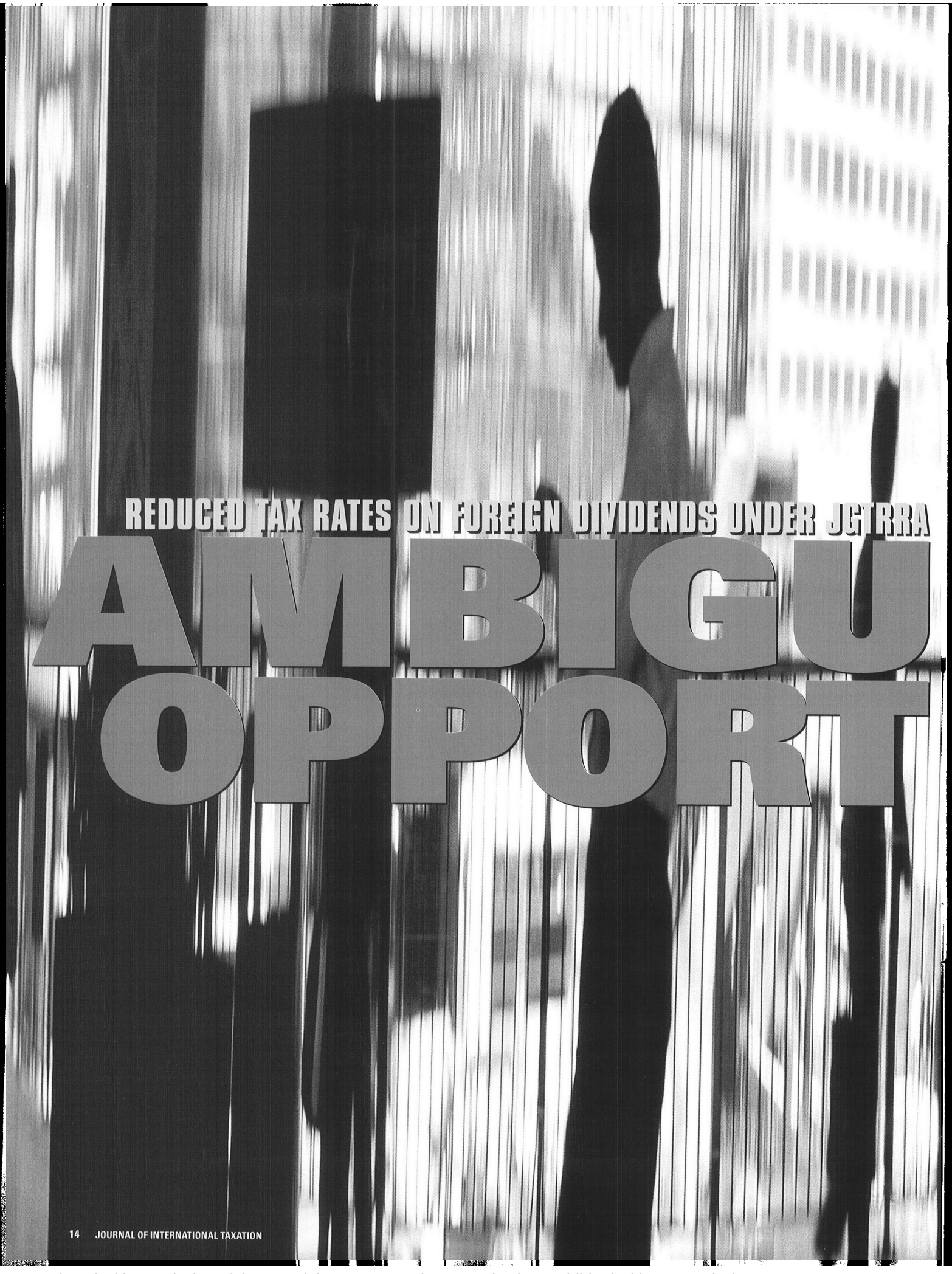
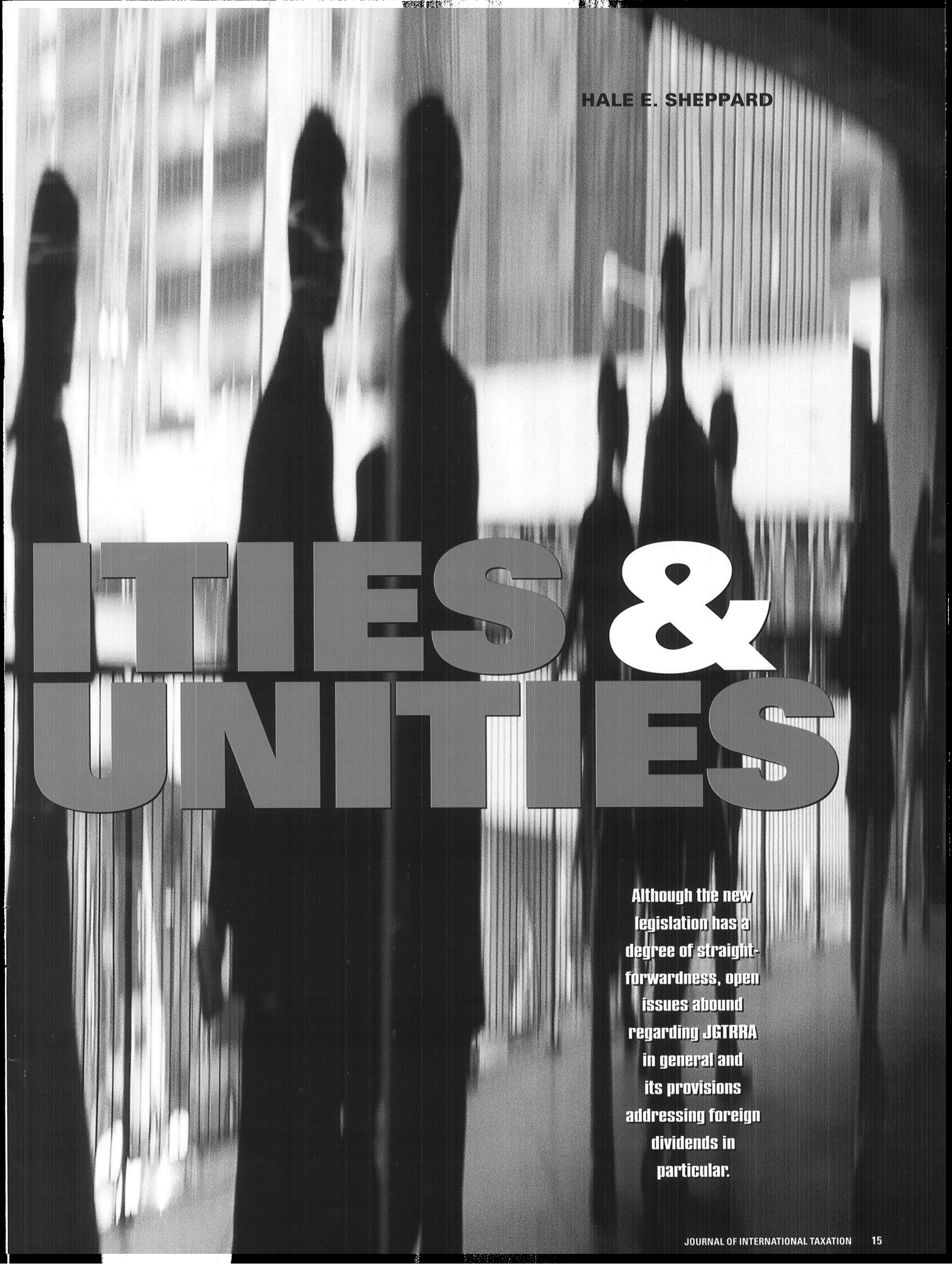




HALE E. SHEPPARD

ITIES & UNTIES

Although the new legislation has a degree of straightforwardness, open issues abound regarding JGTRRA in general and its provisions addressing foreign dividends in particular.

