

## Part I – Rulings and Decisions Under the Internal Revenue Code of 1986

### Credit for Certain Foreign Gross-Basis Withholding Taxes

Notice 2010-65

#### PURPOSE

On November 30, 2005, the Treasury Department and the Internal Revenue Service (IRS) issued Notice 2005-90, 2005-2 C.B. 1163. Notice 2005-90 sets forth an exception to the application of section 901(l)(1)(B) of the Internal Revenue Code with respect to certain back-to-back computer program licensing arrangements. This notice provides additional guidance regarding the application of section 901(l) to other back-to-back licensing arrangements and certain arrangements for the retail distribution of copyrighted articles.

#### BACKGROUND

Section 901(l) generally disallows a credit for foreign gross-basis withholding tax on any item of income (other than dividends) or gain with respect to property if (a) the recipient of the item has not held the property for more than 15 days (within a 31-day testing period), exclusive of periods during which the recipient is protected from risk of loss (section 901(l)(1)(A)), or (b) the recipient is under an obligation (whether pursuant to a short sale or otherwise) to make related payments with respect to positions in substantially similar or related property (section 901(l)(1)(B)). Section 901(l)(3) provides that the Secretary may by regulation provide that section 901(l)(1) does not apply to property where such application is not necessary to carry out the purposes of section 901(l).

Notice 2005-90 states that the Treasury Department and the IRS expect to issue regulations setting forth an exception to the application of section 901(l)(1)(B) to foreign gross-basis withholding taxes imposed on payments in a back-to-back computer program licensing arrangement in the ordinary course of the licensor's and licensee's respective trades or businesses. Notice 2005-90 also requested comments concerning any additional issues that should be addressed by regulations, including whether the exception should apply to other circumstances and to other types of property.

#### DISCUSSION

Following the issuance of Notice 2005-90, the Treasury Department and the IRS received comments regarding business arrangements involving the ordinary course licensing and other transfers of certain intellectual property with respect to which the disallowance of a credit is not necessary to carry out the purposes of section 901(l). One such business arrangement is generally similar to the back-to-back licensing arrangements described in Notice 2005-90, except that the intellectual property involved is property other than rights in, or copies of, computer programs. Another ordinary course of business

arrangement identified by a commentator involves the retail distribution of certain copyrighted articles that does not meet the holding period requirement in section 901(l)(1)(A).

Consistent with Notice 2005-90 and in response to comments received since the issuance of that Notice, the Treasury Department and the IRS intend to issue regulations, pursuant to section 901(l)(3), providing relief from the application of section 901(l)(1)(A) or (B) in the circumstances described below. Specifically, the regulations will provide that (1) section 901(l)(1)(B) will not apply to disallow a credit for foreign gross-basis withholding taxes (which otherwise meet the legal requirements to be treated as creditable taxes) imposed on income or gain with respect to back-to-back licensing arrangements involving certain intellectual property or copyrighted articles entered into in the ordinary course of business; and (2) section 901(l)(1)(A) will not apply to disallow a credit for foreign gross-basis withholding taxes (which otherwise meet the legal requirements to be treated as creditable taxes) imposed on income or gain with respect to retail distribution arrangements for certain copyrighted articles entered into in the ordinary course of business.

#### 1. Relief from application of section 901(l)(1)(B) for certain back-to-back licensing arrangements made in the ordinary course of business

Under a typical business arrangement involving back-to-back licensing, a domestic corporation or a U.S. citizen or resident alien individual (Master Licensor) licenses (or otherwise transfers) rights to certain intellectual property pursuant to a master license agreement or similar arrangement to either an affiliate (foreign or domestic) or an unrelated domestic corporation (or its controlled foreign corporation) (Head Licensee) for the purpose of development, production, exploitation, distribution, or marketing of the intellectual property. Head Licensee (or its affiliates) is in the business of developing, producing, exploiting, distributing or marketing intellectual property. As part of the arrangement, Head Licensee sublicenses rights to the intellectual property to its affiliates or to unrelated corporations (Sublicensees), as permitted under the terms and conditions of the master license agreement. Pursuant to the sublicense agreements, Sublicensees make payments to Head Licensee, which may be subject to foreign gross-basis withholding tax.

