tional licenses; and to indemnify the university/lessor for claims arising from the third party's use of the tower. In PLR 98-16027, the IRS noted that, because the radio tower was permanently affixed to real estate, the rental payments the university received for leasing space on the tower were from real property. Accordingly, the IRS concluded that the rental payments were excluded from the UBIT tax by section 512(b)(3)(A)(i) of the Code.

In PLR 2001-04031, however, the IRS reversed its position on the matter, concluding that rents for space on the same radio tower were for personal property and, thus, not excluded from the UBIT. In PLR 2001-04031, the IRS relied on the section 1245(a)(3)(B) description of personal property when it concluded that the university's radio tower was personal property. The IRS also referred to the definition of "tangible personal property" contained in the regulations under section 48, specifically, regulation section 1.48-1(c) & (d), which identifies radio towers as "tangible personal property." Regulation section 1.1245-3(c)(2) indicates that the language of regulation section 1.1245-3(c)(1) "shall have the same meaning as when used in" regulation section 1.48-1. Thus, per the IRS, the term "tangible personal property," which includes radio towers for purposes of section 48 of the Code, also includes radio towers for purposes of sections 1245(a)(3)(B) and 512(b)(3)(B).

Based on this recent IRS determination that radio towers are personal property, practitioners should take note that what constitutes real property for most purposes might not be classified as real property for purposes of the real property rental UBIT exclusion. Indeed, a basic aspect of the definition of real property for most purposes is that items permanently attached to realty constitute real property. Thus, *Black's Law Dictionary* defines "real property" as "Land, and generally whatever is erected upon or affixed to land." Clearly, a radio tower, which is permanently affixed to real estate, is ordinarily contemplated by such a basic definition of real property. However, PLR 2001-04031 teaches us that, for UBIT purposes, certain types of real property may be treated by the IRS as personal property.

FSC REPEAL AND EXTRATERRITORIAL INCOME EXCLUSION LEGISLATION

by Nancy M. Beckner, Washington, DC

BACKGROUND

The FSC Repeal and Extraterritorial Income Exclusion Act of 2000 (the "Act") [P.L. 106-519] repeals the foreign sales corporation ("FSC") regime (sections 921-927),[1] replacing it with the extraterritorial income exclusion ("EIE"). The Act responds to the outcome of the European Union ("EU") initiated dispute which resulted in the World Trade Organization ("WTO") ruling that FSCs were a prohibited subsidy under international trade law.[2] Unfortunately, the Act has not satisfied the EU, which responded by challenging the EIE on much the same basis as it contested FSCs. The U.S., in turn, has challenged the EU's request for trade sanctions (which could potentially reach $4 billion annually); it is anticipated that the EU will await the outcome of the WTO dispute resolution process before imposing such sanctions. The parties submitted briefs to the WTO panel in February 2001, and it is speculated that the panel's decision will be given by mid-year. Subsequent appeal and arbitration could take several more months.

EU dissatisfaction with the EIE raises the question of whether the U.S. should consider other approaches. According to U.S. Trade Representative Charlene Barshefsky, further action by the U.S. would be taken, if necessary, based upon the WTO dispute settlement panel decision. However, according to an EU delegation press official, the dispute panel will issue an interim report, and it has been suggested that the U.S. should begin looking at other options if the interim report appears unfavorable ("Trade Representative Barshefsky Lauds U.S. Trade Ties with Europe," January 17, 2001, Tax Analysts: Doc 2001-1809). The U.S., of course, believes the EIE is WTO compliant, and on January 23rd, the National Foreign Trade Council released a summary and critique of the European Commission's position, arguing that the Commission has misunderstood the EIE (Tax Analysts: Doc 2001-2415).

OVERVIEW

Codified provisions of the Act are primarily section 114 and sections 941-943. Sections 114(a) and (b) exclude from gross income "extraterritorial income" which is qualifying foreign trade income ("QFTI"); section 114(c) disallows deductions allocable to excluded income; and section 114(d) denies credit for foreign taxes with respect to such income. For U.S. tax purposes (including the alternative minimum tax), any individual or corporate U.S. taxpayer may claim the exclusion, i.e., unlike FSCs, no separate foreign entity is utilized. The Act responds to the WTO determination that a prohibited subsidy includes "revenue foregone that is otherwise due" and also seeks to avoid granting prohibited export-contingent benefits. Unlike FSC dividends (section 245(c)), no 100% dividends received deduction is available for distributions attributable to foreign trade income of a foreign subsidiary. Until administrative guidance is issued, principles of the FSC regulations and administrative guidance are to be applied to analogous concepts under the EIE regime.[3]

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1 Except as otherwise noted, all "section" references are to the Internal Revenue Code of 1986, as amended.

2 *See* United States–Tax Treatment for "Foreign Sales Corporations," WT/DS 108/R, WT/DS 108/AB/R, Report of the Panel, as modified by the Appellate Body, adopted March 20, 2000.