In an effort to stimulate the sluggish domestic economy, the U.S. Congress enacted the Jobs and Growth Tax Relief Reconciliation Act (P.L. 108-27, May 28, 2003) (JGTRRA), which attempts to inspire spending and investment in various ways. Of particular importance to sophisticated investors and international tax practitioners are the provisions that permit certain dividends (which have historically been taxed as ordinary income at rates up to 38.6%) to be taxed at capital gains rates (Section 1(h)(11)). Significant tax savings may ensue since the capital gains rates under JGTRRA are generally reduced to 15%.[1] Before taking advantage of these lower tax rates, however, individual investors must undertake the formidable task of deciphering JGTRRA. Although this new legislation has a degree of straightforwardness, some provisions, such as those addressing the concept of "qualified foreign corporations," remain shrouded in ambiguity. To its credit, the IRS has made significant efforts to clarify the intent, meaning, and scope of these problematic provisions. This regulatory toil notwithstanding, open issues abound regarding JGTRRA in general, and its provisions addressing foreign dividends in particular.

Overview of JGTRRA

The Code generally provides that a taxpayer's "net capital gain" for any year will be subject to a maximum tax rate of 15%.[2] JGTRRA added Section 1(h)(11) to the Code, which provides that "net capital gain" will now include not only a taxpayer's normal net capital gain, but also any "qualified dividend income."[3] To be considered qualified dividend income under JGTRRA, a dividend received by an individual investor must meet two main conditions. First, it must not represent a distribution from certain tax-exempt organizations, mutual savings banks, or deferred compensation plans (Section 1(h)(11)(B)(ii)). Second, it must be distributed by either a "domestic corporation" or a "qualified foreign corporation" (Section 1(h)(11)(B)(i)).

Identifying a "domestic corporation" is relatively simple since, under the Code, a corporation is considered domestic if it is formed in the United States (Sections 7701(a)(3), (4)). For example, a corporation that files its articles of incorporation, bylaws, and other organizational documents in Delaware is a domestic corporation for federal tax purposes. On the other hand, determining whether an entity meets the definition of "qualified foreign corporation" is significantly more difficult. JGTRRA establishes three tests in this regard—the "Possessions Test," the "Treaty Test," and the "Market Test."

Possessions Test. First, an entity will be considered a qualified foreign corporation if it is established in a U.S. possession including Puerto Rico, Guam, American Samoa, and the Virgin Islands ("Possessions Test") (Section 1(h)(11)(C)(i)(II)).

Treaty Test. Second, qualified foreign corporation status will also be granted to an entity if (1) it is eligible for the benefits under a comprehensive income tax treaty with the United States; (2) the U.S.

Treasury Department determines that the treaty is satisfactory for purposes of JGTRRA; and (3) the treaty includes an exchange-of-information program ("Treaty Test") (Section 1(h)(11)(C)(i)(II)). With respect to the first prong, the Conference Report to JGTRRA explained that a company will be considered eligible for the benefits under a comprehensive income tax treaty if it would qualify for such benefits with respect to "substantially all" of its income during the year in which the dividend is paid.

Regarding the second prong, the Conference report provides that the current (1984) U.S.-Barbados income tax treaty is not satisfactory to Treasury since it "may operate to provide benefits that are intended for the purpose of mitigating or eliminating double taxation to corporations that are not at risk of double taxation." Aside from this treaty with Barbados, the Conference Report indicates that, until Treasury formally identifies the tax treaties that it finds acceptable for purposes of JGTRRA, *all* foreign corporations established in nations having comprehensive income tax treaties with the United States that include an exchange-of-information program will be considered qualified foreign corporations.[4]

With regard to the third prong, the United States has signed tax information exchange agreements (TIEAs) with numerous countries, including the Cayman Islands, Barbados, Bermuda, Costa Rica, Dominica, Dominican Republic, Peru, St. Lucia, and Trinidad and Tobago. Although these TIEAs are helpful in thwarting tax evasion, they are not tantamount to comprehensive income tax treaties. Accordingly, despite a notable degree of cooperation with the United States under the TIEAs, these jurisdictions would not satisfy the Treaty Test.[5]

Market Test. Third, an entity will be treated as a qualified foreign corporation if its dividend-paying stock is readily tradable on an established U.S. securities market ("Market Test") (Section 1(h)(11)(C)(ii)). According to the Conference Report to JGTRRA, stock will be treated as "readily tradable" if an American Depository Receipt (ADR) backed by such stock is readily tradable.[6] Shares of foreign corporations are not ordinarily traded on U.S. securities markets. Instead, the foreign corporations list their securities using the ADR system, whereby the foreign corporations issue shares to U.S. depository banks, which, in turn, issue ADRs representing the underlying shares to U.S. investors. Since these ADRs are traded like normal shares, "[f]or practical purposes, the U.S. holders of ADRs are in essentially the same economic position as direct shareholders."[7]

Not qualified foreign corporations. In addition to establishing these three tests, JGTRRA also identifies certain entities that will *not* be considered qualified foreign corporations. In particular, foreign personal holding companies, foreign investment companies, and passive foreign investment companies are prohibited from enjoying the tax advantages offered by JGTRRA (the "Foreign Investment Company Exclusion Test").[8] U.S. investors generally use these three vehicles to defer the payment of taxes by placing funds outside the reach of the IRS. Provided that none of the numerous anti-deferral mechanisms in the Code are triggered, the U.S. investor essentially enjoys a tax-free, non-interest-bearing loan from the IRS until these offshore funds are transferred back to the U.S. investor and taxed accordingly. This "loan," of course, can be invested or otherwise used by the U.S. investor to make yet more money in the meantime.[9] The purpose of the Foreign Investment Company Exclusion Test is, therefore, to limit the benefits of tax deferral by taxing dividends issued by these entities at the top rates, even though they may satisfy the Possessions, Treaty, or Market Test.[10]

Congressional policy. With respect to the justifications for the special dividend rules under JGTRRA, Congress stated that tax policy should lead to national economic growth, and that reducing taxes on certain dividends would lower the cost of capital, trigger the creation of new domestic jobs, and thus facilitate economic growth. The law in place before JGTRRA imposed different tax burdens on the income received from different investments. From the congressional perspective, this disparity distorted the financial decisions of corporations and individuals alike. For instance, Congress believes that the former law encouraged corporations to finance their activities using debt (offering bonds, borrowing funds) instead of equity (issuing stock) since some interest payments made on debt are tax deductible under the Code (see Section 163). Although the use of debt may be beneficial to corporations from a tax perspective, Congress fears that it may lead to an increase in corporate bankruptcies during economic downturns. Moreover, since the former law imposed higher taxes on dividends than on capital gains, corporations were encouraged to retain their profits, as opposed to distributing them to their shareholders as dividends. The shareholders, likewise, had an incentive under the former law to pressure corporations to retain their profits and reinvest them, even though those shareholders could have used the dividend money to make other, more profitable investments. This situation vexed Congress since it created economic inefficiencies when opportunities to obtain higher pre-tax earnings were forsaken in favor of lower pre-tax earnings.[11] To avoid such economically inefficient uses of money, Congress crafted JGTRRA.

JGTRRA Concerns

The enactment of JGTRRA generated considerable excitement for both investors and the international tax community. However, the imprecise and esoteric language in parts of this legislation and its Conference Report have created numerous doubts, which could undermine the overall effectiveness of the new law. Uncertainty is particularly acute

HALE E. SHEPPARD, J.D., LL.M., is a tax attorney with Sharp, Smith & Harrison, P.A., in Tampa, Florida, specializing in international tax planning, cross-border business transactions, and tax controversies.

with respect to those rules addressing "qualified dividend income" and "qualified foreign corporations." In an effort to mitigate confusion and expeditiously implement JGTRRA, the IRS eventually issued a series of explanatory Notices, but this additional guidance did not arrive until approximately five months after JGTRRA was enacted. This lapse triggered several interested groups to express concerns about JGTRRA, many of which are examined below.

