

hedging transactions and currency gain or loss arising from certain interest-bearing liabilities do not constitute (or are not netted against) foreign personal holding company income. This treatment is implemented because the applicable commodities hedging transactions and interest-bearing liabilities typically offset transactions that do not generate foreign personal holding company income.

DATES: Effective Date: These regulations are effective January 31, 2003.

Applicability Date: For dates of applicability, see § 1.954–2(f)(2)(iv)(C), (v)(D), and (g)(2)(ii)(C)(2)(iii).

FOR FURTHER INFORMATION CONTACT: Kenneth Christman or Gregory Spring at (202) 622–3870 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

On May 13, 2002, proposed regulations (REG–154920–01) were published in the **Federal Register** (67 FR 31995) under section 954 governing the definition of *foreign base company income* and *foreign personal holding company income* of a *controlled foreign corporation* (a CFC). These regulations addressed, among other matters, the circumstances in which income from transactions in commodities will be treated as foreign personal holding company income.

Following the publication of the proposed regulations, the IRS scheduled a public hearing and requested written comments on the regulations. The public hearing was canceled because no one requested to speak at the hearing. The IRS received one written comment, which recommended the proposed regulations be finalized as written.

Explanation of Revisions

The language of the proposed regulations is unchanged except for nonsubstantive changes to §§ 1.954–2(g)(2)(ii)(C)(2)(i) and (ii) that more explicitly set out the relationship between those paragraphs and § 1.954–2(g)(2)(ii)(C)(1).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a

Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Kenneth Christman and Ted Setzer of the Office of the Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is 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. In § 1.954–0, paragraph (b) is amended by:

1. Removing the entry for § 1.954–2(f)(2)(iii)(E).
2. Revising the entry for § 1.954–2(f)(2)(iv).
3. Adding entries for § 1.954–2(f)(2)(iv)(C), and (f)(2)(v) through (f)(2)(vi).
4. Adding entries for § 1.954–2(g)(2)(ii)(C)(1) through (g)(2)(ii)(C)(2)(iii).

The additions and revisions read as follows:

§ 1.954–0 Introduction.

* * * * *

(b) * * *

§ 1.954–2 Foreign personal holding company income.

* * * * *

(f) * * *

(2) * * *

(iv) Qualified hedging transaction entered into prior to January 31, 2003.

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(C) Effective date.

(v) Qualified hedging transaction entered into on or after January 31, 2003.

(A) In general.

(B) Exception.

(C) Examples.

(D) Effective date.

(vi) Financial institutions not a producer, etc.

(g) * * *

(2) * * *

(ii) * * *

(C) Regular dealers.

(1) General rule.

(2) Certain interest-bearing liabilities treated as dealer property.

(i) In general.

(ii) Failure to identify certain liabilities.

(iii) Effective date.

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Par. 3. Section 1.954–2 is amended by:

1. Removing paragraph (f)(2)(iii)(E).
 2. Revising the heading of paragraph (f)(2)(iv).
 3. Adding paragraphs (f)(2)(iv)(C) and (f)(2)(v) through (f)(2)(vi).
 4. Adding paragraphs (g)(2)(ii)(C)(1) through (g)(2)(ii)(C)(2)(iii).
 5. Revising paragraph (g)(2)(iii).
- The revisions and additions read as follows:

§ 1.954–2 Foreign personal holding company income.

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(f) * * *

(2) * * *

(iv) *Qualified hedging transaction entered into prior to January 31, 2003.*

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(C) *Effective date.* This paragraph (f)(2)(iv) applies to gain or loss realized by a controlled foreign corporation with respect to a qualified hedging transaction entered into prior to January 31, 2003.

(v) *Qualified hedging transaction entered into on or after January 31, 2003—(A) In general.* The term *qualified hedging transaction* means a bona fide hedging transaction, as defined in paragraph (a)(4)(ii) of this section, with respect to one or more commodities transactions reasonably necessary to the conduct of any business by a producer, processor, merchant or handler of commodities in a manner in which such business is customarily and usually conducted by others. For purposes of this paragraph (f)(2)(v), a producer, processor, merchant or handler of commodities includes a controlled foreign corporation that regularly uses commodities in a manufacturing, construction, utilities, or transportation business.

(B) *Exception.* The term *qualified hedging transaction* does not include a transaction described in section 988(c)(1) (without regard to section 988(c)(1)(D)(i)).

(C) *Examples.* The following examples illustrate the provisions of this paragraph (f)(2)(v):

Example 1. CFC1 is a controlled foreign corporation located in country A. CFC1 manufactures and sells machinery in country B using aluminum and component parts