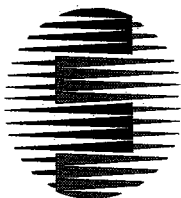


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October 30th, 2009

BY FAX AND TRANSLOGISTIX COURIER
Fax No. 202-622-4408 & CN #84103009

Elizabeth U. Karzon, Branch Chief
Associate Chief Counsel (International) (CC:INTL)
Branch 1 (CC:INTL:B01), 4607 IR
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

RECEIVED
INTERNAL REVENUE SERVICE
2009 OCT 30 PM 12:19

Re: Form 1120-F, Schedules S and V

Dear Ms. Karzon:

This letter addresses several concerns regarding Schedules S and Schedule V to Form 1120-F, which were recently adopted by the Internal Revenue Service (the "Service").

BACKGROUND

The Service posted the Form 1120-F, *US Tax Return for Foreign Corporations*, for the 2008 tax year to www.irs.gov on January 10th, 2009. Instructions for the form were posted on February 7th, 2009. According to those instructions, Schedules S and V were supposed to be filed with Form 1120-F for 2008. The schedules affect corporations that earn US source gross transportation income ("USSGTY") as defined in Section 887.

The Service posted Schedule V, *List of Vessels or Aircraft, Operators, and Owners*, to the irs.gov website on January 30th, 2009. Instructions for the schedule were posted on February 12th, 2009. Schedule S, *Exclusion of Income from the International Operation of Ships or Aircraft Under Section 883*, was posted to the website on February 10th, 2009. Instructions for that schedule were posted on February 18th, 2009.

On April 1st, 2009 we raised an objection to the preemptory introduction of these two schedules for use with returns being filed for the 2008 tax year and listed several concerns regarding the contents of the accompanying instructions by email. The draft Schedules S & V, which have been posted for the 2009 tax year, are identical to those posted for 2008. Thus, we have prepared these formal comments on the schedules and the instructions with a request that they be revised as described below.

COMMENTS

1120-F and Instructions

The first bullet point in the "What's New" section of the Instructions for the Form 1120-F for 2008 advises that, "[N]ew Schedule S (Form 1120-F) must be attached to Form 1120-F if the corporation is claiming a code exemption under section 883." The second bullet point announces that, "[N]ew Schedule V (Form 1120-F) must be attached to Form 1120-F if the corporation is reporting gross transportation income in Section 1, line 9, column (b)."

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We believe the intent of these bullet points is that a corporation with USSGTI will file only one of the schedules. Those paying the four percent (4%) tax under Section 887 should file only Schedule V. Those claiming exclusion of USSGTI under Section 883 should file only Schedule S. Corporations that rely on Section 883 to exclude USSGTI from their income for tax purposes are not “reporting” gross transportation income in Section 1, line 9, column (b), but disclosing it on Schedule S or otherwise as required by Rev. Proc. 91-12 and the Section 883 Regulations.

The main body of the Instructions for Form 1120-F for 2008 support the conclusion that Schedule V is filed only by taxpaying corporations. The instructions for Section 1, Line 9 read as follows: “[E]nter the foreign corporation’s U.S. source gross transportation income on line 9, column (b). Also, attach Schedule V (Form 1120-F).” The instructions continue, “[S]ee page 14 for exclusions from gross income of certain income from ships and aircraft.” On page 14 the Instructions advise that companies may be able to exclude USSGTI under Section 883 if they qualify, in which case they are to file Schedule S.

Although we believe this to be a reasonable interpretation of the Instructions, we believe a clear statement to this effect is warranted. A company that qualifies under Section 883 should not report its excludable income as USSGTI on Form 1120-F in Section 1, Line 9, Column (b). Thus, it should not file Schedule V as well as Schedule S.

Schedule S and Instructions

1. Qualified Income

The Schedule S Instructions define “qualified income” to include all of the categories of income described “on lines 2a through 2h.” Those lines correspond directly to Section 1.883-1(h)(2)(i) through (viii) of the Section 883 Regulations.