Possessions Test concerns. The Possessions Test dictates that an entity will be considered a "qualified foreign corporation" if it is established in a U.S. possession such as Puerto Rico, Guam, Samoa, or the Virgin Islands (Section 1(h)(11)(C)(i)(II)). This standard appears relatively straightforward, but uncertainty lurks. According to one major law firm, JGTRRA is unclear with regard to whether "qualified foreign corporation" includes only entities incorporated under the local law of the U.S. possession or also entities formed (but not incorporated) under the local law of the U.S. possession that elect to be treated as corporations for U.S. tax purposes using the check-the-box Regulations. If the latter is true, the U.S. possessions that have entity-classification provisions identical to those in the Code make it possible to create reverse-hybrid entities. These hybrids would be treated as pass-through entities in the U.S. possession and as corporations in the United States, thereby creating "qualified foreign corporations" that benefit from the lower dividend rates in JGTRRA while at the same time avoiding entity-level taxation in the U.S. possession.[12]

Treaty Test concerns. As mentioned above, an entity will be considered a qualified foreign corporation under JGTRRA if the Treaty Test is met. In other words, for a foreign corporation to issue dividends eligible for reduced tax rates, (1) the corporation must be eligible for the benefits under a comprehensive income tax treaty with the United States; (2) the U.S. Treasury Secretary must determine that the treaty at issue is satisfactory for purposes of JGTRRA; and (3) the treaty must include an exchange-of-information program (Section 1(h)(11)(C)(i)(II)). According to the Conference Report to JGTRRA, a foreign company will meet the first prong if it would qualify for such treaty benefits with respect to "substantially all" of its income during the year in which the dividend is paid. As noted above, with respect to the second prong, the Conference Report does not consider the current U.S.-Barbados income tax treaty "satisfactory." All other foreign corporations established in nations having comprehensive income tax treaties with the United States that include an exchange-of-information program are presumed to be qualified foreign corporations, unless and until Treasury renders a contrary decision.[13]

Determining treaty eligibility. Several groups raised concerns related to the Treaty Test. For instance, the Investment Company Institute urged the IRS to issue additional guidance concerning this standard,[14] suggesting that the IRS recognize that U.S. treaty provisions are not designed to permit individual shareholders to efficiently determine if a particular corporation is eligible for treaty benefits. In fact, the Investment Company Institute explained that no U.S. treaty imposes such an obligation on shareholders; rather, the corporation itself is tasked with making this determination and then conveying it to the shareholders.

Reversing the obligation so that individual shareholders (instead of the corporations) would be charged with determining treaty eligibility would pose an extremely arduous, if not outright insurmountable, challenge for investors for at least two reasons. First, deciding whether a corporation is a "resident" of a particular nation for purposes of a treaty is complex. Second, even if a shareholder manages to accurately determine that a corporation meets the definition of "resident," the limitation-on-benefits provision of the treaty ordinarily denies treaty benefits to the corporation unless

it also meets one of three complicated tests: the publicly traded test, the ownership and base erosion test, or the competent authority test. Accordingly, the Investment Company Institute suggested that the IRS issue rules stating that a dividend paid by a foreign corporation should be considered "qualified dividend income" if (1) the foreign corporation is resident in a treaty country; (2) the shares of stock on which the corporation paid the dividend are publicly traded on a recognized stock exchange; and (3) the shareholder does not have actual knowledge that the corporation is not eligible for the benefits of the treaty with respect to substantially all of its income.[15]

Which treaties are "satisfactory"? The Organization for International Investment expressed concern regarding which treaties will be deemed "satisfactory" and urged Treasury to clarify the matter as soon as possible.[16] Moreover, this group was uneasy as to the language in the Conference Report to JGTRRA, which says that a foreign corporation will be eligible only if it would qualify for treaty benefit with respect to "substantially all" of its income in the year that it issues the dividend. The uneasiness was exacerbated by this phraseology neither appearing in JGTRRA nor being debated in Congress. The Organization for International Investment suggested, in brief, that an entity should be considered a qualified foreign corporation if it is a "resident" of an acceptable treaty country (and thus is subject to complete residency-based taxation in that country) and meets the pertinent limitation-on-benefits provisions in the treaty.[17]

Who is "eligible"? The New York Clearing House Association also raised concerns about the general unavailability of the information needed to determine whether a foreign corporation is "eligible for benefits" of a U.S. tax treaty.[18] To remedy this data scarcity, the Association suggested that the IRS issue guidance to the effect that corporations organized in certain countries should be automatically eligible for treaty benefits for JGTRRA purposes, provided that there is no actual knowledge to the contrary.[19]

Practitioner concerns. Several concerns regarding the Treaty Test have also been voiced by international tax practitioners. First, with respect to a foreign corporation being considered eligible for the benefits in a comprehensive income tax treaty if it qualifies for such benefits with respect to "substantially all" of its income during the year in which the dividend is paid, tax experts contend that this language is unclear and leads to dangerous speculation. They conjecture, for instance, that this phrase could mean substantially all of the corporation's income in general. On the other hand, it could mean that a corporation must qualify for treaty benefits with respect to substantially all of its income that is within the purview of the treaty. Even if the second interpretation were correct, tax practitioners claim that both the intent of this language and exactly how a resident of a treaty country might be eligible with respect to less than all of its income are unclear. Irrespective of how it is ultimately interpreted, tax experts warn that this language engenders problems for shareholders who will be forced to base their determinations on information that is difficult to obtain. In the words of one tax expert, "this difficulty is most acute for those shareholders who are least able to gather the necessary data."

Second, tax experts are dissatisfied by Treasury's failure to identify the treaties that it finds "satisfactory" for JGTRRA purposes. Although one may currently rely on the presumption that *all* U.S. tax treaties (other than with Barbados) are eligible for JGTRRA benefits, knowing the exact countries is immediately important for long-term tax planning.

Third, JGTRRA proves befuddling on a theoretical level. According to some international tax practitioners, one of the primary rationales underlying JGTRRA is to reduce dividend rates in order to mitigate double taxation of corporate profits. Stated differently, the idea was to lessen the severity of the current U.S. system that taxes corporate profits

twice—once when the corporation earns a profit and again when those profits are distributed to shareholders as dividends.[20] The Conference Report to JGTRRA explains that Barbados is ineligible because it "may operate to provide benefits that are intended for the purpose of mitigating or eliminating double taxation to corporations that are not at risk of double taxation."[21] This justification baffles some tax advisors, who maintain that the Conference Report becomes nonsensical when one examines the type of double taxation that U.S. treaties are designed to address. In particular, treaties do not attempt to address the corporate double taxation discussed above where there is *one* sovereign/country (the United States) imposing tax on *two* persons (the corporation and its shareholders). Rather, treaties are intended to mitigate juridical double taxation where there are *two* sovereigns/countries (the United States and Barbados) imposing tax on *one* person (the corporation). Tax experts argue that if the Conference Report to JGTRRA is referring to juridical double taxation, it is unclear why Congress would be concerned about Barbados since dividends received by U.S. investors that were not subject to withholding taxes in this country will be fully taxable in the United States. On the other hand, if the Conference Report to JGTRRA is alluding to corporate double taxation, it would be easier to address this issue by simply disqualifying from JGTRRA those corporations based in tax havens, regardless of their treaty status.[22]

NYSBA concerns. The New York State Bar Association (NYSBA) also formulated several concerns.[23] According to the NYSBA Section of Taxation, in its report to Treasury and the IRS commenting on the dividend provisions of JGTRRA,[24] the question of whether a foreign corporation is eligible for the benefits of a treaty can be accurately answered only by the corporation itself. In other words, only a corporation (and not its shareholders) can determine if it satisfies the first prong of the Treaty Test. The NYSBA pointed out that many foreign corporations had no reason before the enactment of JGTRRA to analyze whether they were eligible for benefits of a U.S. income tax treaty. For instance, if a foreign corporation does not conduct any business activities in the United States (directly or through its subsidiaries), a tax treaty would not have affected its tax treatment. In addition, determining whether a foreign corporation meets the limitation-on-benefits provision in a treaty is onerous. Some foreign corporations are therefore logically hesitant to invest the time and money necessary to do this analysis unless the corporation is actually conducting business operations in the United States. Moreover, even if a foreign corporation decided to make this analysis, there is no obvious methodology under current law by which the corporation would convey its conclusion to U.S. investors if the corporation's securities do not trade on a U.S. securities market. Since the Treaty Test is not restricted to foreign companies that are conducting U.S. business operations, U.S. investors again must rely on external factors.

Concerning the appropriate external indicators, the NYSBA recommended that there be some list of objective factors that can give the IRS a reasonably high degree of comfort that a foreign corporation is a bona fide operating company and treaty resident. Among the potential external factors are the length of time the corporation has been in existence, the nature of its business, the number of its employees, its size, the composition of its assets, whether it is known within its industry, and whether its common stock is traded on a home country stock exchange. The NYSBA requested that the IRS issue rules or allow a presumption to the effect that taxpayers will be permitted to rely on such external indicators to determine whether a corporation is eligible for the benefits of a treaty.

