

747-53A2312, Revision 3, dated February 8, 2007; except as provided by paragraph (u) of this AD. Accomplishment of this repair and modification terminates the repetitive inspections required by paragraph (m) of this AD for that lap joint. This special one-time inspection is not required for lap joints that have been modified in accordance with paragraph (g), (n), (o), or (q) of this AD.

(1) Airplanes that have not been modified in accordance with paragraph (g) or (o) of this AD.

(2) Airplanes on which the sliding probe HFEC inspection method specified in Boeing Service Bulletin 747-53A2312, Revision 1, dated March 29, 1990; or Revision 2, dated October 8, 1992; was used during the last skin inspection required by AD 94-15-06.

#### **Actions After the Special One-Time Inspection if No Cracking Is Found**

(t) For airplanes specified in paragraph (s) of this AD on which no cracking is found during the special one-time inspection, do the applicable repetitive inspections specified in paragraph (t)(1) or (t)(2) of this AD.

(1) If the special one-time inspection was done using the HFEC inspection method in accordance with paragraph (s) of this AD, perform the next inspection required by paragraph (m) of this AD within the next 4,000 flight cycles after doing the inspection required by paragraph (s) of this AD, and repeat the inspection thereafter in accordance with paragraph (m) of this AD.

(2) If the special one-time inspection was done using the detailed inspection method in accordance with paragraph (s) of this AD, perform the next inspection required by paragraph (m) of this AD within the next 500 flight cycles after doing the inspection required by paragraph (s) of this AD, and repeat the inspection thereafter in accordance with paragraph (m) of this AD.

#### **Contacting the Manufacturer**

(u) Where Boeing Alert Service Bulletin 747-53A2312, Revision 3, dated February 8, 2007 specifies to contact Boeing for appropriate action for a repair or inspection, before further flight, do the applicable action in paragraph (u)(1) or (u)(2) of this AD.

(1) Do the repair using a method approved in accordance with the procedures specified in paragraph (v) of this AD.

(2) Do the inspection using a method approved by the Manager, Seattle Aircraft Certification Office (ACO), FAA. For a repair method to be approved by the Manager, Seattle ACO, as required by this paragraph, the Manager's approval letter must specifically refer to this AD.

#### **Alternative Methods of Compliance (AMOCs)**

(v)(1) The Manager, Seattle ACO, FAA, has the authority to approve AMOCs for this AD, if requested in accordance with the procedures found in 14 CFR 39.19.

(2) To request a different method of compliance or a different compliance time for this AD, follow the procedures in 14 CFR 39.19. Before using any approved AMOC on any airplane to which the AMOC applies, notify your appropriate principal inspector (PI) in the FAA Flight Standards District

Office (FSDO), or lacking a PI, your local FSDO.

(3) An AMOC that provides an acceptable level of safety shall be used for any repair required by this AD, if it is approved by an Authorized Representative for the Boeing Commercial Airplanes Delegation Option Authorization Organization who has been authorized by the Manager, Seattle ACO, to make those findings. For a repair method to be approved, the repair must meet the certification basis of the airplane, and the approval must specifically refer to this AD.

(4) AMOCs approved previously in accordance with AD 94-15-06, are approved as AMOCs for the corresponding provisions of this AD if the AMOC does not involve using the existing sliding probe HFEC skin inspection method specified in Boeing Service Bulletin 747-53A2312, Revision 2, dated October 8, 1992, or an earlier version. In addition, the provisions of paragraph (r) of this AD must be applied to AMOCs approved previously in accordance with AD 94-15-06, amendment 39-8977, where applicable.

Issued in Renton, Washington, on October 5, 2007.

**Ali Bahrami,**

*Manager, Transport Airplane Directorate,  
Aircraft Certification Service.*

[FR Doc. E7-20468 Filed 10-16-07; 8:45 am]

**BILLING CODE 4910-13-P**

## **DEPARTMENT OF THE TREASURY**

### **Internal Revenue Service**

#### **26 CFR Part 1**

**[REG-140206-06]**

**RIN 1545-BF93**

### **Withholding Procedures Under Section 1441 for Certain Distributions to Which Section 302 Applies**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Notice of proposed rulemaking and notice of public hearing.

**SUMMARY:** This document contains proposed regulations regarding a withholding agent's obligation to withhold and report tax under Chapter 3 of the Internal Revenue Code when there is a distribution in redemption of stock of a corporation that is actively traded on an established financial market. Specifically, the proposed regulations provide an escrow procedure that a withholding agent must apply while making the determination under section 302 as to whether the distribution in redemption of the stock held by a foreign shareholder is treated as a dividend subject to withholding, or a distribution in part or full payment in exchange for stock. These regulations would affect

corporations that are actively traded on an established financial market and their shareholders. This document also provides a notice of public hearing on these proposed regulations.

