INTERNAL REVENUE
BULLETIN

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HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

ADMINISTRATIVE

Rev. Proc. 2022-39, page 507.
The revenue procedure obsoletes and replaces existing Revenue Procedure 94-69, 1994-2 C.B. 804. The revenue procedure prescribes special procedures for certain eligible LB&I taxpayers who are subject to nearly annual examinations to file a qualified amended return shortly after the opening of an audit. Eligible taxpayers may submit a form to report additional tax due or make an adequate disclosure with respect to an item or position to avoid the accuracy-related penalty described in sections 6662(b)(1) and 6662(b)(2).

EMPLOYEE PLANS

Notice 2022-60, page 502.
This notice sets forth updates on the corporate bond monthly yield curve, the corresponding spot segment rates for November 2022 used under § 417(e)(3)(D), the 24-month average segment rates applicable for November 2022, and the 30-year Treasury rates, as reflected by the application of § 430(h)(2)(C)(iv).

Notice 2022-62, page 506.
This notice sets forth the 2022 Required Amendments List (2022 RA List). The 2022 RA List applies to both individually designed plans qualified under section 401(a) of the Internal Revenue Code (qualified individually designed plans) and individually designed plans that satisfy the requirements of section 403(b) (section 403(b) individually designed plans).

INCOME TAX

REG-112096-22, page 511.
This document contains proposed regulations that clarify and revise certain foreign tax credit regulations that were published on January 4, 2022. Specifically, these proposed regulations amend the definition of a reattribution asset for purposes of allocating and apportioning foreign income taxes; revise the cost recovery rule under the requirements for a tax to be a creditable foreign income tax; and provide a limited exception to the source-based attribution requirement for withholding taxes imposed on royalty payments to be creditable foreign income taxes.

Rev. Rul. 2022-22, page 500.
Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term tax exempt rate. For purposes of sections 382, 1274, 1288, 7872 and other sections of the Code, tables set forth the rates for December 2022.

Finding Lists begin on page ii.

The IRS Mission

Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

Part I

Section 1274.— Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also Sections 42, 280G, 382, 467, 468, 482, 483, 1288, 7520, 7872.)

Rev. Rul. 2022-22

This revenue ruling provides various prescribed rates for federal income tax purposes for December 2022 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(1) for buildings placed in service during the current month. However, under section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, shall not be less than 9%. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2022-22 TABLE 1
Applicable Federal Rates (AFR) for December 2022
Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
		Short-term		
AFR	4.55%	4.50%	4.47%	4.46%
110% AFR	5.01%	4.95%	4.92%	4.90%
120% AFR	5.47%	5.40%	5.36%	5.34%
130% AFR	5.94%	5.85%	5.81%	5.78%
		Mid-term		
AFR	4.27%	4.23%	4.21%	4.19%
110% AFR	4.70%	4.65%	4.62%	4.61%
120% AFR	5.14%	5.08%	5.05%	5.03%
130% AFR	5.58%	5.50%	5.46%	5.44%
150% AFR	6.45%	6.35%	6.30%	6.27%
175% AFR	7.54%	7.40%	7.33%	7.29%
		Long-term		
AFR	4.34%	4.29%	4.27%	4.25%
110% AFR	4.78%	4.72%	4.69%	4.67%
120% AFR	5.22%	5.15%	5.12%	5.10%
130% AFR	5.66%	5.58%	5.54%	5.52%

REV. RUL. 2022-22 TABLE 2
Adjusted AFR for December 2022
Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	3.45%	3.42%	3.41%	3.40%
Mid-term adjusted AFR	3.24%	3.21%	3.20%	3.19%
Long-term adjusted AFR	3.29%	3.26%	3.25%	3.24%

REV. RUL. 2022-22 TABLE 3 Rates Under Section 382 for December 2022	
Adjusted federal long-term rate for the current month	3.29%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	3.29%

REV. RUL. 2022-22 TABLE 4 Appropriate Percentages Under Section 42(b)(1) for December 2022	
Note: Under section 42(b)(2), the applicable percentage for non-federally subsidized new buildings placed in service after July 30, 2008, shall not be less than 9%.	
Appropriate percentage for the 70% present value low-income housing credit	8.00%
Appropriate percentage for the 30% present value low-income housing credit	3.43%

REV. RUL. 2022-22 TABLE 5 Rate Under Section 7520 for December 2022	
Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	5.20%

Section 42.—Low-Income Housing Credit

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2022. See Rev. Rul. 2022-22, page 500.

Section 280G.—Golden Parachute Payments

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2022. See Rev. Rul. 2022-22, page 500.

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of December 2022. See Rev. Rul. 2022-22, page 500.

Section 467.—Certain Payments for the Use of Property or Services

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2022. See Rev. Rul. 2022-22, page 500.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The applicable federal short-term rates are set forth for the month of December 2022. See Rev. Rul. 2022-22, page 500.

Section 482.—Allocation of Income and Deductions Among Taxpayers

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2022. See Rev. Rul. 2022-22, page 500.

Section 483.—Interest on Certain Deferred Payments

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2022. See Rev. Rul. 2022-22, page 500.

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2022. See Rev. Rul. 2022-22, page 500.

Section 7520.—Valuation Tables

The applicable federal mid-term rates are set forth for the month of December 2022. See Rev. Rul. 2022-22, page 500.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The applicable federal short-term, mid-term, and long-term rates are set forth for the month of December 2022. See Rev. Rul. 2022-22, page 500.

Part III

Administrative, Miscellaneous, and Procedural

Update for Weighted Average Interest Rates, Yield Curves, and Segment Rates

Notice 2022-60

This notice provides guidance on the corporate bond monthly yield curve, the corresponding spot segment rates used under § 417(e)(3), and the 24-month average segment rates under § 430(h)(2) of the Internal Revenue Code. In addition, this notice provides guidance as to the interest rate on 30-year Treasury securities under § 417(e)(3)(A)(ii)(II) as in effect for plan years beginning before 2008 and the 30-year Treasury weighted average rate under § 431(c)(6)(E)(ii)(I).

YIELD CURVE AND SEGMENT RATES

Section 430 specifies the minimum funding requirements that apply to single-employer plans (except for CSEC plans under § 414(y)) pursuant to § 412. Section 430(h)(2) specifies the interest rates that must be used to determine a plan's target normal cost and funding target. Under this provision, present value is generally determined using three 24-month average interest rates ("segment rates"), each of which applies to cash flows during specified periods. To the extent provided under § 430(h)(2)(C)(iv), these segment rates are adjusted by the applicable percentage of the 25-year average segment rates for the period ending September 30 of the year preceding the calendar year in which the plan year begins.[1] However, an election may be made under § 430(h)(2)(D)(ii) to use the monthly yield curve in place of the segment rates.

Notice 2007-81, 2007-44 I.R.B. 899, provides guidelines for determining the monthly corporate bond yield curve, and the 24-month average corporate bond segment rates used to compute the target normal cost and the funding target. Consistent with the methodology specified in Notice 2007-81, the monthly corporate bond yield curve derived from October 2022 data is in Table 2022-10 at the end of this notice. The spot first, second, and third segment rates for the month of October 2022 are, respectively, 5.10, 5.83, and 5.68.

The 24-month average segment rates determined under § 430(h)(2)(C)(i) through (iii) must be adjusted pursuant to § 430(h)(2)(C)(iv) to be within the applicable minimum and maximum percentages of the corresponding 25-year average segment rates. The 25-year average segment rates for plan years beginning in 2021, 2022 and 2023 were published in Notice 2020-72, 2020-40 I.R.B. 789, Notice 2021-54, 2021-41 I.R.B. 457, and Notice 2022-40, 2022-40 I.R.B. 266, respectively.

24-MONTH AVERAGE CORPORATE BOND SEGMENT RATES

The three 24-month average corporate bond segment rates applicable for November 2022 without adjustment for the 25-year average segment rate limits are as follows:

	24-Month Average Segment Rates Without 25-Year Average Adjustment		
Applicable Month	**First Segment**	**Second Segment**	**Third Segment**
November 2022	1.76	3.36	3.76

Section 9706(a) of the American Rescue Plan Act of 2021, Pub. L. 117-2 (the ARP), which was enacted on March 11, 2021, changed the 25-year average segment rates and the applicable minimum and maximum percentages used under § 430(h)(2)(C)(iv) of the Code to adjust the 24-month average segment rates.[2] Prior to this change, the applicable minimum and maximum percentages were 85% and 115% for a plan year beginning in 2021, and 80% and 120% for a plan year beginning in 2022, respectively. After this change, the applicable minimum and maximum percentages are 95% and 105% for a plan year beginning in 2021 or 2022. In addition, pursuant to this change, any 25-year average segment rate that is less than 5% is deemed to be 5%.[3]

Pursuant to § 9706(c)(1) of the ARP, these changes apply with respect to plan years beginning on or after January 1, 2020. However, § 9706(c)(2) of the ARP provides that a plan sponsor may elect not to have these changes apply to any plan year beginning before January 1, 2022.[4]

The adjusted 24-month average segment rates set forth in the chart below reflect § 430(h)(2)(C)(iv) of the Code as

[1] Pursuant to § 433(h)(3)(A), the third segment rate determined under § 430(h)(2)(C) is used to determine the current liability of a CSEC plan (which is used to calculate the minimum amount of the full funding limitation under § 433(c)(7)(C)).

[2] Section 80602 of the Infrastructure Investment and Jobs Act, Pub. L. 117-58, makes further changes to the time periods for which specified applicable minimum and maximum percentages apply.

[3] Pursuant to this change, the 25-year averages of the first segment rate for 2021 and 2022 are increased to 5.00% because those 25-year averages as originally published are below 5.00%.

[4] This election may be made either for all purposes for which the amendments under § 9706 of the ARP apply or solely for purposes of determining the adjusted funding target attainment percentage under § 436 of the Code for the plan year.

amended by § 9706(a) of the ARP. These adjusted 24-month average segment rates apply only for plan years for which an election under § 9706(c)(2) of the ARP is not in effect. For a plan year for which such an election does not apply, the 24-month averages applicable for November 2022, adjusted to be within the applicable minimum and maximum percentages of the corresponding 25-year average segment rates in accordance with § 430(h)(2)(C)(iv) of the Code, are as follows:

Adjusted 24-Month Average Segment Rates

For Plan Years Beginning In	Applicable Month	First Segment	Second Segment	Third Segment
2021	November 2022	4.75	5.36	6.11
2022	November 2022	4.75	5.18	5.92
2023	November 2022	4.75	5.00	5.74

The adjusted 24-month average segment rates set forth in the chart below do not reflect the changes to § 430(h)(2)(C)(iv) of the Code made by § 9706(a) of the ARP. These adjusted 24-month average segment rates apply only for plan years for which an election under § 9706(c)(2) of the ARP is in effect. For a plan year for which such an election applies, the 24-month averages applicable for November 2022, adjusted to be within the applicable minimum and maximum percentages of the corresponding 25-year average segment rates in accordance with § 430(h)(2)(C)(iv) of the Code, are as follows:

Pre-ARP Adjusted 24-Month Average Segment Rates

For Plan Years Beginning In	Applicable Month	First Segment	Second Segment	Third Segment
2021	November 2022	3.32	4.79	5.47

30-YEAR TREASURY SECURITIES INTEREST RATES

Section 431 specifies the minimum funding requirements that apply to multiemployer plans pursuant to § 412. Section 431(c)(6)(B) specifies a minimum amount for the full-funding limitation described in § 431(c)(6)(A), based on the plan's current liability. Section 431(c)(6)(E)(ii)(I) provides that the interest rate used to calculate current liability for this purpose must be no more than 5 percent above and no more than 10 percent below the weighted average of the rates of interest on 30-year Treasury securities during the four-year period ending on the last day before the beginning of the plan year. Notice 88-73, 1988-2 C.B. 383, provides guidelines for determining the weighted average interest rate. The rate of interest on 30-year Treasury securities for October 2022 is 4.02 percent. The Service determined this rate as the average of the daily determinations of yield on the 30-year Treasury bond maturing in August 2052. For plan years beginning in November 2022, the weighted average of the rates of interest on 30-year Treasury securities and the permissible range of rate used to calculate current liability are as follows:

Treasury Weighted Average Rates

For Plan Years Beginning In	30-Year Treasury Weighted Average	Permissible Range 90% to 105%
November 2022	2.33	2.09 to 2.44

MINIMUM PRESENT VALUE SEGMENT RATES

In general, the applicable interest rates under § 417(e)(3)(D) are segment rates computed without regard to a 24-month average. Notice 2007-81 provides guidelines for determining the minimum present value segment rates. Pursuant to that notice, the minimum present value segment rates determined for October 2022 are as follows:

Minimum Present Value Segment Rates

Month	First Segment	Second Segment	Third Segment
October 2022	5.10	5.83	5.68

DRAFTING INFORMATION

The principal author of this notice is Tom Morgan of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes). However, other personnel from the IRS participated in the development of this guidance. For further information regarding this notice, contact Mr. Morgan at 202-317-6700 or Tony Montanaro at 626-927-1475 (not toll-free calls).

Table 2022-10
Monthly Yield Curve for October 2022
Derived from October 2022 Data

Maturity	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*	*Maturity*	*Yield*
0.5	4.53	20.5	5.89	40.5	5.65	60.5	5.58	80.5	5.55
1.0	4.79	21.0	5.87	41.0	5.65	61.0	5.58	81.0	5.55
1.5	5.00	21.5	5.86	41.5	5.65	61.5	5.58	81.5	5.55
2.0	5.14	22.0	5.85	42.0	5.64	62.0	5.58	82.0	5.55
2.5	5.22	22.5	5.84	42.5	5.64	62.5	5.58	82.5	5.55
3.0	5.25	23.0	5.83	43.0	5.64	63.0	5.58	83.0	5.55
3.5	5.26	23.5	5.82	43.5	5.64	63.5	5.58	83.5	5.54
4.0	5.26	24.0	5.81	44.0	5.64	64.0	5.58	84.0	5.54
4.5	5.28	24.5	5.80	44.5	5.63	64.5	5.57	84.5	5.54
5.0	5.30	25.0	5.79	45.0	5.63	65.0	5.57	85.0	5.54
5.5	5.33	25.5	5.78	45.5	5.63	65.5	5.57	85.5	5.54
6.0	5.38	26.0	5.77	46.0	5.63	66.0	5.57	86.0	5.54
6.5	5.43	26.5	5.76	46.5	5.62	66.5	5.57	86.5	5.54
7.0	5.49	27.0	5.76	47.0	5.62	67.0	5.57	87.0	5.54
7.5	5.55	27.5	5.75	47.5	5.62	67.5	5.57	87.5	5.54
8.0	5.62	28.0	5.75	48.0	5.62	68.0	5.57	88.0	5.54
8.5	5.68	28.5	5.74	48.5	5.62	68.5	5.57	88.5	5.54
9.0	5.73	29.0	5.73	49.0	5.62	69.0	5.57	89.0	5.54
9.5	5.79	29.5	5.73	49.5	5.61	69.5	5.56	89.5	5.54
10.0	5.83	30.0	5.72	50.0	5.61	70.0	5.56	90.0	5.54
10.5	5.87	30.5	5.72	50.5	5.61	70.5	5.56	90.5	5.54
11.0	5.91	31.0	5.72	51.0	5.61	71.0	5.56	91.0	5.54
11.5	5.94	31.5	5.71	51.5	5.61	71.5	5.56	91.5	5.54
12.0	5.96	32.0	5.71	52.0	5.61	72.0	5.56	92.0	5.54
12.5	5.98	32.5	5.70	52.5	5.60	72.5	5.56	92.5	5.53
13.0	5.99	33.0	5.70	53.0	5.60	73.0	5.56	93.0	5.53
13.5	6.00	33.5	5.70	53.5	5.60	73.5	5.56	93.5	5.53
14.0	6.01	34.0	5.69	54.0	5.60	74.0	5.56	94.0	5.53
14.5	6.01	34.5	5.69	54.5	5.60	74.5	5.56	94.5	5.53
15.0	6.01	35.0	5.68	55.0	5.60	75.0	5.56	95.0	5.53
15.5	6.00	35.5	5.68	55.5	5.60	75.5	5.56	95.5	5.53
16.0	5.99	36.0	5.68	56.0	5.59	76.0	5.55	96.0	5.53
16.5	5.98	36.5	5.67	56.5	5.59	76.5	5.55	96.5	5.53
17.0	5.97	37.0	5.67	57.0	5.59	77.0	5.55	97.0	5.53
17.5	5.96	37.5	5.67	57.5	5.59	77.5	5.55	97.5	5.53
18.0	5.95	38.0	5.67	58.0	5.59	78.0	5.55	98.0	5.53
18.5	5.94	38.5	5.66	58.5	5.59	78.5	5.55	98.5	5.53
19.0	5.92	39.0	5.66	59.0	5.59	79.0	5.55	99.0	5.53
19.5	5.91	39.5	5.66	59.5	5.59	79.5	5.55	99.5	5.53
20.0	5.90	40.0	5.65	60.0	5.58	80.0	5.55	100.0	5.53

2022 Required Amendments List for Individually Designed Qualified and Section 403(b) Plans

Notice 2022-62

I. PURPOSE

This notice sets forth the 2022 Required Amendments List (2022 RA List). The Required Amendments List (RA List) applies to both individually designed plans qualified under section 401(a) of the Internal Revenue Code (Code) (qualified individually designed plans) and individually designed plans that satisfy the requirements of section 403(b) (section 403(b) individually designed plans).

