



American Jobs Creation Act of 2004 International Tax Provisions

By: Mark David Rozen, Joseph Lipari, Abraham Leitner and Michael J. Miller

On October 22, 2004, President Bush signed into law the American Jobs Creation Act of 2004, P.L. 108-357 (the "Act"). The Act contains numerous international tax provisions of which you should be aware. In many important respects, such as in the case of U.S. persons who conduct activities outside the U.S., the new provisions simplify and liberalize the applicable tax rules. In other respects, however, such as in the case of expatriated entities or individuals, the provisions of the Act impose new anti-abuse rules and other restrictions. A number of the Act's significant international tax provisions are described below.

Repeal of Extraterritorial Income Regime and New Incentive for Domestic Production

Section 101 of the Act repeals the extraterritorial income ("ETI") regime that the World Trade Organization has held to be a prohibited export subsidy. Pursuant to certain transition rules, however, taxpayers may continue to claim 80% of benefits of the ETI regime for transactions during 2005 and 60% of such benefits for transactions during 2006. ETI benefits will also remain available for certain transactions in the ordinary course of business pursuant to a binding contract in effect on September 17, 2003. Subject to anti-abuse rules, foreign corporations that elected to be treated as domestic corporations in order to claim the benefits of the ETI regime will be permitted to revoke such elections without triggering tax on the deemed outbound transfer arising from such revocation.

In lieu of the prohibited export subsidy, section 102 of the Act provides a deduction for income attributable to certain domestic production activities. The deduction generally is equal to a specified percentage of the lesser of the taxpayer's "qualified production activities income" or the taxpayer's taxable income (as otherwise determined). The specified percentage is 3% for taxable years beginning in 2005 and 2006, 6% for taxable years beginning in 2007, 2008 and 2009, and 9% for taxable years beginning after 2009. The deduction is limited, however, to 50% of the wages paid during the calendar year that ends during the taxable year. Qualified production activities income may be derived from domestic manufacturing activities as well as certain domestic energy (or water) production activities, the performance of domestic construction activities or the performance of engineering or architectural services in connection with domestic construction projects. Qualified production activities also include the production of certain films even if produced in part outside the U.S.

Temporary DRD for Extraordinary Dividends from CFCs

To induce the repatriation of non-Subpart F income earned by controlled foreign corporations ("CFCs"), section 422 of the Act temporarily provides an elective 85% dividends received deduction ("DRD") for certain extraordinary cash dividends received by corporate United States shareholders from their CFCs, provided that a reinvestment requirement is satisfied. For this purpose, a distribution by the CFC of previously taxed income may be treated as a cash dividend if CFC received a cash dividend from a lower-tier CFC during the election period.

The extraordinary portion of the dividend for which the temporary DRD is available (subject to limitations) generally is the excess of cash dividends received from CFCs during the year over the annual average, for certain "base period" years, of certain actual and deemed distributions from CFCs. Amounts taken into account for the purpose of determining such base period distributions include actual dividends, distributions of previously taxed Subpart F income and amounts included in income due to certain investments in United States property by the CFC. An anti-abuse rule reduces the amount of dividends potentially eligible for the temporary DRD by certain increases in the amount of related-party debt owed by the CFC or other CFCs of which the taxpayer is a United States shareholder. Dividends are only eligible for the temporary DRD if they are invested in the United States pursuant to a "domestic reinvestment plan" which must be approved by certain directors, officers or other comparable officials both before and after payment of the dividend. Permissible reinvestment of repatriated dividends in the U.S. includes use for the funding of worker hiring and training, infrastructure, research and development, capital investments, and the financial stabilization of the corporation for the purposes of job retention or creation, provided, however, that the reinvestment plan cannot designate repatriated funds for use as payment of executive compensation.

