

Part III - Administrative, Procedural, and Miscellaneous

Information reporting for distributions with respect to securities issued by foreign corporations.

Notice 2003-79

SECTION 1. OVERVIEW

The Jobs and Growth Tax Relief Reconciliation Act of 2003 (P.L. 108-27, 117 Stat. 752) (the “2003 Act”) was enacted on May 28, 2003. Subject to certain limitations, the 2003 Act generally provides that a dividend paid to an individual shareholder from either a domestic corporation or a “qualified foreign corporation” is subject to tax at the reduced rates applicable to certain capital gains. A qualified foreign corporation includes certain foreign corporations that are eligible for benefits of a comprehensive income tax treaty with the United States which the Secretary determines is satisfactory for purposes of this provision and which includes an exchange of information program. In addition, a foreign corporation not otherwise treated as a qualified foreign corporation is so treated with respect to any dividend it pays if the stock with respect to which it pays such dividend is readily tradable on an established securities market in the United States.

This notice provides guidance for persons required to make returns and provide statements under section 6042 of the Internal Revenue Code (e.g., Form 1099-DIV) regarding distributions with respect to securities issued by a foreign corporation, and for individuals receiving such statements. The notice provides simplified procedures for persons required to make such returns and provide such statements for 2003. The notice also describes when a security (or an American depositary receipt in respect of such security) issued by a foreign corporation that is other than ordinary or common stock (such as preferred stock) will satisfy the readily tradable test (as described in Section 2.01 below). The notice also describes generally the certification process that Treasury and the IRS intend to develop for future years.

Section 2 of this notice describes the “qualified foreign corporation” determination under the 2003 Act and describes the information reporting requirements with respect to dividends generally. Section 3 addresses the determinations required under the 2003 Act for information reporting of a distribution with respect to a security of a foreign corporation, including how the readily tradable test applies to a security that is other than ordinary or common stock. Section 4 sets forth simplified procedures for information reporting for 2003. Section 5 briefly describes the certification procedure Treasury and the IRS intend to develop for use beginning in 2004.

SECTION 2. BACKGROUND

.01 The 2003 Act

Section 1(h)(1) of the Internal Revenue Code generally provides that a taxpayer's "net capital gain" for any taxable year will be subject to a maximum tax rate of 15 percent (or 5 percent in the case of certain taxpayers). The 2003 Act added section 1(h)(11), which provides that net capital gain for purposes of section (1)(h) means net capital gain (determined without regard to section 1(h)(11)) increased by "qualified dividend income". Qualified dividend income means dividends received during the taxable year from domestic corporations and "qualified foreign corporations." Section 1(h)(11)(B)(i). Subject to certain exceptions, a qualified foreign corporation is any foreign corporation that is either (i) incorporated in a possession of the United States (the "possessions test"), or (ii) eligible for benefits of a comprehensive income tax treaty with the United States which the Secretary determines is satisfactory for purposes of this provision and which includes an exchange of information program (the "treaty test").¹ Section 1(h)(11)(C)(i). Subject to the same exceptions, a foreign corporation that does not satisfy either of these two tests is treated as a qualified foreign corporation with respect to any dividend paid by such corporation if the stock with respect to which such dividend is paid is readily tradable on an established securities market in the United States (the "readily tradable test").² Section 1(h)(11)(C)(ii). A qualified foreign corporation does not include any foreign corporation which for the taxable year of the corporation in which the dividend was paid, or the preceding taxable year, is a foreign personal holding company (as defined in section 552) (a "FPHC"), a foreign investment company (as defined in section 1246(b)) (a "FIC"), or a passive foreign investment company (as defined in section 1297) (a "PFIC") (the "foreign investment company exclusion test"). Section 1(h)(11)(C)(iii).

A distribution with respect to a security issued by a qualified foreign corporation also is subject to the other limitations in section 1(h)(11). In particular, the recipient must satisfy the holding period requirements of section 1(h)(11)(B)(iii) (the "holding period test"). In addition, the distribution must constitute a dividend for U.S. federal income tax purposes. Accordingly, the security with respect to which the distribution is made must be equity rather than debt for U.S. federal income tax purposes (the "equity test"), and the distribution must be out of the corporation's earnings and profits rather than a return of capital (the "E&P test").