Section 5 of Rev. Proc. 2022-40, 2022-47 IRB 487, provides generally that, except as otherwise provided by statute or in regulations or other guidance published in the Internal Revenue Bulletin (IRB), in the case of an individually designed qualified or section 403(b) plan that is not a governmental plan within the meaning of section 414(d), the remedial amendment period for (1) a disqualifying provision or (2) a form defect first occurring after June 30, 2020, that arises as a result of a change in qualification requirements or section 403(b) requirements, as applicable, expires on the last day of the second calendar year that begins after the issuance of the RA List on which the change in qualification requirements or section 403(b) requirements appears. Pursuant to section 5.03(1)(c) and section 6.01 of Rev. Proc. 2022-40, December 31, 2024, generally is both the last day of the remedial amendment period and the plan amendment deadline with respect to (1) a disqualifying provision arising as a result of a change in qualification requirements that appears on the 2022 RA List, and (2) a form defect arising as a result of a change in section 403(b) requirements that appears on the 2022 RA List. Later dates may apply to a governmental plan within the meaning of section 414(d) pursuant to section 5.03(2)(c) of Rev. Proc. 2022-40. References to qualification requirements and to section 403(b) requirements in Parts III and IV of this notice are referred to, separately and collectively, as "requirements."[1]

II. BACKGROUND

Section 401(b) of the Code provides a remedial amendment period during which a plan may be amended retroactively to comply with the qualification requirements under section 401(a). Section 1.401(b)-1 describes the disqualifying provisions that may be amended retroactively and the remedial amendment period during which retroactive amendments may be adopted. That regulation also grants the Commissioner of Internal Revenue the discretion to designate in guidance published in the IRB certain plan provisions as disqualifying provisions and to extend the remedial amendment period.

Section 21.02 of Rev. Proc. 2013-22, 2013-18 IRB 985,[2] establishes an initial remedial amendment period that permits an eligible employer to retroactively correct form defects in its written section 403(b) plan.

Rev. Proc. 2017-18, as modified by Notice 2020-35, 2020-25 IRB 948, provides that the initial remedial amendment period for a form defect in a section 403(b) plan ends on June 30, 2020.

Section 5 of Rev. Proc. 2022-40 provides that except as otherwise provided by statute or in regulations or other guidance published in the IRB, with respect to plans that are not governmental plans within the meaning of section 414(d), the remedial amendment period for (1) a disqualifying provision or (2) a form defect first occurring after June 30, 2020, that arises as a result of a change in qualification requirements or section 403(b) requirements, as applicable, expires on the last day of the second calendar year that begins after the issuance of the RA List on which the change in qualification requirements or section 403(b) requirements appears. Section 5.03(2) provides a special rule for governmental plans that may further extend the remedial amendment period in some cases.

Section 6.01 of Rev. Proc. 2022-40 provides that the plan amendment deadline with respect to (1) a disqualifying provision in a qualified individually designed plan, or (2) a form defect first occurring after June 30, 2020, in a section 403(b) individually designed plan described in section 5 of Rev. Proc. 2022-40 is the date on which the remedial amendment period expires with respect to that disqualifying provision or form defect.

Section 7 of Rev. Proc. 2022-40 provides that the Treasury Department and the IRS publish an annual RA List. In general, a change in qualification requirements or section 403(b) requirements will not appear on an RA List until guidance with respect to that change (including, in certain cases, model amendments) has been provided in regulations or in other guidance published in the IRB. However, in the discretion of the Treasury Department and the IRS, a change in qualification requirements or section 403(b) requirements may be included on an RA List in other circumstances, such as in cases in which a statutory change is enacted and the Treasury Department and the IRS anticipate that no guidance will be issued.

The remedial amendment period applicable to a disqualifying provision or form defect arising as a result of a change in qualification requirements or section 403(b) requirements may be extended beyond the date that normally would apply to an item included on an RA List, if, for example, a statute, regulation, or other guidance published in the IRB provides for a later deadline.

III. CONTENT AND ORGANIZATION OF RA LIST

In general, an RA List includes statutory and administrative changes in requirements that are first effective during the

[1] In order to help plan sponsors achieve operational compliance with changes in requirements, the IRS provides the Operational Compliance List, which is a list of changes in both qualification requirements and section 403(b) requirements that are effective during a calendar year, on the IRS website at https://www.irs.gov/retirement-plans/operational-compliance-list. See section 8 of Rev. Proc. 2022-40.

[2] Rev. Proc. 2013-22 was modified by Rev. Proc. 2014-28, 2014-16 I.R.B. 944, and Rev. Proc. 2015-22, 2015-11 I.R.B. 754, and clarified by Rev. Proc. 2017-18, 2017-5 I.R.B. 743.

plan year in which the list is published.[3] However, an RA List does not include:

- Guidance issued or legislation enacted after the list has been prepared;
- Statutory changes in requirements for which the Treasury Department and the IRS expect to issue guidance that would be included on an RA List issued in a future year;[4]
- Changes in requirements that permit (but do not require) optional plan provisions, in contrast to changes in requirements that cause existing plan provisions (which may include optional plan provisions previously adopted) to become disqualifying provisions or section 403(b) form defects;[5] or
- Changes in the tax laws affecting qualified individually designed plans or section 403(b) individually designed plans that do not change the requirements (such as changes to the tax treatment of plan distributions, or changes to the funding requirements for qualified individually designed plans).

The RA List is divided into two parts. Part A covers changes in requirements that generally would require an amendment to most plans or to most plans of the type affected by the change.

Part B includes changes in requirements that the Treasury Department and the IRS anticipate will not require amendments to most plans but might require an amendment because of an unusual plan provision in a particular plan. For example, if a change affects a particular requirement that most plans incorporate by reference, Part B would include that change because a particular plan might not incorporate the requirement by reference and, thus, might include language inconsistent with the change.

Annual, monthly, or other periodic changes to (1) the various dollar limits that are adjusted for cost of living increases as provided in section 415(d) or other Code provisions, (2) the spot segment rates used to determine the applicable interest rate under section 417(e)(3), and (3) the applicable mortality table under section 417(e)(3), are treated as included on the RA List for the year in which such changes are effective even though they are not directly referenced on that RA List. The Treasury Department and the IRS anticipate that few plans have language that will need to be amended on account of these changes.

The fact that a change in a requirement is included on the RA List does not necessarily mean that a plan must be amended as a result of that change. Each plan sponsor must determine whether a particular change in a requirement requires an amendment to its plan.

IV. 2022 REQUIRED AMENDMENTS LIST

There are no entries listing changes in qualification requirements on the 2022 RA List.[6]

V. DRAFTING INFORMATION

The principal author of this notice is Tom Morgan of the Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Taxes). For further information regarding this notice, contact Mr. Morgan at (202) 317-6700 (not a toll-free number).

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability
(Also: Part I, §§ 6662, 6664; 1.6662-3, 1.6662-4, 1.6664-2.)

Rev. Proc. 2022-39

SECTION 1. PURPOSE

The purpose of this revenue procedure is to obsolete Rev. Proc. 94-69, 1994-2 C.B. 804, and prescribe special procedures for eligible taxpayers to file a qualified amended return in accordance with § 1.6664-2(c)(4)(ii) of the Income Tax Regulations. This revenue procedure also sets forth special procedures for eligible taxpayers to show additional tax due or make adequate disclosure with respect to an item or a position on a previously filed return to avoid imposition of the accuracy-related penalties described in §§ 6662(b)(1) and 6662(b)(2) of the Internal Revenue Code (Code).

SECTION 2. BACKGROUND

.01 Section 6662(b)(1) and (2) impose an accuracy-related penalty equal to 20 percent of the portion of any underpayment that is attributable to (1) negligence or disregard of rules or regulations or (2) any substantial understatement of income tax.

.02 Section 1.6662-3(c) provides, generally, that no penalty for disregard of

[3] RA Lists also may include changes in requirements that were first effective in a prior year that were not included on a prior RA List under certain circumstances, such as changes in requirements that were issued or enacted after the prior year's RA List was prepared.

[4] For example, certain provisions of Division O of the Further Consolidated Appropriations Act, 2020, Pub. L. 116-94, 133 Stat. 2534 (2019), known as the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act), are already effective, but have not been included on an RA List. As explained in Notice 2022-33, 2022-34 IRB 147 (guidance that, in part, extends the deadlines for amending a retirement plan to reflect provisions of the SECURE Act), it is anticipated that (1) guidance will be issued with respect to certain SECURE Act provisions and (2) the guidance and SECURE Act provisions requiring plan amendments will appear on a future RA List.

[5] The remedial amendment period and plan amendment deadline for discretionary changes to the terms of an individually designed qualified or section 403(b) plan are governed by sections 5.03(1)(b), 5.03(2)(b), and 6.02 of Rev. Proc. 2022-40. These deadlines for discretionary changes are not affected by the inclusion of a change in requirements on an RA List.

[6] The 2021 RA List included entries for section 9704 of the American Rescue Plan Act of 2021 (ARP) and Notice 2021-38, 2021-30 IRB 155, relating to special financial assistance for certain eligible multiemployer plans. Under these provisions, the sponsor of an eligible multiemployer plan has the discretion, during a period of several years beginning in 2021, to either apply for or not apply for special financial assistance pursuant to section 9704 of the ARP. If the plan sponsor (1) exercises its discretion to apply for special financial assistance, (2) had previously suspended plan benefits pursuant to section 432(e)(9) of the Code or section 4245(a) of the Employee Retirement Income Security Act of 1974, Pub. L. 93-406, 88 Stat. 829, as amended, and (3) received special financial assistance, then the sponsor is required to amend the plan to provide for reinstatement of the suspended benefits and for make-up payments, in accordance with Notice 2021-38. Beginning in 2022, an amendment made pursuant to section 9704 of the ARP will be treated as a discretionary amendment, and the plan amendment deadlines applicable to discretionary amendments as set forth in Rev. Proc. 2022-40 will apply. Accordingly, for a sponsor of an eligible multiemployer plan that commences payment of previously suspended benefits and make-up payments on account of being granted special financial assistance after 2021, the deadline for adopting the amendment to provide for these payments is the later of (1) the amendment deadline specified in the 2021 RA List that applies to plans eligible for special financial assistance (that is, December 31, 2023), or (2) the amendment deadline that would apply if the amendment were a discretionary amendment (that is, the end of the plan year in which the plan amendment is operationally put into effect, through the commencement of these payments by the plan).

rules or regulations will be imposed on any underpayment attributable to an item or position that is adequately disclosed, has a reasonable basis and, for penalties attributable to disregard of a regulation, represents a good faith challenge to the validity of the regulation.

.03 Section 6662(d)(1) generally defines "substantial understatement" of income tax to be an understatement for the taxable year that exceeds the greater of 10 percent of the tax required to be shown on the return or $5,000 (or, in the case of a corporation other than an S corporation or a personal holding company, exceeds the lesser of (1) 10 percent of the tax required to be shown on the return (or, if greater, $10,000) or (2) $10 million).

.04 In the case of a taxpayer who claims any deduction allowed under § 199A of the Code for the taxable year, an understatement is substantial if it exceeds the greater of 5 percent of the tax required to be shown on the return or $5,000.

.05 Under §§ 6662(d)(2)(B)(ii) and 1.6662-4(e), the tax treatment of an item (other than a tax shelter item or an item attributable to a multiple-party financing transaction if such treatment does not clearly reflect the income of the corporation) for which the taxpayer had a reasonable basis, that is properly substantiated and adequately disclosed, and for which the taxpayer kept adequate books and records is not taken into account in computing the amount of an understatement of income tax for purposes of the substantial understatement penalty.

.06 Section 1.6662-7 provides that the accuracy-related penalty for disregarding rules or regulations or for a substantial understatement of income tax may be avoided by disclosure of a return position only if the position has at least a reasonable basis.

.07 Sections 1.6662-3(c) and 1.6662-4(f) provide the methods for making adequate disclosures for purposes of (1) the penalty for disregard of rules or regulations, and (2) the substantial understatement penalty, respectively. These methods include attaching a properly completed Form 8275, *Disclosure Statement*, to an original return or to a qualified amended return in the case of an item or position other than one that is contrary to a regulation. In the case of a position contrary to a regulation, disclosure must be made on Form 8275-R, *Regulation Disclosure Statement*.

.08 Section 1.6664-2(c)(3) generally provides, among other deadlines, that for purposes of the accuracy-related penalty, a "qualified amended return" is an amended return, or request for an administrative adjustment under § 6227, that is filed after the due date of the return for the taxable year (including extensions) and before the earliest of (1) the date on which the Internal Revenue Service (IRS) first contacts the taxpayer concerning an examination of the return or (2) for certain pass-through items, the date on which the IRS first contacts the pass-through entity in connection with an examination of the return to which the pass-through item relates. In addition, § 1.6664-2(c)(4)(ii) provides that the Commissioner may prescribe by revenue procedure the manner in which the rules governing qualified amended returns apply to particular classes of taxpayers.

.09 Qualified amended returns are intended to encourage voluntary compliance by permitting taxpayers to avoid accuracy-related penalties by filing an amended return before the IRS begins an examination of the taxpayer or the promoter of a transaction in which the taxpayer participated. *See* T.D. 9186, 2005-13 I.R.B. 790 (March 2, 2005) (providing additional circumstances that end the period within which a taxpayer may file an amended return that constitutes a qualified amended return).

.10 To discourage taxpayers from forgoing or delaying the filing of amended returns unless or until the IRS has taken steps to identify taxpayers who filed returns with underpayments, § 1.6664-2(c)(3) sets out events that operate as deadlines after which a taxpayer may not avoid accuracy-related penalties by filing an amended return. *See* T.D. 9186.

.11 Revenue Procedure 94-69 set forth special procedures for taxpayers that were subject to audit each year under the now-discontinued Coordinated Examination Program (CEP). After elimination of the CEP in 2000, Rev. Proc. 94-69 was applied to taxpayers subject to audit under the Coordinated Industry Case Program (CIC). Taxpayers in the CEP and CIC programs were unique in that, unlike most taxpayers, they were generally subject to a continuous examination covering each year's return; and as such, amendments to filed returns were best addressed as the examination of a particular year started through a disclosure to the examination team in lieu of filing a regular qualified amended return.

.12 The special procedures set forth in Rev. Proc. 94-69 allowed taxpayers subject to the CEP and CIC to show additional tax due or to make adequate disclosures with respect to an item or a position and thereby avoid the imposition of accuracy-related penalties under §§ 6662(b)(1) and 6662(b)(2) of the Code. In general, the special procedures allowed these taxpayers to avoid or reduce the accuracy-related penalties to the extent that items resulting in additional tax were reported, or a position contrary to a rule was adequately disclosed, in a written statement furnished to the IRS within a 15-day window beginning with the IRS's written request for such statement.

