Internal Revenue Service, Treasury

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States shareholder’s successor in interest acquires such stock and such successor in interest makes an election under paragraph (b)(1) of this section with respect to a subsequent taxable year of such controlled foreign corporation, the increase in the controlled foreign corporation’s qualified investments in foreign base company shipping operations for such subsequent taxable year shall be determined in accordance with the provisions of §1.954–7(b)(2).

(d) Illustrations. The application of this section may be illustrated by the following examples:

Example 1. Foreign corporation A is a wholly owned subsidiary of domestic corporation M. Both corporations use the calendar year as a taxable year. In a statement filed with its return for 1977, M makes an election under section 955(b)(3) and the election remains in force for the taxable year 1978. At December 31, 1978, A’s qualified investments in foreign base company shipping operations amount to $100,000; and, at December 31, 1979, to $80,000. For purposes of paragraph (a)(1) of this section, A Corporation’s decrease in qualified investments in foreign base company shipping operations for the taxable year 1978 is $20,000 and is determined by ascertaining the amount by which A Corporation’s qualified investments in foreign base company shipping operations at December 31, 1978 ($100,000) exceed its qualified investments in foreign base company shipping operations at December 31, 1979 ($80,000).

Example 2. The facts are the same as in example 1 except that A experiences no changes in qualified investments in foreign base company shipping operations during its taxable years 1980 and 1981. At December 31, 1980, A’s qualified investments in foreign base company shipping operations amount to $90,000. The changes in A’s qualified investments in foreign base company shipping operations occurring in its taxable year 1981 are considered to be zero with respect to the 40-percent stock interest acquired by N Corporation. N uses the calendar year as a taxable year. A remains a controlled foreign corporation immediately after such sale of its stock. A’s qualified investments in foreign base company shipping operations at December 31, 1980, amount to $90,000. The changes in A’s qualified investments in foreign base company shipping operations which occur during the taxable year 1980 is taken into account by M for purposes of paragraph (c)(1) of this section in determining its tax liability for the taxable year 1978. A’s increase in qualified investments in foreign base company shipping operations for the taxable year 1979 with respect to the 60-percent stock interest retained by M is $6,000 and is determined by ascertaining M’s pro rata share (60 percent) of the amount by which A’s qualified investments in foreign base company shipping operations at December 31, 1980 ($90,000) exceed its qualified investments in foreign base company shipping operations at December 31, 1979 ($80,000). N does not make an election under section 955(b)(3) in its return for its taxable year 1980. Corporation A’s increase in qualified investments in foreign base company shipping operations for the taxable year 1980 with respect to the 40-percent stock interest acquired by N is $4,000.

Example 4. The facts are the same as in example 1. Assume further that on September 30, 1979, M sells 40 percent of the only class of stock of A to N Corporation, a domestic corporation. N uses the calendar year as a taxable year. A remains a controlled foreign corporation immediately after such sale of its stock. A’s qualified investments in foreign base company shipping operations at December 31, 1980, amount to $90,000. The changes in A Corporation’s qualified investments in foreign base company shipping operations occurring in its taxable year 1979 are considered to be zero with respect to the 40-percent stock interest acquired by N Corporation. The entire $20,000 reduction in A Corporation’s qualified investments in foreign base company shipping operations which occurs during the taxable year 1980 is taken into account by M for purposes of paragraph (c)(1) of this section in determining its tax liability for the taxable year 1978. A’s increase in qualified investments in foreign base company shipping operations for the taxable year 1979 with respect to the 60-percent stock interest retained by M is $6,000 and is determined by ascertaining M’s pro rata share (60 percent) of the amount by which A’s qualified investments in foreign base company shipping operations at December 31, 1980 ($90,000) exceed its qualified investments in foreign base company shipping operations at December 31, 1979 ($80,000). N does not make an election under section 955(b)(3) in its return for its taxable year 1980. Corporation A’s increase in qualified investments in foreign base company shipping operations for the taxable year 1980 with respect to the 40-percent stock interest acquired by N is $4,000.

(T.D. 7894, 48 FR 22539, May 19, 1983)

§ 1.956–1 Shareholder’s pro rata share of a controlled foreign corporation’s increase in earnings invested in United States property.

