

clear international norm or standard regarding the appropriate treatment of such services, the IRS and Treasury solicited comments on an appropriate rule. Commentators generally suggested that activities be treated as incidental unless they rise to the level of a separate, nonshipping business. The final regulations continue to reserve on this issue, pending further consideration by the IRS and Treasury.

I. Determining Equivalent Exemptions for Each Category of Income

Section 1.883-1(h)(2) of the proposed regulations provides that if an exemption is unavailable in a foreign country for one of the eight enumerated categories of income, the foreign country is not considered to grant an equivalent exemption with respect to that category of income. Paragraph (h)(2)(vi) of this section treats incidental income, other than incidental bareboat charter or dry lease income and incidental container-related income, as one category of income.

Commentators suggested that an equivalent exemption be determined on an item-of-income basis rather than by category of income. Commentators objected to the requirement that a foreign country exempt all items of income within a category of income to be treated as granting an equivalent exemption. The examples provided by commentators indicated that this concern arose primarily in the context of the residual category of incidental income described in paragraph (h)(2)(vi).

The final regulations retain the requirement that a foreign country exempt all items of income within a category of income, but provide an exception for incidental income described in paragraph (h)(2)(vi). The final regulations permit an exemption of any type of incidental income that qualifies under paragraph (g)(1) if a foreign country grants an equivalent exemption with respect to that type of income. For example, if a foreign country grants an equivalent exemption for the sale of airline tickets on behalf of another corporation engaged in international operation of aircraft, as provided in paragraph (g)(1)(iii), but does not provide an equivalent exemption for the inland transportation of cargo, as provided in paragraph (g)(1)(v), the foreign country is nonetheless considered to grant an equivalent exemption for the sale of airline tickets.

Commentators also pointed out that some income items may be described in more than one category of income, and asked which category would apply for

purposes of determining whether the foreign country provides an equivalent exemption. The IRS and Treasury believe that the taxpayer can select any applicable category of income that provides an exemption.

J. Special Rules With Respect to Income Tax Conventions

Section 1.883-1(h)(3)(i) of the proposed regulations provides that if a taxpayer is eligible to exempt income under both an applicable income tax convention and section 883, the taxpayer may claim an exemption under both the applicable income tax convention and section 883 with respect to such category of income. Such an election must be made with respect to all income of the foreign corporation from the international operation of ships or aircraft, and cannot be made separately with respect to different categories of income.

Commentators requested clarification concerning the election to claim an exemption under both the applicable income tax convention and section 883 when the benefits under the two exemptions are not co-extensive with respect to any category of income.

The final regulations have been clarified to provide that if a corporation chooses to claim an exemption under an income tax convention, it may simultaneously claim an exemption under section 883 with respect to any category of income listed in paragraphs (h)(2)(i) through (v), (vii), and (viii) of § 1.883-1 and to any type of income described in paragraph (h)(2)(vi) of § 1.883-1, but only to the extent that such income also is exempt under the income tax convention.

K. Participation in Certain Joint Ventures

Under § 1.883-1(h)(3)(i), a corporation organized in a foreign country that provides an exemption only through an income tax convention is not permitted to claim an exemption under section 883, with one exception. Paragraph (h)(3)(ii) permits such corporation to claim an exemption under section 883 if the foreign corporation participates in a joint venture described in paragraph (e)(2) that is not treated as fiscally transparent with respect to the category of income derived from the joint venture under the income tax laws of the jurisdiction where the foreign corporation is organized, and treaty benefits would be available but for this reason.

Commentators suggested that the exception in § 1.883-1(h)(3)(ii) should apply to single-owner disregarded entities in addition to transparent joint

ventures. This suggestion was not adopted. The IRS and Treasury believe that the policy justification for relief in the joint venture context is not present in the context of a wholly owned entity.

L. Independent Interpretation of Income Tax Conventions

Section 1.883-1(h)(3)(iii) of the proposed regulations clarifies that definitions provided in these regulations do not give meaning or provide guidance regarding similar terms in U.S. income tax conventions or the scope of any treaty exemption. Commentators stated that definitions in the regulations and income tax conventions should have the same scope and be interpreted in the same way. The IRS and Treasury continue to believe that terms used in the proposed regulations should not be used to interpret terms and concepts in U.S. income tax conventions except to the extent that a treaty that entered into force after August 26, 2003 or its legislative history explicitly refers to section 883 and guidance thereunder for its meaning.

Comments Relating to § 1.883-2: Treatment of Publicly-traded Corporations

A. Closely-held Classes of Stock not Treated as Meeting Trading Requirements

Section 1.883-2(d)(3)(i) of the proposed regulations disqualifies a class of stock from being relied on to satisfy the publicly traded test if, at any time during the taxable year, one or more 5-percent shareholders of that class of stock (determined without regard to the attribution rules in § 1.883-4) owns, in the aggregate, 50 percent or more of the total vote and value of that class of stock (closely-held rule).

Commentators pointed out that a company could lose its exemption if a nonqualified shareholder held a sufficiently large block of stock for one day. Commentators suggested requiring a longer period of ownership by nonqualified shareholders before disqualifying a class of stock from being relied on to satisfy the publicly traded test.

This suggestion has been adopted. The final regulations provide that a class of stock will be disqualified if one or more 5-percent shareholders of that class of stock owns, in the aggregate, 50 percent or more of the total vote and value of that class of stock for more than half the number of days during the corporation's taxable year. In this way, the closely-held rule matches the exception provided in § 1.883-2(d)(3)(ii)