The NYSBA also suggested another approach: establishing a program similar to that applicable in cases of original issue discount (OID). Under U.S. tax law, the issuer of a publicly offered debt instrument with OID is required to file Form 8281 (Information Return for Publicly Offered Original Issue Discount Instruments) specifying the annual amount of discount on the bond. That information is then reported by the IRS in Publication 1212 (List of Original Issue Discount Instruments). The NYSBA suggested that a similar program be established to permit a foreign corporation to provide a form to the IRS that states whether dividends on specified classes of shares constitute "qualified dividend income," and that this information would be published by the IRS and updated when it changes. The NYSBA recognizes,

1 Section 1(h)(1)(C). This rate is reduced to 5% or 0% in some situations. See Section 1(h)(1)(B).

2 *Id.*

3 For a brief overview of Section 1(h)(11) and the entire JGTRRA, see U.S. Joint Committee on Taxation, "Summary of Conference Agreement on H.R. 2, The 'Jobs and Growth Tax Relief Reconciliation Act of 2003,'" JCX-54-03 (May 22, 2003).

4 H. Rep't No. 108-126, 108th Cong., 1st Sess. 42 (May 22, 2003) (Conference Report).

5 *RIA's Complete Analysis of the Jobs and Growth Tax Relief Reconciliation Act of 2003*, para. 5022. That a particular nation has signed a TIEA but not a comprehensive income tax treaty does not necessarily mean that such nation has questionable tax practices. Rather, this may simply be attributable to the U.S. Treasury Department concluding that the low level of economic activity between the United States and the nation in question did not merit a treaty.

6 Conference Report, *supra* note 4, at 42, fn. 41.

7 Tolin, "International Aspects of the Dividend Rate Reduction Under U.S. Jobs and Growth Act of 2003," 14 JOIT 22 (December 2003) at 27.

8 Section 1(h)(11)(C)(iii). These entities are defined in Sections 552, 1246, and 1297, respectively.

9 For a discussion of the tax deferral possibilities with foreign personal holding companies, foreign investment companies, and passive foreign investment companies, see Bittker & Lokken, *Fundamentals of International Taxation* (WG&L of RIA, 2002) pages 70-2 to 70-52.

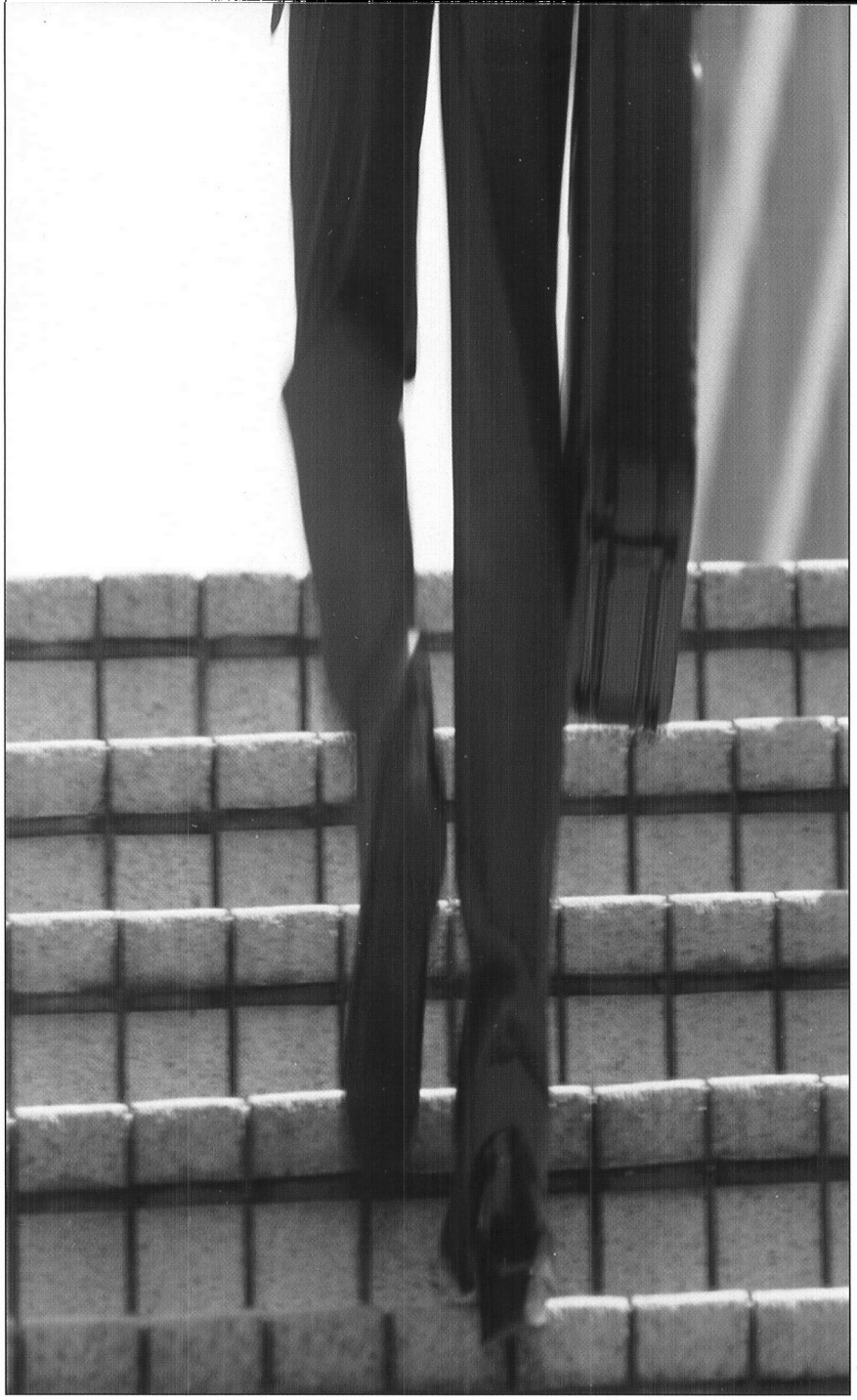
10 Lawson, "ICI Discusses Application of New Qualified Dividend Income Rules to RICs," 2003 Tax Notes Today 147-54 (July 31, 2003).

11 H. Rep't No. 108-94, 108th Cong. 1st Sess. 30-31 (May 8, 2003). See Section 163

12 Cadwalader, Wickersham & Taft LLP, "Law Firm Forwards Newsletter on Recent Legislation to Treasury," 2003 Tax Notes Today 128-19 (July 3, 2003). Following the issuance of the check-the-box Regulations in 1997, eligible business entities have been able to select their own classification for federal tax purposes. See Reg. 301.7701 and Form 8832 (Entity Classification Election).

13 Conference Report, *supra* note 4, page 42.

14 For more information, see www.ici.org.



of course, that safeguards would have to be instituted so that the IRS would feel comfortable that the representations made by the foreign corporations were truthful. Also, for the system to be tenable, taxpayers must be able to rely on the representations made by these foreign corporations to avoid penalties.[25]

Market Test concerns. An entity will meet the Market Test and thus be treated as a "qualified foreign corporation" if its dividend-paying stock is readily tradable on an established U.S. securities market (Section 1(h)(11)(C)(ii)). According to the Conference Report to JGTRRA, stock will be treated as "readily tradable" if an ADR backed by such stock is readily tradable.[26] Despite its supposed simplicity, the Market Test has generated considerable controversy, both with respect to ADRs and to the definitions of "readily tradable" and "established securities market in the United States."

ADRs. The Investment Company Institute claims that it lacks the IRS guidance necessary to determine whether a foreign stock satisfies the Market Test. This group therefore recommends that the IRS issue guidance to clarify that if stock is in the same class as the stock traded on an established U.S. securities market through an ADR program, dividends on any share in that class will constitute "qualified dividend income," irrespective of where the stock in question is acquired.[27] For instance, if a Chilean corporation's shares are traded on the *Bolsa de Comercio* (Chilean securities exchange) and are also traded on a U.S. securities market through ADRs, would shares of that class purchased on the *Bolsa de Comercio* be treated as "readily tradable?"

