§ 1.1441–3 Determination of amounts to be withheld.

(a) Withholding on gross amount. Except as otherwise provided in regulations under section 1441, the amount subject to withholding under §1.1441–1 is the gross amount of income subject to withholding that is paid to a foreign person. The gross amount of income subject to withholding may not be reduced by any deductions, except to the extent that one or more personal exemptions are allowed as provided under §1.1441–4(b)(6).

(b) Withholding on payments on certain obligations—(1) Withholding at time of payment of interest. When making a payment on an interest-bearing obligation, a withholding agent must withhold under §1.1441–1 upon the gross amount of stated interest payable on the interest payment date, regardless of whether the payment constitutes a return of capital or the payment of income within the meaning of section 61. To the extent an amount was withheld on an amount of capital rather than interest, see the rules for adjustments, refunds, or credits under §1.1441–1(b)(8).

(ii) Anti-abuse rule. The exemption in paragraph (b)(2)(i) of this section does not apply if the sale of securities is part of a plan the principal purpose of which is to avoid tax by selling and repurchasing securities and the withholding agent has actual knowledge or reason to know of such plan.

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

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

(i) Exception to withholding on distributions—(1) In general. An election described in paragraph (c)(1) of this section is made by actually reducing the amount of withholding at the time that the payment is made. An intermediary that makes a payment of a distribution is not required to reduce the withholding based on the distributing corporation’s estimates under this paragraph (c)(2) even if the distributing corporation itself elects to reduce the withholding on payments of distributions that it itself makes to foreign persons. Conversely, an intermediary may elect to reduce the
amount of withholding with respect to
the payment of a distribution even if
the distributing corporation does not
so elect for the payments of distribu-
tions that it itself makes of distribu-
tions to foreign persons. The amounts
with respect to which a distributing
corporation or intermediary may elect
to reduce the withholding are as fol-
lows:

(A) A distributing corporation or
intermediary may elect to not with-
hold on a distribution to the extent it
represents a nontaxable distribution
payable in stock or stock rights.

(B) A distributing corporation or
intermediary may elect to not with-
hold on a distribution to the extent it
represents a distribution in part or full
payment in exchange for stock.

(C) A distributing corporation or
intermediary may elect to not with-
hold on a distribution (actual or
deemed) to the extent it is not paid out
of accumulated earnings and profits or
current earnings and profits, based on
a reasonable estimate determined
under paragraph (c)(2)(ii) of this sec-
tion.

(D) A regulated investment company
or intermediary may elect to not with-
hold on a distribution representing a
capital gain dividend (as defined in sec-
tion 852(b)(3)(C)) or an exempt interest
dividend (as defined in section
852(b)(5)(A)) based on the applicable
procedures described under paragraph
(o)(3) of this section.

(E) A U.S. Real Property Holding
Corporation (defined in section
897(c)(2)) or a real estate investment
trust (defined in section 856) or inter-
mediary may elect to not withhold on
a distribution to the extent it is sub-
ject to withholding under section 1445
and the regulations under that section.
See paragraph (c)(4) of this section for
applicable procedures.

(ii) Reasonable estimate of accumu-
lated and current earnings and profits on the
date of payment—(A) General rule. A rea-
sonable estimate for purposes of para-
graph (c)(2)(i)(C) of this section is a de-
termination made by the distributing
corporation at a time reasonably close
to the date of payment of the extent to
which the distribution will constitute a
dividend as defined in section 316. The
determination is based upon the antici-
patated amount of accumulated earnings
and profits and current earnings and
profits for the taxable year in which
the distribution is made, the distribu-
tions made prior to the distribution for
which the estimate is made and all
other relevant facts and circumstanc-
es. A reasonable estimate may be made
based on the procedures described in
§31.3406(b)(2)–4(c)(2) of this chapter.