**DATES:** Written or electronic comments must be received by January 16, 2008. Outlines of topics to be discussed at the public hearing scheduled for February 6, 2008 at 10 a.m. must be received by January 16, 2008.

**ADDRESSES:** Send submissions to CC:PA:LPD:PR (REG-140206-06), 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-140206-06), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC or sent electronically, via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov) (IRS REG-140206-06). The public hearing will be held in room 2140, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

#### **FOR FURTHER INFORMATION CONTACT:**

Concerning the proposed regulations, Kathryn Holman, (202) 622-3440 (not a toll-free number); concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, e-mail [Richard.A.Hurst@irs.counsel.treas.gov](mailto:Richard.A.Hurst@irs.counsel.treas.gov).

#### **SUPPLEMENTARY INFORMATION:**

##### **Paperwork Reduction Act**

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the Office of Management and Budget, Attn: Desk Office for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by January 16, 2008. Comments are specifically requested concerning:

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

The accuracy of the estimated burden associated with the proposed collection of information;

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

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

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

The collection of information in these proposed regulations is in § 1.1441–3(c)(5)(iii). This information is required to allow a U.S. financial institution that is applying the escrow procedure to properly comply with its withholding and reporting obligations under sections 1441, 1442 and 1443 in the case of a distribution made by a corporation with respect to its stock that is actively traded on an established financial market and that requires a determination under section 302 as to whether the distribution is treated as a dividend or a distribution in part or full payment in exchange for stock. The collection of information is mandatory and the respondents are nonresident aliens and foreign corporations.

*Estimated total annual reporting burden:* 1400 hours.

*The estimated annual burden per respondent:* 2 hours.

*Estimated number of respondents:* 700.

*Estimated annual frequency of responses:* 5 times.

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

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential as required by 26 U.S.C. 6103.

## Background

These proposed regulations, REG–140206–06, provide guidance regarding the withholding and reporting obligations of a withholding agent under Chapter 3 of the Internal Revenue Code (Code) in the case of a distribution in redemption of the stock of a corporation that is actively traded on an established financial market within the meaning of § 1.1092(d)–1 (publicly traded). In

general the proposed regulations contemplate a transaction where a publicly traded corporation offers to purchase stock from its shareholders (a self tender), where the amount of stock purchased and the shareholders involved in the transaction (the participating shareholders) depend on a number of factors, including each shareholder's willingness to sell some or all of its stock, and the terms set forth in the offer. The regulations would also apply to transactions described in section 304(a)(2).

In the case of a self-tender, a corporation may purchase stock from some or all of its shareholders and, as a result, each participating shareholder's percentage ownership interest in the corporation may increase, decrease, or remain the same. Although the corporation's self tender offer is denominated as an offer to purchase shares, the tax consequences to the corporation and any participating shareholder of the payment to such a shareholder, as described in this preamble, depend on several factors. Further, where the participating shareholder is a foreign person, withholding under Chapter 3 of the Code may or may not be required.

Sections 1441 and 1442 and § 1.1441–1(b)(1) generally require a person that makes a payment of an "amount subject to withholding" to a beneficial owner that is a foreign person to deduct and withhold 30 percent of the payment unless the payor can reliably associate the payment with documentation upon which the payor can rely to treat the payment as made to a beneficial owner that is a U.S. person or as made to a beneficial owner that is a foreign person entitled to a reduced rate of withholding under the Code, regulations or an income tax treaty.

Section 1.1441–2(a) provides that the term *amounts subject to withholding* means amounts from sources within the United States that constitute fixed or determinable annual or periodical income (FDAP) described in § 1.1441–2(b) or other amounts subject to withholding described in § 1.1441–2(c).

Section 1.1441–2(b)(1) provides that FDAP includes all income described in section 61 of the Code, unless the item of income is described in § 1.1441–2(b)(2). Section 1.1441–2(b)(2)(i) generally excludes from FDAP gains derived from the sale of property. Thus, a distribution to a shareholder that is treated as gain from the sale of stock is excluded from FDAP. Further, to the extent a distribution is a return of capital, it is not gross income under section 61, and thus also is not FDAP.

Section 302 provides rules for determining when a distribution in redemption of stock is treated as a distribution in part or full payment in exchange for stock. That section generally requires a comparison of a shareholder's overall interest in the corporation before the distribution and its overall interest in such corporation after the distribution. See section 302(b). In conducting the comparison, the constructive ownership rules of section 318 generally apply. If the shareholder's interest in the corporation has been sufficiently reduced, then the distribution is treated as a payment in exchange for the shareholder's stock under section 302(a). If the shareholder's interest in the corporation has not been sufficiently reduced, the tax consequences of the distribution are determined under section 301, and such distribution is a dividend to the shareholder to the extent the distribution is out of the distributing corporation's earnings and profits, then applied against and reduce the adjusted basis of the stock, and finally treated as gain from the sale or exchange of property. See section 301(c).

