FDA received a request to extend the comment period. FDA believes that extending the comment period by 45 days is appropriate to allow industry to generate information on products that might be affected by the rule. Therefore, FDA is extending the comment period until May 14, 2007. This extension will provide the public with a total of 105 days to submit comments.

II. Comments

Interested persons may submit to the Division of Dockets Management (see **ADDRESSES**) written or electronic comments on the proposed rule. Submit a single copy of electronic comments or two paper copies of any mailed comments, except that individuals may submit one paper copy. Comments are to be identified with the Docket No. 2005N–0373. Received comments may be seen in the Division of Dockets Management between 9 a.m. and 4 p.m., Monday through Friday.

Dated: March 23, 2007.

Jeffrey Shuren,

Assistant Commissioner for Policy.

[FR Doc. E7–5894 Filed 3–29–07; 8:45 am]

BILLING CODE 4160–01–S

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG–156779–06]

RIN 1545–BG27

Determining the Amount of Taxes Paid for Purposes of Section 901

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: These proposed regulations provide guidance relating to the determination of the amount of taxes paid for purposes of section 901.

The proposed regulations affect taxpayers that claim direct and indirect foreign tax credits. This document also provides notice of a public hearing.

DATES: Written or electronic comments must be received by June 28, 2007. Outlines of topics to be discussed at the public hearing scheduled for July 30, 2007, at 10 a.m. must be received by July 9, 2007.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG–156779–06), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–156779–06), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or sent electronically via the Federal eRulemaking Portal at *http://www.regulations.gov* (IRS REG–156779–06). The public hearing will be held in the Auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning submission of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Kelly Banks (202) 622–7180; concerning the regulations, Bethany A. Ingwalson, (202) 622–3850 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 901 of the Internal Revenue Code (Code) permits taxpayers to claim a credit for income, war profits, and excess profits taxes paid or accrued (or deemed paid) during the taxable year to any foreign country or to any possession of the United States.

Section 1.901–2(a) of the regulations defines a tax as a compulsory payment pursuant to the authority of a foreign country to levy taxes, and further provides that a tax is an income, war profits, or excess profits tax if the predominant character of the tax is that of an income tax in the U.S. sense. Section 1.901–2(e) provides rules for determining the amount of tax paid by a taxpayer for purposes of section 901. Section 1.901–2(e)(5) provides that an amount paid is not a compulsory payment, and thus is not an amount of tax paid, to the extent that the amount paid exceeds the amount of liability under foreign law for tax. For purposes of determining whether an amount paid exceeds the amount of liability under foreign law for tax, § 1.901–2(e)(5) provides the following rule:

> An amount paid does not exceed the amount of such liability if the amount paid is determined by the taxpayer in a manner that is consistent with a reasonable interpretation and application of the substantive and procedural provisions of foreign law (including applicable tax treaties) in such a way as to reduce, over time, the taxpayer's reasonably expected liability under foreign law for tax, and if the taxpayer exhausts all effective and practical remedies, including invocation of competent authority procedures available under applicable tax treaties, to reduce, over time, the taxpayer's liability for foreign tax (including liability pursuant to a foreign tax audit adjustment).

Section 1.901–2(e)(5) provides further that if foreign tax law includes options or elections whereby a taxpayer's liability may be shifted, in whole or part, to a different year, the taxpayer's use or failure to use such options or elections does not result in a noncompulsory payment, and that a settlement by a taxpayer of two or more issues will be evaluated on an overall basis, not on an issue-by-issue basis, in determining whether an amount is a compulsory amount. In addition, it provides that a taxpayer is not required to alter its form of doing business, its business conduct, or the form of any transaction in order to reduce its liability for tax under foreign law.

A. U.S.-Owned Foreign Entities

Commentators have raised questions regarding the application of § 1.901–2(e)(5) to a U.S. person that owns one or more foreign entities. In particular, commentators have raised questions concerning the application of the regulation when one foreign entity directly or indirectly owned by a U.S. person transfers, pursuant to a group relief type regime, a net loss to another foreign entity, which may or may not also be owned by the U.S. person. Certain commentators have expressed concern that foreign taxes paid by the transferor in a subsequent tax year might not be compulsory payments to the extent the transferor could have reduced its liability for those foreign taxes had it chosen not to transfer the net loss in the prior year. This concern arises because the current final regulations apply on a taxpayer-by-taxpayer basis, obligating each taxpayer to minimize its liability for foreign taxes over time, even though the net effect of the loss surrender may be to minimize the amount of foreign taxes paid in the aggregate by the controlled group over time.

Similar questions and concerns arise when one or more foreign subsidiaries of a U.S. person reach a combined settlement with a foreign taxing authority that results in an increase in the amount of one foreign subsidiary's foreign tax liability and a decrease in the amount of a second foreign subsidiary's foreign tax liability.

B. Certain Structured Passive Investment Arrangements

The IRS and Treasury Department have become aware that certain U.S. taxpayers are engaging in highly structured transactions with foreign counterparties in order to generate foreign tax credits. These transactions are intentionally structured to create a foreign tax liability when, removed from the elaborately engineered structure, the basic underlying business transaction

generally would result in significantly less, or even no, foreign taxes. In particular, the transactions purport to convert what would otherwise be an ordinary course financing arrangement between a U.S. person and a foreign counterparty, or a portfolio investment of a U.S. person, into some form of equity ownership in a foreign special purpose vehicle (SPV). The transaction is deliberately structured to create income in the SPV for foreign tax purposes, which income is purportedly subject to foreign tax. The parties exploit differences between U.S. and foreign law in order to permit the U.S. taxpayer to claim a credit for the purported foreign tax payments while also allowing the foreign counterparty to claim a foreign tax benefit. The U.S. taxpayer and the foreign counterparty share the cost of the purported foreign tax payments through the pricing of the arrangement.

Explanation of Provisions

The proposed regulations address the application of § 1.901–2(e)(5) in cases where a U.S. person directly or indirectly owns one or more foreign entities and in cases in which a U.S. person is a party to a highly structured passive investment arrangement described in this preamble. The proposed regulations would treat as a single taxpayer for purposes of § 1.901–2(e)(5) all foreign entities with respect to which a U.S. person has a direct or indirect interest of 80 percent or more. The proposed regulations would treat foreign payments attributable to highly structured passive investment arrangements as noncompulsory payments under § 1.901–2(e)(5) and, thus, would disallow credits for such amounts.

A. U.S.-Owned Foreign Entities

Section 1.901–2(e)(5) requires a taxpayer to interpret and apply foreign law reasonably in such a way as to reduce, over time, the taxpayer's reasonably expected liability under foreign law for tax. This requirement ensures that a taxpayer will make reasonable efforts to minimize its foreign tax liability even though the taxpayer may otherwise be indifferent to the imposition of foreign tax due to the availability of the foreign tax credit. The purpose of this requirement is served if all foreign entities owned by such person, in the aggregate, satisfy the requirements of the regulation. Accordingly, for purposes of determining compliance with § 1.901–2(e)(5), the proposed regulations would treat as a single taxpayer all foreign entities in which the same U.S. person has a direct or indirect interest of 80 percent or more. For this purpose, an interest of 80 percent or more means stock possessing 80 percent or more of the vote and value (in the case of a foreign corporation) or an interest representing 80 percent or more of the income (in the case of non-corporate foreign entities).

The proposed regulations provide that if one 80 percent-owned foreign entity transfers or surrenders a net loss for the taxable year to a second such entity pursuant to a foreign law group relief or similar regime, foreign tax paid by the transferor in a different tax year does not fail to be a compulsory payment solely because such tax would not have been due had the transferor retained the net loss and carried it over to such other year. Similarly, it provides that if one or more 80 percent-owned foreign entities enter into a combined settlement under foreign law of two or more issues, such settlement will be evaluated on an overall basis, not on an issue-by-issue or entity-by-entity basis, in determining whether an amount is a compulsory amount. The proposed regulations include examples to illustrate the proposed rule.

The IRS and Treasury Department intend to monitor structures involving U.S.-owned foreign groups, including those that would be covered by the proposed regulations, to determine whether taxpayers are utilizing such structures to separate foreign taxes from the related income. The IRS and Treasury Department may issue additional regulations in the future in order to address arrangements that result in the inappropriate separation of foreign tax and income.

