

Notice of Proposed Rulemaking and Notice of Public Hearing

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

REG-125443-01

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains amendments to final regulations relating to the withholding of income tax under sections 1441 and 1442 on certain U.S. source income paid to foreign persons and related requirements governing collection, deposit, refunds, and credits of withheld amounts under sections 1461 through 1463. Additionally, this document contains amendments to final regulations under sections 6049 and 6114. These regulations affect persons making payments of U.S. source income to foreign persons.

DATES: Written or electronic comments must be received by June 27, 2005. Requests to speak (with outlines of oral comments to be discussed) at the public hearing scheduled for July 20, 2005, at 10:00AM must be received by June 29, 2005.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-125443-01), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions also may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-125443-01), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the IRS internet site www.irs.gov/regs or via the Federal eRulemaking Portal site at www.regulations.gov (IRS and

REG-125443-01). The public hearing will be held in the IRS Auditorium, Seventh Floor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Ethan Atticks, (202) 622-3840 (not a toll-free number); concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Robin Jones, (202) 622-7180 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been previously reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-1484.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

In Treasury Decision 8734, 1997-2 C.B. 109 [62 FR 53387], the Treasury Department and the IRS issued comprehensive regulations (final regulations) under chapter 3 (sections 1441-1464) and subpart G of Subchapter A of chapter 61 (sections 6041 through 6050S) of the Internal Revenue Code. Those final regulations were amended by T.D. 8804, 1999-1 C.B. 793 [63 FR 72183], T.D. 8856, 2000-1 C.B. 298 [64 FR 73408], T.D. 8881, 2000-1 C.B. 1158 [65 FR 32152], and T.D. 9023, 2002-2 C.B. 955 [67 FR 70310].

In Notice 2001-4, 2001-1 C.B. 267, Notice 2001-11, 2001-1 C.B. 464, and Notice 2001-43, 2001-2 C.B. 72, the Treasury Department and the IRS announced the intention to amend the final regulations to address the matters discussed in those notices. These proposed regulations would implement certain changes announced in those notices and other changes.

Under section 1441 of the Internal Revenue Code (Code), as amended by the American Jobs Creation Act of 2004 (Public Law 108-357, 118 Stat. 1418), "interest-related dividends" and "short-term capital gain dividends" paid by regulated investment companies are exempt from withholding. These proposed regulations would amend the withholding rules in order to reflect the treatment of these new categories of dividends.

Explanation of Provisions

I. Notice 2001-4

A. TIN requirement for certain foreign grantor trusts

The final regulations provide that a withholding certificate that specifies certain payee information and that meets certain requirements may be used for a variety of purposes, including certifying a payee's status as a foreign person or foreign intermediary. Section 1.1441-1(e)(4)(vii)(G) of the final regulations provides that a taxpayer identification number (TIN) must be stated on a withholding certificate from a person representing to be a foreign grantor trust with 5 or fewer grantors.

After the final regulations took effect, some taxpayers requested documentation and reporting relief for simple and grantor trusts that hold an account with a qualified intermediary (QI). In response to this request, the Treasury Department and the IRS provided in section III.C of Notice 2001-4 that, if a foreign simple or grantor trust provides a QI with a Form W-8IMY, "Certificate of Foreign Intermediary, Foreign Flow-Through Entity, or Certain U.S. Branches for United States Tax Withholding," and the trust has 5 or fewer owners, the IRS will not require the trust to provide the QI with a TIN, notwithstanding

§1.1441-1(e)(4)(vii)(G). Section III.C of Notice 2001-4 was superseded by Rev. Proc. 2003-64, 2003-2 C.B. 306, which provides comprehensive guidance for withholding partnerships and withholding trusts. However, Rev. Proc. 2003-64 does not provide any relief from the TIN requirement of §1.1441-1(e)(4)(vii)(G) in the QI context.

In addition to requesting reinstatement of the previously granted relief from the TIN requirement in the QI context, withholding agents have requested relief from the TIN requirement beyond the QI context. In light of these requests, the Treasury Department and the IRS have reexamined the TIN requirement of §1.1441-1(e)(4)(vii)(G) and have concluded that the rule is not serving to enhance enforcement objectives. Therefore, the proposed regulations would reinstate the relief granted in section III.C of Notice 2001-4 for withholding certificates provided to a QI by a foreign grantor trust with 5 or fewer grantors. In addition, the proposed regulations would grant relief from the TIN requirement for withholding certificates that are executed after December 31, 2003, and that are provided to a withholding agent by a foreign grantor trust with 5 or fewer grantors.