(B) Procedures in case of underwith-
holding. A distributing corporation or
intermediary that is a withholding
agent with respect to a distribution
and that determines at the end of the
taxable year in which the distribution
is made that it underwithheld under
section 1441 on the distribution shall be
liable for the amount underwithheld as
a withholding agent under section 1461.
However, for purposes of this section
and §1.1461–1, any amount underwith-
held paid by a distributing corporation,
its paying agent, or an intermediary
shall not be treated as income subject
to additional withholding even if that
amount is treated as additional income
to the shareholders unless the addi-
tional amount is income to the share-
holder as a result of a contractual ar-
rangement between the parties regard-
ing the satisfaction of the share-
holder’s tax liabilities. In addition, no
penalties shall be imposed for failure
to withhold and deposit the tax if—

(1) The distributing corporation made
a reasonable estimate as provided in
paragraph (c)(2)(i)(A) of this section; and

(2) Either—

(i) The corporation or intermediary
pays over the underwithheld amount
on or before the due date for filing a
Form 1042 for the calendar year in
which the distribution is made, pursu-
ant to §1.1461–2(b); or

(ii) The corporation or intermediary
is not a calendar year taxpayer and it
files an amended return on Form 1042X
(or such other form as the Commis-
sioner may prescribe) for the calendar
year in which the distribution is made
and pays the underwithheld amount
and interest within 60 days after the
close of the taxable year in which the
distribution is made.
§ 1.1441–3

(C) Reliance by intermediary on reasonable estimate. For purposes of determining whether the payment of a corporate distribution is a dividend, a withholding agent that is not the distributing corporation may, absent actual knowledge or reason to know otherwise, rely on representations made by the distributing corporation regarding the reasonable estimate of the anticipated accumulated and current earnings and profits made in accordance with paragraph (c)(2)(i)(A) of this section. Failure by the withholding agent to withhold the required amount due to a failure by the distributing corporation to reasonably estimate the portion of the distribution treated as a dividend or to properly communicate the information to the withholding agent shall be imputed to the distributing corporation. In such a case, the Internal Revenue Service (IRS) may collect from the distributing corporation any underwithheld amount and subject the distributing corporation to applicable interest and penalties as a withholding agent.

(D) Example. The rules of this paragraph (c)(2) are illustrated by the following example:

Example. (1) Facts. Corporation X, a publicly traded corporation with both U.S. and foreign shareholders and a calendar year taxpayer, has an accumulated deficit in earnings and profits at the close of 2000. In 2001, Corporation X generates $1 million of current earnings and profits each month and makes an $18 million distribution, resulting in a $12 million dividend. Corporation X plans to make an additional $18 million distribution on October 1, 2002. Approximately one month before that date, Corporation X’s management receives an internal report from its legal and accounting department concerning Corporation X’s estimated current earnings and profits. The report states that Corporation X should generate only $5.1 million of current earnings and profits by the close of the third quarter due to costs relating to substantial organizational and product changes, but these changes will enable Corporation X to generate $12 million of earnings and profits monthly for the last quarter of the 2002 fiscal year. Thus, the total amount of current and earnings and profits for 2002 is estimated to be $9 million.

(ii) Analysis. Based on the facts in paragraph (i) of this Example, including the fact that earnings and profits estimates were made within a reasonable time before the distribution, Corporation X can rely on the estimate under paragraph (c)(2)(i)(A) of this section. Therefore, Corporation X may treat $9 million of the $18 million of the October 1, 2002, distribution to foreign shareholders as a nondividend distribution.

(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)(i)(A) of this section) and the adjustments to the amount withheld are made within the time period described in paragraph (c)(2)(i)(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 §1.1461–1.

(iii) 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.

(4) Coordination with withholding under section 1445—(i) In general. A distribution from a U.S. Real Property Holding Corporation (USRPHC) (or from a corporation that was a USRPHC at any time during the five-year period ending on the date of distribution) with respect to stock that is a U.S. real property interest under section 897(c) or from a Real Estate Investment Trust (REIT) with respect to its stock is subject to the withholding provisions under section 1441 (or section 1442 or 1443) and section 1445. A USRPHC making a distribution shall be treated as satisfying its withholding obligations under both sections if it withholds in accordance with one of the procedures described in either paragraph (c)(4)(i)(A) or (B) of this section. The USRPHC may change the applicable withholding procedure from year to year. For rules regarding distributions by REITs, see paragraph (c)(4)(i)(C) of this section.

