X to sell the bonds. In order to effect the sale, X acts through its agent in the United States, Y. Y sells the bonds and remits the sales proceeds to X. X credits A's account in the foreign country. X does not provide documentation to Y.

(i) *Y's obligations to withhold and report.* Y treats X as the customer, and not A, because Y cannot treat X as an intermediary because it has received no documentation from X. Y is not required to report the sales proceeds under the multiple broker exception under §5f.6045-1(c)(3)(ii) of this chapter, because X is an exempt recipient. Further, Y is not required to report the amount of accrued interest paid to X on Form 1042-S under §1.1461-1(c)(2)(ii) because accrued interest is not an amount subject to reporting unless the withholding agent knows that the obligation is being sold with a primary purpose of avoiding tax.

(ii) *X's obligations to withhold and report.* Although X has effected, within the meaning of paragraph (a)(1) of this section, the sale of a security at an office outside the United States under paragraph (g)(3)(iii) of this section, X is treated as a broker, under paragraph (a)(1) of this section, because as a wholly-owned subsidiary of a U.S. corporation, X is a U.S. payor. See §1.6049-5(c)(5). Under the presumptions described in §1.6049-5(d)(2), X must presume that, with respect to the sales proceeds, A is a U.S. person who is not an exempt recipient. Therefore the payment of sales proceeds to A by X is reportable on a Form 1099 under paragraph (c)(2) of this section. X has no obligation to backup withhold

on the payment based on the exemption under §31.3406(g)-1(e) of this chapter, unless X has actual knowledge that A is a U.S. person that is not an exempt recipient. X is also required to separately report the accrued interest (see paragraph (d)(3) of this section) on Form 1099 under section 6049 because A is also presumed to be a U.S. person who is not an exempt recipient under the presumption rule in §1.6049-5(d)(2) and §1.1441-1(b)(3)(iii) since accrued interest is not an amount subject to reporting and therefore the presumption of foreign status for offshore accounts under §1.1441-1(b)(3)(iii)(D) does not apply.

*Example 8.* The facts are the same as in *Example 7*, except that instead of U.S. corporate bonds that carry stated interest, A owns original issue discount instruments described in section 871(g)(1)(B)(i) (i.e., obligations payable 183 days or less from the date of original issue). In addition, the sale is in a transaction other than a redemption.

(i) *Y's obligations to withhold and report.* Y is not required to report the sales proceeds under the multiple broker exception under §5f.6045-1(c)(3)(ii) of this chapter, because X is an exempt recipient.

(ii) *X's obligations to withhold and report.* Although X has effected, within the meaning of paragraph (a)(1) of this section, the sale of a security at an office outside the United States under paragraph (g)(3)(iii) of this section, X is treated as a broker, under paragraph (a)(1) of this section, because as a wholly-owned subsidiary of a U.S. corporation, X is a U.S. payor. See §1.6049-5(c)(5). Under the presumptions described in §1.6049-5(d)(2), X must presume that, with respect to the sales proceeds, A is a U.S. person who is not an exempt recipient. Therefore the payment of sales proceeds to A by X is reportable on a Form 1099 under paragraph (c)(2) of this section. X has no obligation to backup withhold on the payment based on the exemption under §31.3406(g)-1(e) of this chapter, unless X has actual knowledge that A is a U.S. person that is not an exempt recipient. X is not required to separately report the amount of accrued original issue discount. See paragraph (d)(3) of this section.

*Example 9.* The facts are the same as in *Example 8*, except that X is a foreign corporation that is not a U.S. payor under §1.6049-5(c).

(i) *Y's obligations to withhold and report.* Y is not required to report the sales proceeds under the multiple broker exception under §5f.6045-1(c)(3)(ii) of this chapter, because X is the person responsible for paying the proceeds from the sale to A.

(ii) *X's obligations to withhold and report.* Although A is presumed to be a U.S. payee under the presumptions of §1.6049-5(d)(2), X is not considered to be a broker under paragraph (a)(1) of this section because it is not a U.S. payor under §1.6049-5(c)(5). Therefore X is not required to report the sale under paragraph (c)(2) of this section.

\*\*\*\*\*

Par. 16. Effective January 1, 2001, §1.6049-4 is amended by revising the introductory text of paragraph (c)(1)(ii) to read as follows:

§1.6049-4 *Return of information as to interest paid and original issue discount includible in gross income after December 31, 1982.*



\*\*\*\*\*

(c) \*\*\*\*\* (1) \*\*\*\*\*

(ii) *Exempt recipient defined.* The term *exempt recipient* means any person described in paragraphs (c)(1)(ii)(A) through (Q) of this section. An exempt recipient is generally exempt from information reporting without filing a certificate claiming exempt status unless the provisions of this paragraph (c)(1)(ii) require a payee to file a certificate. A payor may, in any case, require a payee that is a U.S. person not otherwise required to file a certificate under this paragraph (c)(1)(ii) to file a certificate in order to qualify as an exempt recipient. See §31.3406(h)-3(a)(1)(iii) and (c)(2) of this chapter for the certificate that a payee that is a U.S. person must provide when a payor requires the certificate to treat the payee as an exempt recipient under this paragraph (c)(1)(ii). A payor may treat a payee as an exempt recipient based upon a properly completed form as described in §31.3406(h)-3(e)(2) of this chapter, its actual knowledge that the payee is a person described in this paragraph (c)(1)(ii), or the indicators described in this paragraph (c)(1)(ii).

\*\*\*\*\*

Par. 17. Effective January 1, 2001, §1.6049-5 is amended by:

1. Adding a sentence at the end of paragraph (b)(10)(ii).
2. Adding a sentence at the end of the introductory text language of paragraph (b)(11).
3. Revising paragraph (b)(14).
4. Adding a sentence at the end of paragraph (c)(1).
5. Revising paragraph (c)(4).
6. In paragraph (c)(6), removing *Example 3* and redesignating *Examples 4* and *5* as *Examples 3* and *4*, respectively; in newly designated *Example 3*, revise the language “The facts are the same as in *Example 3*” to read “The facts are the same as in *Example 2*”; in addition, in newly designated *Example 4*, revise the language “The facts are the same as in *Example 4*” to read “The facts are the same as in *Example 3*”.
7. Revising the first sentence of paragraph (d)(1) introductory text.
8. Revising paragraphs (d)(2)(i) and (d)(2)(ii), (d)(3), and (d)(4).
9. Removing paragraph (d)(5).

The additions and revisions read as follows:

§1.6049-5 *Interest and original issue discount subject to reporting after December 31, 1982.*

\*\*\*\*\*

(b) \*\*\*\*\*

(10) \*\*\*\*\*

(ii) \*\*\*\*\* The exemption from reporting described in this paragraph (b)(10) shall not apply if the payor has actual knowledge that the payee is a U.S. person who is not an exempt recipient.

(11) \*\*\*\*\* The exemption from reporting described in this paragraph (b)(11) shall not apply if the payor has actual knowledge that the payee is a U.S. person who is not an exempt recipient.

\*\*\*\*\*

(14) Payments made by a foreign intermediary described in §1.1441-1(e)(3)(i) of amounts that it has received in its capacity as an intermediary and that are associated with a valid withholding certificate described in §1.1441-1(e)(3)(ii) or (iii) and payments made by a U.S. branch of a foreign bank or of a foreign insurance company described in §1.1441-1(b)(2)(iv) (other than a U.S. branch that is treated as a U.S. person) that are associated with a valid withholding certificate described in §1.1441-1(e)(3)(v), which certificate the intermediary or branch has furnished to the payor or middleman from whom it has received the payment, unless, and to the extent, the intermediary or branch knows that the payments are required to be reported under §1.6049-4 and were not so reported. For example, if a foreign intermediary or U.S. branch described in §1.1441-1(b)(2)(iv) fails to provide information regarding U.S. persons that are not exempt from reporting under §1.6049-4(c)(1)(ii) to the person from whom the intermediary or U.S. branch receives the payment, the amount paid by the foreign intermediary or U.S. branch to such person is interest or original issue discount. The exception of this paragraph (b)(14) shall not apply to a qualified intermediary that assumes reporting responsibility under chapter 61 of the Internal Revenue Code.

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(c) \*\*\*\*\* (1) \*\*\*\*\* A payor may also rely on documentary evidence associated with a flow-through withholding certificate for payments treated as made to foreign partners of a nonwithholding foreign partnership, as defined in §1.1441-1-

(c)(28), the foreign beneficiaries of a foreign simple trust, as defined in §1.1441-1(c)(24), or foreign owners of a foreign grantor trust, as defined in §1.1441-1(c)(26), even though the partnership or trust account is maintained in the United States.

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(4) *Special documentation rules for certain payments.* This paragraph (c)(4) modifies the provisions of this paragraph (c) for payments to offshore accounts maintained at a bank or other financial institution of amounts that are not subject to withholding under chapter 3 of the Internal Revenue Code, other than amounts described in paragraph (d)(3)(iii) of this section (dealing with U.S. short-term OID and U.S. bank deposit interest). Amounts are not subject to withholding under chapter 3 of the Internal Revenue Code if they are not included in the definition of amounts subject to withholding under §1.1441-2(a) (e.g., deposit interest with foreign branches of U.S. banks, foreign source income, or broker proceeds).

(i) *Special rule when non-renewable documentary evidence is customary.* If it is customary in the country in which a branch or office of a bank or other financial institution is located to obtain documentary evidence described in paragraph (c)(1) of this section, but it is not customary for such documentary evidence to be renewed, then a payor may, in lieu of obtaining a withholding certificate, request such documentary evidence for an account maintained at such branch or office. The bank or other financial institution may rely on such documentary evidence to treat a person as a foreign person without renewing such documentary evidence in accordance with paragraph (c)(2) of this section and §1.1441-1(e)(4)(ii) if it may rely on the documentary evidence as sufficient to establish the person's foreign status under §1.1441-7(b)(7) and (8). If, however, the bank or other financial institution may, under §1.1441-7(b)(8) treat a payee as a foreign person even though it has a residence or mailing address for the payee in the United States, or has standing instructions to pay amounts from its account to an address in the United States or an account maintained in the United States, then the payor shall rely on the documentary evidence only for a period of three full calendar years after the calen-

dar year in which the documentary evidence is provided to the payor or, if earlier, until the payor is aware of a change of circumstances that affects the validity of the documentation as establishing the payee's status as a foreign person.

(ii) *Statement in lieu of documentary evidence.* If under the local laws, regulations, or practices applicable to a type of account or transaction it is not customary to obtain documentary evidence described in paragraph (c)(1) of this section, the bank or other financial institution may, instead of obtaining a beneficial owner withholding certificate described in §1.1441-1(e)(2)(i) or documentary evidence described in paragraph (c)(1) of this section, establish a payee's foreign status based on the statement described in this paragraph (4)(ii) (or such substitute statement as the Internal Revenue Service may prescribe) made on an account opening form. The statement shall be valid only if the mailing and residence addresses of the payee are outside the United States and there are not other indicia of U.S. status. If reliance is not permitted because there are indicia of U.S. status then the payor must obtain either documentary evidence described in paragraph (c)(1) of this section or a Form W-8 described in §1.1441-1(e)(2)(i) to treat the customer as a foreign payee. In such a case, the form or documentary evidence must be renewed every three years in accordance with the renewal procedures set forth in §1.1441-1(e)(4)(ii)(A) for as long as indicia of U.S. status continue to be present. The statement referred to in this paragraph (c)(4)(i) of this section must appear near the signature line and must read as follows:

By opening this account and signing below, the account owner represents and warrants that he/she/it is not a U.S. person for purposes of U.S. Federal income tax and that he/she/it is not acting for, or on behalf of, a U.S. person. A false statement or misrepresentation of tax status by a U.S. person could lead to penalties under U.S. law. If your tax status changes and you become a U.S. citizen or a resident, you must notify us within 30 days.

(iii) *Continuous validity of declaration of foreign status subject to due diligence by financial institution.* A declaration of

foreign status described in paragraph (c)(4)(ii) of this section does not expire unless the bank or financial institution becomes aware of circumstances indicating that the customer may be a U.S. person.

(iv) *Exception for existing accounts.* The rules of paragraphs (c)(4)(i) and (iii) of this section shall apply to accounts opened on or after January 1, 2001. For accounts opened before 2001, a bank or other financial institution may rely on the rules contained in §§35a.9999-3(ii) Q&A 34 and 35a.9999-4T Q&A 1 and 5 of this chapter in effect prior to January 1, 2001 (see 26 CFR Parts 30-39 revised as of April 1, 2000).

\* \* \* \* \*

(d) \* \* \* (1) *Identifying the payee.* The provisions of §§1.1441-1(b)(2), 1.1441-5(c)(1), (e)(2) and (3) shall apply (by applying the term *payor* instead of the term *withholding agent*) to identify the payee for purposes of this section (and other sections of the regulations under this chapter to which this paragraph (d)(1) applies), except to the extent provided in this paragraph (d)(1) in the case of a payment of amounts that are not subject to withholding under chapter 3 of the Internal Revenue Code. \* \* \*

\* \* \* \* \*

(2) *Presumptions of classification and U.S. or foreign status in the absence of documentation—(i) In general.* Except as otherwise provided in this paragraph (d)(2)(i), for purposes of this section (and other sections of regulations under this chapter to which this paragraph (d)(2) applies), the provisions of §1.1441-1(b)(3)(i), (ii), (iii), (vii), (viii), and (ix) and 1.1441-5(d) and (e)(6) shall apply (by applying the term *payor* instead of the term *withholding agent*) to determine the classification (e.g., individual, corporation, partnership, trust), status (i.e., a U.S. or a foreign person), and other relevant characteristics (e.g., beneficial owner or intermediary) of a payee if a payment cannot be reliably associated with valid documentation under §1.1441-1(b)(2)(vii) irrespective of whether the payments are subject to withholding under chapter 3 of the Internal Revenue Code. The provisions of §1.1441-1(b)(3)(iii)(D) and (vii)(B) shall not apply, however, to payments of amounts that are not subject to withholding. In addition, §1.1441-5(d)(2) shall

not apply to treat a partnership as a foreign partnership with respect to amounts that are not subject to withholding unless the payor has actual knowledge of the payee's employer identification number and that number begins with the two digits "98." The rules of §1.1441-1(b)(2)(vii) shall apply for purposes of determining when a payment can reliably be associated with documentation, by applying the term *payor* instead of the term *withholding agent*. For this purpose, the documentary evidence or statement described in paragraph (c)(4) of this section can be treated as documentation with which a payment can be associated.

(ii) *Grace period in the case of indicia of a foreign payee.* When the conditions of this paragraph (d)(2)(ii) are satisfied, the 30-day grace period provisions under section 3406(e) shall not apply and the provisions of this paragraph (d)(2)(ii) shall apply instead. A payor that, at any time during the grace period described in this paragraph (d)(2)(ii), credits an account with payments described in §1.1441-6(c)(2) that are reportable under sections 6042, 6045, 6049, or 6050N may, instead of treating the account as owned by a U.S. person and applying backup withholding under section 3406, if applicable, choose to treat the account as owned by a foreign person if, at the beginning of the grace period, the address that the payor has in its records for the account holder is in a foreign country, the payor has been furnished the information contained in a withholding certificate described in §1.1441-1(e)(2)(i) or (3)(i) (by way of a facsimile copy of the certificate or other non-qualified electronic transmission of the information required to be stated on the certificate), or the payor holds a withholding certificate that is no longer reliable other than because the validity period as described in §1.1441-1(e)(4)(ii)(A) has expired. In the case of a newly opened account, the grace period begins on the date that the payor first credits the account. In the case of an existing account for which the payor holds a Form W-8 or documentary evidence of foreign status, the grace period begins on the date that the payor first credits the account after the existing documentation held with regard to the account can no longer be relied upon (other than because

the validity period described in §1.1441-1(e)(4)(ii)(A) has expired). A new account shall be treated as an existing account if the account holder already holds an account at the branch location at which the new account is opened. It shall also be treated as an existing account if an account is held at another branch location if the institution maintains a coordinated account information system described in §1.1441-1(e)(4)(ix). The grace period terminates on the earlier of the close of the 90th day from the date on which the grace period begins or the date that the documentation is provided. The grace period also terminates when the remaining balance in the account (due to withdrawals or otherwise) is equal to or less than 31 percent of the total amounts credited since the beginning of the grace period that would be subject to backup withholding if the provisions of this paragraph (d)(2)(ii) did not apply. At the end of the grace period, the payor shall treat the amounts credited to the account during the grace period as paid to a U.S. or foreign payee depending upon whether documentation has been furnished and the nature of any such documentation furnished upon which the payor may rely to treat the account as owned by a U.S. or foreign payee. If the documentation has not been received on or before the date of expiration of the grace period, the payor may also apply the presumptions described in this paragraph (d) to amounts credited to the account after the date on which the grace period expires (until such time as the payor can reliably associate the documentation with amounts credited). See §31.6413(a)-3(a)(1)(iv) of this chapter for treating backup withheld amounts under section 3406 as erroneously withheld when the documentation establishing foreign status is furnished prior to the end of the calendar year in which backup withholding occurs. If the provisions of this paragraph (d)(2)(ii) apply, the provisions of §31.3406(d)-3 of this chapter shall not apply. For purposes of this paragraph (d)(2)(ii), an account holder's reinvestment of gross proceeds of a sale into other instruments constitutes a withdrawal and a non-qualified electronic transmission of information on a withholding certificate is a transmission that is not in accordance with the provisions of §1.1441-1(e)(4)(iv). See §1.1092(d)-1

for a definition of the term *actively traded* for purposes of this paragraph (d)(2)(ii).

