

Compute tax on dividends from my foreign stock investments

If you own stock in a foreign company, it's possible that the dividends you earn will be entitled to the same 15 percent maximum tax rate given to dividends paid by domestic corporations starting in 2003. Dividends from foreign corporations, however, are now eligible for the new lower maximum 15 percent tax rate only if the company is a "qualified" foreign corporation.

Dividend tax rate: new low

Under the new 2003 tax law, dividends paid by qualified domestic and foreign corporations are taxed at 15 percent. The new rate applies to dividends received in tax years beginning January 1, 2003. However, the new 15 percent rate is temporary; it expires on December 31, 2008. The tax rate is even lower if you, or your family members, are in the 10 and 15 percent brackets. In that case, the maximum dividend tax rate is five percent for 2003 through 2007. Dividends won't be taxed in 2008 at all for taxpayers in the 10 to 15 percent bracket.

Generally, a dividend qualifies for the 15 or five percent tax rate if it is:

- Common or preferred stock of a domestic corporation;
- Received from qualified foreign corporations;
- American Depositary Receipts (ADRs), which enable taxpayers to purchase shares of foreign corporations at U.S. exchanges; or
- Qualified foreign dividends.

Only specific foreign corporation dividends are eligible for the new lower tax rates. Dividends from foreign corporations are eligible for the lower rates if the foreign corporation:

- Is incorporated in a U.S. possession;
- Is eligible for benefits of an income tax treaty with the U.S.; or
- Stock is traded on an established U.S. securities market.

Treaties

To make the grade as a "qualified foreign corporation," the foreign country must have the appropriate tax treaty with the U.S. To pass muster, the tax treaty must have an exchange-of-information program and the Secretary of the Treasury must determine it is satisfactory.

Fifty-two treaties have received Treasury's approval. They are treaties with Australia, Austria, Belgium, Canada, China, Cyprus, Czech Republic, Denmark, Egypt, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Indonesia, Ireland, Israel, Italy, Jamaica, Japan, Kazakhstan, Latvia, Lithuania, Luxembourg, Mexico, Morocco, the Netherlands, New Zealand, Norway, Pakistan, the Philippines, Poland, Portugal, Romania, Russia, Slovakia, Slovenia, South Africa, South Korea, Spain, Sweden, Switzerland, Thailand, Trinidad and Tobago, Tunisia, Turkey, Ukraine, United Kingdom, and Venezuela.

U.S. securities market

If the foreign corporate stock is traded on an established U.S. securities market, the dividends generally qualify for the new low tax rate. Common stock of a foreign corporation is traded on an established market if it is listed on a national securities exchange registered with the SEC or on NASDAQ. Registered national securities exchanges include:

- American Stock Exchange;
- Boston Stock Exchange;
- Chicago Board Option Exchange;
- Chicago Stock Exchange;
- Cincinnati Stock Exchange;
- International Stock Exchange;
- New York Stock Exchange;
- Philadelphia Stock Exchange; and the
- Pacific Exchange, Inc.

Other markets

The IRS is investigating whether to make foreign stocks not traded on exchanges other than the nine registered national exchanges and NASDAQ eligible for the lower dividend tax rates. The OTC Bulletin Board (over-the-counter stocks) is an example.

Non-qualifiers

Dividends received from a foreign corporation that is a foreign personal holding company, a foreign investment company or a passive foreign investment company are specifically not eligible for the reduced tax rates.

Next step

Figuring out what foreign dividends qualify for the new low tax rate, and when, can be complex. It's important to note that only calendar year taxpayers receive the full benefit of the low rates retroactive to dividends paid on or after January 1, 2003. Fiscal year taxpayers cannot take advantage of the new dividends rates for tax years ending in 2003. Contact our office for assistance in determining whether your foreign dividends qualify for the new low tax rates.