(A) Withholding under section 1441. The USRPHC may choose to withhold on a distribution only under section 1441 (or 1442 or 1443) and not under section 1445. However, the USRPHC may change the applicable withholding procedure from year to year. For rules regarding distributions by REITs, see paragraph (c)(4)(i)(C) of this section.

(B) Withholding under both sections 1441 and 1445. As an alternative to the procedure described in paragraph (c)(4)(i)(A) of this section, a USRPHC may choose to withhold under both sections 1441 (or 1442 or 1443) and 1445 under the procedures set forth in this paragraph (c)(4)(i)(B). The USRPHC must make a reasonable estimate of the portion of the distribution that is a dividend under paragraph (c)(2)(i)(A) of this section, and must—

(1) Withhold under section 1441 (or 1442 or 1443) on the portion of the distribution that is estimated to be a dividend under paragraph (c)(2)(i)(A) of this section; and

(2) Withhold under section 1445(e)(3) and §1.1445–5(e) on the remainder of the distribution or on such smaller portion based on a withholding certificate obtained in accordance with §1.1445–5(e)(2)(iv).

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

(ii) Intermediary reliance rule. A withholding agent that is not the distributing USRPHC must withhold under paragraph (c)(4)(i) of this section, but may, absent actual knowledge or reason to know otherwise, rely on representations made by the USRPHC regarding the determinations required under paragraph (c)(4)(i) of this section. Failure by the withholding agent to withhold the required amount due to a failure by the distributing USRPHC to make these determinations in a reasonable manner or to properly communicate the determinations to the withholding agent shall be imputed to the distributing USRPHC. In such a case, the IRS may collect from the distributing USRPHC any underwithheld amount and subject the distributing USRPHC to applicable interest and penalties as a withholding agent.
(d) Withholding on payments that include an undetermined amount of income—

(1) In general. Where the withholding agent makes a payment and does not know at the time of payment the amount that is subject to withholding because the determination of the source of the income or the calculation of the amount of income subject to tax depends upon facts that are not known at the time of payment, then the withholding agent must withhold an amount under §1.1441–1 based on the entire amount paid that is necessary to assure that the tax withheld is not less than 30 percent (or other applicable percentage) of the recognized gain. For this purpose, the recognized gain is determined without regard to any deduction allowed by the Code from the gains. The amount so withheld shall not exceed 30 percent of the amount payable by reason of the transaction giving rise to the recognized gain. See §1.1441–1(c)(8) regarding adjustments in the case of overwithholding.

(2) Withholding on certain gains. Absent actual knowledge or reason to know otherwise, a withholding agent may liquidate the property prior to payment in order to withhold the required amount of tax under section 1441 or obtain payment of the tax from an alternative source. However, the obligation to withhold under section 1441 is not deferred even if no alternative source can be located. Thus, for purposes of withholding under chapter 3 of the Code, the provisions of §31.3406(h)–2(b)(2)(ii) of this chapter (relating to backup withholding from another source) shall not apply. If the withholding agent satisfies the tax liability related to such payments, the rules of paragraph (f) of this section apply.

(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.