B. Reporting relief for U.S. payors in U.S. possessions

U.S. payors that pay foreign source income outside the United States to U.S. non-exempt recipients generally must report these payments on Form 1099 and, if required, apply backup withholding. After the final regulations became effective, withholding agents requested that the Treasury Department and the IRS reconsider this rule to the extent it requires Form 1099 reporting and backup withholding with respect to income from sources within a possession of the United States paid to a U.S. citizen even if the income is exempt from tax under section 931, 932, or 933.

In response to this request, the Treasury Department and the IRS provided in section V.C of Notice 2001-4 that the final regulations would be amended to provide that income that is derived from sources within a possession of the United States, that is exempt from taxation under section 931, 932, or 933, and that a payor reasonably believes to be paid to a resident of a

possession of the United States is not required to be reported on Form 1099. Section V.C of Notice 2001-4 also provides that U.S. payors will not be required to report such income until the regulations are amended.

These proposed regulations would amend §1.6049-5(c) to implement section V.C. of Notice 2001-4, with modifications. The proposed regulations would provide that U.S. payors are not required to report on Form 1099 income from sources within a possession of the United States that is exempt from tax under section 931, section 932, or section 933. Under the proposed regulations, this exception from Form 1099 reporting would be applicable if the payor could reliably associate the payment of such income with valid documentation that supports a claim that the beneficial owner of the payment is a resident of the U.S. possession.

In addition, the proposed regulations would add new §1.1441-1(c)(30), which for these purposes would define *possessions of the United States* as Guam, American Samoa, the Northern Mariana Islands, Puerto Rico, and the Virgin Islands.

C. Use of documentary evidence in possessions of the United States

The final regulations provide certain exceptions from certain information reporting requirements. One such exception applies in cases in which, among other things, a payment is made outside the United States and the payor can rely on appropriate documentation to treat the payment as made to a foreign person. Section 1.6049-5(c)(1) allows a payor to rely on documentary evidence instead of an applicable withholding certificate described in §1.1441-1(c)(16) (Form W-8) in the case of a payment made to an offshore account. For this purpose, the term *offshore account* means an account maintained at an office or branch of a U.S. or foreign bank at any location outside the United States and outside of possessions of the United States.

When the final regulations took effect, taxpayers requested that the Treasury Department and the IRS consider allowing the use of documentary evidence for an account in a possession of the United States. In response to this request, the Treasury Department and the IRS pro-

vided in section V.D of Notice 2001-4 that documentary evidence may be used in lieu of Form W-8 in a possession of the United States and announced the intention to amend §1.6049-5(c)(1) accordingly.

These proposed regulations would implement Section V.D of Notice 2001-4.

D. Information reporting of foreign source services income

Under section 6041, a U.S. payor must report certain payments made for services performed outside the United States. However, §1.6041-4 provides that information reporting is not required if the payee has provided documentation to establish its status as a foreign beneficial owner or a foreign payee, or if the payee is presumed to be a foreign payee under the presumption rules. Under the presumption rules of §§1.6049-5(d)(2) and 1.1441-1(b)(3)(iii), a U.S. payor must presume that the payee is a U.S. payee if the payee is an individual.

When the final regulations took effect, U.S. payors commented that these rules were overly burdensome because they require U.S. payors making payments for services performed outside the United States to ask all payees to represent that such payees are not U.S. persons.

In response to this comment, the Treasury Department and the IRS provided in section V.E of Notice 2001-4 that a U.S. payor will not be required to report, under section 6041, income paid for services performed outside the United States if (1) the payee of the income is an individual, (2) the U.S. payor does not know that the payee is a U.S. citizen or resident, (3) the payor does not know, and has no reason to know, that the income is (or may be) effectively connected with the conduct of a trade or business within the United States, and (4) all of the services for which payment is made were performed by the payee outside the United States.

The proposed regulations would implement section V.E of Notice 2001-4. The Treasury Department and the IRS are considering whether there are appropriate circumstances, and if so, an appropriate manner, in which such an exception could be extended to payments made to foreign partnerships. Comments are requested on this issue.

