

owed to a related foreign person that is a passive foreign investment company within the meaning of section 1296, then the amount is allowable as a deduction as of the day on which amount is includible in the income of the passive foreign investment company. The day on which the amount is includible in income is determined with reference to the method of accounting under which the earnings and profits of the passive foreign investment company are computed for purposes of sections 1291 through 1297. See sections 1291 through 1297 and the regulations thereunder for the reporting requirements of the passive foreign investment company provisions. This exception shall apply, however, only if the person that owes the amount at issue has made and has in effect an election pursuant to section 1295 with respect to the passive foreign investment company to which the amount at issue is owed.

(iv) *Examples.* The rules of this paragraph (c)(4) may be illustrated by the following examples. Application of the provisions of sections 951 through 964 are provided for illustration only, and do not provide substantive rules concerning the operation of those provisions. The principles of these examples apply equally to the provisions of paragraphs (c)(4) (i) through (iii) of this section.

Example 1. P, a domestic corporation, owns 100 percent of the total combined voting power and value of the stock of both FC1 and FC2. P is a calendar year taxpayer that uses the accrual method of accounting in computing its income and deductions. FC1 is incorporated in Country X, and FC2 is incorporated in Country Y. FC1 and FC2 are controlled foreign corporations within the meaning of section 957, and are both calendar year taxpayers. FC1 computes its taxable income and earnings and profits, for purposes of sections 951 through 964, using the accrual method of accounting, while FC2 uses the cash method. In Year 1 FC1 has gross income of \$10,000 that is described in section 952 (a) ("subpart F income"), and which includes interest owed to FC1 by P that is described in paragraph (b) of this section and that is otherwise allowable as a deduction to P under chapter 1. The interest owed to FC1 is allowable as a deduction to P in Year 1.

Example 2. The facts are the same as in *Example 1*, except that in Year 1 FC1 reports no subpart F income because of the application of section 954 (b)(3)(A) (the subpart F de minimis rule). Because the amount owed to

FC1 by P is includible in FC1's gross income in Year 1, the interest owed to FC1 is allowable as a deduction to P in Year 1.

Example 3. The facts are the same as in *Example 1*. In Year 1, FC1 accrues interest owed to FC2 that would be allowable as a deduction by FC1 under chapter 1 if FC1 were a domestic corporation. The interest owed to FC2 by FC1 is paid by FC1 in Year 2. Because FC2 uses the cash method of accounting in computing its taxable income for purposes of subpart F, the interest owed by FC1 is allowable as a deduction by FC1 in Year 2, and not in Year 1.

(d) *Effective date.* The rules of this section are effective with respect to interest that is allowable as a deduction under chapter 1 (without regard to the rules of this section) in taxable years beginning after December 31, 1983, but are not effective with respect to interest that is incurred with respect to indebtedness incurred on or before September 29, 1983, or incurred after that date pursuant to a contract that was binding on that date and at all times thereafter (unless the indebtedness or the contract was renegotiated, extended, renewed, or revised after that date). The regulations in this section issued under section 267 apply to all other deductible amounts that are incurred after July 31, 1989, but do not apply to amounts that are incurred pursuant to a contract that was binding on September 29, 1983, and at all times thereafter (unless the contract was renegotiated, extended, renewed, or revised after that date).

[T.D. 8465, 58 FR 237, Jan. 5, 1993]

§ 1.267(b)-1 Relationships.

(a) *In general.* (1) The persons referred to in section 267(a) and § 1.267 (a)-1 are specified in section 267(b).

(2) Under section 267(b)(3), it is not necessary that either of the two corporations be a personal holding company or a foreign personal holding company for the taxable year in which the sale or exchange occurs or in which the expenses or interest are properly accruable, but either one of them must be such a company for the taxable year next preceding the taxable year in which the sale or exchange occurs or in which the expenses or interest are accrued.

(3) Under section 267(b)(9), the control of certain educational and charitable organizations exempt from tax under section 501 includes any kind of control, direct or indirect, by means of which a person in fact controls such an organization, whether or not the control is legally enforceable and regardless of the method by which the control is exercised or exercisable. In the case of an individual, control possessed by the individual's family, as defined in section 267(c)(4) and paragraph (a)(4) of § 1.267(c)-1, shall be taken into account.

(b) *Partnerships.* (1) Since section 267 does not include members of a partnership and the partnership as related persons, transactions between partners and partnerships do not come within the scope of section 267. Such transactions are governed by section 707 for the purposes of which the partnership is considered to be an entity separate from the partners. See section 707 and § 1.707-1. Any transaction described in section 267(a) between a partnership and a person other than a partner shall be considered as occurring between the other person and the members of the partnership separately. Therefore, if the other person and a partner are within any one of the relationships specified in section 267(b), no deductions with respect to such transactions between the other person and the partnership shall be allowed:

(i) To the related partner to the extent of his distributive share of partnership deductions for losses or unpaid expenses or interest resulting from such transactions, and

(ii) To the other person to the extent the related partner acquires an interest in any property sold to or exchanged with the partnership by such other person at a loss, or to the extent of the related partner's distributive share of the unpaid expenses or interest payable to the partnership by the other person as a result of such transaction.

(2) The provisions of this paragraph may be illustrated by the following examples:

Example 1. A, an equal partner in the ABC partnership, personally owns all the stock of M Corporation. B and C are not related to A. The partnership and all the partners use an accrual method of accounting, and are on a

calendar year. M Corporation uses the cash receipts and disbursements method of accounting and is also on a calendar year. During 1956 the partnership borrowed money from M Corporation and also sold property to M Corporation, sustaining a loss on the sale. On December 31, 1956, the partnership accrued its interest liability to the M Corporation and on April 1, 1957 (more than 2 1/2 months after the close of its taxable year), it paid the M Corporation the amount of such accrued interest. Applying the rules of this paragraph, the transactions are considered as occurring between M Corporation and the partners separately. The sale and interest transactions considered as occurring between A and the M Corporation fall within the scope of section 267 (a) and (b), but the transactions considered as occurring between partners B and C and the M Corporation do not. The latter two partners may, therefore, deduct their distributive shares of partnership deductions for the loss and the accrued interest. However, no deduction shall be allowed to A for his distributive shares of these partnership deductions. Furthermore, A's adjusted basis for his partnership interest must be decreased by the amount of his distributive share of such deductions. See section 705(a)(2).

Example 2. Assume the same facts as in *Example 1* of this subparagraph except that the partnership and all the partners use the cash receipts and disbursements method of accounting, and that M Corporation uses an accrual method. Assume further, that during 1956 M Corporation borrowed money from the partnership and that on a sale of property to the partnership during that year M Corporation sustained a loss. On December 31, 1956, the M Corporation accrued its interest liability on the borrowed money and on April 1, 1957 (more than 2 1/2 months after the close of its taxable year) it paid the accrued interest to the partnership. The corporation's deduction for the accrued interest is not allowed to the extent of A's distributive share (one-third) of such interest income. M Corporation's deduction for the loss on the sale of the property to the partnership is not allowed to the extent of A's one-third interest in the purchased property.

§ 1.267(c)-1 Constructive ownership of stock.

(a) *In general.* (1) The determination of stock ownership for purposes of section 267(b) shall be in accordance with the rules in section 267(c).

(2) For an individual to be considered under section 267(c)(2) as constructively owning the stock of a corporation which is owned, directly or indirectly, by or for members of his family it is not necessary that he own stock in