In addressing these categories, the Specific Instructions (page 2) for Line 2, “Gross Income from Categories of Qualified Income,” contain no instructions for Lines 2a, 2g and 2h.

a. Line 2a

We presume that Line 2a includes any USSGTI that is not included in any of the categories enumerated on the other lines, but that should be clarified. It would appear that this line is intended for ticket or fare revenue.

b. Line 2g

Line 2g requires the corporation to identify capital gains, but the instructions do not provide any guidance as to how such a calculation should be made. First of all, the inclusion of capital gains as “qualified income” contradicts the provisions of §2.03 of Rev.Proc. 91-12, which states quite clearly that, “the term ‘transportation income’ does not include income from the disposition of vessels, containers or aircraft.” This exact language is repeated *verbatim* in the Schedule V Instructions which we address later in these comments.

We do not believe capital gains – income from the disposition of vessels, etc. – are properly included in USSGTI. We raised the contradiction between §2.03 of Rev.Proc 91-12 and §1.883-1(h)(2)(vi) in the Section 883 Regulations regarding capital gains when the regulations were first published in 2000 and again when they were re-proposed in 2002.

Unfortunately, the Service did not address this contradiction when it re-proposed the Section 883 Regulations in 2002 or when it published the final version in 2003. Yet, the contradiction continues between the approach dictated by Schedule S and that allowed by Schedule V.

c. Line 2h

There are no instructions to guide companies on how to calculate income for Line 2h. Can they rely on the methods discussed for time charter or bareboat income? Do they use the entire pool's operations to determine how much of their income from the pool, partnership, etc. is to be considered USSGTI?

According to the Note immediately underneath Line 2 on the Schedule, the return filer must indicate if any of the amounts reported as income on Line 2 are a "reasonable estimate." If each amount must be a "reasonable estimate," it is incumbent on the Service to provide a basis on which one can determine the "reasonableness" of estimations.

We respectfully suggest that Line 2g of Schedule S be removed and the instructions be revised accordingly. We respectfully suggest that instructions for Lines 2a and 2h be added.

2. Lines 4 & 5

Line 4 asks if any of the shares of the return filer's stock or the stock of any direct, indirect or constructive shareholder of the return filer are issued in bearer form. If Line 4 is checked "yes," then Line 5 instructs the return filer to indicate that, "none of the bearer shares were relied on to satisfy," any of the stock ownership tests.

We have already challenged the validity of the provisions of the Section 883 Regulations that disqualify those who hold their interests in vessel owning foreign corporations directly or indirectly by means of shares issued to bearer. We do not believe the Service has the legal authority to require a company to answer Line 4. Based on the Section 883 Regulations, the Service may be entitled to know the answer to Line 5 even if it has no legal basis to refuse to extend the benefits of Section 883 to an otherwise qualified shareholder.

We respectfully suggest that Line 4 be removed from Schedule S and the instructions be revised accordingly.

Schedule V and Instructions

The "Who Must File" section of the Instructions for Schedule V plainly states that, "[F]oreign corporations that are subject to the 4% tax on their USSGTI under section 887 must complete Schedule V (Form 1120-F)." Further to our earlier comments related to the 1120-F, Schedule S, and their instructions, we believe this description should be elaborated to state that companies must file a Schedule V if their income is subject to the 4% tax and an exemption is not claimed for that income under Section 883 or a US tax convention.

1. USSGTI

The Schedule V Instructions define USSGTI as follows: "...any gross income...that is transportation income (as defined in section 863(c)(3)) to the extent such income is treated as from sources within the United States under section 863(c)(2)(A)."

Section 863(c)(3) reads in relevant part as follows:

“... for purposes of this subsection, the term ‘transportation income’ means any income derived from, or in connection with-- (A) the use (or hiring or leasing for use) of a vessel or aircraft, or (B) the performance of services directly related to the use of a vessel or aircraft.”

Later in the Definitions section, the Instructions incorporate the guidance of Section §2.03 of Rev. Proc. 91-12 as to what constitutes USSGTI as follows: “However, the term transportation income *does not* include income from the disposition of vessels, containers, or aircraft.” Emphasis is in the original.