.13 In 2019, the IRS replaced the CIC Program with the Large Corporate Compliance Program (LCC) effective for audits for taxable years 2017 and later. *See* IRS News Release: IR-2019-95 (May 16, 2019), *LB&I Announces Large Corporate Compliance Program*. Under the LCC, large corporate taxpayers are selected for examination based on their risk profiles and data analytics. Large corporate taxpayers are no longer subject to planned continuous examinations.

.14 The IRS also implemented the Large Partnership Compliance Program (LPC) to address the IRS's compliance approach to large partnerships. *See* Interim Guidance Memo: LB&I-04-1021-0017 (October 21, 2021), *Interim Guidance on Implementation of the Large Partnership Compliance Pilot Program.*

.15 On May 21, 2019, the IRS announced that, as a transition, Rev. Proc. 94-69 would continue to apply to any taxpayer that was both in the CIC (with an open CIC examination as of May 2019 for taxable year 2016 and earlier taxable years) and the LCC (for taxable year 2017 and later taxable years). *See* Interim Guidance Memo: LB&I-04-0419-004 (May 21, 2019), *Interim Guidance on Implementation of the Large Corporate Compliance (LCC) Program*.

.16 On August 19, 2020, the IRS requested comments concerning obsoleting Rev. Proc. 94-69. *See* IRS Statements and Announcements, *IRS Seeks Comments on Revenue Procedure 94-69* (Aug. 19, 2020), at https://www.irs.gov/newsroom/irs-seeks-comments-on-revenue-procedure-94-69. The comments received contended that both large corporate taxpayers and the IRS have benefited from using Rev. Proc. 94-69 to allow those taxpayers to disclose errors on their returns at the start of an audit. The IRS has determined that for a subset of large corporate taxpayers and large partnerships whose tax posture is likely to result in near-annual examinations, special procedures are appropriate for disclosure of errors on a return or items that may result in an underpayment but have a reasonable basis.

.17 The procedures set forth in this revenue procedure allow eligible taxpayers to avoid the accuracy-related penalty described in §§ 6662(b)(1) and 6662(b)(2) to the extent that the taxpayer reports errors resulting in additional tax or adequately discloses the tax treatment of an item that has a reasonable basis as provided in section 4 of this revenue procedure.

.18 The special procedures set forth in this revenue procedure are intended for the disclosure of errors and omissions that were not known at the time of filing a return.

SECTION 3. SCOPE

.01 *Eligible taxpayers*. The special procedures set forth in this revenue procedure are available to eligible taxpayers. An "eligible taxpayer" means any taxpayer selected for examination under the LCC (or successor program) if, on the date on which the IRS first contacts the taxpayer concerning an examination of an income tax return, at least four of the taxpayer's income tax returns for the five taxable years preceding the taxable year at issue are (or were) under examination under the LCC, the CIC, or a successor program. An eligible taxpayer also means any partnership selected for examination under the LPC (or successor program) if, on the date on which the IRS first contacts the partnership concerning an examination of a return of partnership income, at least four of the partnership's returns for the five taxable years preceding the taxable year at issue are (or were) under examination under the LPC (or successor program). Taxpayers selected for examination under the LCC or the LPC will be notified by the IRS if they are eligible taxpayers under this revenue procedure.

.02 *Procedures for ineligible taxpayers*. Taxpayers not eligible for, or making disclosures beyond the scope of, the special procedures set forth in this revenue procedure have the opportunity to utilize existing methods to avoid the imposition of penalties, including by filing a qualified amended return as described in and satisfying the requirements of § 1.6664-2(c)(3), or by adequately disclosing the position on a properly completed Form 8275, Form 8275-R, or Schedule UTP, *Uncertain Tax Position Statement*, filed with a return and satisfying the requirements of §1.6662-3(c).

SECTION 4. QUALIFIED AMENDED RETURN ON FORM 15307

.01 For purposes of avoiding the imposition of the penalty under § 6662(b)(1) for negligence or disregard of rules or regulations, and the substantial understatement penalty under § 6662(b)(2), a properly completed Form 15307, *Post-Filing Disclosure for Specified Large Business Taxpayers* (or successor form), is treated as a qualified amended return with respect to a particular taxable year of an eligible taxpayer if an eligible taxpayer furnished it to the IRS personnel conducting the examination after the tax return with respect to the particular taxable year has been filed but no later than 30 days (or a later date agreed to in writing by the IRS with respect to a particular taxable year) from the date of a written request to the taxpayer that Form 15307 be furnished with respect to that taxable year.

.02 The taxpayer must include a description of all items that would result in one or more adjustments with respect to a particular taxable year if the taxpayer filed a properly completed amended return with respect to that taxable year, or request for an administrative adjustment under § 6227. The description of an item is adequate if it consists of information that reasonably may be expected to apprise the IRS of the identity of the item, its amount, and the nature of the controversy or potential controversy. Each disclosed adjustment with respect to the particular taxable year must be stated separately.

.03 The taxpayer need not include a recomputation of total tax liability with respect to the particular taxable year with Form 15307. Similarly, if an item automatically affects another item with respect to that taxable year, the Form 15307 need not include a recomputation of the affected item. The taxpayer is required to include a computation of the increase (or decrease) in taxable income, or the increase (or decrease) to tax credits if the disclosure relates to tax credits, with respect to each item disclosed on the Form 15307.

.04 The taxpayer may also disclose information for purposes of establishing the reasonable basis of a position even though the taxpayer does not report any items that would result in adjustments with respect to the particular taxable year.

.05 Any additional tax liability with respect to the particular taxable year resulting from the adjustments identified in a written statement described in sections 4.01 through 4.03 of this revenue procedure that is agreed at the conclusion of the examination will be treated as an additional amount of tax shown on a qualified amended return for purposes of determining whether there is an underpayment of tax with respect to that taxable year subject to penalty under §§ 6662(b)(1) and 6662(b)(2). Any additional tax liability resulting from adjustments identified in the written statement with respect to a particular taxable year that is unagreed at the conclusion of the examination (1) will be subject to the deficiency procedures prescribed by §§ 6212 and 6213, or the partnership audit procedures prescribed by §§ 6221 through 6241, as applicable; (2) will not reduce the underpayment subject to penalty under § 6662(b)(1) for negligence; and (3) will not reduce the penalty for substantial understatement of income tax unless there was a reasonable basis for the taxpayer's tax treatment of the item identified in the written statement.

.06 Failure to Provide Adequate Disclosure.

(1) A disclosure based on incomplete information, unreasonable assumptions, or otherwise not in conformity with the requirements of this revenue procedure

and the Form 15307 furnished to the IRS with respect to a particular taxable year will be considered an inadequate disclosure.

(2) A taxpayer deemed to have made an inadequate disclosure will not receive penalty protection under this process with respect to the item or items inadequately disclosed with respect to the particular taxable year. The IRS will inform the taxpayer of any determination that a disclosure is inadequate.

SECTION 5. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 94-69 is obsoleted. "Rev. Proc. 2022-39" should be substituted for "Rev. Proc. 94-69" in any other revenue procedure that refers to Rev. Proc. 94-69.

SECTION 6. EFFECTIVE DATE

.01 This revenue procedure is effective for examinations of eligible taxpayers that begin after November 16, 2022, the date this revenue procedure was released to the public.

.02 The transition relief described in section 2.15 of this revenue procedure continues to apply to the taxpayers eligible for such relief with respect to examinations of taxable year 2020 and earlier years. The transition relief described in section 2.15 of this revenue procedure does not apply with respect to the examination of taxable year 2021 and later years. For examinations of taxable year 2021 and later years, taxpayers who were eligible for the transition relief described in section 2.15 of this revenue procedure can only utilize the special procedures set forth in this revenue procedure if the taxpayer meets the eligibility requirements described in section 3 of this revenue procedure.

SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Jessica Chase of the Office of the Associate Chief Counsel (Procedure and Administration). For further information regarding this revenue procedure, contact Ms. Chase at (202) 317-6845 (not a toll-free number).

Part IV

Notice of Proposed Rulemaking

Guidance Related to the Foreign Tax Credit

REG-112096-22

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to the foreign tax credit, including guidance with respect to the reattribution asset rule for purposes of allocating and apportioning foreign taxes, the cost recovery requirement, and the attribution rule for withholding tax on royalty payments.

DATES: Written or electronic comments and requests for a public hearing must be received by January 23, 2023.

ADDRESSES: Commenters are strongly encouraged to submit public comments electronically. Submit electronic submissions via the Federal eRulemaking Portal at *www.regulations.gov* (indicate IRS and REG-112096-22) by following the online instructions for submitting comments. Once submitted to the Federal eRulemaking Portal, comments cannot be edited or withdrawn. The Department of the Treasury (the "Treasury Department") and the Internal Revenue Service (the "IRS") will publish for public availability any comment submitted electronically, and on paper, to its public docket. Send hard copy submissions to: CC:PA:LPD:PR (REG-112096-22), Room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-112096-22), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Concerning §§1.901-2 and 1.903-1, Teisha Ruggiero, (646) 259-8116; concerning §1.861-20, Suzanne Walsh, (202) 317-4908; concerning submissions of comments and requests for a public hearing, Regina Johnson, (202) 317-6901 (not toll-free numbers) or by sending an email to publichearings@irs.gov (preferred).

SUPPLEMENTARY INFORMATION:

Background

On December 17, 2019, the Treasury Department and the IRS published proposed regulations (REG-105495-19) addressing changes made by the Tax Cuts and Jobs Act (Pub. L. 115-97, 131 Stat. 2054 (2017)) (the "TCJA") and other related foreign tax credit rules in the **Federal Register** (84 FR 69124) (the "2019 Foreign Tax Credit ("FTC") proposed regulations"). Correcting amendments to the 2019 FTC proposed regulations were published in the **Federal Register** on May 15, 2020 (85 FR 29368). The 2019 FTC proposed regulations were finalized as part of TD 9922, published in the **Federal Register** (85 FR 71998) on November 12, 2020 (the "2020 FTC final regulations"). On the same date, the Treasury Department and the IRS published proposed regulations (REG-101657-20) in the **Federal Register** (85 FR 72078) (the "2020 FTC proposed regulations"). The 2020 FTC proposed regulations addressed changes made by the TCJA and other foreign tax credit issues. Correcting amendments to the 2020 FTC final regulations were published in the **Federal Register** on October 1, 2021 (86 FR 54367). A public hearing on the 2020 FTC proposed regulations was held on April 7, 2021. The 2020 FTC proposed regulations were finalized in TD 9959, published in the **Federal Register** (87 FR 276) on January 4, 2022 (the "2022 FTC final regulations"). Correcting amendments to the 2022 FTC final regulations were published in the **Federal Register** on July 27, 2022 (87 FR 45018 and 87 FR 45021).

This document contains proposed regulations (the "proposed regulations") addressing the following issues: (1) the definition of a reattribution asset for purposes of allocating and apportioning foreign income taxes; (2) the application of the cost recovery requirement; and (3) the application of the source-based attribution requirement to withholding taxes on certain royalty payments.

Explanation of Provisions

I. *Allocation and Apportionment of Foreign Income Taxes*

A. *In general*

Section 1.861-20 provides rules for allocating and apportioning foreign income taxes to the statutory and residual groupings, including the categories described in section 904 that apply for purposes of calculating a taxpayer's foreign tax credit limitation. In general, §1.861-20 operates by first assigning the foreign gross income on which the foreign income tax is imposed to statutory and residual groupings based upon the character of the item of U.S. gross income that corresponds to the foreign gross income (the "corresponding U.S. item"). §1.861-20(c) and (d). Foreign income tax expense is allocated to the grouping to which the foreign gross income is assigned, and if foreign gross income is assigned to more than one grouping, deductions computed under foreign law are allocated and apportioned to the groupings and foreign tax expense is apportioned among the groupings based upon foreign taxable income in the groupings. §1.861-20(e) and (f).

The 2022 FTC final regulations provide rules for allocating and apportioning foreign income tax arising from a disregarded payment. Foreign gross income included by reason of the receipt of a disregarded payment has no corresponding U.S. item because Federal income tax law does not give effect to the payment as a receipt of gross income. Section 1.861-20(d)(3)(v) therefore characterizes the disregarded payment under Federal income tax law for purposes of assigning this foreign gross income to the statutory and residual groupings. These rules treat the portion of a disregarded payment, if any, that causes U.S. gross income of the payor taxable unit to be reattributed under either §1.904-4(f)(2) (in the case of a taxpayer that is an individual or domestic corporation) or §1.951A-2(c)(7)(ii)(B) (in the case of a taxpayer that is a foreign corporation) to the recipient taxable unit as a "reattribution payment." §1.861-20(d)(3)(v)(E)(*7*); *see also* part I.B of this Explanation of Provisions for a description of the reattribution payment rules. The excess of a disregarded payment over the portion that is a reattribution payment is treated either as a contribution from one taxable unit to another taxable unit owned by the first taxable unit, or as a remittance of a taxable unit's current and accumulated earnings. §1.861-20(d)(3)(v)(E)(*2*) and (*8*). Section 1.861-20(d)(3)(v)(D) provides a special rule for characterizing disregarded payments that are made in exchange for property and are not reattribution payments.

B. *Reattribution payments, remittances, and the reattribution of assets*

Section 1.861-20(d)(3)(v)(B) assigns foreign gross income from a disregarded payment that is a reattribution payment to the same statutory and residual grouping as the U.S. gross income that is reattributed to the recipient taxable unit. This assignment occurs before taking into account any reattribution payments made by the recipient taxable unit.

Foreign gross income included by reason of a remittance is assigned to the statutory and residual groupings by reference to the proportion of the tax book value of the assets of the remitting taxable unit in the groupings as assigned for purposes of apportioning interest expense. §1.861-20(d)(3)(v)(C)(*1*)(*i*). In other words, the character of the assets of the remitting taxable unit is a proxy for the character of the current and accumulated earnings out of which the remittance is made. To more accurately reflect the character of the remitting taxable unit's earnings, the reattribution asset rule in §1.861-20(d)(3)(v)(C)(*1*)(*ii*) requires that a reattribution of income from one taxable unit (payor taxable unit) to another taxable unit (recipient taxable unit) result in a concomitant reattribution of the tax book value of the assets of the payor taxable unit that generated the reattributed income ("reattribution assets") from the payor taxable unit to the recipient taxable unit.

After further study, the Treasury Department and the IRS have concluded that the reattribution asset rule is not needed for allocating and apportioning foreign tax on a remittance in the case of disregarded property sales, and particularly with respect to disregarded sales of inventory property. For example, consider a domestic corporation that directly owns two taxable units that are disregarded for U.S. Federal income tax purposes: DE1, which manufactures inventory property, and DE2, which distributes inventory property to unrelated customers. DE1 sells the manufactured inventory to DE2 in exchange for a disregarded payment. The disregarded payment that DE1 receives for the sale of inventory property to DE2 becomes a reattribution payment when DE2 on-sells the inventory property and generates gain in a transaction that is regarded for U.S. tax purposes. Accordingly, gain from the sale of the inventory is reattributed from the distributing taxable unit to the manufacturing taxable unit, and a portion of the distributing taxable unit's assets is reattributed to the manufacturing taxable unit. Although the assets of the manufacturing taxable unit contributed to the production of the income of both taxable units, the tax book value of the manufacturing taxable unit's assets is not reattributed to the distributing taxable unit. As a result, the reattribution asset rule, by reattributing assets only from the distributor taxable unit to the manufacturing taxable unit, does not more accurately balance among the taxable units all of the assets that produced the gain from the inventory sale. The reattribution of assets instead changes the ratios of the assets considered held by the taxable units such that a greater percentage of the distributor taxable unit's assets consist of non-inventory assets (for example, cash), and a greater percentage of the manufacturing taxable unit's assets consist of inventory.

