Corporation A has an accumulated deficit as of the end of 1986 that eliminated all pre-1987 accumulated profits. See paragraph (b)(2) of this section. Corporation A has $120 of post-1986 foreign income taxes. Foreign taxes deemed paid by Corporation M under section 902 with respect to the 5u dividend out of post-1986 undistributed earnings are $12 ($120×10%[5u/50u]). Corporation M includes this amount in gross income as a dividend under section 78. Both the foreign taxes deemed paid and the deemed dividend are subject to a separate limitation for dividends from noncontrolled section 902 corporation A. As of January 1, 1988, Corporation A has (50u) in its post-1986 undistributed earnings (50u−100u) and -0- in its post-1986 foreign income taxes, $120 reduced by $120 of foreign taxes that would have been deemed paid if both Corporations M and Z were eligible to compute an amount of deemed paid taxes on the dividend distributed by Corporation A out of post-1986 undistributed earnings ($120×100%[50u/50u]).

(iii) On December 31, 1989, Corporation A distributes a 10u dividend to Corporation M and a 90u dividend to Corporation Z. Although the distribution is considered a dividend in its entirety out of 1989 earnings and profits pursuant to section 316(a)(2), post-1986 undistributed earnings are (100u). Accordingly, for purposes of section 902, Corporation M is deemed to have paid no post-1986 foreign income taxes. See § 1.902–1(b)(4). Corporation A's post-1986 undistributed earnings as of January 1, 1990, are (200u) ((100u)−100u). Corporation A's post-1986 foreign income taxes are not reduced because no taxes were deemed paid.

(iv) On December 31, 1990, Corporation A distributes a 5u dividend to Corporation M and a 45u dividend to Corporation Z. At that time Corporation A has 50u of post-1986 undistributed earnings, and $150 of post-1986 foreign income taxes. Foreign taxes deemed paid by Corporation M under section 902 with respect to the 5u dividend are $15 ($150×10%[5u/50u]). Post-1986 undistributed earnings as of January 1, 1991, are -0- (50u−50u). Post-1986 foreign income taxes as of January 1, 1991, also are -0-, $150 reduced by $150 ($150×100%[50u/50u]) of foreign income taxes that would have been deemed paid if both Corporations M and Z were eligible to compute an amount of deemed paid taxes on the 50u dividend.

[T.D. 8708, 62 FR 937, Jan. 7, 1997, as amended by T.D. 9260, 71 FR 24526, Apr. 25, 2006; 71 FR 77265, Dec. 26, 2006]

§ 1.902–3 Credit for domestic corporate shareholder of a foreign corporation for foreign income taxes paid with respect to accumulated profits of taxable years of the foreign corporation beginning before January 1, 1987.

(a) *Definitions.* For purposes of section 902 and §§ 1.902–3 and 1.902–4:

(1) *Domestic shareholder.* In the case of dividends received by a domestic corporation after December 31, 1964, from a foreign corporation, the term ''domestic shareholder'' means a domestic corporation which owns at least 10 percent of the voting stock of the foreign corporation at the time it receives a dividend from such foreign corporation.

(2) *First-tier corporation.* In the case of dividends received by a domestic shareholder after December 31, 1964, from a foreign corporation, the term ''first-tier corporation'' means a foreign corporation at least 10 percent of the voting stock of which is owned by a domestic shareholder at the time it receives a dividend from such foreign corporation. The term ''first-tier corporation'' also means a DISC or former DISC, but only with respect to dividends from the DISC or former DISC to the extent they are treated under sections 861(a)(2)(D) and 862(a)(2) as income from sources without the United States.

(3) *Second-tier corporation.* (i) In the case of dividends paid to a first-tier corporation by a foreign corporation after January 12, 1971 (i.e., the date of enactment of Pub. L. 91–684, 84 Stat. 2068), but only for purposes of applying this section for a taxable year of a domestic shareholder ending after that date, the foreign corporation is a ''second-tier corporation'' if at least 10 percent of its voting stock is owned by the first-tier corporation at the time the first-tier corporation receives the dividend.