*II. Notice 2001–11 —
Reporting/Withholding on Payments
to Financial Institutions in U.S.
Possessions*

Corporations and partnerships organized in a possession of the United States generally are treated as foreign persons for purposes of applying the final regulations. Accordingly, under the final regulations, a possessions financial institution acting as an intermediary is treated as a non-qualified intermediary that must provide documentation and allocation information for the beneficial owners on whose behalf it acts. In contrast, a U.S. branch of a foreign financial institution may agree with a withholding agent to be treated as a U.S. person. See §1.1441–1(b)(2)(iv)(A) and (E). Under §1.1441–1(b)(1), if such a U.S. branch agrees to be treated as a U.S. person, payments of U.S. source income made to it will be treated as made to a U.S. payee and therefore will not be subject to withholding under section 1441. Possessions financial institutions generally are subject to all of the withholding and reporting obligations of a U.S. withholding agent. Section 7651.

When the final regulations took effect, possessions financial institutions commented that the requirement to provide a withholding agent with customer information should not apply to them, because possessions financial institutions are subject to all of the withholding and information reporting requirements that apply to U.S. withholding agents under Chapters 3 and 61 and section 3406 of the Code, and because they are subject to direct audit supervision by the Internal Revenue Service.

In response to these comments, the Treasury Department and the IRS issued Notice 2001–11, which provided that a possessions financial institution will be treated as a U.S. branch that is subject to the rules of §1.1441–1(b)(2)(iv) and announced the intention to amend the final regulations accordingly.

These proposed regulations would implement Notice 2001–11.

III. Notice 2001–43

A. Reporting of treaty-based return positions

Section 301.6114–1(a) of the final regulations provides that, if a taxpayer takes a return position that a tax treaty overrules or modifies any provision of the Internal Revenue Code and thereby effects a reduction of any tax at any time, the taxpayer must disclose that return position, either on a statement attached to the return or on a return filed for the purpose of making such disclosure. Section 301.6114–1(b) provides that reporting is required unless it is expressly waived. It further provides a nonexclusive list of particular positions for which reporting is required. Section 301.6114–1(c) provides a list of specific exceptions from the general reporting requirements of §301.6114–1(a) and (b).

When the final regulations took effect, taxpayers requested guidance regarding the scope of the reporting required under §301.6114–1(a) and (b) in the case of claims for treaty-reduced withholding made by foreign persons that are not individuals or States. In particular, taxpayers requested the following clarification and relief.

First, because §301.6114–1(c)(1)(i) waives reporting only for individuals and States, clarification was requested regarding whether taxpayers that are not individuals or States and that do not meet the requirements to report under §301.6114–1(b)(4)(ii)(C) are nevertheless required to disclose treaty-based return positions described in subparagraph (b)(4)(ii) under the general rules of §301.6114–1(a) and (b).

Second, because §301.6114–1(c)(2) waives reporting only for individuals who receive less than the threshold amount, a *de minimis* exception was requested for taxpayers that are not individuals.

Third, because the representation under §1.1441–6(b)(1) (that the beneficial owner will file the statement required under §301.6114–1(d)) is required when the beneficial owner is related to the withholding agent within the meaning of section 482, and because the filing under §301.6114–1(b)(4)(ii)(C) is required when the beneficial owner is related to the person obligated to pay the income within the meaning of sections 267(b) and 707(b),

clarification was requested regarding coordination of the representation requirement with the filing requirement.

Finally, because §1.1441–6(b)(1) states that the filing requirement applies only to amounts received during the calendar year that exceed \$500,000 in the aggregate, and because §301.6114–1(a)(1) permits a taxpayer to adopt a taxable year for filing different from the calendar year, taxpayers requested clarification regarding a fiscal-year taxpayer's obligation to report such amounts.

In response to these and other comments, Treasury and the IRS issued Notice 2001–43. Section 2 of Notice 2001–43 provided that the following rules would apply, effective January 1, 2001.

First, reporting is waived for a treaty-based return position described in §301.6114–1(b)(4)(ii), unless the conditions in paragraph (b)(4)(ii)(A) and (B) of this section, paragraph (b)(4)(ii)(C) of this section, or paragraph (b)(4)(ii)(D) of this section are met.