The determination whether a distribution with respect to a security issued by a foreign corporation is eligible for the reduced rates of tax under the 2003 Act therefore requires a series of separate determinations. These determinations are discussed in more detail in Section 3. First, the security with respect to which the distribution is made must satisfy the equity test. Second, the distribution must satisfy the E&P test. Third, the security must satisfy the readily tradable test, or the foreign corporation must satisfy either the possessions test or the treaty test. Fourth, the foreign corporation must satisfy the foreign investment company exclusion test. Fifth, the recipient of the distribution must satisfy the holding period test.

¹ Notice 2003-69, 2003-42 I.R.B. 851, contains the current list of the U.S. tax treaties that meet these requirements.

² Notice 2003-71, 2003-43 I.R.B. 922, provides guidance on when ordinary or common stock is considered readily tradable on an established securities market in the United States.

.02 Information Reporting

In General. Any person that makes payments of dividends aggregating \$10 or more during any calendar year, or any person that receives payments of dividends as a nominee and makes payments aggregating \$10 or more in a calendar year to another person with respect to the dividends received, must report those payments to the IRS by filing an information return. Section 6042(a). In addition, a person filing such a return must furnish to every person with respect to whom such information is reported a statement of the aggregate amount of payments required to be shown on the information return. Section 6042(c). If a person furnishing such a statement is unable to determine the portion of the payment that constitutes a dividend or is paid with respect to a dividend, the person making the payment is required to treat it as a dividend or an amount paid with respect to a dividend. Section 6042(b)(3).³

Information Returns. Information returns under section 6042 must be filed on Form 1099, which specifies that the aggregate amount of dividends (or, in the case of a nominee, amounts paid with respect to dividends) is reported on Form 1099-DIV.⁴ Form 1099-DIV and its instructions have been revised to reflect the 2003 Act. The instructions require filers to enter in Box 1a of the form the aggregate amount of ordinary dividends paid and to enter in Box 1b the portion of dividends in Box 1a that qualifies for reduced rates under the 2003 Act (“qualified dividends”). The instructions direct filers to include in Box 1b dividends for which it is impractical to determine whether the holding period test has been met. As described above, a distribution with respect to a security issued by a foreign corporation must satisfy specific requirements under the 2003 Act in order to be considered a qualified dividend.

Regulations under section 6042 provide that a person required to make an information return under that section generally must do so not later than February 28 (March 31 if filed electronically) of the year following the calendar year in which the dividend was paid. Section 1.6042-2(c) of the Income Tax Regulations. A person required to furnish a payee statement under that section generally must do so not later than January 31 of the year in which the information return is to be filed.⁵

Penalties. Section 6721 imposes a penalty if a person fails to file a timely correct information return, including a return under section 6042. Section 6722 imposes a penalty if a payor fails to furnish to a payee a timely correct information statement, including a statement under section 6042. Section 6724(a) provides that the penalties under sections 6721 and 6722 do not apply if the failure to comply is due to reasonable cause and not to willful neglect.

³ Notice 2003-67, 2003-40 I.R.B. 752, provides guidance to brokers and individuals regarding provisions in the 2003 Act that affect information reporting for payments in lieu of dividends.

⁴ Revenue Procedure 2002-57, 2002-39 I.R.B. 575, provides circumstances under which a person required to file Form 1099 may file a substitute.

⁵ See Section 1.6042-3 of the Income Tax Regulations for guidance on when dividends are subject to information reporting.

Recipients of Payee Statements. Section 6662 imposes a penalty if a taxpayer substantially understates its income tax liability. Section 6664(c) provides that no penalty shall be imposed under section 6662 with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion. The regulations under section 6664 provide that the determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, taking into account all pertinent facts and circumstances. Under those regulations, a taxpayer's reliance on erroneous information reported on a Form 1099 indicates reasonable cause and good faith, provided the taxpayer did not know or have reason to know that the information was incorrect. Section 1.6664-4(b)(1) of the Income Tax Regulations. For these purposes, a taxpayer generally knows, or has reason to know, that the information on an information return is incorrect if such information is inconsistent either with other information reported or furnished to the taxpayer or with the taxpayer's knowledge of the transaction. Id.