Accordingly, proposed §1.861-20(d)(3)(v)(E)(*6*) retains the general definition of reattribution asset but excludes any portion of the tax book value of property transferred in a disregarded sale from being attributed back to the selling taxable unit. Comments are requested on whether similar revisions should be made to the reattribution asset rule in situations other than disregarded property sales. Comments are further requested on other issues related to the allocation and apportionment of foreign income taxes to disregarded payments, which may be considered in future guidance projects.

II. *Creditability of Foreign Taxes Under Sections 901 and 903*

A. *In general*

Section 901 allows a credit for foreign income, war profits, and excess profits taxes, and section 903 provides that such taxes include a tax in lieu of a generally-imposed foreign income, war profits, or excess profits tax (collectively, "foreign income taxes"). Before its amendment by the 2022 FTC final regulations, §1.901-2(a)(1) provided that a foreign levy was an income tax if and only if (1) it was a tax, and (2) the predominant character of that tax was that of an income tax in the U.S. sense. Under former §1.901-2(a)(3), the predominant character of a foreign tax was that of an income tax in the U.S. sense if the tax (1) was likely to reach net gain in the normal circumstances in which it applied (the "net gain requirement"), and (2) was not a "soak-up" tax. To satisfy the net gain requirement, a foreign tax needed to meet the realization, gross receipts, and net income requirements. *See* former §1.901-2(b).

The 2022 FTC final regulations revised the net gain requirement to better align the regulatory tests with principles in the Internal Revenue Code ("Code") for determining the base of a U.S. income tax, as well as to simplify and clarify the application of these tests. The revisions made by the 2022 FTC final regulations ensure that a foreign tax is a creditable net income tax only if the determination of the foreign tax base conforms in essential respects to the determination of taxable income under the Code. In particular, the 2022 FTC final regulations limit the role of the predominant character analysis generally required under the prior regulations, which often required empirical analysis, in determining whether a foreign tax meets each of the net gain requirements. Under the 2022 FTC final regulations, a foreign tax satisfies the net gain requirement only if the tax satisfies the realization requirement, the gross receipts requirement, the cost recovery requirement (formerly the net income requirement), and the attribution requirement. In addition, the 2022 FTC final regulations provide that the determination of whether a foreign tax satisfies each component of the net gain requirement is generally based on the terms of the foreign tax law governing the computation of the tax base and not based on empirical analysis. §1.901-2(b)(1). The 2022 FTC final regulations also maintained the long-standing all-or-nothing rule; that is, a foreign tax either is or is not a foreign income tax, in its entirety, for all persons subject to the foreign tax. §1.901-2(a)(1)(i).

B. *Cost recovery requirement*

1. Application under 2022 FTC final regulations

Consistent with the net income requirement in former §1.901-2(b)(4), the 2022 FTC final regulations require, under the cost recovery requirement, that the base of a foreign tax permits the recovery of significant costs and expenses attributable, under reasonable principles, to the gross receipts included in the tax base. §1.901-2(b)(4)(i)(A). However, to ensure that a foreign tax is a foreign income tax only if the foreign tax allows for the recovery of costs and expenses in a manner that conforms in essential respects to the determination of taxable income under the Code, and to limit the empirical analysis that would otherwise be required, the 2022 FTC final regulations modified the cost recovery requirement in several respects. For example, the 2022 FTC final regulations provide a list of costs and expenses that are always treated as significant (costs and expenses related to capital expenditures, interest, rents, royalties, wages or other payments for services, and research and experimentation). §1.901-2(b)(4)(i)(C)(*1*). Whether other costs and expenses are significant continues to be determined under an empirical analysis; that is, based on whether, for all taxpayers in the aggregate to which the foreign tax applies, the item of cost or expense constitutes a significant portion of the taxpayers' total costs and expenses. *Id*.

However, the 2022 FTC final regulations also recognized that, similar to the United States, foreign countries limit the recovery of certain significant costs and expenses. As a result, §1.901-2(b)(4)(i)(C)(*1*) provides that foreign tax law is considered to permit the recovery of significant costs and expenses, even if recovery of certain significant costs and expenses is disallowed in whole or in part, if such disallowance is consistent with any principle underlying the disallowances required under the Code ("principles-based exception").

2. Response to the 2022 FTC final regulations

Following the publication of the 2022 FTC final regulations, the Treasury Department and the IRS have received a number of questions regarding the application of the cost recovery requirement as well as requests to modify the requirement. In particular, taxpayers and other stakeholders identified a number of foreign tax laws that impose disallowances or other limitations on the recovery of costs and expenses that are not clearly matched to a principle underlying a similar disallowance under the Code, even though, in the view of these stakeholders, the foreign tax as a whole is consistent with a net income tax in the U.S. sense. Moreover, taxpayers noted that, in some instances, it was difficult to determine the principle underlying the foreign disallowance because of a lack of information from the foreign country.

The Treasury Department and the IRS agree that, in certain instances, the cost recovery requirement should be satisfied even if the foreign tax law contains a disallowance or other limitation on the recovery of a particular cost or expense that may not reflect a specific principle underlying a particular disallowance in the Code. The income tax provisions of the Code contain a number of disallowances and other limitations on the deductibility of certain costs and expenses. In some instances, the principle or principles behind the limitation is clear, either because the motivation is articulated in legislative history or because it is possible to determine the principle from the terms of the limitation itself. However, the principles underlying other limitations may be less apparent, making it difficult to determine whether a foreign limitation on the deductibility of certain costs and expenses is consistent with any principle underlying the disallowances under the Code.

As explained in the preamble to the 2022 FTC final regulations, section 901 allows credits for foreign taxes that are income taxes in the U.S. sense, and this standard is met if there is substantial conformity in the principles used to calculate the foreign tax base and the U.S. tax base. Complete conformity between the rules for determining the foreign tax base and the U.S. tax base is not required. Accordingly, the proposed regulations provide additional guidance for evaluating disallowances under foreign tax law that may not mirror the expense disallowance rules in the Code, but that nonetheless do not prevent the foreign tax from being a tax imposed on net income.

Proposed §1.901-2(b)(4)(i) retains the general cost recovery requirement under the 2022 FTC final regulations, but provides that the relevant foreign tax law need only permit recovery of substantially all of each item of significant cost or expense. Consistent with the general approach of the 2022 FTC final regulations, whether a foreign tax permits recovery of substantially all of each item of significant cost or expense is determined based solely on the terms of the foreign tax law. Proposed §1.901-2(b)(4)(i)(C)(*1*).

Proposed §1.901-2(b)(4)(i)(C)(*2*) provides a safe harbor for purposes of applying this requirement. Under the safe harbor, a disallowance of a stated portion of an item (or multiple items) of significant cost or expense does not prevent a foreign tax from satisfying the cost recovery requirement if the portion of the item (or items) that is disallowed does not exceed 25 percent. This safe harbor also permits the foreign tax law to cap deductions of a single item of significant cost or expense or multiple items that relate to a single category of per se significant costs and expenses described in proposed §1.901-2(b)(4)(i)(B)(*2*) so long as the cap, based solely on the terms of the foreign tax law, is not less than 15 percent of gross receipts, gross income, or a similar measure, or in the case of a cap based on a percentage of taxable income, or a similar measure, the cap is not less than 30 percent. A foreign law limitation that caps deductions of multiple items that relate to different categories of per se significant costs and expenses at a stated percentage (for example, a cap on the deduction of all interest and royalties, combined, at 15 percent of gross receipts), or that caps deductions of multiple items of significant costs or expense that are significant under proposed §1.901-2(b)(4)(i)(B)(*1*) at a stated percentage, would not meet the safe harbor. The safe harbor is intended to provide additional certainty where a foreign tax law disallowance is in the form of a stated portion or cap. Taxpayers will not need to identify a corresponding principle underlying the disallowances required under the Code for foreign tax law disallowances that meet the safe harbor. If the foreign tax law contains a disallowance that is not within the safe harbor, and that otherwise prevents the recovery of substantially all of an item of significant cost or expense, then the limitation would be examined under the principles-based exception from the 2022 FTC final regulations, retained in proposed §1.901-2(b)(4)(i)(F)(*1*), which permits more substantial disallowances (including complete disallowances) of an item of significant cost or expense that are consistent with any principle underlying the disallowances required under the Code. The proposed regulations make additional clarifications to this rule, to provide that the principle must be reflected in a disallowance within the income tax provisions of the Code, and if the disallowance addresses a non-tax public policy concern, then such concern must be similar to the non-tax public policy concerns reflected in the Code. In addition, the proposed regulations remove the example of a limit on recovery of interest based upon a measure of taxable income from this principles-based exception because such a limitation would generally be covered by the safe harbor. *See* proposed §1.901-2(b)(4)(iv)(H) (*Example 8*). If the foreign law disallowance does not meet the safe harbor or otherwise permit recovery of substantially all of each item of significant cost or expense, the principles-based exception would be relevant for determining whether the foreign tax could satisfy the cost recovery requirement.

Additionally, proposed §1.901-2(b)(4)(iv)(F) through (J) provide new examples illustrating the application of the cost recovery requirement. The proposed regulations also reorganize the provisions of the cost recovery requirement to accommodate the addition of these new provisions, as well as to better reflect the structure of the requirement.

C. *Attribution requirement for royalty payments*

1. Application under 2022 FTC final regulations

The 2022 FTC final regulations added an attribution requirement in §1.901-2(b)(5) as an element of the net gain requirement to require that a foreign tax conform to the concepts of taxing jurisdiction reflected in the Code that define an income tax in the U.S. sense. The purpose of the attribution requirement is to allow a credit for a foreign tax only if the country imposing the tax has sufficient nexus to the taxpayer's activities or investment of capital that generates the income included in the tax base. This result is consistent with the statutory purpose of the foreign tax credit to relieve double taxation of income through the United States ceding its own taxing rights only where the foreign country has the primary right to tax the income.

With respect to a foreign levy imposed on nonresident taxpayers, the attribution requirement limits the scope of gross receipts and costs included in the base of a foreign tax to those that satisfy the activities-based attribution, source-based attribution, or property-based attribution tests. §1.901-2(b)(5)(i). These tests are consistent with U.S. income tax principles reflected in the Code's provisions that only tax foreign persons' income that is effectively connected with a U.S. trade or business or attributable to U.S. real property, or that is fixed or determinable annual or periodical (FDAP) income sourced in the United States.

Under the source-based attribution requirement in §1.901-2(b)(5)(i)(B), a foreign tax imposed on the nonresident's income on the basis of source meets the attribution requirement only if the foreign tax law's sourcing rules are reasonably similar to the sourcing rules that apply for Federal income tax purposes. In the case of gross income arising from royalties, §1.901-2(b)(5)(i)(B)(*2*) provides that the foreign tax law must source royalties based on the place of use of, or the right to use, the intangible property, consistent with how the Code sources royalty income.

For foreign taxes imposed in lieu of an income tax, the 2022 FTC final regulations also modified the substitution requirement in §1.903-1, including by adding an attribution requirement. Under §1.903-1(c)(2)(iii), a foreign withholding tax must meet the source-based attribution requirement in §1.901-2(b)(5)(i)(B) to qualify as a "covered withholding tax" that may be creditable as a tax in lieu of an income tax. Thus, a withholding tax on a royalty payment is creditable only if the foreign tax law sources royalties based upon the place of use of, or the right to use, the intangible property, consistent with how the Code sources royalty income. The 2022 FTC final regulations also maintained the all-or-nothing rule for the substitution requirement; that is, a foreign tax either is or is not a tax in lieu of an income tax, in its entirety, for all persons subject to the foreign tax. §1.903-1(b)(1). Accordingly, a withholding tax on royalties that is imposed on the basis of the residence of the payor of the royalty is not creditable, whether or not the relevant intangible property is in fact used within the territory of the taxing jurisdiction. §1.903-1(d)(3) and (4) (*Examples 3* and *4*).

The determination of whether a foreign levy meets the requirements under §§1.901-2 and 1.903-1 is made on a levy-by-levy basis. Section 1.901-2(d) provides rules for determining whether one foreign levy is separate from another foreign levy. In general, §1.901-2(d)(1)(ii) provides that separate levies are imposed on particular classes of taxpayers if the tax base is different for those taxpayers. The 2022 FTC final regulations added a special rule for withholding taxes imposed on nonresidents that treats each such tax as a separate levy with respect to each class of gross income (as listed in section 61) to which the tax applies. §1.901-2(d)(1)(iii). This rule allows withholding taxes that are imposed on classes of income that are subject to different sourcing rules of the taxing jurisdiction to be analyzed as separate levies under the covered withholding tax requirement in §1.903-1(c)(2). The 2022 FTC final regulations also provided that if a foreign country imposes a withholding tax on two or more subsets of a separate class of income and a different source rule applies to each subset of income, then separate levies are considered imposed on each subset of that separate class of income. §1.901-2(d)(1)(iii). These special rules reflect the general principle in §1.901-2(d)(1) that the separate levy determination is based upon U.S. principles and not whether foreign tax law imposes the levy or levies pursuant to a single or separate statutes. The rules also enable testing the creditability of a withholding tax on a more granular basis. This approach better reflects the purpose of the attribution requirement to allow a foreign tax credit only where, in the U.S. view, the taxing jurisdiction has the primary right to tax the income.

2. Response to the 2022 FTC final regulations

Following the publication of the 2022 FTC final regulations, the Treasury Department and the IRS received questions regarding the application of the source-based attribution requirement to certain royalty withholding taxes. In addition, the Treasury Department and the IRS received requests (including a petition for rulemaking) to change the requirement, by allowing a credit even if a foreign country sources royalties based on the residence of the payor or by applying a different standard.[1]

As an initial matter, some taxpayers questioned whether the sourcing rule for royalties was applied differently than that for services because §1.901-2(b)(5)(i)(B)(*1*) includes a reference to the use of "reasonable principles" for purposes of applying the source-based attribution requirement to a payment for services, while the equivalent rule in §1.901-2(b)(5)(i)(B)(*2*) for royalties does not. Since the introductory text in §1.901-2(b)(5)(i)(B) states that, in all instances, sourcing rules must be reasonably similar to the sourcing rules under the Code, the same standard applies regardless of whether the relevant payment is for services or for royalties. However, to avoid further confusion, the proposed regulations conform the language of §1.901-2(b)(5)(i)(B)(*1*) and (*2*).

Additionally, the Treasury Department and the IRS are aware that, in some cases, a taxpayer may license intangible property for use solely within the foreign country in which the licensee is resident, but the foreign country sources royalties based on the residence of the payor. In these cases, notwithstanding the actual use of the licensed property in the taxing jurisdiction, a credit would not be allowed for the royalty withholding tax under the source-based attribution requirement for royalties in §1.901-2(b)(5)(i)(B). However, in these cases, the foreign country imposing tax on the royalty income should, from a U.S. perspective, have the primary taxing right over the royalty income because the intangible property giving rise to the royalty is in fact being used solely in that foreign country. That is, notwithstanding the difference in sourcing rules for royalty income, there is complete overlap between the jurisdiction with the primary right to tax based on U.S. tax principles and the taxing rights exercised by the taxing jurisdiction.

The Treasury Department and the IRS have concluded that it is appropriate to provide a limited exception to the source-based attribution requirement of the 2022 FTC final regulations where the taxpayer can substantiate that a withholding tax is imposed on royalties received in exchange for the right to use intangible property solely within the territory of the taxing jurisdiction. The Treasury Department and the IRS have concluded that it would be unduly burdensome for both the taxpayer and the IRS to determine the place of use of all intangible property on a country-by-country basis based on each taxpayer's facts and circumstances. While taxpayers may need to determine the place of use of certain intangible property to determine whether the royalty income is U.S. or foreign source, or for other purposes, those determinations generally do not require taxpayers or the IRS to separately determine the use in a specific foreign country. For this reason, this limited exception applies only if the taxpayer has a written license agreement that provides for the payment of the royalty and that limits the use of the intangible property giving rise to the royalty payment to the territory of the foreign country imposing the tax.

3. The single-country exception

Reflecting this new limited exception, proposed §1.903-1(c)(2)(iii) provides that a tested foreign tax satisfies the source-based attribution requirement if the tax meets either the source-based attribution requirement in §1.901-2(b)(5)(i)(B) or the exception in proposed §1.903-1(c)(2)(iii)(B) (the "single-country exception").