The Organization for International Investment concurred with these concerns about ADRs. This group believes, in particular, that if a foreign corporation has a class of shares (including those shares represented by ADRs) that are readily tradable on an established U.S. securities market, the foreign corporation should be treated as a "qualified foreign corporation" with respect to dividends paid on *all* shares of that class of stock. In defending its stance, the Organization for International Investment argues that this position is consistent with IRS authority that generally treats a person holding an ADR as the direct holder of the underlying shares, and treats an instrument as readily tradable if it is part of an issue that is so traded. Moreover, this group explains that its position is consistent with Article 22 (Limitation on Benefits) of the 1996 U.S. model income tax treaty, which provides that a foreign corporation is eligible for treaty benefits if there is substantial and regular trading in the corporation's principal class of shares.[28]

International tax practitioners have also manifested their doubts with respect to ADRs.[29] As an exercise in statutory interpretation, some tax attorneys point to the Conference Report to JGTRRA, which says that "*a share* shall be treated as so traded if an American Depository Receipt (ADR) backed by such share is so traded."[30] That this phrase refers to "a share" as opposed to "a class of shares" triggers uncertainty. Despite the strict statutory language, it is improbable that Congress intended to create different tax treatment for securities that are virtually identical. As one tax expert put it, "[t]his would indirectly disadvantage foreign issuers for no apparent reason, and

probably amount to giving free money to a few arbitrageurs in the process."[31] To eliminate the existing ambiguity, tax practitioners recommend that the IRS extend "qualified foreign corporation" status with respect to *all shares* of foreign corporations that are represented by ADRs on U.S. securities markets even though *the particular shares* in question are themselves not represented by ADRs on U.S. securities markets.[32]

In its September 4, 2003, report, the NYSBA cited Revenue Rulings[33] concluding that, for purposes of the foreign tax credit rules and some treaties, a person who holds an ADR is treated as if he directly holds the underlying shares. In other words, the IRS has concluded that in certain contexts, the holder of an ADR "simply holds a ticket to the underlying stock" since he can acquire the underlying stock at any time.

With this in mind, the NYSBA identified the issue raised by the other groups: whether shares of the same class underlying an ADR traded on an established U.S. securities market that are not held by the depository for the ADR program will be treated as "readily tradable" on that securities market. This issue may not be overly important for U.S. individual investors who are unlikely to buy foreign stock that is not listed directly on a U.S. securities market; however, it may be crucial to mutual funds and similar collective-investment arrangements that regularly acquire such foreign stock.[34] This issue may also be relevant to U.S. employees of foreign corporations who receive stock-based compensation based on ADRs.

In view of the importance of this issue to particular taxpayers, the NYSBA presents several reasons to support a liberal interpretation of the phrase "a share shall be treated as so traded if an American Depository Receipt (ADR) backed by such shares is so traded." First, as a matter of tax policy, it would be inconsistent not to treat ADRs as equivalents of the underlying stock for tax purposes when the IRS has afforded such treatment for decades in other contexts. Second, in terms of tax administration, conducting a case-by-case analysis to determine just how a taxpayer holds a particular share of stock would be "virtually impossible." Finally, a statutory interpretation that establishes distinct treatment for ADRs and their underlying shares would provide an incentive to sophisticated investors to trade into and out of ADR programs near the ex-dividend date.[35]

Readily tradable and established U. S. securities market. The NYSBA points out that "established securities market" has several distinct meanings throughout the Code. These distinctions notwithstanding, the term generally includes major U.S. securities markets and inter-dealer quotation systems, which are systems of general circulation to brokers or dealers that disseminate buy/sell quotes for securities by identified brokers or dealers like the over-the-counter (OTC) Bulletin Board and NASDAQ.[36] Other definitions of the term apply only to debt instruments, while still others exclude quotation sheets prepared by a securities broker or dealer in the regular course of business that cover only quotations of that particular broker or dealer. This definitional inconsistency led the NYSBA to request that the IRS clarify the precise definition of "established securities market in the United States."

15 Lawson, *supra* note 10. See, e.g., 1996 U.S. model income tax treaty, Article 22 (Limitation on Benefits).

16 For more information, see www.ofii.org.

17 Merrill, "PwC Forwards Dividend Tax Paper to Treasury in Preparation for Upcoming Meeting," 2003 Tax Notes Today 172-31 (September 5, 2003).

18 For more information, see www.nych.org.

19 Nelson, "Banking Group Comments on Effect of Jobs and Growth Tax Relief Act," 2003 Tax Notes Today 157-31 (August 14, 2003).

20 Tolin, *supra* note 7, at 25-26.

21 Conference Report, *supra* note 4, page 42.

22 Tolin, *supra* note 7, at 26.

23 For more information, see www.nysba.org.

24 Andrew N. Berg, Chair of the NYSBA, submitted the report to Assistant Treasury Secretary (Tax Policy) Pamela F. Olson and IRS Commissioner Mark W. Everson on September 4, 2003. See Berg, "NYSBA Comments on Dividend Provisions of Tax Act," 2003 Tax Notes Today 172-14 (September 5, 2003).

25 Berg, "Dividends Provisions of the Jobs and Growth Tax Relief Reconciliation Act of 2003," 2003 Tax Notes Today 199-34 (October 15, 2003); Berg, *supra* note 24.

26 Conference Report, *supra* note 4, page 42, fn. 41.

27 Lawson, *supra* note 10.

28 Note 17, *supra*.

29 Tolin, *supra* note 7.

30 Conference Report, *supra* note 4, page 42, fn. 41 (emphasis added).

31 Tolin, *supra* note 7, at 27.

32 *Id.* at 28.

33 Rev. Rul. 65-218, 1965-2 CB 566; Rev. Rul. 72-271, 1972-1 CB 369.

34 Berg, *supra* note 25.

35 Berg, *supra* note 25.

36 *Id.* For more information, see www.otcbb.com.

Likewise, definitional irregularity plagues "readily tradable." For example, the Code is replete with similar, but not identical, terminology, including "traded," "regularly traded," "primarily traded," "actively traded," and "publicly traded." The NYSBA's proposed solution to this ambiguity is to treat foreign stock as "readily tradable" if it is legitimately and actively trade on a registered national securities market, NASDAQ, or a system with investor safeguards similar to those of NASDAQ. In this manner, shareholders of a closely held foreign corporation that does not meet the Treaty Test cannot elect into the lower tax rates of JGTRRA by causing minimal trading of the foreign corporation's stock. Once it is confirmed that the stock trading is not contrived, the NYSBA believes that the actual level of trading of a particular stock is not relevant to the definition of "readily tradable." This group further suggests that, if *one* stock is traded on an established U.S. market, *all* stock of that class should be deemed "readily tradable."[37]

The Bank of New York also raised concerns and offered suggestions regarding the phrase "readily tradable on an established securities market in the United States." In particular, the Bank urged the IRS to interpret this term consistent with Treasury Regulations addressing accounting methods in installment sales of property.[38] Adopting this interpretation, contends the Bank, will allow NASDAQ, the OTC Bulletin Board, and electronic pink sheets to be considered "over-the-counter markets."[39]

Agreeing with this position, the Organization for International Investment believes that this phrase should be defined to include trading on national securities markets (e.g., the NYSE, AMEX, and NASDAQ), as well as on any over-the-counter market with an inter-dealer quotation system (e.g., pink sheets).[40]

Foreign Investment Company Exclusion Test concerns. The Foreign Investment Company Exclusion Test excludes certain entities from the definition of "qualified foreign corporations," including foreign personal holding companies, foreign investment companies, and passive foreign investment companies (Section 1(h)(11)(C)(iii)).[41] The apparent simplicity of this rule is deceiving. To determine whether a foreign corporation is a passive foreign investment company, it is necessary to apply the "passive income and passive asset tests," which often proves a difficult endeavor (Section 1297(a)). The Investment Company Institute claims that undertaking this analysis would be a "great difficulty."[42] Similarly, the New York Clearing House Association contends that deciding whether an entity is a passive foreign investment company "requires a fact-intensive, annual determination which a payor would generally not be able to make."[43]

The NYSBA warns that it will be difficult for an *individual investor* to assess whether a foreign corporation is a passive foreign investment company because "it is not always easy for a foreign corporation to make that determination itself since U.S. tax principles must be applied to non-U.S. income and assets." The NYSBA admonishes that it will be equally, if not more, difficult for brokers. The revised Form 1099-DIV obligates securities brokers and others to identify which dividends paid to U.S. individual investors are "qualified dividend income." Brokers generally have more sophistication and better resources than the majority of individual investors; nonetheless, their ability to accurately determine whether a foreign corporation is an unacceptable entity (such as a passive foreign investment company) is "not materially greater."[44]

CFC concerns. As explained in the preceding section, the Foreign Investment Company Exclusion Test identifies three specific types of entities that will not be considered "qualified foreign corporations"—foreign personal holding companies, foreign investment companies, and passive foreign investment companies (Section 1(h)(11)(C)(iii)).[45] Conspicuously absent from this list is another type of entity ordinarily used for tax-deferral purposes—the controlled foreign corporation (CFC) (Section 957). As a result, applying the canon of statutory construction *expressio unius est exclusio alterius*, one may conclude that *dividend distributions* from CFCs could qualify for reduced tax rates under JGTRRA, provided that the CFC meets the Treaty Test or the Market Test.

