

Treatment of Income from Certain Government Bonds for Purposes of the Passive Foreign Investment Company Rules

SECTION 1. PURPOSE

This notice provides guidance regarding the treatment of certain government bonds for purposes of determining whether a foreign corporation is a passive foreign investment company (PFIC).

SECTION 2. BACKGROUND

Section 1297(a) provides that a PFIC is any foreign corporation if 75 percent or more of its gross income for the taxable year is passive income or the average percentage of assets held by the corporation during the taxable year which produce passive income or which are held for the production of passive income is at least 50 percent. Section 1297(b)(1) provides that passive income means any income which is of a kind which would be foreign personal holding company income as defined in section 954(c), subject to the exceptions of section 1297(b)(2). Under section 1297(b)(2)(A), the term “passive income” does not include any income derived in the active conduct of a banking business by an institution licensed to do business as a bank in the United States or, to the extent provided in regulations, by any other corporation (active banking exception).

In Notice 89-81, 1989-2 C.B. 399, the Internal Revenue Service (IRS) and the Department of the Treasury (Treasury Department) described rules that would expand the active banking exception to certain foreign corporations not

licensed to do business as a bank in the United States, and identified the types of banking activities that produce income excluded from passive income under the active banking exception. In 1995, the IRS and the Treasury Department issued proposed regulations on the active banking exception. Prop. Reg. §1.1296-4.

SECTION 3. QUALIFYING FOREIGN GOVERNMENT BONDS HELD BY ACTIVE BANKS

Recent economic conditions have resulted in a shift in the assets held by some non-U.S. financial institutions. As a result of these conditions, certain financial institutions are holding government bonds at higher than historical levels. These increased levels have raised an issue concerning the treatment of these financial institutions, and specifically the treatment of government bonds, under the PFIC rules.

This notice announces that, solely for purposes of section 1297 and the taxable years provided in Section 4 of this notice, the income from Qualifying Government Bonds held by an Active Bank qualifies for the active banking exception.

For purposes of this notice, the following terms have the meanings set forth below:

Active Bank. For any taxable year set forth in Section 4 of this notice, an Active Bank is a foreign corporation that:

(i) would not be a PFIC for such taxable year as a result of the application of the active banking exception if the treatment of Qualifying Government Bonds described in this Section 3 applied (and taking into account, if applicable, section 1297(c));

(ii) was not in any prior taxable year beginning in the preceding five calendar years a PFIC, in each case as a result of the application of the active banking exception (taking into account, if applicable, the treatment of Qualifying Government Bonds described in this Section 3 for taxable years set forth in Section 4 of this notice and section 1297(c)); and

(iii) is, and was in each taxable year beginning in the preceding five calendar years, a publicly traded corporation. For purposes of this notice, a corporation will be treated as a publicly traded corporation if (1) one or more classes of stock is regularly traded on a qualified exchange or other market (within the meaning of §1.1296-2), or (2) at least 50 percent of the aggregate vote and value of the shares in the corporation is owned directly or indirectly by another corporation described in clause (1) of this subparagraph.

Qualifying Government Bond. Qualifying Government Bond means a bond or similar instrument that has been issued by the government of the country (or any political subdivision, agency, instrumentality, or local authority thereof) under the laws of which the Active Bank is created or organized.

SECTION 4. EFFECTIVE/APPLICABILITY DATE

This notice shall apply to taxable years of foreign corporations beginning in 2011, 2012, and 2013.

SECTION 5. DRAFTING INFORMATION

The principal author of this notice is Kristine Crabtree of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in its development. For further

information regarding this notice, contact Ms. Crabtree at (202) 622-3840 (not a toll-free call).