In general, the single-country exception applies where (1) the income subject to the tested foreign tax is characterized as gross royalty income, and (2) the payment giving rise to such income is made pursuant to a single-country license. Proposed §1.903-1(c)(2)(iii)(B). Consistent with §1.901-2(b)(5)(i)(B), proposed §1.903-1(c)(2)(iii)(B) provides that foreign tax law generally applies for purposes of determining whether the gross income or gross receipts arising from a transaction are characterized as a royalty, except in the case of a transaction that is considered the sale of a copyrighted article under §1.861-18, which is not treated as a license of intangible property but as a sale of tangible property.

A payment is made pursuant to a single-country license if the terms of the written license agreement under which the payment is made characterize the payment as a royalty and limit the territory of the license to the foreign country imposing the tested foreign tax. Proposed §1.903-1(c)(2)(iv)(A). However, a payment (or

[1] The Treasury Department and the IRS received a petition for rulemaking with respect to the attribution requirement as applied to a tax on a resident but declined to engage in rulemaking on that subject. The Treasury Department and the IRS have determined that the attribution requirement as contained in the 2022 FTC final regulations, including as applied to residents, is appropriate to ensure that a foreign tax is consistent with the general principles of income taxation reflected in the Code. These principles include not only those related to determining realization, gross receipts, and cost recovery, but also principles for determining the scope of the items of gross receipts and costs that may be properly taken into account in computing the tax base on which the foreign tax is imposed.

portion of a payment) may be treated as made pursuant to a single-country license even if the written agreement does not limit the territory of the license to the foreign country imposing the tax or provides for payments in addition to those for the use of intangible property (for example, for related services), if the agreement separately states the portion (whether as a specified amount or as a formula) of the payment subject to the tested foreign tax that is characterized as a royalty and that is with respect to the part of the territory of the license that is solely within the foreign country imposing the tax. *See* proposed §§1.903-1(c)(2)(iv)(B) and (d)(9) (*Example 9*).

The Treasury Department and the IRS are aware that, to qualify for the single-country exception, taxpayers may need to revise existing license agreements. Additionally, because certain withholding taxes may remain non-creditable, taxpayers may be incentivized to maximize the portion of a payment that is made pursuant to a single-country license. For example, a taxpayer that receives royalty payments pursuant to a related-party license agreement that grants the licensee rights to several different types of intangible property—some of which will be exploited solely within the taxing jurisdiction and some outside of the taxing jurisdiction—may be incentivized to amend the related-party license agreement to separately state a royalty amount that purports to qualify for the single-country exception but that may exceed an amount that, under the arm's length principles of section 482 and sourcing principles of section 861, is attributable to the exploitation of the intangible property within the taxing jurisdiction. Additionally, taxpayers may be disincentivized from revising existing agreements to reflect changes in facts and circumstances if doing so would decrease the amount of the royalty that is eligible for the single-country exception.

To address these concerns, proposed §1.903-1(c)(2)(iv)(C) provides that a payment is treated as not made pursuant to a single-country license if the taxpayer knows, or has reason to know, that the required agreement misstates the territory in which the intangible property is used or overstates the amount of the royalty with respect to the part of the territory of the license that is solely within the foreign country imposing the tax. Thus, the required agreement must reflect the relevant facts and circumstances, as known by the taxpayer or as would be known by a reasonably prudent person in the position of the taxpayer, regarding both the amount of the relevant royalty and the territory in which the intellectual property is actually used.

In general, a taxpayer cannot qualify for the single-country exception without satisfying the documentation requirement in proposed §1.903-1(c)(2)(iv)(D). Under proposed §1.903-1(c)(2)(iv)(D), the required agreement pursuant to which the qualifying royalty is paid must be executed no later than the date on which the royalty is paid. However, recognizing that the single-country exception is proposed to be applicable to periods preceding the release of this notice of proposed rulemaking, a special transition documentation rule is provided for royalties paid on or before May 17, 2023. In that case, to satisfy the documentation requirement, the required agreement must be executed no later than May 17, 2023 and the agreement must state (whether in the terms of the agreement or in recitals) that royalties paid on or before the execution of the agreement are considered paid pursuant to the terms of the agreement.

The required agreement must be maintained by the taxpayer and provided to the IRS within 30 days of a request by the Commissioner or another period as agreed between the Commissioner and the taxpayer. *Id.* For purposes of the rule, the term taxpayer includes a partnership upon which foreign law imposes a tax. *See* §1.901-2(f)(4) and (g)(7). Therefore, if the royalty withholding tax is imposed at the partnership level, the documentation required by the proposed regulations must be maintained by the partnership, even though the party that claims the credit is the partner and not the partnership. The Treasury Department and the IRS request comments as to whether special rules may be necessary to address the documentation requirement in the case of partnerships.

Finally, proposed §1.903-1(d)(3) and (8) through (11) provide new examples illustrating the application of the source-based attribution rule and single-country exception for covered withholding taxes on royalties.

4. Separate levy

The proposed regulations also modify the separate levy rule in §1.901-2(d)(1)(iii) for withholding taxes imposed on nonresidents. Specifically, §1.901-2(d)(1)(iii)(B)(*3*) provides that a withholding tax that is imposed on a royalty payment made to a nonresident pursuant to a single-country license is treated as a separate levy from a withholding tax that is imposed on other royalty payments made to such nonresident and from any other withholding taxes imposed on other nonresidents. As with the special separate levy rule for withholding taxes on different classes of income or different subsets of income within a class of income, this rule may result in a foreign withholding tax being considered a separate levy in cases where the foreign tax law considers only a single levy to be imposed. In contrast to a net income tax, this separate levy rule can be applied to withholding taxes because withholding taxes on royalties are imposed on gross income and on a payment-by-payment basis. In addition, as with the other special levy rules, this separate levy rule better aligns the outcomes of the test with the purposes of the foreign tax credit rules, including that of the attribution requirement. The proposed regulations also reorder and reorganize the paragraphs of proposed §1.901-2(d)(1)(iii) to accommodate the addition of this new provision, and to reflect the structure of the rules more logically.

III. *Applicability Dates*

In general, except for proposed §1.861-20(d)(3)(v)(E)(*6*), the proposed regulations are proposed to apply to taxable years ending on or after November 18, 2022. However, once the proposed regulations are finalized, taxpayers may choose to apply some or all of the final regulations to earlier taxable years, subject to certain conditions.

Proposed §1.861-20(d)(3)(v)(E)(*6*) is proposed to apply to taxable years ending on or after the date final regulations adopting these rules are filed with the **Federal Register**. Taxpayers may choose to apply the rules of §1.861-20(d)(3)(v)(E)(*6*), once finalized, to taxable years that begin after December 31, 2019, and end before the date final regulations adopting these rules are filed with the **Federal Register** provided they apply §1.861-20(d)(3)(v)(E)(*6*) consistently to their first taxable year beginning after December 31, 2019, and any subsequent taxable year ending before the date final regulations adopting these rules are filed with the **Federal Register**.

Proposed §1.901-2(b)(4)(i) and (iv), (b)(5)(i)(B)(*2*), and (d)(1)(iii) and proposed §1.903-1(c)(2) and (d)(3), (4), and (8) through (11) are proposed to apply to foreign taxes paid in taxable years ending on or after November 18, 2022. Taxpayers may choose to apply the rules of §1.901-2(b)(4)(i) and (iv), once finalized, for foreign taxes paid in taxable years beginning on or after December 28, 2021, and ending before November 18, 2022, provided that they consistently apply those rules to such taxable years. Taxpayers may also choose to apply the rules of §§1.901-2(b)(5)(i)(B)(*2*) and (d)(1)(iii) and 1.903-1(c)(2) and (d)(3), (4), and (8) through (11), once finalized, for foreign taxes paid in taxable years beginning on or after December 28, 2021, and ending before November 18, 2022, provided that they consistently apply those rules for such taxable years.

Finally, until the effective date of final regulations, a taxpayer may rely on all or part of the proposed regulations, subject to certain conditions. Specifically, a taxpayer may choose to rely on the provisions addressing the reattribution asset rule (proposed §1.861-20(d)(3)(v)(E)(*6*)) for taxable years that begin after December 31, 2019, and end before the effective date of final regulations adopting these rules**.** A taxpayer may also choose to rely on the provisions addressing the cost recovery requirement (proposed §1.901-2(b)(4)(i) and (iv)) for foreign taxes paid in taxable years beginning on or after December 28, 2021, and ending before the effective date of final regulations adopting these rules. Finally, a taxpayer may choose to rely on the provisions addressing the attribution requirement for royalty payments (proposed §1.901-2(b)(5)(i)(B)(*2*) and (d)(1)(iii) and proposed §1.903-1(c)(2) and (d)(3), (4), and (8) through (11)) for foreign taxes paid in taxable years beginning on or after December 28, 2021, and ending before the effective date of final regulations adopting these rules.

If a taxpayer chooses to rely on any of the three portions of the proposed regulations described in the preceding paragraph, the taxpayer and its related parties, within the meaning of sections 267(b) (determined without regard to section 267(c)(3)) and 707(b)(1), must consistently follow all proposed regulations with respect to that portion for all relevant years until the effective date of the final regulations adopting the rules.

Conforming Amendments to Other Regulations and Guidance

The Treasury Department and the IRS intend to make conforming amendments to other regulations, including the cost recovery rules that are not being revised in these proposed regulations and the examples in §§1.901-2(b)(4)(iv) and 1.903-1(d), upon finalization of the proposed regulations.

Special Analyses

I. *Regulatory Planning and Review*

The Administrator of the Office of Information and Regulatory Affairs (“OIRA”), Office of Management and Budget, has determined that this proposed rule is not a significant regulatory action, as that term is defined in section 3(f) of Executive Order 12866. Therefore, OIRA has not reviewed this proposed rule pursuant to section 6(a)(3)(A) of Executive Order 12866 and the April 11, 2018, Memorandum of Agreement between the Treasury Department and the Office of Management and Budget (“OMB”).

II. *Paperwork Reduction Act*

The Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) (“PRA”) requires that a federal agency obtain the approval of the OMB before collecting information from the public, whether such collection of information is mandatory, voluntary, or required to obtain or retain a benefit.

A. *Overview*

The collection of information in these proposed regulations is in proposed §1.903-1(c)(2)(iv)(D). As discussed in part II.C.3 of the Explanation of Provisions, proposed §1.903-1(c)(2)(iii)(B) provides an exception (the “single-country exception”) to the source-based attribution requirement if a taxpayer can substantiate that the payment on which the royalty withholding tax is imposed was made pursuant to an agreement that limits the right to use intangible property to the jurisdiction imposing the tested foreign tax. Proposed §1.903-1(c)(2)(iv)(A). The exception applies only where the taxpayer has a written license agreement that provides for the payment of the royalty and that limits the use of the intangible property giving rise to the royalty payment to the territory of the foreign country imposing the tax. A payment may also qualify for the single-country exception if the agreement separately states the portion (whether as a specified amount or as a formula) of the payment subject to the tested foreign tax that is characterized as a royalty and that is with respect to the portion of the territory of the license that is solely within the foreign country imposing the tax. Proposed §1.903-1(c)(2)(iv)(B).

Proposed §1.903-1(c)(2)(iv)(D) requires taxpayers who claim eligibility for the exception to provide an agreement described in proposed §1.903-1(c)(2)(iv)(A) or (B), as applicable, (the “required agreement”) within 30 days of a request by the Commissioner or another period as agreed between the Commissioner and the taxpayer. Proposed §1.903-1(c)(2)(iv)(D) also provides a transition rule in the case of a royalty paid on or before May 17, 2023 that requires the required agreement to be executed no later than May 17, 2023.

B. *Collection of information — Proposed §1.903-1(c)(2)(iv)(D)*

The Treasury Department and the IRS intend that the information collection requirement in proposed §1.903-1(c)(2)(iv)(D) will be set forth in the forms and instructions identified in Table 1.

Table 1. Tax Forms Impacted

Collection of Information	Number of respondents (estimated)	Forms to which the information may be attached
Proposed §1.903-1(c)(2)(iv)(D)	42,030[2]	Form 1116 and Form 1118

Source: IRS's Compliance Data Warehouse

The estimate for the number of impacted filers with respect to the collection of information in proposed §1.903-1(c)(2)(iv)(D) is based on the number of U.S. corporations that filed a return that had a Form 1118 that reported an amount of withholding tax on rents, royalties, and license fees on Schedule B, Part I, column e; U.S. corporations that filed a return that had a Form 1118 that reported an amount of deemed paid taxes and a Form 5471 that reported an amount of gross royalties and license fees on Schedule C (and thus may have incurred a withholding tax on those royalties); and U.S. individuals that filed a return and had a Form 1116 that reported an amount of withholding tax on rents and royalties on Part II, column n.[3] This represents an upper bound of potentially affected taxpayers: not all taxpayers that have reported an amount of royalty withholding tax paid to a foreign country or that have royalty income on which they may have paid a withholding tax are expected to claim a credit for such tax, and not all taxpayers who claim such a credit are expected to rely on the single country exception in proposed §1.903-1(c)(2)(iii)(B).

The Treasury Department and the IRS expect that taxpayers subject to the collection of information in proposed §1.903-1(c)(2)(iv)(D) will not have a significant increase in burden (if any) because some taxpayers may already have existing license agreements that qualify for the single-country exception in place for a variety of tax and non-tax law reasons, and other taxpayers may not elect to take advantage of the single-country exception. The reporting burden associated with this collection of information will be reflected in future PRA submissions associated with Form 1118 (OMB control number 1545-0123), Form 1065 (OMB control number 1545-0123), and Form 1116 (OMB control numbers 1545-0074 for individuals, and 1545-0121 for estates and trusts). The collection of information in proposed §1.903-1(c)(2)(iv)(D) will be reflected in future Paperwork Reduction Act submissions that the Treasury Department and the IRS will submit to OMB for these forms. The current status of the Paperwork Reduction Act submissions related to these forms is summarized in Table 2.

Because the proposed regulations, including the collection of information in proposed §1.903-1(c)(2)(iv)(D), are proposed to apply to taxes paid in taxable years ending on or after the date the proposed regulations are filed with the **Federal Register**, the Treasury Department and the IRS have submitted the collection of information in proposed §1.903-1(c)(2)(iv)(D) to the OMB for review in accordance with the Paperwork Reduction Act and requested a new OMB control number (the "temporary OMB control number"). After the rulemaking is finalized, the information collection contained within the regulations will be incorporated into the OMB control numbers described in Table 2.

Table 2. Status of Current Paperwork Reduction Submissions.

Form	**Type of Filer**	**Temporary OMB Control Number**	**Incorporated into OMB Control Number(s) after Final Rulemaking**
Form 1116	Trusts & estates	1545-NEW	1545-0121
	Individual	1545-NEW	1545-0074
Form 1118	Business	1545-NEW	1545-0123

Commenters are strongly encouraged to submit public comments electronically. Comments and recommendations for the proposed information collection should be sent to *https://www.reginfo.gov/public/do/PRAMain*, with electronic copies emailed to the IRS at pra.comments@irs.gov (indicate REG-112096-22 on the subject line). This particular information collection can be found by selecting "Currently under Review - Open for Public Comments" then by using the search function. Comments can also be mailed to OMB, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies mailed to the IRS, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collections of information should be received by January 23, 2023.

The likely respondents associated with the temporary OMB control number are

[2] The estimated number of respondents in this Table 1 is based on the number of respondents from the 2020 tax year.

[3] As explained in part II.C.3 of the Explanation of Provisions, the collection of information in proposed §1.903-1(c)(2)(iv)(D) also impacts partnerships and S corporations that pay a withholding tax that is imposed at the partnership or S corporation level under foreign law even though it is the partners or S corporation shareholder that claims the credit for those taxes. The Treasury Department and the IRS lack sufficient data to identify the number of partnerships and S corporations that pay foreign withholding taxes on royalty income. However, the IRS and Treasury Department do not expect that this will impact the number of affected taxpayers since the partners and shareholders that claim a credit for the royalty withholding tax would be captured within the Form 1116 and Form 1118 filers.