The amount of dividends for which a DRD may be allowed generally may not exceed the greater of \$500,000,000 or the amount shown on the applicable financial statements as earnings permanently invested outside the United States. In the case of a controlled group, the limitation must be applied by allocating the \$500,000,000 among the members of the group. No foreign tax credit or deduction is allowed for any foreign taxes attributable to the portion of any dividend for which the DRD is available; however, a taxpayer may specifically identify which dividends qualify for the DRD and which dividends may carry foreign tax credits. S corporations are not eligible for the temporary DRD.

The election is temporary and may only be made for either the taxpayer's last taxable year beginning before October 22, 2004 or the taxpayer's first taxable year beginning during the 1-year period beginning on October 22, 2004. The legislative history emphasizes that there is no intention to make the temporary DRD permanent or extend or enact it in the future. Given the short time frame, the Internal Revenue Service ("IRS") has indicated that issuing guidance on the DRD provision is a high priority.

Corporate Inversions

Taxation of expatriated entities that engage in inversion transactions. The Act contains several provisions to discourage or punish inversion transactions by which formerly U.S. corporations or partnerships expatriate and reorganize as foreign corporations. Section 801 of the

Act generally thwarts inversion transactions by treating the new foreign parent corporation as a domestic corporation if, after the acquisition: (1) 80% of the shares of the new foreign parent corporation are held by the former shareholders of the expatriated domestic corporation or the former partners of the expatriated domestic partnership and (2) the foreign parent corporation's "expanded affiliated group" does not have substantial business activities in the country in which the foreign parent corporation is organized. If these requirements are not satisfied, but would be satisfied if the 80% ownership requirement were reduced to 60%, then the foreign parent corporation is not recharacterized as a domestic corporation, but the expatriated domestic entity and certain related U.S. persons are taxed on their "inversion gains" (including amounts received from the transfer of a license to a related foreign person after the inversion transaction) during the 10-year period following the inversion transaction with no allowance for foreign tax credits or net operating losses. These limitations may not be overridden under a U.S. income tax treaty. Section 801 of the Act applies to inversion transactions and taxable years beginning after March 4, 2003.

Additional provisions relating to inversion transactions. Pursuant to section 802 of the Act, officers, directors and certain other insiders of an expatriated domestic corporation will be subject to an excise tax if any shareholder recognizes gain by reason of the inversion transaction. A domestic corporation will be considered an expatriated domestic corporation for this purpose if section 801 of the Act applies either to treat the new foreign parent corporation as domestic or to tax the domestic corporation and certain related U.S. persons on their "inversion gains" under the rules described above. The excise tax is imposed at long-term capital gains rates on the value of nonqualified stock options and other stock-based compensation rights, whether or not vested, held by the individual (or members of his family) during the 12-month period beginning 6 months before the expatriation date. The excise tax generally is imposed in addition to any applicable income tax imposed in connection with such nonqualified stock options and other stock-based compensation rights. There is an exception, however, for stock options and other compensation with respect to which income or gain is recognized on the expatriation date or during the preceding six-month period. Section 802 of the Act generally applies as of March 4, 2003.

Section 805 of the Act requires the acquiring corporation (or its nominee) in any taxable acquisition to file an information return with the IRS and to provide a written statement to certain shareholders of the acquired corporation. This reporting requirement is general in nature, but presumably is intended to enhance compliance by shareholders of domestic corporations that engage in inversion transactions. Section 805 of the Act applies to acquisitions after October 22, 2004.

Reinsurance of U.S. risks in foreign jurisdictions. Certain U.S. corporations have used reinsurance arrangements with foreign reinsurers to shift taxable income outside the United States. Section 845 of the Internal Revenue Code authorizes the IRS to allocate items among certain related parties to a reinsurance agreement, recharacterize items, or make any other adjustment deemed necessary to reflect the proper source and character each such person's taxable income. Section 803 of the Act clarifies that this authority may also be exercised to reflect the proper amount of each such person's taxable income. Section 803 of the Act applies to any risk reinsured after October 22, 2004.