(f) Tax liability of beneficial owner satisfied by withholding agent—(1) General rule. In the event that the satisfaction of a tax liability of a beneficial owner by a withholding agent constitutes income to the beneficial owner and such income is of a type that is subject to withholding, the amount of the payment deemed made by the withholding agent for purposes of this paragraph (f) shall be determined under the gross-up formula provided in this paragraph (f)(1). Whether the payment of the tax by the withholding agent constitutes a satisfaction of the beneficial owner’s tax liability and whether, as such, it constitutes additional income to the beneficial owner, must be determined under all the facts and circumstances surrounding the transaction, including any agreements between the parties and applicable law. The formula described in this paragraph (f)(1) is as follows:

\[
\text{Payment} = \frac{\text{Gross payment}}{1 - \text{(tax rate)}}
\]

(2) Example. The following example illustrates the provisions of this paragraph (f):

Example. College X awards a qualified scholarship within the meaning of section 117(b) to foreign student, FS, who is in the United States on an F visa. FS is a resident of a country that does not have an income tax treaty with the United States. The scholarship is $20,000 to be applied to tuition, fees, and books, plus benefits in kind consisting of room and board and roundtrip air transportation. College X agrees to pay any U.S. income tax owed by FS with respect to the scholarship. The fair market value of the room and board measured by the amount College X charges non-scholarship students is $6,000. The cost of the roundtrip air transportation is $2,600. Therefore, the total fair market value of the scholarship received by FS is $28,600. However, the amount taxable is limited to the fair market value of the benefits in kind ($8,600) because the portion of the scholarship amount for tuition, fees, and books is not included in gross income under section 117. The applicable rate of withholding is 14 percent under section 1441(b). Therefore, under the gross-up formula, College X is deemed to make a payment of $10,000 ($8,600 divided by (1–.14). The U.S. tax that must be deducted and withheld from the payment under section 1441(b) is $1,400 (.14 × $10,000). College X reports scholarship income of $30,000 and $1,400 of U.S. tax withheld on Forms 1042 and 1042-S.

(g) Conduit financing arrangements—(1) Duty to withhold. A financed entity or other person required to withhold tax under section 1441 with respect to a financing arrangement that is a conduit financing arrangement within the meaning of §1.881–3(a)(2)(iv) shall be required to withhold under section 1441 as if the district director had determined, pursuant to §1.881–3(a)(3), that all conduit entities that are parties to the conduit financing arrangement should be disregarded. The amount of tax required to be withheld shall be determined under §1.881–3(d). The withholding agent may withhold tax at a reduced rate if the financing entity establishes that it is entitled to the benefit of a treaty that provides a reduced rate if the financing entity establishes that it is entitled to the benefit of a treaty that provides a reduced rate of tax on a payment of the type deemed to have been paid to the financing entity. Section 1.881–3(a)(3)(i)(E) shall not apply for purposes of determining whether any person is required to deduct and withhold tax pursuant to this paragraph (g), or whether any party to a financing arrangement is liable for failure to withhold or entitled to a refund of tax pursuant to this paragraph (g), or other person required to withhold tax under sections 1441 or 1461 to 1464 (except to the extent the amount withheld exceeds the tax liability determined under §1.881–3(d)). See §1.1441–7(f) relating to withholding tax liability of the withholding agent in conduit financing arrangements subject to §1.881–3.

(2) Effective date. This paragraph (g) is effective for payments made by financed entities on or after September 11, 1995. This paragraph shall not apply to interest payments covered by section 127(g)(3) of the Tax Reform Act of 1984, and to interest payments with respect to other debt obligations issued prior to October 15, 1984 (whether or
§ 1.1441–4 Exemptions from withholding for certain effectively connected income and other amounts.

(a) Certain income connected with a U.S. trade or business—(1) In general. No withholding is required under section 1441 on income otherwise subject to withholding if the income is (or is deemed to be) effectively connected with the conduct of a trade or business within the United States and is includible in the beneficial owner’s gross income for the taxable year. For purposes of this paragraph (a), an amount is not deemed to be includible in gross income if the amount is (or is deemed to be) effectively connected with the conduct of a trade or business within the United States and the beneficial owner claims an exemption from tax under an income tax treaty because the income is not attributable to a permanent establishment in the United States. To claim a reduced rate of withholding because the income is not attributable to a permanent establishment in the United States, see §1.1441–1(e)(1)(ii). This paragraph (a) does not apply to income of a foreign corporation to which section 543(a)(7) applies for the taxable year or to compensation for personal services performed by an individual. See paragraph (b) of this section for compensation for personal services performed by an individual.

