DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–208280–86; REG–136311–01]

RIN 1545–AJ57; RIN 1545–BA07

Exclusions From Gross Income of Foreign Corporations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of previously proposed rules; notice of proposed rulemaking; and notice of public hearing.

SUMMARY: This document contains new proposed rules implementing the portions of sections 883(a) and (c) of the Internal Revenue Code of 1986, as amended, that relate to the exclusion from gross income available to corporations organized in foreign countries that grant equivalent exemptions to corporations organized in the United States for income derived from the international operation of ships or aircraft. This document also provides notice of a public hearing on the proposed rules and withdraws the notice of proposed rulemaking (REG–208280–86) (65 FR 6065) published on February 8, 2000.

DATES: Written or electronic comments, requests to speak, and outlines of topics to be discussed at the public hearing scheduled for November 12, 2002, at 10 a.m. must be received by October 22, 2002. The proposed amendment to 26 CFR part 1 published on February 8, 2000 (65 FR 6065) is withdrawn as of August 2, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU (REG–136311–01), 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:ITA:RU (REG–136311–01), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, comments may be transmitted electronically via the Internet by submitting comments directly to the IRS Internet site at: *http://www.irs.gov/regs*. 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 rules, Patricia A. Bray, (202) 622–3880; concerning submissions, 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:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection 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 IRS, Attn: IRS Reports Clearance Officer, W:CAR:MP:FP:S Washington, DC 20224. Comments on the collection of information should be received by October 1, 2002. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collection of information in this proposed regulation is in §§ 1.883–1, 1.883–2, 1.883–3. 1.883–4 and 1.883–5. The information required in these sections will enable a foreign corporation to determine if it is eligible to exclude its income from the international operation of a ship or ships or aircraft from gross income on its U.S. Federal income tax return. The information required in these sections will also enable the IRS to monitor compliance with the provisions of the proposed regulations with respect to the stock ownership requirements of § 1.883–1(c)(2), and to make a preliminary determination of whether the foreign corporation is eligible to claim such an exemption and is accurately reporting income as required under section 6012.

The collection of information and responses to these collections of information are mandatory. The likely respondents are foreign corporations engaged in the international operation of a ship or ships or aircraft that wish to claim an exemption from U.S. tax under section 883, and certain of their shareholders owning (directly or indirectly) a majority of the value of the shares of such corporations.

Estimated total annual reporting/recordkeeping burden on corporations: 1400 hours.

The estimated annual burden per respondent varies from 30 minutes to eight hours, depending on the circumstances of the foreign corporation, with an estimated average of one hour.

Estimated number of respondents: 1400.

Estimated annual frequency of responses: Once.

Estimated total annual reporting/recordkeeping burden on shareholders: 22,500 hours.

The estimated annual burden per respondent varies from zero minutes to eight hours, depending on the circumstances of the shareholder or intermediary, with an estimated average of 90 minutes.

Estimated number of respondents: 15,000.

Estimated annual frequency of responses: Zero if the shareholder falls within a special rule that permits the foreign corporation to use the address of record in the shareholder records.

Once every three years if there is no change in reported shareholder information.

Annually in years in which a change of information occurs.

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 and Explanation of Provisions

I. Overview

On February 8, 2000, the IRS and Treasury published a notice of proposed rulemaking (REG–208280–86) in the **Federal Register** (65 FR 6065) under sections 883(a) and (c) (the 2000 proposed regulations). The 2000 proposed regulations, in accordance

with section 883(a) and (c), generally provide that a foreign corporation organized in a qualified foreign country and engaged in the international operation of ships or aircraft shall exclude from its gross income for purposes of United States Federal income taxation qualified income it derives from its international operation of ships or aircraft, provided that the corporation satisfies certain ownership and related documentation and filing requirements. The 2000 proposed regulations explain how to determine whether a foreign country is a qualified foreign country, what income is considered qualified income, and what activities constitute international operation of ships or aircraft. They also specify how a foreign corporation satisfies the ownership and related documentation requirements.

The IRS and Treasury held a public hearing regarding the 2000 proposed regulations on June 8, 2000, and received numerous comments in connection with the hearing and otherwise. In consideration of the substantial number of comments received, and due to the significant impact the regulations have on large segments of the shipping and air transport industries, the IRS and Treasury believe it is appropriate to repropose the regulations in order to address those comments and to provide a further opportunity for comment both on the changes and more generally. Accordingly, this document withdraws the 2000 proposed regulations and provides new proposed regulations, which are referred to herein as the reproposed regulations.

Part II of this preamble discusses the principal differences between the 2000 proposed regulations and the reproposed regulations and the reasons changes have been made. Part II.A provides background. Part II.B addresses comments on the 2000 proposed regulations relating to § 1.883–1 (the general requirements for the exclusion). Part II.C addresses comments relating to § 1.883–2 (the publicly traded test). Part II.D addresses comments relating to § 1.883–3 (the CFC stock ownership test). Part II.E addresses comments relating to § 1.883–4 (the qualified shareholder stock ownership test). Finally, Part II.F addresses comments relating to § 1.883–5 (the effective date of the 2000 proposed regulations).

This preamble addresses each of the five sections of the reproposed regulations in order. Within each section, the preamble discusses first the most significant differences between the 2000 proposed regulations and the reproposed regulations, including: (1) The qualification of participation in a pool, partnership, strategic alliance, joint operating agreement, code-sharing arrangement or other joint venture as operation of ships or aircraft (*see* § 1.883–1(e)(1) and (2) and Part II.B.1 of this preamble); (2) the qualification of certain lightering activity as international operation of ships (*see* § 1.883–1(f)(2)(ii) and Part II.B.2 of this preamble); (3) the treatment of certain income attributable to the inland leg following the international carriage of passengers or cargo (*see* § 1.883–1(g)(1)(v) and (vi) and (g)(2)(vi) and Part II.B.2 of this preamble); (4) the treatment of income from certain container usage in the United States (*see* § 1.883–1(g)(1)(x) and (g)(2)(viii) and Part II.B.3 of this preamble)); and (5) the revision of certain aspects of the closely-held test for qualification of a foreign corporation as a publicly traded corporation (*see* § 1.883–2(d)(3) and Part II.C.2 of this preamble).

II. Section 883(a) and (c): Exclusions From Gross Income of Foreign Corporations

A. Background

The reproposed regulations provide (as do the 2000 proposed regulations) that, in general, qualified income derived by a qualified foreign corporation from its international operation of ships or aircraft is excluded from gross income and exempt from United States Federal income tax. Section 1.883–1 of both the 2000 proposed regulations and the reproposed regulations provide general operational rules and definitions to determine whether a foreign corporation is entitled to this exclusion and exemption, which are elaborated on in §§ 1.883–2 through 1.883–4. The preamble to the 2000 proposed regulations contains a detailed explanation of the provisions in the 2000 proposed regulations. That explanation is not repeated herein. Comments the IRS received on the 2000 proposed regulations and the consequent changes reflected in the reproposed regulations are described herein.

B. Comments Relating to § 1.883–1: Exclusions of Income From the International Operation of Ships or Aircraft

Section 1.883–1 of the 2000 proposed regulations provides, in accordance with section 883, that income derived from the international operation of ships or aircraft by a foreign corporation organized in a foreign country that grants a reciprocal exemption to U.S. corporations shall be exempt from U.S. Federal income tax. In response to comments the IRS received concerning the 2000 proposed regulations, the reproposed regulations modify the rules of the 2000 proposed regulations regarding the definition of *international operation of ships and aircraft* and the scope of income considered derived from such operation.

1. *Operation of ships or aircraft.* Section 1.883–1(e) of the 2000 proposed regulations provides generally that the term *operation of ships or aircraft* includes carriage of passengers or cargo for hire; time or voyage charter (full charter) of a ship, or wet lease of an aircraft; and bareboat charter of a ship, or dry lease of an aircraft. The 2000 proposed regulations also include within the term the active participation by a foreign corporation that is otherwise engaged in the operation of ships or aircraft in a pool, partnership, strategic alliance, joint operating agreement, code-sharing arrangements or other joint venture, that is itself engaged in the operation of ships or aircraft.

i. *Investment in a pool, partnership, strategic alliance, joint operating agreement, code-sharing arrangement or other joint venture.* Commentators suggested modifying the definition of *operation of ships or aircraft* to permit an investor in a pool, partnership, strategic alliance, joint operating agreement, code-sharing arrangement or other joint venture that is itself engaged in the operation of ships or aircraft to be treated as engaged in the operation of ships or aircraft, whether or not the investor is itself so engaged and whether or not its participation is active.

This suggestion has been generally adopted in the reproposed regulations, with modifications. Under § 1.883–1(e)(2) of the reproposed regulations, a foreign corporation is considered engaged in the operation of ships or aircraft with respect to its participation in a pool, partnership, strategic alliance, joint operating agreement, code-sharing arrangement or other joint venture, provided that such arrangement is a fiscally transparent entity under the income tax laws of the United States and that it would be considered engaged in the operation of ships or aircraft if it were a foreign corporation. Alternatively, if the pool, strategic alliance, joint operating agreement, code-sharing arrangement or other joint venture does not rise to the level of a partnership or other entity under the income tax laws of the United States (*e.g.*, it is a contractual arrangement only that involves the carriage of cargo or passengers for hire), a foreign

corporation that participates in such a pool, strategic alliance, joint operating agreement, code-sharing arrangement or other joint venture will be considered engaged in the operation of ships or aircraft only if the foreign corporation is otherwise engaged in the operation of ships or aircraft under paragraph (e)(1). Thus, through participation in a fiscally transparent entity, a foreign corporation may be considered engaged in the operation of ships or aircraft even if it is not itself otherwise engaged in the operation of ships or aircraft. However, through participation in a contractual arrangement that is not a fiscally transparent entity, a foreign corporation may only be considered engaged in the operation of ships or aircraft with respect to activities under such contractual arrangement only if the foreign corporation is otherwise engaged in the operation of ships or aircraft.

Section 1.883–1(e)(5)(iv) and (v) defines for these purposes the terms *entity* and *fiscally transparent entity under the income tax laws of the United States* respectively. In general, an entity is fiscally transparent under the income tax laws of the United States with respect to a category of income if the entity would be considered fiscally transparent under the income tax laws of the United States for purposes of § 1.894–1 with respect to an item of income within that category of income.

In the case of a foreign corporation that is considered engaged in the operation of ships or aircraft with respect to its participation in certain fiscally transparent entities, § 1.883–1(h)(3)(ii) provides an exception to the general rule that a foreign country that provides an exemption only through an income tax convention with the United States will not be considered to grant an equivalent exemption for purposes of section 883. Under the reproposed regulations, a foreign corporation will be treated as organized in a foreign country that grants an equivalent exemption for purposes of section 883 with respect to a category of income derived by or pursuant to a pool, partnership, strategic alliance, joint operating agreement, code-sharing arrangement or other joint venture, but only if treaty benefits are denied to the foreign corporation solely because the foreign corporate interest holder's jurisdiction (*i.e.*, the treaty-partner jurisdiction) views the pool, partnership, strategic alliance, joint operating agreement, code-sharing arrangement or other joint venture as not fiscally transparent.

ii. *Space or slot charters.* Commentators also suggested modifying the definition *operation of ships or aircraft* to include space or slot chartering, which involves the leasing out of a certain amount of space (but less than all of the space) on a ship or aircraft. In the context of passenger aircraft, such a charter may be referred to as a block seat sale or charter. In response to these comments and to clarify the concept of what it means for a foreign corporation to be engaged in the operation of ships or aircraft, the rules of the 2000 proposed regulations have been revised.

Section 1.883–1(e)(1) of the reproposed regulations provides generally that a foreign corporation is considered engaged in the operation of ships or aircraft only during the time it is an owner or lessee of an entire ship or aircraft and the foreign corporation (1) uses that ship or aircraft to carry passengers or cargo for hire; or (2) either (a) leases out the ship under a time or voyage charter (full charter), space or slot charter, or bareboat charter to a lessee or sublessee, provided the ship is used to carry passengers or cargo for hire; or (b) leases out the aircraft under a wet lease (full charter), space, slot, or block-seat charter, or dry lease to a lessee or sublessee, provided the aircraft is used to carry passengers or cargo for hire. In addition, § 1.883–1(g)(1)(ix) clarifies that a foreign corporation that is engaged in the international operation of ships or aircraft within the meaning of § 1.883–1(e) may derive income that is incidental to the operation ships or aircraft by arranging by means of a space or slot charter for the carriage of cargo listed on a bill of lading or airway bill issued by the foreign corporation on the ship or aircraft of another corporation engaged in the international operation of ships or aircraft.

Thus, the reproposed regulations generally adopt the commentators' recommendations regarding space or slot chartering. A foreign corporation that has an ownership interest in an entire ship or an aircraft will be considered engaged in the operation of ships or aircraft if it space or slot charters the ship or block-seat charters the aircraft to another corporation that uses the ship or aircraft to carry passengers or cargo for hire.

iii. *Non-vessel operating common carriers.* The 2000 proposed regulations do not include within the list of activities constituting the operation of ships or aircraft the activities of a non-vessel operating common carrier (an NVOCC). Commentators suggested that NVOCCs should be treated as engaged in the operation of ships because they are common carriers that issue bills of lading and have liability for the goods shipped under that bill of lading just as an ocean common carrier.

The reproposed regulations do not adopt this suggestion. An NVOCC is not engaged in the operation of ships within the meaning of § 1.883–1(e) because it does not own an entire ship or use it in one of the listed activities in § 1.883–1(e)(1). Section 883 does not apply simply because a corporation is a common carrier. Therefore, the activities of an NVOCC continue to be included on the § 1.883–1(e)(3) list of activities that do not constitute the operation of ships or aircraft.

2. *International operation of ships or aircraft.* i. *General definition.* Section 1.883–1(f) of the 2000 proposed regulations distinguishes the international operation of ships or aircraft from the domestic operation of ships or aircraft based largely upon the amendments made to section 863(c)(1) and (2) by the Technical and Miscellaneous Revenue Act of 1988 (TAMRA). In the legislative history to TAMRA, Congress directed that transportation income derived solely from sources within the United States (section 863(c)(1) income) should not be exempt from U.S. income tax under section 883. Congress further provided that transportation income derived 50 percent from sources within the United States (section 863(c)(2) income) should be eligible for exemption from U.S. income tax under section 883. See S. Rep. No. 100–445, 100th Cong., 2d Sess. 241–242 (1988).

Section 863(c)(1) income is defined as income attributable to transportation that begins and ends in the United States. Section 863(c)(2) income is defined as income attributable to transportation that begins or ends in the United States, and that is not section 863(c)(1) income. The 2000 proposed regulations adopt this distinction between section 863(c)(1) income and section 863(c)(2) income in defining the term *international operation* to mean the operation of ships or aircraft on voyages or flights that begin or end in the United States and correspondingly end or begin in a foreign country.

Commentators objected to this definition. Several argued that the term *international operation* should be defined coextensively with the term *international transport,* as used in Article 8 of the OECD Model Income Tax Convention and in the 1996 United States Model Income Tax Convention.

Nevertheless, the IRS and Treasury believe that Congress meant the definition of *international operation* to correspond with the definition of section 863(c)(2) income. Section 863(c)(2) does not apply to

transportation that begins and ends in the United States; it applies to transportation that begins or ends in the United States. Therefore, the reproposed regulations do not modify the definition of *international operation of ships or aircraft* to include transportation that begins and ends in the United States (such as the U.S. inland legs following international transport, discussed immediately below). The IRS and Treasury believe this interpretation to be consistent with the intent of Congress.

ii. *Inland leg of transportation.* The 2000 proposed regulations generally do not include within the definition of international operation the inland leg of transportation of passengers or cargo before or after an intermediate stop in the United States.

Commentators criticized the exclusion of the inland leg in the 2000 proposed regulations as inconsistent with long-standing industry practice and other provisions of domestic law, such as the Shipping Act of 1984, Public Law 98–237, 2 (97 Stat. 67) (March 20, 1984), as amended, Public Law 105–258, Title 1, 101 (112 Stat. 1902) (Oct. 14, 1998), which considers certain inland transportation to form a part of international service. Commentators also suggested that the 2000 proposed regulations contradicted the established U.S. transportation policy of promoting intermodal transportation (*i.e.,* transportation by more than one form of carrier during a single journey).

After reviewing these comments, the IRS and Treasury have determined not to change the definition of international operation of ships or aircraft in the reproposed regulations. As explained above, in Part II.B.2.i, the language of section 883 and the legislative history of TAMRA, in the view of IRS and Treasury, do not permit the inland leg of transportation to be considered international operation of ships or aircraft. In recognition of the need to promote efficient international transportation, however, the IRS and Treasury have amended the rules of the 2000 proposed regulations to include income with respect to certain inland transportation as income from an activity incidental to the international operation of ships or aircraft, and thus eligible for exemption. *See* Part II.B.3, below.

iii. *Cruises to nowhere.* The 2000 proposed regulations generally include within the definition of international operation a round trip cruise that begins in the United States, stops at a foreign port, and returns to the same or another US port. Because the 2000 proposed regulations require a stop at a foreign intermediate port, the 2000 proposed regulations effectively exclude from the definition of international operation of ships or aircraft a ''cruise to nowhere'' (*i.e.,* a cruise that begins and ends in the United States without stopping at a foreign port).

Several commentators criticized the exclusion of cruises to nowhere. The reproposed regulations, however, do not treat a cruise to nowhere as international operation of ships or aircraft. Although a cruise to nowhere travels beyond the U.S. territorial limits, its passengers may embark and disembark only in the United States. A cruise to nowhere begins and ends its voyage in the United States, within the meaning of section 863(c)(1), with respect to its passengers and thus should not constitute international operation of ships or aircraft.

iv. Lightering. The 2000 proposed regulations exclude from the definition of international operation the activities of a lighter vessel that carries cargo to, or picks up cargo from, a vessel located beyond the territorial limits of the United States, and correspondingly loads or unloads that cargo at a U.S. port.

Commentators recommended that lighter vessels that service host vessels engaged in international operation should be considered engaged in international operation. Commentators relied for support on § 1.954–6(b)(3)(iv), which treats a lighter vessel that services a host vessel used in foreign commerce as also used in foreign commerce for purposes of determining foreign base company shipping income.