The proper treatment of certain *inclusions* from CFCs, on the other hand, is not so clear. Generally, if a foreign corporation is a CFC for a specified period, every U.S. shareholder (i.e., a person who owns at least 10% of the total voting stock of the CFC) must include in

gross income (1) his share of Subpart F income, which consists principally of certain passive investment income, income that is generated beyond the reach of any sovereign nation, and income that is artificially deflected from a high-tax to a low-tax environment; and (2) his share of the average amounts of U.S. property held by the CFC (Sections 951(a)(1) and 956). According to some tax practitioners, all such inclusions related to CFCs are essentially "dividends." It could be possible, therefore, for a U.S. shareholder to convert *inclusions* that normally would be subject to high tax rates into *dividends* that would be taxed at reduced rates under JGTRRA by simply moving such income into a CFC. Allowing this would be "blatantly at odds" with established IRS policy with respect to CFCs. To avoid schizophrenic tax policy, some practitioners suggest that the IRS craft a technical distinction between dividends (which would be eligible for the benefits of JGTRRA) and inclusions (which would not).[46]

Holding period requirement concerns. JGTRRA provides that "qualified dividend income" does not include dividends paid on stock that an investor has held for 60 days or less during a period of 120 days, which period begins 60 days before the stock becomes ex-dividend. "Ex-dividend" means the first day on which a share of stock on which a dividend has been declared is sold without the purchaser being entitled to the dividend. In mutual funds, the holding period must be met at two levels—by the mutual fund for the stock that it holds and by the mutual fund shareholders for their investment in mutual fund shares (Section 1(h)(11)(B)(iii) referring to Section 246(c)).

Like many aspects of JGTRRA, the apparent straightforwardness of the holding period requirement may be misleading. According to the NYSBA, complications surrounding this rule include the following: (1) the holding period must be tested for *each* dividend; (2) the 61-day period may be satisfied by combining days before and after the ex-dividend date; and (3) the entire idea of the "ex-dividend" date is unfamiliar to many individual investors. The NYSBA further points out that the Form 1099-DIV that individual investors will receive identifies whether a particular dividend may constitute "qualified dividend income," but not whether the investors can in fact treat the dividend that way. Consequently, this group warns that there is "ample scope for confusion and inadvertent noncompliance," which may be mitigated by the issuance of additional IRS guidance and the incorporation thereof into the instructions to Form 1099-DIV.[47]

IRS Response to JGTRRA Concerns

In response to many of the concerns addressed above, the IRS issued a series of Notices on different aspects of JGTRRA. Examined below are three IRS pronouncements dealing with "qualified dividend income" and "qualified foreign corporations."

Notice 2003-69. The IRS issued Notice 2003-69, 2003-42 IRB 851, on October 20, 2003, to provide additional guidance regarding the Treaty Test.[48] Specifically, this Notice identifies those countries that have comprehensive income tax treaties with the United States that Treasury deems "satisfactory" for purposes of JGTRRA and that contain an exchange-of-information program (Section 1(h)(11)(C)(i)(II)). According to the Notice, corporations established in certain countries will be considered "qualified foreign corporations."[49]

In addition to identifying these preferential nations, Notice 2003-69 expressly disfavors four income tax treaties. The U.S. treaties with Bermuda and the Netherlands Antilles are not considered "comprehensive income tax treaties." The treaty with the former U.S.S.R. is also objectionable, not because of its lack of comprehensiveness, but rather because it is devoid of an exchange-of-information provision. Finally, as discussed in the Conference Report to JGTRRA, the Barbados treaty is inadequate because it purportedly grants tax benefits designed to mitigate or eliminate double taxation where there is no risk of such double taxation.

Notice 2003-71. One week after releasing Notice 2003-69, the IRS issued Notice 2003-71, 2003-43 IRB 922, to address the uncertainty surrounding the Market Test.[50] This Notice states that, for purposes of JGTRRA, common or ordinary stock, as well as an ADR in respect of such stock, will be considered "readily tradable on an established securities market in the United States" if it is listed on a national securities exchange that is registered under the Securities Exchange Act of 1934[51] or on NASDAQ.

37 Berg, *supra* note 25.

38 Peterson, "Bank of New York Expresses Concern Over ADR Dividend Status," 2003 Tax Notes Today 181-37 (September 18, 2003).

39 *Id.* This institution refers to Reg. 15A.453-1(e)(4)(ii).

40 Merrill, *supra* note 17.

41 Note 8, *supra*.

42 Lawson, *supra* note 10.

43 Nelson, *supra* note 19.

44 Berg, *supra* note 25.

45 Note 8, *supra*.

46 Tolin, *supra* note 7, at 29.

47 Berg, *supra* note 25.

48 See "IRS Releases Treaty List for Reduced Dividend Tax Rates," 2003 Tax Notes Today 190-17 (October 1, 2003).

49 For the list of countries, see the Appendix in Notice 2003-69. The Notice specifically requires that a foreign corporation be a "resident" in one of the selected countries within the meaning of "resident" under the relevant treaty and satisfy all other requirements of the relevant treaty, including the limitation-on-benefits provision.

50 See "IRS Defines 'Readily Tradable' on Established U.S. Securities Market," 2003 Tax Notes Today 193-13 (October 6, 2003); "Treasury Announces Guidance on Qualification for New Reduced Dividend Tax Rate," 2003 Tax Notes Today 193-56 (October 6, 2003); "Treasury and IRS Issue Guidance on Qualification for New Reduced Tax Rate on Dividends," JS-778 (October 3, 2003); "Guidance on Qualification for Reduced Tax Rate on Dividends Paid by Foreign Corporations," 15 JOIT 5 (January 2004).

51 American Stock Exchange, Boston Stock Exchange, Cincinnati Stock Exchange, Chicago Stock Exchange, New York Stock Exchange, Philadelphia Stock Exchange, and Pacific Exchange.

Notice 2003-79. Issued on December 15, 2003, Notice 2003-79, 2003-50 IRB 1206, provides guidance to persons required to file an information return regarding dividends issued by a foreign corporation. It also describes when a security or its corresponding ADR issued by a foreign corporation that is not ordinary or common stock (e.g., preferred stock) will fulfill the Market Test.[52]

The Code mandates that any person that makes payments of dividends of $10 or more during any year, or any person that receives dividends as a nominee and then makes payments of $10 or more during a given year to another person with respect to the dividends received, must report those payments to the IRS by filing an information return (Form 1099-DIV) (Section 6042(a)). A person required to file a Form 1099-DIV must also furnish to every person with respect to whom such information is reported to the IRS a statement of the total amount of dividends distributed (Section 6042(c)).

Notice 2003-79 announced that Form 1099-DIV and the corresponding instructions have been revised to reflect the changes introduced by JGTRRA. In particular, parties filing Form 1099-DIV must enter in Box 1a the total amount of ordinary dividends paid during the year and in Box 1b the portion of these dividends that is "qualified dividend income" under JGTRRA. If a person fails to file a timely and correct information return, the IRS is authorized to impose a penalty of up to $250,000 (Section 6721(a)).

Notice 2003-79 also identifies five separate tests that must be for a distribution by a foreign corporation to qualify for the reduced tax rate under JGTRRA. In doing so, the Notice acknowledges the tests described previously in JGTRRA and introduces three new ones, discussed below.

