

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

REG-105248-04

RIN 1545-BE09

Elimination of country-by-country reporting to shareholders of foreign taxes paid by regulated investment companies

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that would generally eliminate country-by-country reporting by a regulated investment company (RIC) to its shareholders of foreign source income that the RIC takes into account and foreign taxes that it pays. RICs will continue to report this information directly to the IRS. The regulations will affect certain RICs that pay foreign taxes and the shareholders of those RICs.

DATES: Written or electronic comments and requests for a public hearing must be received by December 18, 2006.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-105248-04), Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044.

Submissions may be sent electronically via the IRS Internet site at: [www.irs.gov/regs](http://www.irs.gov/regs) or Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (IRS REG-105248-04).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Susan Thompson Baker, (202) 622-3930; concerning submissions of comments and requests for a public hearing, Kelly Banks, (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 **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by November 17, 2006. Comments are specifically requested concerning:

The accuracy of the estimated burden associated with the proposed collection of information;

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

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 service to provide information.

The collection of information in this proposed regulation is in §1.853-4(c) and (d). A RIC is required to notify the IRS of amounts of income received from sources within foreign countries and possessions of the United States and taxes paid to each such foreign country or possession in order that the IRS may monitor shareholder compliance

with the foreign tax credit provisions. The collection of information is required if a RIC elects to pass through the benefits of the foreign tax credit to its shareholders.

Estimated total annual reporting burden: 80 hours

Estimated average annual burden hours per respondent: 2

Estimated annual frequency of responses: 1

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it 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**

This document contains proposed amendments to 26 CFR part 1 under section 853 of the Internal Revenue Code (Code). Section 853 provides a foreign tax credit or deduction to shareholders of a RIC that makes an election under, and that meets the requirements set forth in, that section.

A RIC more than 50 percent of the value of whose total assets at the close of a taxable year consists of stock or securities in foreign corporations may make an election under section 853 (a foreign tax passthrough election). If the RIC makes this election for that taxable year, it forgoes a deduction or credit for certain taxes paid to foreign countries and possessions of the United States (collectively, foreign taxes) (but the amount of the foreign taxes is allowed as an addition to the RIC's deduction for dividends paid for the year). Instead, the RIC passes through to its shareholders a credit or deduction for the foreign taxes it has paid during its taxable year. If the RIC

makes this election, each shareholder includes the shareholder's proportionate share of these foreign taxes in gross income and treats this proportionate share as paid by the shareholder. Each shareholder of an electing RIC further treats as gross income from sources within foreign countries and possessions of the United States the sum of the shareholder's proportionate share of these taxes and the portion of any dividend paid by the RIC that represents income derived from sources within foreign countries and possessions of the United States. Each shareholder may then deduct or claim a credit for the payment of a proportionate share of these taxes.

A RIC electing this treatment must provide information to its shareholders and to the IRS. First, under section 853(c) of the Code, the RIC must designate, in a written notice mailed to shareholders not later than 60 days after the close of its taxable year, each shareholder's proportionate share of foreign taxes paid by the RIC and each shareholder's proportionate share of the RIC's gross income derived from sources within any foreign country or possession of the United States. Section 1.853-3(a) of the current Income tax regulations (the regulations) requires that this notice designate the shareholder's portion of foreign taxes paid to each such foreign country or possession of the United States and the portion of the dividend that represents income derived from sources within each foreign country or possession of the United States.

Second, under §1.853-4(a) of the regulations, the RIC must file with Form 1099-DIV, "Dividends and Distributions", and Form 1096, "Annual Summary and Transmittal of U.S. Information Returns", a statement as part of its income tax return (Form 1120-RIC or its successor) that sets forth the total amount of income received from sources within foreign countries and possessions of the United States; the total amount of foreign taxes paid; the date, form, and contents of the notice to its shareholders; and the proportionate share of this income received and these taxes paid during the taxable year attributable to one share of its stock. The RIC must also file as part of its return for the taxable year a Form 1118, "Foreign Tax Credit—Corporations", that has been

modified so that it is a statement in support of the RIC's foreign tax passthrough election.

The requirement of §1.853-3(a) of the regulations that an electing RIC provide country-by-country information to its shareholders on foreign-source income received and foreign taxes paid was originally adopted at a time when many shareholders generally needed the information to apply a per-country limitation on the foreign tax credit. Because of changes to the foreign tax credit provisions, shareholders generally no longer need country-by-country information on the amounts of foreign-source income and foreign taxes paid.