When a publicly held corporation makes a distribution in redemption of its stock, a determination must be made under section 302 with respect to each shareholder as to whether the redemption is treated as a distribution of property to which section 301 applies (potentially constituting a dividend in whole or in part) or as a distribution in part or full payment in exchange for stock. However, the information necessary for each shareholder to make such a determination generally is not available until after the transaction is completed because the redemption of stock held by other shareholders must be taken into account. Further, because of the application of the constructive ownership rules of section 318, when a distribution is made to a foreign shareholder, a withholding agent will often not be in the best position to make a determination as to whether the distribution to the foreign shareholder should be treated as a payment in exchange for the shareholder's stock or a dividend.

There are two revenue rulings that consider the issue of whether the interest of a shareholder in a publicly held corporation has been sufficiently reduced as a result of a distribution to effect exchange treatment under section 302(a).

In Rev. Rul. 76–385, 1976–2 CB 92, See § 601.601(d)(2)(ii)(b), the IRS ruled that a shareholder who actually and constructively owned 0.000118% of a publicly traded corporation's stock

before a redemption, but only constructively owned 0.0001081% after the redemption, had experienced a “meaningful reduction in proportionate interest” in the corporation under the principles of *United States v. Davis*, 397 U.S. 301 (1970), rehearing denied, 397 U.S. 107 (1970). The shareholder’s interest in the corporation after the redemption therefore was approximately 96.7% of the shareholder’s interest before the redemption, taking constructive ownership into account. Nevertheless, the reduction was considered meaningful, and so the distribution to the shareholder was treated as not essentially equivalent to a dividend under section 302(b)(1) and as a payment in exchange for the shareholder’s stock under section 302(a).

Consistent with Rev. Rul. 76–385, in Rev. Rul. 81–289, 1981–2 CB 82, See § 601.601(d)(2)(ii)(b), the IRS ruled that a shareholder who owned 0.2% of the common stock of a publicly traded company before a redemption, and 0.2% of the common stock in the company after the redemption, did not satisfy the “meaningful reduction” standard of *United States v. Davis*, and that the redemption did not qualify for exchange treatment under section 302(a).

Under the analysis adopted in these revenue rulings, each minority shareholder who participates in a self tender must compute its percentage ownership of the total outstanding stock of the corporation before and after the transaction. If after the transaction the shareholder’s percentage ownership is less than it was before the transaction, the shareholder generally has experienced a “meaningful reduction” in the shareholder’s proportionate interest in the corporation, and the transaction, at least with respect to that shareholder, is considered a distribution in exchange for the stock under section 302(a) and not a distribution of property to which section 301 applies. This result occurs even if another participating shareholder in the same self tender experiences no change or an increase in its percentage ownership of the corporation, and, therefore, is considered to receive a distribution of property to which section 301 applies. See also section 302(b)(2), (3), and (4).

Section 1.1441–3(c) requires a corporation making a distribution with respect to its stock to a foreign shareholder, as well as any intermediary (such as a broker) making a payment of such a distribution, to withhold on the entire amount of the distribution, unless it elects to reduce the amount of withholding under § 1.1441–3(c).

Section 1.1441–3(c)(2)(i)(B) provides that a distributing corporation or intermediary may elect to not withhold on a distribution to the extent it represents a distribution in part or full payment in exchange for stock. Section 1.1441–3(c)(2)(i) provides that a corporation or intermediary makes the election by reducing the amount of withholding at the time that the payment is made. However, a withholding agent cannot avail itself of this election unless it knows the extent to which a distribution represents a payment in exchange for stock under section 302(a). As previously noted, in the context of a distribution in redemption of stock held in a publicly traded corporation, the withholding agent generally will not have this information unless, at the time of the redemption, it has obtained information from each participating shareholder regarding actual and constructive ownership of stock for purposes of the foregoing analysis.

The Treasury Department and the IRS are aware that, in the context of transactions involving distributions in redemption of stock held by foreign persons where such stock is actively traded on an established financial market, the means of compliance with sections 1441, 1442, and 1443 is varied. The Treasury Department and the IRS believe that the discretion permitted by the current regulations, and the resulting different treatment of similar transactions is not appropriate. Accordingly, these proposed regulations provide the procedure (“escrow procedure”) to be followed by U.S. withholding agents to satisfy the withholding, reporting and deposit requirements of the regulations under sections 1441, 1442, and 1443 with respect to any payment of a corporate distribution in redemption of stock made to a foreign account holder with respect to certain self tenders.