Second, reporting under §301.6114–1(b)(4)(ii)(D) is waived for taxpayers that are not individuals or States and that receive amounts of income subject to withholding that do not exceed \$10,000 in the aggregate.

Third, the related-person test for purposes of applying the representation requirement of §1.1441–6(b)(i) was conformed to the related-person test that applies for purposes of the filing requirement of §301.6114–1(b)(4)(ii)(C).

Fourth, the calendar-year rule in §1.1441–6(b)(1) was replaced with a taxable-year rule to conform to §301.6114–1(a)(1).

These proposed regulations would implement Section 2 of Notice 2001–43.

B. Conversion of foreign currency amounts

Section 1.1441–3(e)(2) of the final regulations provides that if an amount subject to tax is paid in a currency other than the U.S. dollar, the amount of withholding under section 1441 shall be determined by applying the applicable rate of withholding to the foreign currency amount and by converting the amount withheld into U.S. dollars at the spot rate on the date of payment. A withholding agent that makes regular or frequent payments in foreign cur-

rency is permitted to use a month end spot rate or a monthly average spot rate.

After the final regulations took effect, some withholding agents that make regular and frequent payments in foreign currency commented that the permitted conversion conventions can expose them to currency risks that would require management by means of hedging transactions. Also, they commented that permitted conventions can require multiple accounting adjustments when payment amounts in the base currency are adjusted or corrected in the course of processing and settlement. They requested that they be permitted to use the spot rate on the date the amount of tax is deposited.

In response to this comment, in Section 3 of Notice 2001–43, the Treasury Department and the IRS provided that a withholding agent that makes regular or frequent payments in foreign currency is permitted to convert the amount withheld into U.S. dollars at the spot rate on the day the tax is deposited, provided that the deposit is made within seven days of the date of payment. Section 3 of Notice 2001–43 also provided that taxpayers using this alternative convention must do so consistently for all nondollar amounts withheld and from year to year. It also provided that such convention could not be changed without the consent of the Commissioner.

These proposed regulations would implement Section 3 of Notice 2001–43.

IV. The American Jobs Creation Act of 2004

The final regulations provide generally that if the amount of distributions designated by a regulated investment company as being subject to 852(b)(3)(C) (relating to capital-gain dividends) or 852(b)(5)(A) (relating to exempt-interest dividends) exceeds the amount that may be designated under those sections for the taxable year, then no penalties will be asserted for any resulting underwithholding if the designations were based on a reasonable estimate, as defined in regulations, and the adjustments to amount withheld are made in accordance with regulations. §1.1441–3(c)(3)(i). These proposed regulations would extend the reasonable-estimate rule to cover distributions designated as being subject to new section 871(k)(1)(C) (relating to in-

terest-related dividends) or 871(k)(2)(C) (relating to short-term capital gain dividends).

Proposed Effective Date

These regulations are proposed to be applicable when final regulations are published in the **Federal Register**.

Special Analyses

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

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely (in the manner described in the “ADDRESSES” portion of this preamble) to the IRS. The Treasury Department and the IRS request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for July 20, 2005, beginning at 10:00 a.m. in the IRS Auditorium (7th Floor), Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 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” portion of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by Wednesday, June 29. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for reviewing outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

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

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Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 301 are proposed to be amended as follows:

PART 1 — INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:
Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.1441–1 is amended as follows:

1. Paragraph (b)(2)(iv)(A) is revised.
2. Paragraph (b)(3)(iii)(E) is added.
3. Paragraph (c)(30) is added.
4. Paragraph (e)(4)(vii)(G) is revised.

The revisions and additions read as follows:

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

* * * * *

(b) * * *

(2) * * *

(iv) *Payments to a U.S. branch of certain foreign banks or foreign insurance companies — (A) U.S. branch treated*