B. Certain Structured Passive Investment Arrangements

The structured arrangements discovered and identified by the IRS and the Treasury Department can be grouped into three general categories: (1) U.S. borrower transactions, (2) U.S. lender transactions, and (3) asset holding transactions. The transactions, including the claimed U.S. tax results, are described in section B.1 of this preamble. Section B.2 of this preamble discusses the purpose of the foreign tax credit regime and explains why allowing a credit in the transactions is inconsistent with this purpose. Section B.3 of this preamble discusses comments the IRS and the Treasury Department have received on the transactions and describes the proposed regulations. The IRS is continuing to scrutinize the transactions under current law and intends to utilize all tools available to challenge the claimed U.S. tax results in appropriate cases.

1. Categories of Structured Passive Investment Arrangements

(a) *U.S. borrower transactions.* The first category consists of transactions in which a U.S. person indirectly borrows funds from an unrelated foreign counterparty. If a U.S. person were to borrow funds directly from a foreign person, the U.S. person generally would make nondeductible principal payments and deductible interest payments. The U.S. person would not incur foreign tax. The foreign lender generally would owe foreign tax on its interest income. In a structured financing arrangement, the U.S. borrower attempts to convert all or a portion of its deductible interest payments and, in certain cases, its nondeductible principal payments into creditable foreign tax payments. The U.S. borrower's foreign tax credit benefit is shared by the parties through the pricing of the arrangement. See *Example 1* of proposed § 1.901–2(e)(5)(iv)(D).

In a typical structured financing arrangement, the loan is made indirectly through an SPV. The foreign lender's interest income (and, in many cases, other income) is effectively isolated in the SPV. The U.S. borrower acquires a direct or indirect interest in the SPV and asserts that it has a direct or indirect equity interest in the SPV for U.S. tax purposes. The U.S. borrower claims a credit for foreign taxes imposed on the income derived by the SPV. The U.S. borrower's purported equity interest may be treated as debt for foreign tax purposes or it may be treated as an equity interest that is owned by the foreign lender for foreign tax purposes. In either case, the foreign lender is treated as owning an equity interest in the SPV for foreign tax purposes, which entitles the foreign lender to receive tax-free distributions from the SPV.

For example, assume that a U.S. person seeks to borrow $1.5 billion from a foreign person. Instead of borrowing the funds directly, the U.S. borrower forms a corporation (SPV) in the same country as the foreign counterparty. The U.S. borrower contributes $1.5 billion to SPV in exchange for 100 percent of the stock of SPV. SPV, in turn, loans the entire $1.5 billion to a corporation wholly owned by the U.S. borrower. The U.S. borrower recovers its $1.5 billion by selling its entire interest in SPV to the foreign counterparty, subject to an obligation to repurchase the interest in five years for $1.5 billion. Each year, SPV earns $120 million of interest income from the U.S. borrower's subsidiary. SPV pays $36 million of foreign tax and distributes the

remaining $84 million to the foreign counterparty.

The U.S. borrower takes the position that, for U.S. tax purposes, the sale-repurchase transaction is a borrowing secured by the SPV stock. Accordingly, the U.S. borrower asserts that it owns the stock of SPV for U.S. tax purposes and has an outstanding debt obligation to the foreign counterparty. It reports the distribution from SPV as dividend income and claims indirect credits under section 902 for the $36 million of foreign taxes paid by SPV. It includes in income the cash dividend of $84 million paid to the foreign counterparty, plus a section 78 gross-up amount of $36 million, for a total of $120 million. The U.S. borrower claims a deduction of $84 million as interest on its debt obligation to the foreign counterparty. In addition, the U.S. borrower's subsidiary claims an interest deduction of $120 million. In the aggregate, the U.S. borrower and its subsidiary claim a foreign tax credit of $36 million and an interest expense deduction (net of income inclusions) of $84 million.

For foreign tax purposes, the foreign counterparty owns the equity of SPV and is not subject to additional foreign tax upon receipt of the dividend. Thus, the net result is that the foreign jurisdiction receives foreign tax payments attributable to what is in substance the lender's interest income, which is consistent with the foreign tax results that would be expected from a direct borrowing.

Both parties benefit from the arrangement. The foreign lender obtains an after-foreign tax interest rate that is higher than the after-foreign tax interest rate it would earn on a direct loan. The U.S. borrower's funding costs are lower on an after-U.S. tax basis (though not on a pre-U.S. tax basis) because it has converted interest expense into creditable foreign tax payments.

The benefit to the parties is solely attributable to the reduction in the U.S. borrower's U.S. tax liability resulting from the foreign tax credits claimed by the U.S. borrower. The foreign jurisdiction benefits from the arrangement because the amount of interest received by SPV exceeds the amount of interest that would have been received by the foreign lender if the transaction had been structured as a direct loan. As a result, the amount paid by SPV to the foreign jurisdiction exceeds the amount of foreign tax the foreign jurisdiction would have imposed on the foreign lender's interest income in connection with a direct loan.

(b) *U.S. lender transactions.* The second category consists of transactions in which a U.S person indirectly loans funds to an unrelated foreign counterparty. If a U.S. person were to loan the funds directly to the foreign person, the U.S. person generally would be subject to U.S. tax on its interest income and the borrower would receive a corresponding deduction for the interest expense. The U.S. person generally would not be subject to foreign tax other than, in certain circumstances, a gross basis withholding tax.

In a typical structured financing arrangement, the U.S. person advances funds to a foreign borrower indirectly through an SPV. The U.S. person asserts that its interest in the SPV is equity for U.S. tax purposes. Income of the foreign borrower (or another foreign counterparty) is effectively shifted into the SPV. The U.S. person receives cash payments from the SPV and claims a credit for foreign taxes imposed on the income recognized by the SPV for foreign tax purposes. The foreign tax credits eliminate all or substantially all of the U.S. tax the U.S. person would otherwise owe on its return and, in many cases, U.S. tax the U.S. person would otherwise owe on unrelated foreign source income. The economic cost of the foreign taxes is shared through the pricing of the arrangement. See *Example 4* of proposed § 1.901–2(e)(5)(iv)(D).

For example, assume a U.S. person seeks to loan $1 billion to a foreign person. In lieu of a direct loan, the U.S. lender contributes $1 billion to a newly-formed corporation (SPV). The foreign counterparty contributes $2 billion to SPV, which is organized in the same country as the foreign counterparty. SPV contributes the total $3 billion to a second special purpose entity (RH), receiving a 99 percent equity interest in RH in exchange. The foreign counterparty owns the remaining 1 percent of RH. RH loans the funds to the foreign counterparty in exchange for a note that pays interest currently and a second zero-coupon note. RH is a corporation for U.S. tax purposes and a flow-through entity for foreign tax purposes.

Each year, the foreign counterparty pays $92 million of interest to RH, and RH accrues $113 million of interest on the zero-coupon note. RH distributes the $92 million of cash it receives to SPV. Because RH is a partnership for foreign tax purposes, SPV is required to report for foreign tax purposes 99 percent ($203 million) of the income recognized by RH. Because RH is a corporation for U.S. tax purposes, SPV recognizes only the cash distributions of $92 million for U.S. tax purposes. SPV pays foreign tax of $48 million on its net income (30 percent of $159 million, or $203 interest income less $44 million interest deduction) and distributes its remaining cash of $44 million to the U.S. lender.

The U.S. lender takes the position that it has an equity interest in SPV for U.S. tax purposes. It claims an indirect credit for the $48 million of foreign taxes paid by SPV. It includes in income the cash dividend of $44 million, plus a section 78 gross-up amount of $48 million. For foreign tax purposes, the U.S. lender's interest in SPV is debt, and the foreign borrower owns 100 percent of the equity of SPV. The foreign counterparty and SPV, in the aggregate, have a net deduction of $44 million for foreign tax purposes.

Both parties benefit from the transaction. The foreign borrower obtains ''cheap financing'' because the $44 million of cash distributed to the U.S. lender is less than the amount of interest it would have to pay on a direct loan with respect to which the U.S. lender would owe U.S. tax. The U.S. lender is better off on an after-U.S. tax basis because of the foreign tax credits, which eliminate the U.S. lender's U.S. tax on the ''dividend'' income.

The benefit to the parties is solely attributable to the reduction in the U.S. lender's U.S. tax liability resulting from the foreign tax credits claimed by the U.S. lender. The foreign jurisdiction benefits because the aggregate foreign tax result is a deduction for the foreign borrower that is less than the amount of the interest deduction the foreign borrower would have had upon a direct loan.

