

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

REG-120509-06

RIN 1545-BF71

Determination of Interest Expense Deduction of Foreign Corporations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In the Rules and Regulations section of this issue of the **Federal Register**, the IRS is issuing temporary regulations under sections 882 and 884 relating to the determination of the interest expense deduction of foreign corporations engaged in a trade or business within the United States. These regulations update the 1996 final interest expense allocation rules for foreign corporations and take into account changes in the foreign banking industry. The rule changes are necessary to conform the final regulations more closely to current operating conditions in the foreign banking industry, and to harmonize the deemed earnings repatriation from a foreign corporation's trade or business within the United States, with the manner in which dividends are repatriated from U.S. resident companies to their foreign shareholders. These regulations are expected to simplify compliance burdens for many foreign corporations that allocate interest expense to effectively connected income and provide greater latitude to taxpayers in determining when their effectively connected earnings are treated as remitted. The text of these regulations also serves as the text of these proposed regulations.

DATES: Written or electronic comments and requests for a public hearing must be received by November 15, 2006.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-120509-06), Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be sent electronically, via the IRS Internet site at www.irs.gov/regs or via the Federal eRulemaking Portal at www.regulations.gov (IRS REG-120509-06).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Gregory Spring or Paul Epstein, (202) 622-3870, concerning submissions of comments, Richard A. Hurst, Richard.A.Hurst@irs.counsel.treas.gov, or (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington DC, 20224. Comments on the collection of information should be received by October 16, 2006. Comments are requested specifically concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application or automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collections of information in these proposed regulations are in §§1.882-5T(d)(5)(ii)(B) and 1.884-1T(e)(3)(iv). This collection of information is required to facilitate administrability of reporting of allocable expense from without the United States. Section 1.882-5T(d)(5)(ii)(B) provides a simplified procedure for taxpayers to calculate an allocable amount of U.S. dollar denominated interest expense booked by foreign banks in foreign locations. The collection of information provides certainty of application and immediate verification in the advance review and resolution of such treatment on examination. Section 1.884-1T(e)(3)(iv) provides the identical collection of information that was promulgated in final regulations in TD 8432 (1992-2 CB 157). The rule provides an election to reduce liabilities for purposes of treating effectively connected earnings and profits as reinvested. It also requires that U.S. connected liabilities be reduced for purposes of determining the allocation of interest expense to effectively connected income. The collection of information facilitates identification and verification of the coordinated treatment of the sections 882 and 884 provisions in accordance with the time, place and manner restrictions for making the election. The collections of information are mandatory. The likely respondents are foreign banks.

Estimated total annual reporting burden: 37.5

Estimated average annual burden hours per respondent: 1/2 hour

Estimated number of respondents: 75

Estimated annual frequency of responses: annually

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

Books and records relating to a 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

In the Rules and Regulations section of this issue of the **Federal Register**, the IRS is issuing temporary regulations under sections 882 and 884 relating to the determination of the interest expense deduction of foreign corporations engaged in a trade or business within the United States. The text of those regulations published in this issue of the **Federal Register** also serves as the text of these proposed regulations. The preamble to those temporary regulations explains the temporary regulations and these proposed 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 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 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 Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for 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 the Treasury Department specifically 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 will be scheduled if requested by any person who timely submits comments. If a public hearing is scheduled, notice of the date, time and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these regulations are Paul S. Epstein and Gregory A. Spring of the Office of Associate Chief Counsel (International).

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR 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 1.882-5 is amended to read as follows:

1. Paragraphs (a)(1), (a)(1)(i), (a)(1)(ii), (a)(1)(ii)(A), (a)(1)(ii)(B), (a)(2), (a)(7), (a)(7)(i), (a)(7)(ii), (b)(2)(ii)(A), (b)(3), (c)(2)(iv), (c)(4), (d)(2)(ii)(A)(2), (d)(2)(ii)(A)(3), (d)(2)(iii)(A), and (d)(5)(ii) are revised.
2. Paragraph (d)(6) Example 5 is added.

The revisions and addition read as follows:

§1.882-5 Determination of interest deduction

(a) * * *

(a)(1) through (a)(2) [The text of this proposed amendment is the same as the text of §1.882-5T(a)(1) through (a)(2) published elsewhere in this issue of the **Federal Register**].

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(a)(7) [The text of this proposed amendment is the same as the text of §1.882-5T(a)(7) published elsewhere in this issue of the **Federal Register**].

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(b) * * *

(2) * * *

(ii) * * *

(b)(2)(ii)(A) [The text of this proposed amendment is the same as the text of §1.882-5T(b)(2)(ii)(A) published elsewhere in this issue of the **Federal Register**].

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(b)(2)(iv) [The text of this proposed amendment is the same as the text of §1.882-5T(b)(2)(iv) published elsewhere in this issue of the **Federal Register**].

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(b)(3) [The text of this proposed amendment is the same as the text of §1.882-5T(b)(3) published elsewhere in this issue of the **Federal Register**].

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(c) * * *

(2) * * *

(c)(2)(iv) [The text of this proposed amendment is the same as the text of §1.882-5T(c)(2)(iv) published elsewhere in this issue of the **Federal Register**].

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(c)(4) [The text of this proposed amendment is the same as the text of §1.882-5T(c)(4) published elsewhere in this issue of the **Federal Register**].

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(d) * * *

(2) * * *

(ii) * * *

(A) * * *

(d)(2)(ii)(A)(2) through (3) [The text of these proposed amendments are the same as the text of §1.882-5T(d)(2)(ii)(A)(2) through (3) published elsewhere in this issue of the **Federal Register**].

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(d)(2)(iii)(A) [The text of this proposed amendment is the same as the text of §1.882-5T(d)(2)(iii)(A) published elsewhere in this issue of the **Federal Register**].

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(5) * * *

(i) * * *

(d)(5)(ii) [The text of this proposed amendment is the same as the text of §1.882-5T(d)(5)(ii) published elsewhere in this issue of the **Federal Register**].

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(d)(6) Example 5 [The text of this proposed amendment is the same as the text of §1.882-5T(d)(6) Example 5 published elsewhere in this issue of the **Federal Register**].

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Par. 3. Section 1.884-1 is amended by revising the entries for paragraphs §1.884-1(e)(3)(ii), (e)(3)(iv) and (e)(5) Example 2 to read as follows:

§1.884-1 Determination of interest deduction

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(e) * * *

(3) * * *

(e)(3)(ii) [The text of this proposed amendment is the same as the text of §1.884-1T(e)(3)(ii) published elsewhere in this issue of the **Federal Register**].

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(e)(3)(iv) [The text of this proposed amendment is the same as the text of §1.884-1T(e)(3)(iv) published elsewhere in this issue of the **Federal Register**].

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(5) * * *

(e)(5) Example 2 [The text of this proposed amendment is the same as the text of §1.884-1T(e)(5) Example 2 published elsewhere in this issue of the **Federal Register**].

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Mark E. Mathews

Deputy Commissioner for Services and Enforcement.