The Treasury Department and the IRS have received comments suggesting that the section 853 regulations should be amended to eliminate per-country reporting to shareholders and that Form 1116, "Foreign Tax Credit – Individual, Estate or Trust", should be modified to indicate that distributions from RICs are exempt from per-country shareholder reporting. According to these comments, eliminating the reporting of this information not only would reduce the time and expense required of RICs to compile and disseminate this tax information but also would reduce the confusion that their shareholders experience upon receipt of the extensive tables used to report this per-country information.

Even though the section 904 foreign tax credit limitation has been applied on a separate category of income basis, instead of on a per-country basis, since 1976, the Treasury Department and the IRS have continued to require the reporting of per-country information by RICs. This per-country information remains relevant to the IRS's monitoring compliance with the section 901 rules that disallow credits for refundable and noncompulsory payments and for taxes paid to certain countries. See §1.901-2(e)(2) and (5), providing that credit is not allowed for amounts that are in excess of final liability under foreign law for tax, and section 901(j), denying credit for tax paid to countries

described in section 901(j)(2)(A) and subjecting income from sources in those countries to separate foreign tax credit limitations .

Although per-country information with respect to foreign income and foreign taxes is needed for the IRS to monitor compliance, the Treasury Department and the IRS believe that taxpayer burden can be reduced by continuing to require this information to be supplied with the RIC's tax return but generally not requiring it to be reported to the RIC's shareholders as well. Accordingly, the proposed regulations would revise §1.853-3 and §1.853-4 to require that a RIC provide aggregate per-country information on a statement filed with its tax return and would require that only summary foreign income and foreign tax amounts be reported to its shareholders. Once this proposed rule becomes final, the instructions to Forms 1116 and 1118 will be modified to permit summary reporting at the shareholder level similar to the summary reporting currently permitted with respect to "section 863(b) income" on Forms 1116 and 1118.

### **Explanation of Provisions**

Proposed amendments to §1.853-1 of the regulations would update the regulations to reflect statutory amendments providing that the foreign tax passthrough election is not applicable to taxes for which the RIC would not be allowed a credit by reason of section 901(j) (denying credit for taxes paid to certain countries, including those with which the United States does not have diplomatic relations), section 901(k) and (l) (denying credit for withholding taxes paid on certain income where certain holding period requirements are not met), or any similar provision.

The proposed amendments would change in two ways the regulations that set forth requirements for a RIC seeking to make and to notify shareholders of a foreign tax passthrough election:

First, references in §1.853-3(a) and (b) of the regulations to required statements to shareholders of dollar amounts of taxes paid to specific countries, and to dollar amounts of income considered as received from specific countries, would be changed

to require that a RIC (or a shareholder of record of the RIC who is a nominee acting as a custodian of a unit investment trust) state only the total amount of the shareholder's proportionate share of creditable foreign taxes paid, income from sources within countries described in section 901(j), if any, and income derived from sources within other foreign countries or possessions of the United States.

Second, proposed amendments to §1.853-3(b) extend various deadlines to reflect statutory changes since the regulations were issued. Thus the number of days following the close of its taxable year by which a RIC must notify its shareholders in writing of the making of a foreign tax passthrough election would be increased to 60. References to the number of days following the close of the taxable year by which a nominee acting as a custodian of a unit investment trust must notify holders of interests in the unit investment trust would be increased to 70. Similarly, references to the number of days following the close of a RIC's taxable year by which a statement that holders of interests in unit investment trusts have been directly notified by the RIC (or a statement that the RIC has failed or is unable to notify these holders of interests) must be filed with the IRS and transmitted to a nominee would be increased to 60.

Section 1.853-4 of the regulations would be modified to create more flexibility in the references to specific forms. The current regulations require a RIC to file statements with Form 1099 and Form 1096 and to file, as a part of its return for the taxable year, a Form 1118, modified so that it becomes a statement in support of the election made by a RIC to pass through taxes paid to a foreign country or a possession of the United States. The first of these requirements, the requirement to file statements with Forms 1099 and 1096, is proposed to be eliminated. The proposed regulations would retain the general requirement that a RIC must file as part of its return a statement that elects the application of section 853 for the taxable year.