#### Explanation of Provisions

The proposed regulations set forth an escrow procedure for withholding agents to follow in the case of a payment made after December 31, 2008 of a corporate distribution in redemption of stock that is actively traded on an established financial market within the meaning of § 1.1092(d)–1 (section 302 payment).

In general, the proposed regulations require a U.S. financial institution (withholding agent) to set aside in an escrow account 30 percent (or the applicable dividend rate provided under a treaty) of the amount of the section 302 payment. The withholding agent is then required to provide information to

the foreign beneficial owner regarding the distribution, including the total number of the distributing corporation’s shares outstanding before and after the distribution. The withholding agent must also provide a written statement explaining the conditions under which the section 302 payment will be treated as a dividend or a payment in exchange for stock (including an explanation of the constructive ownership rules under section 318). In the written explanation provided to the foreign beneficial owner, the withholding agent must request that the beneficial owner provide a written certification to the withholding agent within 60 days as to whether the distribution is either a dividend or a payment in exchange for stock.

The certification to be provided by the foreign beneficial owner must contain, among other requirements, the beneficial owner’s name and account number, a certification that the distribution is a payment in exchange for stock or is a dividend, and the number of shares actually and constructively owned by the beneficial owner before and after the distribution. The beneficial owner’s certification must be signed under penalties of perjury.

A withholding agent may generally rely on a certification received from a foreign beneficial owner in determining its section 1441 obligations with respect to payments for such beneficial owner’s stock. However, if the withholding agent knows or has reason to know that the certification is unreliable or incorrect, or the withholding agent does not receive a certification from a foreign beneficial owner, the withholding agent is required to treat the amount set aside in escrow as tax withheld on the 61st day, and deposit that amount pursuant to the applicable regulations.

Although a qualified intermediary (QI) may, and a withholding foreign partnership and a withholding foreign trust (WP/WT) must, assume primary withholding responsibility under section 1441 and receive payments without any withholding by the U.S. financial institution, under the proposed regulations, in the case of a section 302 payment, the QI or WP/WT cannot assume primary withholding responsibility and receive the payment in gross. The QI or WP/WT must apply the procedure described in this preamble and provide the U.S. financial institution with a withholding statement that details the appropriate rate of withholding and information reporting for amounts paid to the QI or WP/WT. In addition, if there is a chain of QIs or WPs/WTs this procedure must be

followed at each level in the chain. The U.S. financial institution shall treat beneficial owners that are U.S. non-exempt recipients, and that hold stock in the distributing corporation through QIs, WPs/WTs, NQIs and flow-throughs, in accordance with the section 302 payment certifications obtained from those U.S. non-exempt recipients and shall instruct foreign intermediaries and foreign flow-through entities to do the same.

These proposed regulations would apply for redemptions of stock that are made after December 31, 2008.

However, a withholding agent may, at its option, rely on these proposed regulations for a redemption of stock that occurs before January 1, 2009.

The Treasury Department and the IRS are aware that withholding agents serve various customer bases: some may maintain accounts for a small number of account holders, others may maintain accounts for a much greater number of account holders. Comments are requested on alternatives to the escrow procedure described in this proposed regulation for withholding agents that maintain accounts for large numbers of customers.

#### Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required.

It has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations.

These regulations impose a collection of information on small entities, and the Regulatory Flexibility Act (5 U.S.C. chapter 6) applies. This rule regulates securities brokerages that have foreign customers that respond to a tender offer by a U.S. publicly traded corporation to purchase some of its stock from its shareholders. The Small Business Administration (SBA) has established size standards for types of economic activities which are classified based on the North American Industry Classification Codes (NAICS). The regulations specifying size standards are set forth in Title 13, Code of Federal Regulations, part 121 (13 CFR part 121), Small Business Size Regulations. The NAICS Code for a small securities brokerage is specified at 13 CFR 121.201. Pursuant to subsector 523120 of the NAICS, a small securities brokerage is one with receipts of less than 6.5 million dollars. According to NAICS 523120, U.S. Census Bureau, Statistics of U.S. Business (2002), there are a total of 7,886 securities brokerages

of which 7,113 generate revenue less than \$5 million and 224 generate revenue between \$5 million and \$10 million. It is estimated that 7,213 of the securities brokerages are considered small businesses. The IRS requests information regarding the number of transactions these small securities brokerages engage in each year involving self tenders by public corporations. In the case of a tender offer by a publicly held corporation, it is estimated that a brokerage clerk would spend two hours preparing the paperwork and verifying the computations required to accurately withhold with respect to foreign customers. According to the Bureau of Labor Statistics, the mean hourly wage of a brokerage clerk is \$18.34, so it is estimated that it will cost a small securities brokerage \$36.68 per transaction. This cost is not significant when compared to the annual revenue of the small securities brokerage. Pursuant to section 605(b) of the Regulatory Flexibility Act, 5 U.S.C. 605, the Chief Counsel certifies that this rule will not have a significant economic impact on a substantial number of small entities. The IRS invites specific comments on the economic impact of compliance from members of the public who believe there will be a significant economic impact on small businesses that are regulated by this rule. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

#### Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and the Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for February 6, 2008, beginning at 10 a.m. in room 2140 of the Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the 12th street entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For

information about having your name placed on the building access list to attend the hearing, see the **FOR FURTHER INFORMATION CONTACT** section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments, and an outline of the topics to be discussed, and the time to be devoted to each topic (signed original and eight (8) copies) by January 16, 2008. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

#### Drafting Information

The principal author of these proposed regulations is Kathryn Holman, Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

#### List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

#### Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

#### PART 1—INCOME TAXES

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

**Authority:** 26 U.S.C. 7805 \* \* \*

**Par. 2.** Section 1.1441–3 is amended as follows:

1. A sentence is added at the end of paragraph (c)(2)(i)(B).
2. Paragraph (c)(5) is added.
3. A sentence is added at the end of paragraph (d)(1).

The additions read as follows.

#### § 1.1441–3 Determination of amounts to be withheld.

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \*

(i) \* \* \*

(B) \* \* \* The preceding sentence shall not apply to a public section 302 distribution to which paragraph (c)(5) applies.

\* \* \* \* \*

(5) *Special rules for certain distributions to which section 302 applies—(i) Withholding*

*responsibility*—(A) *General rule.* A corporation that makes a public section 302 distribution, or any intermediary (described in § 1.1441–1(c)(13)) making a payment of such a distribution, is required to withhold under section 1441, 1442 or 1443 on the entire amount of the distribution unless the provisions of paragraph (c)(5)(iii) of this section have been applied. The provisions of paragraph (c)(2)(i)(B) or (d)(1) of this section do not apply to a public section 302 distribution.

(B) *Effective/applicability date.* The rules of this paragraph (c)(5) apply to public section 302 distributions made after December 31, 2008.

(ii) *Definitions.* Solely for purposes of this paragraph (c)(5), the following definitions shall apply:

(A) *Public section 302 distribution* means a distribution by a corporation in redemption of its stock for which there is an established financial market within the meaning of § 1.1092(d)–1.

(B) *Section 302 payment* means payment of a public section 302 distribution.

(C) *Distributing corporation* means a corporation making or treated as making a public section 302 distribution.

(iii) *Escrow procedure*—(A) *Application*—(1) *In general.* The escrow procedure in this paragraph (c)(5)(iii) may be applied only by an intermediary (described in § 1.1441–1(c)(13)) that is a U.S. financial institution. A U.S. financial institution making a section 302 payment to a foreign account holder, and applying this escrow procedure, is not required to withhold on the entire amount of a section 302 payment under the general rule of paragraph (c)(5)(i).

(B) *Escrow account*—(1) *In general.* A U.S. financial institution shall set aside in an escrow account on the date it receives a section 302 payment from a distributing corporation with respect to stock of a foreign account holder 30 percent (or the applicable dividend rate provided by a tax treaty for a qualifying foreign account holder) of the amount and shall credit the foreign account holder's account with the balance of the section 302 payment.

(2) *Qualified intermediaries.* The amount set aside, under paragraph (c)(5)(iii)(B)(1) of this section shall include 30 percent (or the applicable dividend rate provided by a treaty) of the amount paid to any qualified intermediary (QI) (whether or not the QI has assumed primary withholding responsibility) and to any withholding foreign partnership or withholding foreign trust (WP/WT).

(C) *Request for section 302 payment certification.* On or before the date it

receives the section 302 payment, the U.S. financial institution shall provide the following information and instructions, in writing, to the foreign beneficial owner—

(1) The total number of distributing corporation's shares outstanding before and after the public section 302 distribution;

(2) An explanation of the conditions under which the section 302 payment will be treated as a dividend or a payment in exchange for stock for Federal income tax purposes (including an explanation of any applicable constructive ownership rules); and

(3) A request that the beneficial owner of the account provide a certification (section 302 payment certification), within 60 days of the section 302 payment, stating whether the section 302 payment is either a dividend or a payment in exchange for stock under the Internal Revenue Code.

(D) *Content of section 302 payment certification.* The section 302 payment certification must include the following information:

(1) The beneficial owner's name and account number.

(2) The distributing corporation's name.

(3) The total shares of the distributing corporation outstanding immediately before and immediately after the public section 302 distribution.

