

Internal Revenue Service, Treasury

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§ 1.881-1 Manner of taxing foreign corporations.

- (a) *Classes of foreign corporations.* For purposes of the income tax, foreign corporations are divided into two classes, namely, foreign corporations which at

no time during the taxable year are engaged in trade or business in the United States and foreign corporations which, at any time during the taxable year, are engaged in trade or business in the United States.

(b) *Manner of taxing*—(1) *Foreign corporations not engaged in U.S. business*. A foreign corporation which at no time during the taxable year is engaged in trade or business in the United States is taxable, as provided in § 1.881-2, on all income received from sources within the United States which is fixed or determinable annual or periodical income and on other items of income enumerated under section 881(a). Such a foreign corporation is also taxable on certain income from sources within the United States which, pursuant to § 1.882-2, is treated as effectively connected for the taxable year with the conduct of a trade or business in the United States.

(2) *Foreign corporations engaged in U.S. business*. A foreign corporation which at any time during the taxable year is engaged in trade or business in the United States is taxable, as provided in § 1.882-1, on all income from whatever source derived, whether or not fixed or determinable annual or periodical income, which is effectively connected for the taxable year with the conduct of a trade or business in the United States. Such a foreign corporation is also taxable, as provided in § 1.882-1, on income received from sources within the United States which is not effectively connected for the taxable year with the conduct of a trade or business in the United States and consists of (i) fixed or determinable annual or periodical income, or (ii) other items of income enumerated in section 881(a). A foreign corporation which at any time during the taxable year is engaged in trade or business in the United States is also taxable on certain income from sources within the United States which, pursuant to § 1.882-2, is treated as effectively connected for the taxable year with the conduct of a trade or business in the United States.

(c) *Meaning of terms*. For the meaning of the term “engaged in trade or business within the United States”, as used in section 881 and this section, see section 864(b) and the regulations there-

under. For determining when income, gain, or loss of a foreign corporation for a taxable year is effectively connected for that year with the conduct of a trade or business in the United States, see section 864(c), the regulations thereunder, and § 1.882-2. The term *foreign corporation* has the meaning assigned to it by section 7701(a)(3) and (5) and the regulations thereunder. However, for special rules relating to possessions of the United States, see § 1.881-5.

(d) *Rules applicable to foreign insurance companies*—(1) *Corporations qualifying under subchapter L*. A foreign corporation carrying on an insurance business in the United States at any time during the taxable year, which, without taking into account its income not effectively connected for the taxable year with the conduct of a trade or business in the United States, would qualify for the taxable year under part I, II, or III of subchapter L if it were a domestic corporation, shall be taxable for such year under that part on its entire taxable income (whether derived from sources within or without the United States) which is, or which pursuant to section 882 (d) or (e) and § 1.882-2 is treated as, effectively connected for the taxable year with the conduct of a trade or business (whether or not its insurance business) in the United States. Any income derived by that foreign corporation from sources within the United States which is not effectively connected for the taxable year with the conduct of a trade or business in the United States is taxable as provided in section 881(a) and § 1.882-1. See sections 842 and 861 through 864, and the regulations thereunder.

(2) *Corporations not qualifying under subchapter L*. A foreign corporation which carries on an insurance business in the United States at any time during the taxable year, and which, without taking into account its income not effectively connected for the taxable year with the conduct of a trade or business in the United States, would not qualify for the taxable year under part I, II, or III of subchapter L if it were a domestic corporation, and a foreign insurance company which does not carry on an insurance business in the

United States at any time during the taxable year, shall be taxable—

(i) Under section 881(a) and § 1.881-2 or § 1.882-1 on its income from sources within the United States which is not effectively connected for the taxable year with the conduct of a trade or business in the United States,

(ii) Under section 882(a)(1) and § 1.882-1 on its income (whether derived from sources within or without the United States) which is effectively connected for the taxable year with the conduct of a trade or business in the United States, and

(iii) Under section 882(a)(1) and § 1.882-1 on its income from sources within the United States which pursuant to section 882 (d) or (e) and § 1.882-2, is treated as effectively connected for the taxable year with the conduct of a trade or business in the United States.

(e) *Other provisions applicable to foreign corporations*—(1) *Accumulated earnings tax.* For the imposition of the accumulated earnings tax upon the accumulated taxable income of a foreign corporation formed or availed of for tax avoidance purposes, whether or not such corporation is engaged in trade or business in the United States, see section 532 and the regulations thereunder.

(2) *Personal holding company tax.* For the imposition of the personal holding company tax upon the undistributed personal holding company income of a foreign corporation which is a personal holding company, whether or not such corporation is engaged in trade or business in the United States, see sections 541 through 547, and the regulations thereunder. Except in the case of a foreign corporation having personal service contract income to which section 543(a)(7) applies, a foreign corporation is not a personal holding company if all of its stock outstanding during the last half of the taxable year is owned by nonresident alien individuals, whether directly or indirectly through foreign estates, foreign trusts, foreign partnerships, or other foreign corporations. See section 542(c)(7).