U.S. persons who pay or accrue foreign withholding taxes on royalty income.

Estimated total annual reporting burden: 420,300 hours

Estimated average annual burden per respondent: 10 hours

Estimated number of respondents: 42,030

Estimated frequency of responses: Annually.

The Treasury Department and the IRS expect to add the burden for this temporary OMB control number to OMB control numbers 1545-0123, 1545-0074, and 1545-0121 after the final rulemaking. For 1545-0123 and 1545-0074, the Treasury Department and the IRS estimate burdens on a taxpayer-type basis rather than a provision-specific basis.

III. *Regulatory Flexibility Act*

Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that the proposed regulations will not have a significant economic impact on a substantial number of small entities within the meaning of section 601(6) of the Regulatory Flexibility Act.

The proposed regulations provide guidance affecting individuals and corporations claiming foreign tax credits. The domestic small business entities that are subject to the foreign tax credit rules in the Code and in the proposed regulations are generally those that operate in a foreign country or that have income from sources outside of the United States and pay foreign taxes. The reattribution asset definition in proposed §1.861-20(d)(3)(v)(E)(*6*) applies only to taxable units that make or receive disregarded payments that are considered reattribution payments which result in the reattribution of assets from one taxable unit to another. §1.861-20(d)(3)(v)(C)(*1*)(*ii*). In addition, some provisions of these proposed regulations, such as proposed §1.903-1, apply only to entities that license intellectual property for use in a foreign country and receive royalty payments that are subject to foreign withholding tax. The Treasury Department and the IRS do not expect that the proposed regulations will likely affect a substantial number of domestic small business entities because it is infrequent for domestic small entities to engage in significant foreign operations or in the types of transactions giving rise to the foreign taxes addressed by these proposed regulations. However, the Treasury Department and the IRS do not have adequate data readily available to assess the number of small entities potentially affected by the final regulations.

The Treasury Department and the IRS have determined that the proposed regulations will not have a significant economic impact on domestic small business entities. To provide an upper bound estimate of the impact these final regulations could have on business entities, the Treasury Department and the IRS calculated, based on e-file data for the 2020 tax year, foreign tax credits as a percentage of four different tax-related measures of annual receipts (*see* Table 3 for variables) by corporations. As demonstrated by the data in Table 3 below, foreign tax credits as a percentage of all four measures of annual receipts are substantially less than the three to five percent threshold for significant economic impact for corporations with business receipts less than $250 million.

Table 3. FTCs as Percentage of Annual Receipts

Size (by Business Receipts)	Under $500k	$500k to $1M	$1M to $5M	$5M to $10M	$10M to $50M	$50M to $100M	$100M to $250M	$250M or more
FTC/Gross Receipts	0.00%	0.00%	0.00%	0.01%	0.01%	0.02%	0.03%	0.05%
FTC/Business Receipts	0.00%	0.00%	0.00%	0.00%	0.01%	0.02%	0.03%	0.05%
FTC/Total Income	0.00%	0.00%	0.00%	0.01%	0.02%	0.04%	0.07%	0.57%
FTC/(Total Income-Total Deductions)	–0.02%	0.03%	0.05%	0.11%	0.16%	0.41%	0.72%	3.33%
Source: RAAS:KDA (Tax Year 2020 CDW E-File Data 9-26-22)								
Note: Business Receipts = Total Income + Cost of Goods Sold								

The Treasury Department and the IRS anticipate that only a small fraction of existing foreign tax credits would be impacted by these regulations, and thus, the economic impact of these regulations will be considerably smaller than the effects shown in Table 3. A portion of economic impact of these proposed regulations derive from the collection of information requirement in proposed §1.903-1(c)(2)(iv)(D). The Treasury Department and the IRS do not have readily available data to determine the incremental burden that this collection of information will have on small business entities. However, the Treasury Department and the IRS believe this collection of information will only marginally increase taxpayers' burdens because some taxpayers may already have existing license agreements that qualify for the single-country exception for a variety of tax and non-tax law reasons, and other taxpayers may not elect to take advantage of the single-country exception. Furthermore, as demonstrated in Table 3 in this Part III of the Special Analyses, foreign tax credits do not have a significant economic impact for any gross-receipts class of business entities. Therefore, proposed §1.903-1(c)(2)(iv)(D) will not have a significant economic impact on small business entities. Accordingly, it is hereby certified that the proposed regulations will not have a significant economic impact on a substantial number of small entities.

IV. *Section 7805(f)*

Pursuant to section 7805(f), these proposed regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses. The Treasury Department and the IRS also request comments from the public on the certifications in this Part III of the Special Analyses.

V. *Unfunded Mandates Reform Act*

Section 202 of the Unfunded Mandates Reform Act of 1995 (UMRA) requires that agencies assess anticipated costs and benefits and take certain other actions before issuing a final rule that includes any Federal mandate that may result in expenditures in any one year by a state, local, or tribal government, in the aggregate, or by the private sector, of $100 million in 1995 dollars, updated annually for inflation. This proposed rule does not include any Federal mandate that may result in expenditures by state, local, or tribal governments, or by the private sector in excess of that threshold.

VI. *Executive Order 13132: Federalism*

Executive Order 13132 (entitled "Federalism") prohibits an agency from publishing any rule that has federalism implications if the rule either imposes substantial, direct compliance costs on State and local governments, and is not required by statute, or preempts State law, unless the agency meets the consultation and funding requirements of section 6 of the Executive order. This proposed rule does not have federalism implications and does not impose substantial direct compliance costs on state and local governments or preempt State law within the meaning of the Executive order.

Comments and Request for Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS as prescribed in this preamble under the **ADDRESSES** heading. The Treasury Department and the IRS request comments on all aspects of the proposed rules, and specifically on the issues identified in Parts I.B and II.C.3 of the Explanation of Provisions. All comments will be available at *www.regulations.gov* or upon request.

A public hearing will be scheduled if requested in writing by any person that timely submits written comments. Requests for a public hearing are encouraged to be made electronically. If a public hearing is scheduled, notice of the date and time for the public hearing will be published in the **Federal Register**. Announcement 2020-4, 2020-17 IRB 1, provides that until further notice, public hearings conducted by the IRS will be held telephonically. Any telephonic hearing will be made accessible to people with disabilities.

Drafting Information

The principal authors of the proposed regulations are Jeffrey L. Parry, Teisha M. Ruggiero, and Suzanne M. Walsh of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, the Treasury Department and IRS propose to amend 26 CFR part 1 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 1.861-20 is amended by revising paragraphs (d)(3)(v)(E)(*6*) and (i) to read as follows:

§1.861-20 Allocation and apportionment of foreign income taxes.

* * * * *

(d) * * *

(3) * * *

(v) * * *

(E) * * *

(*6*) *Reattribution asset*. The term *reattribution asset* means an asset that produces one or more items of gross income, computed under Federal income tax law, to which a disregarded payment, other than a disregarded payment received in exchange for property, is allocated under the rules of paragraph (d)(3)(v)(B)(*2*) of this section.

* * * * *

(i) *Applicability dates*. (1) Except as provided in paragraphs (i)(2) through (4) of this section, this section applies to taxable years beginning after December 31, 2019.

(2) Paragraphs (b)(19) and (23) and (d)(3)(i), (ii), and (v) of this section apply to taxable years that begin after December 31, 2019, and end on or after November 2, 2020.

(3) Paragraph (d)(3)(v)(E)(*6*) of this section applies to taxable years that end on or after [date the final rule is filed with the **Federal Register**]. Taxpayers may choose to apply the rules in paragraph (d)(3)(v)(E)(*6*) of this section to taxable years beginning after December 31, 2019, and ending before [date the final rule is filed with the **Federal Register**], provided they apply paragraph (d)(3)(v)(E)(*6*) of this section consistently to their first taxable year beginning after December 31, 2019, and any subsequent taxable year beginning before [date the final rule is filed with the **Federal Register**]. Otherwise, for taxable years beginning after December 31, 2019, and ending before [date the final rule is filed with the **Federal Register**], *see* §1.861-20(d)(3)(v)(E)(*6*) as contained in 26 CFR part 1 revised as of July 27, 2022.

(4) Paragraph (h) of this section applies to taxable years beginning after December 28, 2021.

Par 3. Section 1.901-2 is amended:

1. By revising paragraph (b)(4)(i)(A).
2. By redesignating paragraphs (b)(4)(i)(B), (b)(4)(i)(C)(*3*), and (b)(4)(i)(D) as paragraph (b)(4)(i)(G), (b)(4)(i)(D), and (b)(4)(i)(E), respectively.
3. By adding new paragraph (b)(4)(i)(B).
4. By revising paragraph (b)(4)(i)(C).
5. By revising the first sentence of newly redesignated paragraph (b)(4)(i)(D).
6. By adding paragraph (b)(4)(i)(F).
7. In newly redesignated paragraph (b)(4)(i)(G)(*1*), by removing the language "one or more significant costs and expenses" and adding the language "substantially all of each item of significant cost or expense" in its place.
8. In paragraph (b)(4)(iv)(A)(*2*), by removing the language "significant costs and expenses" and adding the

language “substantially all of each item of significant cost or expense” in its place.

9. In paragraph (b)(4)(iv)(B)(*2*), by removing the language “(b)(4)(i)(B)(*2*)” and adding the language “(b)(4)(i)(G)(*2*)” in its place.
10. By removing and reserving paragraph (b)(4)(iv)(C).
11. In paragraphs (b)(4)(iv)(D)(*2*) and (b)(4)(iv)(E)(*2*), by removing the language “(b)(4)(i)(C)(*2*)” and adding the language “(b)(4)(i)(F)(*2*)” in its place.
12. By adding paragraphs (b)(4)(iv)(F) through (J).
13. By revising paragraphs (b)(5)(i)(B)(*2*), (d)(1)(iii), and (h).

The revisions and additions read as follows:

§ 1.901-2 Income, war profits, or excess profits tax paid or accrued.

* * * * *

(b) * * *

(4) * * *

(i) * * *

(A) *In general*. A foreign tax satisfies the cost recovery requirement if the base of the tax is computed by reducing gross receipts (as described in paragraph (b)(3) of this section) to permit recovery of substantially all of each item of significant cost or expense (including each item of cost or expense related to the categories described in paragraph (b)(4)(i)(B)(*2*) of this section) attributable, under reasonable principles, to such gross receipts. *See* paragraph (b)(4)(i)(B) of this section for rules regarding the determination of what is a significant cost or expense, paragraph (b)(4)(i)(C) of this section for rules regarding the recovery of substantially all of an item, paragraph (b)(4)(i)(E) of this section for rules regarding principles for attributing costs and expenses to gross receipts, and paragraph (b)(4)(i)(F) of this section for exceptions to this rule. A foreign tax need not permit recovery of significant costs and expenses, such as certain personal expenses, that are not attributable, under reasonable principles, to gross receipts included in the foreign tax base. A foreign tax whose base is gross receipts, with no reduction for costs and expenses, satisfies the cost recovery requirement only if there are no significant costs and expenses described in paragraph (b)(4)(i)(B) of this section attributable to the gross receipts included in the foreign tax base. *See* paragraph (b)(4)(iv)(A) of this section (*Example 1*). A foreign tax that provides an alternative cost allowance satisfies the cost recovery requirement only as provided in paragraph (b)(4)(i)(G) of this section.

(B) *Significant costs and expenses*—(*1*) *In general*. Except as provided in paragraph (b)(4)(i)(B)(*2*) of this section, whether an item of cost or expense is significant for purposes of this paragraph (b)(4)(i) is determined based on whether, for all taxpayers in the aggregate to which the foreign tax applies, the item of cost or expense constitutes a significant portion of the taxpayers’ total costs and expenses.

(*2*) *Per se significant costs and expenses*. An item of cost or expense (as characterized under foreign law) related to capital expenditures, interest, rents, royalties, wages or other payments for services, and research and experimentation is always treated as an item of significant cost or expense for purposes of this paragraph (b)(4)(i).

(C) *Recovery of substantially all of each item*—(*1*) *In general*. Whether a foreign tax permits recovery of substantially all of each item of significant cost or expense is determined based solely on the terms of the foreign tax law.

(*2*) *Safe harbor*. One or more disallowances of a stated portion of an item (or multiple items) of significant cost or expense does not prevent a foreign tax from being considered to permit recovery of substantially all of each item of significant cost or expense if the total portion of the item (or items) that is disallowed does not exceed 25 percent. A limitation that caps the recovery of an item of significant cost or expense, or multiple items of cost or expense that relate to a single category of significant costs and expenses described in paragraph (b)(4)(i)(B)(*2*) of this section does not prevent a foreign tax from being considered to permit recovery of substantially all of each item of significant cost or expense if the limitation is a qualifying cap. For such purpose, a limitation that caps the recovery at a stated portion of gross receipts, gross income, or a similar measure is a qualifying cap if the stated portion of such measure is not less than 15 percent. A limitation that caps the recovery at a stated portion of taxable income (determined without regard to the item at issue) or a similar measure is a qualifying cap if the stated portion of such measure is not less than 30 percent.

(*3*) *Non-recovery of significant costs and expenses*. Significant costs and expenses (such as interest expense) are not considered to be recovered by reason of the time value of money attributable to the acceleration of a tax benefit or economic benefit attributable to the timing of the recovery of other costs and expenses (such as the current expensing of debt-financed capital expenditures).

(D) * * * A foreign tax law permits recovery of substantially all of each item of significant cost or expense even if such item of cost or expense is recovered earlier or later than it is recovered under the Internal Revenue Code unless the time of recovery is so much later as effectively to constitute a denial of such recovery. * * *

* * * * *

(F) *Exceptions*—(*1*) *Disallowances consistent with U.S. principles*. Notwithstanding paragraph (b)(4)(i)(A) of this section, a disallowance of all or a portion of an item of significant cost or expense does not prevent a foreign tax from satisfying the cost recovery requirement if such disallowance is consistent with any principle underlying the disallowances required under the income tax provisions of the Internal Revenue Code, including the principles of limiting base erosion or profit shifting and addressing non-tax public policy concerns similar to those reflected in the Internal Revenue Code. For example, a foreign tax may satisfy the cost recovery requirement even if the foreign tax law disallows deductions in connection with hybrid transactions, disallows deductions attributable to gross receipts that in whole or in part are excluded, exempt or eliminated from taxable income, or disallows certain deductions consistent with non-tax public policy considerations similar to those underlying the disallowances contained in section 162. *See* paragraphs (b)(4)(iv)(I) and (J) of this section (*Examples 9* and *10*).

(*2*) *Amounts that need not be recovered*. A foreign tax law may satisfy the cost recovery requirement even if the foreign tax law does not permit recovery of costs and expenses attributable to wage income or to investment income that is not derived from a trade or business. In addition, in determining whether a foreign tax (the "tested foreign tax") meets the cost recovery requirement, it is immaterial whether the tested foreign tax allows a deduction for other taxes that would qualify as foreign income taxes (determined without regard to whether such other tax allows a deduction for the tested foreign tax). *See* paragraphs (b)(4)(iv)(D) and (E) of this section (*Examples 4* and *5*).

* * * * *

(iv) * * *

(F) *Example 6: Substantially all; application of the safe harbor*—(*1*) *Facts*. Country X imposes a tax ("Country X tax") on the income of corporations that are resident in Country X. Under Country X tax law, full deductions are allowed for each item of significant cost or expense attributable under reasonable principles to the gross receipts included in the Country X tax base, except that Country X tax law disallows a deduction for 25 percent of a taxpayer's costs and expenses for royalties related to patents.