QFTI requires a computation of the amount of gross income that, if excluded, will result in a reduction in the taxpayer's taxable income from the transaction equal to the greatest of: (1) 30% of the taxpayer's foreign sale and leasing income ("FSLI") from the transaction, (2) 1.2% of the taxpayer's foreign trading gross receipts ("FTGR") from the transaction, or (3) 15% of the taxpayer's foreign trade income ("FTI") from the transaction.[4] The amount of QFTI determined under the 1.2% method is limited to 200% of QFTI that would result using the 15% method. Taxpayers may choose any of these methods. After determining the reduction in taxable income, the amount of gross income excluded is calculated by a gross-up for related expenses.[5]

FTGR are gross receipts from activities involving "qualifying foreign trade property" ("QFTP") with respect to certain "economic processes" that take place outside the U.S. This requirement will be met if the taxpayer (or person acting under contract with the taxpayer) participates outside the U.S. in the solicitation, negotiation or making of the contract relating to the transaction and incurs foreign direct costs that equal or exceed 50% of total direct costs (i.e., attributable direct costs incurred in section 942(b)(3) activities).[6]

FTGR must be from the sale, exchange or other disposition of QFTP, from the lease or rental (including licensing) of such property for use outside the U.S., for services related or subsidiary to such disposition, lease or rental, for engineering or architectural services for construction projects outside the U.S., or for the performance of certain managerial services for unrelated persons. Excluded are receipts involving QFTP or services for ultimate use in, or in certain cases by, the U.S. and receipts involving certain subsidized transactions. Taxpayers may elect to exclude gross receipts from being FTGR and instead use related foreign tax credits (in lieu of the section 114 exclusion) to avoid double taxation.

QFTP is similar to export property under the FSC regime; however, QFTP is not required to have been manufactured, produced, grown or extracted (collectively, "manufactured") in the U.S., and the U.S. content requirement has been modified. Such property must be held primarily for sale, lease or rental in the ordinary course of trade or business for direct use, consumption or disposition outside the U.S., and not more than 50% of the property's fair market value can be attributable to the sum of the fair market value of articles manufactured outside the U.S. *plus* direct costs of labor performed outside the U.S. Property that is otherwise QFTP but that is manufactured outside the U.S. will be QFTP only if it is manufactured by (1) a U.S. corporation, (2) a U.S. citizen/resident individual, (3) a foreign corporation that elects domestic treatment, or (4) a partnership or other pass through entity all of the partners/owners of which are persons described in (1) - (3). QFTP does not include property leased for use by a related person or certain other property excluded under sections 943(a)(3) or (4).

FTI is taxable income, determined without the QFTI exclusion, attributable to FTGR.

FSLI is FTI allocable to foreign economic processes (sections 942(2)(A)(i) or (3) activities); it also includes FTI derived in connection with the lease of QFTP for use by the lessee outside the U.S. and the sale of such property. Special limits apply to manufacturing profits and property acquired from a related person.

OTHER RULES

Among the EIE regime's other important rules are the following: (1) for certain taxpayers, a foreign source income limit applies to sales of QFTP manufactured in the U.S. (section 943(c)); (2) a foreign corporation that manufactures property in the ordinary course of its trade or business or substantially all of the gross receipts of which are reasonably expected to be FTGR may, subject to various limitations, elect domestic treatment (section 943(e)); (3) shared partnerships (section 943(f)) may be used to allocate QFTI and other items among partners, based on separate accounts (somewhat analogous to shared FSCs under section 927(g)); and (4) members of agricultural and horticultural co-operatives may treat as excludable QFTI the portion of their patronage dividends that is attributable to QFTI (section 943(g)).

EFFECTIVE DATE, TRANSITION & GUIDANCE

The FSC repeal was effective September 30, 2000, and the EIE applies to transactions entered into after that date; no new FSC election may be made after the effective date, and an existing FSC having no foreign trade income for a five consecutive year period after December 31, 2001 will cease to be a FSC. However, under the Act's transition rules, the FSC regime may continue to apply to many transactions. For FSCs in existence on September 30, 2000 and at all times thereafter, the amendments made by the Act will not apply to any transaction in the ordinary course of trade or business of the FSC if the transaction occurs before January 1, 2002 or after December 31, 2001 pursuant to a binding contract (including certain purchase, renewal and replacement options) between the FSC (or a relat-

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3 H.R. Rep. No. 106-845 (the "House Report"); *see also* "Effective Date, Transition & Guidance" below.

4 "[These three choices correspond in principle to the three methods available under the FSC transfer pricing rules ...." Lubkin, "Extraterritorial Exclusions: Replacing the Foreign Sales Corporation," 29 Tax Mgt. Int'l J. (BNA), Nov. 10, 2000, at 611, 619.

5 *See* the General Example in the House Report.

6 Section 942(b)(2)(B) provides an alternative 85% test if foreign direct costs in each of at least two categories of direct costs equals or exceeds 85% of total direct costs attributable to activities in such categories.

ed person) and a person who is not a FSC, if that contract is effect on September 30, 2000 and at all times thereafter. Alternatively, taxpayers may elect to have the new regime apply to such transactions.