While the IRS and Treasury did not adopt the commentators' approach, the reproposed regulations, unlike the 2000 proposed regulations, do not require that a ship be operated on voyages that begin or end in the United States and correspondingly end or begin in a foreign country. Instead, the reproposed regulations require simply that the ship or aircraft be operated on voyages or flights that begin or end in the United States and correspondingly end or begin outside the United States. In servicing a host vessel beyond the territorial limits of the United States, a lighter vessel begins its voyage outside the United States alongside the host vessel with respect to the cargo transported, and ends its voyage with respect to that cargo upon delivery of the cargo in the United States. Accordingly, under § 1.883–1(f)(2)(ii) of the reproposed regulations, lightering activity that extends beyond United States territorial waters will constitute the international operation of a ship.

3. *Activities Incidental to International Operation.* Section 1.883–1(g) of the 2000 proposed regulations provides that certain activities of an operator of a ship or aircraft are so closely related to the primary activity of the international operation of ships or aircraft that income from those incidental activities shall be considered income from the international operation of ships or aircraft, and thus eligible for exemption.

i. *Intermodal containers.* Section 1.883–1(g)(1)(v) of the 2000 proposed regulations provides that rental of containers during the international carriage of goods by sea by the operator of a ship or by air by the operator of an aircraft is incidental to the international operation of ships or aircraft. By contrast, § 1.883–1(g)(2)(iv) of the 2000 proposed regulations provides that the rental of containers for a domestic leg of transportation in connection with international carriage of cargo is not incidental to the international operation of ships or aircraft.

As discussed above in Part II.B.2(ii), the reproposed regulations do not change the general definition of the term *international operation of ships or aircraft* to cover the inland leg. The IRS and Treasury, however, recognize that intermodal transportation is a critical adjunct to the international transportation of cargo.

Accordingly, § 1.883–1(g)(1)(x) of the reproposed regulations treats certain container rental activities in the United States as incidental to the international operation of ships or aircraft. The reproposed regulations limit incidental treatment to the rental of containers for use in the United States for a period not exceeding five days beyond the original delivery date to the consignee as stated on the bill of lading. The reproposed regulations also impose other limitations on incidental treatment, and no other rental of containers within the United States is considered incidental to the international operation of ships or aircraft (*e.g.,* the extended rental of containers for use by the customer for temporary warehousing of cargo).

ii. *Inland legs of transportation—cargo transport.* As discussed above, the 2000 proposed regulations may treat some inland legs of transportation of cargo as domestic because the international transportation provided by a ship or aircraft is considered to end when the cargo is transferred from the ship or aircraft and clears customs or is considered to begin when the ship or aircraft is loaded at the United States port or airport. Again as discussed above, commentators argued that this rule inhibits intermodal transportation.

In recognition of this concern, § 1.883–1(g)(1)(v) of the reproposed regulations provides that (i) if a foreign corporation engaged in the international operation of ships or aircraft issues a through bill of lading, airway bill or similar document for the carriage of cargo from a port or airport outside the United States to an intermediate port or airport in the United States and then to an inland destination within the United States, or from an inland point of origin in the United States to an intermediate U.S. port or airport and then to a destination outside the United States, and (ii) to fulfill its common carrier obligations under the bill, the foreign corporation arranges through a related or unrelated corporation (either by subcontracting or otherwise) for carriage of cargo by air, ship, truck or rail between the U.S. port or airport and the inland point either preceding or following the international carriage of that cargo, then the activity of arranging for that transportation is incidental to its international operation of ships or aircraft, and income from such activity is thus eligible for exemption.

The reproposed regulations do not provide the same treatment where the bill of lading issued by the foreign corporation is solely for the international carriage of cargo between a U.S. port or airport where the cargo is loaded on or unloaded from the ship or aircraft and a point outside the United States. In such cases, arranging for further transportation of the cargo by another party on an inland leg is not incidental to the international operation of ships or aircraft. See § 1.883–1(g)(2)(vi). In addition, if the qualified foreign corporation carries cargo between a U.S. inland point and a U.S. port or airport with its own trucks, buses or rail service preceding or following the international carriage of such cargo by the qualified foreign corporation, the activity is not incidental to its international operation of ships or aircraft. See § 1.883–1(g)(2)(vii).

iii. *Inland legs of transportation—passenger transport under a code-sharing arrangement.* Under the 2000 proposed regulations, passenger carriage is deemed to begin or end upon a change of aircraft. Pursuant to that rule, international transportation provided by an air carrier ends when a passenger changes planes at a gateway city en route from a foreign point of origin to a U.S. destination, or begins when a passenger changes planes at a gateway city en route to a foreign destination. Thus, under the 2000 proposed regulations, an inland leg of passenger transportation is not treated as international even if it follows international transportation and is pursuant to a through ticket sold by a foreign airline, for example, under a code-sharing arrangement with a U.S. airline or is pursuant to an interline ticket.

Commentators argued that this rule would give rise to inefficiency, inhibit economies of scale from developing within the airline industry, and limit services available to passengers desiring international travel.

In recognition of these comments, § 1.883–1(g)(1)(vi) of the reproposed regulations provides that the sale or issuance of an interline or code-sharing passenger ticket for the carriage of persons by air between the U.S. gateway and another U.S. city preceding or following international transportation is an activity incidental to the international operation of aircraft. This rule only applies, however, if all such flight segments are provided pursuant to the passenger's original invoice, ticket, or itinerary.

4. *Activities not incidental to international operation of ships or aircraft.* i. *Hotel accommodations.* Under the 2000 proposed regulations, the sale or arranging for train travel, land tour packages and port city hotels is not an activity incidental to the international operation of ships or aircraft. Commentators suggested that an exception to that general rule be provided in the case of arranging for hotels for the one night before or after the international carriage of a passenger.

The reproposed regulations adopt this suggestion. It is not always possible for a cruise ship passenger to arrive at the port city on the morning of the scheduled departure or to arrange for a return flight home on the evening of the arrival back in port. Arranging for one night's accommodation in such situations is an adjunct to the operation of the cruise business. Thus, arranging for one night in a hotel before or after a cruise is considered incidental to the international operation of ships under § 1.883–1(g)(1)(vii) of the reproposed regulations.

ii. *Ground services and other services.* Under § 1.883–1(g)(2)(vi) of the 2000 proposed regulations, services performed for parties other than passengers, consignors or consignees, such as ground services at ports or airports or ship or aircraft maintenance, are not considered incidental to the international operation of ships or aircraft.

Several commentators suggested that income from services other than ground services provided by an operator, such as crewing, operating casinos, fleet management, operating reservations systems, and marketing or administrative services to consignors, consignees, as well as to members of the same pool, partnership, strategic alliance, joint operating agreement, code-sharing or other joint venture or joint operating arrangement, should be considered incidental.

The IRS and Treasury believe that no clear international norm or standard has developed regarding the appropriate treatment of such services. Accordingly, the reproposed regulations, in § 1.883–1(g)(3), reserve on the treatment of ground services, maintenance and catering, as well as other services not mentioned as included among incidental activities. The IRS and Treasury solicit comments on the appropriate rule.

5. *Activities incidental to the international operation of ships or aircraft performed by pool, partnership, strategic alliance, joint operating agreement, code-sharing arrangement or other joint venture.* The 2000 proposed regulations do not address whether activities performed by a pool, partnership, strategic alliance, joint operating agreement, code-sharing arrangement or other joint venture can be considered incidental to the international operation of ships or aircraft.

Commentators argued that activities a foreign corporation would perform for itself, absent such an arrangement or entity, should be incidental to the foreign corporation's international operation of ships or aircraft, within the meaning of § 1.883–1(g).

In response to these comments, § 1.883–1(g)(4) of the reproposed regulations broadens the scope of incidental activities. An activity may be considered incidental to the international operation of ships or aircraft by a foreign corporation, and income derived by the foreign corporation with respect to such activity is deemed to be income derived from the international operation of ships or aircraft, if the activity is performed by or pursuant to a pool, partnership, strategic alliance, joint operating agreement, code-sharing arrangement or other joint venture in which such foreign corporation participates, if (i) the activity is incidental to the international operation of ships or aircraft by the pool, partnership, strategic alliance, joint operating agreement, code-sharing arrangement or other joint venture, provided the joint venture is itself engaged in the operation of ships or aircraft; or (ii) such activity would be incidental to the international operation of ships or

aircraft by the foreign corporation, if it performed such activity itself, and provided the foreign corporation is otherwise is engaged in the operation of ships or aircraft.

6. *Interaction with income tax conventions.* i. *Eligibility for benefits under both a treaty and this regulation.* Section 1.883–1(h)(3) of the 2000 proposed regulations contains special rules regarding income tax conventions. Under the 2000 proposed regulations, if a corporation is organized in a foreign country that offers an exemption under an income tax convention and also some other means, such as a diplomatic note pursuant to section 883, the foreign corporation must choose annually whether to claim an exemption under section 894 and the income tax convention, or under section 883.

Commentators objected to this rule, stating that there was no tax policy rationale for requiring a foreign corporation eligible for an exemption under both section 883 and an income tax convention to make an annual election to claim under one or the other.

In response to these comments, § 1.883–1(h)(3)(i) of the reproposed regulations provides that if the taxpayer is eligible to exempt income under both an applicable income tax convention and section 883, the taxpayer may claim an exemption under both the applicable income tax convention and section 883 with respect to such category of income. As under the 2000 proposed regulations, however, such an election must be made with respect to all income of the foreign corporation from the international operation of ships or aircraft, and cannot be made separately with respect to different categories of income.

ii. *Regulation not intended to be used for interpretation of U.S. income tax conventions.* Many U.S. income tax conventions define the terms regarding international transport used therein, such as the term *international traffic,* but some conventions do not define such terms. In general, conventions provide that undefined terms have the meaning provided by the domestic laws of the contracting state from which treaty benefits are claimed. The 2000 proposed regulations do not state specifically whether the definitions and descriptions of terms used within those regulations should be used to interpret similar terms or concepts in income tax conventions or to delimit the scope of the exemption available under treaties for profits from shipping and air transport.

Treasury and IRS have received a number of inquiries regarding whether terms used in the 2000 proposed regulations should be used to interpret terms and concepts in U.S. income tax conventions, most commonly with respect to the definition of *international traffic* and related terms and concepts in the shipping and air transport article (typically, Article 8 of the convention).

In response to these inquiries, § 1.883–1(h)(3)(iii) of the reproposed regulations clarifies that definitions provided in these regulations do not give meaning or provide guidance regarding similar terms in U.S. income tax conventions or the scope of any treaty exemption. For example, the definition of the term *international operation of ships or aircraft* will not control the meaning of the terms *international traffic* and *international transport,* as used in U.S. income tax conventions. *See* H.R. Conf. Rep. No. 99–841, 99th Cong., 2d Sess. 599 (1986), reprinted in 1986–3 C.B. vol. 4, at 599 (''The conferees wish to clarify that the [conference] agreement's provisions do not deny any benefits available under present law in an income tax treaty between the United States and a foreign country.'').

7. *Substantiation and reporting requirements.* For a foreign corporation to be considered a qualified foreign corporation under § 1.883–1(c), the 2000 proposed regulations require that the corporation identify on its return each category of qualified income for which it claims an exemption and provide a reasonable estimate of the amount of qualified income for each such category.

Commentators criticized this requirement on the ground that many foreign corporations, such as foreign airlines, do not keep books and records based on U.S. generally accepted accounting principles reflecting each separate item of income. Commentators also complained that foreign corporations could not determine without significant administrative burden how much income would be from sources within the United States under U.S. income tax principles.

In response to these comments, § 1.883–1(c)(3) of the reproposed regulations provides that a reasonable estimate of each category of qualified income for which an exemption is claimed must be provided to the extent such amounts are readily determinable. This standard is consistent with the general standards in § 1.6012–2(g)(1)(i) for information included on returns filed by foreign corporations that claim an exemption from income tax by reason of U.S. domestic law or a U.S. income tax convention.

C. Comments Relating to § 1.883–2: Treatment of Publicly-Traded Corporations

Section 883(c)(1) provides that a foreign corporation shall not be eligible for the exclusion of income from the international operation of ships or aircraft if 50 percent or more of the value of its stock is owned by individuals who are not residents of a qualified foreign country. Section 883(c)(3) provides, however, that this rule shall not apply to any foreign corporation whose stock is primarily and regularly traded on an established securities market in either the United States or a qualified foreign country.

Section 1.883–2 of the 2000 proposed regulations provides rules regarding section 883(c)(3). As explained more fully in the preamble to those regulations, the branch profits tax rules under § 1.884–5(d) provide the framework for § 1.883–2. Section 1.883–2(d) of the 2000 proposed regulations defines the term *regularly traded.* For the stock of foreign corporation to be considered regularly traded, one or more classes of the corporation's stock that in the aggregate represent 80 percent or more of the total combined voting power of all classes of stock of such corporation entitled to vote must be listed on an established securities market. In addition, the 2000 proposed regulations provide that a class of stock cannot be counted for purposes of meeting the regularly traded requirement if one or more persons who own at least 5 percent of the value of the outstanding shares of the class of stock (5-percent shareholders) own in the aggregate 50 percent of more of the value of stock in the class.

As discussed below, in response to comments received, the reproposed regulations modify the 2000 proposed regulations rules regarding the 80 percent listing requirement and the rules for closely-held classes of stock. The reproposed regulations do not, however, modify the rules regarding the reporting (on the corporation's Form 1120F) of the names of any 5-percent shareholders upon which the foreign corporation intends to rely to satisfy section 883(c). Moreover, the reproposed regulations do not adopt a suggestion regarding the treatment for purposes of the stock ownership test of section 883(c)(1) of shareholders in a publicly-traded class of stock of a non-publicly traded corporation.

1. *Regularly traded listing threshold.* Under the 2000 proposed regulations, in accordance with Section 883(c)(3)(A), the stock of a foreign corporation must be regularly traded for the foreign

corporation to satisfy the publicly traded test. To determine whether the foreign corporation's stock is regularly traded, § 1.883–2(d) of the 2000 proposed regulations generally adopts the threshold used in connection with the branch profits tax rules of § 1.884–5(d)(4)(i)(A). Under § 1.883–2(d), the stock of a corporation is regularly traded if one or more classes of stock of the corporation are listed on an established securities market in the United States or in a qualified foreign country, and those classes, in the aggregate, represent 80 percent or more of the total combined voting power of all classes of stock of such corporation entitled to vote and of the total value of the stock (provided also that certain trading requirements are satisfied).

Commentators objected to the 80 percent listing requirement. Commentators suggested that in cases where a corporation has an initial public offering of a new class of stock, or where a founding family retains voting control through a separate class of stock from the publicly traded class, the 80 percent listing requirement could make it impossible for the corporation to be regularly traded, even where the listed class or classes are widely held and actively traded. For example, commentators posited that a foreign government's minority interest of 25 percent held in a separate unlisted class over the time period required for privatization of a national airline would disqualify the airline, even if its stock were otherwise widely held and actively traded.

In response to these comments, § 1.883–2(d)(1) of the reproposed regulations reduces the 80 percent listing requirement to 50 percent. The lower percentage corresponds more closely with recent U.S. treaty policy regarding the publicly traded test contained in the Limitation on Benefits articles of certain U.S. income tax conventions. This modification of the general regularly traded test also mitigates some commentators' concerns regarding the closely-held test, as explained below in Part II.C.2.

2. *Closely-held classes of stock.* Section 1.883–2(d)(3) of the 2000 proposed regulations disqualifies a class of stock from being relied on to satisfy the publicly traded test if, at any time during the taxable year, one or more 5-percent shareholders of that class of stock (determined without regard to the attribution rules in § 1.883–4) owns, in the aggregate, 50 percent or more of the total value of that class of stock. The 2000 proposed regulations, however, provide an exception to this disqualification. An otherwise qualifying closely-held class of stock still can meet the regularly traded test if the foreign corporation can establish that more than 50 percent of the value of the outstanding shares of that class of stock are owned or treated as owned by persons who are qualified shareholders for more than half the number of days during the taxable year. These rules are based upon the closely-held test provided in § 1.884–5(d)(4)(iii) with respect to the branch profits tax.

Several commentators suggested that the legislative history of section 883 does not support the adoption of a closely-held test. Commentators pointed out a number of statutory distinctions between sections 883 and 884 in advocating deletion of the closely-held test in its entirety.

Other commentators contended that the closely-held rules effectively eliminate the publicly traded test as a viable alternative to the qualified shareholder stock ownership test for closely-held corporations that otherwise meet the listing and trading requirements. These commentators felt it would be administratively impossible to identify and document that qualified shareholders hold more than 50 percent of the value of the outstanding shares of a class of stock because the corporation would not be able to collect sufficient information from individuals owning shares through the widely-held block of stock or from custodians such as financial institutions holding shares on behalf of customers. These commentators therefore requested that the closely-held test be deleted, or that the widely-held block be treated as owned by qualified shareholders, such that the foreign corporation only would have to look to the qualified 5-percent shareholders of the closely-held block to prove up the difference between the percentage owned by the widely-held block and 50 percent.

The reproposed regulations take into account the principal concerns of the commentators. While the reproposed regulations retain the closely-held test and do not change substantially the definition of a closely-held class of stock, the reproposed regulations broaden the exception in § 1.883–2(d)(3)(ii). Under the reproposed regulations, a class of stock will not be treated as closely-held if the foreign corporation can establish that qualified shareholders, applying the attribution rules of § 1.883–4(c), own enough shares of the closely-held block of stock to preclude non-qualified shareholders in the closely-held block of stock from owning 50 percent or more of the total value of the class of stock for more than half the number of days during the taxable year. A foreign corporation may establish that a class of stock meets this exception if it obtains documentation described in § 1.883–4(d) from those qualified shareholders owning shares in the closely-held block of stock whom the foreign corporation has relied upon to meet the exception. This change broadens the exception to the closely-held test by allowing a foreign corporation to prove that a class of shares is not closely-held using information solely from shareholders within the closely-held block of stock.

In addition, § 1.883–2(d)(3)(iii)(B) of the reproposed regulations provides that an investment company will not be treated as a 5-percent shareholder for purposes of the closely-held test if no person owning an interest in the investment company owns, after application of the attribution rules of § 1.883–4(c), 5 percent or more of the value of the outstanding shares of the class of stock of the foreign corporation seeking qualified foreign corporation status. This rule prevents a corporation from having a closely-held class of stock simply because an investment company that meets the above requirements causes a class of stock of that corporation to be owned more than 50 percent in the aggregate by 5-percent shareholders.

