

Office of Chief Counsel  
Internal Revenue Service  
**memorandum**

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to: Deborah Palacheck  
Director, Withholding and International Individual Compliance

from: John J. Sweeney  
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subject: Withholding Credits on U.S. Source Income Distributed by a Foreign Complex Trust to U.S. Beneficiaries

This memorandum responds to your request for advice concerning the creditability of tax withheld under section 1441 (a chapter 3 tax) on payments of U.S. source income to a foreign complex trust when the foreign trust distributes in the same taxable year certain amounts that were subject to withholding to one or more U.S. beneficiaries and allocates the portion of the tax withheld associated with the distribution to the U.S. beneficiary.<sup>1</sup> This memorandum also addresses the processing of a federal income tax return of a foreign complex trust that allocates credits for section 1441 withholding associated with U.S. source income distributed to a U.S. beneficiary.<sup>2</sup> This memorandum does not address how a U.S. beneficiary may substantiate a credit for section 1441 withholding associated with U.S. source income paid to the foreign trust and included on the beneficiary's federal income tax return. This advice may not be used or cited as precedent.

## ISSUES

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<sup>1</sup> This memorandum does not address the creditability of U.S. withholding taxes on an accumulated distribution (as defined in section 665(b)) from a foreign complex trust to a U.S. beneficiary.

<sup>2</sup> All section references are to the Internal Revenue Code of 1986 (Code) and the income tax regulations issued thereunder.

(1) Whether, under section 1462, a U.S. beneficiary who receives a distribution of U.S. source income from a foreign complex trust may claim a credit for taxes withheld under section 1441 on payments of this income to the foreign complex trust that are included in the trust's income for the taxable year.

(2) Whether the IRS may generally accept for return processing purposes a foreign trust's Form 1040-NR, U.S. Nonresident Alien Income Tax Return, that includes a statement reporting the U.S. source income paid, credited, or required to be distributed to a U.S. beneficiary and a credit for the section 1441 withholding that is reported as associated with this income.

## CONCLUSIONS

(1) Under section 1462, a U.S. beneficiary of a foreign complex trust may claim a credit for taxes withheld under section 1441 on payments of U.S. source income to the foreign complex trust and included in the trust's income for the year of payment provided that the foreign trust distributes all or a portion of the income to the U.S. beneficiary during the taxable year, properly allocates the withholding associated with the distribution to the U.S. beneficiary, and does not itself claim a credit or refund with respect to the section 1441 withholding allocated to the beneficiary. Additionally, the U.S. beneficiary must include on its federal income tax return the amount of income required to be reported under section 1462 that is associated with the distribution and the amount of credit properly allocable to the income reportable from the distribution. The U.S. beneficiary must also substantiate entitlement to the credit for the withholding.<sup>3</sup>

(2) Further, the IRS may generally accept for return processing purposes a foreign trust's Form 1040-NR, U.S. Nonresident Alien Income Tax Return, that includes a statement reporting the foreign trust's U.S. source income that is paid, credited or required to be distributed to a U.S. beneficiary and the amount of credits for section 1441 withholding that are associated with such income.

## FACTS

The following facts are limited to address the specific issues for which you have requested advice.

FT is a foreign complex trust subject to subpart C, part I, subchapter J, chapter 1 of the Code that is not a resident of a country with which the United States has an income tax treaty in effect. It operates on a calendar year basis. Distributions to beneficiaries of FT are at the discretion of its trustee. FT's beneficiaries are C, an individual who is a U.S. citizen, and a number of nonresident alien individuals.

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<sup>3</sup> As discussed above, this memorandum does not address how a U.S. beneficiary may substantiate a credit for section 1441 withholding.

FT receives U.S. source dividends from DC, a domestic corporation, during the taxable year. DC withholds at the rate of 30-percent on the dividends paid to FT during the calendar year in accordance with section 1441 and Treas. Reg. § 1.1441-5(e)(2) and (4). DC reports the U.S. source dividends paid to FT, and the withholding, on Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, on which FT is identified as the recipient of the income. Treas. Reg. § 1.1461-1(c)(1).

FT has no capital gains and no other income for the year. FT's taxable income is composed entirely of the U.S. source dividend income. FT distributes to C the dividends it received from DC. FT makes no other distributions during the taxable year to any of its beneficiaries. For the taxable year, FT files a Form 1040-NR (with the "Estate or Trust" box checked) reporting the gross amount of the dividend income in accordance with §1.1462-1(a). Because the gross amount of the trust's income is distributed with respect to C, the trust has no taxable income. See section 661(a). FT reports the distribution of U.S. source dividend income to C, and the amount of taxes withheld under section 1441 withholding associated with such income and allocated to C. In addition, FT issues a Foreign Nongrantor Trust Beneficiary Statement to C reporting the allocation of U.S. source dividend income.

