



[4830-01-p]

## DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9572]

RIN 1545-BK53

Dividend Equivalents from Sources within the United States.

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations relating to dividend equivalents for purposes of section 871(m) of the Internal Revenue Code (Code). The regulations provide guidance to nonresident aliens and foreign corporations that hold notional principal contracts (NPCs) providing for payments determined by reference to payments of dividends from sources within the United States. The text of the temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules Section in this issue of the **Federal Register**.

DATES: Effective Date: These regulations are effective **[INSERT DATE THIS DOCUMENT IS PUBLISHED IN THE FEDERAL REGISTER]**.

Applicability Date: For dates of applicability, see §§ 1.863-7T(f), 1.871-16T(g), 1.881-2T(f), 1.1441-2T(g), 1.1441-3T(k), 1.1441-4T(h), 1.1441-7T(h), and 1.1461-1T(j).

FOR FURTHER INFORMATION CONTACT: Mark E. Erwin or D. Peter Merkel at (202) 622-3870 (not a toll-free number).

## SUPPLEMENTARY INFORMATION:

### **Background**

This document contains temporary regulations under section 871(m). Congress enacted section 871(m) (originally designated as section 871(l)) on March 18, 2010 in section 541 of the Hiring Incentives to Restore Employment Act (HIRE Act), Public Law 111-147 (124 Stat. 71).

Section 871(m) applies to securities loans, sale-repurchase transactions (repos), certain NPCs defined as “specified notional principal contracts” (specified NPCs), and any similar transactions that provide for a payment contingent upon or determined by reference to a U.S. source dividend (dividend equivalent). Section 871(m) treats a dividend equivalent as a dividend from sources within the United States for purposes of sections 871(a), 881, and 4948(a), and chapters 3 and 4 of subtitle A of the Code. Section 871(m) generally applies to any dividend equivalent made after September 14, 2010. With respect to payments made after March 18, 2012, section 871(m)(3)(B) provides that any NPC will be a specified NPC unless the Secretary determines that such contract is of a type which does not have the potential for tax avoidance.

Notice 2010-46, 2010-24 IRB 757, outlined a proposed framework for limiting withholding in the case of a series of securities lending or sale-repurchase transactions. While the Treasury Department and the IRS anticipate issuing proposed regulations addressing the issues raised in Notice 2010-46, these regulations do not address these concerns. See §601.601(d)(2).

### **Explanation of Provisions**

Section 1.871-16T(b) of these temporary regulations incorporates the definition of a specified NPC as provided in section 871(m)(3)(A). These temporary regulations extend the applicability of the section 871(m)(3)(A) statutory definition of a specified NPC through December 31, 2012. Proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules Section in this issue of the **Federal Register** outline the proposed treatment of dividend equivalents under section 871(m) beginning January 1, 2013. The Treasury Department and the IRS believe that an extension of the statutory definition of the term specified NPC is necessary to allow taxpayers and withholding agents to modify their systems and other operating procedures to comply with the rules described in the notice of proposed rulemaking.

These temporary regulations also amend several regulations to clarify the application of section 871(m). For example, temporary regulations modify §1.863-7 to provide that that section does not apply to a dividend equivalent under section 871(m). Section 1.881-2T(b)(3) provides that section 871(m) and §1.871-16T apply to dividend equivalents received by foreign corporations. Certain regulations under section 1441 have been amended to require a withholding agent to withhold tax owed with respect to a dividend equivalent.

Notwithstanding these temporary regulations, the Commissioner may challenge transactions that are designed to avoid the application of these rules under applicable judicial doctrines. Nothing in these rules precludes the Commissioner from asserting that a contract labeled as an NPC or other equity derivative is in fact an ownership interest in the equity referenced in the contract.

### **Special Analyses**

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), refer to the special analyses section of the preamble to the cross-reference notice of proposed rulemaking published in the proposed rules section in this issue of the **Federal Register**. Pursuant to section 7805(f) of the Code, these temporary regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on the impact on small businesses.

#### **Drafting Information**

The principal author of these regulations is D. Peter Merkel, the Office of Associate Chief Counsel (International). 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.

#### **Amendments to the Regulations**

Accordingly, 26 CFR part 1 is amended as follows:

##### **PART 1-- INCOME TAXES**

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 871(m) and 7805 \* \* \*

Par. 2. Section 1.863-7 is amended by revising paragraph (a)(1) to read as follows:

§1.863-7 Allocation of income attributable to certain notional principal contracts under section 863(a).

(a) Scope--(1) Introduction. [Reserved]. For further guidance, see §1.863-7T(a)(1).