The instructions to Form 1040 for 2003 state that some distributions that are reported as qualified dividends in Box 1b of Form 1099-DIV may not actually be qualified dividends. For example, the instructions provide examples illustrating situations in which amounts reported as qualified dividends in Box 1b of Form 1099-DIV are not qualified dividends because the recipient of the dividends failed to satisfy the holding period test.

SECTION 3. ANALYSIS

This Section discusses the information reporting determinations with respect to each of the tests relevant to whether a distribution with respect to a security issued by a foreign corporation is a qualified dividend.

.01 Equity Test

In order to be a qualified dividend, a distribution must be made with respect to equity rather than indebtedness, as determined under U.S. federal income tax principles. The characterization of an instrument for U.S. federal income tax purposes depends on the terms of the instrument and all surrounding facts and circumstances. See, e.g., Notice 94-47, 1994-1 C.B. 357.

Common or ordinary shares generally are treated as equity for U.S. federal income tax purposes. For a security issued by a foreign corporation other than a common or an ordinary share (such as a preferred share), a person required to make a return under section 6042 may not be aware of all the information relevant to determining whether a particular security is debt or equity, although such a person does have access to information contained in public filings with the SEC. A foreign corporation generally will have all the information relevant to applying the equity test.

For 2003 information reporting, a person required to make a return under section 6042 for a distribution with respect to a security issued by a foreign corporation shall

treat the security as satisfying the equity test if the security is a common or an ordinary share. In addition, if the security is not a common or an ordinary share, such person shall treat the security as satisfying the equity test if the foreign corporation has a public statement filed with the SEC stating that the security will be, should be, or more likely than not will be properly classified as equity rather than as debt for U.S. federal income tax purposes.

For 2004 and future information reporting, Treasury and the IRS intend to issue regulations providing a certification procedure under which foreign corporations may certify that a security with respect to which a distribution is made meets the equity test. As discussed below, it is expected that it will be possible to make such certification either in a public SEC filing (such as in a Form 20-F) or in a public statement with a copy filed with the IRS.

.02 E&P Test

In order to be a qualified dividend, a distribution must be a dividend. Section 316 generally provides that a dividend means any payment made by a corporation to its shareholders out of earnings and profits. A person required to file an information return under section 6042 may not know in a given circumstance whether a distribution by a corporation represents a distribution of earnings and profits. If a person making a payment of or with respect to a distribution by a corporation is unable to determine the portion of such a payment that is a dividend or is paid with respect to a dividend, then under section 6042 the person making the payment must treat the entire payment as a dividend or as an amount paid with respect to a dividend. Section 6042(b)(3).

.03 Tests in the Alternative: Readily Tradable Test, Possessions Test, and Treaty Test

(a) Readily Tradable Test. A foreign corporation is treated as a qualified foreign corporation with respect to any dividend paid by such corporation if the stock with respect to which that dividend is paid is readily tradable on an established securities market in the United States. Notice 2003-71 defines when ordinary or common stock is considered readily tradable on an established securities market in the United States. In addition, for 2003, a security (or an American depositary receipt in respect of such security) issued by a foreign corporation that is other than ordinary or common stock (such as preferred stock) will satisfy the readily tradable test if it is listed on a national securities exchange that is registered under section 6 of the Securities Exchange Act of 1934 (15 U.S.C. § 78f) or on the Nasdaq Stock Market as described in Notice 2003-71. (See Section 3.01 for discussion of the equity test.)

(b) Possessions Test. The 2003 Act provides that, in order to satisfy the possessions test, a corporation must be incorporated in a possession of the United States. For 2003 and future years, a person required to make a return under section 6042 shall treat a corporation incorporated in a possession of the United States as satisfying the possessions test.

(c) Treaty Test. The 2003 Act provides that, in order to satisfy the treaty test, a

corporation must be eligible for benefits of a comprehensive income tax treaty with the United States which the Secretary determines is satisfactory for purposes of section 1(h)(11) and which includes an exchange of information program. Notice 2003-69 contains the current list of treaties that meet the requirements of the 2003 Act.