(c) *Asset holding transactions.* The third category of transactions (''asset holding transactions'') consists of transactions in which a U.S. person that owns an income-producing asset moves the asset into a foreign taxing jurisdiction. For example, assume a U.S. person owns passive-type assets (such as debt obligations) generating an income stream that is subject to U.S. tax. In an asset holding transaction, the U.S. person transfers the assets to an SPV that is subject to tax in a foreign jurisdiction on the income stream. Ordinarily, such a transfer would not affect the U.S. person's after-tax position since the U.S. person could claim a credit for the foreign tax paid and, thereby, obtain a corresponding reduction in the amount of U.S. tax it would otherwise owe. In the structured transactions, however, the cost of the foreign tax is shared by a foreign person who obtains a foreign tax benefit by participating in the arrangement. Thus, the U.S. person is better off paying the foreign tax instead of U.S. tax because

it does not bear the full economic burden of the foreign tax.

In a typical structured transaction, a foreign counterparty participates in the arrangement with the SPV. For example, the foreign counterparty may be considered to own a direct or indirect interest in the SPV for foreign tax purposes. The foreign counterparty's participation in the arrangement allows it to obtain a foreign tax benefit that it would not otherwise enjoy. The foreign counterparty compensates the U.S. person for this benefit in some manner. This compensation, which can be viewed as a reimbursement for a portion of the foreign tax liability resulting from the transfer of the assets, puts the U.S. person in a better after-U.S. tax position. See *Example 7* of proposed § 1.901–2(e)(5)(iv)(D).

The benefit to the parties is solely attributable to the reduction in the U.S. taxpayer's U.S. tax liability resulting from the foreign tax credits claimed by the U.S. taxpayer. The foreign jurisdiction benefits because the foreign taxes purportedly paid by the SPV exceed the amount by which the foreign counterparty's taxes are reduced.

2. Purpose of the Foreign Tax Credit

The purpose of the foreign tax credit is to mitigate double taxation of foreign source income. Because the foreign tax credit provides a dollar-for-dollar reduction in U.S. tax that a U.S. person would otherwise owe, the U.S. person generally is indifferent, subject to various foreign tax credit limitations, as to whether it pays foreign tax on its foreign source income (if fully offset by the foreign tax credit) or whether it pays U.S. (and no foreign) tax on that income.

The structured arrangements described in section B.1 of this preamble violate this purpose. A common feature of all these arrangements is that the U.S. person and a foreign counterparty share the economic cost of the foreign taxes claimed as credits by the U.S. person. This creates an incentive for the U.S. person to subject itself voluntarily to the foreign tax because there is a U.S. tax motivation to do so. The result is an erosion of the U.S. tax base in a manner that is not consistent with the purpose of the foreign tax credit provisions.

Although the foreign counterparty derives a foreign tax benefit in these arrangements, the foreign jurisdiction generally is made whole because of the payments to the foreign jurisdiction made by the special purpose vehicle. In fact, the aggregate amount of payments to the foreign jurisdictions in connection with these transactions generally exceeds the amount of foreign tax that would have been imposed in the ordinary course. Only the U.S. fisc experiences a reduction in tax payments as a result of the structured arrangements.

The IRS and Treasury Department recognize that often there is a business purpose for the financing or portfolio investment underlying the otherwise elaborately engineered transactions. However, it is inconsistent with the purpose of the foreign tax credit to permit a credit for foreign taxes that result from intentionally structuring a transaction to generate foreign taxes in a manner that allows the parties to obtain duplicate tax benefits and share the cost of the tax payments. The result in these structured arrangements is that both parties as well as the foreign jurisdiction benefit at the expense of the U.S. fisc.

3. Comments and Proposed Regulations

The IRS and Treasury Department have determined that it is not appropriate to allow a credit in connection with these highly engineered transactions where the U.S. taxpayer benefits by intentionally subjecting itself to foreign tax. The proposed regulations would revise § 1.901–2(e)(5) to provide that an amount paid to a foreign country in connection with such an arrangement is not an amount of tax paid. Accordingly, under the proposed regulations, a taxpayer would not be eligible to claim a foreign tax credit for such a payment. For periods prior to the effective date of final regulations, the IRS will continue to utilize all available tools under current law to challenge the U.S. tax results claimed in connection with such arrangements, including the substance over form doctrine, the economic substance doctrine, debt-equity principles, tax ownership principles, existing § 1.901–2(e), section 269, and the partnership anti-abuse rules of § 1.701–2.

Certain commentators recommended that the IRS and Treasury Department adopt a broad anti-abuse rule that would deny a foreign tax credit in any case where allowance of the credit would be inconsistent with the purpose of the foreign tax credit regime. Other commentators recommended a narrower approach that would only deny foreign tax credits attributable to transactions that include particular features. The IRS and Treasury Department are concerned that a broad anti-abuse rule would create uncertainty for both taxpayers and the IRS. The IRS and Treasury Department have concluded that, at this time, a targeted rule denying foreign tax credits in arrangements similar to the arrangements described in section B.1 of this preamble is more appropriate.

For periods after the effective date of final regulations, the IRS and Treasury Department will continue to scrutinize other arrangements that are not covered by the regulations but are inconsistent with the purpose of the foreign tax credit. Such arrangements may include arrangements that are similar to arrangements described in the proposed regulations, but that do not meet all of the conditions included in the proposed regulations. The IRS will utilize all available tools, including those described above, to challenge the claimed U.S. tax results in appropriate cases. In addition, the IRS and Treasury Department may issue additional regulations in the future in order to address such other arrangements.

The proposed regulations would retain the general rule in the existing regulations that a taxpayer need not alter its form of doing business or the form of any transaction in order to reduce its foreign tax liability. However, the proposed regulations would provide that, notwithstanding the general rule, an amount paid to a foreign country (a ''foreign payment'') is not a compulsory payment, and thus is not an amount of tax paid, if the foreign payment is attributable to a structured passive investment arrangement. For this purpose, the proposed regulations would define a structured passive investment arrangement as an arrangement that satisfies six conditions. The six conditions consist of features that are common to the three types of arrangements identified in section B.1 of this preamble. The IRS and Treasury Department believe it is appropriate to treat foreign payments attributable to these arrangements as voluntary payments because such arrangements are intentionally structured to generate the foreign payment.

The first condition is that the arrangement utilizes an entity that meets two requirements (an ''SPV''). The first requirement is that substantially all of the gross income (for United States tax purposes) of the entity is attributable to passive investment income and substantially all of the assets of the entity are assets held to produce such passive investment income. The second requirement is that there is a purported foreign tax payment attributable to income of the entity. The purported foreign tax may be paid by the entity itself, by the owner(s) of the entity (if the entity is treated as a pass-through entity under foreign law) or by a lower-tier entity (if the lower-tier

entity is treated as a pass-through entity under U.S. law).

For purposes of this first requirement, passive investment income is defined as income described in section 954(c), with two modifications. The first modification is that if the entity is a holding company that owns a direct equity interest (other than a preferred interest) of 10 percent or more in another entity (a lower-tier entity) that is predominantly engaged in the active conduct of a trade or business (or substantially all the assets of which consist of qualifying equity interests in other entities that are predominantly engaged in the active conduct of a trade or business), passive investment income does not include income attributable to the interest in such lower-tier entity. This exception does not apply if there are arrangements under which substantially all of the opportunity for gain and risk of loss with respect to such interest in the lower-tier entity are borne by either the U.S. party or the counterparty (but not both). Accordingly, a direct equity interest in any such lower-tier entity is not held to produce passive investment income provided there are no arrangements under which substantially all of the entity's opportunity for gain and risk of loss with respect to the lower-tier entity are borne by either the U.S. party or the counterparty (but not both). This modification is based on the notion that an entity is not a passive investment vehicle of the type targeted by these regulations if the entity is a holding company for one or more operating companies. This modification ensures that a joint venture arrangement between a U.S. person and a foreign person is not treated as a passive investment arrangement solely because the joint venture is conducted through a holding company structure.

The second modification is that passive investment income is determined by disregarding sections 954(c)(3) and (c)(6) and by treating income attributable to transactions with the counterparties (described in this preamble) as ineligible for the exclusions under sections 954(h) and (i). Sections 954(c)(3) and (c)(6) provide exclusions for certain related party payments of dividends, interest, rents, and royalties. Those exclusions are not appropriate for these transactions because these transactions can be structured utilizing related party payments. The modifications to the application of sections 954(h) and (i) are intended to ensure that income derived from the counterparty cannot qualify for the exclusion from passive investment income, but will not prevent other income from qualifying for those exclusions. The IRS and Treasury Department intend that the structured financing arrangements described in this preamble do not qualify for the active banking, financing or insurance business exceptions to the definition of passive investment income. Comments are requested on whether further modifications or clarifications to the proposed regulations' definition of passive investment income are appropriate to ensure this result.