(4) A certification from the beneficial owner that either—

(i) The section 302 payment is a payment in exchange for stock because the beneficial owner's proportionate interest has been reduced but not completely terminated;

(ii) The section 302 payment is a payment in exchange for stock because the beneficial owner's interest in the distributing corporation is completely terminated; or

(iii) The section 302 payment is a dividend.

(5) With respect to the certifications in paragraph (c)(5)(iii)(D)(4)(i) and (ii) of this section, the number of shares actually and constructively owned by the beneficial owner before and after the distribution and the beneficial owner's percentage ownership before and after the distribution.

(6) A penalties of perjury statement.

(7) The signature of the beneficial owner and date of signature.

(E) *Receipt of section 302 payment certification*—(1) *Payment in exchange for stock.* If, within the 60-day period described in paragraph (c)(5)(iii)(C)(3), the U.S. financial institution receives from the foreign beneficial owner a section 302 payment certification stating that the section 302 payment is a

payment in exchange for stock, and if the U.S. financial institution does not know or have reason to know that the information in the section 302 payment certification is unreliable or incorrect, the U.S. financial institution shall credit the account with the amount set aside with respect to the beneficial owner who provides the certification. The entire amount paid (including the amount initially set aside) shall be reported as capital gains on Form 1042–S Foreign Person's U.S. Source Income Subject to Withholding.

(2) *Unreliable or incorrect exchange certification.* If the U.S. financial institution knows or has reason to know that the information in the section 302 payment certification is unreliable or incorrect, the U.S. financial institution shall treat the payment as a payment for which no section 302 payment certification has been received and shall follow the withholding and reporting procedures in paragraph (c)(5)(iii)(E)(4) of this section.

(3) *Dividend.* If, within the 60-day period, the U.S. financial institution receives a section 302 payment certification from the foreign beneficial owner stating that the section 302 payment is a dividend, the U.S. financial institution shall treat the amount set aside as tax withheld as of the time it receives the section 302 payment certification, and shall deposit that amount pursuant to the applicable regulations. The entire amount paid shall be reported on Form 1042–S as dividends.

(4) *No timely certification received.* If, within the 60-day period, the U.S. financial institution does not receive a section 302 payment certification, or is treated under paragraph (c)(5)(iii)(E)(2) of this section as not receiving a section 302 payment certification, the U.S. financial institution shall treat the amount set aside as tax withheld as of the 61st day, and shall deposit that amount pursuant to the applicable regulations. The entire amount paid shall be reported on Form 1042–S as dividends.

(5) *Late certification.* If, after the 60-day period has expired, the U.S. financial institution receives a section 302 payment certification from a foreign beneficial owner that the section 302 payment is a payment in exchange for stock and the conditions stated in § 1.1461–2(a) are satisfied, the U.S. financial institution may apply the refund or offset procedures of that paragraph.

(6) *Determination of incorrect treatment.* If, after the 60-day period has expired, the U.S. financial institution determines that the section 302 payment

was incorrectly treated as a distribution in exchange for stock, the procedures set forth regarding underwithholding in § 1.1461-2(b) are applicable.

(7) *Undocumented beneficial owners.* The U.S. financial institution shall withhold at 30 percent on the entire amount paid to a beneficial owner that is not properly documented under §§ 1.1441-1, 1.1441-5, etc. and that is presumed to be a foreign person, whether or not the U.S. financial institution has received a section 302 payment certification from such beneficial owner. The U.S. financial institution shall report the entire amount paid on Form 1042-S as dividends.

(F) *Amounts in excess of section 302 payment.* If the amount the U.S. financial institution credits to the account of the foreign beneficial owner from the escrow account includes an amount in excess of the section 302 payment, such as interest accrued on the escrowed funds, the U.S. financial institution shall report and withhold on such excess amount in accordance with the rules under Chapter 3 of the Internal Revenue Code.

(G) *U.S. non-exempt recipients.* The U.S. financial institution shall treat beneficial owners that are U.S. non-exempt recipients, and that hold stock in the distributing corporation through QIs, WPs/WTs, NQIs and flow-throughs, in accordance with the section 302 payment certifications obtained from those U.S. non-exempt recipients and shall instruct foreign intermediaries and foreign flow-through entities to do the same.

(H) *Notice to distributing corporation.* The U.S. financial institution shall notify the distributing corporation, in writing, by the filing date of Form 1042-S, of the aggregate amount of the section 302 payment that the U.S. financial institution has reported on Forms 1042-S as capital gains, and the aggregate amount of the section 302 payment that it has reported on Forms 1042-S as dividends.