(ii) In the case of dividends paid to a first-tier corporation by a foreign corporation after January 12, 1971, but only for purposes of applying this section for a taxable year of a domestic shareholder ending before January 13, 1971, or in the case of any dividend paid to a first-tier corporation by a foreign corporation before January 13, 1971, the foreign corporation is a ''second-tier corporation'' if at least 50 percent of its voting stock is owned by the first-tier corporation at the time the first-tier corporation receives the dividend.

(4) *Third-tier corporation.* In the case of dividends paid to a second-tier corporation (as defined in paragraph (a)(3) (i) or (ii) of this section) by a foreign corporation after January 12, 1971, but only for purposes of applying this section for a taxable year of a domestic shareholder ending after that date, the foreign corporation is a ''third-tier corporation'' if at least 10 percent of its voting stock is owned by the second-tier corporation at the time the second-tier corporation receives the dividend.

(5) *Foreign income taxes.* The term ''foreign income taxes'' means income, war profits, and excess profits taxes, and taxes included in the term ''income, war profits, and excess profits taxes'' by reason of section 903, imposed by a foreign country or a possession of the United States.

(6) *Dividend.* For the definition of the term ''dividend'' for purposes of applying section 902 and this section, see section 316 and the regulations thereunder.

(7) *Dividend received.* A dividend shall be considered received for purposes of section 902 and this section when the cash or other property is unqualifiedly made subject to the demands of the distributee. See § 1.301–1(b).

(b) *Domestic shareholder owning stock in a first-tier corporation*—(1) *In general.* (i) If a domestic shareholder receives dividends in any taxable year from its first-tier corporation, the credit for foreign income taxes allowed by section 901 includes, subject to the conditions and limitations of this section, the foreign income taxes deemed, in accordance with paragraph (b)(2) of this section, to be paid by such domestic shareholder for such year.

(ii) If dividends are received by a domestic shareholder from more than one first-tier corporation, the taxes deemed to be paid by such shareholder under section 902(a) and this paragraph (b) shall be computed separately with respect to the dividends received from each of such first-tier corporations.

(iii) Any taxes deemed paid by a domestic shareholder for the taxable year pursuant to section 902(a) and paragraph (b)(2) of this section shall, except as provided in § 1.960–3(b), be included in the gross income of such shareholder for such year as a dividend pursuant to section 78 and § 1.78–1. For the source of such a section 78 dividend, see paragraph (h)(1) of this section.

(iv) Any taxes deemed, under paragraph (b)(2) of this section, to be paid by the domestic shareholder shall be deemed to be paid by such shareholder only for purposes of the foreign tax credit allowed under section 901. See section 904 for other limitations on the amount of the credit.

(v) For rules relating to reduction of the amount of foreign income taxes deemed paid or accrued with respect to foreign mineral income, see section 901(e) and § 1.901–3.

(vi) For the nonrecognition as a foreign income tax for purposes of this section of certain income, profits, or excess profits taxes paid or accrued to a foreign country in connection with the purchase and sale of oil or gas extracted in such country, see section 901(f) and the regulations thereunder.

(vii) For rules relating to reduction of the amount of foreign income taxes deemed paid with respect to foreign oil and gas extraction income, see section 907(a) and the regulations thereunder.

(viii) See the regulations under sections 960, 962, and 963 for special rules relating to the application of section 902 in computing the foreign tax credit of United States shareholders of controlled foreign corporations.

(2) *Amount of foreign taxes deemed paid by a domestic shareholder.* To the extent dividends are paid by a first-tier corporation to its domestic shareholder out of accumulated profits, as defined in paragraph (e) of this section, for any taxable year, the domestic shareholder shall be deemed to have paid the same proportion of any foreign income taxes paid, accrued or deemed, in accordance with paragraph (c)(2) of this section, to be paid by such first-tier corporation on or with respect to such accumulated profits for such year which the amount of such dividends (determined without regard to the gross-up under section 78) bears to the amount by which such accumulated profits exceed the amount of such taxes (other than those deemed,

under paragraph (c)(2) of this section, to be paid). For determining the amount of foreign income taxes paid or accrued by such first-tier corporation on or with respect to the accumulated profits for the taxable year of such first-tier corporation, see paragraph (f) of this section.