Expatriated Individuals

Section 804 of the Act eliminates the tax-avoidance purpose test of prior law and provides objective standards for determining whether former citizens or former long-term residents are subject to the alternative tax regime applicable to certain expatriates. Subject to limited exceptions for certain dual citizens or minors, the alternative tax regime applies if the individual's average net income tax for a specified period or his net worth on the date of expatriation exceeds a specified threshold, or if the individual fails to certify under penalty of perjury that he or she has complied with his U.S. federal tax obligations for the five preceding taxable years. An individual who satisfies the objective test may not request a private letter ruling and is subject to the alternative tax regime regardless of his or her reasons for expatriating. A citizen or long-term resident who becomes a nonresident alien under the normal residence rules will continue to be treated as a citizen or resident unless certain notice requirements are satisfied. (The statute literally imposes this notice requirement on all residents, whether or not long-term residents, but this appears to be an error and it is hoped that a technical correction will be made.) In addition, former citizens or long-term residents otherwise subject to the alternative tax regime generally will be treated as citizens or residents for any calendar year in which they are physically present in the U.S. for more than 30 days. Further, individuals subject to the alternative tax regime will be subject to gift tax on gifts of certain closely-held foreign corporations that hold U.S.-situated property. (This change brings the gift tax rule into conformity with the comparable look-through rule that already applied for U.S. estate tax purposes.) Finally, such individuals will be subject to an annual return-filing requirement during the 10-year period during which the alternative tax regime applies, regardless of whether they have any U.S. federal tax liability for any such year. The Act does not include the mark-to-market provision of prior proposed legislation. Section 804 of the Act applies to individuals who relinquish citizenship or terminate long-term residency after June 3, 2004.

Repeal of Foreign Personal Holding Company Rules

Section 413 of the Act repeals the anti-deferral rules applicable to foreign personal holding companies. In some situations, this will permit greater opportunities to defer income, or to eliminate unnecessary holding companies, since the foreign personal holding company rules are in some respects more restrictive than those applicable to CFC. Section 413 of the Act also repeals the rules applicable to foreign investment companies. Both provisions apply to taxable years of foreign corporations beginning after 2004 and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.

Penalty for Failure to Report Foreign Accounts

Section 821 of the Act increases the penalties for failure to report transactions and accounts with foreign financial institutions. The penalty for a willful failure to report is the greater of \$100,000 or 50% of the amount of the unreported transaction or account balance. In addition, a penalty of up to \$10,000 may be imposed in the case of a non-willful failure, subject to a reasonable cause exception. Section 821 of the Act applies to violations occurring after October 22, 2004.

CFC Rules

Exception to "United States property" for CFC investment rules. Section 407 of the Act creates two new exceptions to the definition of "United States property" for purposes of section 956 of the Internal Revenue Code, which taxes United States shareholders of a CFC on certain investments in United States property by the CFC. Pursuant to section 407 of the Act, United States property will not include (1) securities held by a CFC in the ordinary course of its business as a dealer in securities if certain requirements are satisfied or (2) obligations of a U.S. person, other than a corporation, if such U.S. person is neither a "United States shareholder" of the CFC nor a partnership, estate or trust in which the CFC (or any related person) is a partner, beneficiary or trustee. Under prior law, obligations of an unrelated domestic corporation already were excluded from the scope of United States property but obligations of unrelated domestic persons other than corporations were not excluded. Section 407 of the Act applies to taxable years of foreign corporations beginning after 2004 and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.