(a) In general. Section 956(a)(1) and paragraph (b) of this section provide

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rules for determining the amount of a
controlled foreign corporation's earn-
ings invested in United States property
at the close of any taxable year. Such
amount is the aggregate amount in-
vested in United States property to the
extent such amount would have con-
stituted a dividend if it had been dis-
tributed on such date. Subject to the
provisions of section 951(a)(4) and the
regulations thereunder, a United
States shareholder of a controlled for-
eign corporation is required to include
in his gross income his pro rata share,
as determined in accordance with para-
graph (c) of this section, of the con-
trolled foreign corporation’s increase
for any taxable year in earnings in-
vested in United States property but
only to the extent such share is not ex-
cludable from his gross income under
the provisions of section 959(a)(2) and
the regulations thereunder.

(b) Amount of a controlled foreign cor-
poration’s investment of earnings in
United States property—(1) Dividend limi-
tation. The amount of a controlled for-
eign corporation’s earnings invested at
the close of its taxable year in United
States property is the aggregate
amount of such property held, directly
or indirectly, by such corporation at
the close of its taxable year to the ex-
tent such amount would have con-
stituted a dividend under section 316
and §§ 1.316–1 and 1.316–2 (determined
after the application of section 955(a))
if it had been distributed on such clos-
ing day. For purposes of this subpara-
graph, the determination of whether an
amount would have constituted a divi-
dend if distributed shall be made with-
out regard to the provisions of section
959(d) and the regulations thereunder.

(2) Aggregate amount of United States
property. For purposes of determining
an increase in earnings invested in
United States property for any taxable
year beginning after December 31, 1975,
the aggregate amount of United States
property held by a controlled foreign
corporation at the close of—

(i) Any taxable year beginning after
December 31, 1975, and

(ii) The last taxable year beginning
before January 1, 1976 does not include
stock or obligations of a domestic cor-
poration described in section
956(b)(2)(F) or movable property de-
scribed in section 956(b)(2)(G).

(3) Treatment of earnings and profits.
For purposes of making the determina-
tion under subparagraph (1) of this
paragraph as to whether an amount of
investment would have constituted a
dividend if distributed at the close of
any taxable year of a controlled foreign
corporation, earnings and profits of the
controlled foreign corporation shall be
considered not to include any amounts
which are attributable to—

(i) Amounts which have been in-
cluded in the gross income of a United
States shareholder of such controlled
foreign corporation under section
951(a)(1)(B) (or which would have been
so included but for section 959(a)(2))
and have not been distributed, or

(ii)(a) Amounts which are included in
the gross income of a United States
shareholder of such controlled foreign
corporation under section 551(b) or
would be so included under such sec-
tion but for the fact that such amounts
were distributed to such shareholder
during the taxable year, or

(b) Amounts which, for any prior tax-
able year, have been included in the
gross income of a United States share-
holder of such controlled foreign cor-
poration under section 551(b) and have
not been distributed.

The rules of this subparagraph apply
only in determining the limitation on a
controlled foreign corporation’s in-
crease in earnings invested in United
States property. See section 959 and
the regulations thereunder for limita-
tions on the exclusion from gross in-
come of previously taxed earnings and
profits.

(4) [Reserved]
year to which section 959(c)(1) and the regulations thereunder apply, from his pro rata share of

(ii) The controlled foreign corporation’s earnings invested in United States property at the close of its current taxable year, as determined under paragraph (b) of this section.

(2) Illustration. The application of this paragraph may be illustrated by the following examples:

Example 1. A is a United States shareholder and direct owner of 60 percent of the only class of stock of R Corporation, a controlled foreign corporation during the entire period here involved. Both A and R Corporation use the calendar year as a taxable year. Corporation R’s aggregate investment in United States property on December 31, 1964, which would constitute a dividend (as determined under paragraph (b) of this section) if distributed on such date is $150,000. During the taxable year 1964, R Corporation distributed $50,000 to which section 959(c)(1) applies. Corporation R’s aggregate investment in United States property on December 31, 1965, is $225,000; and R Corporation’s current and accumulated earnings and profits on such date (determined as provided in paragraph (b) of this section) are $225,000. A’s pro rata share of R Corporation’s increase for 1965 in earnings invested in United States property is $75,000, determined as follows:

(i) Aggregate investment in United States property on December 31, 1965 .................................. $250,000

(ii) Current and accumulated earnings and profits on December 31, 1965 .................................. 225,000

(iii) Amount of earnings invested in United States property on December 31, 1965, which would constitute a dividend if distributed on such date (lesser of item (i) or item (iii)) .................................................. 225,000