Equity Test. To be "qualified dividend income," a distribution must be made with respect to equity, such as stock, rather than indebtedness, such as bonds and loans ("Equity Test"). This characterization as equity or debt is based on the instrument in question and all surrounding facts and circumstances. Notice 2003-79 explains that common or ordinary stock is generally treated as equity for U.S. tax purposes. However, with regard to preferred stock issued by a foreign corporation, a person required to file a Form 1099-DIV may not have all of the information necessary to determine whether it is debt or equity.

Notice 2003-79 provides that, for purposes of filing Forms 1099-DIV for dividends issued during 2003, a person required to file such information return will treat the security as satisfying the Equity Test if it is a common or ordinary share. If the security is *not* common or ordinary stock, that person will treat the security as satisfying the Equity Test if the foreign corporation has a public statement filed with the U.S. Securities and Exchange Commission (SEC) stating that the security "will be, should be, or more likely than not will be" properly classified as equity rather than as debt.[53] This task has been problematic for many foreign entities, which exhibit "a varying degree of confidence in how the [JGTRRA] applies to their dividends." A recent survey of U.S. tax and securities filings reveals that some foreign entities say that they will qualify for the reduced tax rate; others believe that they will qualify; while still others acknowledge that the question is unclear and simply refer U.S. holders to their own tax advisors. According to tax practitioners, this inconsistency and uncertainty are largely attributable to "open questions about which foreign issuers qualify for the lower rate and under what circumstances."[54]

E&P Test. To be considered "qualified dividend income" under JGTRRA, a distribution must first be a "dividend" for federal tax purposes, which generally means that the corporate distribution was made out of its earnings and profits ("E&P Test"). Notice 2003-79 recognizes that a person required to file a Form 1099-DIV may not always know whether a distribution meets the E&P Test. Notice 2003-79 provides, therefore, that when a person is unable to determine *what portion* of a particular corporate distribution is a dividend, the person must treat the *entire distribution* as a dividend.[55]

Market, Possessions, or Treaty Test. In addition to satisfying the Equity Test and the E&P Test, the foreign corporation must also meet the Market Test, Possessions Test, or Treaty Test. With regard to the Market Test, Notice 2003-79 is limited to simply repeating the explanation of this condition as provided earlier in JGTRRA, the corresponding Conference Report, and Notice 2003-71.[56] Likewise, Notice 2003-79's discussion of the Possessions Test is minimal, as it simply repeats the explanation provided previously in JGTRRA. However, Notice 2003-

79 provides new information regarding the Treaty Test, explaining in particular that treaties generally confer benefits only on "residents" of the relevant countries and frequently include a limitation-on-benefits provision designed to ensure that treaty benefits are not available to persons engaged in treaty shopping.[57] Notice 2003-79 acknowledges that analyzing whether a particular foreign corporation is eligible for benefits under a certain treaty is a fact-driven determination, but maintains that a foreign corporation generally will have all of the pertinent information.[58]

In light of this fact-intensive analysis and the need for persons required to file Forms 1099-DIV to begin work on them immediately, Notice 2003-79 contains a simplified procedure for 2003. Specifically, Notice 2003-79 provides that a person required to file a Form 1099-DIV will treat a foreign corporation as satisfying the Treaty Test, provided that (1) the foreign corporation is organized in a country whose income tax treaty with the United States is listed in Notice 2003-69; and (2) if the relevant treaty contains a limitation-on-benefits provision, the corporation's common or ordinary stock is listed on an exchange covered by the publicly traded test in that limitation-on-benefits provision. Notice 2003-79 clarifies, though, that a person will not treat a foreign corporation as satisfying the Treaty Test if that person knows or has reason to know that the corporation is not eligible for benefits under the relevant treaty. For purposes of Notice 2003-79, a person will be considered to have reason to know that the corporation is not eligible for treaty benefits if the corporation has so stated in its most recent SEC annual filing for the security.

Foreign Investment Company Exclusion Test. As noted above, the Foreign Investment Company Exclusion Test, initially described in JGTRRA, provides that foreign personal holding companies, foreign investment companies, and passive foreign investment companies may not be considered "qualified foreign corporations." Notice 2003-79 explains that foreign corporations will generally have all of the information necessary to determine whether they fall within one of these three categories, especially since many of these foreign entities are publicly traded in the United States and thus required to make and disclose this determination annually to the SEC. Notice 2003-79 nevertheless recognizes that not all foreign companies are publicly traded on U.S. markets and that not all foreign corporations that are so traded make a determination of their status annually.

Notice 2003-79 therefore provides a simplified reporting procedure for 2003 based on the knowledge of those persons required to file Form 1099-DIV. In particular, the Notice says that a person will treat a foreign corporation as satisfying the Foreign Investment Company Exclusion Test unless the person knows or has reason to know that the corporation is or expects to be a foreign personal holding company, foreign investment company, or passive foreign investment company. For purposes of Notice 2003-79, a person would have reason to know if a corporation has stated in its most recent annual public filing with the SEC that it is or expects to be one of these three types of entities.

Holding Period Test. JGTRRA provides that a shareholder who receives a dividend must satisfy certain holding period requirements for the dividend to be considered "qualified dividend income." According to the Form 1099-DIV instructions, a person required to make such a filing must report in Box 1b (i.e., as qualified dividend income) any dividends for which it is impractical to determine whether the recipient has met the holding period requirements. Therefore, if a person required to file Form 1099-DIV determines that a particular shareholder has satisfied the relevant holding period requirements or if it is impractical for that person to make the determination, the person may presume that the shareholder satisfies the holding period.

With regard to penalties, Notice 2003-79 provides that the IRS will waive them if a person required to file Form 1099-DIV makes a good faith effort to comply with Notice 2003-79. Similarly, the shareholder who receives Form 1099-DIV will likely not be penalized by the IRS for amounts treated as qualified dividend income unless he knows or has reason to know that the distribution did not, in fact, constitute qualified dividend income.[59]

Open Issues

The three IRS Notices undoubtedly served to clarify various issues related to JGTRRA. Absolute clarity, however, is yet to be achieved. In fact, uncertainty

for investors and international tax professionals has been perpetuated by the issues that the IRS intentionally left unresolved. For example, Notice 2003-69 explains that Treasury and the IRS intend to update the list of countries satisfying the Treaty Test as necessary when new treaties are executed and existing treaties are renegotiated. Notice 2003-69 further announces that the U.S. government will continue to study the operations of income tax treaties to ensure that each accomplishes its proposed objectives, thereby maintaining their "satisfactory" status for purposes of JGTRRA. Taken together, the guidance in Notice 2003-69 regarding the Treaty Test is, at best, temporary, and, at worst, alterable at the discretion of the IRS.

Likewise, Notice 2003-71 dealing with the Market Test also leaves open issues. It states, for instance, that Treasury intends to codify the information in the Notice by issuing appropriate Regulations. Good intentions notwithstanding, promulgating Regulations is an arduous, painstaking, and time-consuming process that often takes years to yield results. In the interim, uncertainty will likely fester. Notice 2003-71 also broaches the prospect of expanding the Market Test for future years, and solicits public comments on this issue. At this point, therefore, the scope of the Market Test is unsettled.

Finally, Notice 2003-71 states that Treasury and the IRS are currently analyzing the proper tax treatment of dividends distributed with respect to stock that is not listed on the New York Stock Exchange, NASDAQ, etc. In particular, the U.S. government is considering whether or to what extent other stock (e.g., that listed on the OTC Bulletin Board or on electronic pink sheets) should be able to satisfy the Market Test based on factors such as trading volume, minimum number of market makers, maintenance and publication of historical trade or quotation data, and issuer reporting requirements. Until this issue is resolved, determining which stocks should be considered readily tradable on a U.S. securities market will be troublesome.

Similar to its two predecessors, Notice 2003-79 deliberately ignores or postpones some issues. With regard to the Equity Test, Notice 2003-79 states that the IRS intends to issue Regulations providing a certification procedure under which foreign corporations may verify that a distribution meets the Equity Test, and such certification will likely be made in a public SEC filing (such as Form 20-F) or in a public statement with a copy filed with the IRS. Likewise, the IRS indicates in Notice 2003-79 that it intends to develop certification procedures under which a foreign corporation may certify that it meets the Treaty Test or the Foreign Investment Company Exclusion Test.[60] The IRS claims that these yet-to-be-developed certification initiatives will be in place for tax years after 2003, but uncertainty will surely reign until solid rules are introduced.