(*2*) *Analysis*. Under paragraph (b)(4)(i)(B)(*2*) of this section, an item of cost or expense related to royalties is always treated as a significant cost or expense, and therefore, under paragraph (b)(4)(i)(A) of this section, absent an exception, Country X tax law must permit recovery of substantially all of each item of cost or expense related to royalties, including the item of royalties related to patents. The stated percentage of costs and expenses from royalties related to patents (25 percent) that is disallowed under Country X tax law does not exceed 25 percent. Accordingly, under the safe harbor in paragraph (b)(4)(i)(C)(*2*) of this section, the disallowance does not prevent the Country X tax from being considered to permit recovery of substantially all of each item of cost or expense related to royalties, and therefore the Country X tax satisfies the cost recovery requirement.

(G) *Example 7: Substantially all; application of the safe harbor*—(*1*) *Facts*. Country X imposes a tax ("Country X tax") on the income of corporations that are resident in Country X. Under Country X tax law, full deductions are allowed for each item of significant cost or expense attributable under reasonable principles to the gross receipts included in the Country X tax base, except that Country X tax law disallows a deduction for 15 percent of a taxpayer's costs and expenses for rents and 25 percent of a taxpayer's costs and expenses for interest.

(*2*) *Analysis*. Under paragraph (b)(4)(i)(B)(*2*) of this section, an item of cost or expense related to rents or interest is always treated as a significant cost or expense, and therefore, under paragraph (b)(4)(i)(A) of this section, absent an exception, Country X tax law must permit recovery of substantially all of each item of cost or expense related to royalties and interest. The stated percentage of the costs and expenses related to rents (15 percent) that is disallowed under Country X tax law does not exceed 25 percent. Additionally, the stated percentage of the costs and expenses related to interest (25 percent) that is disallowed under Country X law does not exceed 25 percent. Accordingly, under the safe harbor in paragraph (b)(4)(i)(C)(*2*) of this section, the disallowances do not prevent the Country X tax from being considered to permit recovery of substantially all of each item of cost or expense related to rents and interest, and therefore the Country X tax satisfies the cost recovery requirement.

(H) *Example 8: Substantially all; application of the safe harbor*—(*1*) *Facts*. Country X imposes a tax ("Country X tax") on the income of corporations that are resident in Country X. Under Country X tax law, full deductions are allowed for each item of significant cost or expense attributable under reasonable principles to the gross receipts included in the Country X tax base, except that Country X tax law caps the recovery of the deduction of interest at 30 percent of the taxpayer's taxable income determined without regard to interest expense.

(*2*) *Analysis*. Under paragraph (b)(4)(i)(B)(*2*) of this section, an item of cost or expense related to interest is always treated as a significant cost or expense, and therefore, under paragraph (b)(4)(i)(A) of this section, absent an exception, Country X tax law must permit recovery of substantially all of each item of cost or expense related to interest. The stated cap on recovery in Country X tax law with respect to interest (30 percent of taxable income determined without regard to interest expense) is not less than 30 percent of taxable income determined without regard to interest expense. Additionally, the cap on recovery relates to a single category of significant costs and expenses described in paragraph (b)(4)(i)(B)(*2*) of this section. Accordingly, under the safe harbor in paragraph (b)(4)(i)(C)(*2*) of this section, the disallowance does not prevent the Country X tax from being considered to permit recovery of substantially all of each item of cost or expense related to interest, and therefore the Country X tax satisfies the cost recovery requirement.

(I) *Example 9: Permissible disallowance based on U.S. principles*—(*1*) *Facts.* Country X imposes a tax on the income of corporations that are resident in Country X. Under Country X tax law, full deductions are allowed for each item of significant cost or expense attributable under reasonable principles to the gross receipts included in the Country X tax base, except that under Country X's anti-hybrid rules, a deduction is disallowed for any payment, including interest, royalties, rents, or payments for services, made by a Country X resident to a related entity located outside of Country X if the payment is not included in gross income by the payee or the payee is not subject to tax.

(*2*) *Analysis*. Under paragraph (b)(4)(i)(B)(*2*) of this section, each item of cost or expense related to interest, rents, royalties, and payments for services is always treated as a significant cost or expense, and therefore, under paragraph (b)(4)(i)(A) of this section, absent an exception, Country X tax law must permit recovery of substantially all of each item of cost or expense related to interest, rents, royalties, and payments for services. Country X tax law does not permit recovery of any portion of any item of significant cost or expense that is subject to the anti-hybrid rules. As a result, the safe harbor in paragraph (b)(4)(i)(C)(*2*) of this section does not apply to such item. Further, because a deduction is disallowed for any item of cost or expense that is subject to the Country X anti-hybrid rules, the Country X tax law completely disallows certain items of cost and expense related to interest, rents, royalties, and payments for services and thus does not permit recovery of substantially all of each item of significant cost or expense related to interest, rents, royalties, and payments for services. However, under paragraph (b)(4)(i)(F)(*1*) of this section, a disallowance of all or a portion of an item of significant cost or expense does not prevent a foreign tax from satisfying the cost recovery requirement if the disallowance is consistent with any principle underlying the disallowances required under the income tax provisions of the Internal Revenue Code. The income tax provisions of the Internal Revenue Code, specifically section 267A, contain disallowances of deductions based on the principle of limiting base erosion or profit shifting. Country X's disallowance of deductions for any payment, including interest, royalties, rents, or payments for services also reflects the principle of limiting base erosion or profit shifting. Accordingly, because Country X's anti-hybrid rules are consistent with the principle of limiting base erosion or profit shifting, the Country X tax satisfies the cost recovery requirement.

(J) *Example 10: Permissible disallowance based on U.S. principles*—(*1*) *Facts*. Country X imposes a tax on the income of corporations that are resident in Country X. Under Country X tax law, full deductions are allowed for each item of significant cost or expense attributable to the gross receipts included in the Country X tax base, except that no deduction is permitted for any stock-based payments for services.

(*2*) *Analysis*. Under paragraph (b)(4)(i)(B)(*2*) of this section, each item of cost or expense related to wages or other payments for services is always treated as a significant cost or expense, and therefore, under paragraph (b)(4)(i)(A) of this section, absent an exception, Country X tax law must permit recovery of substantially all of each item of cost or expense related to wages or other payments for services. Country X tax law denies a deduction for any stock-based payments for services, and therefore the safe harbor in paragraph (b)(4)(i)(C)(*2*) of this section is not satisfied. Further, given that no deduction is allowed for stock-based payments for services, the Country X tax law completely disallows an item of cost or expense related to wages or other payments for services and thus does not permit recovery of substantially all of each item of significant cost or expense related to wages or other payments for services. However, under paragraph (b)(4)(i)(F)(*1*) of this section, a disallowance of all or a portion of an item of significant cost or expense does not prevent a foreign tax from satisfying the cost recovery requirement if such disallowance is consistent with any principle underlying the disallowances required under the income tax provisions of the Internal Revenue Code. The income tax provisions of the Internal Revenue Code contain targeted disallowances or limits on the deductibility of certain items of compensation in particular circumstances based on non-tax public policy reasons, including to influence the amount or use of a certain type of compensation in the labor market. For example, section 162(m) imposes limits on deductions for compensation of certain highly-paid employees, and section 280G limits the deductibility of certain "parachute payments" provided to individuals when an entity undergoes a change of control. Country X's targeted disallowance of deductions for the portion of payments for services attributable to stock-based compensation also reflects a principle of influencing the amount or use of a certain type of compensation (stock-based compensation) in the labor market. Accordingly, because the Country X tax law's disallowance is consistent with a principle underlying the disallowances required under the income tax provisions of the Internal Revenue Code, the Country X tax satisfies the cost recovery requirement.

(5) * * *

(i) * * *

(B) * * *

(*2*) *Royalties*. Under the foreign tax law, gross income from royalties must be sourced based on the place of use of, or the right to use, the intangible property, as determined under reasonable principles (which do not include determining the place of use of, or the right to use, the intangible property based on the location of the payor).

* * * * *

(d) * * *

(1) * * *

(iii) *Tax imposed on nonresidents*—(A) *In general*. A foreign levy imposed on nonresidents is always treated as a separate levy from that imposed on residents, even if the base of the tax as applied to residents and nonresidents is the same, and even if the levies are treated as a single levy under foreign tax law.

(B) *Withholding tax*—(*1*) *In general*. Except as otherwise provided in this paragraph (d)(1)(iii)(B), a withholding tax (as defined in section 901(k)(1)(B)) that is imposed on a payment giving rise to gross income of nonresidents is treated as a separate levy as to each separate class of income described in section 61 (for example, interest, dividends, rents, or royalties) subject to the withholding tax.

(*2*) *Subsets of income*. If two or more subsets of a separate class of income are subject to a withholding tax based on different income attribution rules (for example, if technical services are subject to tax based on the residence of the payor and other services are subject to tax based on where the services are performed), separate levies are considered to be imposed with respect to each subset of that separate class of income.

(*3*) *Royalty income*. A withholding tax that is imposed on a payment giving rise to gross royalty income of a nonresident that is made pursuant to a single-country license (as determined under §1.903-1(c)(2)(iv)) is treated as a separate levy from a withholding tax that is imposed on other gross royalty income of such nonresident and is also treated as a separate levy from any withholding tax imposed on other nonresidents.

* * * * *

(h) *Applicability dates*—(1) *In general*. Except as provided in paragraphs (h)(2) and (3) of this section, this section applies to foreign taxes paid (within the meaning of paragraph (g) of this section) in taxable years beginning on or after December 28, 2021. For foreign taxes that relate to (and if creditable are considered to accrue in) taxable years beginning before December 28, 2021, and that are remitted in taxable years beginning on or after December 28, 2021, by a taxpayer that accounts for foreign income taxes on the accrual basis, *see* §1.901-2 as contained in 26 CFR part 1 revised as of April 1, 2021.

(2) *Certain foreign taxes paid to Puerto Rico*. For foreign taxes paid to Puerto Rico by reason of section 1035.05 of the Puerto Rico Internal Revenue Code of 2011, as amended (13 L.P.R.A. 30155) (treating certain income, gain or loss as effectively connected with the active conduct of a trade or business with Puerto Rico), this section applies to foreign taxes paid (within the meaning of paragraph (g) of this section) in taxable years beginning on or after January 1, 2023. For foreign taxes described in the preceding sentence that are paid in taxable years beginning before January 1, 2023, *see* §1.901-2 as contained in 26 CFR part 1 revised as of April 1, 2021.

(3) *Modifications to cost recovery and royalty attribution rules*. Paragraphs (b)(4)(i) and (iv), (b)(5)(i)(B)(*2*), and (d)(1)(iii) of this section apply to foreign taxes paid (within the meaning of paragraph (g) of this section) in taxable years ending on or after November 18, 2022. For foreign taxes described in the preceding sentence that are paid in taxable years ending before November 18, 2022, *see* §1.901-2(b)(4)(i) and (iv), (b)(5)(i)(B)(*2*), and (d)(1)(iii) as contained in 26 CFR part 1 revised as of July 27, 2022. Taxpayers may choose to apply the rules in paragraphs (b)(4)(i) and (iv) of this section to foreign taxes paid in taxable years beginning on or after December 28, 2021, and ending before November 18, 2022 provided that they consistently apply those rules to such taxable years. Additionally, taxpayers may choose to apply the rules of paragraphs (b)(5)(i)(B)(*2*) and (d)(1)(iii) of this section to foreign taxes paid in taxable years beginning on or after December 28, 2021, and ending before November 18, 2022, provided that they consistently apply those rules and the rules of §1.903-1(c)(2) and (d)(3), (4), and (8) through (11) to such taxable years.

* * * * *

Par 4. Section 1.903-1 is amended:

1. By revising paragraphs (c)(2) introductory text and (c)(2)(iii).
2. By adding paragraph (c)(2)(iv).
3. By revising paragraph (d)(3).
4. By removing and reserving paragraph (d)(4).
5. By adding paragraphs (d)(8) through (11).
6. By revising paragraph (e).

The revisions and additions read as follows:

§ 1.903-1 Taxes in lieu of income taxes.

* * * * *

(c) * * *

(2) *Covered withholding tax*. A tested foreign tax is a covered withholding tax if, based on the foreign tax law (except as provided in paragraph (c)(2)(iii)(B) of this section), the requirements in paragraphs (c)(1)(i) and (c)(2)(i) through (iii) of this section are met with respect to the tested foreign tax. *See* also §1.901-2(d)(1)(iii) for rules treating withholding taxes as separate levies with respect to each class of income subject to the tax, with respect to each subset of a class of income that is subject to different income attribution rules, or with respect to withholding tax that is imposed on a payment giving rise to gross royalty income of a nonresident that is made pursuant to a single-country license (as determined under paragraph (c)(2)(iv) of this section).

* * * * *

(iii) *Source-based attribution requirement*. The income subject to the tested foreign tax satisfies the requirements in paragraph (c)(2)(iii)(A) or (B) of this section.

(A) The income subject to the tested foreign tax satisfies the attribution requirement described in §1.901-2(b)(5)(i)(B).

(B) The income subject to the tested foreign tax is characterized as royalty income and the payment giving rise to such income is made pursuant to a single-country license as determined under paragraph (c)(2)(iv) of this section. For purposes of this paragraph (c)(2)(iii)(B) and paragraph (c)(2)(iv) of this section, whether the income is characterized as royalty income is determined under the foreign tax law, except that income from the sale of a copyrighted article (as determined under rules similar to §1.861-18) is not characterized as royalty income regardless of the characterization of the income under the foreign tax law.

(iv) *Single-country license*—(A) *In general*. Except as otherwise provided in this paragraph (c)(2)(iv), for purposes of paragraph (c)(2)(iii)(B) of this section, a payment is made pursuant to a single-country license if the terms of the license agreement pursuant to which the payment is made characterize the payment as a royalty and limit the territory of the license to the foreign country imposing the tested foreign tax.

(B) *Separately stated portions*. If a written agreement that is not described in paragraph (c)(2)(iv)(A) of this section separately states a portion (whether as a specified amount or as a formula) of the payment subject to the tested foreign tax and such portion is both characterized as a royalty under the terms of the agreement and is attributable to the part of the territory of the license that is solely within the foreign country imposing the tested foreign tax, then that portion of the payment is treated as made pursuant to a single-country license.

(C) *Validity of agreement*. A payment is considered not made pursuant to a single-country license if the taxpayer knows, or has reason to know, that the terms of the agreement pursuant to which the payment is made misstate the territory in which the relevant intangible property is used or overstate the amount of the royalty with respect to the part of the territory of the license that is solely within the foreign country imposing the tested foreign tax. A taxpayer is considered to have reason to know if its knowledge of relevant of facts or circumstances is such that a reasonably prudent person in the position of the taxpayer would question whether the terms of the agreement misstate the territory in which the relevant intangible property is used or overstate the amount of a royalty. For purposes of this section, the principles of sections 482 and 861 apply to determine whether the terms of the agreement misstate the territory in which the relevant intangible property is used or overstate the amount of a royalty. *See* paragraph (d)(11) of this section (*Example 11*).

(D) *Documentation*. A taxpayer must provide the agreement described in paragraph (c)(2)(iv)(A) or (B) of this section, as applicable (the "required agreement"), within 30 days of a request by the Commissioner or another period as agreed between the Commissioner and the taxpayer. Except as provided in the next sentence, the required agreement pursuant to which the royalty is paid must be executed no later than the date of payment that gives rise to the gross royalty income that is subject to the tested foreign tax. In the case of a royalty that is paid before the date on which the required agreement is executed, in order to meet the requirement of this paragraph (c)(2)(iv)(D), the required agreement must be executed no later than May 17, 2023, and the agreement must state that royalties paid on or before the date of execution of the agreement are, for purposes of this paragraph (c)(2)(iv), considered paid pursuant to the terms of the agreement.

(d) * * *

(3) *Example 3: Withholding tax on royalties; attribution requirement*—(i) *Facts*. YCo, a resident of Country Y, is a controlled foreign corporation wholly owned by USP, a domestic corporation. In Year 1, YCo enters into a written license agreement (the "Agreement") with XCo, a resident of Country X unrelated to YCo or USP, for the right to use YCo's intangible property ("IP") in a territory defined by the Agreement as the entire world, including Country X, in exchange for payments that the terms of the Agreement characterize as royalties. The payments made by XCo to YCo under the Agreement are also characterized as royalties under the laws of Country X. Under Country X's tax law, all gross royalty payments made by a Country X resident to a nonresident are treated as giving rise to Country X source income and are subject to a 20 percent withholding tax, regardless of whether the nonresident payee has a taxable presence in Country X. Country X has a generally-imposed net income tax within the meaning of paragraph (c)(1)(i) of this section, and nonresidents subject to the withholding tax on royalties are not also subject to a Country X net income tax on their royalty income. In Year 1, XCo withholds 20u (units of Country X currency) of tax on a 100u royalty paid to YCo under the Agreement.