(iv) Aggregate investment in United States property on December 31, 1964, which would constitute a dividend if distributed on such date .... $150,000

Less: Amounts distributed during 1964 to which section 959(c)(1) applies ............................. 50,000 100,000

(v) R Corporation’s increase for 1965 in earnings invested in United States property (item (iii) minus item (iv)) .................................. 125,000

(vi) A’s pro rata share of R Corporation’s increase for 1965 in earnings invested in United States property (item (v) times 60 percent) .................................. 75,000

Example 2. The facts are the same as in example 1, except that R Corporation’s current and accumulated earnings and profits on December 31, 1965, are $100,000 instead of $225,000. Accordingly, even though R Corporation’s aggregate investment in United States property on December 31, 1965, of $250,000 exceeds the net amount ($100,000) taken into account under subparagraph (1)(i) of this paragraph as of December 31, 1964, by $150,000, there is no increase for taxable year 1965 in earnings invested in United States property because of the dividend limitation of paragraph (b)(1) of this section. Corporation R’s aggregate investment in United States property on December 31, 1966, is unchanged ($250,000); Corporation R’s current and accumulated earnings and profits on December 31, 1966, are $175,000, and, as a consequence, its aggregate investment in United States property which would constitute a dividend if distributed on that date is $175,000. Corporation R pays no amount during 1965 to which section 959(c)(1) applies. Corporation R’s increase for the taxable year 1965 in earnings invested in United States property is $75,000, and A’s pro rata share of that amount is $45,000 ($75,000 times 60 percent).

(d) Date and basis of determinations. The determinations made under paragraph (c)(1)(i) of this section with respect to the close of the preceding taxable year of a controlled foreign corporation and under paragraph (c)(1)(ii) with respect to the close of the current taxable year of such controlled foreign corporation for purposes of determining the United States shareholder’s pro rata share of such corporation’s increased investment of earnings in United States property for the current taxable year, shall be made as of the last day of the current taxable year of such corporation but on the basis of stock owned, within the meaning of section 958(a) and the regulations thereunder, by such United States shareholder on the last day of the current taxable year of a controlled foreign corporation.

The last sentence of section 956(a)(2).

The application of this paragraph may be illustrated from the following example:

Example. Domestic corporation M owns 60 percent of the only class of stock of A Corporation, a controlled foreign corporation during the entire period here involved. Both M Corporation and A Corporation use the calendar year as a taxable year. Corporation A’s investment of earnings in United States property at the close of the taxable year 1963 is $100,000, as determined under paragraph (b) of this section, and M Corporation includes the pro rata share of such amount ($60,000) in gross income for its taxable year 1963. On June 1, 1964, M Corporation acquires an additional 25 percent of A Corporation’s outstanding stock from a person who is not a
United States person as defined in section 957(d). Corporation A’s investment of earnings in United States property at the close of the taxable year 1964, as determined under paragraph (b) of this section, is unchanged ($100,000). Corporation A pays no amount during 1963 to which section 959(c)(1) applies. Corporation M is not required, by reason of the acquisition in 1964 of A Corporation’s stock, to include an additional amount in its gross income with respect to A Corporation’s investment of earnings in United States property even though the earnings invested in United States property by A Corporation attributable to the stock acquired by M Corporation were not previously taxed. The determination made under paragraph (c)(1)(i) of this section as well as the determination made under paragraph (c)(1)(ii) of this section with respect to A Corporation’s investment for 1964 of earnings in United States property are made on the basis of stock owned by M Corporation (85 percent) at the close of 1964.

(e) Amount attributable to property—(1) General rule. Except as provided in subparagraph (2) of this paragraph, for purposes of paragraph (b)(1) of this section the amount taken into account with respect to any United States property shall be its adjusted basis, as of the applicable determination date, reduced by any liability (other than a liability described in subparagraph (3) of this paragraph) to which such property is subject on such date. To be taken into account under this subparagraph, a liability must constitute a specific charge against the property involved. Thus, a liability evidenced by an open account or a liability secured only by the general credit of the controlled foreign corporation will not be taken into account. On the other hand, if a liability constitutes a specific charge against several items of property and cannot definitely be allocated to any single item of property, the liability shall be apportioned against each of such items of property in that ratio which the adjusted basis of such item on the applicable determination date bears to the adjusted basis of all such items at such time. A liability in excess of the adjusted basis of the property which is subject to such liability shall not be taken into account for the purpose of reducing the adjusted basis of other property which is not subject to such liability. See §1.956-1T(e)(6) for a special rule for determining amounts attributable to United States property acquired as the result of certain non-recognition transactions.