Finally, the reproposed regulations in § 1.883–4(d)(3)(viii) adopt the suggestion of one commentator that an otherwise publicly-traded foreign corporation seeking qualified foreign corporation status or a publicly-traded shareholder corporation that is traded on an established securities market in the United States may rely on its latest SEC Form 13G filing (Statement of Beneficial Ownership by Certain Persons) for the taxable year to determine if the class of stock being considered has a 5-percent shareholder. The IRS and Treasury believe these changes to the 2000 proposed regulations will facilitate compliance with the closely-held test.

3. *Publicly-traded classes of stock of a non-publicly traded corporation.* Regulations under section 884 regarding the branch profits tax provide that a publicly traded class of stock is treated as owned by individuals who are residents of a qualified foreign country. Such a provision might be relevant as well in the context of section 883 if one or more classes of the corporation's stock are publicly traded but the corporation itself is not considered publicly traded. If these other classes were treated as owned by qualified shareholders, the foreign corporation might be more likely to satisfy section 883(c), as provided in §§ 1.883–1(c)(2)

and 1.883–4. Commentators recommended that the reproposed regulations adopt the rule of the branch profit regulations.

The reproposed regulations, however, do not adopt this suggestion. The IRS and Treasury believe that the reduction in the listing threshold from 80 percent to 50 percent and the change in the exception to the closely-held test provide sufficient latitude for foreign corporations seeking to comply with the publicly traded test. Moreover, as discussed below in Part II.E.1, the reproposed regulations adopt commentators' suggestions regarding the treatment of certain institutional 5-percent shareholders for purposes of § 1.883–4 which should also ease compliance.

4. *Identification of 5-percent qualified shareholders on return.* Sections 1.883–2(f) and 1.883–4(e) of the 2000 proposed regulations require that the foreign corporation identify on its Form 1120F, ''U.S. Income Tax Return of a Foreign Corporation,'' its qualified shareholders that own, or are treated as owning within the meaning of § 1.883–4(c), 5 percent or more of the stock of the foreign corporation and upon which the foreign corporation intends to rely to satisfy the stock ownership test of § 1.883–1(c)(2).

Commentators were concerned that the identity of such qualified shareholders might be disclosed. Although the name of a 5-percent shareholder is return information that is not subject to disclosure under section 6110, commentators believed that such information might nevertheless become public, for example, in the context of taxpayer litigation. They also expressed concern that there could be spontaneous exchanges of information with treaty partners that do not have the same non-disclosure restrictions as the United States. Some commentators suggested that the documentation instead be made available to a third party for use by the Commissioner upon request.

The reproposed regulations do not adopt these suggestions, in the interest of sound tax administration. The IRS and Treasury believe that there exist sufficient safeguards in our treaties and in the Internal Revenue Code to prevent the unintended disclosure of the identity of qualified 5-percent shareholders relied upon to satisfy the requirements of §§ 1.883–2(f) and 1.883–4(e).

D. Comments Relating to § 1.883–3—Treatment of Controlled Foreign Corporations

Section 883(c)(2) provides that the stock ownership test of section 883(c)(1) shall not apply to controlled foreign corporations (CFCs). Under the 2000 proposed regulations, a CFC is considered to satisfy the CFC exception of section 883(c)(1) if it meets the requirements of § 1.883–3. To meet those requirements, a CFC must, among other things, pass the income inclusion test of § 1.883–3(b). The income inclusion test contained in the 2000 proposed regulations requires that more than 50 percent of the subpart F income derived by the CFC from the international operation of ships or aircraft be includible in the gross income of one or more U.S. citizens, individual residents of the United States, or domestic corporations. For example, a CFC owned by a domestic partnership, the partners of which are residents of foreign countries, would not meet the income inclusion test.

One commentator argued that the income inclusion test was too restrictive because it could deny qualified foreign corporation status to CFCs legitimately owned and controlled by U.S. shareholders. For example, a foreign corporation owned by U.S. citizens who are family members could be a CFC as a result of the constructive ownership rules of section 958(b), but fail the income inclusion test because not all the family members own directly or indirectly, under section 958(a), 10 percent or more of the CFC's voting stock, and thus may not be required to include in their gross income the subpart F income of the CFC.

The CFC exception of the 2000 proposed regulation has not been changed substantively in these reproposed regulations. The Conference report accompanying the legislation that added the CFC exception provides with respect to the exception that ''corporations are not considered residents of countries that exempt U.S. persons unless 50 percent or more of the ultimate individual owners are U.S. shareholders of controlled foreign corporations''. H.R. Conf. Rep. No. 99–841, 99th Cong., 2d Sess. 598 (1986), reprinted in 1986–3 C.B. vol. 4, at 598 (1986). The intent of the CFC exception therefore is for the general ownership requirement 883(c)(1) to apply unless the foreign corporation is a CFC and 50 percent or more of the subpart F income of that corporation derived from the international operation of ships or aircraft is includible by U.S. citizens, individual residents or domestic corporations.

The reproposed regulations do clarify the operation of the income inclusion test by specifying with greater precision than the 2000 proposed regulations that the income inclusion test only applies to subpart F income derived from the international operation of ships and aircraft.

E. Comments Relating to § 1.883–4—Qualified Shareholder Stock Ownership Test

As noted above, section 883(c)(1) provides that a foreign corporation shall not be eligible for the exclusion of income from the international operation of ships or aircraft if 50 percent or more of the value of its stock is owned by individuals who are not residents of a qualified foreign country. Section 1.882–4 of the 2000 proposed regulations provides detailed rules regarding this statutory requirement.

In response to comments the IRS received regarding those provisions of the 2000 proposed regulations, the reproposed regulations modify the rules regarding the permissible categories of qualified shareholders, the requirements for establishing qualified shareholder status under an income tax convention, the attribution of ownership in the case of taxable non-stock corporations, and the preparation of ownership statements from foreign governments. As discussed below, however, the reproposed regulations generally do not modify the 2000 proposed regulations with respect to the treatment of bearer shares or with respect to the attribution of ownership of discretionary trusts.

1. *Qualified shareholders.* Under the 2000 proposed regulations, a foreign corporation may satisfy the stock ownership test of § 1.883–1(c)(2) if it meets the qualified shareholder stock ownership test of § 1.883–4. The qualified shareholder stock ownership test generally requires more than 50 percent ownership by qualified shareholders. Section 1.883–4(b) of the 2000 proposed regulations provides a list of persons who can be qualified shareholders.

Several commentators requested the inclusion of additional categories of qualified shareholders. One commentator suggested that foreign airlines covered by a bilateral air services agreement between the United States and another country should be deemed to satisfy the ownership requirements of § 1.883–4(a) because these agreements require substantial ownership and effective control by nationals of the other country. In response to this comment, the reproposed regulations add shareholders of such airlines to the list of qualified shareholders in § 1.883–4(b)(1)(i)(F), subject to certain conditions.

Other commentators suggested that the list of qualified shareholders include

a mutual fund, money market manager, regulated investment company, open and closed-end fund, investment partnership or other type of investment vehicle available to the public and subject to regulation by the Securities and Exchange Commission. Such entities have great difficulty in demonstrating that more than 50 percent of the value of their shares is owned, or treated as owned, by qualified shareholders.

The reproposed regulations do not adopt these suggestions. The IRS and Treasury recognize the difficulty in proving ownership of such entities, but many owners of such entities may in fact be U.S. residents or other non-qualified shareholders. However, § 1.883–4(d)(3)(viii) of the reproposed regulations does permit a publicly traded corporation to rely on its Form 13G ''Statement of Beneficial Ownership by Certain Persons'' to identify 5-percent shareholders for purposes of the documentation requirements of § 1.883–2(e). Certain of these entities may be able to rely upon this section without additional compliance burden because they are already required to file Form 13G and identify 5-percent shareholders.

2. *Bearer shares.* Section 1.883–4(b)(1)(ii) of the 2000 proposed regulations provides that a shareholder is a qualified shareholder only if the shareholder does not own its interest in the foreign corporation through bearer shares, either directly or by applying the attribution rules of § 1.883–4(c).

Several commentators criticized this rule. They contended that the restriction on the use of bearer shares raises concerns of fundamental fairness and that the IRS should not attempt to regulate the personal property rights of nonresident alien individuals. These commentators suggested that the rule should be deleted or substantially modified to allow the use of bearer shares whose ownership can be substantiated to the satisfaction of the Commissioner.

Due to the difficulty of reliably demonstrating the true ownership of such shares, the reproposed regulations do not adopt this suggestion, in the interest of sound tax administration.

3. *Certain limitation on benefits article restrictions in income tax conventions applied to shareholders.* Under § 1.883–4(b)(3)(i) of the 2000 proposed regulations, a shareholder resident in a treaty country is not a qualified shareholder by virtue of the treaty exemption unless the foreign corporation of which it is a shareholder would be able to satisfy, if it were organized in the treaty country, any additional requirement imposed by the shipping and air transport article or the limitation of benefits article of the treaty upon which the shareholder relies.

Commentators objected to this rule because it effectively prevents many foreign corporations, especially airlines, from relying on ownership resident in a treaty country to obtain a section 883 exemption. Commentators also argued that the provision would act as a significant and inappropriate barrier to joint venture corporations with owners or partners resident in treaty countries.

In response to these comments, the reproposed regulations modify the 2000 proposed regulations, so that if a shareholder relies on an income tax convention to demonstrate residence in a qualified foreign country, the shareholder alone must satisfy the residence requirements and limitation on benefits requirements of the convention. The reproposed regulations thus eliminate the requirement that the corporation seeking qualified foreign corporation status itself must satisfy any additional requirements.

4. *Taxable non-stock corporations.* The 2000 proposed regulations, in § 1.883–4(c), provide for attribution of ownership through various entities for purposes of the closely-held test in § 1.883–2(d)(3)(ii) and the stock ownership test in § 1.883–4(a).

Several commentators called for additional guidance on attribution of ownership in the case of taxable non-stock corporations entitled to deduct amounts distributed for charitable purposes.

The reproposed regulations address this request for guidance in § 1.883–4(c)(5). Under this provision, if a taxable non-stock corporation is entitled in its country of organization to deduct from its taxable income amounts distributed for charitable purposes, the corporation may deem a recipient of such charitable distributions to be a shareholder owning stock in the same proportion as the amount received in the taxable year bears to the total income of the corporation in that taxable year. Whether each such recipient is a qualified shareholder then may be determined under § 1.883–4(b) or under the special rules of § 1.883–4(d)(3)(vii).

5. *Discretionary trusts.* The 2000 proposed regulations, in § 1.883–4(c)(3)(i), adopt the attribution rules for discretionary trusts contained in the branch profits tax regulations under § 1.884–5(b)(2)(iii)(A). If a beneficiary's actuarial interest in a nongrantor trust cannot be determined, then stock held by the trust will not be attributed to any beneficiary unless all beneficiaries with an interest in the stock are qualified shareholders.

One commentator recommended that the regulations instead follow Notice 97–19 (1997–1 C.B. 394), which provides guidance for purposes of section 877 in determining the net worth of an individual beneficiary of a trust. Notice 97–19 generally attributes all interests in a trust based on relevant facts and circumstances, in order to assure that an individual will not avoid the application of section 877 by alleging he or she has no actuarially determinable interest in a trust.

The reproposed regulations do not adopt this suggestion because of the substantially different purpose of the trust attribution rules under section 877 as opposed to section 883. The purpose of those rules is to attribute trust income to United States persons using constructive attribution. The purpose of the trust attribution rules under section 883 is to determine whether a foreign corporation is a qualified foreign corporation by virtue of the residence of its shareholders. This difference in purpose prevents effective use of the section 877 methodology.

6. *Substantiation of stock ownership.* Section 1.883–4(b)(1)(iii) of the 2000 proposed regulations provides that a shareholder is a qualified shareholder only if the shareholder provides to the foreign corporation the documentation required in § 1.883–4(d), and the foreign corporation meets the reporting requirements of § 1.883–4(e) with respect to such shareholder.

Several commentators argued that the requirement that the foreign corporation obtain ownership statements was excessive, at least with respect to foreign corporations that do not have U.S. branches. Other commentators suggested that certain qualified professionals and financial institutions be authorized to provide ownership statements on behalf of foreign governments. They noted that, as drafted, practical compliance with the procedures may be difficult in countries where ownership of a shipping company, for example, is held by several state enterprises, some of which have begun the privatization process or are in transition to privatization and where any state supervision or control may be remote from the shipping company.

The reproposed regulations under § 1.883–4(d) generally retain the structure and substance of the 2000 proposed regulations with respect to the substantiation of stock ownership. However, § 1.883–4(d)(4)(ii) of the reproposed regulations, regarding ownership statements from foreign

governments, permits foreign corporations with shareholders that are foreign governments to engage accounting or law firms or financial institutions to prepare certificates as to ultimate beneficial interest with respect to the aggregate government investment in the stock of the foreign corporation.

F. Comments Related to § 1.883–5—Effective Date

Section 1.883–5 of the 2000 proposed regulations provides that the regulations will apply to taxable years of the foreign corporation ending 30 days or more after the date the regulations are published as final regulations in the **Federal Register**.

A number of commentators argued that compliance with the 2000 proposed regulations would require foreign corporations to develop new accounting and record-keeping conventions and procedures. Some commentators therefore suggested that the effective date be extended to taxable years beginning 30 days or more after the date these regulations are published as final regulations in the **Federal Register**. Other commentators suggested that the regulations should not be effective earlier than six months or one year after the publication date of the final regulations.

In response to these suggestions, the reproposed regulations provide that they will apply to taxable years of a foreign corporation beginning 30 days or more after the date these regulations are published as final regulations in the **Federal Register**.

In addition, when the reproposed regulations are published as final, taxpayers will be permitted to elect to apply the provisions of §§ 1.883–1 through 1.883–4, as finalized, to any open taxable year beginning after 1986. Such election shall apply to the taxable year of the election and to all subsequent taxable years. Notwithstanding this election, the substantiation and reporting requirements of § 1.883–1(c)(3) (relating to the substantiation and reporting required to be treated as a qualified foreign corporation) and §§ 1.883–2(f), 1.883–3(d) and 1.883–4(e) (relating to additional information to be included in the return to demonstrate whether the foreign corporation satisfies the stock ownership test) will not apply to any years beginning before the effective date of the final regulations. However, if a foreign corporation complies with the proposed regulations, including the substantiation and reporting rules, such compliance will be considered substantial evidence that the foreign corporation is a qualified foreign corporation.

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 this notice of proposed rulemaking does not impose a collection of information on U.S. 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 (8) copies) that are submitted timely to the IRS. The IRS and Treasury request comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be made available for public inspection and copying.

A public hearing has been scheduled for November 12, 2002, at 10 a.m., in room 4718, Internal Revenue Building, 1111 Constitution Ave., NW., Washington, DC. All visitors must present photo identification to enter the building at the Constitution Avenue entrance. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 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 this hearing. Persons who wish to present oral comments at the hearing must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by October 22, 2002. 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 receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

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

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Withdrawal of Proposed Amendments

Accordingly, under the authority of 26 U.S.C. 7805, the proposed amendment to 26 CFR Part 1 that was published in the **Federal Register** on Tuesday, February 8, 2000, (65 FR 6065) is withdrawn.

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 entries in numerical order to read as follows:

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

Section 1.883–1 is also issued under 26 U.S.C. 883.

Section 1.883–2 is also issued under 26 U.S.C. 883.

Section 1.883–3 is also issued under 26 U.S.C. 883.

Section 1.883–4 is also issued under 26 U.S.C. 883.

Section 1.883–5 is also issued under 26 U.S.C. 883. * * *

Par. 2. Section 1.883–0 is added to read as follows:

§ 1.883–0 Outline of major topics.

This section lists the major paragraphs contained in §§ 1.883–1 through 1.883–5.

§ 1.883–0 Outline of major topics.

§ 1.883–1 Exclusion of income from the international operation of ships or aircraft.

(a) General rule.

(b) Qualified income.

(c) Qualified foreign corporation.

(1) General rule.

(2) Stock ownership test.

(3) Substantiation and reporting requirements.

(i) General rule.

(ii) Further documentation.

(4) Commissioner's discretion to cure defects in documentation.

(d) Qualified foreign country.

(e) Operation of ships or aircraft.

(1) General rule.

(2) Pool, partnership, strategic alliance, joint operating agreement,

(*2*) Ownership statements from non-government pension funds.

(*3*) Time for making determinations.

(D) Ownership statements from taxable non-stock corporations.

(5) Availability and retention of documents for inspection.

(e) Reporting requirements.

§ 1.883–5 Effective date.

(a) General rule.

(b) Election for retroactive application.

(c) Transitional information reporting rule.

Par. 3. § 1.883–1 is revised to read as follows:

§ 1.883–1 Exclusion of income from the international operation of ships or aircraft.

(a) *General rule.* Qualified income derived by a qualified foreign corporation from its international operation of ships or aircraft is excluded from gross income and exempt from United States Federal income tax. Paragraph (b) of this section defines the term *qualified income*. Paragraph (c) of this section defines the term *qualified foreign corporation*. Paragraph (f) of this section defines the term *international operation of ships or aircraft*.

(b) *Qualified income.* Qualified income is income derived from the international operation of ships or aircraft that—

(1) Is properly includible in any of the income categories described in paragraph (h)(2) of this section; and

(2) Is the subject of an equivalent exemption, as defined in paragraph (h) of this section, granted by the qualified foreign country, as defined in paragraph (d) of this section, in which the foreign corporation seeking qualified foreign corporation status is organized.

(c) *Qualified foreign corporation*—(1) *General rule.* A qualified foreign corporation is a corporation that is organized in a qualified foreign country and considered engaged in the international operation of ships or aircraft. The term *corporation* is defined in section 7701(a)(3) and the regulations thereunder. Paragraph (d) of this section defines the term *qualified foreign country*. Paragraph (e) of this section defines the term *operation of ships or aircraft,* and paragraph (f) of this section defines the term *international operation of ships or aircraft.* To be a qualified foreign corporation, the corporation must satisfy the stock ownership test of paragraph (c)(2) of this section and satisfy the substantiation and reporting requirements described in paragraph (c)(3) of this section. A corporation may be a qualified foreign corporation with respect to one category of qualified income but not with respect to another such category. See paragraph (h)(2) of this section for a discussion of the categories of qualified income.