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(3) *Payments to foreign intermediaries or flow-through entities*—(i) *Payments of amounts subject to withholding under chapter 3 of the Internal Revenue Code.* In the case of payments of amounts that the payor may treat as made to a foreign intermediary or flow-through entity in accordance with §§1.1441-1(b)(3)(ii)(C) and (b)(3)(v)(A), 1.1441-5(c) or (e) and that are subject to withholding under §1.1441-2(a), the provisions of §§1.1441-1(b)(2)(v) and 1.1441-5(c)(1), (e)(2), and (3) shall apply (by applying the term *payor* instead of the term *withholding agent*) to identify the payee. If a payment of an amount subject to withholding cannot be reliably associated with valid documentation from a payee in accordance with §1.1441-1(b)(2)(vii) the presumption rules of §1.1441-1(b)(3)(v) and §1.1441-5(d) and (e)(6) shall apply to determine the payees status for purposes of this section (and other sections of regulations under this chapter to which this paragraph (d)(3) applies).

(ii) *Payments of amounts not subject to withholding under chapter 3 of the Internal Revenue Code.* Except as provided in paragraph (d)(3)(iii) of this section, amounts that are not subject to withholding under chapter 3 of the Internal Revenue Code that the payor may treat as paid to a foreign intermediary or flow-through entity shall be treated as made to an exempt recipient described in §1.6049-4(c) except to the extent that the payor has actual knowledge that any person for whom the intermediary or flow-through entity is collecting the payment is a U.S. person who is not an exempt recipient. In the case of such actual knowledge, the payor shall treat the payment that it knows is allocable to such U.S. person as a payment to a U.S. payee who is not an exempt recipient.

(iii) *Special rule for payments of certain short-term original issue discount and bank deposit interest*—(A) *General rule.* A payment of U.S. source deposit interest described in section 871(i)(2)(A) or 881(d)(3) or interest or original issue discount on the redemption of an obligation with a maturity from the date of issue of 183 days or less (short-term OID) described in section 871(g)(1)(B) or 881(e)

that the payor may treat as paid to a foreign intermediary or flow-through entity in accordance with the provisions of §1.1441-1(b)(3)(ii)(C) or (v)(A) shall be treated as paid to an undocumented U.S. payee that is not an exempt recipient under paragraph §1.6049-4(c) unless the payor has documentation from the payees of the payment and the payment is allocated to foreign payees, as a group, and to each U.S. non-exempt recipient payee. See §1.1441-1(e)(3)(iv)(C)(2).

(B) *Payee may be an intermediary.* If a payment is made to a person described in §1.6049-4(c)(1)(ii) that has not provided an intermediary withholding certificate under §1.1441-1(e)(3)(i) but the payor knows or has reason to know that the payee may be an intermediary, the payor must apply the rules of paragraph (d)(3)(iii)(A) of this section. A payor has reason to know that such a person may be an intermediary if that person has provided documentation under §1.1441-3(b)(ii)(C) or (v)(A) for another account with the same payor.

(iv) *Short-term deposits and repurchase transactions.* The provisions of paragraph (d)(3)(ii) of this section and not paragraph (d)(3)(iii) of this section shall apply to deposits with banks and other financial institutions that remain on deposit for a period of two weeks or less, to amounts of original issue discount arising from a sale and repurchase transaction that is completed within a period of two weeks or less, or to amounts described in paragraphs (b)(7), (10) and (11) of this section (relating to certain obligations issued in bearer form).

(4) *Examples.* The rules of paragraphs (d)(1) through (3) of this section are illustrated by the following examples:

*Example 1.* (i) *Facts.* USP is a U.S. payor as defined in paragraph (c)(5) of this section. USP pays interest from sources within the United States to an account maintained in the United States by X. The interest is not deposit interest described in sections 871(i)(2)(A) or 881(d). USP does not have a withholding certificate from X as defined in §1.1441-1(c)(16). Moreover, USP cannot treat X as an exempt recipient, as defined in §1.6049-4(c)(1)(ii), without documentation and there is no indication that X is an individual, trust, or estate.

(ii) *Analysis.* The U.S. source interest is an amount subject to withholding as defined in §1.1441-2(a). Under paragraph (d)(1) of this section, USP must apply the provisions of §§1.1441-1(b)(2) and 1.1441-5(c) and (e) to determine the payee of the interest. Under §1.1441-1(b)(2)(i), X, the person to whom the pay-

ment is made, is considered to be the payee, unless X is determined to be a flow-through entity, in which case the rules of §1.1441-5 apply to determine the payee. Under paragraph (d)(2)(i) of this section, the rules of §1.1441-1(b)(3)(ii) apply to determine the classification of a payee as an individual, trust, estate, corporation, or partnership. Under §1.1441-1(b)(3)(ii)(B), X is presumed to be a partnership, since X does not appear to be an individual, trust or estate, and X cannot be presumed to be an exempt recipient in the absence of documentation. Paragraph (d)(2)(i) of this section requires USP to apply the provisions of §§1.1441-1(b)(3)(iii) and 1.1441-5(d) to determine whether X is presumed to be a U.S. or foreign partnership. Under §§1.1441-1(b)(3)(iii) and 1.1441-5(d)(2), X is presumed to be a U.S. partnership in absence of any indicia of foreign partnership status. The U.S. source interest paid to X is reportable under section 6049 on Form 1099 and the interest is subject to backup withholding under section 3406 because X has not provided its TIN on a valid Form W-9.

*Example 2. (i) Facts.* The facts are the same as in *Example 1*, except that the interest paid by USP is from sources outside the United States.

(ii) *Analysis.* Interest from sources outside the United States is not an amount subject to withholding, as defined in §1.1441-2(a). Under paragraph (d)(1) of this section, USP must apply the provisions of §§1.1441-1(b)(2) and 1.1441-5(c) and (e) to determine the payee. Under §1.1441-1(b)(2)(i), X, the person to whom the payment is made, is considered to be the payee, unless X is determined to be a flow-through entity, in which case the rules of §1.1441-5(c) or (e) apply to determine the payee. Under paragraph (d)(2)(i) of this section, the rules of §1.1441-1(b)(3)(ii) apply to determine the classification of a payee as an individual, trust, estate, corporation, or partnership. These rules apply irrespective of whether the payment is an amount subject to withholding. Under §1.1441-1(b)(3)(ii)(B), X is presumed to be a partnership, since X does not appear to be an individual, trust or estate, and X cannot be presumed to be an exempt recipient in the absence of documentation. Paragraph (d)(2)(i) of this section requires USP to apply the provisions of §§1.1441-1(b)(3)(iii) and 1.1441-5(d) to determine whether, X is presumed to be a U.S. or foreign partnership. Under §§1.1441-1(b)(3)(iii) and 1.1441-5(d)(2), X is presumed to be a U.S. partnership in absence of any indicia of foreign partnership status. The foreign source interest is a payment subject to reporting on Form 1099 under §1.6049-5(a). Further, because X is a non-exempt recipient that has failed to provide its TIN on a valid Form W-9, the foreign source interest is subject to backup withholding under section 3406.

*Example 3. (i) Facts.* USP is a U.S. payor as defined in paragraph (c)(5) of this section. USP makes a payment of U.S. source interest outside the United States to an offshore account of X. See paragraphs (c)(1) for a definition of offshore account and (e) for a payment outside the United States. USP does not have a withholding certificate from X as defined in §1.1441-1(c)(16) nor does it have documentary evidence as described in §1.1441-1(e)(1)(ii)(A)(2) and 1.6049-5(c)(1).

(ii) *Analysis.* The interest is an amount subject to withholding as defined in §1.1441-2(a). Under paragraph (d)(1) of this section, USP must apply the

provisions of §1.1441-1(b)(2) and §1.1441-5(c) and (e) to determine the payee. Under §1.1441-1(b)(2)(i), X, the person to whom the payment is made, is considered to be the payee, unless X is determined to be a flow-through entity, in which case the rules of §1.1441-5(c) or (e) apply to determine the payee. Under paragraph (d)(2)(i) of this section, the rules of §1.1441-1(b)(3)(ii) apply to determine the classification of a payee as an individual, trust, estate, corporation, or partnership. Under §1.1441-1(b)(3)(ii)(B), X is presumed to be a partnership, since X does not appear to be an individual, trust or estate, and X cannot be presumed to be an exempt recipient in the absence of documentation. Paragraph (d)(2)(i) of this section requires USP to apply the provisions of §§1.1441-1(b)(3)(iii) and 1.1441-5(d) to determine whether, X is presumed to be a U.S. or foreign partnership. Under §§1.1441-1(b)(3)(iii)(D) and 1.1441-5(d)(2), X is presumed to be a foreign partnership. Therefore, under paragraph (d)(1) of this section and §1.1441-5(c)(1)(i)(E), the payees of the interest are presumed to be the partners of X. Under §1.1441-5(d)(3), the partners are presumed to be undocumented foreign persons. Therefore, USP must withhold 30 percent of the interest payment under §1.1441-1(b)(1) and report the payment on Form 1042-S in accordance with §1.1461-1(c).

*Example 4. (i) Facts.* The facts are the same as in *Example 3*, except that the interest is paid by F, a non-U.S. payor.

(ii) *Analysis.* The analysis and result are the same as in *Example 3*. F is a withholding agent under §1.1441-7 and its status as a non-U.S. payor under paragraph (c)(5) of this section is irrelevant.

*Example 5. (i) Facts.* USP is a U.S. payor as defined in paragraph (c)(5) of this section. USP makes a payment outside the United States of interest from sources outside the United States to an offshore account of X. USP does not have a withholding certificate from X as defined in §1.1441-1(c)(16) nor does it have documentary evidence as described in §§1.1441-1(e)(1)(ii)(A)(2) and 1.6049-5(c)(1). USP does not have actual knowledge of an employer identification number for X. X does not appear to be an individual, trust, or estate and cannot be treated as an exempt recipient, as defined in §1.6049-4(c)(1)(ii) in the absence of documentation.

(ii) *Analysis.* The interest is not an amount subject to withholding as defined in §1.1441-2(a). Under paragraph (d)(1) of this section, USP must apply the rules of §§1.1441-1(b)(2) and 1.1441-5(c) and (e) to determine the payee of the interest. Under §1.1441-1(b)(2)(i), X, the person to whom the payment is made, is considered to be the payee, unless X is determined to be a flow-through entity, in which case the rules of §1.1441-5(c) or (e) apply to determine the payee. Under paragraph (d)(2)(i) of this section, §1.1441-1(b)(3)(ii) applies to determine X's classification as an individual, trust, estate, corporation or partnership. Under §1.1441-1(b)(3)(ii)(B), X is treated as a partnership, since it does not appear to be an individual, trust, or estate and cannot be treated as an exempt recipient without documentation. Paragraph (d)(2)(i) of this section requires USP to apply the provisions of §§1.1441-1(b)(3)(iii) and 1.1441-5(d) to determine whether, X is presumed to be a U.S. or foreign partnership. Paragraph (d)(2)(i) also states that the presumptions of foreign status for payments made to offshore accounts contained in

§§1.1441-1(b)(3)(iii)(D) and 1.1441-5(d)(2) do not apply to amounts that are not subject to withholding. Therefore, under §§1.1441-1(b)(3)(iii) and 1.1441-5(d)(2), X is presumed to be a U.S. partnership because it does not have actual knowledge that X's employer identification number begins with the digits "98." Therefore, USP must treat X as a U.S. person that is not an exempt recipient and report the payment on Form 1099 under section 6049. Under §31.3406(g)-1(e) of this chapter, however, USP is not required to backup withhold on the payment unless it has actual knowledge that X is a U.S. person that is not an exempt recipient.

*Example 6. (i) Facts.* The facts are the same as in *Example 5*, except that the interest is paid by F, a non-U.S. payor, as defined under paragraph (c)(5) of this section.

(ii) *Analysis.* The analysis is the same as under *Example 5*. However, because F is a non-U.S. payor paying foreign source interest outside the United States, paragraph (b)(6) of this section exempts the payment from reporting under section 6049.

*Example 7. (i) Facts.* USP, a U.S. payor as defined in paragraph (c)(5) of this section, makes a payment of U.S. source interest to NQI, a foreign corporation and a nonqualified intermediary as defined in §1.1441-1(c)(14). The interest is not deposit interest as defined in sections 871(i)(2)(A) and 881(d). The interest is paid inside the United States to an account maintained in the United States. NQI has provided USP with a nonqualified intermediary withholding certificate, as described in §1.1441-1(e)(3)(iii), but has not attached any documentation from the persons on whose behalf it acts or a withholding statement as described in §1.1441-1(e)(3)(iv).

(ii) *Analysis.* U.S. source interest is an amount subject to withholding under §1.1441-2(a). USP may treat the payment as made to a foreign intermediary under §1.1441-1(b)(3)(v)(A) because USP has received a nonqualified intermediary withholding certificate from NQI. Under paragraph (d)(3)(i) of this section, USP must apply §1.1441-1(b)(2)(v) to determine the payees of the payment. Under §1.1441-1(b)(2)(v)(A), USP must treat the persons on whose behalf NQI is acting as the payees. Paragraph (d)(3)(i) of this section also requires USP to apply the presumption rules of §1.1441-1(b)(3)(v) if it cannot reliably associate the payment with valid documentation from a payee. See §1.1441-1(b)(2)(vii). Under §1.1441-1(b)(3)(v)(B), the interest is treated as paid to an unknown foreign payee because it cannot be reliably associated with documentation under §1.1441-1(b)(2)(vii). Therefore, the payment is not subject to reporting on Form 1099 under paragraph (b)(12) of this section because the payment is presumed made to a foreign person. The payment is subject to withholding, however, under §1.1441-1(b) at a rate of 30 percent and is subject to reporting on Form 1042-S under §1.1461-1(c).

*Example 8. (i) Facts.* The facts are the same as in *Example 7*, except that the interest is paid outside the United States, as defined in paragraph (e) of this section to an offshore account, as defined in paragraph (c)(1) of this section.

(ii) *Analysis.* The analysis and results are the same as in *Example 7*. The rules of §1.1441-1(b)(3)(v) apply irrespective of where the account is maintained or the payment made.

*Example 9. (i) Facts.* The facts are the same as in *Example 8*, except that the interest is paid by F, a

non-U.S. payor, as defined in paragraph (c)(5) of this section.

(ii) *Analysis.* The analysis and results are the same as in *Example 7*.

*Example 10.* (i) USP, a U.S. payor as defined in paragraph (c)(5) of this section, makes a payment of foreign source interest to NQI, a foreign corporation and a nonqualified intermediary as defined in §1.1441-1(c)(14). NQI has provided USP with a nonqualified intermediary withholding certificate, as described in §1.1441-1(e)(3)(iii), but has not attached any documentation from the persons on whose behalf it acts or a withholding statement as described in §1.1441-1(e)(3)(iv).

(ii) *Analysis.* Foreign source interest is not an amount subject to withholding under chapter 3 of the Internal Revenue Code. See §1.1441-2(a). Under paragraph (d)(3)(ii)(A) of this section, amounts that are not subject to withholding under chapter 3 of the Internal Revenue Code that a payor may treat as paid to a foreign intermediary are treated as made to an exempt recipient described in §1.6049-4(c). Therefore, the foreign source interest is not subject to reporting on Form 1099.

*Example 11.* (i) *Facts.* USP is a U.S. payor as defined in paragraph (c)(5) of this section. USP pays U.S. source original issue discount from the redemption of an obligation described in section 871(g)(1)(B) to NQI, a foreign corporation that is a nonqualified intermediary as defined in §1.1441-1(c)(14). The redemption proceeds are paid to an account NQI has with USP in the United States. NQI provides a nonqualified intermediary withholding certificate as described in §1.1441-1(e)(3)(iii) but does not attach any payee documentation or a withholding statement described in §1.1441-1(e)(3)(iv).