(2) Rule for pledges and guarantees. For purposes of this section the amount taken into account with respect to any pledge or guarantee described in paragraph (c)(1) of §1.956-2 shall be the unpaid principal amount on the applicable determination date of the obligation with respect to which the controlled foreign corporation is a pledgor or guarantor.

(3) Excluded charges. For purposes of subparagraph (1) of this paragraph, a specific charge created with respect to any item of property principally for the purpose of artificially increasing or decreasing the amount of a controlled foreign corporation’s investment of earnings in United States property will not be recognized; whether a specific charge is created principally for such purpose will depend upon all the facts and circumstances of each case. One of the factors that will be considered in making such a determination with respect to a loan is whether the loan is from a related person, as defined in section 954 (d)(3) and paragraph (e) of §1.954-1.

(4) Statement required. If for purposes of this section a United States shareholder of a controlled foreign corporation reduces the adjusted basis of property which constitutes United States property on the ground that such property is subject to a liability, he shall attach to his return a statement setting forth the adjusted basis of the property before the reduction and the amount and nature of the reduction.

(5)–(6) [Reserved] For further guidance, see §1.956-1T(e)(5) and (e)(6).

(f) Effective/applicability dates. (1) Paragraph (e)(5) of this section is effective June 14, 1988, with respect to investments made on or after June 14,
§ 1.956–1T Shareholder's pro rata share of a controlled foreign corporation's increase in earnings invested in United States property (temporary).

(a) [Reserved]
(b)(1)–(3) [Reserved]
(4) Treatment of certain investments of earnings in United States Property—(i) Special rule. For purposes of §1.956–1(b)(1) of the regulations, a controlled foreign corporation will be considered to hold indirectly (A) the investments in United States property held on its behalf by a trustee or a nominee or (B) at the discretion of the District Director, investments in U.S. property acquired by any other foreign corporation that is controlled by the controlled foreign corporation, if one of the principal purposes for creating, organizing, or funding (through capital contributions or debt) such other foreign corporation is to avoid the application of section 956 with respect to the controlled foreign corporation. For purposes of this paragraph (b), a foreign corporation will be considered to hold indirectly the investment in United States property held on its behalf by a trustee or a nominee or (B) at the discretion of the District Director, investments in U.S. property acquired by any other foreign corporation that is controlled by the controlled foreign corporation, if one of the principal purposes for creating, organizing, or funding (through capital contributions or debt) such other foreign corporation is to avoid the application of section 956 with respect to the controlled foreign corporation.

(ii) Effective date. This section is effective June 14, 1988, with respect to investments made on or after June 14, 1988.

(c)–(d) [Reserved]
(e)(1)–(4) [Reserved]
(5) Exclusion for certain recourse obligations. For purposes of §1.956–1(e)(1) of the regulations, in the case of an investment in United States property consisting of an obligation of a related person, as defined in section 954(d)(3) and paragraph (e) of §1.954–1, a liability will not be recognized as a specific charge if the liability representing the charge is with recourse with respect to the general credit or other assets of the investing controlled foreign corporation.

(6) Adjusted basis of property acquired in certain nonrecognition transactions—(i) Scope and purpose. This paragraph (e)(6) provides rules for determining, solely for purposes of section 956, the basis in United States property acquired by a controlled foreign corporation pursuant to an exchange in which the controlled foreign corporation's basis in such United States property is determined under section 362(a).

Example 1. P, a domestic corporation, owns all of the outstanding stock of FS1, a controlled foreign corporation, and all of the outstanding stock of FS2, also a controlled foreign corporation. FS1 sells products to FS2 in exchange for trade receivables due in 60 days. FS2 has no earnings and profits. FS1 has substantial accumulated earnings and profits. FS2 loans to P an amount equal to the debt it owes FS1. FS2 pays the trade receivables according to the terms of the receivables. FS1 will not be considered to hold indirectly the investment in United States property under this paragraph (b)(4), because there was no transfer of funds to FS2.

Example 2. The facts are the same as in Example 1, except that FS2 does not pay the receivables. FS1 is considered to hold indirectly the investment in United States property under this paragraph (b)(4), because there was a transfer of funds to FS2, a principal purpose of which was to avoid the application of section 956 to FS1.