The requirement that substantially all of the assets of the entity produce passive investment income is intended to ensure that an entity engaged in an active trade or business is not treated as an SPV solely because, in a particular year, it derives only passive investment income.

The second overall condition is that a person (a ''U.S. party'') would be eligible to claim a credit under section 901(a) (including a credit for foreign taxes deemed paid under section 902 or 960) for all or a portion of the foreign payment if such payment were an amount of tax paid. Such eligibility to claim the credit could arise because the U.S. party would be treated as having paid or accrued the foreign payment for purposes of section 901 if it were an amount of tax paid. Alternatively, the U.S. party's eligibility to claim the credit could arise because the U.S. party owns an equity interest in the SPV or another entity that would be treated as having paid or accrued the foreign payment for purposes of section 901 if it were an amount of tax paid.

The third overall condition is that the foreign payment or payments are (or are expected to be) substantially greater than the amount of credits, if any, that the U.S. party would reasonably expect to be eligible to claim under section 901(a) if such U.S. party directly owned its proportionate share of the assets owned by the SPV other than through a branch, a permanent establishment or any other arrangement (such as an agency arrangement) that would subject the income generated by its share of the assets to a net basis foreign tax. For example, if the SPV owns a note that generates interest income with respect to which a foreign payment is made, but foreign law (including an applicable treaty) provides for a zero rate of withholding tax on interest paid to non-residents, the U.S. party would not reasonably expect to pay foreign tax for which it could claim foreign tax credits if it directly owned the note and directly earned the interest income.

The fourth condition is that the arrangement is structured in such a manner that it results in a foreign tax benefit (such as a credit, deduction, loss, exemption or a disregarded payment) for a counterparty or for a person that is related to the counterparty, but not related to the U.S. party.

The fifth condition is that the counterparty is a person (other than the SPV) that is unrelated to the U.S. party and that (i) directly or indirectly owns 10 percent or more of the equity of the SPV under the tax laws of a foreign country in which such person is subject to tax on the basis of place of management, place of incorporation or similar criterion or otherwise subject to a net basis foreign tax or (ii) acquires 20 percent or more of the assets of the SPV under the tax laws of a foreign country in which such person is subject to tax on the basis of place of management, place of incorporation or similar criterion or otherwise subject to a net basis foreign tax.

The sixth condition is that the U.S. and an applicable foreign country treat the arrangement differently under their respective tax systems. For this purpose, an applicable foreign country is any foreign country in which either the counterparty, a person related to the counterparty (but not related to the U.S. party) or the SPV is subject to net basis tax. To provide clarity and limit the scope of this factor, the proposed regulations provide that the arrangement must be subject to one of four specified types of inconsistent treatment. Specifically, the U.S. and the foreign country (or countries) must treat one or more of the following aspects of the arrangement differently, and the U.S. treatment of the inconsistent aspect must materially affect the amount of foreign tax credits claimed, or the amount of income recognized, by the U.S. party to the arrangement: (i) The classification of an entity as a corporation or other entity subject to an entity-level tax, a partnership or other flow-through entity or an entity that is disregarded for tax purposes; (ii) the characterization as debt, equity or an instrument that is disregarded for tax purposes of an instrument issued in the transaction, (iii) the proportion of the equity of the SPV (or an entity that directly or indirectly owns the SPV) that is considered to be owned directly or indirectly by the U.S. party and the counterparty; or (iv) the amount of taxable income of the SPV for one or more tax years during which the arrangement is in effect.

Under the proposed regulations, a foreign payment would not be a compulsory payment if it is attributable to an arrangement that meets the six conditions. The proposed regulations

would treat a foreign payment as attributable to such an arrangement if the foreign payment is attributable to income of the SPV. Such foreign payments include a payment by the SPV, a payment by the owner of the SPV (if the SPV is a pass-through entity under foreign law) and a payment by a lower-tier entity that is treated as a pass-through entity under U.S. law. For this purpose, a foreign payment is not treated as attributable to the income of the SPV if the foreign payment is a gross basis withholding tax imposed on a distribution or payment from the SPV to the U.S. party. Such taxes could be considered to be noncompulsory payments because the U.S. party intentionally subjects itself to the taxes as part of the arrangement. However, the IRS and Treasury Department have determined that such taxes should not be treated as attributable to the arrangement because, among other reasons, the foreign counterparty generally does not derive a duplicative foreign tax benefit and, therefore, generally does not share the economic cost of such taxes.

The IRS and Treasury Department considered excluding all foreign payments with respect to which the economic cost is not shared from the definition of foreign payments attributable to the arrangement, but determined that such a rule would be difficult to administer. The IRS and Treasury Department request comments on whether it would be appropriate to exclude certain foreign payments from the definition of foreign taxes attributable to the structured passive investment arrangement. Comments should address the rationale and administrable criteria for identifying any such exclusions.

Certain commentators recommended that the proposed regulations include a requirement that the foreign tax credits attributable to the arrangement be disproportionate to the amount of taxable income attributable to the arrangement. This recommendation has not been adopted for three reasons. First, the IRS and Treasury Department were concerned that such a requirement would create too much uncertainty and would be unduly burdensome for taxpayers and the IRS. Second, the extent to which interest and other expenses, as well as returns on borrowed funds and capital, should be considered attributable to a particular arrangement is not entirely clear. A narrow view could present opportunities for manipulation, especially for financial institutions having numerous alternative placements of leverage for use within the group, while an expansive view could undercut the utility of such a test. Third, the fundamental concern in these transactions is that they create an incentive for taxpayers voluntarily to subject themselves to foreign tax. This concern exists irrespective of whether the particular arrangement generates a disproportionate amount of foreign tax credits.

The IRS and Treasury Department considered whether it would be appropriate to permit a taxpayer to treat a foreign payment attributable to an arrangement that meets the definition of a structured passive investment arrangement as an amount of tax paid, if the taxpayer can show that tax considerations were not a principal purpose for the structure of the arrangement. Alternatively, the IRS and Treasury Department considered whether it would be appropriate to treat a foreign payment as an amount of tax paid if a taxpayer shows that there is a substantial business purpose for utilizing a hybrid instrument or entity, which would not include reducing the taxpayer's after-tax costs or enhancing the taxpayer's after-tax return through duplicative foreign tax benefits. The IRS and Treasury Department determined not to include such a rule in these proposed regulations due to administrability concerns. Comments are requested, however, on whether the final regulations should include such a rule as well as how such a rule could be made to be administrable in practice, including what reasonably ascertainable evidence would be sufficient to establish such a substantial non-tax business purpose, or the lack of a tax-related principal purpose. Comments should also address whether it would be appropriate to adopt a broader anti-abuse rule and permit a taxpayer to demonstrate that it should not apply.

C. Effective Date

The regulations are proposed to be effective for foreign taxes paid or accrued during taxable years of the taxpayer ending on or after the date on which the final regulations are published in the **Federal Register**. No inference is intended regarding the U.S. tax consequences of structured passive investment arrangements prior to the effective date of the regulations.

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 also has 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 businesses.

Comments and 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 regulations 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 30, 2007, at 10 a.m. in the Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. 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** section 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 electronic or written comments and an outline of the topics to be discussed and time to be devoted to each topic (a signed original and eight (8) copies) by July 9, 2007. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

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

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 continues to read in part as follows:

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

Par. 2. Section 1.901–2 is amended by adding paragraphs (e)(5)(iii) and (iv), and revising paragraph (h) to read as follows:

§ 1.901–2 Income, war profits, or excess profits tax paid or accrued.

* * * * *

(e)(5) * * *

(iii) *U.S.-owned foreign entities*—(A) *In general.* If a U.S. person described in section 901(b) directly or indirectly owns stock possessing 80 percent or more of the total voting power and total value of one or more foreign corporations (or, in the case of a non-corporate foreign entity, directly or indirectly owns an interest in 80 percent or more of the income of one or more such foreign entities), the group comprising such foreign corporations and entities (the ''U.S.-owned group'') shall be treated as a single taxpayer for purposes of paragraph (e)(5) of this section. Therefore, if one member of such a U.S.-owned group transfers or surrenders a net loss for the taxable year to a second member of the U.S.-owned group and the loss reduces the foreign tax due from the second member pursuant to a foreign law group relief or similar regime, foreign tax paid by the first member in a different year does not fail to be a compulsory payment solely because such tax would not have been due had the member that transferred or surrendered the net loss instead carried over the loss to reduce its own income and foreign tax liability in that year. Similarly, if one or more members of the U.S.-owned group enter into a combined settlement under foreign law of two or more issues involving different members of the group, such settlement will be evaluated on an overall basis, not on an issue-by-issue or entity-by-entity basis, in determining whether an amount is a compulsory amount. The provisions of this paragraph (e)(5)(iii) apply solely for purposes of determining whether amounts paid are compulsory payments of foreign tax and do not, for example, modify the provisions of section 902 requiring separate pools of post-1986 undistributed earnings and post-1986 foreign income taxes for each member of a qualified group.