(ii) *Analysis.* Under paragraph (d)(3)(ii)(A) of this section, USP must treat the payment as made to an undocumented U.S. payee that is not an exempt recipient and report the payment on Form 1099. Further, because the payment is made inside the United States, the exception to backup withholding for offshore accounts contained in §31.3406(g)-1(e) of this chapter does not apply and the payment is subject to backup

withholding.

*Example 12.* (i) *Facts.* P, a payor, makes a payment to NQI of U.S. source interest on debt obligations issued prior to July 18, 1984. Therefore, the interest does not qualify as portfolio interest under section 871(h) or 881(d). NQI is a nonqualified foreign intermediary, as defined in §1.1441-1(c)(14), and has furnished P a valid nonqualified intermediary withholding certificate described in §1.1441-1(e)(3)(iii) to which it has attached a valid Form W-9 for A, and two valid beneficial owner Forms W-8, one for B and one for C. A is not an exempt recipient under §1.6049-4(c). NQI furnishes a withholding statement, described in §1.1441-1(e)(3)(iv), in which it allocates 20 percent of the U.S. source interest to A, but does not allocate the remaining 80 percent of the interest between B and C. B's withholding certificate indicates that B is a foreign pension fund, exempt from U.S. tax under the U.S. income tax treaty with Country T. C's withholding certificate indicates that C is a foreign corporation not entitled to a reduced rate of withholding.

(ii) *Analysis.* Under paragraph (d)(3)(i) of this section, P applies the rules of §1.1441-1(b)(2)(v) to determine the payees of the interest. Under that section, the payees are the persons on whose behalf NQI acts—A, B and C. Because P can reliably associate 20 percent of the payment with valid documentation provided by A, P must treat 20 percent of the interest as paid to A, a U.S. person not exempt from reporting, and report the payment on Form 1099. P cannot reliably associate the remaining 80 percent of the payment with valid documentation under §1.1441-1(b)(2)(vii) and, therefore, under paragraph (d)(3)(i) of this section must apply the presumption rules of §1.1441-1(b)(3)(v). Under that section, the interest is presumed paid to an unknown foreign payee. Under paragraph (b)(12) of this section, P is not required to report the interest presumed paid to a foreign person on Form 1099. Under §1.1441-1(b), 80 percent of the interest is subject to 30 percent withholding, however, and the interest is reportable on Form 1042-S under §1.1461-1(c).

*Example 13.* (i) *Facts.* The facts are the same as in

*Example 12*, except that P can reliably associate 30 percent of the payment of interest to B, but cannot reliably associate the remaining 70 percent with A or C.

(ii) *Analysis.* Under paragraph (d)(3)(i) of this section, P applies the rules of §1.1441-1(b)(2)(v) to determine the payees of the interest. Under that section, the payees are the persons on whose behalf NQI acts—A, B and C. Because P can reliably associate 30 percent of the payment with B, a foreign pensions fund exempt from withholding under an income tax treaty, P may treat that payment as paid to B and not subject to reporting on Form 1099 under paragraph (b)(12) of this section. P cannot reliably associate the remaining 70 percent of the payment with valid documentation under §1.1441-1(b)(2)(vii) and, therefore, under paragraph (d)(3)(i) of this section must apply the presumption rules of §1.1441-1(b)(3)(v). Under that section, the interest is presumed paid to an unknown foreign payee. Under paragraph (b)(12) of this section, P is not required to report the interest presumed paid to a foreign person on Form 1099. Under §1.1441-1(b), 80 percent of the interest is subject to 30 percent withholding, however, and the interest is reportable on Form 1042-S under §1.1461-1(c).

*Example 14.* (i) *Facts.* The facts are the same as in *Example 12*, except that P also makes a payment of foreign source interest to NQI.

(ii) *Analysis.* Under paragraph (d)(3)(ii)(A), P may treat the foreign source interest as paid to an exempt recipient as defined in §1.6049-4(c) and not subject to reporting on Form 1099 even though some or all of the foreign source interest may in fact be owned by A, the U.S. person that is not exempt from reporting.

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## Parts 1 and 31 [Amended]

Par. 18. Effective January 1, 2001, in the list below, for each section indicated in the left column remove the language in the middle column and add the language in the right column:

Section	Remove	Add
1.1441-1(b)(1), first sentence	to a beneficial owner that is a U.S. person	to a payee that is a U.S. person
1.1441-1(b)(2)(iii)(A), last sentence	1.1441-6(b)(4)	1.1441-6(b)(2)
1.1441-1(b)(2)(iii)(B), third sentence	1.1441-6(b)(4)	1.1441-6(b)(2)
1.1441-1(b)(2)(vi), second sentence	1.6049-5(c)(4)	1.6049-5(c)(1)
1.1441-1(b)(4)(iii), last sentence	§1.6049-5(c)(4)	§1.6049-5(c)(1)
1.1441-1(b)(4)(v), third sentence	§1.6049-5(c)(4)	§1.6049-5(c)
1.1441-1(b)(4)(xviii), third sentence	is required	is not required

1.1441-1(b)(7)(i)(A)	§1.1441-4(a)(2)(i) or (3)	§1.1441-4(a)(2)(ii) or (3)(i)
1.1441-1(b)(7)(iii), first sentence	§1.1441-4(a)(2)(i)	§1.1441-4(a)(2)(ii) or (3) or (3)(i)
1.1441-1(b)(9), second sentence	a withholding certificate	an intermediary or flow-through withholding certificate
1.1441-1(b)(9), second sentence	a U.S. beneficial owner	a U.S. payee
1.1441-1(e)(1)(ii)(A)(2)	with respect to an offshore account	to an offshore account
1.1441-1(e)(2)(i), fifth sentence	See §1.1441-6(b)(4)(ii)	See §1.1441-6(b)(2)
1.1441-1(e)(2)(ii), sixth sentence	See §1.1441-6(b)(4)(i)	See §1.1441-6(b)
1.1441-1(e)(4)(viii), introductory text, second sentence	§1.1441-6(b)(2)(ii)	§1.1441-6(c)(2)
1.1441-1(e)(4)(viii), third sentence	§1.1441-6(b)(4)(ii)	§1.1441-6(b)(1)
1.1441-3(c)(2)(i), introductory text, second sentence	estimate of earnings and profits,	estimates under this paragraph (c)(2),
1.1441-4(a)(3)(ii)	payment to a foreign financial institution (within the meaning of §1.165-12(c)(1)(iv)) shall	payment shall
1.1441-4(a)(3)(ii)	counterparty	payee
1.1441-7(b)(1), first sentence	is incorrect.	is unreliable or incorrect.
1.1441-7(b)(1), third sentence	contained in, or attached to, a withholding certificate	contained in, or associated with, a withholding certificate
1.1441-7(b)(1), third sentence	are not correct and	are incorrect or unreliable and
1.1461-1(b)(2), first sentence	Form 1042X	Form 1042
1.6045-1(j), first sentence	the end of the second calendar month following the close of the calendar year of such reporting period	February 28 of the following calendar year
1.6049-4(c)(1)(ii)(A), second sentence	meets the	meets one of the
31.3406(h)-3(a), introductory text,	the payee certifies	a payee that is a U.S. person certifies first sentence

Robert E. Wenzel,  
*Deputy Commissioner  
of Internal Revenue.*

Approved May 5, 2000.

Jonathan Talisman,  
*Deputy Assistant Secretary  
of the Treasury.*

(Filed by the Office of the Federal Register on May  
15, 2000, 8:45 a.m., and published in the issue of the  
Federal Register for May 22, 2000, 65 F.R. 32151)

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## **Section 7520.—Valuation Tables**

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2000. See Rev. Rul. 2000–28, page 1157 .

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## **Section 7872.—Treatment of Loans With Below-Market Interest Rates**

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2000. See Rev. Rul. 2000–28, page 1157.

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## Part III. Administrative, Procedural, and Miscellaneous

### Notice of Proposed Rulemaking and Notice of Public Hearing

#### Certain Corporate Reorganizations Involving Disregarded Entities

REG-106186-98

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations that provide guidance to corporations and their shareholders about whether certain transactions qualify as corporate reorganizations. The proposed regulations apply to certain mergers under state or Federal law between two entities, one of which is a corporation and the other of which, for Federal tax purposes, is disregarded as an entity separate from its owner (for example, a qualified REIT subsidiary, a qualified subchapter S subsidiary, or a limited liability company with a single corporate owner that does not elect to be treated as a separate corporation). This document also provides a notice of public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by August 14, 2000. Requests to speak (with outlines of oral comments to be discussed) at the public hearing scheduled for August 8, 2000, must be received by July 18, 2000.

ADDRESSES: Send submissions to CC:DOM:CORP:R (REG-106186-98), room 5226, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 am and 5 pm to: CC:DOM:CORP:R (REG-106186-98), Courier's desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC 20044. 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.gov/tax\\_regs/reglist.html](http://www.irs.gov/tax_regs/reglist.html).

The public hearing will be held in room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Reginald Mombrun, (202) 622-7750, concerning submissions of comments, 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:

#### Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) that provide guidance as to whether certain mergers under state or Federal law between two entities, one of which is a corporation and the other of which, for Federal tax purposes, is disregarded as an entity separate from its owner can be statutory mergers qualifying as reorganizations under section 368(a)(1)(A) of the Internal Revenue Code of 1986 (Code). The Code provides general nonrecognition treatment for reorganizations specifically described in section 368(a). Section 368(a)(1)(A) provides that the term *reorganization* means "a statutory merger or consolidation." Section 1.368-2(b)(1) provides that a statutory merger must be accomplished under the "corporation laws of the United States or a State or territory or the District of Columbia." In addition to meeting the requirements of section 368(a), a merger transaction must meet other reorganization requirements such as the requirement that the persons engaged in the transaction each qualify as "a party to a reorganization" under section 368(b), the continuity of interest requirement of §1.368-1(e), and the continuity of business enterprise requirement of §1.368-1(d).

Certain entities that are respected under state law are disregarded for Federal tax purposes. These entities include a qualified REIT subsidiary, a qualified subchapter S subsidiary (QSub), and an entity that is disregarded under §301.7701-3 as an entity separate from its owner. Section 856(i)(2) provides that a corporation that is wholly

owned by a real estate investment trust (REIT) is a qualified REIT subsidiary. Section 1361(b)(3)(B) provides that a QSub is an eligible domestic corporation, wholly owned by an S corporation, for which the S corporation makes a QSub election. Under §301.7701-3, a business entity that is not classified as a corporation per se (see §301.7701-2(b)((1), (3), (4), (5), (6), (7) or (8); for example, a limited liability company) can elect to be treated as a corporation or, if it has a single owner, can choose to be disregarded. (These entities hereinafter are collectively referred to as Disregarded Entities, and the corporation that owns the Disregarded Entity is referred to as the Owner.) For Federal tax purposes, all of the assets, liabilities, and items of income, deduction, and credit of a Disregarded Entity are treated as those of its Owner.

Because qualified REIT subsidiaries and QSubs are corporations under state law, state merger laws generally permit them to merge with other corporations. In addition, many state merger laws permit mergers between limited liability companies and corporations.

Commentators have raised questions as to whether the merger under state or Federal law of a Disregarded Entity into an acquiring corporation or of a target corporation into a Disregarded Entity can qualify as a reorganization under section 368(a)(1)(A). These regulations address this issue.

#### Explanation of Provisions

The proposed regulations provide guidance on the tax treatment of the following two transactions: (1) the merger of a Disregarded Entity into an acquiring corporation, and (2) the merger of a target corporation into a Disregarded Entity. Under the Federal tax laws, the merger under state or Federal law of a Disregarded Entity into an acquiring corporation in which the Owner exchanges its interest in the Disregarded Entity for stock in the acquiring corporation and the Disregarded Entity ceases to exist as a result of the transaction by operation of the state or Federal merger law (hereinafter, the merger of a Disregarded Entity into an acquiring corporation) is treated as if the Owner trans-



ferred the assets of the Disregarded Entity to the acquiring corporation. Conversely, the merger under state or Federal law of a target corporation into a Disregarded Entity in which the shareholders of the target corporation exchange their target corporation stock for stock in the Owner and the Disregarded Entity does not lose its status as a Disregarded Entity as a result of the transaction (hereinafter, the merger of a target corporation into a Disregarded Entity) is treated as if the Owner acquired all of the assets of the target corporation.

The proposed regulations reflect Treasury's and the IRS' view that neither merger is a statutory merger qualifying as a reorganization under section 368(a)(1)(A). Compliance with a corporate law merger statute does not by itself qualify a transaction as a "statutory merger" for purposes of section 368(a)(1)(A). See *Roebeling v. Commissioner*, 143 F.2d 810, 812 (3d Cir. 1944), *cert. denied*, 323 U.S. 773 (1944). The proposed regulations contain the requirements that must be satisfied for a state or Federal law merger or consolidation to qualify as a reorganization under section 368(a)(1)(A). In addition, the proposed regulations remove the word "corporation" from the requirement that, in order to qualify as a reorganization under section 368(a)(1)(A), a merger or consolidation must be effected pursuant to the corporation law of the relevant jurisdiction. This change is necessary to conform the regulations to the IRS' long-standing position that a merger or consolidation may qualify as a reorganization under section 368(a)(1)(A) even if it is undertaken pursuant to laws other than the corporation law of the relevant jurisdiction. See Rev. Rul. 84-104 (1984-2 C.B. 94) (a "consolidation" pursuant to the National Banking Act, 12 U.S.C. 215, is treated as a merger for Federal tax purposes).

#### *The Merger of a Disregarded Entity into an Acquiring Corporation*

Consistent with the views of all the commentators, Treasury and the IRS believe that the merger of a Disregarded Entity into an acquiring corporation is not a statutory merger qualifying as a reorganization under section 368(a)(1)(A) because the Owner's assets (other than those held in the Disregarded Entity) are not transferred to the acquiring corporation and the

Owner does not cease to exist as a result of the state or Federal law merger transaction. "A merger ordinarily is an absorption by one corporation of the properties and franchises of another whose stock it has acquired. The merged corporation ceases to exist, and the merging corporation alone survives." *Cortland Specialty Co. v. Commissioner of Internal Revenue*, 60 F. 2d 937, 939 (2d Cir. 1932), *cert. denied*, 288 U.S. 599 (1933). The merger of a Disregarded Entity into an acquiring corporation, in which the Owner's assets and liabilities are divided between the Owner and the acquiring corporation after the transaction, is a divisive transaction, not a transaction in which the assets of the Owner and the acquiring corporation are combined. Congress intended that section 355 be the sole means under which divisive transactions will be afforded tax-free status and, thus, specifically required the liquidation of the acquired corporation in reorganizations under both sections 368(a)(1)(C) and 368(a)(1)(D) in order to prevent these reorganizations from being used in divisive transactions that did not satisfy section 355. See S. Rep. No. 1622, 83<sup>rd</sup> Cong., 2<sup>d</sup> Sess. 274 (1954); S. Rpt. No. 169, 98<sup>th</sup> Cong., 2<sup>d</sup> Sess. 204 (1984) and Rev. Rul. 2000-5 (2000-5 I.R.B. 436).

Accordingly, consistent with existing law, the proposed regulations provide that for a merger to qualify as a reorganization under section 368(a)(1)(A), it must, by operation of the merger statute of the relevant jurisdiction, result in one corporation acquiring the assets of the merging corporation and the merging corporation ceasing to exist. Thus, the merger of a Disregarded Entity into an acquiring corporation cannot qualify as a reorganization under section 368(a)(1)(A). However, the transaction may be treated as a reorganization under section 368(a)(1)(C), (D), or (F) if all applicable requirements are met (including the liquidation of the Owner). The transaction also may be described in section 351.

#### *The Merger of a Target Corporation into a Disregarded Entity*

There has been a split in views as to whether the merger of a target corporation into a Disregarded Entity is a statutory merger qualifying as a reorganization under section 368(a)(1)(A). Some com-

mentators argue that, because the Disregarded Entity is disregarded for Federal tax purposes, the transaction should be treated for Federal tax purposes as a merger into the Owner. Thus, they argue, as long as the Owner is a corporation, all other relevant reorganization requirements are satisfied, and the target corporation could have merged into the Owner in a transaction that qualifies as a reorganization under section 368(a)(1)(A), the merger should qualify as a reorganization under section 368(a)(1)(A). According to these commentators, treating such a merger as a statutory merger into the Owner qualifying as a reorganization under section 368(a)(1)(A) does not inappropriately facilitate avoidance of any reorganization requirement under section 368. Accordingly, the commentators argue there is no sound policy for not permitting the merger of a target corporation into a Disregarded Entity to be treated as a statutory merger into the Owner qualifying as a reorganization under section 368(a)(1)(A).