The basis for calculating USSGTI on which the 4% tax under Section 887 is imposed must be the same as that used by corporations seeking to exclude USSGTI under Section 883. If capital gains are not included in the calculation of USSGTI as Rev. Proc. 91-12 and the Schedule V Instructions state, why are they included as an item of USSGTI to be declared on Line 2g of Schedule S? There is no point in excluding income that is not subject to tax. The contradiction between the two Schedules must be reconciled. The instructions with respect to capital gains should be the same on both Schedule S and Schedule V.

2. Operator

We believe the definition of “operator” in the Instructions for Schedule V is too inclusive and should be further modified. The shipping industry generally divides itself into asset owners, those whose assets are employed in shipping operations, and non-asset operators, those who employ others’ assets to transport passengers or freight. Asset owners either bareboat vessels to others who become “demise owners” and are responsible as if they were registered owners for obtaining all of the vessel’s international trading papers, or the asset owners charter out their vessels directly to charterers on a voyage or period basis. The companies that charter in tonnage from owners or demise owners may charter them to others further up the chain. The person at the top of the chain is the freight interest who pays the freight bill. That person does not earn “income” and thus is not covered by Section 887.

Using the foregoing approach, the questions on the Schedule V could be revised along the following lines:

- Question 3: “Was the vessel/aircraft chartered out on a bareboat basis?”
- Question 4: “Was the vessel/aircraft chartered in on a bareboat basis?”
- Question 5: “Was the vessel/aircraft chartered in on a time or voyage hire basis?”
- Question 6: “Was the vessel/aircraft chartered out on a time or voyage hire basis?”

The instructions for Lines 3, 4, 5, and 6 could be tailored along the lines of the instructions for Line 4 on the current schedule to enable the Service to gather the additional information it requests be added in an attachment to the schedule. Question 3 would request information on the demise owner to which the registered owner bareboat the vessel. Question 4 would request information on the registered owner from which the demise owner acquired the vessel. Question 5 would request information on the company from which the charterer obtained the vessel, and Question 6 would request information on the company to which the vessel was chartered. The question of who is an “operator” and who is an “owner” would thus be bypassed as not relevant to the real inquiry, namely, where in the chain of control of the vessel was the

corporation filing the return and on what basis did that corporation receive income subject to US taxation.

3. *Line 9*

The instructions regarding Line 9 on Schedule V are confusing. The Line 4 instructions for bareboat lessors use the term "lessee" and "lease." That categorization is straightforward in that the registered owner of a vessel that is chartered out on a bareboat basis to another company, i.e., to a lessee or demise owner, will receive bareboat hire. However, the Note that follows the instructions for Line 9, uses the term "rental" with "charter" in parentheses, but follows with the word "lessor" with the term "charter." The instructions should be consistent in distinguishing among companies in the chain as suggested earlier. Using terms that reflect the commercial arrangements in shipping will simplify the instructions and ensure more accurate reporting.

The Note labeled "Important" following the instructions for Line 9 on Schedule V is confusing. I believe it is meant to apply to all companies that earn USSGTI on a bareboat or time basis. However, use of the term "leases" and reference to Line 4 could lead one to the conclusion that providing a description of the method used to determine USSGTI applies only to those who receive bareboat hire.

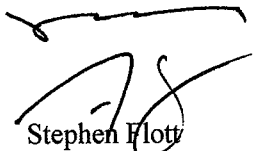
On its face, the Note cannot apply to companies that earn income on a voyage basis because generally they receive a fixed sum for the voyage based on a price per tonne of cargo, commonly called "freight."

Suggested Revenue Procedure

Finally, based on the scope of the two schedules and their contents, we believe a new Revenue Procedure should be considered to update the guidance in Rev. Proc. 91-12 to account for the two new two schedules and their instructions.

We look forward to addressing any concerns, reservations, or questions that the Service may have about these comments, or to assist the Service in improving the tax administration of Section 887 and Section 883. Thank you in advance for your time.

Yours truly,


Stephen Flott
Benjamin G. Snipes