as a U.S. person in certain cases. A payment to a U.S. branch of a foreign person is a payment to a foreign person. However, a U.S. branch described in this paragraph (b)(2)(iv)(A) and a withholding agent (including another U.S. branch described in this paragraph (b)(2)(iv)(A)) may agree to treat the branch as a U.S. person for purposes of withholding on specified payments to the U.S. branch. Notwithstanding the preceding sentence, a withholding agent making a payment to a U.S. branch treated as a U.S. person under this paragraph (b)(2)(iv)(A) shall not treat the branch as a U.S. person for purposes of reporting the payment made to the branch. Therefore, a payment to such U.S. branch shall be reported on Form 1042-S under §1.1461-1(c). Further, a U.S. branch that is treated as a U.S. person under this paragraph (b)(2)(iv)(A) shall not be treated as a U.S. person for purposes of the withholding certificate it may provide to a withholding agent. Therefore, the U.S. branch must furnish a U.S. branch withholding certificate on Form W-8 as provided in paragraph (e)(3)(v) of this section and not a Form W-9. An agreement to treat a U.S. branch as a U.S. person must be evidenced by a U.S. branch withholding certificate described in paragraph (e)(3)(v) of this section furnished by the U.S. branch to the withholding agent. A U.S. branch described in this paragraph (b)(2)(iv)(A) is any U.S. branch of a foreign bank subject to regulatory supervision by the Federal Reserve Board or a U.S. branch of a foreign insurance company required to file an annual statement on a form approved by the National Association of Insurance Commissioners with the Insurance Department of a State, a Territory, or the District of Columbia. In addition, a financial institution organized in a possession of the United States will be treated as a U.S. branch for purposes of this paragraph (b)(2)(iv)(A). The Internal Revenue Service (IRS) may approve a list of U.S. branches that may qualify for treatment as a U.S. person under this paragraph (b)(2)(iv)(A) (see §601.601(d)(2) of this chapter). See §1.6049-5(c)(5)(vi) for the treatment of U.S. branches as U.S. payors if they make a payment that is subject to reporting under chapter 61 of the Internal Revenue Code. Also see §1.6049-5(d)(1)(ii) for the treatment of

U.S. branches as foreign payees under chapter 61 of the Internal Revenue Code.

* * * * *

(3) * * *

(iii) * * *

(E) *Certain payments for services.* A payment for services is presumed to be made to a foreign person if —

(1) The payee is an individual;

(2) The withholding agent does not know, or have reason to know, that the payee is a U.S. citizen or resident;

(3) The withholding agent does not know, or have reason to know, that the income is (or may be) effectively connected with the conduct of a trade or business within the United States; and

(4) All of the services for which the payment is made were performed by the payee outside of the United States.

* * * * *

(c) * * *

(30) *Possessions of the United States.* For purposes of the regulations under chapter 3 and 61 of the Internal Revenue Code, *possessions of the United States* means Guam, American Samoa, the Northern Mariana Islands, Puerto Rico, and the Virgin Islands.

* * * * *

(e) * * *

(4) * * *

(vii) * * *

(G) A withholding certificate executed on or before December 31, 2003, from a person representing to be a grantor trust with 5 or fewer grantors, except where such withholding certificate is provided to a qualified intermediary.

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Par. 3. Section 1.1441-3 is amended by revising paragraphs (c)(3) and (e)(2) to read as follows:

§1.1441-3 Determination of amounts to be withheld.

* * * * *

(c) * * *

(3) *Special rules in the case of distributions from a regulated investment company* — (i) *General rule.* If the amount of any distributions designated as being subject to section 852(b)(3)(C) or 5(A), or 871(k)(1)(C) or (2)(C), exceeds the amount that may be designated

under those sections for the taxable year, then no penalties will be asserted for any resulting underwithholding if the designations were based on a reasonable estimate (made pursuant to the same procedures as described in paragraph (c)(2)(ii)(A) of this section) and the adjustments to the amount withheld are made within the time period described in paragraph (c)(2)(ii)(B) of this section. Any adjustment to the amount of tax due and paid to the IRS by the withholding agent as a result of underwithholding shall not be treated as a distribution for purposes of section 562(c) and the regulations thereunder. Any amount of U.S. tax that a foreign shareholder is treated as having paid on the undistributed capital gain of a regulated investment company under section 852(b)(3)(D) may be claimed by the foreign shareholder as a credit or refund under §1.1464-1.

(ii) *Reliance by intermediary on reasonable estimate.* For purposes of determining whether a payment is a distribution designated as subject to section 852(b)(3)(C) or (5)(A), or 871(k)(1)(C) or (2)(C), a withholding agent that is not the distributing regulated investment company may, absent actual knowledge or reason to know otherwise, rely on the designations that the distributing company represents have been made in accordance with paragraph (c)(3)(i) of this section. Failure by the withholding agent to withhold the required amount due to a failure by the regulated investment company to reasonably estimate the required amounts or to properly communicate the relevant information to the withholding agent shall be imputed to the distributing company. In such a case, the IRS may collect from the distributing company any underwithheld amount and subject the company to applicable interest and penalties as a withholding agent.