(B) *Special rules.* All domestic corporations that are members of a consolidated group (as that term is defined in § 1.1502–1(h)) shall be treated as one domestic corporation for purposes of this paragraph (e)(5)(iii). For purposes of this paragraph (e)(5)(iii), indirect ownership of stock or another equity interest (such as an interest in a partnership) shall be determined in accordance with the principles of section 958(a)(2), whether the interest is owned by a U.S. or foreign person.

(C) *Examples.* The following examples illustrate the rules of this paragraph (e)(5)(iii):

Example 1. (i) *Facts.* A, a domestic corporation, wholly owns B, a country X corporation. B, in turn, wholly owns several country X corporations, including C and D. B, C, and D participate in group relief in country X. Under the country X group relief rules, a member with a net loss may choose to surrender the loss to another member of the group. In year 1, C has a net loss of (1,000x) and D has net income of 5,000x for country X tax purposes. Pursuant to the group relief rules in country X, C agrees to surrender its year 1 net loss to D and D agrees to claim the net loss. D uses the net loss to reduce its year 1 net income to 4,000x for country X tax purposes, which reduces the amount of country X tax D owes in year 1 by 300x. In year 2, C earns 3,000x with respect to which it pays 900x of country X tax. Country X permits a taxpayer to carry forward net losses for up to ten years.

(ii) *Result.* Paragraph (e)(5)(i) of this section provides, in part, that an amount paid to a foreign country does not exceed the amount of liability under foreign law for tax if the taxpayer determines such amount in a manner that is consistent with a reasonable interpretation and application of the substantive and procedural provisions of foreign law (including applicable tax treaties) in such a way as to reduce, over time, the taxpayer's reasonably expected liability under foreign law for tax. Under paragraph (e)(5)(iii)(A) of this section, B, C, and D are treated as a single taxpayer for purposes of testing whether the reasonably expected foreign tax liability has been minimized over time, because A directly and indirectly owns 100 percent of each of B, C, and D. Accordingly, none of the 900x paid by C in year 2 fails to be a compulsory payment solely because C could have reduced its year 2 country X tax liability by 300x by choosing to carry forward its year 1 net loss to year 2 instead of surrendering it to D to reduce D's country X liability in year 1.

Example 2. (i) *Facts.* L, M, and N are country Y corporations. L owns 100 percent of the common stock of M, which owns 100 percent of the stock of N. O, a domestic corporation, owns a security issued by M that is treated as debt for country Y tax purposes and as stock for U.S. tax purposes. As a result, L owns 100 percent of the stock of M for country Y purposes while O owns 99 percent of the stock of M for U.S. tax purposes. L, M, and N participate in group relief in country Y. Pursuant to the group relief rules in country Y, M may surrender its loss to any member of the group. In year 1, M has a net loss of $10 million, N has net income of $25 million, and L has net income of $15 million. M chooses to surrender its year 1 net loss to L. Country Y imposes tax of 30 percent on the net income of country Y corporations. Accordingly, in year 1, the loss surrender has the effect of reducing L's country Y tax by $3 million. In year 1, N makes a payment of $7.5 million to country Y with respect to its net income of $25 million. If M had surrendered its net loss to N instead of L, N would have had net income of $15 million, with respect to which it would have owed only $4.5 million of country Y tax.

(ii) *Result.* M and N, but not L, are treated as a single taxpayer for purposes of paragraph (e)(5) of this section because O directly and indirectly owns 99 percent of each of M and N, but owns no direct or indirect interest in L. Accordingly, in testing whether M and N's reasonably expected foreign tax liability has been minimized over time, L is not considered the same taxpayer as M and N, collectively, and the $3 million reduction in L's year 1 country Y tax liability through the surrender to L of M's $10 million country Y net loss in year 1 is not considered to reduce M and N's collective country Y tax liability.

(iv) *Certain structured passive investment arrangements*—(A) *In general.* Notwithstanding paragraph (e)(5)(i) of this section, an amount paid to a foreign country (a ''foreign payment'') is not a compulsory payment, and thus is not an amount of tax paid, if the foreign payment is attributable to an arrangement described in paragraph (e)(5)(iv)(B) of this section. For purposes of this paragraph (e)(5)(iv), a foreign payment is attributable to an arrangement described in paragraph (e)(5)(iv)(B) of this section if the foreign payment is described in paragraph (e)(5)(iv)(B)(*1*)(*ii*) of this section.

(B) *Conditions.* An arrangement is described in this paragraph (e)(5)(iv)(B) if all of the following conditions are satisfied:

(*1*) *Special purpose vehicle (SPV).* An entity that is part of the arrangement meets the following requirements:

(*i*) Substantially all of the gross income (for United States tax purposes) of the entity is passive investment income as defined in paragraph (e)(5)(iv)(C)(*4*) of this section, and substantially all of the assets of the entity are assets held to produce such passive investment income. As provided in paragraph (e)(5)(iv)(C)(*4*)(*ii*) of this section, passive investment income generally does not include income of a holding company from qualified equity interests in lower-tier entities that are predominantly engaged in the active conduct of a trade or business. Thus, except as provided in paragraph (e)(5)(iv)(C)(*4*)(*ii*) of this section,

qualified equity interests of a holding company in such lower-tier entities are not held to produce passive investment income and the ownership of such interests will not cause the holding company to satisfy this paragraph (e)(5)(iv)(B)(*1*)(*i*).

(*ii*) There is a foreign payment attributable to income of the entity (as determined under the laws of the foreign country to which such foreign payment is made), including the entity's share of income of a lower-tier entity that is a branch or pass-through entity under the laws of such foreign country. A foreign payment attributable to income of an entity includes a foreign payment attributable to income that is required to be taken into account by an owner of the entity, if the entity is a branch or pass-through entity under the laws of such foreign country. A foreign payment attributable to income of an entity also includes a foreign payment attributable to income of a lower-tier entity that is a branch or pass-through entity for U.S. tax purposes. A foreign payment attributable to income of the entity does not include a withholding tax (within the meaning of section 901(k)(1)(B)) imposed on a distribution or payment from the entity to a U.S. party (as defined in paragraph (e)(5)(iv)(B)(*2*) of this section).

(*2*) *U.S. party.* A person (a ''U.S. party'') would be eligible to claim a credit under section 901(a) (including a credit for foreign taxes deemed paid under section 902 or 960) for all or a portion of the foreign payment described in paragraph (e)(5)(iv)(B)(*1*)(*ii*) of this section if the foreign payment were an amount of tax paid.

(*3*) *Direct investment.* The foreign payment or payments described in paragraph (e)(5)(iv)(B)(*1*)(*ii*) of this section are (or are expected to be) substantially greater than the amount of credits, if any, the U.S. party would reasonably expect to be eligible to claim under section 901(a) for foreign taxes attributable to income generated by the U.S. party's proportionate share of the assets owned by the SPV if the U.S. party directly owned such assets. For this purpose, direct ownership shall not include ownership through a branch, a permanent establishment or any other arrangement (such as an agency arrangement) that would result in the income generated by the U.S. party's proportionate share of the assets being subject to tax on a net basis in the foreign country to which the payment is made. A U.S. party's proportionate share of the assets of the SPV shall be determined by reference to such U.S. party's proportionate share of the total value of all of the outstanding interests in the SPV that are held by its equity owners and creditors.

(*4*) *Foreign tax benefit.* The arrangement is structured in such a manner that it results in a foreign tax benefit (such as a credit, deduction, loss, exemption or a disregarded payment) for a counterparty described in paragraph (e)(5)(iv)(B)(*5*) of this section or for a person that is related to the counterparty (determined under the principles of paragraph (e)(5)(iv)(C)(*6*) of this section by applying the tax laws of a foreign country in which the counterparty is subject to tax on a net basis) but is not related to the U.S. party (within the meaning of paragraph (e)(5)(iv)(C)(*6*) of this section).

(*5*) *Unrelated counterparty.* The arrangement involves a counterparty. A counterparty is a person (other than the SPV) that is not related to the U.S. party (within the meaning of paragraph (e)(5)(iv)(C)(*6*) of this section) and that meets one of the following conditions:

(*i*) The person is considered to own directly or indirectly 10 percent or more of the equity of the SPV under the tax laws of a foreign country in which the person is subject to tax on the basis of place of management, place of incorporation or similar criterion or otherwise subject to a net basis tax.