(2) *Stock ownership test.* To be a qualified foreign corporation, a foreign corporation must satisfy the publicly-traded test of § 1.883–2(a), the CFC stock ownership test of § 1.883–3(a), or the qualified shareholder stock ownership test of § 1.883–4(a).

(3) *Substantiation and reporting requirements*—(i) *General rule.* To be a qualified foreign corporation, a foreign corporation must include the following information in its Form 1120F, ''U.S. Income Tax Return of a Foreign Corporation,'' in the manner prescribed by such form and its accompanying instructions—

(A) The corporation's name and address (including mailing code);

(B) The corporation's U.S. taxpayer identification number;

(C) The foreign country in which the corporation is organized;

(D) The applicable authority for an equivalent exemption, for example, citation of a statute in the country where the corporation is organized, a diplomatic note between the United States and such country, Rev. Rul. 2001–48 (2001–42 I.R.B. 324, October 15, 2001) as amended from time to time (*see* § 601.601(d)(2) of this chapter), or, in the case of a corporation described in paragraph (h)(3)(ii) of this section, an income tax convention between the United States and such country;

(E) The category or categories of qualified income for which an exemption is being claimed;

(F) A reasonable estimate of the amount of income in each category of qualified income for which the exemption is claimed, to the extent such amounts are readily determinable;

(G) Any other information required under §§ 1.883–2(f), 1.883–3(d), or 1.883–4(e), as applicable; and

(H) Any other relevant information specified by the Form 1120F and its accompanying instructions.

(ii) *Further documentation.* If the Commissioner requests in writing that the foreign corporation document or substantiate representations made under paragraph (c)(3)(i) of this section, or under § 1.883–2(f), 1.882–3(d) or 1.883–4(e), the foreign corporation must provide the documentation or substantiation within 60 days following the written request. If the foreign corporation does not provide the documentation and substantiation requested within the 60-day period, but demonstrates that the failure was due to reasonable cause and not willful neglect, the Commissioner may grant the foreign corporation a 30-day extension to provide the documentation or substantiation. Whether a failure to obtain the documentation or substantiation in a timely manner was due to reasonable cause and not willful neglect shall be determined by the Commissioner after considering all the facts and circumstances.

(4) *Commissioner's discretion to cure defects in documentation.* The Commissioner retains the discretion to cure any defects in the documentation where the Commissioner is satisfied that the foreign corporation would otherwise be a qualified foreign corporation.

(d) *Qualified foreign country.* A qualified foreign country is a foreign country that grants to corporations organized in the United States an equivalent exemption, as described in paragraph (h) of this section, for the category of qualified income, as described in paragraph (h)(2) of this section, derived by the foreign corporation seeking qualified foreign corporation status. A foreign country may be a qualified foreign country with respect to one category of qualified income but not with respect to another such category.

(e) *Operation of ships or aircraft*—(1) *General rule.* Except as provided in paragraph (e)(2) of this section, a foreign corporation is considered engaged in the operation of ships or aircraft only during the time it is an owner or lessee of one or more entire ships or aircraft and uses such ships or aircraft in one or more of the following activities—

(i) Carriage of passengers or cargo for hire;

(ii) In the case of a ship, the leasing out of the ship under a time or voyage charter (full charter), space or slot charter, or bareboat charter, as those terms are defined in paragraph (e)(5) of this section, provided the ship is used to carry passengers or cargo for hire; and

(iii) In the case of aircraft, the leasing out of the aircraft under a wet lease (full charter), space, slot, or block-seat charter, or dry lease, as those terms are defined in paragraph (e)(5) of this section, provided the aircraft is used to carry passengers or cargo for hire.

(2) *Pool, partnership, strategic alliance, joint operating agreement, code-sharing arrangement or other joint venture.* A foreign corporation is considered engaged in the operation of ships or aircraft with respect to its participation in a pool, partnership, strategic alliance, joint operating agreement, code-sharing arrangement or other joint venture that is either—

(i) An entity, as defined in paragraph (e)(5)(iv) of this section, that is a fiscally transparent entity under the income tax

laws of the United States, as defined in paragraph (e)(5)(v) of this section, with respect to the category of income derived from such operation, and that would be considered engaged in the operation of ships or aircraft under paragraph (e)(1) of this section if it were a foreign corporation; or

(ii) A pool, strategic alliance, joint operating agreement, code-sharing arrangement or other joint venture that is not an entity, as defined in paragraph (e)(5)(iv) of this section, involving one or more activities described in paragraphs (e)(1)(i) through (iii) of this section, but only if the foreign corporation is otherwise engaged in the operation of ships or aircraft under paragraph (e)(1) of this section.

(3) *Activities not considered operation of ships or aircraft.* Activities that do not constitute operation of ships or aircraft include, but are not limited to—

(i) The activities of a nonvessel-operating common carrier, as defined in paragraph (e)(5)(vii) of this section;

(ii) Ship or aircraft management;

(iii) Obtaining crews for ships or aircraft operated by another party;

(iv) Acting as a ship's agent;

(v) Ship or aircraft brokering;

(vi) Freight forwarding;

(vii) The activities of travel agents and tour operators;

(viii) Rental by a container leasing company of containers and related equipment; and

(ix) The activities of a concessionaire.

(4) *Examples.* The rules of paragraphs (e)(1) through (3) of this section are illustrated by the following examples:

Example 1. Three tiers of charters—(i) Facts. A, B, and C are foreign corporations. A purchases a ship. A and B enter into a bareboat charter of the ship for a term of 20 years, and B, in turn, enters into a time charter of the ship with C for a term of 5 years. Under the time charter, B is responsible for the complete operation of the ship, including providing the crew and maintenance. C uses the ship during the term of the time charter to carry its customers' freight between U.S. and foreign ports. C owns no ships. (ii) *Analysis.* Because A is the owner of the entire ship and leases out the ship under a bareboat charter to B, and because the sublessor, C, uses the ship to carry cargo for hire, A is considered engaged in the operation of a ship under paragraph (e)(1) of this section during the term of the time charter. B leases in the entire ship from A and leases out the ship under a time charter to C, who uses the ship to carry cargo for hire. Therefore, B is considered engaged in the operation of a ship under paragraph (e)(1) of this section during the term of the time charter. C time charters the entire ship from B and uses the ship to carry its customers' freight during the term of the charter. Therefore, C is also engaged in the operation of a ship under paragraph (e)(1) of this section during the term of the time charter.

Example 2. Partnership with contributed shipping assets—(i) *Facts.* X, Y, and Z, each a foreign corporation, enter into a partnership, P. P is a fiscally transparent entity under the income tax laws of the United States, as defined in paragraph (e)(5)(iv) and (v) of this section, with respect to all relevant categories of income. Under the terms of the partnership agreement, each partner contributes all of the ships in its fleet to P in exchange for interests in the partnership and shares in the P profits from the international carriage of cargo. The partners share in the overall management of P, but each partner, acting in its capacity as partner, continues to crew and manage all ships previously in its fleet.

(ii) *Analysis.* P owns the ships contributed by the partners and uses these ships to carry cargo for hire. Therefore, if P were a foreign corporation, it would be considered engaged in the operation of ships within the meaning of paragraph (e)(1) of this section. Accordingly, because P is a fiscally transparent entity under the income tax laws of the United States, as defined in paragraph (e)(5)(v) of this section, X, Y, and Z are each considered engaged in the operation of ships through P, within the meaning of paragraph (e)(2)(i) of this section, with respect to their distributive share of income from P's international carriage of cargo.

Example 3. Joint venture with chartered in ships—(i) *Facts.* Foreign corporation A owns a number of foreign subsidiaries involved in various aspects of the shipping business, including S1, S2, S3, and S4. S4 is a foreign corporation that provides cruises but does not own any ships. S1, S2, and S3 are foreign corporations that own cruise ships. S1, S2, S3, and S4 form joint venture JV, in which they are all interest holders, to conduct cruises. JV is fiscally transparent under the income tax laws of the United States, as defined in paragraph (e)(5)(v) of this section, with respect to its income from the carriage of passengers. Under the terms of the joint venture, S1, S2, and S3 each enter into time charter agreements with JV, pursuant to which S1, S2, and S3 retain control of the navigation and management of the individual ships, and JV will use the ships to carry passengers for hire. The overall management of the cruises line will be provided by S4.

(ii) *Analysis.* S1, S2, and S3 each owns ships and time charters those ships to JV, which uses the ships to carry passengers for hire. Accordingly, S1, S2, and S3 are each considered engaged in the operation of ships under paragraph (e)(1) of this section. JV leases in entire ships by means of the time charters, and JV uses those ships to carry passengers on cruises. Thus, JV would be engaged in the operation of ships within the meaning of paragraph (e)(1) of this section if it were a foreign corporation. Therefore, although S4 does not directly own or lease in a ship, S4 also is engaged in the operation of ships, within the meaning of paragraph (e)(2)(i) of this section, with respect to its participation in JV.

(5) *Definitions*—(i) *Bareboat charter.* A bareboat charter is a contract for the use of a ship or aircraft whereby the lessee is in complete possession, control, and command of the ship or aircraft. For example, in a bareboat charter, the lessee is responsible for the navigation and management of the ship or aircraft, the crew, supplies, repairs and maintenance, fees, insurance, charges, commissions and other expenses connected with the use of the ship or aircraft. The lessor of the ship bears none of the expense or responsibility of operation of the ship or aircraft.

(ii) *Code-sharing arrangement.* A code-sharing arrangement is an arrangement in which one air carrier puts its identification code on the flight of another carrier. This arrangement allows the first carrier to hold itself out as providing service in markets where it does not otherwise operate or where it operates infrequently. Code-sharing arrangements can range from a very limited agreement between two carriers involving only one market to agreements involving multiple markets and alliances between or among international carriers which also include joint marketing, baggage handling, one-stop check-in service, sharing of frequent flyer awards, and other services. For rules involving the sale of code-sharing tickets, see paragraph (g)(1)(vi) of this section.

(iii) *Dry lease.* A dry lease is the bareboat charter of an aircraft.

(iv) *Entity.* For purposes of this paragraph (e), an entity is any person that is treated by the United States as other than an individual for U.S. Federal income tax purposes. The term includes disregarded entities.

(v) *Fiscally transparent entity under the income tax laws of the United States.* For purposes of this paragraph (e), an entity is fiscally transparent under the income tax laws of the United States with respect to a category of income if the entity would be considered fiscally transparent under the income tax laws of the United States for purposes of § 1.894–1 with respect to an item of income within that category of income.

(vi) *Full charter.* Full charter (or full rental) means a time charter or a voyage charter of a ship or a wet lease of an aircraft but during which the full crew and management are provided by the lessor.

(vii) *Nonvessel operating common carrier.* A nonvessel operating common carrier is an entity that does not exercise control over any part of a vessel, but holds itself out to the public as providing transportation for hire, issues bills of lading, assumes responsibility or is liable by law as a common carrier for safe transportation of shipments, and

arranges in its own name with other common carriers, including those engaged in the operation of ships, for the performance of such transportation.

(viii) *Space or slot charter.* A space or slot charter is a contract for use of a certain amount of space (but less than all of the space) on a ship or aircraft, and may be on a time or voyage basis. When used in connection with passenger aircraft this sort of charter may be referred to as the sale of block seats.

(ix) *Time charter.* A time charter is a contract for the use of a ship or aircraft for a specific period of time, during which the lessor of the ship or aircraft retains control of the navigation and management of the ship or aircraft (*i.e.,* the lessor continues to be responsible for the crew, supplies, repairs and maintenance, fees and insurance, charges, commissions and other expenses connected with the use of the ship or aircraft).

(x) *Voyage charter.* A voyage charter is a contract similar to a time charter except that the ship or aircraft is chartered for a specific voyage or flight rather than for a specific period of time.

(xi) *Wet lease.* A wet lease is the time or voyage charter of an aircraft.

(f) *International operation of ships or aircraft*—(1) *General rule.* The term *international operation of ships or aircraft* means the operation of ships or aircraft, as defined in paragraph (e) of this section, with respect to the carriage of passengers or cargo on voyages or flights that begin or end in the United States, as determined under paragraph (f)(2) of this section. The term does not include the carriage of passengers or cargo on a voyage or flight that begins and ends in the United States, even if the voyage or flight contains a segment extending beyond the territorial limits of the United States, unless the passenger disembarks or the cargo is unloaded outside the United States. Operation of ships or aircraft beyond the territorial limits of the United States does not constitute in itself international operation of ships or aircraft.

(2) *Determining whether income is derived from international operation of ships or aircraft.* Whether income is derived from international operation of ships or aircraft is determined on a passenger by passenger basis (as provided in paragraph (f)(2)(i) of this section) and on an item-of-cargo by item-of-cargo basis (as provided in paragraph (f)(2)(ii) of this section). In the case of the bareboat charter of a ship or the dry lease of an aircraft, whether the charter income for a particular period is derived from international operation of ships or aircraft is determined by reference to how the ship or aircraft is used by the lowest-tier lessee in the chain of lessees (as provided in paragraph (f)(2)(iii) of this section).

(i) *International carriage of passengers*—(A) *General rule.* Except in the case of a round trip described in paragraph (f)(2)(i)(B) of this section, income derived from the carriage of a passenger will be income from international operation of ships or aircraft if the passenger is carried between a beginning point in the United States and an ending point outside the United States, or vice versa. Carriage of a passenger will be treated as ending at the passenger's final destination even if, en route to the passenger's final destination, a stop is made at an intermediate point for refueling, maintenance, or other business reasons, provided the passenger does not change ships or aircraft at the intermediate point. Similarly, carriage of a passenger will be treated as beginning at the passenger's point of origin even if, en route to the passenger's final destination, a stop is made at an intermediate point, provided the passenger does not change ships or aircraft at the intermediate point. Carriage of a passenger will be treated as beginning or ending at a U.S. or foreign intermediate point if the passenger changes ships or aircraft at that intermediate point.

(B) *Round trip travel on ships.* In the case of income from the carriage of a passenger on a ship that begins its voyage in the United States, calls on one or more foreign intermediate ports, and returns to the same or another U.S. port, such income from carriage of a passenger on the entire voyage will be treated as income derived from international operation of ships or aircraft under paragraph (f)(2)(i)(A) of this section. This result obtains even if such carriage includes one or more intermediate stops at a U.S. port or ports and even if the passenger does not disembark at the foreign intermediate point.

(ii) *International carriage of cargo.* Income from the carriage of cargo will be income derived from international operation of ships or aircraft if the cargo is carried between a beginning point in the United States and an ending point outside the United States, or vice versa. Carriage of cargo will be treated as ending at the final destination of the cargo even if, en route to that final destination, a stop is made at a U.S. intermediate point, provided the cargo is transported to its ultimate destination on the same ship or aircraft. If the cargo is transferred to another ship or aircraft, the carriage of the cargo may nevertheless be treated as ending at its final destination, if the same taxpayer transports the cargo to and from the U.S. intermediate point and the cargo does not pass through customs at the U.S. intermediate point. Similarly, carriage of cargo will be treated as beginning at the cargo's point of origin, even if en route to its final destination a stop is made at a U.S. intermediate point, provided the cargo is transported to its ultimate destination on the same ship or aircraft. If the cargo is transferred to another ship or aircraft at the U.S. intermediate point, the carriage of the cargo may nevertheless be treated as beginning at the point of origin, if the same taxpayer transports the cargo to and from the U.S. intermediate point and the cargo does not pass through customs at the U.S. intermediate point. Repackaging, recontainerization, or any other activity involving the unloading of the cargo at the U.S. intermediate point does not change these results, provided the same taxpayer transports the cargo to and from the U.S. intermediate point and the cargo does not pass through customs at the U.S. intermediate point. A lighter vessel that carries cargo to, or picks up cargo from, a vessel located beyond the territorial limits of the United States and correspondingly loads or unloads that cargo at a U.S. port, carries cargo between a point in the United States and a point outside the United States. However, a lighter vessel that carries cargo to, or picks up cargo from, a vessel located within the territorial limits of the United States, and correspondingly loads or unloads that cargo at a U.S. port, is not engaged in international operation of ships or aircraft. Income from the carriage of military cargo on a voyage that begins in the United States, stops at a foreign intermediate port or a military prepositioning location, and returns to the same or another U.S. port without unloading its cargo at the foreign intermediate point, will nevertheless be treated as derived from international operation of ships or aircraft.

(iii) *Bareboat charter of ships or dry lease of aircraft used in international operation of ships or aircraft.* If a qualified foreign corporation bareboat charters a ship or dry leases an aircraft to a lessee, and the lowest tier lessee in the chain of ownership uses such ship or aircraft for the international carriage of passengers or cargo for hire, as described in paragraphs (f)(2)(i) and (ii) of this section, then the amount of charter income attributable to the period the ship or aircraft is used by the lowest

tier lessee is income from international operation of ships or aircraft. The foreign corporation must adopt a reasonable method consistently applied for determining the amount of the charter income that is attributable to such international operation of ships or aircraft. Two reasonable methods for determining the amount of charter income attributable to international operation of ships or aircraft are the following:

(A) *Ratio based on use.* Multiply the amount of charter income by a fraction, the numerator of which is the total number of days of uninterrupted travel on voyages or flights of such ship or aircraft between the United States and the farthest point or points where cargo or passengers are loaded en route to, or discharged en route from, the United States during the smaller of the taxable year or the particular charter period, and the denominator of which is the total number of days in the smaller of the taxable year or the particular charter period. For this purpose, the number of days during which the ship or aircraft is not generating transportation income, within the meaning of section 863(c)(2), are not included in the numerator of the fraction. For example, the numerator of the fraction does not include days during which the ship or aircraft is out of service while being repaired or maintained or days during which the ship is not being used to carry cargo or persons for hire.

(B) *Ratio based on gross income.* Multiply the amount of charter income by a fraction, the numerator of which is the U.S. source gross transportation income, as that term is defined in section 887(b), earned from the operation of the vessel or aircraft by the lowest tier lessee during the smaller of the taxable year or the particular charter period, and the denominator of which is the total gross income of the lessee from the operation of the ship or aircraft during the smaller of the taxable year or the particular charter period. An allocation based on the net income of such lessee, however, will not be considered reasonable for purposes of this paragraph (f)(2)(iii)(B).