C files a federal income tax return on which C includes the U.S. source dividend income paid to FT and a claim for credit for the section 1441 withholding that is associated with such income.

## LAW AND ANALYSIS

### Credit for Withholding

Section 1462 provides that income on which any tax is required to be withheld at source under chapter 3 (sections 1441 through 1464) shall be included in the return of the recipient of the income, and any amount of tax withheld shall be credited against the amount of income tax computed on such return. Section 1.1462-1(a) directs

that the entire amount of income from which tax is required to be withheld shall be included in gross income in the return required to be made by the beneficial owner of the income, without deduction for the amount required to be or actually withheld, but the amount of the tax actually withheld shall be allowed as a credit against the total income tax computed in the beneficial owner's return.

Section 1.1462-1(b) addresses credits for amounts paid to persons who are not the beneficial owner. Section 1.1462-1(b) provides that

Amounts withheld at source under chapter 3 [of the Code] on payments to (or effectively connected income allocable to) a fiduciary, partnership, or intermediary are deemed to have been paid by the taxpayer ultimately liable for the tax upon such income...If a beneficiary of a trust is subject to the taxes imposed by section 1, 2, 3, or 11 upon any portion of the income

received from a foreign trust, the part of any amount withheld at source which *is properly allocable to the income so taxed to such beneficiary* shall be credited against the amount of income tax computed upon the beneficiary's return, and any excess shall be refunded. (*Emphasis added*).

#### Withholding Credit Allocations to FT's U.S. Beneficiary, C

Tax imposed on a payment described in section 871(a) made to a foreign person that is the beneficial owner of the payment is required to be collected by a withholding agent under sections 1441(a) and (b). A withholding agent is required to treat a foreign complex trust as a foreign person and the beneficial owner of amounts paid to it regardless of whether the foreign trust is ultimately taxable on the payments made to it. See Treas. Reg. §§ 1.1441-1(c)(6)(ii)(D) and 1.1441-5(e)(2). Although FT is treated as the beneficial owner with respect to DC's U.S. source dividend payment to FT for withholding purposes, sections 661, 662, and 1462 govern whether, and to what extent, C is taxable on FT's U.S. source dividend income.

Section 661(a) provides, in part, that a complex trust is entitled to a deduction in computing taxable income in any taxable year equal to the sum of (1) amounts required to be distributed currently; and (2) any other amounts properly paid or credited or required to be distributed for such taxable year, but such deduction shall not exceed the distributable net income of the foreign complex trust.

Section 662(a) provides, in general, that the beneficiaries of the complex trust must include in gross income amounts properly paid, credited, or required to be distributed to them, but such inclusions shall not exceed the distributable net income of the foreign complex trust. Section 662(b) provides, in general, that the amounts determined under section 662(a) shall have the same character in the hands of the beneficiary as in the hands of the trust.

As assumed herein, C reports the U.S. source dividend income paid to FT on its federal income tax return consistently with sections 662 and 1462. Because C is ultimately liable to the taxes imposed under section 1 on FT's U.S. source dividend income, the section 1441 withholding that is properly allocable to such income shall be creditable against the amount of income tax computed on C's federal tax return, and any excess shall be refunded. Treas. Reg. §1.1462-1(b).<sup>4</sup>

As a result of the above analysis, the IRS may generally accept for return processing purposes FT's Form 1040-NR that includes a statement reporting U.S. source income that is paid, credited or required to be distributed to C, a U.S. beneficiary

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<sup>4</sup> For example, if based on the facts of this memorandum FT received \$100x of U.S source dividends subject to 30% withholding by DC and distributed the \$70X of cash remaining after the withholding, C would be required to report \$100X of income and may claim credit for the \$30x of withholding against its income tax liability for the year.

of FT, and that allocates a credit for the section 1441 withholding that is associated with such income to C. Provided that FT properly allocates a credit for section 1441 withholding that is associated with U.S. source income that is paid, credited or required to be distributed to C, FT itself may not also claim a credit or refund with respect to the section 1441 withholding allocated to C.<sup>5</sup>

[REDACTED]

Please call Charles Rioux at (202) 317-4992 if you have any further questions.

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<sup>5</sup> This conclusion does not affect the rules applicable to domestic trusts and estates under sections 643(d) and 643(g), respectively, concerning the allocation of credits for backup withholding and payments of estimated taxes between the trust or estate and its beneficiaries. See the analysis in CCA 200644018.