



# TaxNewsFlash

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## Notice 2023-31: Extension of transition period for single-country exception documentation requirement under section 903

The IRS today released an advance version of [Notice 2023-31](#) [PDF 90 KB] announcing that when proposed regulations under section 903 are finalized, the Treasury Department and the IRS intend to extend the transition period for the single-country exception's documentation requirement from May 17, 2023, to 180 days after the date the proposed regulations are finalized.

### Background

Section 903 allows a credit for foreign taxes in lieu of generally-imposed foreign income, war profits, or excess profits taxes. For foreign withholding taxes, Treas. Reg. § 1.903-1(c)(2)(iii) provides that the foreign withholding tax must meet the source-based attribution requirement in Treas. Reg. § 1.901-2(b)(5)(i)(B) to qualify as a "covered withholding tax" that may be creditable as a tax in lieu of an income tax. Thus, a withholding tax on a royalty payment is creditable only if the foreign tax law sources royalties based upon the place of use of, or the right to use, the intangible property, consistent with how the Code sources royalty income.

Treasury and the IRS on November 22, 2022, published proposed regulations (REG-112096-22) that include a limited exception to the source-based attribution requirement for withholding taxes on certain royalty payments. Under Prop. Reg. § 1.903-1(c)(2)(iii), a tested foreign tax satisfies the source-based attribution requirement if the tax meets either the source-based attribution requirement or the single-country exception. In general, the single-country exception applies if (1) the income subject to the tested foreign tax is characterized as royalty income under the foreign tax law, and (2) the payment giving rise to such income is made pursuant to a single-country license (such license, the required agreement).

Under Prop. Reg. § 1.903-1(c)(2)(iv)(D), the required agreement pursuant to which the royalty is paid must be executed no later than the date on which the royalty is paid. However, recognizing that the single-country exception is proposed to be applicable to periods preceding the release of the proposed regulations, Prop. Reg. § 1.903-1(c)(2)(iv)(D) provides a special transition documentation rule that allows an agreement to be executed no later than May 17, 2023, for royalties paid on or before May 17, 2023.

### **Extension of transition documentation rule**

To allow for an orderly implementation of the requirements of the single-country exception, including for relevant periods before the finalization of the single-country exception, Treasury and the IRS intend to modify the transition documentation rule when the single-country exception in Prop. Reg. § 1.903-1(c)(2)(iii)(B) is finalized to provide that the required agreement must be executed no later than 180 days after the date final regulations adopting the single-country exception are filed with the Federal Register.

Consistent with the preamble to the proposed regulations, taxpayers may rely on the modified transition documentation rule as described in the notice for foreign taxes paid in taxable years beginning on or after December 28, 2021, and ending before the effective date of final regulations adopting the single-country exception, provided that the foreign tax is otherwise eligible for the single-country exception under the proposed regulations.

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