(g) *Activities incidental to the international operation of ships or aircraft*—(1) *General rule.* Certain activities of a foreign corporation engaged in the international operation of ships or aircraft are so closely related to the international operation of ships or aircraft that they are considered incidental to such operation, and income derived by the foreign corporation from its performance of these incidental activities is deemed to be income derived from the international operation of ships or aircraft. Examples of such activities include—

(i) Temporary investment of working capital funds to be used in the international operation of ships or aircraft by the foreign corporation;

(ii) Sale of tickets by the foreign corporation engaged in the international operation of ships for the international carriage of passengers by ship on behalf of another corporation engaged in the international operation of ships;

(iii) Sale of tickets by the foreign corporation engaged in the international operation of aircraft for the international carriage of passengers by air on behalf of another corporation engaged in the international operation of aircraft;

(iv) Contracting with concessionaires for performance of services onboard during the international operation of the foreign corporation's ships or aircraft;

(v) Providing through a related or unrelated corporation (either by subcontracting or otherwise) for the carriage of cargo preceding or following the international carriage of cargo under a through bill of lading, airway bill or similar document;

(vi) To the extent not described in paragraph (g)(1)(iii) of this section, the sale or issuance by the foreign corporation engaged in the international operation of aircraft of interline or code-sharing tickets for the carriage of persons by air between a U.S. gateway and another U.S. city preceding or following international carriage of passengers, provided that all such flight segments are provided pursuant to the passenger's original invoice, ticket or itinerary;

(vii) Arranging for port city hotel accommodations within the United States for a passenger for the one night before or after the international carriage of that passenger by the foreign corporation engaged in the international operation of ships;

(viii) Bareboat charter of ships or dry lease of aircraft normally used by the foreign corporation in international operation of ships or aircraft but currently not needed, if the ship or aircraft is used by the lessee for international carriage of cargo or passengers;

(ix) Arranging by means of a space or slot charter for the carriage of cargo listed on a bill of lading or airway bill or similar document issued by the foreign corporation on the ship or aircraft of another corporation engaged in the international operation of ships or aircraft; and

(x) Rental of containers by the foreign corporation for use in the United States for a period not exceeding five days beyond the original delivery date by the foreign corporation to the consignee as stated on the bill of lading, provided that—

(A) The consignee takes delivery in the United States;

(B) The container is owned by or leased to the foreign corporation; and

(C) The container is identified (for example, by a 4 digit alpha code and serial number) on a bill of lading or attached manifest or similar document issued by the foreign corporation that provides for the transportation of cargo between points not solely within the United States.

(2) *Activities not considered incidental to the international operation of ships or aircraft.* Examples of activities that are not considered incidental to the international operation of ships or aircraft include—

(i) The sale of or arranging for train travel, bus transfers, or land tour packages;

(ii) Arranging for port city hotel accommodations within the United States other than as provided in paragraph (g)(1)(vii) of this section;

(iii) The sale of airline tickets or cruise tickets other than as provided in paragraph (g)(1)(ii), (iii), or (vi) of this section;

(iv) The sale or rental of real property;

(v) Treasury activities involving the investment of excess funds or funds awaiting repatriation, even if derived from the international operation of ships or aircraft;

(vi) The carriage of passengers or cargo on ships or aircraft on domestic legs of transportation not treated as either international operation of ships or aircraft under paragraph (f) of this section or as an activity that is incidental to such operation under paragraph (g)(1) of this section;

(vii) The carriage of cargo by bus, truck or rail by a foreign corporation between a U.S. inland point and a U.S. gateway port or airport preceding or following the international carriage of such cargo by the foreign corporation; and

(viii) Rental of containers attributable to the use of a container within the United States other than as provided in paragraph (g)(1)(x) of this section.

(3) *Services*—(i) *Ground services, maintenance and catering.* [Reserved]

(ii) *Other services.* [Reserved]

(4) *Activities involved in a pool, partnership, strategic alliance, joint operating agreement, code-sharing arrangement or other joint venture.* Notwithstanding paragraph (g)(1) of this section, an activity is considered incidental to the international operation of ships or aircraft by a foreign

corporation, and income derived by the foreign corporation with respect to such activity is deemed to be income derived from the international operation of ships or aircraft, if the activity is performed by or pursuant to a pool, partnership, strategic alliance, joint operating agreement, code-sharing arrangement or other joint venture in which such foreign corporation participates, provided that—

(i) Such activity is incidental to the international operation of ships or aircraft by the pool, partnership, strategic alliance, joint operating agreement, code-sharing arrangement or other joint venture, and provided that it is described in paragraph (e)(2)(i) of this section; or

(ii) Such activity would be incidental to the international operation of ships or aircraft by the foreign corporation, if it performed such activity itself, and provided the foreign corporation is engaged in the operation of ships or aircraft under paragraph (e)(1) of this section.

(h) *Equivalent exemption*—(1) *General rule.* A foreign country grants an equivalent exemption when it exempts from taxation income from the international operation of ships or aircraft derived by corporations organized in the United States. Whether a foreign country provides an equivalent exemption must be determined separately with respect to each category of income, as provided in paragraph (h)(2) of this section. An equivalent exemption may be available for income derived from the international operation of ships even though income derived from the international operation of aircraft may not be exempt, and vice versa. For rules regarding foreign corporations organized in countries that provide exemptions only through an income tax convention, see paragraph (h)(3) of this section. An equivalent exemption may exist where the foreign country—

(i) Generally imposes no tax on income, including income from the international operation of ships or aircraft;

(ii) Specifically provides a domestic law tax exemption for income derived from the international operation of ships or aircraft, either by statute, decree, or otherwise; or

(iii) Exchanges diplomatic notes with the United States, or enters into an agreement with the United States, that provides for a reciprocal exemption for purposes of section 883.

(2) *Determining equivalent exemptions for each category of income.* Whether a foreign country grants an equivalent exemption must be determined separately with respect to income from the international operation of ships and income from the international operation of aircraft for each category of income listed in (i) through (viii) of this section paragraph (h)(2). If an exemption is unavailable in the foreign country for a particular category of income, the foreign country is not considered to grant an equivalent exemption with respect to that category of income. Income in that category is not considered to be the subject of an equivalent exemption and thus is not eligible for exemption from income tax in the United States, even though the foreign country may grant an equivalent exemption for other categories of income. The following categories of income derived from the international operation of ships or aircraft may be exempt from United States income tax if an equivalent exemption is available—

(i) Income from the carriage of passengers and cargo;

(ii) Time or voyage (full) charter income of a ship or wet lease income of an aircraft;

(iii) Bareboat charter income of a ship or dry charter income of an aircraft;

(iv) Incidental bareboat charter income or incidental dry lease income;

(v) Incidental container-related income;

(vi) Income incidental to the international operation of ships or aircraft other than incidental income described in paragraph (h)(2)(iv) and (v) of this section;

(vii) Capital gains derived by a qualified foreign corporation engaged in the international operation of ships or aircraft from the sale, exchange or other disposition of a ship, aircraft, container or related equipment or other moveable property used by that qualified foreign corporation in the international operation of ships or aircraft; and

(viii) Income from participation in a pool, partnership, strategic alliance, joint operating agreement, code-sharing arrangement, international operating agency, or other joint venture described in paragraph (e)(2) of this section.

(3) *Special rules with respect to income tax conventions*—(i) *General rule.* Except as provided in paragraph (h)(3)(ii) of this section, if a corporation is organized in a foreign country that provides an exemption only through an income tax convention with the United States, the foreign corporation is not organized in a foreign country that grants an equivalent exemption. Rather, the foreign corporation must satisfy the terms of that convention to receive a benefit under the convention, and the foreign corporation may not claim an exemption under section 883. If the corporation is organized in a foreign country that offers an exemption under an income tax convention and also by some other means, such as by diplomatic note or domestic statutory law, the foreign corporation may choose annually whether to claim an exemption under section 883 based upon the equivalent exemption provided by such other means, under the income tax convention, or under both the income tax convention and section 883. Any such choice will apply with respect to all qualified income of the corporation from the international operation of ships or aircraft and cannot be made separately with respect to different categories of such income. If a foreign corporation bases its claim for an exemption on section 883, the foreign corporation must satisfy all of the requirements of this section to qualify for an exemption from U.S. income tax. See § 1.883–4(b)(3) for rules regarding satisfying the ownership test of paragraph (c)(2) of this section using shareholders resident in a foreign country that offers an exemption under an income tax convention.

(ii) *Participation in certain joint ventures.* Notwithstanding paragraph (h)(3)(i) of this section, if a corporation is organized in a foreign country that provides an exemption only through an income tax convention with the United States, the foreign corporation will be treated as organized in a foreign country that grants an equivalent exemption under section 883 with respect to a category of income derived through participation in a pool, partnership, strategic alliance, joint operating agreement, code-sharing arrangement or other joint venture described in paragraph (e)(2) of this section, but only where treaty benefits would be available under the treaty but for the treatment of the pool, partnership, strategic alliance, joint operating agreement, code-sharing arrangement or other joint venture as not fiscally transparent with respect to that category of income under the income tax laws of the foreign country in which the foreign corporate interest holder is organized for purposes of § 1.894–1(d)(3)(iii)(A).

(iii) *Independent interpretation of income tax conventions.* Nothing in this section and §§ 1.833–2 through 1.883–5 affects the rights or obligations under any income tax convention. The definitions provided in this section and §§ 1.833–2 through 1.883–5 shall neither give meaning to similar terms used in income tax conventions nor provide guidance regarding the scope of any exemption provided by such conventions.

(4) *Exemptions not qualifying as equivalent exemptions*—(i) *General rule.* Certain types of exemptions provided to corporations organized in the United States by foreign countries do not satisfy the equivalent exemption requirements of this section. The following paragraphs provide descriptions of some of the types of exemptions that do not qualify as equivalent exemptions for purposes of this section.

(ii) *Reduced tax rate or time limited exemption.* The exemption granted by the foreign country's law or income tax convention must be a complete exemption. The exemption may not constitute merely a reduction to a non-zero rate of tax levied against the income of corporations organized in the United States derived from the international operation of ships or aircraft or a temporary reduction to a zero rate of tax, such as in the case of a tax holiday.

(iii) *Inbound or outbound freight tax.* With respect to the carriage of cargo, the foreign country must provide an exemption from tax for income from transporting freight both inbound and outbound. For example, a foreign country that imposes tax only on outbound freight will not be treated as granting an equivalent exemption for income from transporting freight inbound into that country.

(iv) *Exemptions for limited types of cargo.* A foreign country must provide an exemption from tax for income from transporting all types of cargo. For example, if a foreign country were generally to impose tax on income from the international carriage of cargo but were to provide a statutory exemption for income from transporting agricultural products, the foreign country would not be considered to grant an equivalent exemption with respect to income from the international carriage of cargo, including agricultural products.

(v) *Territorial tax systems.* A foreign country with a territorial tax system will be treated as granting an equivalent exemption if it treats all income derived from the international operation of ships or aircraft derived by a U.S. corporation as entirely foreign source and therefore not subject to tax, including income derived from a voyage or flight that begins or ends in that foreign country.

(vi) *Countries that tax on a residence basis.* A foreign country that provides an equivalent exemption to corporations organized in the United States but also imposes a residence-based tax on certain corporations organized in the United States may nevertheless be considered to grant an equivalent exemption if the residence-based tax is imposed only on a corporation organized in the United States that maintains its center of management and control or other comparable attributes in that foreign country. If the residence-based tax is imposed on corporations organized in the United States and engaged in the international operation of ships or aircraft that are not managed and controlled in that foreign country, the foreign country shall not be treated as a qualified foreign country and shall not be considered to grant an equivalent exemption for purposes of this section.

(vii) *Exemptions within categories of income.* A foreign country must provide an exemption from tax for all income in a category of income, as defined in paragraph (h)(2) of this section. For example, a country that exempts income from the bareboat charter of passenger aircraft but not the bareboat charter of cargo aircraft does not provide an equivalent exemption. However, an equivalent exemption may be available for income derived from the international operation of ships even though income derived from the international operation of aircraft may not be exempt, and vice versa.

(i) *Treatment of possessions.* For purposes of this section, a possession of the United States will be treated as a foreign country. A possession of the United States will be considered to grant an equivalent exemption and will be treated as a qualified foreign country if it applies a mirror system of taxation. If a possession does not apply a mirror system of taxation, the possession may nevertheless be a qualified foreign country if, for example, it provides for an equivalent exemption through its internal law. A possession applies the mirror system of taxation if the United States Internal Revenue Code of 1986, as amended, applies in the possession with the name of the possession used instead of ''United States'' where appropriate.

(j) *Expenses related to qualified income.* If a qualified foreign corporation derives qualified income from the international operation of ships or aircraft as well as income that is not qualified income, and the non-qualified income is effectively connected with the conduct of a trade or business within the United States, the foreign corporation may not deduct from such non-qualified income any amount otherwise allowable as a deduction from qualified income, if that qualified income is excluded under this section. See section 265(a)(1).

Par. 4. Sections 1.883–2 through 1.883–5 are added to read as follows:

§ 1.883–2 Treatment of publicly-traded corporations.

(a) *General rule.* A foreign corporation satisfies the stock ownership test of § 1.883–1(c)(2) if it is considered a publicly-traded corporation and satisfies the substantiation and reporting requirements of paragraphs (e) and (f) of this section. To be considered a publicly-traded corporation, the stock of the foreign corporation must be primarily traded and regularly traded, as defined in paragraphs (c) and (d) of this section, respectively, on one or more established securities markets, as defined in paragraph (b) of this section, in either the United States or any qualified foreign country.

(b) *Established securities market*—(1) *General rule.* For purposes of this section, the term *established securities market* means, for any taxable year—

(i) A foreign securities exchange that is officially recognized, sanctioned, or supervised by a governmental authority of the qualified foreign country in which the market is located, and has an annual value of shares traded on the exchange exceeding $1 billion during each of the three calendar years immediately preceding the beginning of the taxable year;

(ii) A national securities exchange that is registered under section 6 of the Securities Act of 1934 (15 U.S.C. 78f);

(iii) A United States over-the-counter market, as defined in paragraph (b)(4) of this section;

(iv) Any exchange designated under a Limitation on Benefits article in a United States income tax convention; and

(v) Any other exchange that the Secretary may designate by regulation or otherwise.

(2) *Exchanges with multiple tiers.* If an exchange in a foreign country has more than one tier or market level on which stock may be separately listed or traded, each such tier shall be treated as a separate exchange.

(3) *Computation of dollar value of stock traded.* For purposes of paragraph (b)(1)(i) of this section, the value in U.S. dollars of shares traded during a calendar year shall be determined on the basis of the dollar value of such shares traded as reported by the International Federation of Stock Exchanges located in Paris, or, if not so reported, then by converting into U.S. dollars the aggregate value in local currency of the shares traded using an exchange rate equal to the average of the spot rates on the last day of each month of the calendar year.

(4) *Over-the-counter market.* An over-the-counter market is any market reflected by the existence of an

interdealer quotation system. An interdealer quotation system is any system of general circulation to brokers and dealers that regularly disseminates quotations of stocks and securities by identified brokers or dealers, other than by quotation sheets that are prepared and distributed by a broker or dealer in the regular course of business and that contain only quotations of such broker or dealer.

(5) *Discretion to determine that an exchange does not qualify as an established securities market.* The Commissioner may determine that a securities exchange that otherwise meets the requirements of paragraph (b) of this section does not qualify as an established securities market, if—

(i) The exchange does not have adequate listing, financial disclosure, or trading requirements (or does not adequately enforce such requirements); or

(ii) There is not clear and convincing evidence that the exchange ensures the active trading of listed stocks.

(c) *Primarily traded.* For purposes of this section, stock of a corporation is primarily traded in a country on one or more established securities markets, as defined in paragraph (b) of this section, if, with respect to each class of stock described in paragraph (d)(1)(i) of this section (relating to classes of stock relied on to meet the regularly traded test)—

(1) The number of shares in each such class that are traded during the taxable year on all established securities markets in that country exceeds

(2) The number of shares in each such class that are traded during that year on established securities markets in any other single country.

(d) *Regularly traded*—(1) *General rule.* For purposes of this section, stock of a corporation is regularly traded on one or more established securities markets, as defined in paragraph (b) of this section, if—

(i) One or more classes of stock of the corporation that, in the aggregate, represent more than 50 percent of the total combined voting power of all classes of stock of such corporation entitled to vote and of the total value of the stock of such corporation are listed on such market or markets during the taxable year; and

(ii) With respect to each class relied on to meet the more than 50 percent requirement of paragraph (d)(1)(i) of this section—

(A) Trades in each such class are effected, other than in *de minimis* quantities, on such market or markets on at least 60 days during the taxable year (or 1/6 of the number of days in a short taxable year); and

(B) The aggregate number of shares in each such class that are traded on such market or markets during the taxable year are at least 10 percent of the average number of shares outstanding in that class during the taxable year (or, in the case of a short taxable year, a percentage that equals at least 10 percent of the average number of shares outstanding in that class during the taxable year multiplied by the number of days in the short taxable year, divided by 365).

(2) *Classes of stock traded on a domestic established securities market treated as meeting trading requirements.* A class of stock that is traded during the taxable year on an established securities market located in the United States shall be considered to meet the trading requirements of paragraph (d)(1)(ii) of this section if the stock is regularly quoted by dealers making a market in the stock. A dealer makes a market in a stock only if the dealer regularly and actively offers to, and in fact does, purchase the stock from, and sell the stock to, customers who are not related persons (as defined in section 954(d)(3)) with respect to the dealer in the ordinary course of a trade or business.

(3) *Closely-held classes of stock not treated as meeting trading requirements*—(i) *General rule.* Except as provided in paragraph (d)(3)(ii) of this section, a class of stock of a foreign corporation that otherwise meets the requirements of paragraph (d)(1) or (2) of this section shall not be treated as meeting such requirements for a taxable year if, at any time during the taxable year, one or more persons who own at least 5 percent of the vote and value of the outstanding shares of the class of stock, as determined under paragraph (d)(3)(iii) of this section (each a 5-percent shareholder), own, in the aggregate, 50 percent or more of the vote and value of the outstanding shares of the class of stock. If one or more 5-percent shareholders own, in the aggregate, 50 percent or more of the vote and value of the outstanding shares of the class of stock, such shares held by the 5-percent shareholders will constitute a closely-held block of stock.