More restrictive bank deposit exception for purposes of determining CFC's investment in U.S. property. Section 837 of the Act limits the type of U.S. bank deposits that may be made by CFCs without triggering a taxable investment in United States property. To satisfy the exception, deposits must be made with (1) a bank as defined in section 2(c) of the Bank Holding Company Act of 1956, with certain modifications or (2) a greater-than-80% subsidiary of a "bank holding company" or "financial holding company" as defined in certain provisions of the Bank Holding Company Act of 1956. This essentially reverses the taxpayer-favorable result reached by the Sixth Circuit in *The Limited, Inc. v. Commissioner*, 286 F.3d 324 (6th Cir. 2002), *rev'g*, 113 T.C. 169 (1999), which treated an affiliate whose operations were limited to the administration of the private label credit card program of the United States shareholder as engaged in the banking business. Section 837 of the Act applies as of October 22, 2004.

Look-thru treatment for sales of partnership interests. Section 412 of the Act treats income from the sale by a CFC of certain partnership interests as income from the sale of a proportionate share of the assets of the partnership for purposes of determining whether the sale triggers "Subpart F income." Look-through treatment applies only if the CFC is a "25-percent owner" of the partnership. Section 412 of the Act applies to taxable years of foreign corporations beginning after 2004 and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.

Treatment of deemed payments from outbound transfer of intangible property. Section 406 of the Act clarifies that deemed purchase payments arising from an outbound transfer of intangible property to a foreign corporation, in a transaction that otherwise qualifies for tax-free treatment, will be characterized as royalties for purposes of applying the separate limitation categories of the foreign tax credit. Therefore, if the foreign corporation is a CFC, certain "look-through" rules applicable to royalties received from a CFC may permit the royalties to be characterized as nonpassive income for foreign tax credit purposes. Section 406 of the Act applies to amounts treated as received on or after August 5, 1997.

Modified subpart F exception for certain commodities transactions. Section 414 of the Act modifies the exception from Subpart F for income from certain commodity hedging

transactions and certain active business gains from the sale of commodities. In contrast with prior law, the latter exception applies even if the CFC has a substantial business apart from its commodities business, as long as substantially all of the CFC's commodities consist of inventory, depreciable property or supplies used in its business. Section 414 of the Act applies to transactions entered into after 2004.

Modification of active financing exception. Section 416 of the Act modifies the existing temporary rules that exclude from Subpart F income qualified banking or financing income of a CFC. Under this provision, the requirement that certain activities be performed by the CFC (or a qualified business unit thereof) in its home country may be satisfied if such activities are performed by employees of a related person if the related person is also an "eligible CFC" (or a qualified business thereof) and certain additional requirements are satisfied. Section 414 of the Act applies to taxable years of foreign corporations beginning after 2004 and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.

Deferral permitted for certain aircraft and shipping income. Section 415 of the Act repeals the Subpart F rules applicable to "foreign base company shipping income." The provision also prescribes a safe harbor pursuant to which certain rents from the lease of an aircraft or vessel will qualify as active rents and thus will not be treated as foreign personal holding company income. Section 415 of the Act applies to taxable years of foreign corporations beginning after 2004 and to taxable years of United States shareholders with or within which such taxable years of foreign corporations end.

Inbound Provisions

Limitation on importation of built-in losses. Section 836 of the Act limits the importation of built-in losses through tax-free transfers to a domestic corporation of loss properties by foreign persons not subject to U.S. tax. Where the limitation applies, the corporation must take a fair market value tax basis in the assets received from the transferor. A similar limitation applies in the case of tax-free contributions to a corporation by U.S. persons, but in this case the transferor and transferee may jointly elect to reduce the basis of the stock received by the transferor in lieu of reducing the basis of the assets contributed to the corporation. Section 836 of the Act generally applies to transactions after October 22, 2004.

Liquidation of U.S. holding company treated as a dividend. Section 893 of the Act provides that a distribution made in liquidation of a U.S. holding company to its foreign shareholder will be treated as a dividend, potentially subject to U.S. withholding tax. For this purpose, a U.S. holding company means a domestic corporation that is the common parent of an affiliated group and substantially all of the assets of which consist of stock in members of the affiliated group. An exception is provided where the holding company has been in existence for five years prior to the liquidation. Under prior law, such a distribution would have been treated as received in exchange for the shareholder's stock and would not have been taxable. Section 893 of the Act is effective for distributions occurring on or after October 22, 2004.