\* \* \* \* \*

Par. 3. Section 1.863-7T is added as follows:

§1.863-7T Allocation of income attributable to certain notional principal contracts under section 863(a) (temporary).

(a) Scope--(1) Introduction. This section provides rules relating to the source and, in certain cases, the character of notional principal contract income. However, this section does not apply to income from a section 988 transaction within the meaning of section 988 and the regulations thereunder, relating to the treatment of certain nonfunctional currency transactions. Further, this section does not apply to a dividend equivalent as defined in section 871(m) or §1.871-15. Notional principal contract income is income attributable to a notional principal contract as defined in §1.446-3(c). An agreement between a taxpayer and a qualified business unit (as defined in section 989(a)) of the taxpayer, or among qualified business units of the same taxpayer, is not a notional principal contract, because a taxpayer cannot enter into a contract with itself.

(a)(2) through (e) [Reserved]. For further guidance, see §1.863-7(a)(2) through (e).

(f) Effective/applicability date. This section applies to payments made on or after **[INSERT DATE THIS DOCUMENT IS PUBLISHED IN THE FEDERAL REGISTER]**.

(g) Expiration date. This section expires January 16, 2015.

Par. 4. Section 1.871-15T is added and reserved to read as follows:

§1.871-15T Treatment of dividend equivalents (temporary). [Reserved]

Par. 5. Section 1.871-16T is added to read as follows:

§1.871-16T Specified notional principal contracts (temporary).

(a) [Reserved].

(b) Specified notional principal contracts between March 18, 2012 and January 1, 2013. With respect to payments made after March 18, 2012 and before January 1, 2013, the term specified notional principal contract means any notional principal contract (as defined in §1.446-3) if--

(1) In connection with entering into such contract, any long party to the contract transfers the underlying security to any short party to the contract;

(2) In connection with the termination of such contract, any short party to the contract transfers the underlying security to any long party to the contract;

(3) The underlying security is not readily tradable on an established securities market; or

(4) In connection with entering into such contract, the underlying security is posted as collateral by any short party to the contract with any long party to the contract.

(c) through (f) [Reserved].

(g) Effective/applicability date. This section applies to payments made on or after **[INSERT DATE THIS DOCUMENT IS PUBLISHED IN THE FEDERAL REGISTER]**.

(h) Expiration date. This section expires January 16, 2015.

Par. 6. Section 1.881-2 is amended by adding paragraph (b)(3) to read as follows:

§1.881-2 Taxation of foreign corporations not engaged in U.S. business.

\* \* \* \* \*

(b) \* \* \*

(3) [Reserved]. For further guidance, see §1.881-2T(b)(3).

\* \* \* \* \*

Par. 7. Section 1.881-2T is added as follows:

§1.881-2T Taxation of foreign corporations not engaged in U.S. business (temporary).

(a) through (b)(2) [Reserved]. For further guidance, see §1.881-2(a) through (b)(2).

(3) Dividend Equivalents. For rules applicable to a foreign corporation's receipt of a dividend equivalent, see section 871(m) and §1.871-16T.

(c) through (e) [Reserved]. For further guidance, see §1.881-2(c) through (e).

(f) Effective/applicability date. This section applies on or after **[INSERT DATE**

**THIS DOCUMENT IS PUBLISHED IN THE FEDERAL REGISTER]**.

(g) Expiration date. The applicability of this section expires on January 16, 2015.

Par. 8. Section 1.1441-2 is amended by adding paragraphs (b)(6) and (e)(7) to read as follows:

§1.1441-2 Amounts subject to withholding.

\* \* \* \* \*

(b) \* \* \*

(6) [Reserved]. For further guidance, see §1.1441-2T(b)(6).

\* \* \* \* \*

(e) \* \* \*

(7) [Reserved]. For further guidance, see §1.1441-2T(e)(7).

\* \* \* \* \*

Par. 9. Section 1.1441-2T is added to read as follows:

§1.1441-2T Amounts subject to withholding (temporary).

(a) through (b)(5) [Reserved]. For further guidance, see §1.1441-2(a) through (b)(5).

(6) Dividend equivalents. Amounts subject to withholding include the payment of a dividend equivalent described in section 871(m). For this purpose, the term payment includes any gross amount that is used in computing any net amount that is transferred to or from the taxpayer under the terms of the contract.

(c) through (e)(6) [Reserved]. For further guidance, see §1.1441-2(c) through (e)(6).