Other commentators argue that, as a technical matter, the better interpretation of the applicable provisions of the Code and regulations is that the merger of a target corporation into a Disregarded Entity is not a statutory merger of the target corporation into the Owner qualifying as a reorganization under section 368(a)(1)(A). Congress added the word "statutory" in 1934 so that the definition "will conform more closely to the general requirements of [state or Federal] corporation law." See H.R. Rep. No. 704, 73<sup>rd</sup> Cong., 2<sup>nd</sup> Sess. 14 (1934). Treasury and the IRS believe that it is inappropriate to treat the state or Federal law merger of a target corporation into a Disregarded Entity instead as a statutory merger of the target corporation into the Owner, because the Owner, the only potential party to a reorganization under section 368(b), is not a party to the state or Federal law merger transaction. A reorganization under section 368(a)(1)(A) is a combination of the assets and liabilities of two corporations through a merger under state or Federal law. A merger of a target corporation into a Disregarded Entity differs from a merger of a target corporation into the Owner because the target corporation and the Owner have combined their assets and liabilities only under the Federal tax

rules concerning Disregarded Entities, and not under state or Federal merger law, the law on which Congress relied in enacting section 368(a)(1)(A).

Accordingly, the proposed regulations provide that the merger of a target corporation into a Disregarded Entity is not a statutory merger of the target corporation into the Owner qualifying as a reorganization under section 368(a)(1)(A). Such a transaction may qualify as a reorganization under section 368(a)(1)(C), section 368(a)(1)(D), or section 368(a)(1)(F) if all relevant requirements are met. Such a transaction also may qualify for non-recognition of gain under section 351.

### Proposed Effective Date

These regulations as proposed apply to any transaction occurring on or after the date these regulations are published as final regulations in the **Federal Register**.

### Comments Requested

Several states permit the merger of a domestic corporation into a foreign corporation under state law. Treasury and the IRS are studying whether this transaction qualifies as a reorganization under section 368(a)(1)(A) and request comments on this issue.

### 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. 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, and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. 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.

### 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 copies)

that are submitted timely to the IRS. 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.gov/tax\\_regs/reglist.html](http://www.irs.gov/tax_regs/reglist.html). The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for August 8, 2000, beginning at 10:00 AM in Room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the 10<sup>th</sup> 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" portion of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by July 18, 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 reviewing outlines has passed. Copies of the agenda will be available free of charge at the hearing.

### Drafting Information

The principal author of these regulations is Reginald Mombrun of the office of the Assistant Chief Counsel (Corporate), IRS. However, other personnel from the IRS and the 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 continues to read in part as follows:

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

Par. 2. Section 1.368-2 is amended by revising paragraph (b)(1) to read as follows:

*§1.368-2 Definition of terms.*

\* \* \* \* \*

(b) (1) In order to qualify as a reorganization under section 368(a)(1)(A), the transaction must be a merger or consolidation involving two corporations effected pursuant to the laws of the United States or a State or territory, or the District of Columbia. In addition, by operation of such a merger law, the transaction must result in one corporation acquiring the assets of the merging corporation and the merging corporation ceasing to exist. Similarly, by operation of such a consolidation law, the transaction must result in one newly formed corporation acquiring the assets of both consolidating corporations, and both consolidating corporations ceasing to exist. Thus, the merger under state or Federal law of an entity that is disregarded as an entity separate from its owner for Federal tax purposes into an acquiring corporation in which the owner exchanges its interest in the disregarded entity for stock in the acquiring corporation and the disregarded entity ceases to exist as a result of the transaction by operation of the state or Federal merger law is not a statutory merger qualifying as a reorganization under section 368(a)(1)(A). Moreover, the merger of a target corporation into an entity that is disregarded as an entity separate from its owner for Federal tax purposes that does not lose its status as a disregarded entity as a result of the transaction is not a statutory merger qualifying as a reorganization under section 368(a)(1)(A). Examples of entities that are disregarded as entities separate from their owners include a qualified REIT subsidiary (within the meaning of section 856(i)(2)), a qualified subchapter S subsidiary (within the meaning of section 1361(b)(3)(B)), and a business entity that is not classified as a corporation and that has a single owner (as provided in §301.7701-2(c)(2) of this chapter). The preceding five sentences apply to any transaction occurring on or after [Date These Regulations Are Published As Final Regulations In The Federal Register].

\*\*\*\*\*

Robert E. Wenzel,  
Deputy Commissioner  
Internal Revenue.

(Filed by the Office of the Federal Register on May 11, 2000, 2:30 p.m., and published in the issue of the Federal Register for May 16, 2000, 65 F.R. 31115)

## Notice of Proposed Rulemaking and Notice of Public Hearing

### Dollar-Value LIFO Regulations; Inventory Price Index Computation Method

#### REG-107644-98

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations under section 472 of the Internal Revenue Code that relate to accounting for inventories under the last-in, first-out (LIFO) method. The proposed regulations provide guidance regarding methods of valuing dollar-value LIFO pools and affect persons who elect to use the dollar-value LIFO and inventory price index computation (IPIC) methods. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written and electronic comments must be received by August 17, 2000. Requests to speak (with outlines of oral comments) at a public hearing scheduled for September 15, 2000 at 10 a.m., must be received by August 25, 2000.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-107644-98), 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-107644-98), 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/reglist.html](http://www.irs.ustreas.gov/tax_regs/reglist.html). The public hearing will be held in room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Jeffery G. Mitchell, (202)622-4970; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Guy Traynor of the Regulations Unit at (202) 622-7180 (not toll-free calls).

#### SUPPLEMENTARY INFORMATION:

##### Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) that relate to the last-in, first-out (LIFO) inventory accounting method under section 472 of the Internal Revenue Code (Code). The LIFO method of accounting for goods treats inventories on hand at the end of the year as consisting first of inventory on hand at the beginning of the year and then of inventories acquired during the year.

Under §1.472-8, a taxpayer is permitted to use the dollar-value LIFO method of accounting for inventories, which accounts for inventories in terms of dollars of cost rather than specific goods. The dollar-value LIFO method measures increases or decreases in inventory quantities by comparing the total cost of the quantity of goods on hand at the beginning and end of the taxable year in terms of equivalent-value dollars, i.e., base-year cost. The current-year dollar cost of beginning and ending inventory may be converted into a base-year dollar cost using price indexes. Then, the quantity of base-year cost in beginning and ending inventory can be compared and the increase (increment) or decrease (liquidation) can be measured.

Section 472(f) directs the Secretary to prescribe regulations that permit the use of suitable published governmental price indexes for purposes of the LIFO method. The IRS and Treasury Department prescribed the inventory price index computation (IPIC) method in §1.472-8(e)(3) (TD 7814, 47 FR 11271, 1982-1 C.B. 84), pursuant to authority contained in sections 472 and 7805. Under the IPIC

method, inventory price indexes are computed with reference to consumer or producer price indexes published by the United States Bureau of Labor Statistics (BLS). The IPIC method was intended to simplify the use of the dollar-value LIFO method so that the LIFO method could be used by more taxpayers and would be easier to use by taxpayers already using the dollar-value LIFO method.

##### Explanation of Provisions

This document contains proposed amendments to the IPIC method provided in §1.472-8(e)(3) of computing the LIFO value of a dollar-value inventory pool that are intended to simplify and clarify certain aspects of the IPIC method as well as to modify the computational methodology so that the IPIC method produces a more accurate and suitable inventory price index. In addition, the proposed regulations provide rules for computing the LIFO value of a dollar-value pool when a taxpayer receives LIFO inventories in certain nonrecognition transactions.

##### 1. Elimination of Requirement to Use 10 Percent Categories and BLS Weights

Section 1.472-8(e)(3)(iii) of the regulations provides detailed rules for assigning inventory items to index categories published by the BLS in the "CPI Detailed Report" or the "PPI Detailed Report" for purposes of computing an inventory price index. Items are first assigned to the most detailed index category listed in the appropriate table of the "CPI Detailed Report" or the "PPI Detailed Report" that contains those items. If the total current-year cost of the items in a single detailed index category equals or exceeds 10 percent of the total inventory value, the taxpayer must use the published index for that selected index category for all items that are included in that detailed index category. If the total current-year cost of items in a single detailed index category is less than 10 percent of the total inventory value, the taxpayer must investigate successively less detailed index categories until it reaches an index category that meets the 10 percent threshold. The taxpayer, however, may only use the published index for a less detailed selected index category if it has at least one item that would have been included in each of the most detailed index

categories subsumed by the selected category. For example, a taxpayer may only use the published index for the “Fresh fruits” category from the “CPI Detailed Report” if its inventory includes at least one apple, banana, orange, citrus fruit other than orange, and other fresh fruit. If the taxpayer’s inventory does not contain at least one item in each of the most detailed index categories within the selected index category, the taxpayer must compute an appropriate index for the selected index category. An appropriate index for the selected index category is a weighted average of the published indexes for the most detailed index categories that include at least one of the taxpayer’s inventory items. The weights to be used in computing the appropriate index are the BLS weights listed for the detailed index categories. In computing an index for a pool, however, a taxpayer must weight the appropriate indexes for the selected index categories comprising the pool according to the taxpayer’s actual inventory weights for those selected index categories.

The proposed regulations eliminate the requirement to use 10 percent categories and BLS weights to determine an appropriate index for two reasons. First, the weight assigned to an index category by the BLS may vary dramatically from the taxpayer’s actual inventory weight for that category. Consequently, the index computed for those items using BLS weights will not accurately reflect the taxpayer’s inflation experience. Second, the requirement to use 10 percent categories and BLS weights was intended to simplify the index computation procedure for those taxpayers that did not keep detailed inventory records. In practice, however, this requirement adds complexity to the index computation for most taxpayers. Moreover, even the most detailed BLS index categories are fairly broad and, with current inventory recordkeeping procedures and practices, most taxpayers have sufficiently detailed books and records to classify their inventory items according to the most detailed BLS index categories.

The proposed regulations require a taxpayer to classify its inventory items into the most detailed index category listed in the “CPI Detailed Report” or the “PPI Detailed Report.” For purposes of computing a weighted average pool index, the

weight assigned to each selected index category will be the relative current-year cost of the items in that category. The IRS and Treasury Department request written comments regarding rules for excluding index categories that contain items with a de minimis amount of relative current-year cost from the pool index computation.

## 2. *Weighted Harmonic Mean for Computing Pool Index*

A pool index computed using the dollar-value LIFO method should reflect a weighted average of the inflation rates of the items contained in the ending inventory. Under LIFO methods that compute an internal index, the index computation procedure automatically produces an appropriately weighted pool index. However, when a taxpayer computes a LIFO inventory pool index using externally generated inflation rates, the taxpayer must weight the inflation rates to compute an appropriate composite index for the pool.

Section 1.472–8(e)(3)(iii)(B) states that the appropriate indexes are weighted according to the relative current-year costs of the items in each selected index category. However, the regulations do not set forth how to compute a weighted average of the appropriate indexes using the amount of relative current-year costs in each selected index category. The IRS provided an example of IPIC weighting methodology in Rev. Proc. 84–57 (1984–2 C.B. 496). The example computes a weighted average pool index based on a weighted arithmetic mean of the appropriate indexes. (Weighted Arithmetic Mean = [Sum of (Weight x Appropriate Index)] / Sum of Weights). The example provided in Rev. Proc. 98–49 (1998–37 I.R.B. 9), also used a weighted arithmetic mean to compute a weighted average percent change for a selected index category.

The IRS and Treasury Department have determined that a weighted arithmetic mean is mathematically inappropriate for averaging inflation indexes based on current-year costs. The mathematically correct method of averaging inflation indexes using relative current-year costs is a weighted harmonic mean. (Weighted Harmonic Mean = Sum of Weights / Sum of [Weight / Appropriate Index]). Therefore, the proposed regulations make the

weighted harmonic mean the only acceptable method of computing a weighted average pool index using relative current-year costs of items in ending inventory.

## 3. *Double-extension or Link-Chain Method of Index Computation*

The current regulations do not indicate whether the inventory price index should be computed using a link-chain or double-extension methodology. Section 1.472–8(e)(3)(ii) merely states that “[a]n inventory price index computed [under the IPIC method] shall be a stated percentage of the percent change in the selected consumer or producer price index or indexes for a specific category or categories of goods.”

In practice, some taxpayers have used a link-chain methodology, and others a double-extension methodology. The proposed regulations specifically permit either method. The proposed regulations also explain how to compute an index under each method and provide examples.

## 4. *Selecting Indexes as of an Appropriate Month*

Section 1.472–8(e)(3)(iii)(C) states that a taxpayer not using the retail inventory method must select indexes “as of the month or months” most appropriate to its method of determining current-year cost, or make a one-time binding election of an appropriate representative month. The IRS has ruled that a month is an appropriate representative month if there is a nexus between the selected month, the taxpayer’s method of determining current-year cost, and the taxpayers’ historical experience of inventory purchases. Rev. Rul. 89–29 (1989–1 C.B. 168). In practice, there has been confusion about the meaning of the phrase “month or months most appropriate to the taxpayer’s method of determining current-year cost.”

The proposed regulations clarify that, for each dollar-value pool, a taxpayer should either annually determine the month most appropriate to its method of determining the current-year cost of the pool (appropriate month) or make a one-time election of a representative appropriate month (representative month) for the pool. The principles of Rev. Rul. 89–29 continue to apply for purposes of determining whether a particular month is appropriate or representative. An appropri-

ate index is computed by comparing the published cumulative index for the appropriate or representative month to the published cumulative index for the appropriate or representative month used for the immediately preceding year (in the case of a taxpayer using the link-chain IPIC method) or the published cumulative index for the month preceding the first day of the base year (in the case of a taxpayer using the double-extension IPIC method). The proposed regulations also clarify that a taxpayer electing to use a representative month must use an appropriate month, rather than the representative month, to compute an appropriate index in certain circumstances, such as a short taxable year.

#### 5. Taxpayers Eligible to Use “Department Store Inventory Price Indexes”

The current regulations prohibit the use of the IPIC method by a taxpayer that is eligible to use inventory price indexes prepared by the BLS for the purpose of valuing the LIFO inventories of a specific industry. Specifically, §1.472–8(e)(3)(i) provides that a taxpayer eligible to use the retail price indexes prepared by the BLS and published in “Department Store Inventory Price Indexes” may not use the IPIC method.

Some retailers may carry goods traditionally carried by department stores and other goods that are not traditionally carried by department stores. Such taxpayers may qualify as department stores, but “Department Store Inventory Price Indexes” may not provide indexes that are applicable for some of the taxpayers’ departments. Whenever one or more departments of a department store do not fit into any one of the 23 major groups established by the BLS or into the special combinations listed in Rev. Proc. 86–46 (1986–2 C.B. 739), the taxpayer may use either an index that represents an average for the whole of the remainder of the LIFO inventory or the store total index published by the BLS. However, the express terms of the current regulations prohibit taxpayers eligible to value their LIFO inventories using “Department Store Inventory Price Indexes” from using the IPIC method to compute an index for any dollar-value pool.

The proposed regulations eliminate the eligibility restrictions applicable to the

IPIC method. Generally, any taxpayer may adopt the IPIC method as long as it uses that method for all goods accounted for under the dollar-value LIFO method. However, a taxpayer eligible to use “Department Store Inventory Price Indexes” may elect to use those indexes for LIFO inventory items that fall within any of the 23 major groups listed in “Department Store Inventory Price Indexes” and the IPIC method for the remainder of its LIFO inventory items, or may elect to use the IPIC method for all of its LIFO inventories. The proposed regulations do not, however, affect the ability of an eligible taxpayer to use “Department Store Inventory Price Indexes” to value its LIFO inventories in accordance with §1.472–1(k) and Rev. Proc. 86–46.

#### 6. Selection from “CPI Detailed Report” or “PPI Detailed Report”

Section 1.472–8(e)(3)(iii)(C) states that a retailer may select indexes from the “CPI Detailed Report” or the “PPI Detailed Report,” but if equally appropriate indexes may be selected from either, a retailer using the retail inventory method must select from the “CPI Detailed Report” and a retailer not using the retail inventory method must select from the “PPI Detailed Report.”