(*ii*) In a single transaction or series of transactions, the person directly or indirectly acquires 20 percent or more of the value of the assets of the SPV under the tax laws of a foreign country in which the person is subject to tax on the basis of place of management, place of incorporation or similar criterion or otherwise subject to a net basis tax. For purposes of determining the percentage of assets of the SPV acquired by the person, an asset of the SPV shall be disregarded if a principal purpose for transferring such asset to the SPV was to avoid this paragraph (e)(5)(iv)(B)(*5*)(*ii*).

(*6*) *Inconsistent treatment.* The U.S. and an applicable foreign country (as defined in paragraph (e)(5)(iv)(C)(*1*) of this section) treat one or more of the following aspects of the arrangement differently under their respective tax systems, and the U.S. treatment of the inconsistent aspect would materially affect the amount of income recognized by the U.S. party or the amount of credits claimed by the U.S. party if the foreign payment described in paragraph (e)(5)(iv)(B)(*1*)(*ii*) of this section were an amount of tax paid:

(*i*) The classification of the SPV (or an entity that has a direct or indirect ownership interest in the SPV) as a corporation or other entity subject to an entity-level tax, a partnership or other flow-through entity or an entity that is disregarded for tax purposes.

(*ii*) The characterization as debt, equity or an instrument that is disregarded for tax purposes of an instrument issued by the SPV (or an entity that has a direct or indirect ownership interest in the SPV) to the U.S. party, the counterparty or a person related to the U.S. party or the counterparty.

(*iii*) The proportion of the equity of the SPV (or an entity that directly or indirectly owns the SPV) that is considered to be owned directly or indirectly by the U.S. party and the counterparty.

(*iv*) The amount of taxable income of the SPV for one or more tax years during which the arrangement is in effect.

(C) *Definitions*—(*1*) *Applicable foreign country.* An *applicable foreign country* means each foreign country to which a foreign payment described in paragraph (e)(5)(iv)(B)(*1*)(*ii*) of this section is made or which confers a foreign tax benefit described in paragraph (e)(5)(iv)(B)(*4*) of this section.

(*2*) *Entity.* For purposes of paragraph (e)(5)(iv)(B)(*1*) and (e)(5)(iv)(C)(*4*) of this section, the term *entity* includes a corporation, trust, partnership or disregarded entity described in § 301.7701–2(c)(2)(i) of this chapter.

(*3*) *Indirect ownership.* For purposes of paragraph (e)(5)(iv) of this section, indirect ownership of stock or another equity interest (such as an interest in a partnership) shall be determined in accordance with the principles of section 958(a)(2), whether the interest is owned by a U.S. or foreign entity.

(4) *Passive investment income*—(i) *In general.* For purposes of paragraph (e)(5)(iv) of this section, the term *passive investment income* means income described in section 954(c), as modified by this paragraph (e)(5)(iv)(C)(*4*)(*i*) and paragraph (e)(5)(iv)(C)(*4*)(*ii*) of this section. In determining whether income is described in section 954(c), sections 954(c)(3) and 954(c)(6) shall be disregarded, and sections 954(h) and (i) shall be taken into account by applying those provisions at the entity level as if the entity were a controlled foreign corporation (as defined in section 957(a)). In addition, for purposes of the preceding sentence, any income of an entity attributable to transactions with a person that would be a counterparty (as defined in paragraph (e)(5)(iv)(B)(*5*) of this section) if the entity were an SPV, or with other persons that are described in paragraph (e)(5)(iv)(B)(*4*) of this section and that are eligible for a foreign tax benefit described in such paragraph (e)(5)(iv)(B)(*4*), shall not be treated as

qualified banking or financing income or as qualified insurance income, and shall not be taken into account in applying sections 954(h) and (i) for purposes of determining whether other income of the entity is excluded from section 954(c)(1) under section 954(h) or (i).

(*ii*) *Income attributable to lower-tier entities.* Except as provided in this paragraph (e)(5)(iv)(C)(*4*)(*ii*), income of an entity that is attributable to an equity interest in a lower-tier entity is passive investment income. If the entity is a holding company and directly owns a qualified equity interest in another entity (a ''lower-tier entity'') that is engaged in the active conduct of a trade or business and that derives more than 50 percent of its gross income from such trade or business, then none of the entity's income attributable to such interest is passive investment income, provided that there are no arrangements whereby substantially all of the entity's opportunity for gain and risk of loss with respect to such interest is borne by the U.S. party (or a related person) or the counterparty (or a related person), but not both parties. For purposes of the preceding sentence, an entity is a holding company, and is considered to be engaged in the active conduct of a trade or business and to derive more than 50 percent of its gross income from such trade or business, if substantially all of its assets consist of qualified equity interests in one or more entities, each of which is engaged in the active conduct of a trade or business and derives more than 50 percent of its gross income from such trade or business and with respect to which there are no arrangements whereby substantially all of the entity's opportunity for gain and risk of loss with respect to such interest is borne by the U.S. party (or a related person) or the counterparty (or a related person), but not both parties. For purposes of this paragraph (e)(5)(iv)(C)(*4*)(*ii*), a lower-tier entity that is engaged in a banking, financing, or similar business shall not be considered to be engaged in the active conduct of a trade or business unless the income derived by such entity would be excluded from section 954(c)(1) under section 954(h) or (i), determined by applying those provisions at the lower-tier entity level as if the entity were a controlled foreign corporation (as defined in section 957(a)). In addition, for purposes of the preceding sentence, any income of an entity attributable to transactions with a person that would be a counterparty (as defined in paragraph (e)(5)(iv)(B)(*5*) of this section) if the entity were an SPV, or with other persons that are described in paragraph (e)(5)(iv)(B)(*4*) of this section and that are eligible for a foreign tax benefit described in such paragraph (e)(5)(iv)(B)(*4*), shall not be treated as qualified banking or financing income or as qualified insurance income, and shall not be taken into account in applying sections 954(h) and (i) for purposes of determining whether other income of the entity is excluded from section 954(c)(1) under section 954(h) or (i).

(*5*) *Qualified equity interest.* With respect to an interest in a corporation, the term *qualified equity interest* means stock representing 10 percent or more of the total combined voting power of all classes of stock entitled to vote and 10 percent or more of the total value of the stock of the corporation or disregarded entity, but does not include any preferred stock (as defined in section 351(g)(3)). Similar rules shall apply to determine whether an interest in an entity other than a corporation is a qualified equity interest.

(*6*) *Related person.* Two persons are related for purposes of paragraph (e)(5)(iv) of this section if—

(*i*) One person directly or indirectly owns stock (or an equity interest) possessing more than 50 percent of the total value of the other person; or

(*ii*) The same person directly or indirectly owns stock (or an equity interest) possessing more than 50 percent of the total value of both persons.

(*7*) *Special purpose vehicle (SPV).* For purposes of this paragraph (e)(5)(iv), the term *SPV* means the entity described in paragraph (e)(5)(iv)(B)(*1*) of this section.

(D) *Examples.* The following examples illustrate the rules of paragraph (e)(5)(iv) of this section. No inference is intended as to whether a taxpayer would be eligible to claim a credit under section 901(a) if a foreign payment were an amount of tax paid.

Example 1. U.S. borrower transaction. (i) *Facts.* A domestic corporation (USP) forms a country M corporation (Newco), contributing $1.5 billion in exchange for 100 percent of the stock of Newco. Newco, in turn, loans the $1.5 billion to a second country M corporation (FSub) wholly owned by USP. FSub is engaged in the active conduct of manufacturing and selling widgets and derives more than 50 percent of its gross income from such business. USP then sells its entire interest in Newco to a country M corporation (FP) for the original purchase price of $1.5 billion, subject to an obligation to repurchase the interest in five years for $1.5 billion. The sale has the effect of transferring ownership of the Newco stock to FP for country M tax purposes. The sale-repurchase transaction is structured in a way that qualifies as a collateralized loan for U.S. tax purposes. Therefore, USP remains the owner of the Newco stock for U.S. tax purposes. In year 1, FSub pays Newco $120 million of interest. Newco pays $36 million to country M with respect to such interest income and distributes the remaining $84 million to FP. Under country M law, the $84 million distribution is excluded from FP's income. FP is not related to USP within the meaning of paragraph (e)(5)(iv)(C)(*6*) of this section. Under an income tax treaty between country M and the U.S., country M does not impose country M tax on interest received by U.S. residents from sources in country M.