Treaties generally confer benefits only on “residents” of the countries that are parties to the treaty and frequently include a “limitation on benefits” provision designed to ensure that treaty benefits are not available to persons engaged in “treaty shopping.” For example, the mere fact that a corporation is organized in a country may not be sufficient for the corporation to qualify for benefits under the relevant treaty. The terms of each treaty, including any limitation on benefits provision, reflect the particular circumstances of the relevant treaty partner relative to the United States. The determination as to whether a particular foreign corporation would be eligible for benefits under a particular treaty can be a fact-intensive determination. A foreign corporation generally will have all the information relevant to applying the treaty test. For example, a foreign corporation that receives U.S. source income eligible for a reduced rate of withholding under a treaty generally must complete a Form W-8BEN certifying under penalties of perjury that, among other items, it is a resident of the relevant country within the meaning of the relevant treaty and satisfies the limitation on benefits provision, if any, provided in that treaty. As discussed in Section 5 below, for 2004 and future information reporting Treasury and the IRS intend to develop a certification procedure under which a foreign corporation may certify that it meets the treaty test. For corporations that complete a Form W-8BEN for other purposes, it is expected that filing a copy of this form with the IRS could be used as a means of meeting the certification requirement with respect to the treaty test, depending on the circumstances.

Treasury and the IRS recognize that the fact-intensive nature of the determination whether a foreign corporation is eligible for benefits under a treaty, coupled with the need for persons required to make information returns to begin work now on processing those returns and related payee statements, makes it appropriate to use a simplified procedure for 2003 information reporting.

For 2003 information reporting, a person required to make a return under section 6042 shall treat a foreign corporation as satisfying the treaty test provided that (i) the foreign corporation is organized in a country whose income tax treaty with the United States is listed in Notice 2003-69, and (ii) if the relevant treaty contains a limitation on benefits provision, the corporation’s common or ordinary stock is listed on an exchange covered by the public trading test in that limitation on benefits provision. However, a person required to make such a return shall not treat a foreign corporation as satisfying the treaty test if such person knows or has reason to know that the corporation is not eligible for benefits under the relevant treaty. For this purpose, a person will be considered to have reason to know the corporation is not eligible for treaty benefits if the corporation has so stated in its most recent SEC annual filing (if any) for the security (e.g., Form 20-F).

For example, assume that a foreign corporation is incorporated in Austria and that its common stock is listed on the Vienna exchange. The U.S.-Austria income tax

treaty is listed in Notice 2003-69, and the Vienna exchange is covered by the public trading test in the limitation on benefits provision of the U.S.-Austria income tax treaty. A person required to make a return under section 6042 would treat the Austrian corporation as satisfying the treaty test unless the person knew or had reason to know that the corporation was not eligible for benefits of the U.S.-Austria income tax treaty.

.04 Foreign Investment Company Exclusion Test

The 2003 Act provides that a qualified foreign corporation does not include any foreign corporation that is a FPHC, FIC, or PFIC for the taxable year in which the dividend was paid or the preceding year. A foreign corporation generally will have all of the information relevant to making these determinations. Many foreign corporations that are publicly traded in the United States currently make these determinations each year and provide discussions regarding one or more of these determinations in their annual filings with the SEC, such as Form 20-F. However, not all foreign companies provide such a discussion in their U.S. public filings. Additionally, many foreign companies that are not publicly traded in the United States do not include discussions regarding these determinations in their public filings in their home jurisdiction.