The proposed regulations eliminate the need for a retailer to determine whether the “CPI Detailed Report” and “PPI Detailed Report” contain equally appropriate indexes. The proposed regulations require retailers using the retail inventory method to select indexes from the “CPI Detailed Report.” All other taxpayers must select indexes from the “PPI Detailed Report.”

#### 7. Elimination of Requirement to Convert Published Indexes into Retail Price Indexes or Cost Price Indexes

Section 1.472–8(e)(3)(iii)(C) provides that if a retailer using the retail inventory method selects an index from the “PPI Detailed Report,” the selected index must be converted into a retail price index, and that if a retailer not using the retail inventory method selects an index from the “CPI Detailed Report,” the selected index must be converted into a cost price index. The regulations further provide that manufacturers, processors, wholesalers, jobbers, and distributors must convert se-

lected indexes into cost price indexes.

This conversion requirement in the current regulations was intended to more accurately represent the taxpayer’s inflation experience relative to the selected price index. However, due to the inability of many taxpayers to determine gross profit percentages at the detailed index category level and the fact that gross profit percentages for many taxpayers are relatively constant, this conversion requirement may not actually increase the accuracy of the indexes used in the inventory price index computation. The IRS and Treasury Department have concluded that the administrative burden of converting published indexes into retail price or cost price indexes outweighs any benefits of increased accuracy from the procedure. Thus, the proposed regulations eliminate the requirement to convert published price indexes into either retail price indexes or cost price indexes.

#### 8. Relocation and Clarification of Special Pooling Rules

Section 1.472–8(e)(3)(iv) provides special, elective pooling rules for retailers, wholesalers, jobbers, and distributors that use the IPIC method. Such taxpayers are permitted to establish an inventory pool for any group of goods included in one of the eleven general categories of consumer goods described in the “CPI Detailed Report.” Although wholesalers, jobbers and distributors are allowed to pool goods according to categories found in the “CPI Detailed Report,” they must select indexes from the “PPI Detailed Report” pursuant to §1.472–8(e)(3)(iii)(C). The current regulations provide no special, elective pooling rules for manufacturers that use the IPIC method. However, Rev. Proc. 84–57 provides that an inventory pool or pools may be established for any group of goods included within one of the 15 general categories of producer goods described in Table 6 of the “PPI Detailed Report.”

The proposed regulations provide special, elective pooling rules for LIFO inventories accounted for under the IPIC method. Specifically, retailers using the retail inventory method may establish an inventory pool for any group of goods accounted for under the IPIC method included within one of the general expenditure categories (i.e., major groups) in

Table 3 of the “CPI Detailed Report.” Retailers not using the retail method, wholesalers, jobbers, distributors, processors, and manufacturers may establish an inventory pool for any group of goods accounted for under the IPIC method included within one of the 2-digit commodity codes (i.e., major commodity groups) in Table 6 of the “PPI Detailed Report.” The special, elective pooling rules provided in the proposed regulations correspond with the pooling rules found in section 474(b) so that a taxpayer may change from the simplified dollar-value LIFO method of section 474 to the IPIC method without changing its pooling structure. In addition, the special, elective pooling rules for taxpayers using the IPIC method are relocated with the general pooling rules applicable to all taxpayers in §1.472–8(b) and (c).

#### 9. Clarification of the Definition of “Eligible Small Business”

Section 1.472–8(e)(3)(ii) permits an eligible small business, as defined under section 474(b) of the Internal Revenue Code of 1954, to compute an inventory price index for its pool(s) using 100 percent of the percent change in the selected indexes. All other taxpayers must compute an inventory price index for their pools using 80 percent of the percent change in the selected indexes. At the time the regulations were published, section 474(b) defined an eligible small business as a taxpayer with average annual gross receipts that did not exceed \$2,000,000 for the 3-taxable-year period ending with the taxable year.

Section 474 was amended by the Tax Reform Act of 1986. Public Law 99-514, 100 Stat. 2348. An eligible small business is now defined by section 474(c) as a taxpayer with average annual gross receipts that do not exceed \$5,000,000 for the 3 preceding taxable years. The proposed regulations clarify that the IPIC method definition of “eligible small business” mirrors the definition in current section 474.

#### 10. New Base Year for IPIC Method Changes

Section 1.472–8(e)(vi) requires a taxpayer that changes to the IPIC method from another dollar-value LIFO method to treat the year of change as the base year

in determining the LIFO value of the inventory pool(s) for the year of change and later taxable years. The taxpayer is also required to restate indexes of existing layers of increment in terms of new base-year cost. This procedure is generally known as updating the base year.

The proposed regulations clarify that the base year updating procedure applies in the case of a voluntary change to the IPIC method, but is discretionary in the case of an involuntary change to the IPIC method. If an examining agent determines that a taxpayer’s dollar-value LIFO method does not clearly reflect income, the agent may require the taxpayer to change to the double-extension IPIC method on a cut-off basis with or without an updated base year. If the examining agent chooses not to update the base year, the examining agent will ascertain the amount of any increment in terms of base-year cost for the year of change by comparing the total base-year cost of the beginning inventory determined under the taxpayer’s dollar-value LIFO method and the total base-year cost of the ending inventory determined under the double-extension IPIC method. Any increment so determined will be valued using the index computed under the double-extension IPIC method.

#### 11. Inventories Received in a Nonrecognition Transaction

Under current law, the treatment of LIFO inventories received in a nonrecognition transaction depends upon whether the transaction qualifies as a corporate reorganization to which section 381 applies. Section 381(c)(5) provides that inventory accounting methods generally carry over, uninterrupted, to a transferee in a transaction described in section 381(a).

However, inventory accounting methods generally do not carry over to a transferee in other nonrecognition transactions such as transfers to a controlled corporation under section 351, divisive “D” reorganizations under section 368(a)(1)(D), or contributions to a partnership under section 721 (non-section 381 transfers). *Textile Apron Company, Inc. v. Commissioner*, 21 T.C. 146 (1953), *acq.*, 1954–1 C.B. 7. But see §1.263A–7(c)(4); 1.1502–17. If a transferee that has never owned inventories or that has accounted for inventories using a method other than

LIFO wants to use the LIFO method to account for inventories received in a non-section 381 transfer, it must elect the LIFO method for the year of transfer. The inventories received in the transfer are treated as opening inventory and their cost is determined using the average cost method as provided in section 472(b)(3). Rev. Rul. 70–564 (1970–2 C.B. 109). A transferee that previously elected to use the LIFO method may account for the LIFO inventories received in a non-section 381 transfer using its preexisting LIFO method. The LIFO layers of the transferor retain the transferor’s original acquisition dates and costs and are integrated into the transferee’s existing LIFO layers. *Commissioner v. Joseph E. Seagram & Sons, Inc.*, 394 F.2d 738 (1968), *rev’g*, 46 T.C. 698 (1966); Rev. Rul. 70–565 (1970–2 C.B. 110).

An election to use the dollar-value LIFO method for LIFO inventories received in a non-section 381 transfer, however, may not continue the LIFO reserve of the transferor. If the mix of goods in the inventory changes significantly after the transfer, the mechanics of the dollar-value LIFO method may produce an increment in the first taxable year that effectively eliminates the LIFO reserve established by the transferor. This occurs because the transferee’s base year is the year in which it elects LIFO.

A taxpayer using the dollar-value LIFO method determines whether there is an increase or decrease in the quantity of inventory by comparing the base-year cost of the ending inventory to the base-year cost of the beginning inventory. When inventory is received in a non-section 381 transfer, the transferee’s basis is determined by reference to the transferor’s basis in the inventory. The transferee’s base-year cost, however, is not determined by reference to the transferor’s base-year cost. The transferee’s base-year cost of inventory received in a non-section 381 transfer is equal to the transferee’s cost of the inventory, which is generally the carryover basis of the inventory. Since the transferor’s basis was established by reference to the actual cost of the goods in years prior to the transfer, the carryover basis of the inventory may be considerably lower than what it would cost to purchase or produce the goods in the current year. If a new item enters the

transferee's inventory, §1.472-8(e)(2)(iii) only permits the transferee to reconstruct the base-year unit cost of that item back to the year in which it elected LIFO. If the transferee elected LIFO in the year in which the non-section 381 transfer occurred, the base-year unit cost of the new item will not be comparable to the base-year unit cost of the items that were received in the transfer and comprised the opening inventory. The disparity in the base-year unit costs may produce an increment in terms of base-year cost that would not have occurred but for the low base-year unit cost of the inventory received in the transfer.

While the current regulations contain a provision requiring a taxpayer that changes to the IPIC method from another LIFO method to treat the year of change as the base year in determining the LIFO value of the inventory pool(s) for the year of change and later taxable years, the provision does not apply to an initial adoption of LIFO by a transferee. When a transferee elects the LIFO and IPIC methods for LIFO inventories received in a non-section 381 transfer, the transferee will have an increment in the year in which the inventories are received even without a significant change in the mix of goods in the transferee's ending inventory. The IPIC method invariably produces an increment because the index used to convert the current-year cost of the ending inventory to base-year cost will reflect only one year of inflation while the difference between the current-year cost and the carryover basis of the opening inventory reflects more than one year of inflation.

The IRS and Treasury Department have determined that recapture of the LIFO reserve established by the transferor's use of the dollar-value LIFO method solely by virtue of the mechanical application of the dollar-value LIFO method after a non-section 381 transfer is inappropriate, given the business continuity principles governing the tax treatment of the underlying transaction. Accordingly, the proposed regulations provide that if a transferee uses the dollar-value LIFO method for inventories that were received in a nonrecognition transaction to which section 381 does not apply and that were accounted for using the dollar-value LIFO method by the transferor, the transferee must use the year of

transfer as the base year and the transferor's current-year cost of the inventory received as the new base-year cost of such inventory for purposes of determining future increments and liquidations. The proposed regulations do not affect a newly formed transferee's ability to elect new accounting methods or the holdings of Rev. Rul. 70-564 and Rev. Rul. 70-565. However, the new base year rule does not apply to a non-section 381 transaction if the transaction was made with the principal purpose of availing the transferee of a method of accounting that would be unavailable to the transferor (or would be unavailable without securing consent from the Commissioner). In determining the principal purpose of a transfer, consideration will be given to all of the facts and circumstances. However, if a transferor acquired inventory in a bargain purchase within the five taxable years preceding the year of the transfer and accounted for that inventory using a dollar-value LIFO method that did not treat the bargain purchase inventory and physically identical inventory acquired at market prices as separate items, the transfer will be deemed made with the principal purpose of availing the transferee of a method of accounting that would be unavailable to the transferor (or would be unavailable without securing consent from the Commissioner).

#### **Proposed Effective Date**

These regulations are proposed to be effective for taxable years beginning on or after the date they are published in the **Federal Register** as final regulations.

#### **Effect on Other Documents**

Rev. Proc. 84-57 will become obsolete as of the date these regulations are published in the **Federal Register** as final regulations. In addition, Rev. Proc. 98-49 is modified with respect to the requirements to use 10 percent categories and BLS weights, to compute a weighted average using a weighted arithmetic mean, and to convert selected indexes to cost, as of the date these regulations are published in the **Federal Register** as final regulations.

#### **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a signifi-

cant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue 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.

#### **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) and electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for September 15, 2000, at 10 a.m., in room 4718, Internal Revenue Building, 1111 Constitution Avenue, 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 the hearing.

Persons who wish to present oral comments at the hearing must submit written or electronic comments by August 17, 2000, and submit an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by August 25, 2000.

A period of 10 minutes will be allocated to each person for making com-

ments.

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 regulations is Jeffery G. Mitchell of the Office of Assistant Chief Counsel (Income Tax and Accounting). 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 an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*  
§1.472-8 also issued under 26 U.S.C. 472. \* \* \*

Par. 2. Section 1.472-8 is amended as follows:

- 1. Paragraph (b)(4) is added.
- 2. The text of paragraph (c) following the paragraph heading is redesignated as paragraph (c)(1) and a paragraph heading for newly designated (c)(1) is added.
- 3. Paragraph (c)(2) is added.
- 4. Paragraphs (e)(3) and (h) are revised.

The revisions and additions read as follows:

§1.472-8 *Dollar-value method of pricing LIFO inventories.*

\* \* \* \* \*

(b) \* \* \*

(4) *Inventory price index pools.* A manufacturer or processor that elects to use the inventory price index computation method described in paragraph (e)(3) of this section to value its dollar-value pools may establish an inventory pool for any group of goods included within one of the 2-digit commodity codes (i.e., major commodity groups) in Table 6 (Producer price indexes for commodity groups, subgroups, product classes, and individual items) of the “PPI Detailed Report” published by the United States Bureau of Labor Statistics (available from New Orders, Superintendent of Docu-

ments, P.O. Box 371954, Pittsburgh, PA 15250-7954). Inventory pools that comprise less than 5 percent of the total inventory value may be combined to form a single miscellaneous inventory pool. If the resulting miscellaneous inventory pool itself comprises less than 5 percent of the total inventory value, that pool may be combined only with the largest inventory pool.

(c) \* \* \*(1) *In general.* \* \* \*

(2) *Inventory price index pools.* A retailer using the retail inventory method that elects to use the inventory price index computation method described in paragraph (e)(3) of this section (the IPIC method) may establish an inventory pool for any group of goods accounted for under the IPIC method included within one of the general expenditure categories (i.e., major groups) in Table 3 (Consumer Price Index for all Urban Consumers (CPI-U): U.S. city average, detailed expenditure categories) of the “CPI Detailed Report” published by the United States Bureau of Labor Statistics (available from New Orders, Superintendent of Documents, P.O. Box 371954, Pittsburgh, PA 15250-7954). A retailer not using the retail inventory method, wholesaler, jobber, or distributor electing to use the IPIC method may establish an inventory pool for any group of goods accounted for under the IPIC method included within one of the 2-digit commodity codes (i.e., major commodity groups) in Table 6 (Producer price indexes for commodity groups, subgroups, product classes, and individual items) of the “PPI Detailed Report” published by the United States Bureau of Labor Statistics. Inventory pools that comprise less than 5 percent of the total inventory value may be combined to form a single miscellaneous inventory pool. If the resulting miscellaneous inventory pool itself comprises less than 5 percent of the total inventory value, that pool may be combined only with the largest inventory pool.

\* \* \* \* \*

(e) \* \* \*

(3) *Inventory price index computation method—(i) In general.* The inventory price index computation method provided by this paragraph (e)(3) (the IPIC method) is a method of determining the LIFO value of a dollar-value inventory pool with reference to indexes published

by the United States Bureau of Labor Statistics (BLS). An inventory price index computed using the IPIC method will be accepted by the Commissioner as an appropriate method of computing an index, and the use of that inventory price index to compute the LIFO value of a dollar-value inventory pool will be accepted as accurate, reliable, and suitable. The appropriateness of a taxpayer’s computation of an inventory price index, including the selection of the consumer or producer price indexes and the propriety of all computations incidental to the use of those consumer or producer price indexes, will be determined in connection with the examination of the taxpayer’s income tax return. A taxpayer using the IPIC method may elect to establish inventory pools in accordance with the special rules in paragraphs (b)(4) and (c)(2) of this section or the general rules for establishing inventory pools in paragraphs (b) and (c) of this section. Taxpayers eligible to use the IPIC method are described in paragraph (e)(3)(ii) of this section. The manner in which an inventory price index is computed using the IPIC method is described in paragraph (e)(3)(iii) of this section. Rules relating to the adoption of, or change to, the IPIC method are in paragraph (e)(3)(iv) of this section.

(ii) *Eligibility.* Any taxpayer electing to use the dollar-value LIFO method may elect to compute an inventory price index in accordance with the IPIC method. Except as provided in this paragraph (e)(3)(ii), a taxpayer using the IPIC method must use that method in determining the value of all goods for which the taxpayer has elected to use the dollar-value LIFO method. A taxpayer that uses the retail price indexes prepared by the BLS and published in “Department Store Inventory Price Indexes” (available from the BLS by calling (202)606-6325 and entering document code 2415) may elect to use the IPIC method for inventory items that do not fall within any of the major groups listed in “Department Store Inventory Price Indexes.”