Exception to FIRPTA treatment of certain REIT distributions. Pursuant to the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA"), a foreign shareholder of a real estate investment trust ("REIT") who receives certain distributions attributable to dispositions of U.S.

real property by the REIT generally is treated as having disposed of an interest in U.S. real property; and gain from such deemed disposition is taxable under FIRPTA. Section 418 of the Act creates an exception to this "look-through" rule for shareholders of a public REIT owning 5 percent or less of the publicly traded shares of the REIT. The new exception conforms to the previously existing exception applicable for gain recognized by public shareholders upon disposition of their REIT shares and removes a substantial disincentive to foreign investment in U.S. REITs. Section 418 of the Act applies to taxable years beginning after October 22, 2004.

Look-through treatment for RIC distributions and RIC assets. Section 411 of the Act allows Regulated Investment Companies ("RICs") to designate a portion of the dividends paid to their foreign shareholders as derived from either portfolio interest income and/or short-term capital gains to the extent that these amounts would not otherwise be subject to U.S. tax in the hands of such foreign shareholders. In addition, the estate of a foreign decedent will be able to exclude from U.S. estate tax stock in a RIC to the extent that the RIC's assets, if held by the estate directly, would not be subject to U.S. estate tax, *i.e.*, portfolio debt securities and short-term OID obligations. The new "look-through rules" remove a substantial disincentive to foreign investment in U.S. money market funds. Section 411 of the Act applies to RIC dividends paid for RIC taxable years beginning after 2004 (but before 2008) and to estates of decedents dying after 2004 (but before 2008).

Expanded class of foreign source income treated as effectively connected. Section 894 of the Act expands the class of items of foreign source income that may be treated as effectively connected with a U.S. trade or business if attributable to a U.S. office. The "U.S. office rule," which previously applied only to certain rents, royalties, dividends, interest, and income from the sale or exchange of certain noncapital assets, now applies to economic equivalents of these items. Section 894 of the Act applies to taxable years beginning after October 22, 2004.

Residence and source rules for U.S. possessions. Section 937 of the Act defines the term "bona fide resident" of a U.S. possession (relevant for determining eligibility for various benefits available to such residents) as an individual who spends at least 183 days during the taxable year in the relevant possession and who does not have a tax home outside the possession. In addition, to qualify as a bona fide resident the individual cannot have a closer connection to the United States or a foreign country than to such possession. Section 937 of the Act also provides that in determining whether income is treated as sourced in a possession or as effectively connected to a trade or business in a possession the rules applicable in determining whether income is U.S. source or effectively connected apply. A new reporting requirement is also added for any individual that ceases to be a bona fide resident of a possession. Section 937 of the Act is generally effective for taxable years ending after October 22, 2004, except that the 183-day requirement referred to above and the new sourcing rules apply to taxable years beginning after October 22, 2004.

Reduced withholding tax on dividends to Puerto Rico corporations. Section 420 of the Act reduces the withholding tax on U.S. source dividends paid to qualifying corporations organized in Puerto Rico from 30% to 10%. Section 420 of the Act applies to taxable years beginning after October 22, 2004.

Foreign Tax Credit Rules

Foreign tax credit baskets reduced from nine to two. In a significant simplification of the foreign tax credit regime, section 404 of the Act generally reduces the number of foreign tax credit limitation "baskets" to two: passive category income and general category income. For a member of a financial services group or any other person predominantly engaged in the active conduct of a banking, insurance, financing or other similar business, "financial services income" is characterized as general category income. Section 404 of the Act applies to taxable years beginning after 2006.

Foreign tax credit carrybacks and carryforwards. Section 417 of the Act extends the foreign tax credit carryforward period to ten years, but reduces the carryback period to one year. Section 417 of the Act applies to excess foreign taxes that (without regard to such provision) may be carried to any taxable year ending after October 22, 2004.