Section 1.853-4(a) of the regulations would also require that a RIC agree to provide certain information on foreign-source income received and foreign taxes paid. The information required to be provided is set forth in §1.853-4(c). Section 1.853-4(d) would provide that this required information is to be provided on or with a modified Form 1118 but would add that it may instead be provided in such other form or manner as may be prescribed by the Commissioner. This change would facilitate future changes in administrative practice if, for example, forms are renumbered or become obsolete.

### **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 collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### **Comments and Requests for Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that



timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

The Treasury Department and the IRS invite suggestions regarding any provisions that should be added to the proposed regulations if the reporting of per-country information to shareholders is to be eliminated for calendar year 2006. In addition, the Treasury Department and the IRS invite comments both on the date by which final regulations should be published in order for a change in reporting practice to be practical for 2006 and on any effective date concerns regarding the reporting of per-country information to the IRS.

### **Drafting Information**

The principal author of this regulation is Susan Thompson Baker of the Office of Associate Chief Counsel (Financial Institutions and Products).

### **List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

### **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 in part as follows:

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

Section 1.853-1 also issued under 26 U.S.C. 901(j).

Section 1.853-2 also issued under 26 U.S.C. 901(j).

Section 1.853-3 also issued under 26 U.S.C. 901(j).

Section 1.853-4 also issued under 26 U.S.C. 901(j) and 26 U.S.C. 6011. \* \* \*

Par. 2. Section 1.853-1 is amended by adding a sentence at the end of paragraph (a) to read as follows:

§1.853-1 Foreign tax credit allowed to shareholders.

(a) In general. \* \* \* In addition, the election is not applicable to any tax with respect to which the regulated investment company is not allowed a credit by reason of any provision of the Internal Revenue Code other than section 853(b)(1), including, but not limited to, section 901(j), section 901(k), or section 901(l).

\* \* \* \* \*

Par. 3. Section 1.853-2 is amended by revising paragraph (d) to read as follows:

§1.853-2 Effect of election.

\* \* \* \* \*

(d) Example. This section is illustrated by the following example:

Example. (i) Facts. X Corporation, a regulated investment company with 250,000 shares of common stock outstanding, has total assets, at the close of the taxable year, of \$10 million (\$4 million invested in domestic corporations, \$3.5 million in Foreign Country A corporations, and \$2.5 million in Foreign Country B corporations). X Corporation received dividend income of \$800,000 from the following sources: \$300,000 from domestic corporations, \$250,000 from Country A corporations, and \$250,000 from Country B corporations. All dividends from Country A corporations and from Country B corporations were properly characterized as income from sources without the United States. The dividends from Country A corporations were subject to a 10 percent withholding tax (\$25,000) and the dividends from Country B corporations were subject to a 20 percent withholding tax (\$50,000). X Corporation's only expenses for the taxable year were \$80,000 of operation and management expenses related to both its U.S. and foreign investments. In this case, Corporation X properly apportioned the \$80,000 expense based on the relative amounts of its U.S. and foreign source gross income. Thus, \$50,000 in expense was apportioned to foreign source income ( $\$80,000 \times \$500,000/\$800,000$ , total expense times the fraction of foreign dividend income over total dividend income) and \$30,000 in expense was apportioned to U.S. source income ( $\$80,000 \times \$300,000/\$800,000$ , total expense times the fraction of U.S. source dividend income over total dividend income). During the taxable year, X Corporation distributes to its shareholders the entire \$645,000 income that is available for distribution (\$800,000, less \$80,000 in expenses, less \$75,000 in foreign taxes withheld).

(ii) Section 853 election. X Corporation meets the requirements of section 851 to be considered a RIC for the taxable year and the requirements of section 852(a) for part 1 of subchapter M to apply for the taxable year. X Corporation notifies each

shareholder by mail, within the time prescribed by section 853(c), that by reason of the election the shareholders are to treat as foreign taxes paid \$0.30 per share of stock (\$75,000 of foreign taxes paid, divided by the 250,000 shares of stock outstanding). The shareholders must report as income \$2.88 per share (\$2.58 of dividends actually received plus the \$0.30 representing foreign taxes paid). Of the \$2.88 per share, \$1.80 per share (\$450,000 of foreign source taxable income divided by 250,000 shares) is to be considered as received from foreign sources. The \$1.80 consists of \$0.30, the foreign taxes treated as paid by the shareholder and \$1.50, the portion of the dividends received by the shareholder from the RIC that represents income of the RIC treated as derived from foreign sources (\$500,000 of foreign source income, less \$50,000 of expense apportioned to foreign source income, less \$75,000 of foreign tax withheld, which is \$375,000, divided by 250,000 shares).