(iii) *Computation of an inventory price index—(A) In general.* An inventory price index computed using the IPIC method is used to convert the current-year cost of the inventory in a dollar-value inventory pool to base-year cost for purposes of determining whether an incre-



ment or liquidation in terms of base-year cost exists and to value the increment, if any, at current-year cost. A taxpayer must compute a separate inventory price index for each dollar-value inventory pool. The computation of an index for each pool involves the following four steps which are described in more detail in this paragraph (e)(3)(iii): first, selection of a BLS table and an appropriate month, second, selection of an index category, third computation of an appropriate index for each selected index category, and fourth, computation of a pool index. A taxpayer may compute an inventory price index for each dollar-value inventory pool under the IPIC method using a double-extension method (the double-extension IPIC method) or a link-chain method (the link-chain IPIC method) without regard to whether the use of a double-extension method is impractical or unsuitable. See paragraphs (e)(3)(iii)(D) and (E) of this section. The use of the double-extension IPIC method or the link-chain IPIC method is a method of accounting, and whichever method is adopted must be applied consistently to all of the taxpayer's dollar-value inventory pools accounted for using the IPIC method.

(B) *Selection of a BLS table and appropriate month—(1) In general.* An inventory price index computed using the IPIC method is computed with reference to the consumer or producer price indexes for specific categories of inventory items listed in the “CPI Detailed Report” or “PPI Detailed Report” published by the BLS for the appropriate month. A taxpayer may elect to use either the preliminary or final indexes published by the BLS for the appropriate month provided that the chosen indexes are used consistently from year to year. A taxpayer that elects to use final indexes must use preliminary indexes for the appropriate month for any taxable year in which it files its original federal income tax return before the BLS publishes final indexes.

(2) *BLS table selection.* Manufacturers, processors, wholesalers, jobbers, distributors, and retailers not using the retail inventory method must select indexes from Table 6 (Producer price indexes for commodity groups, subgroups, product classes, and individual items) of the “PPI Detailed Report,” unless the taxpayer can demonstrate that the selection of an index

from another table of the “PPI Detailed Report” would be more appropriate. Retailers using the retail inventory method must select indexes from Table 3 (Consumer Price Index for all Urban Consumers (CPI-U): U.S. city average, detailed expenditure categories) of the “CPI Detailed Report.”

(3) *Appropriate month.* In the case of a retailer using the retail inventory method, the appropriate month is the last month of the retailer's taxable year. In the case of all other taxpayers, the appropriate month is a month most appropriate to the taxpayer's method of determining the current-year cost of each dollar-value inventory pool under paragraph (e)(2)(ii) of this section. A taxpayer not using the retail inventory method may annually select an appropriate month for each dollar-value inventory pool or make an election of a representative appropriate month (representative month). An election of a representative month is a method of accounting and must be used for the taxable year of the election and all subsequent taxable years, unless the taxpayer obtains the consent of the Commissioner as provided in §1.446-1(e) to change or revoke its election. The election of a representative month must be clearly set forth on Form 970. See paragraph (e)(3)(iv)(A) of this section.

(C) *Selection of an index category—(1) In general.* The inventory items in each dollar-value pool should be classified according to the most detailed listings in the appropriate tables of the “CPI Detailed Report” or the “PPI Detailed Report.” The selection of a consumer or producer price index category for a specific item to compute an inventory price index under the IPIC method is a method of accounting. However, the selection of a new consumer or producer price index category for a specific item as a result of revisions to the “CPI Detailed Report” or the “PPI Detailed Report” is a change in underlying facts and not a change in method of accounting. Change in method of accounting rules relating to changes in selected indexes are in paragraph (e)(3)(iv) of this section.

(2) *Index selection from the PPI Detailed Report.* Manufacturers, processors, wholesalers, jobbers, distributors, and retailers not using the retail inventory method must classify their inventory

items according to the detailed listings in the appropriate table(s) of the “PPI Detailed Report.” Each specific inventory item in the taxpayer's inventory must be assigned to the most detailed index category listed in the appropriate tables (as determined under paragraph (e)(3)(iii)(B)(2) of this section) of the “PPI Detailed Report” that includes that specific inventory item. Manufacturers and processors must assign each raw material inventory item to the most detailed index category that includes that raw material and each finished good inventory item to the most detailed index category that includes that finished good. Manufacturers and processors must assign work-in-process inventory items to the most detailed index category that includes the finished good into which the item will be manufactured or processed. For this purpose, the term finished good means a good that is in a saleable state. For example, a gasoline engine manufacturer that also produces pistons for the engines must assign finished pistons that have not yet been affixed to an engine block and the piston work-in-process items to the most detailed index category that includes pistons. Finished pistons that have been affixed to an engine block must be assigned to the most detailed index category that includes the engine.

(3) *Index selection from the CPI Detailed Report.* Retailers using the retail inventory method must classify their inventory items according to the detailed listings in the appropriate tables of the “CPI Detailed Report.” Each specific inventory item in the taxpayer's inventory must be placed in the most detailed index category listed in the appropriate table (as determined under paragraph (e)(3)(iii)(B)(2) of this section) of the “CPI Detailed Report” that includes that specific inventory item.

(D) *Computation of an appropriate index—(1) Double-extension IPIC method.* In the case of a taxpayer using the double-extension IPIC method, an appropriate index for a selected index category is the percent change in the published cumulative indexes for that category for the index period between the appropriate or representative month of the current taxable year (determined under paragraph (e)(3)(iii)(B)(3) of this section) and the month preceding the first day of

the base year (the base month). The percent change in the published indexes is equal to the quotient of the published cumulative index for the appropriate or representative month of the current year divided by the published cumulative index for the base month.

(2) *Link-chain IPIC method.* In the case of a taxpayer using the link-chain IPIC method, an appropriate index for a selected index category is the percent change in the published cumulative indexes for that category during the index period between the appropriate or representative month of the current taxable year (determined under paragraph (e)(3)(iii)(B)(3) of this section) and the appropriate or representative month used for the immediately preceding taxable year. The percent change in the published indexes is equal to the quotient of the published cumulative index for the appropriate or representative month of the current year divided by the published cumulative index for the appropriate or representative month used for the immediately preceding year (or, for the month immediately preceding the first day of the taxable year, if such year is the first taxable year in which the taxpayer uses dollar-value LIFO).

(3) *Limitation on index period.* A taxpayer electing to use a representative month under paragraph (e)(3)(iii)(B)(3) of this section must use an appropriate month, rather than the representative month, to determine the index period in the circumstances described in this paragraph (e)(3)(iii)(D)(3) and other similar circumstances. For example, if the first taxable year in which the taxpayer uses the IPIC method is also the first taxable year in which the taxpayer uses the dollar-value LIFO method, the index period is the period between the month immediately preceding the first day of the taxable year and an appropriate month for that taxable year. Likewise, in the case of a short taxable year, the index period ordinarily is the period between the base month (double-extension IPIC method) or the appropriate or representative month used for the preceding taxable year (link-chain IPIC method) and the appropriate month for the short

taxable year. Similarly, if a taxpayer using the link-chain IPIC method is granted consent to change its method of determining the current-year cost of a dollar-value pool and its representative month, the index period is the period between the old representative month used for the preceding taxable year and the new representative month for the year of change.

(E) *Computation of a pool index—(1) Weighted average pool index.* To compute an inventory price index for a dollar-value pool, a taxpayer must compute a weighted average pool index. A weighted average pool index is a weighted harmonic mean of the appropriate indexes (determined under paragraph (e)(3)(iii)(D) of this section) for each selected index category represented in the taxpayer's ending inventory. The formula for computing a weighted harmonic mean is: Sum of weights / Sum of (Weight / Appropriate Index). The costs to be used in computing a weighted harmonic mean are the relative amount of current-year costs (or, in the case of a retailer using the retail inventory method, the relative retail selling prices) in each index category represented in the ending inventory of the pool.

(2) *Double-extension IPIC method.* Under the double-extension IPIC method, an inventory price index computed for each pool is 1.0 plus a stated percentage of the increase since the base date in the weighted average pool index determined under paragraph (e)(3)(iii)(E)(1) of this section. In the case of an eligible small business as defined in section 474, the stated percentage is 100%. In the case of all other taxpayers, the stated percentage is 80%. Thus, the inventory price index for an eligible small business is equal to the weighted average pool index determined under paragraph (e)(3)(iii)(E)(1) of this section. The inventory price index for all other taxpayers is computed using the following formula:  $1 + [0.8 * (\text{weighted average pool index} - 1)]$ .

(3) *Link-chain IPIC method.* Under the link-chain IPIC method, an inventory price index for each pool is 1.0 plus a stated percentage of the increase since the base date in a cumulative index. In the

case of an eligible small business as defined in section 474, the stated percentage is 100%. In the case of all other taxpayers, the stated percentage is 80%. The cumulative index for each taxable year is the product of the weighted average pool index determined under paragraph (e)(3)(iii)(E)(1) of this section multiplied by the cumulative index for the immediately preceding taxable year. The cumulative index for the taxable year is computed using the following formula: (weighted average pool index \* preceding year's Cumulative Index). The inventory price index for a taxable year of an eligible small business is equal to the cumulative index for the taxable year. The inventory price index for a taxable year of all other taxpayers is computed using the following formula:  $1 + [0.8 * (\text{Cumulative Index for the taxable year} - 1)]$ .

(F) *Examples.* The following examples illustrate the rules of this paragraph (e)(3)(iii):

*Example 1. Double-extension Method.* (i) *Introduction.* R is a retail furniture merchant with more than \$5,000,000 in average annual gross receipts for all relevant years. For the taxable year ending December 31, 1996, R used the first-in, first-out method of identifying inventory and valued its inventory at cost. R's inventory on December 31, 1996, had a cost of \$850,000.00. R elected to use the dollar-value LIFO and double-extension IPIC methods for its taxable year ending December 31, 1997. R determines the current-year cost of inventory items by reference to the actual cost of the goods most recently purchased. R elected to pool its inventory in accordance with the special IPIC pooling rules of paragraph (b)(4) of this section. R does not use the retail inventory method. All of R's inventory items fall within the 2-digit commodity code in Table 6 (Producer price indexes for commodity groups, subgroups, product classes, and individual items) of the "PPI Detailed Report" for "furniture and household durables." Therefore, R will maintain a single inventory pool.

(ii) *Select a BLS table and appropriate month for the 1997 taxable year.* R determines that the appropriate month for the taxable year ending December 31, 1997, is October. Because R is a retailer not using the retail inventory method, R must select indexes from the "PPI Detailed Report." The indexes in Table 6 of the "PPI Detailed Report" are appropriate for R's inventory.

(iii) *Select index categories for the 1997 taxable year.* R's inventory items can be classified into five detailed categories listed in Table 6 of the "PPI Detailed Report" published for October, 1997. The categories and current-year cost of items in those categories can be summarized as follows:

<i>Commodity Code</i>	<i>Category</i>	<i>Current-Year Cost</i>
12120101	Living Room Table	\$111,924.00
12120211	Dining Room Table	\$159,578.00
12120216	Dining Room Chairs	\$ 98,639.00
12130101	Upholstered Sofas	\$332,488.00
12130111	Upholstered Chairs	<u>\$218,751.00</u>
		<u>\$921,380.00</u>

(iv) *Compute appropriate indexes for the 1997 taxable year.* Because R elected to use the double-extension IPIC method, R will compute appropriate

indexes in accordance with paragraph (e)(3)(iii)(D)(I) of this section (published cumulative index for October, 1997 divided by published

cumulative index for December, 1996). R computes the appropriate indexes as follows:

<i>Category</i>	<i>Oct. '97 Index</i>	<i>Dec. '96 Index</i>	<i>Appropriate Index</i>
Living Room Table	172.4	169.2	1.018913
Dining Room Table	171.9	168.1	1.022606
Dining Room Chairs	172.8	169.7	1.018268
Upholstered Sofas	142.2	140.9	1.009226
Upholstered Chairs	134.1	132.5	1.012075

(v) *Compute a weighted average pool index for the 1997 taxable year.* R must first compute a weighted

average pool index using the formula set forth in paragraph (e)(3)(iii)(E)(I) of this section (Sum of weights /

Sum of [Weight / Appropriate Index]). The weighted average pool index is computed as follows:

<i>Category</i>	<i>Weight</i>	<i>Appropriate Index</i>	<i>Quotient</i>
Living Room Table	\$111,924.00	1.018913	\$109,846.47
Dining Room Table	159,578.00	1.022606	156,050.33
Dining Room Chairs	98,639.00	1.018268	96,869.39
Upholstered Sofas	332,488.00	1.009226	329,448.51
Upholstered Chairs	<u>218,751.00</u>	1.012075	<u>216,141.10</u>
Total	<u>\$921,380.00</u>		<u>\$908,355.80</u>
<i>Sum of Weights</i>	\$921,380.00	<i>Sum of (Weight/Appropriate Index)</i>	<i>Weighted Average Pool Index</i>
		\$908,355.80	1.0143382

(vi) *Compute an inventory price index for the 1997 taxable year.* R computes an inventory price index for the pool using the formula set forth in paragraph (e)(3)(iii)(E)(2) of this section. The inventory price index is 1.0114710 (1 + [0.8 \* (1.0143382 - 1)]).

year cost and determines that the amount of the layer of increment for the taxable year in terms of base-year cost is \$60,930.71 (\$910,930.71 - \$850,000.00). R multiplies the base-year cost of the increment by the inventory price index computed for the taxable year and determines that the LIFO value of the increment is \$61,629.65 (\$60,930.71 \* 1.011471). Thus, the LIFO value of R's inventory at the end of the 1997 taxable year is \$911,629.65 (\$850,000 opening inventory + \$61,629.65 increment).

under the double-extension IPIC method to determine the LIFO value of its dollar-value pool. R determines that the appropriate month for the taxable year ending December 31, 1998, is November.

(vii) *Determine the LIFO value of the pool for the 1997 taxable year.* R determines the total base-year cost of its ending inventory by dividing the total current-year cost of the inventory items in the pool by the inventory price index. The total base-year cost of R's ending inventory is \$910,930.71 (\$921,380 / 1.011471). R compares the ending inventory at base-year cost to the beginning inventory at base-

(viii) *Select a BLS table and appropriate month for the 1998 taxable year.* For the 1998 taxable year, R must compute a new inventory price index

(ix) *Select index categories for the 1998 taxable year.* The inventory items contained in R's ending inventory can be classified into five detailed categories listed in Table 6 of the "PPI Detailed Report" published for November, 1998. The categories and current-year cost of items in those categories can be summarized as follows:

<i>Commodity Code</i>	<i>Category</i>	<i>Current-Year Cost</i>
12120103	Living Room Desks	\$125,008.00
12120211	Dining Room Table	\$136,216.00
12120216	Dining Room Chairs	\$113,569.00
12130101	Upholstered Sofas	\$343,900.00
12130111	Upholstered Chairs	<u>\$233,050.00</u>
		<u>\$951,743.00</u>

(x) *Compute appropriate indexes for the 1998 taxable year.* Because R uses the double-extension IPIC method, R will compute an appropriate index

in accordance with paragraph (e)(3)(iii)(D)(1) of this section (published cumulative index for November, 1998 divided by published cumulative index for

December, 1996). R computes the appropriate indexes as follows:

Category	Nov. '98 Index	Dec. '96 Index	Appropriate Index
Living Room Desks	172.6	160.3	1.076731
Dining Room Table	174.8	168.1	1.039857
Dining Room Chairs	177.0	169.7	1.043017
Upholstered Sofas	144.9	140.9	1.028389
Upholstered Chairs	136.6	132.5	1.030943

(xi) Compute a pool index for the 1998 taxable year. R must first compute a weighted average pool

index using the formula set forth in paragraph (e)(3)(iii)(E)(I) of this section (Sum of weights / (Sum

of [Weight / Appropriate Index])). The weighted average pool index is computed as follows:

Category	Weight	Appropriate Index	Quotient
Living Room Desks	\$125,008.00	1.076731	\$116,099.56
Dining Room Table	136,216.00	1.039857	130,994.93
Dining Room Chairs	113,569.00	1.043017	108,885.09
Upholstered Sofas	343,900.00	1.028389	334,406.53
Upholstered Chairs	<u>233,050.00</u>	1.030943	<u>226,055.17</u>
Total	<u>\$951,743.00</u>		<u>\$916,441.28</u>
Sum of Weights \$951,743.00		Sum of (Weight/Appropriate Index) \$916,441.28	Weighted Average Pool Index 1.0385204

(xii) Compute an inventory price index for the 1997 taxable year. R computes the inventory price index for the pool using the formula set forth in paragraph (e)(3)(iii)(E)(2) of this section. The inventory price index is 1.0308163 (1 + [0.8 \* (1.0385204 - 1)]).