* * * * *

(e) * * *

(2) *Payments in foreign currency.* If the amount subject to withholding tax is paid in a currency other than the U.S. dollar, the amount of withholding under section 1441 shall be determined by applying the applicable rate of withholding to the foreign currency amount and converting the amount withheld into U.S. dollars on the date of payment at the spot rate (as defined in §1.988-1(d)(1)) in effect on that date. A

withholding agent making regular or frequent payments in foreign currency may use a month-end spot rate or a monthly average spot rate. In addition, such a withholding agent may use the spot rate on the date the amount of tax is deposited (within the meaning of §1.6302-2(a)), provided that such deposit is made within seven days of the date of the payment giving rise to the obligation to withhold. A spot rate convention must be used consistently for all non-dollar amounts withheld and from year to year. Such convention cannot be changed without the consent of the Commissioner. The U.S. dollar amount so determined shall be treated by the beneficial owner as the amount of tax paid on the income for purposes of determining the final U.S. tax liability and, if applicable, claiming a refund or credit of tax.

* * * * *

Par. 4. In §1.1441-6, paragraph (b)(1) is revised to read as follows:

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

* * * * *

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

of this section. See §1.6049-5(e) for the definition of payments made outside the United States and §1.6049-5(c)(1) for the definition of offshore account. For purposes of this paragraph (b)(1), a beneficial owner withholding certificate described in §1.1441-1(e)(2)(i) contains information necessary to support the claim for a treaty benefit only if it includes the beneficial owner's taxpayer identifying number (except as otherwise provided in paragraph (c)(1) of this section and §1.1441-6(g)) and the representations that the beneficial owner derives the income under section 894 and the regulations thereunder, if required, and meets the limitation on benefits provisions of the treaty, if any. The withholding certificate must also contain any other representations required by this section and any other information, certifications, or statements as may be required by the form or accompanying instructions in addition to, or in place of, the information and certifications described in this section. Absent actual knowledge or reason to know that the claims are incorrect (and subject to the standards of knowledge in §1.1441-7(b)), a withholding agent may rely on the claims made on a withholding certificate or on documentary evidence. A withholding agent may also rely on the information contained in a withholding statement provided under §§1.1441-1(e)(3)(iv) and 1.1441-5(c)(3)(iv) and (e)(5)(iv) to determine whether the appropriate statements regarding section 894 and limitation on benefits have been provided in connection with documentary evidence. If the beneficial owner is related to the person obligated to pay the income, within the meaning of section 267(b) or 707(b), the withholding certificate must also contain a representation that the beneficial owner will file the statement required under §301.6114-1(d) of this chapter (if applicable). The requirement to file an information statement under section 6114 for income subject to withholding applies only to amounts received during the taxpayer's taxable year that, in the aggregate, exceed \$500,000. See §301.6114-1(d) of this chapter. The Internal Revenue Service (IRS) may apply the provisions of §1.1441-1(e)(1)(ii)(B) to notify the withholding agent that the certificate cannot be relied upon to grant benefits under an income tax treaty. See §1.1441-1(e)(4)(viii)

regarding reliance on a withholding certificate by a withholding agent. The provisions of §1.1441-1(b)(3)(iv) dealing with a 90-day grace period shall apply for purposes of this section.

* * * * *

Par. 5. Section 1.6049-5 is amended as follows:

1. Paragraph (c)(1) is revised.
2. Paragraphs (c)(5)(i), (ii), (iii), (iv), (v) and (vi) are redesignated as paragraphs (c)(5)(i)(A), (B), (C), (D), (E), and (F), respectively.
3. A new heading is added to paragraph (c)(5)(i).
4. New paragraph (c)(5)(ii) is added.

The revisions and additions read as follows:

§1.6049-5 Interest and original issue discount subject to reporting after December 31, 1982.