Repeal of 90% AMT limitation for foreign tax credits. Section 421 of the Act repeals the limitation that prevents foreign tax credits from offsetting more than 90% of a taxpayer's alternative minimum tax liability. Section 421 of the Act applies to taxable years beginning after 2004.

Recapture of overall foreign loss account on disposition of CFC stock. If a taxpayer has an "overall foreign loss," up to 50% of the foreign-source income earned in a subsequent year may be recharacterized as U.S.-source income, thereby precluding the use of a foreign tax credit with respect to such income. This recharacterization is intended to "recapture" the benefit of having used the prior years' foreign losses to offset U.S.-source income. If a taxpayer disposes of property which has been used predominantly outside the United States before the loss has been recaptured, the disposition triggers taxable income, which is deemed to have a U.S. source, without regard to the 50% limit, even if the disposition otherwise qualifies for nonrecognition treatment. Section 895 of the Act backstops this recapture rule by providing for the same result in the case of certain dispositions of shares of a CFC. Exceptions apply to certain restructurings in which the transferor (or, in certain cases, a member of the transferor's consolidated group) continues to own the shares or assets of the CFC. Section 895 of the Act applies to dispositions after October 22, 2004.

Overall domestic loss. Section 402 of the Act provides that, if in one year a taxpayer sustains an "overall domestic loss" that offsets foreign-source income, a portion of the taxpayer's taxable income from U.S. sources in subsequent years will be recharacterized as foreign-source for foreign tax credit purposes. The amount of income so recharacterized in any year may not exceed 50% of the taxpayer's taxable income from U.S. sources for such year. The new rules for overall domestic losses parallel the existing rules for overall foreign losses. Section 402 of the Act applies to losses for taxable years beginning after 2006.

Dividend look-through rules extended to 10/50 companies. A "10/50 company" is a foreign corporation, other than a CFC, of which the taxpayer owns shares possessing 10% of the total voting power. Pursuant to section 403 of the Act, all dividends from a 10/50 company are allocated among foreign tax credit limitation categories on a "look-through" basis, *i.e.*, in proportion to the amounts of income earned by the 10/50 company in each category. Under prior

law, dividends paid by 10/50 companies from profits accumulated during taxable years beginning prior to 2003 were not characterized on a look-through basis and were subject to a separate limitation. Section 403 of the Act applies to taxable years beginning after 2002.

Attribution of stock held through partnerships for purposes of deemed-paid foreign tax credit. Section 405 of the Act clarifies that, for purposes of determining whether a domestic corporation possesses the requisite interest in a foreign corporation to qualify for a deemed-paid foreign tax credit, stock owned by a partnership will be attributed proportionately to its partners. Section 405 of the Act applies to taxable years beginning after October 22, 2004.

Holding period requirement. Section 832 of the Act generally disallows foreign tax credits for foreign withholding taxes imposed on income other than dividends unless a 15-day holding period requirement is satisfied. An exception is available for dealers. The Department of the Treasury is authorized to issue regulations providing for additional exceptions, *e.g.*, for hedging risk of loss from currency or interest rate fluctuations and possibly for hedging a limited amount of credit risk. Under prior law, the 15-day (or, in some cases, 45-day) holding period requirement only applied to dividends. Section 832 of the Act applies to amounts paid or accrued more than 30 days after October 22, 2004.

Shipping Provisions

Alternative tax regime for international shipping activities. Section 248 of the Act allows corporations to elect to pay a "tonnage tax" in lieu of the corporate tax on income from certain international shipping activities. The tonnage tax is the product of maximum corporate income tax rate and a notional amount based on the net tonnage of the corporation's qualifying vessels. Income that does not qualify for taxation under this alternative regime continues to be taxed under the regular corporate income tax rules. Items of loss, deduction or credit that are attributable to income that is excluded from the regular corporate income tax base pursuant to the election are disallowed. Foreign corporations that elect to apply the alternative tax regime will not be subject to the tonnage tax on any shipping income that qualifies for exclusion under a U.S. tax treaty or the Internal Revenue Code. Section 248 applies for taxable years beginning after October 22, 2004.