(xiii) Determine the LIFO value of the pool for the 1998 taxable year. R determines the total base-year cost of its ending inventory by dividing the total current-year cost of the inventory items in the pool by the pool index. The total base-year cost of the ending inventory is \$923,290.60 (\$951,743.00 / 1.0308163). R compares the ending inventory at base-year cost to the beginning inventory at base-year cost and determines that the amount of the layer

of increment for the taxable year in terms of base-year cost is \$12,359.89 (\$923,290.60 - \$910,930.71). R multiplies the base-year cost of the increment by the pool index computed for the taxable year and determines that the LIFO value of the increment is \$12,740.78 (\$12,359.89 \* 1.0308163). Thus, the LIFO value of R's inventory at the end of the 1997 taxable year is \$924,370.43 (\$850,000.00 base year layer + \$61,629.65 1997 layer + \$12,740.78 1998 layer).

*Example 2. Link-chain Method.* (i) *Introduction.* The facts are the same as *Example 1*, except that R uses the link-chain IPIC method. The double-extension IPIC method and the link-chain IPIC method yield the same results for the first taxable year in

which the IPIC method is used. Therefore, this example only illustrates how R would compute an inventory price index and determine the LIFO value of its dollar-value pool for the 1998 taxable year.

(ii) *Select a BLS table and appropriate month for the 1998 taxable year.* R determines that the appropriate index month for the taxable year ending December 31, 1998, is November.

(iii) *Select index categories for the 1998 taxable year.* R's inventory items can be classified into five detailed categories listed in Table 6 of the "PPI Detailed Report" published for November, 1998. The categories and current-year cost of items in those categories can be summarized as follows:

Commodity Code	Category	Current-Year Cost
12120103	Living Room Desks	\$125,008.00
12120211	Dining Room Table	\$136,216.00
12120216	Dining Room Chairs	\$113,569.00
12130101	Upholstered Sofas	\$343,900.00
12130111	Upholstered Chairs	<u>\$233,050.00</u>
		<u>\$951,743.00</u>

(iv) Compute appropriate indexes for the 1998 taxable year. Because R uses the link-chain IPIC method, R will compute an appropriate index in ac-

cordance with paragraph (e)(3)(iii)(D)(2) of this section (published cumulative index for the November, 1998 divided by published cumulative index for the

October, 1997). R computes the appropriate indexes as follows:

Category	Nov. '98 Index	Oct. '97 Index	Appropriate Index
Living Room Desks	172.6	162.0	1.065432
Dining Room Table	174.8	171.9	1.016870
Dining Room Chairs	177.0	172.8	1.024306
Upholstered Sofas	144.9	142.2	1.018987
Upholstered Chairs	136.6	134.1	1.018643

(v) Compute a pool index for the 1998 taxable year. R must first compute a weighted average pool

index using the formula set forth in paragraph (e)(3)(iii)(E)(1) of this section (Sum of weights / Sum

of [Weight / Appropriate Index])). The weighted average pool index is computed as follows:

Category	Weight	Appropriate Index	Quotient
Living Room Desks	\$125,008.00	1.065432	\$117,330.81
Dining Room Table	136,216.00	1.016870	133,956.16
Dining Room Chairs	113,569.00	1.024306	110,874.09
Upholstered Sofas	343,900.00	1.018987	337,492.04
Upholstered Chairs	<u>233,050.00</u>	1.018643	<u>228,784.77</u>
Total	<u>\$951,743.00</u>		<u>\$928,437.87</u>
<i>Sum of Weights</i> \$951,743.00		<i>Sum of (Weight/Appropriate Index)</i> \$928,437.87	<i>Weighted Average Pool Index</i> 1.0251014

(vi) *Compute an inventory price index for the 1997 taxable year.* R computes the inventory price index in accordance with paragraph (e)(3)(iii)(E)(3) of this section. R multiplies the weighted average pool index by the prior year's cumulative index to get the cumulative index for the taxable year. Because 1997 was the first year in which R used the link-chain IPIC method, the prior year's cumulative index is equal to the 1997 weighted average pool index. The cumulative index for 1998 is 1.0397995 (1.0143382 \* 1.0251014). R computes the inventory price index using the formula set forth in paragraph (e)(3)(iii)(E)(3) of this section. The inventory price index is 1.0318396 (1 + [0.80 \* (1.0397995 - 1)]).

(vii) *Determine the LIFO value of the pool for the 1998 taxable year.* R determines the total base-year cost of its ending inventory by dividing the total current-year cost of the inventory items in the pool by the inventory price index. The total base-year cost of the ending inventory is \$922,374.95 (\$951,743.00 / 1.0318396). R compares the ending inventory at base-year cost to the beginning inventory at base-year cost and determines that the amount of the layer of increment for the taxable year in terms of base-year cost is \$11,444.24 (\$922,374.95 - \$910,930.71). R multiplies the base-year cost of the increment by the pool index computed for the taxable year and determines that the LIFO value of the increment is \$11,808.62 (\$11,444.24 \* 1.0318396). Thus, the LIFO value of R's inventory at the end of the 1998 taxable year is \$923,438.27 (\$850,000 base year layer + \$61,629.65 1997 layer + \$11,808.62 1998 layer).

(iv) *Adoption or change of method—*  
**(A) Adoption or change to IPIC method.** The use of an inventory price index computed using the IPIC method is a method of accounting. A taxpayer permitted to adopt the dollar-value LIFO method without first securing the consent of the Commissioner may also adopt the IPIC method incident to that adoption without first securing the consent of the Commissioner. The IPIC method may be adopted and used only if the taxpayer indicates on a Form 970, "Application to Use LIFO Inventory Method," or in such other manner as may be acceptable to the Commissioner, a listing of each dollar-value inventory pool, the type of goods included

in each pool, the consumer or producer price index or indexes selected for each pool, whether the taxpayer will use the double-extension IPIC method or the link-chain IPIC method of computing an inventory price index, and if the taxpayer makes a one-time binding election of an appropriate representative month, the representative month. In the case of a taxpayer permitted to adopt the IPIC method without requesting the Commissioner's consent, the Form 970 shall be attached to the taxpayer's income tax return for the taxable year of that adoption. In all other cases, a taxpayer may change to the IPIC method prescribed by this paragraph only after first securing the consent of the Commissioner as provided in §1.446-1(e). In such cases, the Form 970 containing the information described above must be attached to a Form 3115, "Application for Change in Accounting Method," filed in accordance with §1.446-1(e). Taxpayers must maintain adequate books and records in order to satisfy the requirements of §1.472-2(h), including adequate books and records of the use and computations of the IPIC method. Notwithstanding the rules in paragraph (e)(1) of this section, a taxpayer that adopts or changes to the use of an inventory price index computed using the IPIC method is not required to demonstrate that the use of any other method of computing the LIFO value of a dollar-value inventory pool is impractical.

**(B) Change in selected index.** The selection of a consumer or producer price index category for a specific item to compute an appropriate index under paragraph (e)(3)(iii)(B) of this section is a method of accounting. A taxpayer desiring to change the selection of such a consumer or producer price index must secure the consent of the Commissioner as provided in §1.446-1(e).

**(C) New base year—****(1) Voluntary change—****(i) In general.** In the case of a taxpayer using a method other than the IPIC method to determine the LIFO value of a dollar-value inventory pool, any layers of inventory increments previously determined by that method and the LIFO value of those layers are retained if the taxpayer voluntarily changes to the use of the IPIC method. In the case of a taxpayer changing the selection of an index category for an inventory item, any layers of inventory increments previously determined and the LIFO value of those layers are retained. Instead of using the earliest taxable year for which the taxpayer adopted the LIFO method for any items in the pool, the year of change is used as the new base year in determining the LIFO value of the inventory pool for the year of change and later taxable years. The cumulative index as of the first day of the year of change (the base date) is 1.00. The base-year costs of layers of increment in the pool at the beginning of the year of change must be restated in terms of new base-year cost, using the year of change as the new base year, and the indexes for previously determined inventory increments must be recomputed accordingly. The new base-year cost of a pool is equal to the total current-year cost of all the items in the pool as determined pursuant to the taxpayer's established method of determining the total current-year cost of items making up the pool under paragraph (e)(2)(ii) of this section. See paragraph (f)(2) of this section for rules relating to a change to the dollar-value method from another method of pricing LIFO inventories.

**(ii) Example.** The following example illustrates the rules of this paragraph (e)(3)(iv)(C)(1):

*Example.* (i) X began using a dollar-value LIFO method other than the IPIC method in 1990 and main-

tains a single dollar-value pool. X is granted permission to change to the IPIC method, beginning with the

taxable year ending December 31, 2000. X will continue to use a single dollar-value pool under the IPIC

method. X's beginning inventory as of January 1, 2000, computed using its former method, is as follows:

	<i>Base-Year Costs</i>	<i>Index</i>	<i>LIFO Value</i>
Base layer	\$135,000	1.00	\$135,000
1991 layer	20,000	1.43	28,600
1994 layer	60,000	1.55	93,000
1995 layer	13,000	1.59	20,670
1997 layer	<u>2,000</u>	1.61	<u>3,220</u>
Totals	<u>\$230,000</u>		<u>\$280,490</u>

(ii) Under X's method of determining the current-year cost of items, the current-year cost of the beginning inventory is \$391,000. Thus, X's new base-year cost as of January 1, 2000 is \$391,000. X

allocates this new base-year cost to each LIFO layer based on the ratio of old base-year cost of the layer to the total old base-year cost of the pool. To recompute the indexes for each of its LIFO layers, X di-

vides the LIFO value of each layer by the new base-year cost attributable to the layer. The new base-year costs, recomputed indexes, and LIFO value of X's inventory are as follows:

	<i>Base-Year Costs</i>	<i>Index</i>	<i>LIFO Value</i>
Base layer	\$229,500	0.588235	\$135,000
1991 layer	34,000	0.841176	28,600
1994 layer	102,000	0.911765	93,000
1995 layer	22,100	0.935294	20,670
1997 layer	<u>3,400</u>	0.947059	<u>3,220</u>
Totals	<u>\$391,000</u>		<u>\$280,490</u>

(2) *Involuntary change—(i) In general.* If a taxpayer uses a method of accounting other than the IPIC method to determine the LIFO value of a dollar-value inventory pool and the Commissioner determines that the method does not clearly reflect income, the Commissioner may require the taxpayer to change to the IPIC method. If a taxpayer is unable to provide a sufficient basis, including information from its books and records, to compute an adjustment under section 481, and the Commissioner requires the taxpayer to change to the IPIC method, the Commissioner will require the

taxpayer to change to the double-extension IPIC method and implement the change on a cut-off basis without a new base year. Under the cut-off basis without a new base year, the Commissioner will determine the amount of any increment in terms of base-year cost for the year of change by comparing the total base-year cost of the beginning inventory under the taxpayer's method and the total base-year cost of the ending inventory under the double-extension IPIC method described in this paragraph (e)(3) and value any increment so determined using the inventory price index

computed under the double-extension IPIC method.

(ii) *Example.* The following example illustrates the rules of this paragraph (e)(3)(iv)(C)(2):

*Example.* (i) Y began using a dollar-value LIFO method other than the IPIC method in 1994 and maintains a single dollar-value pool. Under Y's method of determining the current-year cost of items, the current-year cost of Y's ending inventory for the 2000 taxable year is \$348,160. Y's beginning inventory as of January 1, 2000, computed using its method, is as follows:

	<i>Base-Year Costs</i>	<i>Index</i>	<i>LIFO Value</i>
Base layer	\$105,000	1.00	\$105,000
1995 layer	3,000	1.70	5,100
1996 layer	5,500	2.00	11,000
1997 layer	2,900	2.50	7,250
1998 layer	<u>1,400</u>	2.85	<u>3,990</u>
Totals	<u>\$117,800</u>		<u>\$132,340</u>

(ii) Upon examination, it is determined that Y's dollar-value LIFO method does not clearly reflect income. If Y is unable to provide the examining agent with a sufficient basis to compute a section 481 adjustment arising from a change to a dollar-value LIFO method that does clearly reflect income, and the examining agent chooses to change Y to the IPIC method, the change will be implemented as follows. First, the examining agent will compute an inventory price index under the double-extension IPIC method in accordance with this paragraph (e)(3). For purposes of this example, as-

sume that the inventory price index computed under the double-extension IPIC method is 1.438793. Second, the examining agent will divide the current-year cost of Y's ending inventory by the inventory price index to determine the base-year cost of Y's inventory under the double-extension IPIC method. The base-year cost is \$241,980.60 (\$348,160 / 1.438793). Third, the examining agent will compare the base-year cost of the ending inventory determined under the double-extension IPIC method to the base-year cost of the beginning inventory determined under Y's method of ac-

counting to determine the amount of any increment. The increment at base-year cost for the 2000 taxable year is \$124,180.60 (\$241,980.60 - \$117,800.00). Fourth, the examining agent will value the increment by multiplying the base-year cost of the increment by the inventory price index. The LIFO value of the increment is \$178,670.18 (\$241,980.60 \* 1.438793). Finally, the examining agent will reduce Y's cost of goods sold and increases Y's gross income for the 2000 taxable year by the increase in the LIFO value of the 2000 ending inventory, or \$178,670.18.

(v) *Effective date*—(A) *In general.* The rules of this paragraph (e)(3) and paragraphs (b)(4) and (c)(2) of this section are applicable for taxable years beginning on or after the date these regulations are published in the **Federal Register** as final regulations.

(B) *Change in method of accounting.* Any change in a taxpayer's method of accounting necessary to comply with this paragraph (e)(3) or paragraphs (b)(4) or (c)(2) of this section is a change in method of accounting to which the provisions of section 446 and the regulations thereunder apply. For the first taxable year beginning on or after the date these regulations are published in the **Federal Register** as final regulations, a taxpayer is granted the consent of the Commissioner to change its method of accounting to a method required or permitted by this paragraph (e)(3) and paragraphs (b)(4) and (c)(2) of this section. A taxpayer that wants to change its method of accounting under this paragraph (e)(3)(v) must follow the automatic consent procedures in Rev. Proc. 99-49 (1999-52 I.R.B. 725)(see §601.601(d)(2) of this chapter). However, the scope limitations in section 4.02 of Rev. Proc. 99-49 do not apply. In addition, if the taxpayer's method of accounting for its LIFO inventories is an issue under consideration at the time the application is filed with the national office, the audit protection of section 7 of Rev. Proc. 99-49 does not apply. If a taxpayer changing its method of accounting under this paragraph (e)(3)(v)(B) is under examination, before an appeals office, or before a federal court with respect to any income tax issue, the taxpayer must provide a copy of the application to the examining agent(s), appeals officer or counsel for the government, as appropriate, at the same time it files the application with the national office. A change under this paragraph (e)(3)(v)(B) must be made using a cut-off basis and new base year in accordance with paragraph (e)(3)(iv)(C)(I) of this section. Because a change under this paragraph (e)(3)(v)(B) is made on a cut-off basis, a section 481(a) adjustment is not required. However, a taxpayer changing its method of accounting under this paragraph (e)(3)(v)(B) must comply with the requirements of section 10.04(3) of the APPENDIX of Rev. Proc. 99-49 (concerning bargain purchases).

\* \* \* \* \*

(h) *Inventories received in certain non-recognition transactions*—(1) *In general.* Except as provided in paragraph (h)(3) of this section, if inventories are received in a transaction described in paragraph (h)(2) of this section, then for purposes of determining future increments and liquidations the transferee must use the year of the transfer as the base year and the current-year cost (determined under the transferor's method of accounting) of the inventories received as the new base-year cost of such inventories. Likewise, the transferee must use the current-year cost (determined under the transferee's method of accounting) of its beginning inventory, if any, as the new base-year cost of the beginning inventory for purposes of determining future increments and liquidations. The total new base-year cost of the transferee's beginning inventory is equal to the new base-year cost of the inventories received and the new base-year cost of the beginning inventory. The cumulative index as of the first day of the year in which the inventory is received (the base date) is 1.00. The base-year costs of any layers of increment in the pool, as determined after the transfer, must be restated in terms of new base-year costs and the indexes for all such layers must be restated in terms of the new base year index. See paragraph (e)(3)(iv)(C)(I) of this section for an example of this computation.

(2) *Transactions to which this paragraph (h) applies.* A transaction is described in this paragraph (h) if—

(i) The transferee determines its basis in the inventories, in whole or in part, by reference to the basis of the inventories in the hands of the transferor;

(ii) The transferor used the dollar-value LIFO method to account for the transferred inventories;

(iii) The transferee uses the dollar-value LIFO method to account for the inventories in the year of the transfer; and

(iv) The transaction is not described in section 381(a).