As discussed below, Treasury and the IRS intend to develop a certification procedure for 2004 and future information reporting under which a foreign corporation may certify that it satisfies the foreign investment company exclusion test. For 2003 information reporting, Treasury and the IRS believe it is appropriate to use a simplified procedure that is based on the knowledge of persons required to make a return under section 6042. Accordingly, a person required to make a return under section 6042 for 2003 shall treat a foreign corporation as satisfying the foreign investment company exclusion test unless the person knows or has reason to know that the corporation is or expects to be a FPHC, FIC, or PFIC. For this purpose, a person would have the requisite reason to know if a corporation has stated in its most recent annual public filing with the SEC that it is or expects to be a FPHC, FIC, or PFIC.⁶

.05 Holding Period Test

The 2003 Act provides that a recipient of a dividend must satisfy certain holding period requirements in order for the dividend to be considered a qualified dividend. The instructions to Form 1099-DIV direct a person required to file Form 1099-DIV to report in Box 1b as qualified dividends any dividends for which it is impractical to determine whether the recipient has met the holding period requirements for the stock with respect to which the dividend is paid. Accordingly, if a person required to make a return under section 6042 has determined that a recipient has satisfied the relevant holding period requirements or if it is impractical for such person to determine whether a recipient has satisfied the holding period requirements, the person required to make such return shall treat the recipient as satisfying the holding period test.

.06 Waiver of Penalties for Reporting Based on Simplified Procedures

⁶ A U.S. person owning a share in a foreign corporation may be subject to a number of separate reporting rules. See e.g., Form 8621 (annual return for shareholders owning stock in a PFIC).

The IRS will exercise its authority under section 6724(a) of the Code to waive penalties under sections 6721 and 6722 with respect to reporting of calendar year 2003 payments if a person required to make a return under section 6042 makes a good faith effort to report payments consistent with the simplified procedures contained in this notice.

.07 Distributions That Do Not Satisfy the Simplified Procedures In This Notice

This notice describes simplified information reporting procedures for 2003 for a distribution with respect to a security issued by a foreign corporation. A person required to make a return under section 6042 may believe a particular distribution should be reported in Box 1b of Form 1099-DIV as a qualified dividend even though the distribution does not satisfy the simplified information reporting procedures. In that case, the person required to make a return under section 6042 may report the distribution in Box 1b as a qualified dividend, subject to the applicable penalty provisions.

For example, assume that a foreign corporation incorporated in the United Kingdom issues equity securities to U.S. persons in a private placement under SEC Rule 144A. Assume further that the foreign corporation does not have its ordinary or common stock listed on any stock exchange. Finally, assume that the equity, E&P and holding period tests are satisfied. Under these facts, the securities would not satisfy the readily tradable test (because the privately placed securities would not be considered readily tradable) and the foreign corporation would not satisfy the possessions test (because the corporation is not incorporated in a possession). Additionally, the simplified procedure described in this notice regarding the treaty test would not be satisfied (because the foreign corporation's ordinary or common stock is not listed on exchange covered by the public trading test in the limitation on benefits provision of the U.S.-U.K. income tax treaty). A person required to make a return under section 6042 may nonetheless believe that the foreign corporation is in fact eligible for benefits under the U.S.-U.K. income tax treaty and thus satisfies the treaty test. Such a person could report a distribution with respect to the security in Box 1b of Form 1099-DIV as a qualified dividend. However, a person doing so could be subject to applicable penalty provisions if the foreign corporation did not in fact satisfy the treaty test and such person did not have reasonable cause for believing the foreign corporation satisfied the treaty test.

.08 Payments Reported on Form 1099-DIV for 2003

For taxable years beginning in 2003, a recipient of Form 1099-DIV may treat amounts reported in Box 1b as qualified dividends, unless and to the extent that the recipient knows or has reason to know that such amounts are not qualified dividends. As provided in § 1.6664-4(b)(1), such reliance may constitute reasonable cause and good faith reliance for purposes of applicable penalties, depending on the facts and circumstances. In addition, a recipient of Form 1099-DIV may treat a dividend excluded from Box 1b as a qualified dividend if such person believes the dividend is a qualified dividend, subject to applicable penalties in the event the amount so reported is not in

fact a qualified dividend.