(3) *Foreign personal holding companies.* For the mandatory inclusion in the gross income of the United States shareholders of the undistributed for-

ign personal holding company income of a foreign personal holding company, see section 551 and the regulations thereunder.

(4) *Controlled foreign corporations*—(i) *Subpart F income and increase of earnings invested in U.S. Property.* For the mandatory inclusion in the gross income of the U.S. shareholders of the subpart F income, of the previously excluded subpart F income withdrawn from investment in less developed countries, of the previously excluded subpart F income withdrawn from investment in foreign base company shipping operations, and of the increase in earnings invested in U.S. property, of a controlled foreign corporation, see sections 951 through 964, and the regulations thereunder.

(ii) *Certain accumulations of earnings and profits.* For the inclusion in the gross income of U.S. persons as a dividend of the gain recognized on certain sales or exchanges of stock in a foreign corporation, to the extent of certain earnings and profits attributable to the stock which were accumulated while the corporation was a controlled foreign corporation, see section 1248 and the regulations thereunder.

(5) *Changes in tax rate.* For provisions respecting the effect of any change in rate of tax during the taxable year on the income of a foreign corporation, see section 21 and the regulations thereunder.

(6) *Consolidated returns.* Except in the case of certain corporations organized under the laws of Canada or Mexico and maintained solely for the purpose of complying with the laws of that country as to title and operation of property, a foreign corporation is not an includible corporation for purposes of the privilege of making a consolidated return by an affiliated group of corporations. See section 1504 and the regulations thereunder.

(7) *Adjustment of tax of certain foreign corporations.* For the application of pre-1967 income tax provisions to corporations of a foreign country which imposes a more burdensome income tax than the United States, and for the adjustment of the income tax of a corporation of a foreign country which imposes a discriminatory income tax on the income of citizens of the United

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States or domestic corporations, see section 896.

(f) *Effective/applicability date.* This section applies for taxable years beginning after December 31, 1966. For corresponding rules applicable to taxable years beginning before January 1, 1967, see 26 CFR 1.881-1 (Revised as of January 1, 1971).

(Secs. 7805 (68A Stat. 917; 26 U.S.C. 7805) and 7654(e) (86 Stat. 1496; 26 U.S.C. 7654(e)) of the Internal Revenue Code of 1954)

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§ 1.881-2 Taxation of foreign corporations not engaged in U.S. business.

(a) *Imposition of tax.* (1) This section applies for purposes of determining the tax of a foreign corporation which at no time during the taxable year is engaged in trade or business in the United States. However, see also § 1.882-2 where such corporation has an election in effect for the taxable year in respect to real property income or receives interest on obligations of the United States. Except as otherwise provided in § 1.871-12, a foreign corporation to which this section applies is not subject to the tax imposed by section 11 or section 1201(a) but, pursuant to the provisions of section 881(a), is liable to a flat tax of 30 percent upon the aggregate of the amounts determined under paragraphs (b) and (c) of this section which are received during the taxable year from sources within the United States. Except as specifically provided in such paragraphs, such amounts do not include gains from the sale or exchange of property. To determine the source of such amounts, see sections 861 through 863, and the regulations thereunder.

(2) The tax of 30 percent is imposed by section 881(a) upon an amount only to the extent the amount constitutes gross income.

(3) Deductions shall not be allowed in determining the amount subject to tax under this section.

(4) Except as provided in § 1.882-2, a foreign corporation which at no time during the taxable year is engaged in trade or business in the United States

has no income, gain, or loss for the taxable year which is effectively connected for the taxable year with the conduct of a trade or business in the United States. See section 864(c)(1)(B) and § 1.864-3.

(5) Gains and losses which, by reason of section 882(d) and § 1.882-2, are treated as gains or losses which are effectively connected for the taxable year with the conduct of a trade or business in the United States by such a foreign corporation shall not be taken into account in determining the tax under this section. See, for example, paragraph (c)(2) of § 1.871-10.

(6) Interest received by a foreign corporation pursuant to certain portfolio debt instruments is not subject to the flat tax of 30 percent described in paragraph (a)(1) of this section. For rules applicable to a foreign corporation's receipt of interest on certain portfolio debt instruments, see sections 871(h), 881(c), and § 1.871-14.

(b) *Fixed or determinable annual or periodical income*—(1) *General rule.* The tax of 30 percent imposed by section 881(a) applies to the gross amount received from sources within the United States as fixed or determinable annual or periodical gains, profits, or income. Specific items of fixed or determinable annual or periodical income are enumerated in section 881(a)(1) as interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, and emoluments, but other items of fixed or determinable annual or periodical gains, profits, or income are also subject to the tax as, for instance, royalties, including royalties for the use of patents, copyrights, secret processes and formulas, and other like property. As to the determination of fixed or determinable annual or periodical income, see paragraph (a) of § 1.1441-2. For special rules treating gain on the disposition of section 306 stock as fixed or determinable annual or periodical income for purposes of section 881(a), see section 306(f) and paragraph (h) of § 1.306-3.

(2) *Substitute payments.* For purposes of this section, a substitute interest payment (as defined in § 1.861-2(a)(7)) received by a foreign person pursuant to a securities lending transaction or a sale-repurchase transaction (as defined