(3) *Anti-avoidance rule.* The rule in paragraph (h)(1) of this section will not apply to a transaction entered into with the principal purpose to avail the transferee of a method of accounting that would be unavailable to the transferor (or would be unavailable to the transferor

without securing consent from the Commissioner). In determining the principal purpose of a transfer, consideration will be given to all of the facts and circumstances. However, a transfer is deemed made with the principal purpose to avail the transferee of a method of accounting that would be unavailable to the transferor without securing consent from the Commissioner if the transferor acquired inventory in a bargain purchase within the five taxable years preceding the year of the transfer and used a dollar-value LIFO method to account for that inventory that did not treat the bargain purchase inventory and physically identical inventory acquired at market prices as separate items. Inventory is deemed acquired in a bargain purchase if the actual cost of the inventory (or, if appropriate, the allocated cost of the inventory) was less than or equal to 50 percent of the replacement cost of physically identical inventory. Inventory is not considered acquired in a bargain purchase if the actual cost of the inventory (or, if appropriate, the allocated cost of the inventory) was greater than or equal to 75 percent of the replacement cost of physically identical inventory.

(4) *Effective date.* The rules of this paragraph (h) are applicable for transfers on or after the date these regulations are published in the **Federal Register** as final regulations.

Robert E. Wenzel,  
Deputy Commissioner  
of Internal Revenue.

(Filed by the Office of the Federal Register on May 18, 2000, 8:45 a.m., and published in the issue of the Federal Register for May 19, 2000, 65 F.R. 31841)

## Partnership Options and Convertible Instruments

### Notice 2000-29

#### PURPOSE

This notice invites public comment on the federal income tax treatment of the exercise of an option to acquire a partnership interest, the exchange of convertible debt for a partnership interest, and the exchange of a preferred interest in a partnership for a common interest in that partnership.

## BACKGROUND

In a variety of situations, partnerships issue options or convertible debt that allow the holder to acquire by purchase or conversion an equity interest in an entity classified as a partnership for federal tax purposes. Partnerships also issue convertible preferred partnership interests that allow a partner to acquire a materially different interest in the partnership upon conversion. Often, these instruments are exercised or converted when the partnership interest to be received is more valuable than the sum of consideration previously transferred to the partnership plus any consideration transferred upon exercise or conversion. In addition, convertible preferred partnership interests often are converted at a time when the partnership interest to be received is more valuable than the interest being converted (disregarding the value of the conversion right). Taxpay-

ers have noted significant uncertainties as to the federal income tax consequences of using such instruments and have expressed a need for guidance.

## REQUEST FOR PUBLIC COMMENT

The Internal Revenue Service and the Treasury Department request comments on the tax consequences to the recipient of the partnership interest as well as to the partnership upon the exercise of a partnership option or conversion of a debt or preferred equity interest in that partnership.

Taxpayers may submit comments in writing to:

Internal Revenue Service  
Attn: CC:DOM:CORP:R (Notice  
2000-29, Room 5226)  
P.O. Box 7604  
Ben Franklin Station  
Washington, D.C. 20044

Alternatively, taxpayers may submit comments electronically at:

[sharon.y.horn@M1.IRSCounsel.treas.gov](mailto:sharon.y.horn@M1.IRSCounsel.treas.gov)

All comments should be received by September 15, 2000. The comments submitted will be available for public inspection and copying.

## DRAFTING INFORMATION

The principal author of this notice is Audrey W. Ellis of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice contact Ms. Ellis at (202) 622-3060 (not a toll-free call).



## Part IV. Items of General Interest

### Supplemental Information on Revenue Procedure 2000-12 for Prospective Qualified Intermediaries

#### Announcement 2000-48

AGENCY: Internal Revenue Service (IRS), Treasury

Revenue Procedure 2000-12, 2000-4 I.R.B. 387 sets forth a qualified intermediary (QI) withholding agreement that governs the withholding and information reporting obligations of certain financial institutions. This announcement provides guidance for financial institutions that are considering the qualified intermediary regime.

The QI system is a significant step forward for both taxpayers and the IRS. It does, however, represent a paradigm shift to greater self-regulation. Treasury and the IRS believe that it is appropriate to allow the greatest self-regulation under circumstances in which Treasury and the IRS have the greatest confidence that such self-regulation will be effective. In pursuit of that objective, Treasury and the IRS considered allowing QI status only for businesses operating in jurisdictions with which the United States has a bilateral tax treaty or tax information exchange agreement. In response to taxpayer comments, however, that approach was not adopted. Taxpayers requested that the QI system have the broadest scope possible, so that financial institutions can potentially act as qualified intermediaries in all jurisdictions in which they do business. In an attempt to balance these competing concerns, Treasury and the IRS intend to permit financial institutions to act as qualified intermediaries in accordance with the provisions of this announcement.

#### *QI Agreements in Countries Without KYC Rules.*

As noted above, Treasury and the IRS believe it is appropriate to permit the self-

regulation envisioned by the QI system only under circumstances in which Treasury and the IRS have confidence that such self-regulation may be effective. Because Treasury and the IRS regard know-your-customer (KYC) rules as a vital component of adequate self-regulation, the IRS generally will not extend the QI system to any country that does not have KYC rules or has unacceptable KYC rules. The IRS will, however, permit a branch of a financial institution (but not a separate juridical entity affiliated with the financial institution) located in such a country to act as a qualified intermediary if the branch is part of an entity organized in a country that has acceptable KYC rules and the entity agrees to apply its home country KYC rules to the branch. As is the case with any violations of the QI agreement by the branch, failure to obtain adequate documentation will cause the entity to be in default of its agreement and may cause the agreement to be terminated.

#### *Heightened Enforcement of QI Agreement in Specified Tax Haven and Secrecy Jurisdictions.*

Treasury and the IRS believe that self-regulation is most likely to be effective in jurisdictions that are characterized by adequate transparency and a willingness to provide tax information to the IRS. Accordingly, the IRS will apply more rigorous oversight to financial institutions or their branches in jurisdictions that are tax havens or bank secrecy jurisdictions and show an unwillingness to cooperate with the United States to reform their practices relating to transparency and the provision of tax information ("specified tax havens and secrecy jurisdictions"). It will do so, for example, by imposing increased or more rigorous audit requirements and/or stricter enforcement standards (including a more rigorous approach to defaults) on businesses operating in such jurisdictions. The IRS will begin immediately making determinations of which jurisdictions meet these criteria, but may not have

made all such determinations prior to entering into QI agreements. As such, QIs should not assume that, because they have an agreement covering a business in a particular jurisdiction, such jurisdiction will not later be identified as a specified tax haven or secrecy jurisdiction. Any enhanced audit requirements or stricter enforcement standards will, however, be imposed only on agreements entered into or renewed after identification of the jurisdiction as a specified tax haven or secrecy jurisdiction.

#### *Certification Prior to Renewal.*

As stated above, Treasury and the IRS believe that self-regulation is most likely to be effective in jurisdictions that are characterized by adequate transparency and a willingness to provide tax information to the IRS. A QI agreement generally has a duration of six calendar years. After the six year period, the agreement may be renewed upon the signatures of both the QI and the IRS. It is expected that the IRS will agree to renew a QI agreement or, in the case of new agreements that become effective on or after January 1, 2004, enter a new agreement for QIs in a particular country only if the IRS receives a certification from the Treasury Department that the country has effective rules and/or procedures for providing tax information to the United States for both civil tax administration and criminal tax enforcement purposes (including, for example, under an income tax treaty or a tax information exchange agreement), or has taken significant steps towards achieving such effective provision of information.

## Announcement of the Disbarment and Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under Section 330, Title 31 of the United States Code, the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service

matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled

agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear in the weekly Bulletin for five successive weeks or as long as it is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing before an administrative law judge, the following individuals has been disbarred from practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Kolesar, Gary	N. Patchogue, NY	CPA	October 27, 1999

## Announcement of the Consent Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Ser-

vice matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or suspended from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, en-

rolled agent or enrolled actuary, and date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Quann, Warren	Elk Grove, CA	Attorney	Indefinite from March 1, 1999
Helms, W. Richard	Western Springs, IL	Attorney	March 1, 1999 to August 31, 2002

Dillahunty, Larry L.	St. Petersburg, FL	Attorney	March 1, 1999 to February 28, 2003
Friesen, Alan	Lincoln, NE	CPA	March 8, 1999 to July 7, 2002
Cummins, Richard L.	Torrance, CA	CPA	March 20, 1999 to March 19, 2002
Potter, Thomas C.	Oneonta, NY	CPA	April 16, 1999 to October 15, 2000
Jenkins, Gordon	Idaho Falls, ID	Attorney	May 1, 1999 to October 31, 2002
Blair Jr., John D.	Charleston, WV	CPA	June 1, 1999 to May 31, 2002
Cadle, Larry	Anchorage, AK	Attorney	June 21, 1999 to December 31, 2001
Schorr, Harvey	Voorheese, NJ	CPA	July 1, 1999 to December 31, 2001
Fernandez, Michael J.	Camillus, NY	CPA	July 7, 1999 to July 6, 2000
Polking, William G.	Carol, IA	Attorney	September 27, 1999 to September 26, 2000
Luxen, Robert J.	Oak Lawn, IL	CPA	October 1, 1999 to June 30, 2001
Underwood, Kenneth	Chattanooga, TN	CPA	October 14, 1999 to April 13, 2001
Vancho, John	Greenwich, CT	CPA	November 1, 1999 to October 31, 2001
Enkulenko, Thomas	Moscow, PA	CPA	November 15, 1999 to November 14, 2000
Moody, James E.	Pittsburgh, PA	CPA	December 1, 1999 to November 30, 2000
Patterson, Robert A.	Marietta, GA	CPA	December 13, 1999 to December 12, 2002
Hanson, Raymond L.	Boise, ID	CPA	January 1, 2000 to December 31, 2001
Wallach, Steven	North Brook, IL	CPA	February 25, 2000 to February 24, 2002

Watkins Sr., Richard	Washington, MO	CPA	March 15, 2000 to September 14, 2002
Peltin, Ronald	Escanaba, MI	Enrolled Agent	March 15, 2000 to March 14, 2003
Arwood, B. Joe	Chuckey, TN	CPA	March 20, 2000 to June 19, 2001
Gazzola, Frank L.	N. Mankato, MN	CPA	May 1, 2000 to October 31, 2002
O'Hearn, James	Bakersfield, CA	Enrolled Agent	June 1, 2000 to May 31, 2002
Dooner Jr., William	Toms River, NJ	Enrolled Agent	June 1, 2000 to August 31, 2000

## Announcement of the Expedited Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under title 31 of the Code of Federal Regulations, section 10.76, the Director of Practice is authorized to immediately suspend from practice before the Internal Revenue Service any practitioner who, within five years, from the date the expedited proceeding is instituted, (1) has had a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause; or (2) has been convicted of any crime under title 26 of the United States Code or, of a felony under title 18 of the United States Code involving dishonesty or breach of trust.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are

prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by, or sharing fees with, any practitioner disbarred or suspended from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify practitioners under expedited suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled

agent, or enrolled actuary, and date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent, or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under suspension from practice before the Internal Revenue Service by virtue of the expedited proceeding provisions of the applicable regulations:

Name	Address	Designation	Date of Suspension
Moeller, David G.	Golden Valley, MN	Attorney	Indefinite from March 8, 1999
Dais, Robert E.	Plano, TX	CPA	Indefinite from March 15, 1999
Taylor, Donald J.	Sequim, WA	CPA	Indefinite from March 15, 1999
Thurson, Terrance N.	Jacksonville, FL	CPA	Indefinite from March 15, 1999

Hartman, Richard	Merrick, NY	Attorney	Indefinite from March 15, 1999
Mandel, Stewart I.	Univ. Heights, OH	Attorney	Indefinite from March 15, 1999
Gowin, Dennis L.	Falls Church, VA	CPA	Indefinite from March 15, 1999
Kelly, Richard	Lloyd Harbor, NY	Attorney	Indefinite from March 16, 1999
Nagel, Maxine M.	Renton, WA	CPA	Indefinite from March 16, 1999
Cox, James L.	Bedford, TX	CPA	Indefinite from March 23, 1999
Shields, Morris R.	Omaha, NE	CPA	Indefinite from March 23, 1999
Stradone, Mark A.	San Antonio, TX	CPA	Indefinite from March 24, 1999
Anderson, David J.	Minnetonka, MN	CPA	Indefinite from March 28, 1999
Budenz, Lawrence J.	Miamisburg, OH	CPA	Indefinite from March 28, 1999
Hogan, Kelly M.	Ogallala, NE	Attorney	Indefinite from March 28, 1999
Fernez, Daniel J.	Monroe, CT	CPA	Indefinite from March 28, 1999
Fitsos, John	Sacramento, CA	Attorney	Indefinite from March 28, 1999
Schweitzer, Clifford A.	Aberdeen, SD	CPA	Indefinite from April 2, 1999
Magdalena, Lynn Joseph	McAlester, OK	CPA	Indefinite from April 2, 1999
Parrott, George	Nashville, TN	CPA	Indefinite from April 2, 1999
Elder Jr., Wilton K.	Burlington, NC	Attorney	Indefinite from May 6, 1999
Passero, Robert	Seal Beach, CA	CPA	Indefinite from July 8, 1999

Stringham, Richard	Columbia, MO	CPA	Indefinite from July 8, 1999
Koseluk, Alexander F.	Omaha, NE	Attorney	Indefinite from July 19, 1999
Dotson, Marshall F.	Jacksonville, NC	Attorney	Indefinite from July 27, 1999
Schaffer, Clark D.	Atlantic Beach, FL	CPA	Indefinite from July 27, 1999
Zimmerman, Robert	Alpharetta, GA	CPA	Indefinite from January 17, 2000

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## Definition of Terms

*Revenue rulings and revenue procedures (hereinafter referred to as “rulings”) that have an effect on previous rulings use the following defined terms to describe the effect:*

*Amplified* describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

*Clarified* is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

*Distinguished* describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

*Modified* is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it ap-

plies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

*Obsoleted* describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

*Revoked* describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

*Superseded* describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the

new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

*Supplemented* is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

*Suspended* is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

## Abbreviations

*The following abbreviations in current use and formerly used will appear in material published in the Bulletin.*

A—Individual.  
Acq.—Acquiescence.  
B—Individual.  
BE—Beneficiary.  
BK—Bank.  
B.T.A.—Board of Tax Appeals.  
C.—Individual.  
C.B.—Cumulative Bulletin.  
CFR—Code of Federal Regulations.  
CI—City.  
COOP—Cooperative.  
Ct.D.—Court Decision.  
CY—County.  
D—Decedent.  
DC—Dummy Corporation.  
DE—Donee.  
Del. Order—Delegation Order.  
DISC—Domestic International Sales Corporation.  
DR—Donor.  
E—Estate.  
EE—Employee.

E.O.—Executive Order.  
ER—Employer.  
ERISA—Employee Retirement Income Security Act.  
EX—Executor.  
F—Fiduciary.  
FC—Foreign Country.  
FICA—Federal Insurance Contribution Act.  
FISC—Foreign International Sales Company.  
FPH—Foreign Personal Holding Company.  
F.R.—Federal Register.  
FUTA—Federal Unemployment Tax Act.  
FX—Foreign Corporation.  
G.C.M.—Chief Counsel’s Memorandum.  
GE—Grantee.  
GP—General Partner.  
GR—Grantor.  
IC—Insurance Company.  
I.R.B.—Internal Revenue Bulletin.  
LE—Lessee.  
LP—Limited Partner.  
LR—Lessor.  
M—Minor.  
Nonacq.—Nonacquiescence.  
O—Organization.  
P—Parent Corporation.

PHC—Personal Holding Company.  
PO—Possession of the U.S.  
PR—Partner.  
PRS—Partnership.  
PTE—Prohibited Transaction Exemption.  
Pub. L.—Public Law.  
REIT—Real Estate Investment Trust.  
Rev. Proc.—Revenue Procedure.  
Rev. Rul.—Revenue Ruling.  
S—Subsidiary.  
S.P.R.—Statements of Procedural Rules.  
Stat.—Statutes at Large.  
T—Target Corporation.  
T.C.—Tax Court.  
T.D.—Treasury Decision.  
TFE—Transferee.  
TFR—Transferor.  
T.I.R.—Technical Information Release.  
TP—Taxpayer.  
TR—Trust.  
TT—Trustee.  
U.S.C.—United States Code.  
X—Corporation.  
Y—Corporation.  
Z—Corporation.

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### Key to Abbreviations:

Ann	Announcement
CD	Court Decision
DO	Delegation Order
EO	Executive Order
PL	Public Law
PTE	Prohibited Transaction Exemption
RP	Revenue Procedure
RR	Revenue Ruling
SPR	Statement of Procedural Rules
TC	Tax Convention
TD	Treasury Decision
TDO	Treasury Department Order

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