For FSCs in existence on September 30, 2000, sections 5(c)(3)(A) and (B) of the Act offer some relief from problems resulting from the lack of a 100% dividends received deduction. If the FSC would be able to make the domestic election under section 943(e) because substantially all of its gross receipts are FTGR and it makes the election not later than for its first taxable year beginning after December 31, 2001, the election (i.e., the section 367 consequences) will not require shareholders to include in gross income FSC earnings and profits accumulated in taxable years ending before October 1, 2000, and certain other modifying rules will apply to alter the effect of certain other income triggering provisions of the Code. This special relief is also available for certain electing controlled foreign corporations ("CFCs"), as defined foreign corporations in section 957; to qualify, such CFCs must be wholly owned, directly or indirectly, by a U.S. corporation, meet certain gross income requirements, and have regularly sold (or paid commissions) to a related FSC (section 5(c)(3)(C) of the Act).

The IRS will shortly issue a Revenue Procedure addressing the three elections available under the Act; a Notice providing interim guidance should follow shortly thereafter; and Treasury is diligently working on proposed regulations. The IRS has already provided new Form 8873, Extraterritorial Income Exclusion, for taxpayers having post-September 30, 2000 transactions.

ADDITIONAL COMMENTS

Some analysts view the EIE as a move by the U.S. toward a partial territorial tax system. Whether the conceptual modification represented by the EIE (as stated in the House Report) is reflected in other U.S. international tax reform remains to be seen. Given the current EU position, the pending WTO report and possible U.S. response should the report be unfavorable, the most that can be said is that, longer-term, U.S. taxpayers engaging in, or contemplating, transactions of the types covered by the Act face some uncertainty about the tax regime under which they will conduct international business.

THE IRS PROPOSES NEW AND SIMPLIFIED RULES FOR REQUIRED MINIMUM DISTRIBUTIONS FROM IRAS AND QUALIFIED PENSIONS PLANS

by David L. Silverman, Great Neck, NY

INTRODUCTION

The objective of many participants of qualified pension plans and IRAs is to delay distributions as long as possible and, when required to take distributions, to withdraw the least amount over the longest period of time. On January 11, 2001, the IRS revised the 1987 proposed regulations under Code section 401(a)(9) governing minimum required distributions from qualified pension plans and IRAs. All qualified pension plans must provide for annual minimum required distributions that commence no later than the "required beginning date," which is April 1st following the year in which the participant attains the age of 70½, or retires, if later. The penalty for failing to take required distributions at the required beginning date and annually thereafter is a 50% excise tax, which is imposed on the difference between the minimum required distribution and the actual distribution made in any given year.

The 2001 proposed regulations, which are elective for 2001 but mandatory thereafter, change the distribution rules by (i) reducing minimum required distributions and greatly simplifying their determination; (ii) lengthening the distribution period; (iii) extending the deadline for designating a beneficiary without adverse consequences from the required beginning date to December 31 following the year of death; and (iv) implementing new reporting requirements imposed upon IRA trustees. Most of these changes, except for the new reporting requirements, are favorable to the participant. Note that the new rules apply to participants in qualified plans and persons who have contributed to their own IRAs. It is not clear, however, whether the IRS will apply the new rules to inherited IRAs. A summary of the current rules and important changes follows.

PARTICIPANT'S DEATH BEFORE REQUIRED BEGINNING DATE

If the participant dies before the required beginning date, plan benefits must be distributed (i) in annual installments over the life expectancy of any nonspouse designated beneficiary, with distributions commencing no later than December 31 of the year after the year in which the participant died, with the life expectancy being reduced by one for each subsequent year; (ii) in annual installments over the life expectancy of a spouse designated beneficiary beginning no later than December 31 of the year after the year in which the participant died or, if later, by December 31 of the year in which the participant would have reached age 70½, with the life expectancy of the spouse being redetermined annually; or (iii) within five years of the participant's

7 Under section 943(e)(4)(B)(i), a domestic election is treated as if the assets of the foreign corporation were transferred to a domestic corporation in an exchange described in section 354. This treatment can produce various adverse income triggering results for shareholders under section 367, the Subpart F provision relating to the investment of earnings and profits of a CFC in U.S. property and sections 1248 and 884. Section 5(c)(3) of the Act modifies these results for qualifying FSCs and CFCs which make a timely domestic election.

8 Comments of John Meagher, legislative counsel to House Ways and Means Comm., as reported by Amy Hamilton in "Son of FSC," 89 Tax Notes (TA) 985 (Nov. 20, 2000), and Lubkin, "FSC Replacement Update," 30 Tax Mgt Int'l J. (BNA), Jan. 23, 2001, at 33, 35. *See also* the statement in the House Report, Reasons for Change, that " [w]hat the Committee is intending ... is once again to incorporate elements of a territorial tax system into the U.S. tax system of worldwide taxation...."