(ii) *Result.* The payment by Newco to country M is not a compulsory payment, and thus is not an amount of tax paid. First, Newco is an SPV because all of Newco's income is passive investment income described in paragraph (e)(5)(iv)(C)(*4*) of this section, Newco's only asset, a note, is held to produce such income, and the payment to country M is attributable to such income. Second, if the foreign payment were treated as an amount of tax paid, USP would be deemed to pay the foreign payment under section 902(a) and, therefore, would be eligible to claim a credit for such payment under section 901(a). Third, USP would not pay any country M tax if it directly owned Newco's loan receivable. Fourth, distributions from Newco to FP are exempt from tax under country M law. Fifth, FP is a counterparty because FP and USP are unrelated and FP owns more than 10 percent of the stock of Newco under country M law. Sixth, FP is the owner of 100 percent of Newco's stock for country M tax purposes, while USP is the owner of 100 percent of Newco's stock for U.S. tax purposes, and USP's ownership of the stock would materially affect the amount of credits claimed by USP if the payment to country M were an amount of tax paid. If the foreign payment were treated as an amount of tax paid, USP's ownership of the stock for U.S. tax purposes would make USP eligible to claim a credit for such amount under sections 901(a) and 902(a). Because the payment to country M is not an amount of tax paid, USP has dividend income of $84 million and is not deemed to pay any country M tax under section 902(a). USP also has interest expense of $84 million. FSub's post-1986 undistributed earnings are reduced by $120 million of interest expense.

Example 2. U.S. borrower transaction. (i) *Facts.* The facts are the same as in *Example 1*, except that FSub is a wholly-owned subsidiary of Newco. In addition, FSub agrees not to pay, and Newco and FP agree not to cause FSub to pay, dividends during the five-year period in which FP holds the Newco stock subject to the obligation of USP to repurchase the stock.

(ii) *Result.* The results are the same as in *Example 1.* Although Newco wholly owns FSub, which is engaged in the active conduct of manufacturing and selling widgets and derives more than 50 percent of its income from such business, income attributable to Newco's stock in FSub is passive investment income because there are arrangements whereby substantially all of Newco's opportunity for gain and risk of loss with respect to its stock in FSub is borne by USP.

See paragraph (e)(iv)(C)(*4*)(ii) of this section. Accordingly, Newco's stock in FSub is held to produce passive investment income. Thus, Newco is an SPV because all of Newco's income is passive investment income described in paragraph (e)(5)(iv)(C)(*4*) of this section, Newco's assets are held to produce such income, and the payment to country M is attributable to such income.

Example 3. Active business; no SPV. (i) *Facts.* A, a domestic corporation, wholly owns B, a country X corporation engaged in the manufacture and sale of widgets. On January 1, 2008, C, also a country X corporation, loans $400 million to B in exchange for an instrument that is debt for U.S. tax purposes and equity for country X tax purposes. As a result, C is considered to own 20 percent of the stock of B for country X tax purposes. B loans $55 million to D, a country Y corporation wholly owned by A. For its 2008 tax year, B has $166 million of net income attributable to its sales of widgets and $3.3 million of interest income attributable to the loan to D. Country Y does not impose tax on interest paid to nonresidents. B makes a payment of $50.8 million to country X with respect to B's net income. Country X does not impose tax on dividend payments between country X corporations. A and C are not related within the meaning of paragraph (e)(5)(iv)(C)(*6*) of this section.

(ii) *Result.* B is not an SPV within the meaning of paragraph (e)(5)(iv)(B)(*1*) of this section because the amount of interest income received from D does not constitute substantially all of B's income and the $55 million loan to D does not constitute substantially all of B's assets. Accordingly, the $50.8 million payment to country X is not attributable to an arrangement described in paragraph (e)(5)(iv) of this section.

Example 4. U.S. lender transaction. (i) *Facts.* (A) A country X corporation (foreign bank) contributes $2 billion to a newly-formed country X corporation (Newco) in exchange for 100 percent of Newco's common stock. A U.S. bank (USB) contributes $1 billion to Newco in exchange for securities that are treated as stock of Newco for U.S. tax purposes and debt of Newco for country X tax purposes. The securities represent 10 percent of the total voting power of Newco. Newco contributes the entire $3 billion to a newly-formed country X entity (RH) in exchange for 99 percent of RH's equity. Foreign bank owns the remaining 1 percent of RH. RH is treated as a corporation for U.S. tax purposes and a partnership for country X tax purposes. RH loans the entire $3 billion it receives from Newco to foreign bank in exchange for a note that pays interest currently and a zero-coupon note. Under an income tax treaty between country X and the U.S., country X does not impose country X tax on interest received by U.S. residents from sources in country X. Country X does not impose tax on dividend payments between country X corporations. USB and the foreign bank are not related within the meaning of paragraph (e)(5)(iv)(C)(*6*) of this section.

(B) In year 1, foreign bank pays RH $92 million of interest and accrues $113 million of interest on the zero-coupon note. RH distributes the $92 million of cash it receives to Newco. Newco distributes $44 million to USB. Because RH is a partnership for country X purposes, Newco is required to report for country X purposes 99 percent ($203 million) of the income recognized by RH. Newco is entitled to interest deductions of $44 million for distributions to USB on the securities for country X tax purposes and, thus, has $159 million of net income for country X tax purposes. Newco makes a payment to country X of $48 million with respect to its net income. For U.S. tax purposes, Newco's post-1986 undistributed earnings pool for year 1 is $44 million ($92 million–$48 million). For country X tax purposes, foreign bank is entitled to interest expense deductions of $205 million.

(ii) *Result.* (A) The payment to country X is not a compulsory payment, and thus is not an amount of tax paid. First, Newco is an SPV because all of Newco's income is passive investment income described in paragraph (e)(5)(iv)(C)(*4*) of this section, Newco's sole asset, stock of RH, is held to produce such income, and the payment to country X is attributable to such income. Second, if the foreign payment were treated as an amount of tax paid, USB would be deemed to pay the $48 million under section 902(a) and, therefore, would be eligible to claim a credit under section 901(a). Third, USB would not pay any country X tax if it directly owned its proportionate share of Newco's asset, the 99 percent interest in RH, because under the U.S.-country X tax treaty country X would not impose tax on USB's distributive share of RH's interest income. Fourth, foreign bank is entitled to interest deductions under country X law for interest it pays and accrues to RH, and will receive tax-free dividends from Newco upon payment of the accrued interest. Fifth, foreign bank and USB are unrelated and foreign bank is considered to own more than 10 percent of Newco under country X law. Sixth, the U.S. and country X view several aspects of the transaction differently, and the U.S. treatment would materially affect the amount of credits claimed by USB if the country X payment were an amount of tax paid. If the country X payment were treated as an amount of tax paid, the equity treatment of the securities for U.S. tax purposes would make USB eligible to claim a credit for the payment under sections 901(a) and 902(a). Moreover, the fact that Newco recognizes a smaller amount of income for U.S. tax purposes than it does for country X tax purposes would increase the amount of credits USB would be eligible to claim upon receipt of the $44 million distribution. Because the $48 million payment to country X is not an amount of tax paid, USB has dividend income of $44 million. It is not deemed to pay tax under section 902(a).

(B) In addition, RH is an SPV because all of RH's income is passive investment income described in paragraph (e)(5)(iv)(C)(*4*) of this section, RH's sole assets, notes of foreign bank, are held to produce such income, and Newco's payment to country X is attributable to such income. Second, if the foreign payment were treated as an amount of tax paid, USB would be deemed to pay the $48 million under section 902(a) and, therefore, would be eligible to claim a credit under section 901(a). Third, USB would not pay any country X tax if it directly owned its proportionate share of RH's assets, notes of foreign bank, because under the U.S.-country X tax treaty country X would not impose tax on interest paid by foreign bank to USB. Fourth, foreign bank is entitled to interest deductions under country X law for interest it pays and accrues to RH, and will receive tax-free dividends from Newco upon payment of the accrued interest. Fifth, foreign bank and USB are unrelated and foreign bank is considered to own directly or indirectly more than 10 percent of RH under country X law. Sixth, the U.S. and country X view several aspects of the transaction differently, and the U.S. treatment would materially affect the amount of credits claimed by USB if the country X payment were an amount of tax paid. If the country X payment were treated as an amount of tax paid, the equity treatment of the Newco securities for U.S. tax purposes would make USB eligible to claim a credit for the payment under sections 901(a) and 902(a). Moreover, the entity classification of RH for U.S. tax purposes results in Newco recognizing a smaller amount of income for U.S. tax purposes than it does for country X tax purposes, which would increase the amount of credits USB would be eligible to claim upon receipt of the $44 million distribution. Because the $48 million payment to country X is not an amount of tax paid, USB has dividend income of $44 million. It is not deemed to pay tax under section 902(a).