SECTION 4. SUMMARY OF GUIDANCE FOR 2003

.01 Persons Required to File Form 1099-DIV

For 2003 information reporting, a person required to make a return under section 6042 shall report a distribution with respect to a security issued by a foreign corporation in Box 1b of Form 1099-DIV as a qualified dividend if:

1. either the security with respect to which the distribution is made is a common or an ordinary share, or a public SEC filing contains a statement that the security will be, should be, or more likely than not will be treated as equity rather than debt for U.S. federal income tax purposes; and

2. either:

a. the security is considered “readily tradable on an established securities market in the United States”;

b. the foreign corporation is organized in a possession of the United States;

or

c. the foreign corporation is organized in a country whose income tax treaty with the United States is listed in Notice 2003-69, and if the relevant treaty contains a limitation on benefits provision, the corporation’s common or ordinary stock is listed on an exchange covered by that limitation on benefits provision’s public trading test, unless the person required to file an information return knows or has reason to know that the corporation is not eligible for benefits under that treaty; and

3. the person required to file Form 1099-DIV does not know or have reason to know that the foreign corporation is or expects to be, in the taxable year of the corporation in which the dividend was paid or was, in the preceding taxable year, a FPHC, FIC, or PFIC; and

4. the person required to make a return under section 6042 determines that the owner of the distribution has satisfied the holding period test or it is impractical for such person to make such determination.

The IRS will exercise its authority under section 6724(a) of the Code to waive penalties under sections 6721 and 6722 with respect to reporting of calendar year 2003 payments if persons required to file Form 1099-DIV make a good faith effort to report payments consistent with the above rules. A person required to make a return under section 6042 may report a distribution in Box 1b as a qualified dividend even if the distribution does not satisfy the simplified information reporting procedures for 2003, subject to the applicable penalty provisions.

.02 Recipients of Form 1099-DIV for 2003

For taxable years beginning in 2003, a recipient of Form 1099-DIV may treat amounts reported in Box 1b as qualified dividends, unless and to the extent the recipient knows or has reason to know that such amounts are not qualified dividends.

SECTION 5. SUMMARY OF EXPECTED GUIDANCE FOR FUTURE YEARS

For years after 2003, Treasury and the IRS intend to issue regulations providing procedures for a foreign corporation to certify that it is a qualified foreign corporation. It is expected that such regulations generally will require persons required to file information returns to report a distribution with respect to a security issued by a foreign corporation as a qualified dividend if the corporation has made an appropriate certification under penalties of perjury to the effect that:

1. for any security that is not a common or an ordinary share, the security is equity rather than debt for U.S. federal income tax purposes;
2. where a security is not readily tradable on an established securities market in the United States and where the foreign corporation is not incorporated in a possession, the foreign corporation is eligible for the benefits of a tax treaty with the United States that meets the requirements of the 2003 Act; and
3. the foreign corporation is not, in the taxable year of the corporation in which the dividend was paid, and was not, in the preceding taxable year, a FPHC, FIC, or PFIC.

It is expected that certifications will be made annually and that these certifications would be made available by the foreign corporation to the public. It is further expected that the regulations will provide procedures under which a foreign corporation submits its certification to the IRS for date stamping. For publicly traded companies, it is expected that the regulations will provide that such certification may be made in a public SEC filing (such as in a Form 20-F).

SECTION 6. EFFECTIVE DATE

This notice is effective for taxable years beginning on or after January 1, 2003.

SECTION 7. COMMENTS

Treasury and the IRS invite interested persons to comment on the information reporting and certification procedures to be developed for years after 2003. Written comments may be submitted to CC:PA:LPD:PR (Notice 2003-79), room 5207, 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 am and 5 pm to: CC:PA:LPD:PR (Notice 2003-79), Courier's desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224. Alternatively, taxpayers may submit comments electronically via the following e-mail address: Notice.Comments@irsounsel.treas.gov. Please include "Notice 2003-79" in the subject line of any electronic communications.

SECTION 8. PAPERWORK REDUCTION ACT

The information collection referenced in this notice has been previously reviewed and approved by the Office of Management and Budget as part of the promulgation of Form 1099-DIV. See OMB Control Number 1545-0110. This notice merely provides additional guidance regarding the proper filing of such returns and furnishing of such statements.

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 OMB control number.

Books or 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.

SECTION 9. CONTACT INFORMATION

The principal author of this notice is Michelle S. Lyon of the Office of Associate Chief Counsel (International). For further information regarding this notice contact Ms. Lyon on (202) 622-3880 (not a toll-free call).