Par. 4. Section 1.853-3 is amended by:

1. Revising paragraph (a).
2. Removing the number "55<sup>th</sup>" and adding the number "70<sup>th</sup>" in its place in the first sentence of paragraph (b).
3. Revising the second sentence of paragraph (b).
4. Removing the number "45" and adding the number "60" in its place in each place in which it appears in the fifth sentence of paragraph (b).

The revisions read as follows:

§1.853-3 Notice to shareholders.

(a) General rule. If a regulated investment company makes an election under section 853(a), in the manner provided in §1.853-4, the regulated investment company is required under section 853(c) to furnish its shareholders with a written notice mailed not later than 60 days after the close of its taxable year. The notice must designate the shareholder's portion of creditable foreign taxes paid to foreign countries or possessions of the United States and the portion of the dividend that represents income derived from sources within each country that is attributable to a period during which section 901(j) applies to such country, if any, and the portion of the dividend that represents income derived from other foreign countries and possessions of the United States. For

purposes of section 853(b)(2) and paragraph (b) of §1.853-2, the amount that a shareholder may treat as the shareholder's proportionate share of foreign taxes paid and the amount to be included as gross income derived from any foreign country that is attributable to a period during which section 901(j) applies to such country or gross income from sources within other foreign countries or possessions of the United States shall not exceed the amount so designated by the regulated investment company in such written notice. If, however, the amount designated by the regulated investment company in the notice exceeds the shareholder's proper proportionate share of foreign taxes or gross income from sources within foreign countries or possessions of the United States, the shareholder is limited to the amount correctly ascertained.

(b) Shareholder of record custodian of certain unit investment trusts. \* \* \* The notice shall designate the holder's proportionate share of the amounts of creditable foreign taxes paid to foreign countries or possessions of the United States and the holder's proportionate share of the dividend that represents income derived from sources within each country that is attributable to a period during which section 901(j) applies to such country, if any, and the holder's proportionate share of the dividend that represents income derived from other foreign countries or possessions of the United States shown on the notice received by the nominee identified as such. \* \* \*

\* \* \* \* \*

Par. 5. Section 1.853-4 is amended by:

1. Revising paragraphs (a) and (b).
2. Adding paragraphs (c) and (d).

The revisions and additions read as follows:

§1.853-4 Manner of making election.

(a) General rule. To make an election under section 853 for a taxable year, a regulated investment company must file a statement of election as part of its Federal income tax return for the taxable year. The statement of election must state that the regulated investment company elects the application of section 853 for the taxable year and agrees to provide the information required by paragraph (c) of this section.

(b) Irrevocability of the election. The election shall be made with respect to all foreign taxes described in paragraph (c)(2) of this section, and must be made not later than the time prescribed for filing the return (including extensions). This election, if made, shall be irrevocable with respect to the dividend (or portion) and the foreign taxes paid with respect thereto, to which the election applies.

(c) Required information. A regulated investment company making an election under section 853 must provide the following information:

(1) The total amount of taxable income received in the taxable year from sources within foreign countries and possessions of the United States and the amount of taxable income received in the taxable year from sources within each such foreign country or possession.

(2) The total amount of income, war profits, or excess profits taxes (described in section 901(b)(1)) to which the election applies that were paid in the taxable year to such foreign countries or possessions and the amount of such taxes paid to each such foreign country or possession.

(3) The amount of income, war profits, or excess profits taxes paid during the taxable year to which the election does not apply by reason of any provision of the Internal Revenue Code other than section 853(b), including, but not limited to, section 901(j), section 901(k), or section 901(l).

(4) The date, form, and contents of the notice to its shareholders.

(5) The proportionate share of creditable foreign taxes paid to each such foreign country or possession during the taxable year and foreign income received from sources within each such foreign country or possession during the taxable year attributable to one share of stock of the regulated investment company.

(d) Time and manner of providing information. The information specified in paragraph (c) of this section must be provided at the time and in the manner prescribed by the Commissioner and, unless otherwise prescribed, must be provided on or with a modified Form 1118 filed as part of the RIC's timely filed Federal income tax return for the taxable year.

\* \* \* \* \*

Deputy Commissioner for Services and Enforcement.