* * * * *

(c) *Applicable rules* — (1) *Documentary evidence for offshore accounts and for possessions accounts.* A payor may rely on documentary evidence described in this paragraph (c)(1) instead of a beneficial owner withholding certificate described in §1.1441-1(e)(2)(i) in the case of a payment made outside the United States to an offshore account, in the case of a payment made to a U.S. possessions account or, in the case of broker proceeds described in §1.6045-1(c)(2), in the case of a sale effected outside the United States (as defined in §1.6045-1(g)(3)(iii)(A)). For purposes of this paragraph (c)(1), an *offshore account* means an account maintained at an office or branch of a U.S. or foreign bank or other financial institution at any location outside the United States (i.e., other than in any of the fifty States or the District of Columbia) and outside of possessions of the United States. Thus, for example, an account maintained in a foreign country at a branch of a U.S. bank or of a foreign subsidiary of a U.S. bank is an offshore account. For purposes of this paragraph (c)(1), a *U.S. possessions account* means an account maintained at an office or branch of a U.S. or foreign bank or other financial institution located within a possession of the United States. For the definition of a payment made outside the United States, see paragraph (e) of this section. A payor may

rely on documentary evidence if the payor has established procedures to obtain, review, and maintain documentary evidence sufficient to establish the identity of the payee and the status of that person as a foreign person (including, but not limited to, documentary evidence described in §1.1441-6(c)(3) or (4)); and the payor obtains, reviews, and maintains such documentary evidence in accordance with those procedures. A payor maintains the documents reviewed by retaining the original, certified copy, or a photocopy (or microfiche or similar means of record retention) of the documents reviewed and noting in its records the date on which and by whom the document was received and reviewed. Documentary evidence furnished for the payment of an amount subject to withholding under chapter 3 of the Code must contain all of the information that is necessary to complete a Form 1042-S for that payment. A payor may also rely on documentary evidence associated with a flow-through withholding certificate for payments treated as made to foreign partners of a nonwithholding foreign partnership, as defined in §1.1441-1(c)(28), the foreign beneficiaries of a foreign simple trust, as defined in §1.1441-1(c)(24), or foreign owners of a foreign grantor trust, as defined in §1.1441-1(c)(26), even though the partnership or trust account is maintained in the United States.

(5) *** (i) *Definition.* ***

(ii) *Reporting by U.S. payors in U.S. possessions.* U.S. payors are not required to report on Form 1099 income that is from sources within a possession of the United States and that is exempt from taxation under section 931, 932, or 933, each of which sections exempts certain income from sources within a possession of the United States paid to a *bona fide* resident of that possession. For purposes of this paragraph (c)(5)(ii), a U.S. payor may treat the beneficial owner as a *bona fide* resident of the possession of the United States from which the income is sourced if, prior to payment of the income, the U.S. payor can reliably associate the payment with valid documentation that supports the claim of residence in the possession of the United States from which the income is sourced. This paragraph (c)(5)(ii) shall not apply if the U.S. payor has actual knowledge or reason to know that the documentation is unreliable or incorrect or that the income does not satisfy the requirements for exemption under section 931, 932, or 933. For the rules determining whether income is from sources within a possession of the United States, see section 937(b) and the regulations thereunder.

PART 301 — PROCEDURE AND ADMINISTRATION

Par. 6. The authority citation for part 301 continues to read, in part, as follows:

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

Par. 7. In §301.6114-1 is amended as follows:

1. Paragraphs (c)(1)(i) through (c)(1)(vii) are redesignated as paragraphs (c)(1)(ii) through (c)(1)(viii), respectively.

2. New paragraph (c)(1)(i) is added.

3. Paragraph (c)(7) is added.

The additions and revision read as follows:

§301.6114-1 *Treaty-based return positions.*

(c) *** (1) ***

(i) For amounts received on or after January 1, 2001, return positions described in paragraph (b)(4)(ii) of this section, unless the conditions in paragraphs (b)(4)(ii)(A) and (B) of this section, paragraph (b)(4)(ii)(C) of this section, or paragraph (b)(4)(ii)(D) of this section are met;

(7) Reporting under paragraph (b)(4)(ii)(D) of this section is waived with respect to a taxable year for taxpayers that are not individuals or states and that, on or after January 1, 2001, receive amounts of income subject to withholding that do not exceed \$10,000 in the aggregate for such taxable year.

Mark E. Matthews,
*Deputy Commissioner for
Services and Enforcement.*

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