

§ 1.861-12

These recharacterization adjustments yield the following final taxable income figures:

Final taxable income	X	Y	Z	Total
Domestic	-40.00	22.75	112.25	95.00
Foreign Passive	0	3.25	3.25	6.50
Foreign General	0	49.00	24.50	73.50
Total	-40.00	75.00	140.00	175.00

(h) *Effective/applicability date.* The rules of this section apply for taxable years beginning after December 31, 1986.

[T.D. 8228, 53 FR 35490, Sept. 14, 1988, as amended by T.D. 8916, 65 FR 274, Jan. 3, 2001; T.D.9456, 74 FR 38875, Aug. 4, 2009]

§ 1.861-12 Characterization rules and adjustments for certain assets.

(a) through (c)(1) [Reserved] For further guidance, see § 1.861-12T(a) through (c)(1).

(2) *Basis adjustment for stock in non-affiliated 10 percent owned corporations—*(i) *Taxpayers using the tax book value method—*(A) *General rule.* For purposes of apportioning expenses on the basis of the tax book value of assets, the adjusted basis of any stock in a 10 percent owned corporation owned by the taxpayer either directly or, for taxable years beginning after April 25, 2006, indirectly through a partnership or other pass-through entity shall be—

(1) Increased by the amount of the earnings and profits of such corporation (and of lower-tier 10 percent owned corporations) attributable to such stock and accumulated during the period the taxpayer or other members of its affiliated group held 10 percent or more of such stock; or

(2) Reduced (but not below zero) by any deficit in earnings and profits of such corporation (and of lower-tier 10 percent owned corporations) attributable to such stock for such period.

(c)(2)(i)(B) through (c)(3) [Reserved] For further guidance, see § 1.861-12T(c)(2)(i)(B) through (c)(3).

(4) *Characterization of stock of noncontrolled section 902 corporations—*(i) *General rule.* The principles of § 1.861-12T(c)(3) shall apply to stock in a noncontrolled section 902 corporation (as defined in section 904(d)(2)(E)). Accordingly, stock in a noncontrolled section 902 corporation shall be characterized

as an asset in the various separate limitation categories on the basis of either the asset method described in § 1.861-12T(c)(3)(ii) or the modified gross income method described in § 1.861-12T(c)(3)(iii). Stock in a noncontrolled section 902 corporation the interest expense of which is apportioned on the basis of assets shall be characterized in the hands of its domestic shareholders (as defined in § 1.902-1(a)(1)) under the asset method described in § 1.861-12T(c)(3)(ii). Stock in a noncontrolled section 902 corporation the interest expense of which is apportioned on the basis of gross income shall be characterized in the hands of its domestic shareholders under the gross income method described in § 1.861-12T(c)(3)(iii).

(ii) *Nonqualifying shareholders.* Stock in a noncontrolled section 902 corporation shall be characterized as a passive category asset in the hands of a shareholder that is not eligible to compute an amount of foreign taxes deemed paid with respect to a dividend from the noncontrolled section 902 corporation for the taxable year, and in the hands of any shareholder with respect to whom look-through treatment is not substantiated. See § 1.904-5(c)(4)(iii).

(5) *Effective/applicability date.* Paragraphs (c)(2)(i)(A) and (4) of this section apply to taxable years of shareholders ending on or after April 20, 2009. See 26 CFR § 1.861-12T(c)(2)(i) introductory text, (2)(i)(A), (2)(i)(B), and (4) (revised as of April 1, 2009) for rules applicable to taxable years of shareholders ending after the first day of the first taxable year of the noncontrolled section 902 corporation beginning after December 31, 2002, and ending before April 20, 2009.

(d) through (j) [Reserved] For further guidance, see § 1.861-12T(d) through (j).

[T.D. 9452, 74 FR 27874, June 11, 2009]

§ 1.861-12T Characterization rules and adjustments for certain assets (temporary).

(a) *In general.* These rules are applicable to taxpayers in apportioning expenses under an asset method to income in various separate limitation categories under section 904(d), and supplement other rules provided in §§ 1.861-9T, 1.861-10T, and 1.861-11T. The