Delayed effective date of section 883 regulations. In 2003, regulations were finalized pursuant to section 883 of the Internal Revenue Code, which provides a reciprocal exemption for certain income derived by a foreign corporation from the international operation of ships or aircraft. Among other changes, these regulations impose burdensome new documentation and substantiation rules. Section 423 of the Act delays the effective date of the new regulations until tax years of foreign corporations beginning after September 24, 2004.

Miscellaneous Provisions

New source rule for interest paid by partnerships. Section 410 of the Act provides that, in the case of a partnership that is predominantly engaged in the active conduct of a trade or business outside the U.S., any interest that is neither paid by the partnership's U.S. trade or business nor allocable to effectively connected income will have a foreign source and thus will not be subject to U.S. withholding tax. This change generally makes the treatment of foreign partnerships consistent with that of foreign corporations. Pursuant to regulations in effect prior to

the Act, all interest paid by a foreign partnership that engages in a U.S. trade or business had a U.S. source. Section 410 of the Act applies to taxable years beginning after 2003.

Election to allocate interest expense on a worldwide basis. Section 401 of the Act modifies the interest-expense allocation rules by permitting the domestic members of an affiliated group to elect to determine their foreign-source taxable income by allocating and apportioning interest expense on a worldwide basis. If the election is made, the third-party interest of the group's domestic members that is allocated to foreign sources generally will equal the excess of (1) the product of the worldwide group's third-party interest expense and a fraction the numerator of which is the worldwide group's foreign assets and the denominator of which is the worldwide group's worldwide assets, over (2) the third-party interest expense of the group's foreign members to the extent allocated to foreign sources by applying the allocation formula solely to such foreign members of the group. These rules are applied separately to certain financial institutions, and a worldwide affiliated group may elect to treat certain financial corporations as financial institutions for this purpose. Section 401 of the Act applies to taxable years beginning after 2008.

Prevention of mismatch of income and deductions in certain transactions with related CFCs and PFICs. Section 841 of the Act generally prevents the issuer of an original issue discount ("OID") instrument held by a related foreign CFC or passive foreign investment company ("PFIC") from deducting such OID, prior to the year in which corresponding interest payments are made, except to the extent that the OID is includible in the income of the CFC's or the PFIC's direct or indirect U.S. owners. Similar rules apply to other unpaid amounts owned to a CFC or PFIC. (The statute appears to prescribe such matching rule even where the CFC or PFIC is unrelated to the taxpayer, but this appears to be an error and it is hoped that a technical correction will be made.) The Treasury Department has the authority to exempt certain transactions from the scope of this matching rule. Section 841 of the Act is effective for payments accrued on or after October 22, 2004.

No basis for certain nonresident alien contributions to retirement plans. Section 906 of the Act precludes any addition to basis for employer or employee contributions to a retirement plan with respect to a non-resident alien employee performing services outside the U.S., if the contribution was not subject to either U.S. or foreign tax when made but would have been subject to U.S. or foreign tax if paid as cash compensation when the services were performed. Additions to basis similarly are precluded for earnings attributable to employer or employee contributions if the employee was a nonresident alien when the earnings were paid or accrued and was not subject to U.S. or foreign tax thereon. Section 906 of the Act applies to distributions made on or after October 22, 2004.

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If you wish to learn more about the international provisions of the Act, please call Sanford H. Goldberg at (212) 903-8745, Howard J. Levine at (202) 293-3400, Mark David Rozen at (212) 903-8743, Joseph Lipari at (212) 903-8765, Abraham Leitner at (212) 903-8736, or Michael J. Miller at (212) 903-8757.

Roberts & Holland LLP