(ii) *Exception.* Paragraph (d)(3)(i) of this section shall not apply to a class of stock if the foreign corporation can establish that qualified shareholders, as defined in § 1.883–4(b), applying the attribution rules of § 1.883–4(c), own sufficient shares in the closely-held block of stock to preclude non-qualified shareholders in the closely-held block of stock from owning 50 percent or more of the total value of the class of stock of which the closely-held block is a part for more than half the number of days during the taxable year. Any shares that are owned, after application of the attribution rules in § 1.883–4(c), by a qualified shareholder shall not also be treated as owned by a non-qualified shareholder in the chain of ownership for purposes of the preceding sentence. A foreign corporation must obtain the documentation described in § 1.883–4(d) from the qualified shareholders relied upon to satisfy this exception. However, no person shall be treated for purposes of this paragraph (d)(3) as a qualified shareholder if such person holds an interest in the class of stock directly or indirectly through bearer shares.

(iii) *Five-percent shareholders*—(A) *Related persons.* Solely for purposes of determining whether a person is a 5-percent shareholder, persons related within the meaning of section 267(b) shall be treated as one person. In determining whether two or more corporations are members of the same controlled group under section 267(b)(3), a person is considered to own stock owned directly by such person, stock owned through the application of section 1563(e)(1), and stock owned through the application of section 267(c). In determining whether a corporation is related to a partnership under section 267(b)(10), a person is considered to own the partnership interest owned directly by such person and the partnership interest owned through the application of section 267(e)(3).

(B) *Investment companies.* For purposes of this paragraph (d)(3), an investment company registered under the Investment Company Act of 1940, as amended, shall not be treated as a 5-percent shareholder if no person owns both 5 percent or more of the value of the outstanding interests in the investment company (applying the attribution rules of § 1.883–4(c)) and 5-percent or more of the value of the shares of the class of stock of the foreign corporation seeking qualified foreign corporation status (applying the attribution rules of § 1.883–4(c)).

(4) *Anti-abuse rule.* Trades between or among related persons described in section 267(b), as modified by paragraph (d)(3)(iii) of this section, and trades conducted in order to meet the requirements of paragraph (d)(1) of this section shall be disregarded. A class of stock shall not be treated as meeting the trading requirements of paragraph (d)(1) of this section if there is a pattern of trades conducted to meet the requirements of that paragraph. For example, trades between two persons

that occur several times during the taxable year may be treated as an arrangement or a pattern of trades conducted to meet the trading requirements of paragraph (d)(1)(ii) of this section.

(5) *Example.* The closely-held test in paragraph (d)(3) of this section is illustrated by the following example:

Example. Closely-held exception—(i) Facts. X is a foreign corporation organized in a qualified foreign country and engaged in the international operation of ships. X has one class of stock, which is primarily traded on an established securities market in the qualified foreign country. The stock of X meets the regularly traded requirements of paragraph (d)(1)(ii) of this section without regard to paragraph (d)(3)(i) of this section. A, B, C and D are four members of the corporation's founding family who each own, during the entire taxable year, 25 percent of the stock of Hold Co, a company that issues registered shares. Hold Co, in turn, owns 60 percent of the stock of X during the entire taxable year. The remaining 40 percent of the stock of X is not owned by any 5-percent shareholder, as determined under paragraph (d)(3)(iii) of this section. A, B, and C are not residents of a qualified foreign country, but D is a resident of a qualified foreign country. (ii) *Analysis.* Because Hold Co owns 60 percent of the stock of X for more than half the number of days during the taxable year, Hold Co is a 5-percent shareholder that owns 50 percent or more of the value of the stock of X. Thus, the shares owned by Hold Co constitute a closely-held block of stock. Under paragraph (d)(3)(i) of this section, the stock of X will not be regularly traded within the meaning of paragraph (d)(1) of this section unless X can establish, under paragraph (d)(3)(ii) of this section, that qualified shareholders within the closely-held block of stock own sufficient shares in the closely-held block of stock to preclude non-qualified shareholders in the closely-held block of stock from owning 50 percent or more of the value of the outstanding shares in the class of stock for more than half the number of days during the taxable year. A, B, and C are not qualified shareholders within the meaning of § 1.883–4(b) because they are not residents of a qualified foreign country, but D is a resident of a qualified foreign country and therefore is a qualified shareholder. D owns 15 percent of the outstanding shares of X through Hold Co (25 percent × 60 percent = 15 percent) while A, B, and C in the aggregate own 45 percent of the outstanding shares of X through Hold Co. D, therefore, owns sufficient shares in the closely-held block of stock to preclude the non-qualified shareholders in the closely-held block of stock, A, B and C, from owning 50 percent or more of the value of the class of stock (60 percent − 15 percent = 45 percent) of which the closely-held block is a part. Provided that X obtains from D the documentation described in § 1.883–4(d), X's sole class of stock meets the exception in paragraph (d)(3)(ii) of this section and will not be disqualified from the regularly traded test by virtue of paragraph (d)(3)(i) of this section.

(e) *Substantiation that a foreign corporation is publicly traded*—(1) *General rule.* A foreign corporation that relies on the publicly traded test of this section to meet the stock ownership test of § 1.883–1(c)(2) must substantiate that the stock of the foreign corporation is primarily and regularly traded on one or more established securities markets, as that term is defined in paragraph (b) of this section. If one of the classes of stock on which the foreign corporation relies to meet this test is closely-held within the meaning of paragraph (d)(3)(i) of this section, the foreign corporation must obtain an ownership statement described in § 1.883–4(d) from each qualified shareholder and intermediary that it relies upon to satisfy the exception to the closely-held test, but only to the extent such statement would be required if the foreign corporation were relying on the qualified shareholder stock ownership test of § 1.883–4 with respect to those shares of stock. The foreign corporation must also maintain and provide to the Commissioner upon request a list of its shareholders of record and any other relevant information known to the foreign corporation supporting its entitlement to an exemption under this section.

(2) *Availability and retention of documents for inspection.* The documentation described in paragraph (e)(1) of this section must be retained by the corporation seeking qualified foreign corporation status until the expiration of the statute of limitations for the taxable year of the foreign corporation to which the documentation relates. Such documentation must be made available for inspection by the Commissioner at such time and such place as the Commissioner may request in writing.

(f) *Reporting requirements.* A foreign corporation relying on this section to satisfy the stock ownership test of § 1.883–1(c)(2) must provide the following information in addition to the information required in § 1.883–1(c)(3) to be included in its Form 1120F for the taxable year. The information must be current as of the end of the corporation's taxable year and must include the following—

(1) The name of the country in which the stock is primarily traded;

(2) The name of the established securities market or markets on which that the stock is listed;

(3) A description of each class of stock relied upon to meet the requirements of paragraph (d) of this section, including the number of shares issued and outstanding as of the close of the taxable year;

(4) For each class of stock relied upon to meet the requirements of paragraph (d) of this section, if one or more 5-percent shareholders, as described in paragraph (d)(3)(iii) of this section, own in the aggregate 50 percent or more of the value of the outstanding shares of that class of stock at any time during the taxable year—

(i) The highest total percentage of the value of the class of stock that is owned by 5-percent shareholders, as described in paragraph (d)(3)(iii) of this section, at any time during the taxable year;

(ii) For each qualified shareholder who owns or is treated as owning stock in the closely-held block upon whom the corporation intends to rely to satisfy the exception to the closely-held test of paragraph (d)(3)(ii) of this section—

(A) The name of each such shareholder;

(B) The percentage of the total value of the class of stock held by each such shareholder;

(C) The address of record of each such shareholder;

(D) The country of residence of each such shareholder, determined under § 1.883–4(b)(2) (residence of individual shareholders) or § 1.883–4(d)(3) (special rules for residence of certain shareholders);

(E) The portion of the taxable year of the corporation during which the stock was closely-held without regard to the exception in paragraph (d)(3)(ii) of this section; and

(5) Any other relevant information specified by Form 1120F and its accompanying instructions.

§ 1.883–3 Treatment of controlled foreign corporations.

(a) *General rule.* A foreign corporation satisfies the stock ownership test of § 1.883–1(c)(2) if it is a controlled foreign corporation (CFC), as defined in section 957(a), and satisfies the income inclusion test in paragraph (b) of this section and the substantiation and reporting requirements of paragraphs (c) and (d) of this section, respectively. A CFC that fails the income inclusion test of paragraph (b) of this section will not be a qualified foreign corporation unless it meets either the publicly traded test of § 1.883–2(a) or the qualified shareholder stock ownership test of § 1.883–4(a).

(b) *Income inclusion test*—(1) *General rule.* A CFC shall not be considered to satisfy the requirements of paragraph (a) of this section unless more than 50 percent of the CFC's adjusted net foreign base company income (as defined in § 1.954–1(d) and as increased or decreased by section 952(c)) derived from the international operation of ships

or aircraft is includible in the gross income of one or more United States citizens, individual residents of the United States or domestic corporations, pursuant to section 951(a)(1)(A) or another provision of the Internal Revenue Code, for the taxable years of such persons in which the taxable year of the CFC ends.

(2) *Examples.* The income inclusion test of paragraph (b)(1) of this section is illustrated in the following examples:

Example 1. Ship Co is a CFC organized in a qualified foreign country. All of ship Co's income is foreign base company shipping income that is derived from the international operation of ships. All of its shares are owned by a domestic partnership that is a United States shareholder for purposes of section 951(b). All of the partners in the domestic partnership are citizens and residents of foreign countries. Ship Co fails the income inclusion test of paragraph (b)(1) of this section because no amount of Ship Co's subpart F income that is adjusted net foreign base company income derived from the international operation of ships is includible under any provision of the Internal Revenue Code in the gross income of one or more United States citizens, individual residents of the United States or domestic corporations. Therefore, Ship Co must satisfy the qualified shareholder stock ownership test of § 1.883–4(a), in order to satisfy the stock ownership test of § 1.883–1(c)(2) and to be considered a qualified foreign corporation.

Example 2. Ship Co is a CFC organized in a qualified foreign country. All of ship Co's income is foreign base company shipping income that is derived from the international operation of ships. Corp A, a domestic corporation, owns 50 percent of the value of the stock of Ship Co. X, a domestic partnership, owns the remaining 50 percent of the value of the stock of Ship Co. A United States citizen is a partner owning a 10 percent income interest in X. Individual partners owning 80 percent of X are citizens and residents of foreign countries. There are no special allocations of partnership income. Ship Co satisfies the income inclusion test of paragraph (b)(1) of this section because 55 percent (50 percent + (10 percent x 50 percent)) of the subpart F income that is adjusted net foreign base company income derived from the international operation of ships would be includible in the gross income of U.S. citizens, individual residents of the United States or domestic corporations. If Ship Co satisfies the substantiation and reporting requirements of paragraphs (c) and (d) of this section, it will meet the stock ownership test of § 1.883–1(c)(2).

(c) *Substantiation of CFC stock ownership*—(1) *General rule.* A foreign corporation that relies on this section to satisfy the stock ownership test of § 1.883–1(c)(2) must substantiate all the facts necessary to satisfy the Commissioner that it qualifies under the income inclusion test of paragraph (b)(1) of this section. For purposes of the income inclusion test, if the CFC has one or more United States shareholders, as defined in section 951(b), that are domestic partnerships, estates, or trusts, the pro rata share of the subpart F income includible in the gross income of such shareholders will only be treated as includible in the income of any partner, beneficiary or other interest owner of such United States shareholder that is a United States citizen, resident of the United States or a domestic corporation if the CFC obtains the documentation described in paragraph (c)(2) of this section.

(2) *Documentation from certain United States shareholders*—(i) *General rule.* A CFC only meets the documentation requirements of paragraph (c)(1) of this section if the CFC obtains the following documentation with respect to each United States shareholder, as defined in section 951(b), that is a partnership, estate or trust, for the taxable year of the shareholder which ends with or within the taxable year of the CFC—

(A) A copy of the Form 5471, ''Information Return of U.S. Persons with Respect to Certain Foreign Corporations,'' filed with the controlling United States shareholder's return;

(B) A written statement, signed under penalties of perjury by a person authorized to sign the U.S. Federal tax return of each such United States shareholder, providing the following information with respect to each United States citizen, individual resident of the United States or domestic corporation that is a partner, beneficiary or other interest owner of each such United States shareholder and upon whom the CFC intends to rely to satisfy the income inclusion test of paragraph (b)(1) of this section—

(*1*) The name, address from the CFC's corporate records (that is a specific street address and not a non-residential address, such as a post office box or in care of a financial intermediary or stock transfer agent), and taxpayer identification number of the interest owner;

(*2*) The interest owner's proportionate interest in the United States shareholder that reflects that owner's share of subpart F income required to be included in income on such interest owner's U.S. Federal income tax return;

(*3*) The percentage of the vote and the percentage of the value of shares of the CFC owned by each such interest owner pursuant to the attribution rules in § 1.883–4(c)(2)(i); and

(C) Any other information as specified in guidance published by the Internal Revenue Service (see § 601.601(d)(2) of this chapter).

(ii) *Availability and retention of documents for inspection.* The documentation described in paragraph (c)(2)(i) of this section must be retained by the corporation seeking qualified foreign corporation status (the CFC) until the expiration of the statute of limitations for the taxable year of the CFC to which the documentation relates. Such documentation must be made available for inspection by the Commissioner at such place as the Commissioner may request in writing.

(d) *Reporting requirements.* A foreign corporation that relies on the CFC test of this section to satisfy the stock ownership test of § 1.883–1(c)(2) must provide the following information in addition to the information required in § 1.883–1(c)(3) to be included in its Form 1120F for the taxable year. The information must be current as of the end of the corporation's taxable year and must include the following—

(1) The name, address from the CFC's corporate records (that is a specific street address and not a non-residential address, such as a post office box or in care of a financial intermediary or stock transfer agent), and taxpayer identification number of each United States shareholder, as defined in section 951(b), of the CFC;

(2) The percentage of the vote and value of the shares of the CFC that is owned by each United States shareholder, as defined in section 951(b);

(3) If one or more of the United States shareholders is a domestic partnership, estate or trust, the name, address, taxpayer identification number and percentage of the vote and the percentage of the value of shares of the CFC owned (as determined under § 1.883–4(c)(2)(i)) by each interest owner of each such United States shareholder that is a United States citizen, individual resident of the United States or a domestic corporation; and

(4) Any other relevant information specified by Form 1120F and its accompanying instructions.

§ 1.883–4 Qualified shareholder stock ownership test.

(a) *General rule.* A foreign corporation satisfies the stock ownership test of § 1.883–1(c)(2) if more than 50 percent of the value of its outstanding shares is owned, or treated as owned by applying the attribution rules of paragraph (c) of this section, for at least half of the number of days in the foreign corporation's taxable year by one or more qualified shareholders, as defined

in paragraph (b) of this section. A shareholder may be a qualified shareholder with respect to one category of income while not being a qualified shareholder with respect to another. A foreign corporation will not be considered to satisfy the stock ownership test of A1.883–1(c)(2) pursuant to this section unless the foreign corporation meets the substantiation and reporting requirements of paragraphs (d) and (e) of this section.

(b) *Qualified shareholder*—(1) *General rule.* A shareholder is a qualified shareholder only if the shareholder—

(i) With respect to the category of income for which the foreign corporation is seeking an exemption, is—

(A) An individual not described in paragraph (b)(1)(i)(E) or (F) of this section, who is a resident, as described in paragraph (b)(2) of this section, of a qualified foreign country, as defined in § 1.883–1(d);

(B) The government of a qualified foreign country (or a political subdivision or local authority of such country);

(C) A foreign corporation that is organized in a qualified foreign country and meets the publicly traded test of § 1.883–2(a);

(D) A not-for-profit organization described in paragraph (b)(4) of this section that is not a pension fund as defined in paragraph (b)(5) of this section and that is organized in a qualified foreign country;

(E) An individual beneficiary of a pension fund (as defined in paragraph (b)(5)(iv) of this section) that is administered in or by a qualified foreign country, who is treated as a resident under paragraph (d)(3)(iii) of this section, of a qualified foreign country; or

(F) A shareholder of foreign corporation that is an airline covered by a bilateral Air Services Agreement in force between the United States and the qualified foreign country in which the airline is organized, provided the United States has not waived the ownership requirement in the Air Services Agreement, or that the ownership requirement has not otherwise been made ineffective;

(ii) Does not own its interest in the foreign corporation through bearer shares, either directly or by applying the attribution rules of paragraph (c) of this section; and

(iii) Provides to the foreign corporation the documentation required in paragraph (d) of this section and the foreign corporation meets the reporting requirements of paragraph (e) of this section with respect to such shareholder.

(2) *Residence of individual shareholders*—(i) *General rule.* Except for an individual described in paragraph (b)(1)(i)(E) or (F) of this section, an individual is a resident of a qualified foreign country only if the individual is fully liable to tax as a resident in such country (e.g., an individual who is liable to tax on a remittance basis in a foreign country will not be treated as a resident of that country) and, in addition—

(A) The individual has a tax home, within the meaning of paragraph (b)(2)(ii) of this section, in that qualified foreign country for 183 days or more of the taxable year; or

(B) The individual is treated as a resident of a qualified foreign country based on special rules pursuant to paragraph (d)(3) of this section.

(ii) *Tax home.* For purposes of this section, an individual's tax home is considered to be located at the individual's regular or principal (if more than one regular) place of business. If the individual has no regular or principal place of business because of the nature of his business (or lack of a business), then the individual's tax home is located at his regular place of abode in a real and substantial sense. If an individual has no regular or principal place of business and no regular place of abode in a real and substantial sense in a qualified foreign country for 183 days or more of the taxable year, that individual does not have a tax home for purposes of this section. A foreign estate or trust, as defined in section 7701(a)(31), does not have a tax home for purposes of this section. See paragraph (c)(3) of this section for alternative rules in the case of trusts or estates.

(3) *Certain income tax convention restrictions applied to shareholders.* For purposes of paragraph (b)(1) of this section, a shareholder described in paragraph (b)(1) of this section may be considered a resident of, or organized in, a qualified foreign country if that foreign country provides an exemption by means of an income tax convention with the United States, but only if the shareholder demonstrates that it is treated as a resident of that country under the convention and qualifies for benefits under any Limitation on Benefits article, and that the convention provides an exemption for the relevant category of income. If the convention has a requirement in the shipping and air transport article other than residence, such as place of registration or documentation of the ship or aircraft, the shareholder is not required to demonstrate that the corporation seeking qualified foreign corporation status could satisfy any such additional requirement.

