

DEPARTMENT OF THE TREASURY**Internal Revenue Service****26 CFR Parts 1 and 602**

[TD 9087]

RIN 1545-BA07

Exclusions From Gross Income of Foreign Corporations**AGENCY:** Internal Revenue Service (IRS), Treasury.**ACTION:** Final regulations.

SUMMARY: This document contains final regulations implementing sections 883(a) and (c) that relate to income derived by foreign corporations from the international operation of ships or aircraft. The final regulations reflect changes made by the Tax Reform Act of 1986 and subsequent legislative amendments. The final regulations provide, in general, that a foreign corporation organized in a qualified foreign country and engaged in the international operation of ships or aircraft shall exclude qualified income from gross income for purposes of U.S. Federal income taxation, provided that the corporation can satisfy certain ownership and related documentation requirements. The final regulations explain when a foreign country is a qualified foreign country and what income is considered to be qualified income. The final regulations specify how a foreign corporation may satisfy the ownership and related documentation requirements. In addition, the final regulations describe the information that the foreign corporation must include on its U.S. income tax return in order to claim an exemption. All foreign corporations engaged in the international operation of ships or aircraft that claim an exemption from U.S. Federal income tax based on section 883 are affected by these regulations.

DATES: *Effective Date:* These regulations are effective August 26, 2003.

Applicability Date: These regulations are applicable to taxable years of the foreign corporation beginning 30 days or more after August 26, 2003.

FOR FURTHER INFORMATION CONTACT: Patricia A. Bray or David L. Lundy at (202) 622-3880 (not a toll-free number).

SUPPLEMENTARY INFORMATION:**Paperwork Reduction Act**

The collections of information contained in these final regulations have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork

Reduction Act (44 U.S.C. 3507) under control number 1545-1677. Responses to these collections of information are mandatory.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number assigned by the Office of Management and Budget.

For corporations, the estimated annual burden per respondent varies from 30 minutes to eight hours, depending on the individual circumstances of the foreign corporation, with an estimated average of one hour. For shareholders, the estimated annual burden per respondent varies from zero minutes to eight hours, depending on the individual circumstances of the shareholder or intermediary, with an estimated average of 90 minutes.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, W:CAR:MP:T:T:SP, Washington, DC 20224, and to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to this collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

A notice of proposed rulemaking (REG-208280-86) under sections 883(a) and (c) was published in the **Federal Register** (65 FR 6065) on February 8, 2000 (the 2000 proposed regulations). Due to the substantial number of comments that were received on the 2000 proposed regulations, and the significant impact the regulations have on large segments of the shipping and air transport industries, the 2000 proposed regulations were withdrawn on August 2, 2002. A revised notice of proposed rulemaking (REG-136311-01) was published in the **Federal Register** (67 FR 50510) on August 2, 2002 (the proposed regulations), and provided an opportunity for additional comments. A public hearing on the proposed regulations was held on November 25, 2002. Numerous comments have been received. After consideration of all the comments, the proposed regulations are

adopted as revised by this Treasury decision.

The preamble to the 2000 proposed regulations contains a detailed explanation of the provisions in the 2000 proposed regulations, and the preamble to the proposed regulations describes the comments received on the 2000 proposed regulations and the consequent changes reflected in the proposed regulations. The explanations contained in those preambles are not repeated herein. The comments submitted to the IRS on the proposed regulations and the consequent changes reflected in the final regulations are described herein.

Public Comments*Comments Relating to § 1.883-1: Exclusion of Income From the International Operation of Ships or Aircraft***A. Substantiation and Reporting Requirements**

For a foreign corporation to be considered a qualified foreign corporation under § 1.883-1(c)(3), the proposed regulations require that the corporation provide on its return a reasonable estimate of the amount of income in each category of qualified income for which an exemption is claimed to the extent such amounts are readily determinable. Commentators criticized this requirement on the ground that it could require the creation of a separate accounting system, and would necessitate the allocation of expenses to each of the specific categories of income. Commentators suggested that whether amounts are *readily determinable* should depend on whether records to ascertain such amounts are available in the ordinary course of business.

The IRS and Treasury believe that the suggested definition of *readily determinable* does not ensure that adequate records will be maintained. That term should be interpreted in accordance with § 1.6012-2(g)(1)(i). However, the final regulations have been revised to clarify that a reasonable estimate of the gross amount of income in each category is required. Accordingly, there is no requirement that expenses be allocated to each category of income.

B. Operation of Ships or Aircraft

Section 1.883-1(e) of the proposed regulations provides generally that a corporation is considered engaged in the operation of ships or aircraft only when it is an owner or lessee of an entire ship or aircraft used in the carriage of passengers or cargo for hire.