(I) *Application of Escrow Procedure to Qualified Intermediaries.* As provided in paragraph (c)(5)(iii)(A) of this section, only the U.S. financial institution may establish an escrow account and the amounts set aside in the escrow account shall include 30 percent (or the applicable treaty rate applicable to dividends) on payments made to a direct account holder that is a QI (including a QI that has assumed primary withholding responsibility). Under the procedure described in paragraph (c)(5)(iii)(I)(3), a QI shall provide the U.S. financial institution with a withholding statement as

required in the QI Agreement. If there is a chain of QIs, each QI in the chain shall apply the procedure. The procedures described in this paragraph (I) shall be applied to withholding foreign partnerships and withholding foreign trusts within the meaning of §§ 1.1441-5(c)(2) and (e)(5)(v), respectively, in the same manner as the procedures apply to a QI.

(1) *Request for section 302 payment certification.* The U.S. financial institution shall provide the information and instructions described in paragraph (c)(5)(iii)(C) of this section to the QI, and the QI shall provide the same information and instructions to its account holders including account holders that are U.S. non-exempt recipients.

(2) *Content of section 302 payment certification.* The content of the section 302 payment certification shall include the information described in paragraph (c)(5)(iii)(D) of this section.

(3) *Receipt of section 302 payment certification—(i) Payment in exchange for stock.* If, within the 60-day period described in paragraph (c)(5)(iii)(C), the QI receives from the beneficial owner a section 302 payment certification stating that the section 302 payment is a payment in exchange for stock and if the QI does not know or have reason to know that the information in the section 302 payment certification is unreliable or incorrect, the QI shall reflect such treatment in its withholding statement provided to the U.S. financial institution, and, based upon the withholding statement, the U.S. financial institution shall release payment from its escrow and the QI shall credit the beneficial owner's account with the amount set aside by the U.S. financial institution with respect to the beneficial owner who provided the certification. The entire amount paid (including the amount initially set aside) shall be reported on the QI's pooled basis Form 1042-S as capital gains.

(ii) *Unreliable or incorrect exchange certification.* If the QI knows or has reason to know that the information in the section 302 payment certification is unreliable or incorrect, the QI shall treat the payment as a payment for which no section 302 payment certification has been received and shall follow the withholding and reporting procedures in paragraph (c)(5)(iii)(I)(3)(iv) of this section.

(iii) *Dividend.* If, within the 60-day period, QI receives a section 302 payment certification stating that the section 302 payment is a dividend, the QI shall reflect such treatment in its withholding statement and shall treat

the payment as a dividend for purposes of its reporting and withholding responsibilities under the QI agreement. The entire amount paid shall be reported on its pooled basis Form 1042-S as dividends.

(iv) *No timely certification received.* If, within the 60-day period, the QI does not receive a section 302 payment certification, or is treated under paragraph (c)(5)(iii)(I)(3)(ii) of this section as not receiving a section 302 payment certification, the QI shall reflect such treatment in its withholding statement provided to the U.S. financial institution and shall treat the payment as a dividend for purposes of its reporting and withholding responsibilities under the QI agreement. The entire amount paid shall be reported on its pooled basis Form 1042-S as dividends.

(v) *Late certification.* If, after the 60-day period has expired, the QI receives a section 302 payment certification from a beneficial owner that the section 302 payment is a payment in exchange for stock and the conditions stated in the QI agreement regarding the refund and offset procedures are satisfied, the QI may apply such refund or offset procedures.

(vi) *Determination of incorrect treatment.* If, after the 60-day period has expired, the QI determines that the section 302 payment was incorrectly treated as a distribution in exchange for stock, the procedures set forth regarding adjustments for underwithholding in the QI agreement are applicable.

(vii) *Undocumented beneficial owners.* The QI shall withhold at 30 percent on the entire amount paid to a beneficial owner that is not properly documented and that is presumed to be a foreign person, whether or not the QI has received a section 302 payment certification from such beneficial owner. The QI shall report the entire amount paid on its pooled basis Form 1042-S as dividends.

(4) *U.S. non-exempt recipients.* The QI shall treat direct account holders that are U.S. non-exempt recipients, and that hold stock in the distributing corporation, in accordance with the section 302 payment certifications obtained from those U.S. non-exempt recipients and shall instruct foreign intermediaries and foreign flow-through entities to do the same.

(J) *Intermediaries that are not qualified intermediaries.* If the U.S. financial institution has an account holder that is an intermediary that is not a QI ("NQI"), the U.S. financial institution shall apply the rules of paragraph (c)(5)(iii)(J)(1) through (4) of this section. Where the provisions of

this paragraph (j) refer only to the U.S. financial institution, they shall apply in the same manner to a QI or WP/WT and where they refer to an NQI, they shall apply in the same manner to a flow-through that is not a WP or WT.

(1) The U.S. financial institution shall provide the information and instructions described in paragraph (c)(5)(iii)(C) of this section to the NQI and the NQI shall provide the same information and instructions to its account holders.

(2) The content of the section 302 payment certification shall include the information described in paragraph (c)(5)(iii)(D) of this section.