There are a variety of business reasons independent of U.S. tax considerations for parties to structure a back-to-back licensing arrangement with respect to intellectual property. For example, Master Licensor may contract with an unrelated Head Licensee as part of a distribution arrangement in which Licensee distributes an article embodying Master Licensor's intellectual property through its affiliated Sublicensees around the world. In such a case, Master Licensor may be unwilling for business or practical reasons to enter into a contractual relationship with each Sublicensee in each foreign jurisdiction and may therefore require that its only contractual relationship be with Head Licensee. Alternatively, Master Licensor may license the intellectual property to an affiliated domestic or foreign Head Licensee that distributes articles embodying the intellectual

property by means of contractual relationships with unrelated Sublicensees in foreign jurisdictions.

A back-to-back licensing arrangement may be part of the manner by which an unrelated Head Licensee conducts its business. For example, where Head Licensee has expertise in exploiting the intellectual property, it may be ordinary and customary for Head Licensee to acquire rights to the intellectual property from Master Licensor as part of a production or development process before the article embodying the intellectual property is distributed through sublicensing arrangements with Head Licensee's foreign or domestic affiliates.

a. Covered intellectual property and copyrighted articles

Pursuant to the authority granted under section 901(l)(3), the Treasury Department and the IRS have determined that the application of section 901(l)(1)(B) to foreign gross-basis withholding taxes imposed on payments in a back-to-back licensing arrangement with respect to covered intellectual property or a covered copyrighted article entered into in the ordinary course of business, as that term is defined in section 1(b) of this notice, is not necessary to carry out the purposes of section 901(l). For purposes of this notice, "covered intellectual property" means intellectual property rights in any film, television program or recording; literary, musical or artistic composition; computer program; right to publicity (e.g., name and likeness); or other similar property, and a "covered copyrighted article" means a copy of any film, television program or recording; literary, musical or artistic composition; computer program; or other similar property.

b. Back-to-back licensing arrangement

For purposes of this notice, a "back-to-back licensing arrangement with respect to covered intellectual property or a covered copyrighted article" is a transaction or series of transactions in which: (1) a domestic corporation or individual who is a citizen or resident of the United States owns a right or rights in covered intellectual property or a covered copyrighted article (master licensor) and transfers a right or rights in the covered intellectual property or the covered copyrighted article to a domestic corporation or a controlled foreign corporation within the meaning of section 957 (head licensee) pursuant to an agreement (a master license agreement or similar arrangement) that is confined to the development, production, exploitation, distribution, or marketing of the intellectual property or the copyrighted article; (2) the head licensee transfers a right or rights in the covered intellectual property or the covered copyrighted article to one or more corporations (sublicensees), as permitted by the terms and conditions of the master license agreement, for the purpose of development, production, exploitation, distribution or marketing of the intellectual property or the copyrighted article or for the sublicensee's own use; and (3) the head licensee is a member of the worldwide affiliated group that includes either the master licensor or the sublicensee. For purposes of this notice, a worldwide affiliated group is as defined in section 864(f)(1)(C), determined without regard to the exception in section 1504(a)(4) treating certain preferred stock as not stock.

The relief described in section 1 of this notice applies without regard to the form of the transaction or the treatment of the transaction under foreign law, and includes the transfer of rights in the intellectual property or the copyrighted article through a license, sale, lease or exchange for U.S. tax purposes.

c. Ordinary course of business

For purposes of this notice, a back-to-back licensing arrangement with respect to covered intellectual property or a covered copyrighted article is in the “ordinary course of business” if: (A) the arrangement is consistent with the normal business practices of the master licensor with respect to licensing of intellectual property or a copyrighted article of the type that is the subject of the back-to-back licensing arrangement (as defined in section 1(a) of this notice) independent of U.S. federal tax considerations; (B) the head licensee and each sublicensee (other than a sublicensee that licenses the intellectual property or copyrighted article exclusively for its own use) are regularly engaged in a trade or business, within the meaning of § 1.367(a)-2T(b)(2), of developing, producing, exploiting, distributing or marketing the intellectual property or the copyrighted article that is the subject of the back-to-back licensing arrangement; and (C) for each payment made by a sublicensee under the sublicense agreement with respect to which foreign gross-basis withholding tax is imposed, the sublicensee uses the right to the intellectual property or the copyrighted article that is the subject of the sublicense agreement in a trade or business within the meaning of § 1.367(a)-2T(b)(2). For purposes of clause (B), the head licensee or the sublicensee shall be considered to be regularly engaged in the business of developing, producing, exploiting, distributing or marketing the intellectual property or the copyrighted article that is the subject of the back-to-back licensing arrangement if any member of its worldwide affiliated group is so engaged with respect to that specific intangible.