(ii) *Analysis*—(A) *Separate levy*. Under §1.901-2(d)(1)(iii)(B)(*1*), Country X's withholding tax imposed on gross royalty income of nonresidents is treated as a separate levy. Under §1.901-2(d)(1)(iii)(B)(*3*), the 20u of Country X withholding tax imposed on the 100u of royalties paid by XCo to YCo is treated as a separate levy from the Country X withholding tax on royalties if the Agreement pursuant to which the royalties are paid is a single-country license under paragraph (c)(2)(iv) of this section. The Agreement does not meet the requirements of paragraph (c)(2)(iv) of this section because it neither limits the territory of the license to Country X nor separately states the portion of the payment that is with respect to the part of the territory of the license that is solely within Country X. Thus, the 20u of Country X withholding tax paid by YCo is not treated as a separate levy under §1.901-2(d)(1)(iii)(B)(*3*).

(B) *Covered withholding tax*. Under paragraph (c)(2) of this section, a tested foreign tax is a covered withholding tax if paragraphs (c)(1)(i) and (c)(2)(i) through (iii) of this section are met. Country X's withholding tax on royalties meets the requirements of paragraphs (c)(1)(i) and (c)(2)(i) and (ii) of this section because Country X has a generally-imposed net income tax, Country X's withholding tax on the royalties paid pursuant to the Agreement is imposed on the gross royalty income of persons who are nonresidents of Country X, and nonresidents subject to the withholding tax on royalties are not also subject to the Country X generally-imposed net income tax on their royalty income. However, the Country X withholding tax on royalties paid pursuant to the Agreement does not meet the requirements of §1.901-2(b)(5)(i)(B) and paragraph (c)(2)(iii)(A) of this section because Country X's sourcing rule for royalties (based on residence of the payor) is not based on the place of use of, or the right to use, the intangible property. Additionally, the payment that is subject to Country X's withholding tax is not made pursuant to a single-country license under paragraph (c)(2)(iv) of this section for the reasons described in paragraph (d)(3)(ii)(A) of this section (the separate levy analysis of this paragraph (d)(3) (*Example 3*)). Therefore, the requirement in paragraph (c)(2)(iii)(B) of this section is not met. Accordingly, the Country X withholding tax paid by YCo is not a covered withholding tax, and none of the 20u Country X withholding tax paid by YCo with respect to the 100u royalty payment made to XCo is a foreign income tax.

* * * * *

(8) *Example 8: Withholding tax on royalties; single-country license*—(i) *Facts*. The facts are the same as in paragraph (d)(3)(i) of this section (the facts of *Example 3*) except that in Year 1, YCo enters into a written license agreement (the "Agreement") with XCo for the right to use YCo's IP in a territory defined by the Agreement as Country X, in exchange

for payments that the terms of the Agreement characterize as royalties, and XCo in fact only uses the IP in Country X. In Year 1, XCo withholds 20u of tax from 100u of royalties paid to YCo under the Agreement.

(ii) *Analysis*—(A) *Separate levy*. Under §1.901-2(d)(1)(iii)(B)(*1*), Country X's withholding tax imposed on gross royalty income of nonresidents is treated as a separate levy. Under §1.901-2(d)(1)(iii)(B)(*3*), the 20u of Country X withholding tax imposed on the 100u of royalties paid by XCo to YCo is treated as a separate levy from the Country X withholding tax on royalties if the Agreement pursuant to which the royalties are paid is a single-country license under paragraph (c)(2)(iv) of this section. The Agreement meets the requirements of paragraph (c)(2)(iv)(A) of this section because it is a written license agreement that characterizes the payment as a royalty and limits the territory of the license to Country X. Thus, the 20u Country X withholding tax paid by YCo is treated as a separate levy under §1.901-2(d)(1)(iii)(B)(*3*).

(B) *Covered withholding tax*. Under paragraph (c)(2) of this section, a tested foreign tax is a covered withholding tax if paragraphs (c)(1)(i) and (c)(2)(i) through (iii) of this section are met. Country X has a generally-imposed net income tax, Country X's withholding tax on the royalties paid pursuant to the Agreement is a withholding tax that is imposed on the gross income of persons who are nonresidents of Country X, and nonresidents subject to the withholding tax on royalties paid pursuant to the Agreement are not also subject to a net income tax on their royalty income. Thus, the requirements of paragraphs (c)(1)(i) and (c)(2)(i) and (ii) of this section are met. The withholding tax paid by YCo does not meet the requirements of §1.901-2(b)(5)(i)(B) and paragraph (c)(2)(iii)(A) of this section because Country X's source rule for royalties (based on residence of the payor) is not based on the place of use of, or the right to use, the intangible property. However, the payment that is subject to Country X's withholding tax is made pursuant to a single-country license under paragraph (c)(2)(iv) of this section for the reasons described in paragraph (d)(8)(ii)(A) of this section (the separate levy analysis of this *Example 8*). Therefore, the requirement in paragraph (c)(2)(iii)(B) of this section is met. Accordingly, the Country X withholding tax on the payment made by XCo to YCo pursuant to the Agreement is a covered withholding tax and all of the 20u of Country X withholding tax paid by YCo with respect to the 100u of royalties under the Agreement is a foreign income tax.

(9) *Example 9: Withholding tax on royalties; separately stated portion*—(i) *Facts*. The facts are the same as in paragraph (d)(3)(i) of this section (the facts of *Example 3*) except that in Year 1, YCo enters into a written agreement (the "Agreement") with XCo for the right to use YCo's IP in a territory defined by the Agreement as the entire world, as well as for YCo to provide certain services to XCo in Country Y, in exchange for a payment equal to 10 percent of XCo's annual revenue. The Agreement provides a formula for determining the amount of the payment that is characterized as a royalty and that is with respect to the part of the territory that is within Country X (the "separately stated formula"). The separately stated formula provides that the first 30u of the payment represents payment for services provided by YCo, and that 40 percent of the remainder of the payment represents payment of a royalty with respect to the part of the territory of the license that is solely within Country X. The portion of the payment by XCo to YCo that is characterized as services income under the Agreement is also characterized as services income under the laws of Country X. Additionally, all payments by a resident of Country X for services provided by a nonresident are treated as giving rise to Country X source income, regardless of where the services are performed, and gross income from services is subject to the same 20 percent withholding tax as gross royalty income. In Year 1, XCo earns gross income of 1,800u and pays YCo 180u under the Agreement. XCo withholds 12u of tax from the 60u of royalties attributable to the part of the territory of the license that is solely within Country X that are paid to YCo under the separately stated formula in the Agreement. The portion of the payment by XCo to YCo that is characterized as a royalty with respect to the part of the territory of the license that is solely within Country X under the separately stated formula in the Agreement is also characterized as a royalty under the laws of Country X. XCo withholds 24u of tax from the remaining 120u payment paid to YCo under the Agreement, consisting of 6u of tax on the 30u payment for services and 18u of tax on 90u of royalties. YCo does not know, or have reason to know, that the terms of the Agreement misstate the territory in which YCo's IP is used or overstate the amount of the royalty with respect to the part of the territory of the license that is solely within Country X.

(ii) *Analysis*—(A) *Separately stated portion*. The analysis is the same as in paragraph (d)(8)(ii) of this section (the analysis of *Example 8*), except that the portion of the payment that is a royalty with respect to the part of the territory of the license that is solely within Country X under the separately stated formula in the Agreement is treated as made pursuant to a single-country license under paragraph (c)(2)(iv) of this section because the Agreement is a written agreement that separately states the portion of the payment that is characterized as a royalty and that is with respect to the part of the territory of the license that is solely within Country X. Thus, the Country X withholding tax on the portion of the payment from XCo to YCo that is a payment of a royalty with respect to the part of the territory of the license that is solely within Country X under the separately stated formula under the Agreement is a separate levy and a covered withholding tax. Accordingly, the 12u Country X withholding tax paid by YCo from the 60u of royalties with respect to the part of the territory of the license that is solely within Country X is a foreign income tax.

(B) *Remaining portion of royalties*. The analysis is the same as paragraph (d)(3)(ii) of this section (the analysis of *Example 3*). Specifically, the 18u Country X withholding tax on the 90u royalty payment that is not with respect to the part of the territory that is within Country X is neither a separate levy nor a covered withholding tax. Accordingly, none of the 18u Country X withholding tax paid by YCo with respect to the remaining 90u royalty payment under the Agreement is a payment of foreign income tax.

(C) *Services portion*. Under §1.901-2(d)(1)(iii)(B)(*1*), Country X's withholding tax imposed on gross services income of nonresidents is a separate levy. The Country X withholding tax of 6u on the 30u payment for services made by XCo to YCo under the Agreement is not a covered withholding tax. The withholding tax paid by YCo does not meet the requirements of §1.901-2(b)(5)(i)(B) and paragraph (c)(2)(iii)(A) of this section because Country X's sourcing rule for services (based on residence of the payor) is not reasonably similar to the sourcing rule that applies under the Internal Revenue Code (based on where the services are performed). The special separate levy and covered withholding tax rules for single-country licenses under §1.901-2(d)(1)(iii)(B)(*3*) and paragraph (c)(2)(iii)(B) of this section do not apply to withholding taxes on payments for services. Accordingly, none of the 6u of Country X withholding tax paid by YCo with respect to the 30u payment for services under the Agreement is a payment of foreign income tax.

(10) *Example 10: Characterization of payment*—(i) *Facts*. The facts are the same as in paragraph (d)(3)(i) of this section (the facts of *Example 3*), except that in Year 1, YCo enters into a written license agreement (the "Agreement") with XCo for the right to use YCo's IP in a territory defined by the Agreement as Country X, in exchange for a payment that the terms of the Agreement characterize as a royalty, but that is characterized as a payment for services under the laws of Country X, and all payments of services paid by a resident of Country X to a nonresident are treated as giving rise to Country X source income, regardless of where the services are performed, and are subject to a 20 percent withholding tax.

(ii) *Analysis*. Under §1.901-2(d)(1)(iii)(B)(*1*), Country X's withholding tax imposed on gross services income of nonresidents is a separate levy. The Country X withholding tax of 20u on the 100u payment for services made by XCo to YCo under the Agreement is not a covered withholding tax. The withholding tax paid by YCo does not meet the requirements of §1.901-2(b)(5)(i)(B) and paragraph (c)(2)(iii)(A) of this section because Country X's sourcing rule for services (based on residence of the payor) is not reasonably similar to the sourcing rule that applies under the Internal Revenue Code (based on where the services are performed). The special separate levy and covered withholding tax rules for single-country licenses under §1.901-2(d)(1)(iii)(B)(*3*) and paragraph (c)(2)(iii)(B) of this section do not apply to withholding taxes on income that is not characterized as royalty income under the foreign tax law. Accordingly, none of the 20u Country X withholding tax paid by YCo with respect to the 100u paid under the Agreement is a payment of foreign income tax.

(11) *Example 11: Withholding tax on royalties, validity of agreement*—(i) *Facts*. The facts are the same as in paragraph (d)(3)(i) of this section (the facts of *Example 3*), except that XCo is a controlled foreign corporation wholly owned by USP. Additionally, in Year 2, XCo and YCo cancel the written license agreement entered into in Year 1 and YCo enters into two new written license agreements with XCo, one agreement which grants XCo the right to use certain YCo IP in a territory defined as Country X (the "Country X Agreement"), and one of which grants XCo the right to use the same YCo IP

in a territory defined as the entire world except for Country X (the "Rest of World Agreement"). Both agreements characterize the payments under the agreements as royalties, and the payments are also characterized as royalties under the laws of Country X. In Year 2, XCo withholds a total of 20u of tax from a total of 100u of royalties paid to YCo under the Country X Agreement and the Rest of World Agreement. Based on the terms of each agreement, 18u of tax was withheld from 90u of royalties paid to YCo under the Country X Agreement, and 2u of tax from 10u of royalties paid to YCo under the Rest of World Agreement. YCo knew or had reason to know that under the principles of sections 482 and 861, with respect to the 100u of royalties paid by XCo to YCo, 40u is attributable to XCo's use of YCo IP in Country X and 60u is attributable to use of YCo IP outside Country X.

(ii) *Analysis*—(A) *Rest of World Agreement*. The analysis is the same as paragraph (d)(3)(ii) of this section (the analysis of *Example 3*). Specifically, the 2u Country X withholding tax on the 10u royalty payment under the Rest of World Agreement is neither a separate levy nor a covered withholding tax. Accordingly, none of the 2u Country X withholding tax paid by YCo with respect to the 10u royalty payment under the Rest of World Agreement is a payment of foreign income tax.

(B) *Country X Agreement*. The analysis is the same as paragraph (d)(3)(ii) of this section (the analysis of *Example 3*), except that the reason that the Country X Agreement does not meet the requirements of paragraph (c)(2)(iv) of this section is that YCo knew or had reason to know that the terms of the Country X Agreement overstate the amount of the royalty with respect to Country X. Thus, the 18u Country X withholding tax on the 90u royalty payment under the Country X Agreement is neither a separate levy nor a covered withholding tax. Accordingly, none of the 18u Country X withholding tax paid by YCo with respect to the 90u royalty payment under the Country X Agreement is a payment of foreign income tax.

(e) *Applicability dates*—(1) *In general*. Except as provided in paragraphs (e)(2) and (3) of this section, this section applies to foreign taxes paid (within the meaning of §1.901-2(g)) in taxable years beginning on or after December 28, 2021. For foreign taxes that relate to (and if creditable are considered to accrue in) taxable years beginning before December 28, 2021, and that are remitted in taxable years beginning on or after December 28, 2021, by a taxpayer that accounts for foreign income taxes on the accrual basis, *see* §1.903-1 as contained in 26 CFR part 1 revised as of April 1, 2021.

(2) *Certain foreign taxes paid to Puerto Rico*. For foreign taxes paid to Puerto Rico under section 3070.01 of the Puerto Rico Internal Revenue Code of 2011, as amended (13 L.P.R.A. 31771) (imposing an excise tax on a controlled group member's acquisition from another group member of certain personal property manufactured or produced in Puerto Rico and certain services performed in Puerto Rico), this section applies to foreign taxes paid (within the meaning of §1.901-2(g)) in taxable years beginning on or after January 1, 2023. For foreign taxes described in the preceding sentence that are paid in taxable years beginning before January 1, 2023, *see* §1.903-1 as contained in 26 CFR part 1 revised as of April 1, 2021.

(3) *Modifications to the covered withholding tax rules*. Paragraphs (c)(2) and (d)(3), (4), and (8) through (11) of this section apply to foreign taxes paid (within the meaning of §1.901-2(g)) in taxable years ending on or after November 18, 2022. For foreign taxes that are paid in taxable years ending before November 18, 2022, *see* §1.903-1(c)(2) and (d)(3) and (4) as contained in 26 CFR part 1 revised as of July 27, 2022. Taxpayers may choose to apply the rules in paragraphs (c)(2) and (d)(3), (4), and (8) through (11) of this section to foreign taxes paid in taxable years beginning on or after December 28, 2021, and ending before November 18, 2022, provided that they consistently apply those rules and the rules of §1.901-2(b)(5)(i)(B)(*2*) and (d)(1)(iii) to such taxable years.

Melanie R. Krause,
Acting Deputy Commissioner for Services and Enforcement.

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Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2021–27 through 2021–52 is in Internal Revenue Bulletin 2021–52, dated December 27, 2021.

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2021–27 through 2021–52 is in Internal Revenue Bulletin 2021–52, dated December 27, 2021.

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We Welcome Comments About the Internal Revenue Bulletin

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