(7) Rules for dividend equivalents. With respect to a dividend equivalent described in section 871(m), a payment is considered made to a person when any gross amount is used in computing any net amount that is transferred to or from the person under the terms of the contract pursuant to a transaction described in section 871(m)(2). When a dividend equivalent is used to determine a net payment, the person entitled to the gross dividend equivalent is considered to have received a payment even if that person receives no payment because the net payment equals zero or that person makes a net payment.

(f) [Reserved]. For further guidance, see §1.1441-2(f).

(g) Effective/applicability date. This section applies on or after **[INSERT DATE THIS DOCUMENT IS PUBLISHED IN THE FEDERAL REGISTER]**.

(h) Expiration date. The applicability of this section expires on January 16, 2015.



Par. 10. Section 1.1441-3 is amended by redesignating paragraph (h) as paragraph (j) and adding new paragraphs (h) and (i) to read as follows:

§1.1441-3 Determination of amounts to be withheld.

\* \* \* \* \*

(h) [Reserved]. For further guidance, see §1.1441-3T(h).

(i) [Reserved]. For further guidance, see §1.1441-3T(i).

\* \* \* \* \*

Par. 11. Section 1.1441-3T is added to read as follows:

§1.1441-3T Determination of amounts to be withheld (temporary).

(a) through (g) [Reserved]. For further guidance, see §1.1441-3(a) through (g).

(h) Dividend equivalents--(1) In general. The gross amount of a dividend equivalent described in section 871(m) is subject to withholding in an amount equal to the gross amount of the dividend equivalent used in computing any net amount that is transferred to or from the taxpayer.

(2) Procedures for withholding with respect to a dividend equivalent paid prior to a notional principal contract (NPC) becoming a specified NPC. [Reserved].

(i) Estimate or other determination of the portion of a distribution attributable to a dividend equivalent--(1) In general. In determining the amount subject to withholding as a dividend equivalent, a withholding agent may use a distributing corporation's estimate or other determination with respect to the underlying security (as defined in section 871(m)(4)(C)) in applying the provisions of paragraphs (c)(2) through (c)(4) of this section. However, a withholding agent that elects to use any such estimate will be liable for the amount by which the actual amount required to be withheld exceeds the amount

actually withheld and applicable penalties and interest resulting from its reliance on such estimate or determination. Failure of the withholding agent to withhold the required amount shall not be attributed to the distributing corporation.

(2) [Reserved]

(j) [Reserved]. For further guidance, see §1.1441-3(j).

(k) Effective/applicability date. This section applies on or after **INSERT DATE**  
**THIS DOCUMENT IS PUBLISHED IN THE FEDERAL REGISTER**.

(l) Expiration date. The applicability of this section expires on January 16, 2015.

Par. 12. Section 1.1441-4 is amended by revising paragraph (a)(3)(i) and adding paragraph (a)(3)(iii) to read as follows:

§1.1441-4 Exemptions from withholding for certain effectively connected income and other amounts.

(a) \* \* \*

(3) \* \* \*

(i) [Reserved]. For further guidance, see §1.1441-3T(a)(3)(i).

\* \* \* \* \*

(iii) [Reserved]. For further guidance, see §1.1441-3T(a)(3)(iii).

\* \* \* \* \*

Par. 13. Section 1.1441-4T is added to read as follows:

§1.1441-4T Exemptions from withholding for certain effectively connected income and other amounts (temporary).

(a)(1) through (a)(2) [Reserved]. For further guidance, see §1.1441-4(a)(1) through (a)(2).

(3) Income on notional principal contracts—(i) General rule. Except as otherwise provided in paragraph (a)(3)(iii) of this section, a withholding agent that pays amounts attributable to a notional principal contract described in §1.863-7(a) or §1.988-2(e) shall have no obligation to withhold on the amounts paid under the terms of the notional principal contract regardless of whether a withholding certificate is provided. However, a withholding agent must file returns under §1.1461-1(b) and (c) reporting the income that it must treat as effectively connected with the conduct of a trade or business in the United States under the provisions of this paragraph (a)(3). Except as otherwise provided in paragraph (a)(3)(ii) of this section, a withholding agent must treat the income as effectively connected with the conduct of a U.S. trade or business if the income is paid to, or to the account of, a qualified business unit of a foreign person located in the United States or, if the payment is paid to, or to the account of, a qualified business unit of a foreign person located outside the United States, the withholding agent knows, or has reason to know, the payment is effectively connected with the conduct of a trade or business within the United States. Income on a notional principal contract does not include the amount characterized as interest under the provisions of §1.446-3(g)(4).

(ii) [Reserved]. For further guidance, see §1.1441-4(a)(3)(ii).