(ii) Special rules for U.S. branches of foreign persons—(A) U.S. branches of certain foreign banks or foreign insurance companies. A payment to a U.S. branch described in §1.1441–1(b)(2)(iv)(A) is presumed to be effectively connected with the conduct of a trade or business in the United States without the need to furnish a certificate, unless the U.S. branch provides a U.S. branch withholding certificate described in §1.1441–1(e)(3)(v) that represents otherwise. If no certificate is furnished but the income is not, in fact, effectively connected income, then the branch must withhold whether the payment is collected on behalf of other persons or on behalf of another branch of the same entity. See §1.1441–1(b)(2)(iv) and (6)

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

(a) Certain income connected with a U.S. trade or business—(1) In general. No withholding is required under section 1441 on income otherwise subject to withholding if the income is (or is deemed to be) effectively connected with the conduct of a trade or business within the United States and is includible in the beneficial owner’s gross income for the taxable year. For purposes of this paragraph (a), an amount is not deemed to be includible in gross income if the amount is (or is deemed to be) effectively connected with the conduct of a trade or business within the United States and the beneficial owner claims an exemption from tax under an income tax treaty because the income is not attributable to a permanent establishment in the United States. To claim a reduced rate of withholding because the income is not attributable to a permanent establishment in the United States, see §1.1441–1(e)(1)(ii). This paragraph (a) does not apply to income of a foreign corporation to which section 543(a)(7) applies for the taxable year or to compensation for personal services performed by an individual. See paragraph (b) of this section for compensation for personal services performed by an individual.

(ii) Special rules for U.S. branches of foreign persons—(A) U.S. branches of certain foreign banks or foreign insurance companies. A payment to a U.S. branch described in §1.1441–1(b)(2)(iv)(A) is presumed to be effectively connected with the conduct of a trade or business in the United States without the need to furnish a certificate, unless the U.S. branch provides a U.S. branch withholding certificate described in §1.1441–1(e)(3)(v) that represents otherwise. If no certificate is furnished but the income is not, in fact, effectively connected income, then the branch must withhold whether the payment is collected on behalf of other persons or on behalf of another branch of the same entity. See §1.1441–1(b)(2)(iv) and (6)

Except as otherwise provided in paragraph (g) of this section, this section applies to payments made after December 31, 2000.


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

(a) Certain income connected with a U.S. trade or business—(1) In general. No withholding is required under section 1441 on income otherwise subject to withholding if the income is (or is deemed to be) effectively connected with the conduct of a trade or business within the United States and is includible in the beneficial owner’s gross income for the taxable year. For purposes of this paragraph (a), an amount is not deemed to be includible in gross income if the amount is (or is deemed to be) effectively connected with the conduct of a trade or business within the United States and the beneficial owner claims an exemption from tax under an income tax treaty because the income is not attributable to a permanent establishment in the United States. To claim a reduced rate of withholding because the income is not attributable to a permanent establishment in the United States, see §1.1441–1(e)(1)(ii). This paragraph (a) does not apply to income of a foreign corporation to which section 543(a)(7) applies for the taxable year or to compensation for personal services performed by an individual. See paragraph (b) of this section for compensation for personal services performed by an individual.

(ii) Special rules for U.S. branches of foreign persons—(A) U.S. branches of certain foreign banks or foreign insurance companies. A payment to a U.S. branch described in §1.1441–1(b)(2)(iv)(A) is presumed to be effectively connected with the conduct of a trade or business in the United States without the need to furnish a certificate, unless the U.S. branch provides a U.S. branch withholding certificate described in §1.1441–1(e)(3)(v) that represents otherwise. If no certificate is furnished but the income is not, in fact, effectively connected income, then the branch must withhold whether the payment is collected on behalf of other persons or on behalf of another branch of the same entity. See §1.1441–1(b)(2)(iv) and (6)