(3) The NQI shall provide the section 302 payment certification to the U.S. financial institution together with the otherwise required documentation and a withholding statement made in accordance with the section 302 payment certification.

(4) The U.S. financial institution shall treat the section 302 payment as a dividend or a payment in exchange for stock based on the information and documentation provided to it under paragraph (c)(5)(iii)(j)(3) of this section. The U.S. financial institution shall withhold and report on a specific payee basis in accordance with this information.

(d) \* \* \* (1) \* \* \* This paragraph does not apply to a public section 302 distribution to which paragraph (c)(5) applies.

\* \* \* \* \*

**Linda E. Stiff,**

*Deputy Commissioner for Services and Enforcement.*

[FR Doc. E7-20504 Filed 10-16-07; 8:45 am]

**BILLING CODE 4830-01-P**

## DEPARTMENT OF THE TREASURY

### Internal Revenue Service

#### 26 CFR Part 1

[REG-114125-07]

RIN 1545-BG57

#### Compensation for Labor or Personal Services: Artists and Athletes

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** This document contains proposed changes to existing final regulations regarding the source of compensation for labor or personal services. The proposed changes are needed to clarify the determination of source of compensation of a person,

including an artist or athlete, who is compensated for labor or personal services performed at specific events. These proposed regulations affect such an individual.

**DATES:** Written or electronic comments and requests for a public hearing must be received by January 15, 2008.

**ADDRESSES:** Send submissions to: CC:PA:LPD:PR (REG-114125-07), 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-114125-07), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or sent electronically via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS-REG-114125-07).

**FOR FURTHER INFORMATION CONTACT:** Concerning the proposed regulations, David Bergquist at (202) 622-3850; concerning the submissions of comments and requests for a hearing, Regina Johnson at (202) 622-7180 (not toll free numbers).

#### SUPPLEMENTARY INFORMATION:

##### Background

This document contains proposed amendments under 26 CFR part 1 under section 861 of the Internal Revenue Code (Code). On July 14, 2005, final regulations that revised and amended § 1.861-4 were published in the **Federal Register** (70 FR 40663) as TD 9212. In these final regulations, § 1.861-4(b)(2)(ii)(C)(3) was reserved with respect to compensation for labor or personal services performed partly within and partly without the United States by an artist or an athlete who is an employee.

Section 861(a)(3) of the Internal Revenue Code provides that, subject to certain exceptions, compensation for labor or personal services performed in the United States is gross income from sources within the United States. See also § 1.861-4(a) of the regulations. Section 862(a)(3) of the Code provides that compensation for labor or personal services performed without the United States is gross income from sources without the United States. Section 1.861-4(b) provides rules for determining the source of compensation for labor or personal services performed partly within and partly without the United States. Section 1.861-4(b)(2)(i) provides rules for determining the source of compensation for labor or personal services performed partly within and partly without the United

States by an individual other than as an employee. Section 1.861-4(b)(2)(ii) provides rules for determining the source of compensation for labor or personal services performed partly within and partly without the United States by an individual as an employee.

Under § 1.861-4(b)(2)(ii), if an individual performs labor or personal services as an employee, the source of the individual's compensation is generally determined on a time basis, with certain fringe benefits sourced on a geographic basis. An individual may determine the source of his or her compensation as an employee for labor or personal services performed partly within and partly without the United States under an alternative basis if the individual establishes to the satisfaction of the Commissioner that, under the facts and circumstances of the particular case, the alternative basis more properly determines the source of the compensation than the general rules of § 1.861-4(b)(2)(ii). See § 1.861-4(b)(2)(ii)(C)(1)(i). In addition, the Commissioner may, under the facts and circumstances of the particular case, determine the source of compensation that is received by an individual as an employee under an alternative basis if such compensation is not for a specific time period, provided that the Commissioner's alternative basis determines the source of compensation in a more reasonable manner than the basis used by the individual.

The final regulations at § 1.861-4(b)(2)(ii)(C)(3) provided a reservation with respect to the source of compensation for labor or personal services performed partly within and partly without the United States by an artist or athlete who is an employee. The preamble of TD 9212 indicated that it was intended that the rule for artists and athletes who are employees, when issued, would require such individuals to determine the proper source of their compensation for labor or personal services on the basis that most correctly reflects the proper source of income under the facts and circumstances of the particular case, consistent with current law.

#### Explanation of Provisions

The proposed regulations would set forth a new "events basis" rule in § 1.861-4(b)(2)(ii)(C) and make certain other clarifying changes to the existing final regulations. The proposed regulations also would remove § 1.861-4(b)(2)(ii)(C)(3), which reserved with respect to artists and athletes.

The amount of income received by a person, including an individual who is an artist or an athlete, that is properly