In addition to those issues purposefully left unresolved by the three IRS Notices, other concerns raised by investors and the tax community still linger. A partial list of these remaining problems includes the following:

- Will the Possessions Test be redefined to disallow use of reverse hybrid entities?
- What exactly does "substantially all" of a corporation's income mean in the context of the Treaty Test?
- Which SEC documents must an investor review to confirm that a particular corporation does or does not satisfy the Foreign Investment Company Exclusion Test?
- What is the proper tax treatment of inclusions from CFCs?

Expected Responses to JGTRRA

Under JGTRRA, "qualified dividend income" is taxed at rates lower than those applicable to interest, compensation, and other items of ordinary income. Moreover, these tax breaks apply to certain dividends issued by foreign corporations, a situation that has been categorized as "groundbreaking" and an "amazing concession."[61] As a result of the new tax environment created by JGTRRA, it is likely that several events will occur and structures will be used.

Issue hybrid securities. Those entities fortunate enough to be considered "qualified foreign corporations" may issue hybrid securities, which will be treated as *debt* under local law and as *equity* under U.S. tax law.[62] In this manner, the U.S. investor takes advantage of the lower tax rates on dividends under JGTRRA, while simultaneously allowing the foreign corporation to claim interest deductions and avoid foreign withholding tax.[63]

Switch compensation form. Corporate executives who normally receive a salary (which is taxed at higher rates as ordinary income) may opt to receive instead preferred stock that pays "qualified dividend *(Continued on page 62)*

52 See "IRS Issues Guidance on QFC Dividend Information Reporting," 2003 Tax Notes Today 229-2 (November 28, 2003); "Treasury, IRS Issue Guidance on Dividends Information Reporting," 2003 Tax Notes Today 229-15 (November 28, 2003); "Treasury & IRS Issue Guidance on Information Reporting on Dividends From Foreign Corporations," JS-1027 (November 26, 2003).

53 Notice 2003-79, section 3.01.

54 Tolin, *supra* note 7, at 22, 24.

55 Notice 2003-79, section 3.02.

56 *Id.*, section 3.03(a).

57 *Id.*, section 3.03(c).

58 *Id.* For example, Notice 2003-79 explains that a foreign corporation that receives U.S.- source income eligible for a reduced withholding rate under a treaty generally must complete a Form W-8BEN (Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding) certifying that it is a resident of the relevant country within the meaning of the relevant treaty and satisfies the limitation-on-benefits provision in that treaty.

59 Notice 2003-79, sections 3.04-3.08.

60 *Id.*, sections 3.01-3.04.

61 Gnaedinger, "Canadian, U.S. Tax Treatment of Shareholder Dividends: You Pay Your Money and Make Your Choice," 2003 Tax Notes Today 113-5 (June 12, 2003).

62 Cadwalader, *supra* note 12.

63 *Id.* See also Tolin, *supra* note 7, at 29.

(Continued from page 27) income" and is thus subject to the lower tax rates of JGTRRA. Tax experts posit that this switch in form of compensation will appeal to American executives of foreign corporations, particularly if the transaction is designed so that the foreign corporation is permitted a tax deduction for dividends paid in accordance with local laws.[64] Other tax advisors warn, though, that before making this switch, a corporation would be wise to examine various factors, including that corporations can deduct salaries but not dividends, and the bad publicity associated with executive stock options in the wake of the Enron scandal.[65]

Use low-taxed foreign corporations. Efforts may be made to identify foreign corporations in low-tax jurisdictions that meet the Treaty Test so that these entities may be used to convert ordinary income into "qualified dividend income" without subjecting it to corporate tax. According to some tax firms, if the local laws of United States treaty partner countries allow the organization of low-taxed foreign corporations that qualify as "residents" and fulfill the limitation-of-benefits provision, and the foreign corporation manages to avoid being characterized as a passive foreign investment corporation, the foreign corporation could hold U.S. bonds or other income-generating property and then distribute income as low-taxed dividends without any substantial corporate-level tax.

Rearrange investment mix. Taxpayers may rearrange their investment portfolios so as to hold more equity securities of qualified foreign corporations.[66] As certain tax analysts explain, "[f]or those investors who are wise enough (or lucky enough) to have appreciated securities in their portfolios, the new lower rates on long-term capital gains presents an opportunity to sell some or all of these holdings and to use the proceeds to rebalance their investment mix."[67]

Shift retirement plan investments. JGTRRA could affect retirement plans. Dividends and certain capital gains within a retirement plan will be tax-deferred until they are distributed. Ultimately, however, they will likely be taxed at a 35% rate, which is considerably higher than the 15% rates of JGTRRA. Consequently, U.S. investors may shift those investments that bear interest into retirement plans and place investments that produce dividends and capital gains in accounts held individually.[68]

Compile list of qualified foreign corporations. In an attempt to simultaneously reduce uncertainty and mitigate costs, multiple organizations may unite to compile a list of entities that will be considered "qualified foreign corporations." For example, shortly after Notice 2003-79 was issued, a group of securities brokers joined together to hire Ernst & Young to begin developing just such a database.[69]

Distribute dividends. Since capital gains and dividends will generally be taxed at the same rates, it is logical to presume that U.S. investors would have no tax-based preferences. However, since dividends are normally more immediate and secure, investors will likely opt to receive them over capital gains. As a result, corporations may face increasing pressure from shareholders to distribute dividends. Some tax practitioners speculate that corporations may capitulate to this pressure and issue artificially high dividends to take advantage of the tax rates that are temporarily lowered under JGTRRA. Other tax analysts second this prediction, explaining that "[i]t would appear likely that corporations will at least initiate or increase dividend payments in the hope of attracting capital, raising their stock price, and, therefore, making it easier to raise capital."[70]

Revise treaties. Finally, several nations may revise their treaties with the United States in hopes of meeting the Treaty Test. As explained previously, Notice 2003-69 identified four tax treaties that are unacceptable for purposes of JGTRRA. The U.S. treaties with Bermuda and the Netherlands Antilles are not "comprehensive income tax treaties," the treaty with the former U.S.S.R. does not contain an exchange-of-information program, and the Barbados treaty is not "satisfactory" because it allegedly provides tax benefits designed to mitigate or eliminate double taxation where there is no risk of such double taxation. Displeased with its omission, Barbados has recently taken action. Treaty negotiators from United States and Barbados met in October 2003 to discuss a revision of the 1984 treaty (amended by the 1991 protocol). According to a former IRS international tax counsel, the sole reason for the renewed negotiations is to ensure that this bilateral tax pact meets the Treaty Test.[71] It is quite possible that other nations will follow in the near future.

Conclusion

The reduction of tax rates on capital gains to 15% or less, combined with the treatment of certain dividends (including foreign dividends) as capital gains, makes JGTRRA appealing to many U.S. individual investors. Unappealing, however, is the uncertainty surrounding various provisions of the new law, particularly those pertaining to "qualified dividend income" and "qualified foreign corporations." As this article demonstrates, this insecurity has provoked numerous concerns from many in the tax and investment communities. The IRS Notices issued to address these concerns were undeniably helpful, but significant doubts remain as a result of the items intentionally left unresolved by the IRS and other open questions. Amid this atmosphere of continued uncertainty, U.S. investors interested in availing themselves of the tax benefits in JGTRRA would be wise to do so only after diligent planning, review of the ever-changing law, and consultations with competent tax advisors. ●

64 Cadwalader, *supra* note 12.

65 CCH Incorporated, *Jobs and Growth Tax Relief Reconciliation Act of 2003: Law, Explanation and Analysis* (2003), page 31 (comments of Michael J. Grace of Jackson & Campbell).

66 Cadwalader, *supra* note 12.

67 CCH, *supra* note 65, page 92; RIA, *supra* note 5.

68 Kehoe, "Money Matters; Federal Tax Changes Provide Relief," 230 New York Law Journal 16 (August 8, 2003).

69 "Broker/Dealers Choose Ernst & Young to Develop Database of Foreign Equities That Qualify for 15% Dividend Tax Rate," PR Newswire (December 19, 2003).

70 CCH, *supra* note 65, pages 23 and 30 (comments of Tim Kochis of Kochis Fitz).

71 Bell, "U.S., Barbados Step Up Tax Treaty Negotiations," 2003 Tax Notes Today 208-3 (October 28, 2003).