(4) *Not-for-profit organizations.* The term *not-for-profit organization* means an organization that meets the following requirements—

(i) It is a corporation, association taxable as a corporation, trust, fund, foundation, league or other entity operated exclusively for religious, charitable, educational, or recreational purposes, and not organized for profit;

(ii) It is generally exempt from tax in its country of organization by virtue of its not-for-profit status; and

(iii) Either—

(A) More than 50 percent of its annual support is expended on behalf of persons described in paragraph (b)(1)(i)(A) of this section (see paragraph (d)(3)(v) of this section for rules regarding the residence of individual beneficiaries); or

(B) More than 50 percent of its annual support is derived from persons described in paragraph (b)(1)(i)(A) of this section (see paragraph (d)(3)(v) of this section for rules regarding the residence of individual supporters).

(5) *Pension funds*—(i) *Pension fund defined.* The term *pension fund* shall mean a government pension fund or a non-government pension fund, as those terms are defined, respectively, in paragraphs (b)(5)(ii) and (iii) of this section, that is a trust, fund, foundation, or other entity that is established exclusively for the benefit of employees or former employees of one or more employers, the principal purpose of which is to provide retirement, disability, and death benefits to beneficiaries of such entity and persons designated by such beneficiaries in consideration for prior services rendered.

(ii) *Government pension funds.* A government pension fund is a pension fund that is a controlled entity of a foreign sovereign within the principles of § 1.892–2T(c)(1) (relating to pension funds established for the benefit of employees or former employees of a foreign government).

(iii) *Non-government pension funds.* A non-government pension fund is a pension fund that—

(A) Is administered in a foreign country and is subject to supervision or regulation by a governmental authority (or other authority delegated to perform such supervision or regulation by a governmental authority) in such country;

(B) Is generally exempt from income taxation in its country of administration;

(C) Has 100 or more beneficiaries; and

(D) The trustees, directors or other administrators of which pension fund provide the documentation required in paragraph (d) of this section.

(iv) *Beneficiary of a pension fund.* The term *beneficiary of a pension fund* shall mean any person who has made contributions to a pension fund, as that term is defined in paragraph (b)(5)(i) of this section, or on whose behalf contributions have been made, and who is currently receiving retirement, disability, or death benefits from the pension fund or can reasonably be expected to receive such benefits in the future, whether or not the person's right to receive benefits from the fund has vested. See paragraph (c)(7) of this section for rules regarding the computation of stock ownership through non-government pension funds.

(c) *Rules for determining constructive ownership*—(1) *General rules for attribution.* For purposes of applying paragraph (a) of this section and the exception to the closely-held test in § 1.883–2(d)(3)(ii), stock owned by or for a corporation, partnership, trust, estate, or mutual insurance company or similar entity shall be treated as owned proportionately by its shareholders, partners, beneficiaries, grantors, or other interest holders, as provided in paragraphs (c)(2) through (7) of this section. The proportionate interest rules of this paragraph (c) shall apply successively upward through a chain of ownership, and a person's proportionate interest shall be computed for the relevant days or period taken into account in determining whether a foreign corporation satisfies the requirements of paragraph (a) of this section. Stock treated as owned by a person by reason of this paragraph (c) shall be treated as actually owned by such person for purposes of this section. An owner of an interest in an association taxable as a corporation shall be treated as a shareholder of such association for purposes of this paragraph (c). No attribution will apply to an interest held directly or indirectly through bearer shares.

(2) *Partnerships*—(i) *General rule.* A partner shall be treated as having an interest in stock of a foreign corporation owned by a partnership in proportion to the least of—

(A) The partner's percentage distributive share of the partnership's dividend income from the stock;

(B) The partner's percentage distributive share of gain from disposition of the stock by the partnership; or

(C) The partner's percentage distributive share of the stock (or proceeds from the disposition of the stock) upon liquidation of the partnership.

(ii) *Partners resident in the same country.* For purposes of this paragraph, all qualified shareholders that are partners in a partnership and that are residents of, or organized in, the same qualified foreign country shall be treated as one partner. Thus, the percentage distributive shares of dividend income, gain and liquidation rights of all qualified shareholders that are partners in a partnership and that are residents of, or organized in, the same qualified foreign country are aggregated prior to determining the least of the three percentages set out in paragraph (c)(2)(i) of this section. For the meaning of the term *resident,* see paragraph (b)(2) of this section.

(iii) *Examples.* The rules of paragraph (c)(2)(ii) of this section are illustrated by the following examples:

Example 1. Stock held solely by qualified shareholders through a partnership. Country X grants an equivalent exemption. A and B are individual residents of Country X and are qualified shareholders within the meaning of paragraph (b)(1) of this section. A and B are the sole partners of Partnership P. P's only asset is the stock of Corporation Z, a Country X corporation seeking a reciprocal exemption under this section. A's distributive share of P's income and gain on the disposition of P's assets is 80 percent, but A's distributive share of P's assets (or the proceeds therefrom) on P's liquidation is 20 percent. B's distributive share of P's income and gain is 20 percent and B is entitled to 80 percent of the assets (or proceeds therefrom) on P's liquidation. Under the attribution rules of paragraph (c)(2)(ii) of this section, A and B will be treated as a single partner owning in the aggregate 100 percent of the stock of Z owned by P.

Example 2. Stock held by both qualified and non-qualified shareholders through a partnership. Assume the same facts as in *Example 1* except that C, an individual who is not a resident of a qualified foreign country, is also a partner in P and that C's distributive share of P's income is 60 percent. The distributive shares of A and B are the same as in *Example 1,* except that A's distributive share of income is 20 percent. Under the attribution rules of paragraph (c)(2)(ii) of this section, qualified shareholders A and B will be treated as a single partner owning in the aggregate 40 percent of the stock of Z owned by P (i.e., the lowest aggregate percentage of A and B's distributive shares of dividend income (40 percent), gain (100 percent), and liquidation rights (100 percent) with respect to the Z stock). Thus, only 40 percent of the Z stock is treated as owned by qualified shareholders.

Example 3. Stock held through tiered partnerships. Country X grants an equivalent exemption. A and B are individual residents of Country X and are qualified shareholders within the meaning of paragraph (b)(1) of this section. A and B are the sole partners of Partnership P. P is a partner in Partnership P1, which owns the stock of Corporation Z, a Country X corporation seeking a reciprocal exemption under this section. Assume that P's distributive share of the dividend income, gain and liquidation rights with respect to the Z stock held by P1 is 40 percent. Assume that of the remaining partners of P1 only D is a qualified shareholder. D's distributive share of P1's dividend income and gain is 15 percent; D's distributive share of P1's assets on liquidation is 25 percent. Under the attribution rules of paragraph (c)(2)(ii) of this section, A and B, treated as a single partner, will own 40 percent of the Z stock owned by P1 (100 percent x 40 percent) and D will be treated as owning 15 percent of the Z stock owned by P1 (the least of D's dividend income (15 percent), gain (15 percent), and liquidation rights (25 percent) with respect to the Z stock). Thus, 55 percent of the Z stock owned by P1 is treated as owned by qualified shareholders.

(3) *Trusts and estates*—(i) *Beneficiaries.* In general, an individual shall be treated as having an interest in stock of a foreign corporation owned by a trust or estate in proportion to the individual's actuarial interest in the trust or estate, as provided in section 318(a)(2)(B)(i), except that an income beneficiary's actuarial interest in the trust will be determined as if the trust's only asset were the stock. The interest of a remainder beneficiary in stock will be equal to 100 percent minus the sum of the percentages of any interest in the stock held by income beneficiaries. The ownership of an interest in stock owned by a trust shall not be attributed to any beneficiary whose interest cannot be determined under the preceding sentence, and any such interest, to the extent not attributed by reason of this paragraph (c)(3)(i), shall not be considered owned by a beneficiary unless all potential beneficiaries with respect to the stock are qualified shareholders. In addition, a beneficiary's actuarial interest will be treated as zero to the extent that someone other than the beneficiary is treated as owning the stock under paragraph (c)(3)(ii) of this section. A substantially separate and independent share of a trust, within the meaning of section 663(c), shall be treated as a separate trust for purposes of this paragraph (c)(3)(i), provided that payment of income, accumulated income or corpus of a share of one beneficiary (or group of beneficiaries) cannot affect the proportionate share of income, accumulated income or corpus of another beneficiary (or group of beneficiaries).

(ii) *Grantor trusts.* A person is treated as the owner of stock of a foreign corporation owned by a trust to the extent that the stock is included in the portion of the trust that is treated as owned by the person under sections 671 through 679 (relating to grantors and others treated as substantial owners).

(4) *Corporations that issue stock.* A shareholder of a corporation that issues stock shall be treated as owning stock of a foreign corporation that is owned by such corporation on any day in a proportion that equals the value of the stock owned by such shareholder to the value of all stock of such corporation. If, however, there is an agreement, express or implied, that a shareholder of a corporation will not receive distributions from the earnings of stock owned by the corporation, the shareholder will not be treated as owning that stock owned by the corporation.

(5) *Taxable non-stock corporations.* A taxable non-stock corporation that is entitled in its country of organization to deduct from its taxable income amounts distributed for charitable purposes may deem a recipient of such charitable distributions to be a shareholder of such taxable non-stock corporation in the same proportion as the amount that such beneficiary receives in the taxable year bears to the total income of such taxable non-stock corporation in the taxable year. Whether each such recipient is a qualified shareholder may then be determined under paragraph (b) of this section or under the special rules of paragraph (d)(3)(vii) of this section.

(6) *Mutual insurance companies and similar entities.* Stock held by a mutual insurance company, mutual savings bank, or similar entity (including an association taxable as a corporation that does not issue stock interests) shall be considered owned proportionately by the policy holders, depositors, or other owners in the same proportion that such persons share in the surplus of such entity upon liquidation or dissolution.

(7) *Computation of beneficial interests in non-government pension funds.* Stock held by a pension fund shall be considered owned by the beneficiaries of the fund equally on a pro-rata basis if—

(i) The pension fund meets the requirements of paragraph (b)(5)(iii) of this section;

(ii) The trustees, directors or other administrators of the pension fund have no knowledge, and no reason to know, that a pro-rata allocation of interests of the fund to all beneficiaries would differ significantly from an actuarial allocation of interests in the fund (or, if the beneficiaries' actuarial interest in the stock held directly or indirectly by the pension fund differs from the beneficiaries's actuarial interest in the pension fund, the actuarial interests computed by reference to the beneficiaries' actuarial interest in the stock);

(iii) Either—

(A) Any overfunding of the pension fund would be payable, pursuant to the governing instrument or the laws of the foreign country in which the pension fund is administered, only to, or for the benefit of, one or more corporations that are organized in the country in which the pension fund is administered, individual beneficiaries of the pension fund or their designated beneficiaries, or social or charitable causes (the reduction of the obligation of the sponsoring company or companies to make future contributions to the pension fund by reason of overfunding shall not itself result in such overfunding being deemed to be payable to or for the benefit of such company or companies); or

(B) The foreign country in which the pension fund is administered has laws that are designed to prevent overfunding of a pension fund and the funding of the pension fund is within the guidelines of such laws; or

(C) The pension fund is maintained to provide benefits to employees in a particular industry, profession, or group of industries or professions and employees of at least 10 companies (other than companies that are owned or controlled, directly or indirectly, by the same interests) contribute to the pension fund or receive benefits from the pension fund; and

(iv) The trustees, directors or other administrators provide the relevant documentation as required in paragraph (d) of this section.

(d) *Substantiation of stock ownership*—(1) *General rule.* A foreign corporation that relies on this section to satisfy the stock ownership test of § 1.883–1(c)(2), must establish all the facts necessary to satisfy the Commissioner that more than 50 percent of the value of its shares is owned, or treated as owned applying paragraph (c) of this section, by qualified shareholders. A foreign corporation cannot meet this requirement with respect to any stock that is issued in bearer form. A shareholder that holds shares in the foreign corporation either directly or indirectly in bearer form cannot be a qualified shareholder.

(2) *Application of general rule*—(i) *Ownership statements.* Except as provided in paragraph (d)(3) of this section, a person shall only be treated as a qualified shareholder of a foreign corporation if—

(A) For the relevant period, the person completes an ownership statement described in paragraph (d)(4) of this section or has a valid ownership statement in effect under paragraph (d)(2)(ii) of this section;

(B) In the case of a person owning stock in the foreign corporation indirectly through one or more intermediaries (including mere legal owners or recordholders acting as nominees), each intermediary in the chain of ownership between that person and the foreign corporation seeking qualified foreign corporation status completes an intermediary ownership statement described in paragraph (d)(4)(v) of this section or has a valid intermediary ownership statement in effect under paragraph (d)(2)(ii) of this section; and

(C) The foreign corporation seeking qualified foreign corporation status obtains the statements described in paragraphs (d)(2)(i)(A) and (B) of this section.

(ii) *Three-year period of validity.* The ownership statements required in paragraph (d)(2)(i) of this section shall remain valid until the earlier of the last day of the third calendar year following the year in which the ownership statement is signed, or the day that a change of circumstance occurs that makes any information on the ownership statement incorrect. For example, an ownership statement signed on September 30, 2000, remains valid through December 31, 2003, unless a change of circumstance occurs that makes any information on the ownership statement incorrect.

(3) *Special rules*—(i) *Substantiating residence of certain shareholders.* A foreign corporation seeking qualified foreign corporation status or an intermediary that is a direct or indirect shareholder of such foreign corporation may substantiate the residence of certain shareholders, for purposes of paragraph (b)(2)(i)(B) of this section, under one of the following special rules in paragraphs (d)(3)(ii) through (viii) of this section, in lieu of obtaining the ownership statements required in paragraph (d)(2)(i) of this section from such shareholders.

(ii) *Special rule for registered shareholders owning less than one percent of widely-held corporations.* A foreign corporation with at least 250 registered shareholders, that is not a publicly-traded corporation, as described in § 1.883–2 (a widely-held corporation), is not required to obtain an ownership statement from an individual shareholder owning less than one

percent of the widely-held corporation at all times during the taxable year if the requirements of paragraphs (d)(3)(ii)(A) and (B) are satisfied. If the widely-held foreign corporation is the foreign corporation seeking qualified foreign corporation status, or an intermediary that meets the documentation requirements of paragraphs (d)(4)(v)(A) and (B) of this section, the widely-held foreign corporation may treat the address of record in its ownership records as the residence of any less than one percent individual shareholder if—

(A) The individual's address of record is a specific street address and not a non-residential address, such as a post office box or in care of a financial intermediary or stock transfer agent; and

(B) The officers and directors of the widely-held corporation neither know nor have reason to know that the individual does not reside at that address.

(iii) *Special rule for beneficiaries of pension funds*—(A) *Government pension fund.* An individual who is a beneficiary of a government pension fund, as defined in paragraph (b)(5)(ii) of this section, may be treated as a resident of the country in which the pension fund is administered if the pension fund satisfies the documentation requirements of paragraphs (d)(4)(v)(A) and (C)(*1*) of this section.

(B) *Non-government pension fund.* An individual who is a beneficiary of a non-government pension fund, as described in paragraph (b)(5)(iii) of this section, may be treated as a resident of the country of the beneficiary's address as it appears on the records of the fund, provided it is not a nonresidential address, such as a post office box or an address in care of a financial intermediary, and provided none of the trustees, directors or other administrators of the pension fund know, or have reason to know, that the beneficiary is not an individual resident of such foreign country. The rules of this paragraph (d)(3)(iii)(B) shall apply only if the non-government pension fund satisfies the documentation requirements of paragraphs (d)(4)(v)(A) and (C)(*2*) of this section.

(iv) *Special rule for stock owned by publicly-traded corporations.* Any stock in a foreign corporation seeking qualified foreign corporation status that is owned by a publicly-traded corporation will be treated as owned by an individual resident in the country where the publicly-traded corporation is organized if the foreign corporation receives the statement described in paragraph (d)(4)(iii) of this section from the publicly-traded corporation and copies of any relevant ownership statements from shareholders of the publicly-traded corporation relied on to satisfy the exception to the closely-held test of § 1.883–2(d)(3)(ii), as required in paragraph (d)(2)(i) of this section.

(v) *Special rule for not-for-profit organizations.* For purposes of meeting the ownership requirements of paragraph (a) of this section, a not-for-profit organization may rely on the addresses of record of its individual beneficiaries and supporters to determine the residence of an individual beneficiary or supporter, within the meaning of paragraph (b)(2)(i)(B) of this section, to the extent required under paragraph (b)(4) of this section, provided that—

(A) The addresses of record are not nonresidential addresses such as a post office box or in care of a financial intermediary;

(B) The officers, directors or administrators of the organization do not know or have reason to know that the individual beneficiaries or supporters do not reside at that address; and

(C) The foreign corporation seeking qualified foreign corporation status receives the statement required in paragraph (d)(4)(iv) of this section from the not-for-profit organization.

(vi) *Special rule for a foreign airline covered by an air services agreement.* A foreign airline that is covered by a bilateral Air Services Agreement in force between the United States and the qualified foreign country in which the airline is organized may rely exclusively on the Air Services Agreement currently in effect and will not have to otherwise substantiate its ownership under this section, provided that the United States has not waived the ownership requirements in the agreement or that the ownership requirements have not otherwise been made ineffective. Such an airline will be treated as owned by qualified shareholders resident in the country where the foreign airline is organized.

(vii) *Special rule for taxable non-stock corporations.* Any stock in a foreign corporation seeking qualified foreign corporation status that is owned by a taxable non-stock corporation will be treated as owned, in any taxable year, by the recipients of distributions made during that taxable year, as set out in paragraph (c)(5) of this section. The taxable non-stock corporation may treat the address of record in its distribution records as the residence of any recipient if—

(A) An individual recipient's address is in a qualified foreign country and is a specific street address and not a non-residential address, such as a post office box or in care of a financial intermediary or stock transfer agent;

(B) The address of a non-individual recipient's principal place of business is in a qualified foreign country;

(C) The officers and directors of the taxable non-stock corporation neither know nor have reason to know that the recipients do not reside or have their principal place of business at such addresses; and

(D) The foreign corporation receives the statement described in paragraph (d)(4)(v)(D) of this section from the taxable non-stock corporation intermediary.