2. Relief from application of section 901(l)(1)(A) for certain retail distribution arrangements made in the ordinary course of business

Under a typical business arrangement involving retail distribution of certain copyrighted articles, a domestic corporation owns a copyright which is used to produce copyrighted articles. In the ordinary course of its trade or business, the corporation, which may or may not hold the copyrighted articles for the minimum holding period described in section 901(l)(1)(A), transfers such copyrighted articles directly or indirectly through U.S. affiliates to retail customers in foreign jurisdictions. The transactions with retail customers would generally be treated as sales in determining whether for U.S. tax purposes the income is from sources within the United States. See, e.g., § 1.861-18. Retail customers in foreign jurisdictions make payments to the domestic corporation or its U.S. affiliate that, nevertheless, may be subject to foreign gross-basis withholding taxes.

a. Covered copyrighted articles

Pursuant to the authority granted under section 901(l)(3), the Treasury Department and the IRS have determined that the application of section 901(l)(1)(A) to foreign gross-basis withholding taxes imposed on payments in a retail distribution arrangement for covered copyrighted articles (as that term is defined in section 1(a) of this notice) entered into in the ordinary course of business (as that term is defined in section 2(c) of this notice) is not necessary to carry out the purposes of section 901(l).

b. Retail distribution arrangement

For purposes of this notice, a “retail distribution arrangement for covered copyrighted articles” is a transaction in which: (1) a domestic corporation owns a copyright which is used to produce a covered copyrighted article; (2) the domestic corporation transfers directly or indirectly through one or more U.S. affiliates the covered copyrighted article to foreign retail customers; and (3) such arrangement is in the ordinary course of business of the domestic corporation and, if appropriate, its U.S. affiliate(s). For purposes of this notice, a U.S. affiliate is any member of the domestic corporation’s affiliated group as defined in section 1504(a).

c. Ordinary course of business

For purposes of this notice, a retail distribution arrangement for covered copyrighted articles is in the “ordinary course of business” if: (A) the arrangement is consistent with the normal business practices of the domestic corporation with respect to sales of copyrighted articles of the type that is the subject of the retail distribution arrangement (as defined in section 2(a) of this notice) independent of U.S. federal tax considerations; and (B) the domestic corporation, or the U.S. affiliate in the case of a domestic corporation that transfers the covered copyrighted articles indirectly through such affiliate, is regularly engaged in a trade or business, within the meaning of § 1.367(a)-2T(b)(2), of selling the covered copyrighted articles that are the subject of the retail distribution arrangement.

## EFFECT ON OTHER DOCUMENTS

This notice supplements but does not modify or affect the application of the exception described in Notice 2005-90.

## EFFECTIVE DATE

The regulations described in this notice will apply to amounts that are paid or accrued after September 23, 2010. Until regulations incorporating the guidance set forth in this notice are issued, taxpayers may rely on the guidance contained in this notice.

## REQUEST FOR COMMENTS AND CONTACT INFORMATION

The Treasury Department and the IRS request comments concerning the exceptions to section 901(l)(1) described in this notice, the scope of the active dealer exception in section 901(l)(2) to persons for whom intangible property or copyrighted articles are described in section 1221(a)(1), as well as the exception described in Notice 2005-90 and other issues with respect to which the Treasury Department and the IRS requested comments in Notice 2005-90. Written comments may be submitted to the Office of Associate Chief Counsel (International), Attention: Suzanne Walsh, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224. Alternatively, taxpayers may submit comments electronically to [Notice.comments@irscounsel.treas.gov](mailto:Notice.comments@irscounsel.treas.gov). Comments will be available for public inspection and copying. For further information regarding this notice, contact Ms. Walsh of the Office of Associate Chief Counsel (International) at (202)-622-3850 (not a toll-free call).