Example 5. Active business; no SPV. (i) *Facts.* A, a country X corporation, and B, a domestic corporation, each contribute $1 billion to a newly-formed country X entity (C) in exchange for stock of C. C is treated as a corporation for country X purposes and a partnership for U.S. tax purposes. C contributes $1.95 billion to a newly-formed country X corporation (D) in exchange for 100 percent of D's stock. It loans its remaining $50 million to D. Accordingly, C's sole assets are stock and debt of D. D uses the entire $2 billion to engage in the business of manufacturing and selling widgets. For the 2015 tax year, D derives $300 million of income from its widget business and derives $2 million of interest income. For the 2015 tax year, C has dividend income of $200 million and interest income of $3.2 million with respect to its investment in D. Country X does not impose tax on dividends received by one country X corporation from a second country X corporation. C makes a payment of $960,000 to country X with respect to C's net income.

(ii) *Result.* C's dividend income is not passive investment income, and C's stock in D is not held to produce such income, because C owns at least 10 percent of D and D derives more than 50 percent of its income from the active conduct of its widget business. See paragraph (e)(5)(iv)(C)(*4*)(*ii*) of this section. As a result, less than substantially all of C's income is passive investment income and less than substantially all of C's assets are held to produce passive investment income. Accordingly, C is not an SPV within the meaning of paragraph (e)(5)(iv)(B)(*1*) of this

section, and the $960,000 payment to country X is not attributable to an arrangement described in paragraph (e)(5)(iv) of this section.

Example 6. Active business; no SPV. (i) *Facts.* The facts are the same as in *Example 5,* except that instead of loaning $50 million to D, C contributes the $50 million to E in exchange for 10 percent of the stock of E. E is a country Y entity that in not engaged in the active conduct of a trade or business. Also, for the 2015 tax year, D pays no dividends to C, E pays $3.2 million in dividends to C, and C makes a payment of $960,000 to country X with respect to C's net income.

(ii) *Result.* C's dividend income attributable to its stock in E is passive investment income, and C's stock in E is held to produce such income. C's stock in D is not held to produce passive investment income because C owns at least 10 percent of D and D derives more than 50 percent of its income from the active conduct of its widget business. See paragraph (e)(5)(iv)(C)(*4*)(*ii*) of this section. As a result, less than substantially all of C's assets are held to produce passive investment income. Accordingly, C does not meet the requirements of paragraph (e)(5)(iv)(B)(*1*) of this section, and the $960,000 payment to country X is not attributable to an arrangement described in paragraph (e)(5)(iv) of this section.

Example 7. Asset holding transaction. (i) *Facts.* (A) A domestic corporation (USP) contributes $6 billion of country Z debt obligations to a country Z entity (DE) in exchange for all of the class A and class B stock of DE. A corporation unrelated to USP and organized in country Z (Fcorp) contributes $1.5 billion to DE in exchange for all of the class C stock of DE. DE uses the $1.5 billion contributed by Fcorp to redeem USP's class B stock. The class C stock is entitled to ''all'' income from DE. However, Fcorp is obligated immediately to contribute back to DE all distributions on the class C stock. USP and Fcorp enter into—

(*1*) A forward contract under which USP agrees to buy after five years the class C stock for $1.5 billion; and

(*2*) An agreement under which USP agrees to pay Fcorp interest at a below-market rate on $1.5 billion.

(B) For U.S. tax purposes, these steps create a secured loan of $1.5 billion from Fcorp to USP. Therefore, for U.S. tax purposes, USP is the owner of both the class A and class C stock. DE is a disregarded entity for U.S. tax purposes and a corporation for country Z tax purposes. In year 1, DE earns $400 million of interest income on the country Z debt obligations. DE makes a payment to country Z of $100 million with respect to such income and distributes the remaining $300 million to Fcorp. Fcorp contributes the $300 million back to DE. USP and Fcorp are not related within the meaning of paragraph (e)(5)(iv)(C)(*6*) of this section. Country Z does not impose tax on interest income derived by U.S. residents.

(C) Country Z treats Fcorp as the owner of the class C stock. Pursuant to country Z tax law, Fcorp is required to report the $400 million of income with respect to the $300 million distribution from DE, but is allowed to claim credits for DE's $100 million payment to country Z. For country Z tax purposes, Fcorp's contribution increases its basis in the class C stock. When the class C stock is later ''sold'' to USP for $1.5 billion, the increase in tax basis will result in a country Z tax loss for Fcorp. Each year, the amount of the basis increase (and, thus, the amount of the loss generated) will be approximately $300 million.

(ii) *Result.* The payment to country Z is not a compulsory payment, and thus is not an amount of tax paid. First, DE is an SPV because all of DE's income is passive investment income described in paragraph (e)(5)(iv)(C)(*4*) of this section, all of DE's assets are held to produce such income, and the payment to country Z is attributable to such income. Second, if the payment were treated as an amount of tax paid, USP would be eligible to claim a credit for such amount under section 901(a). Third, USP would not pay any country Z tax if it directly owned DE's assets. Fourth, Fcorp is entitled to claim a credit under country Z tax law for the payment and will recognize a loss under country Z law upon the ''sale'' of the class C stock. Fifth, Fcorp and USP are not related within the meaning of paragraph (e)(5)(iv)(C)(*6*) of this section and Fcorp is considered to own more than 10 percent of DE under country Z law. Sixth, the United States and country X view certain aspects of the transaction differently and the U.S. treatment would materially affect the amount of credits claimed by USP if the country Z payment were an amount of tax paid. USP's ownership of the class C stock for U.S. tax purposes would make USP eligible to claim a credit for the country Z payment if the payment were treated as an amount of tax paid.

* * * * *

(h) *Effective date.* Paragraphs (a) through (e)(5)(ii) and paragraph (g) of this section, § 1.901–2A, and § 1.903–1 apply to taxable years beginning after November 14, 1983. Paragraphs (e)(5)(iii) and (iv) of this section are effective for foreign taxes paid or accrued during taxable years of the taxpayer ending on or after the date on which these regulations are published as final regulations in the **Federal Register**.

Kevin M. Brown,

Deputy Commissioner for Services and Enforcement.

[FR Doc. E7–5862 Filed 3–29–07; 8:45 am]

BILLING CODE 4830–01–P

DEPARTMENT OF LABOR

Occupational Safety and Health Administration

29 CFR Part 1910

[Docket No. OSHA–2007–0021]

RIN 1218–AC11

Announcement of Additional Stakeholder Meetings on Occupational Exposure to Ionizing Radiation

AGENCY: Occupational Safety and Health Administration, Labor.

ACTION: Announcement of additional stakeholder meetings.

SUMMARY: The Occupational Safety and Health Administration (OSHA) invites interested parties to participate in or observe informal stakeholder meetings on Occupational Exposure to Ionizing Radiation. These meetings are a continuation of OSHA's information collection efforts on ionizing radiation.

DATES: *Stakeholder meetings:* The stakeholder meeting dates are:

1. 8:30 a.m.–1 p.m., April 19, 2007, Chicago, IL.

2. 8:30 a.m.–4:30 p.m., April 26, 2007, Washington, DC.

Notice of intention to attend a stakeholder meeting: You must submit a notice of intention to attend (i.e., to participate or observe) the Chicago, IL or Washington, DC, stakeholder meeting by April 11, 2007.

ADDRESSES: *Stakeholder meetings:* The stakeholder meeting locations are:

1. Crown Plaza Chicago O'Hare, 5440 North River Road, Rosemont, IL 60018.

2. Frances Perkins Building, U.S. Department of Labor, 200 Constitution Avenue, NW., Washington, DC 20210.

Notices of intention to attend a stakeholder meeting: You may submit your notice of intention to attend (i.e., to participate or observe) a stakeholder meeting by any of the following methods:

Electronic: OSHA encourages you to submit your notice of intention to attend to *navas.liset@dol.gov*.

Facsimile: You may fax your notice of intention to attend to (202) 693–1678.

Regular mail, express delivery, hand delivery, messenger and courier service: Submit your notice of intention to attend to Liset Navas, OSHA, Directorate of Standards and Guidance, Room N–3718, U.S. Department of Labor, 200 Constitution Avenue, NW., Washington, DC 20210; telephone (202) 693–1950. The Department of Labor's and OSHA's normal hours of operation are 8:15 a.m. to 4:45 p.m., e.t.

Instructions: For further information on the stakeholder meetings and