(viii) *Special rule for closely-held corporations traded in the United States.* To demonstrate that a class of stock is not closely-held for purposes of § 1.883–2(d)(3)(i), a foreign corporation whose stock is traded on an established securities market in the United States may rely on its most current SEC Form 13G filing (Statement of Beneficial Ownership by Certain Persons) for the taxable year to identify its 5-percent shareholders in each class of stock relied upon to meet the regularly traded test, without having to make any independent investigation to determine the identity of the 5-percent shareholder. However, if any class of stock is determined to be closely-held within the meaning of § 1.883–2(d)(3)(i), the publicly traded corporation cannot satisfy the requirements of § 1.883–2(e) unless it obtains sufficient documentation described in this paragraph (d) to demonstrate that the requirements of § 1.883–2(d)(3)(ii) are met with respect to the 5-percent shareholders.

(4) *Ownership statements from shareholders*—(i) *Ownership statements from individuals.* An ownership statement from an individual is a written statement signed by the individual under penalties of perjury stating—

(A) The individual's name, permanent address, and country where the individual is fully liable to tax as a resident, if any;

(B) If the individual was not a resident of the country for the entire taxable year of the foreign corporation seeking qualified foreign corporation status, each of the foreign countries in which the individual resided and the dates of such residence during the taxable year of such foreign corporation;

(C) If the individual directly owns stock in the corporation seeking qualified foreign corporation status, the name of the corporation, the number of shares in each class of stock of the corporation that are so owned, and the

period of time during the taxable year of the foreign corporation during which the individual owned the stock;

(D) If the individual directly owns an interest in a corporation, partnership, trust, estate or other intermediary that directly or indirectly owns stock in the corporation seeking qualified foreign corporation status, the name of the intermediary, the number and class of shares or amount and nature of the interest of the individual in such intermediary, and the period of time during the taxable year of the corporation seeking qualified foreign corporation status during which the individual held such interest;

(E) To the extent known by the individual, a description of the chain of ownership through which the individual owns stock in the corporation seeking qualified foreign corporation status, including the name and address of each intermediary standing between the intermediary described in paragraph (d)(4)(i)(D) of this section and the foreign corporation and whether this interest is owned either directly or indirectly through bearer shares; and

(F) Any other information as specified in guidance published by the Internal Revenue Service (*see* § 601.601(d)(2) of this chapter).

(ii) *Ownership statements from foreign governments.* An ownership statement from a foreign government that is a qualified shareholder is a written statement—

(A) Signed by any one of the following—

(*1*) An official of the governmental authority, agency or office who has supervisory authority with respect to the government's ownership interest and who is authorized to sign such a statement on behalf of the authority, agency or office; or

(*2*) The competent authority of the foreign country (as defined in the income tax convention between the United States and the foreign country); or

(*3*) An income tax return preparer that, for purposes of this paragraph (d)(4)(ii) only, shall mean a firm of licensed or certified public accountants, a law firm whose principals or members are admitted to practice in one or more states, territories or possessions of the United States or the country of such government, or a bank or other financial institution licensed to do business in such foreign country and having assets at least equivalent to 50 million U.S. dollars and who is authorized to represent the government or governmental authority; and

(B) That provides—

(*1*) The title of the official or other person signing the statement;

(*2*) The name and address of the government authority, agency or office that has supervisory authority and, if applicable, the income tax preparer which has prepared such ownership statement;

(*3*) The information described in paragraphs (d)(4)(i)(C) through (F) of this section (as if the language applied ''government'' instead of ''individual'') with respect to the government's direct or indirect ownership of stock in the corporation seeking qualified resident status;

(*4*) In the case of an ownership statement prepared by an income tax return preparer, a statement under penalties of perjury identifying the documentation relied upon in the conduct of due diligence for the taxable year to determine the aggregate government investment in the stock of the shipping or aircraft company in preparation of such ownership statement attached to a valid power of attorney to represent the taxpayer for the taxable year; and

(*5*) Any other information as specified in guidance published by the Internal Revenue Service (*see* § 601.601(d)(2) of this chapter).

(iii) *Ownership statements from publicly-traded corporate shareholders.* An ownership statement from a publicly-traded corporation that is a direct or indirect owner of the corporation seeking qualified foreign corporation status is a written statement, signed under penalties of perjury by a person that would be authorized to sign a tax return on behalf of the shareholder corporation containing the following information—

(A) The name of the country in which the stock is primarily traded;

(B) The name of the established securities market or markets on which that the stock is listed;

(C) A description of each class of stock relied upon to meet the requirements of § 1.883–2(d)(1), including the number of shares issued and outstanding as of the close of the taxable year;

(D) For each class of stock relied upon to meet the requirements of § 1.883–2(d)(1), if one or more 5-percent shareholders, as defined in § 1.883–2(d)(3)(i), own in the aggregate 50 percent or more of the value of the outstanding shares of that class of stock at any time during the taxable year, state—

(*1*) The highest total percentage of the value of the class of stock that is owned by such 5-percent shareholders;

(*2*) For each qualified shareholder who owns or is treated as owning stock in the closely-held block upon whom the corporation intends to rely to satisfy the exception to the closely-held test of § 1.883–2(d)(3)(ii)—

(*i*) The name of each such shareholder;

(*ii*) The percentage of the total value of the class of stock held by each such shareholder;

(*iii*) The address of record of each such shareholder;

(*iv*) The country of residence of each such shareholder, determined under paragraph (b)(2) or (d)(3) of this section; and

(E) The portion of the taxable year of the corporation during which the stock was closely-held without regard to the exception in § 1.883–2(d)(3)(ii);

(F) The information described in paragraphs (d)(4)(i)(C) through (F) of this section (as if the language applied ''publicly-traded corporation'' instead of ''individual'') with respect to the publicly-traded corporation's direct or indirect ownership of stock in the corporation seeking qualified resident status; and

(G) Any other information as specified in guidance published by the Internal Revenue Service (*see* § 601.601(d)(2) of this chapter).

(iv) *Ownership statements from not-for-profit organizations.* An ownership statement from a not-for-profit organization (other than a pension fund as defined in paragraph (b)(5) of this section) is a written statement signed by a person authorized to sign a tax return on behalf of the organization under penalties of perjury stating—

(A) The name, permanent address, and principal location of the activities of the organization (if different from its permanent address);

(B) The information described in paragraphs (d)(4)(i)(C) through (F) of this section (as if it the language applied ''not-for-profit organization'' instead of ''individual'');

(C) A representation that the not-for-profit organization satisfies the requirements of paragraph (b)(4) of this section; and

(D) Any other information as specified in guidance published by the Internal Revenue Service (*see* § 601.601(d)(2) of this chapter).

(v) *Ownership statements from intermediaries*—(A) *General rule.* The foreign corporation seeking qualified foreign corporation status under the shareholder stock ownership test must obtain an intermediary ownership statement from each intermediary standing in the chain of ownership between it and the qualified

shareholders on whom it relies to meet this test. An intermediary ownership statement is a written statement signed under penalties of perjury by the intermediary (if the intermediary is an individual) or a person who would be authorized to sign a tax return on behalf of the intermediary (if the intermediary is not an individual) containing the following information—

(*1*) The name, address, country of residence, and principal place of business (in the case of a corporation or partnership) of the intermediary, and, if the intermediary is a trust or estate, the name and permanent address of all trustees or executors (or equivalent under foreign law), or if the intermediary is a pension fund, the name and permanent address of place of administration of the intermediary;

(*2*) The information described in paragraphs (d)(4)(i)(C) through (F) of this section (as if the language applied ''intermediary'' instead of ''individual'');

(*3*) If the intermediary is a nominee for a shareholder or another intermediary, the name and permanent address of the shareholder, or the name and principal place of business of such other intermediary;

(*4*) If the intermediary is not a nominee for a shareholder or another intermediary, the name and country of residence (within the meaning of paragraph (b)(2) of this section) and the proportionate interest in the intermediary of each direct shareholder, partner, beneficiary, grantor, or other interest holder (or if the direct holder is a nominee, of its beneficial shareholder, partner, beneficiary, grantor, or other interest holder), on which the foreign corporation seeking qualified foreign corporation status intends to rely to satisfy the requirements of paragraph (a) of this section. In addition, such intermediary must obtain from all such persons an ownership statement that includes the period of time during the taxable year for which the interest in the intermediary was owned by the shareholder, partner, beneficiary, grantor or other interest holder. For purposes of this paragraph (d)(4)(v)(A), the proportionate interest of a person in an intermediary is the percentage interest (by value) held by such person, determined using the principles for attributing ownership in paragraph (c) of this section;

(*5*) If the intermediary is a widely-held corporation with registered shareholders owning less than one percent of the stock of such widely-held corporation, the statement set out in paragraph (d)(4)(v)(B) of this section, relating to ownership statements from widely-held intermediaries with registered shareholders owning less than one percent of such widely-held intermediaries;

(*6*) If the intermediary is a pension fund, within the meaning of paragraph (b)(5) of this section, the statement set out in paragraph (d)(4)(v)(C) of this section, relating to ownership statements from pension funds;

(*7*) If the intermediary is a taxable non-stock corporation, within the meaning of paragraph (c)(5) of this section, the statement set out in paragraph (d)(4)(v)(D) of this section, relating to ownership statements from intermediaries that are taxable non-stock corporations; and

(*8*) Any other information as specified in guidance published by the Internal Revenue Service (*see* § 601.601(d)(2) of this chapter).

(B) *Ownerships statements from widely-held intermediaries with registered shareholders owning less than one percent of such widely-held intermediary.* An ownership statement from an intermediary that is a corporation with at least 250 registered shareholders, but that is not a publicly-traded corporation within the meaning of § 1.883–2, and that relies on paragraph (d)(3)(ii) of this section, relating to the special rule for registered shareholders owning less than one percent of widely-held corporations, must provide the following information in addition to the information required in paragraph (d)(4)(v)(A) of this section—

(*1*) The aggregate proportionate interest by country of residence in the widely-held corporation of such registered shareholders or other interest holders whose address of record is a specific street address and not a non-residential address, such as a post office box or in care of a financial intermediary or stock transfer agent; and

(*2*) A representation that the officers and directors of the widely-held intermediary neither know nor have reason to know that the individual shareholder does not reside at his or her address of record in the corporate records; and

(*3*) Any other information as specified in guidance published by the Internal Revenue Service (*see* § 601.601(d)(2) of this chapter).

(C) *Ownership statements from pension funds—(1) Ownership statements from government pension funds.* A government pension fund (as defined in paragraph (b)(5)(ii) of this section) that relies on paragraph (d)(3)(iii) of this section (relating to the special rules for pension funds) generally must provide the documentation required in paragraph (d)(4)(v)(A) of this section, and, in addition, the government pension fund must also provide the following information—

(*i*) The name of the country in which the plan is administered;

(*ii*) A representation that the fund is established exclusively for the benefit of employees or former employees of a foreign government, or employees or former employees of a foreign government and non-governmental employees or former employees that perform or performed governmental or social services;

(*iii*) A representation that the funds that comprise the trust are managed by trustees who are employees of, or persons appointed by, the foreign government;

(*iv*) A representation that the trust forming part of the pension plan provides for retirement, disability, or death benefits in consideration for prior services rendered;

(*v*) A representation that the income of the trust satisfies the obligations of the foreign government to the participants under the plan, rather than inuring to the benefit of a private person; and

(*vi*) Any other information as specified in guidance published by the Internal Revenue Service (*see* § 601.601(d)(2) of this chapter).

(*2*) *Ownership statement from non-government pension funds.* The trustees, directors, or other administrators of the non-government pension fund, as defined in paragraph (b)(5)(iii) of this section, that rely on paragraph (d)(3)(iii) of this section, relating to the special rules for pension funds, generally must provide the pension fund's intermediary ownership statement described in paragraph (d)(4)(v)(A) of this section. In addition, the non-government pension fund must also provide the following information—

(*i*) The name of the country in which the pension fund is administered;

(*ii*) A representation that the pension fund is subject to supervision or regulation by a governmental authority (or other authority delegated to perform such supervision or regulation by a governmental authority) in such country, and, if so, the name of the governmental authority (or other authority delegated to perform such supervision or regulation);

(*iii*) A representation that the pension fund is generally exempt from income taxation in its country of administration;

(*iv*) The number of beneficiaries in the pension plan;

(*v*) The aggregate percentage interest of beneficiaries by country of residence based on addresses shown on the books

and records of the fund, provided the addresses are not nonresidential addresses, such as a post office box or an address in care of a financial intermediary, and provided none of the trustees, directors or other administrators of the pension fund know, or have reason to know, that the beneficiary is not a resident of such foreign country;

(*vi*) A representation that the pension fund meets the requirements of paragraph (b)(5)(iii) of this section;

(*vii*) A representation that the trustees, directors or other administrators of the pension fund have no knowledge, and no reason to know, that a pro-rata allocation of interests of the fund to all beneficiaries would differ significantly from an actuarial allocation of interests in the fund (or, if the beneficiaries' actuarial interest in the stock held directly or indirectly by the pension fund differs from the beneficiaries' actuarial interest in the pension fund, the actuarial interests computed by reference to the beneficiaries' actuarial interest in the stock);

(*viii*) A representation that any overfunding of the pension fund would be payable, pursuant to the governing instrument or the laws of the foreign country in which the pension fund is administered, only to, or for the benefit of, one or more corporations that are organized in the country in which the pension fund is administered, individual beneficiaries of the pension fund or their designated beneficiaries, or social or charitable causes (the reduction of the obligation of the sponsoring company or companies to make future contributions to the pension fund by reason of overfunding shall not itself result in such overfunding being deemed to be payable to or for the benefit of such company or companies); or that the foreign country in which the pension fund is administered has laws that are designed to prevent overfunding of a pension fund and the funding of the pension fund is within the guidelines of such laws; or that the pension fund is maintained to provide benefits to employees in a particular industry, profession, or group of industries or professions, and that employees of at least 10 companies (other than companies that are owned or controlled, directly or indirectly, by the same interests) contribute to the pension fund or receive benefits from the pension fund; and

(*ix*) Any other information as specified in guidance published by the Internal Revenue Service (*see* § 601.601(d)(2) of this chapter).

(*3*) *Time for making determinations.* The determinations required to be made under this paragraph (d)(4)(v)(C) shall be made using information shown on the records of the pension fund for a date during the foreign corporation's taxable year to which the determination is relevant.

(*D*) *Ownership statements from taxable non-stock corporations.* An ownership statement from an intermediary that is a taxable non-stock corporation must provide the following information in addition to the information required in paragraph (d)(4)(v)(A) of this section—

(*1*) With respect to paragraph (d)(4)(v)(A)(*7*) of this section, for each beneficiary that is treated as a qualified shareholder, the name, address of residence (in the case of an individual beneficiary, the address must be a specific street address and not a non-residential address, such as a post office box or in care of a financial intermediary; in the case of a non-individual beneficiary, the address of the principal place of business) and percentage that is the same proportion as the amount that the beneficiary receives in the tax year bears to the total net income of the taxable non-stock corporation in the tax year;

(*2*) A representation that the officers and directors of the taxable non-stock corporation neither know nor have reason to know that the individual beneficiaries do not reside at the address listed in paragraph (d)(4)(v)(D)(*1*) of this section or that any other non-individual beneficiary does not conduct its primary activities at such address or in such country of residence; and

(*3*) Any other information as specified in guidance published by the Internal Revenue Service (see § 601.601(d)(2) of this chapter).

(5) *Availability and retention of documents for inspection.* The documentation described in paragraphs (d)(3) and (4) of this section must be retained by the corporation seeking qualified foreign corporation status (the foreign corporation) until the expiration of the statute of limitations for the taxable year of the foreign corporation to which the documentation relates. Such documentation must be made available for inspection by the Commissioner at such time and place as the Commissioner may request in writing.

(e) *Reporting requirements.* A foreign corporation relying on the qualified shareholder stock ownership test of this section to meet the stock ownership test of § 1.883–1(c)(2) must provide the following information in addition to the information required in § 1.883–1(c)(3) to be included in its Form 1120F, ''U.S. Income Tax Return of a Foreign Corporation'' for each taxable year. The information should be current as of the end of the corporation's taxable year. The information must include the following—

(1) A representation that more than 50 percent of the value of the outstanding shares of the corporation is owned (or treated as owned by reason of paragraph (c) of this section) by qualified shareholders for each category of income for which the exemption is claimed;

(2) With respect to each individual qualified shareholder owning 5 percent or more of the foreign corporation, applying the attribution rules of paragraph (c) of this section, and relied upon to meet the 50 percent ownership test of paragraph (a) of this section, the name and street address, as represented on each such individual's ownership statement;

(3) With respect to all qualified shareholders relied upon to satisfy the 50 percent ownership test of paragraph (a) of this section, the total percentage of the value of the outstanding shares owned, applying the attribution rules of paragraph (c) of this section, by all qualified shareholders resident in a qualified foreign country, by country; and

(4) Any other relevant information specified by the Form 1120F and its accompanying instructions.

§ 1.883–5 Effective dates.

(a) *General rule.* Sections 1.883–1 through 1.883–4 apply to taxable years of a foreign corporation seeking qualified foreign corporation status beginning 30 days or more after the date these regulations are published as final regulations in the **Federal Register**.

(b) *Election for retroactive application.* When these regulations are published as final regulations, taxpayers will be permitted to elect to apply §§ 1.883–1 through 1.883–4, as finalized, for any open taxable year of the foreign corporation beginning after December 31, 1986, except that the substantiation and reporting requirements of § 1.883–1(c)(3) (relating to the substantiation and reporting required to be treated as a qualified foreign corporation) or §§ 1.883–2(f), 1.883–3(d) and 1.883–4(e) (relating to additional information to be included in the return to demonstrate whether the foreign corporation satisfies the stock ownership test) will not apply to any year beginning before the applicable date of the final regulations. Such election shall apply to the taxable year of the election and to all subsequent

taxable years prior to the effective date of this regulation. Pending finalization of these regulations, if a foreign corporation complies with the proposed regulations, it will be considered substantial evidence that the foreign corporation is a qualified foreign corporation.

(c) *Transitional information reporting rule.* For taxable years of the foreign corporation beginning 30 days or more after the date these regulations are published as final regulations in the **Federal Register**, and until such time as the Form 1120F and its instructions are revised to conform to §§ 1.883–1 through 1.883–4, the information required in § 1.883–1(c)(3) and § 1.883–2(f), 1.883–3(d) or 1.883–4(e), as applicable, must be included on a written statement signed under penalties of perjury by a person authorized to sign the return, attached to the Form 1120F, and filed with the return.

Robert E. Wenzel,

Deputy Commissioner of Internal Revenue.

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