(iii) Exception for specified notional principal contracts. A withholding agent that makes a payment attributable to a specified notional principal contract described in section 871(m), or §1.871-16T that is not treated as effectively connected with the conduct of a trade or business within the United States shall have an obligation to withhold on the amount of such payment that is a dividend equivalent.

(b) through (g) [Reserved]. For further guidance, see §1.1441-4(b) through (g).

(h) Effective/applicability date. This section applies on or after **INSERT DATE**

**THIS DOCUMENT IS PUBLISHED IN THE FEDERAL REGISTER**.

(i) Expiration date. The applicability of this section expires on January 16, 2015.

Par. 14. Section 1.1441-7 is amended by:

1. Redesignating paragraph (a)(2) as paragraph (a)(3) and revising newly designated paragraph (a)(3).

2. Adding a new paragraph (a)(2).

The revision and addition reads as follows:

§1.1441-7 General provisions relating to withholding agents.

(a) \* \* \*

(2) [Reserved]. For further guidance, see §1.1441-7T(a)(2).

(3) Examples. The following examples illustrate the rules of paragraph (a)(1) of this section:

Examples 1 through 5. [Reserved]. For further guidance, see §1.1441-7T(a)(3)

Examples 1 through 5.

Example 6. [Reserved]. For further guidance, see §1.1441-7T(a)(3) Example 6.

\* \* \* \* \*

Par. 15. Section 1.1441-7T is added to read as follows:

§1.1441-7T General provisions relating to withholding agents (temporary).

(a)(1) [Reserved]. For further guidance, see §1.1441-7(a)(1).

(2) Withholding agent with respect to dividend equivalents. Each person that is a party to any contract or arrangement that provides for the payment of a dividend

equivalent, as defined in section 871(m), shall be treated as having control and custody of such payment.

(3) Examples. The following examples illustrate the rules of paragraphs (a)(1) and (a)(2) of this section:

Example 1 through Example 5 [Reserved]. For further guidance, see §1.1441-7(a)(3), Example 1 through Example 5.

Example 6. FC, a foreign corporation, enters into a notional principal contract (NPC) with Bank X, a bank organized in the United States. The NPC is a specified NPC for purposes of section 871(m). FC is the long party to the contract and Bank X is the short party. The NPC references a specified number of shares of dividend-paying common stock issued by a domestic corporation. As the long party, FC receives payments from Bank X based on any appreciation in the value of the common stock and dividends paid with respect to the common stock. As the short party, Bank X receives payment from FC based on any depreciation in the value of the common stock and a payment based on LIBOR. Bank X is a withholding agent because Bank X is deemed to have control and custody of a dividend equivalent as a party to the NPC. If FC's tax liability under section 881 has not been satisfied in full by Bank X as withholding agent, FC is required to file a return on Form 1120-F (U.S. Income Tax Return of a Foreign Corporation).

(b)(1) through (g) [Reserved]. For further guidance, see §1.1441-7(b)(1) through (g).

(h) Effective/applicability date. This section applies on or after **[INSERT DATE]**

**THIS DOCUMENT IS PUBLISHED IN THE FEDERAL REGISTER**.

(i) Expiration date. The applicability of this section expires on January 16, 2015.

Par. 16. Section 1.1461-1 is amended by:

1. Redesignating paragraphs (c)(2)(i)(L) and (c)(2)(i)(M) as (c)(2)(i)(M) and (c)(2)(i)(N), respectively.

3. Adding a new paragraph (c)(2)(i)(L).

The addition reads as follows:

§1.1461-1 Payment and returns of tax withheld.

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \*

(i) \* \* \*

(L) [Reserved]. For further guidance, see §1.1461-1T(c)(2)(L).

\* \* \* \* \*

Par. 17. Section 1.1461-1T is added as follows:

§1.1461-1T Payment and returns of tax withheld (temporary).

(a) through (c)(2)(i)(K) [Reserved]. For further guidance, see §1.1461-1(a) through (c)(2)(i)(K).

(L) Dividend equivalents as defined in section 871(m) and the regulations thereunder;

(c)(2)(i)(M) through (i) [Reserved]. For further guidance, see §1.1461-1(c)(2)(i)(M) through (i).

(j) Effective/applicability date. This section applies on or after **[INSERT DATE**

**THIS DOCUMENT IS PUBLISHED IN THE FEDERAL REGISTER]**.

(k) Expiration date. The applicability of this section expires on January 16, 2015.

Steven T. Miller,  
Deputy Commissioner for Services and Enforcement.

Approved: January 3, 2012.

Emily S. McMahon,  
Acting Assistant Secretary of the Treasury (Tax Policy).

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