(c) *First-tier corporation owning stock in a second-tier corporation*—(1) *In general.* For purposes of applying section 902(a) and paragraph (b)(2) of this section, if a first-tier corporation receives dividends in any taxable year from its second-tier corporation, the foreign income taxes deemed to be paid by the first-tier corporation on or with respect to its own accumulated profits for such year shall be the amount determined in accordance with paragraph (c)(2) of this section. This paragraph (c) shall not apply unless the product of—

(i) The percentage of voting stock owned by the domestic shareholder in the first-tier corporation at the time that the domestic shareholder receives dividends from the first-tier corporation in respect of which foreign income taxes are deemed to be paid by the domestic shareholder under paragraph (b)(1) of this section, and

(ii) The percentage of voting stock owned by the first-tier corporation in the second-tier corporation equals at least 5 percent. The percentage under paragraph (c)(1)(ii) of this section of voting stock owned by the first-tier corporation in the second-tier corporation is determined as of the time that the dividend distributed by the second-tier corporation is received by the first-tier corporation and thus included in accumulated profits of the first-tier corporation out of which dividends referred to in paragraph (c)(1)(i) of this section are distributed by the first-tier corporation to the domestic shareholder.

Example. On February 10, 1976, foreign corporation B pays a dividend out of its accumulated profits for 1975 to foreign corporation A. On February 16, 1976, the date on which it receives the dividend, A Corporation owns 40 percent of the voting stock of B Corporation. Both corporations use the calendar year as the taxable year. On June 1, 1976, A Corporation sells its stock in B Corporation. On January 17, 1977, A Corporation pays a dividend out of its accumulated profits for 1976 to domestic corporation M. M Corporation owns 30 percent of the voting stock of A Corporation on January 20, 1977, the date on which it receives the dividend. M Corporation uses a fiscal year ending on April 30 as the taxable year. On February 16, 1976, A Corporation satisfies the 10-percent stock ownership requirement referred to in paragraph (a)(3) of this section with respect to B Corporation, and on January 20, 1977, M Corporation satisfies the 10-percent stock-ownership requirement referred to in paragraph (a)(2) of this section with respect to A Corporation. The 5-percent requirement of this paragraph (c)(1) is also satisfied since 30 percent (the percentage of voting stock owned by M Corporation in A Corporation on January 20, 1977), when multiplied by 40 percent (the percentage of voting stock owned by A Corporation in B Corporation on February 16, 1976), equals 12 percent. Accordingly, for its taxable year ending on April 30, 1977, M Corporation is entitled to a credit for a portion of the foreign income taxes paid, accrued, or deemed to be paid, by A Corporation for 1976; and for 1976 A Corporation is deemed to have paid a portion of the foreign income taxes paid or accrued by B Corporation for 1975.

(2) *Amount of foreign taxes deemed paid by a first-tier corporation.* A first-tier corporation which receives dividends in any taxable year from its second-tier corporation shall be deemed to have paid for such year the same proportion of any foreign income taxes paid, accrued, or deemed, in accordance with paragraph (d)(2) of this section, to be paid by its second-tier corporation on or with respect to the accumulated profits, as defined in paragraph (e) of this section, for the taxable year of the second-tier corporation from which such dividends are paid which the amount of such dividends bears to the amount by which such accumulated profits of the second-tier corporation exceed the taxes so paid or accrued. For determining the amount of the foreign income taxes paid or accrued by such second-tier corporation on or with respect to the accumulated profits for the taxable year of such second-tier corporation, see paragraph (f) of this section.

(d) *Second-tier corporation owning stock in a third-tier corporation*—(1) *In general.* For purposes of applying section 902(b)(1) and paragraph (c)(2) of this section, if a second-tier corporation receives dividends in any taxable year from its third-tier corporation, the foreign income taxes deemed to be paid by the second-tier corporation on or with respect to its own accumulated profits for such year shall be the amount determined in accordance with paragraph (d)(2) of this section. This paragraph (d) shall not apply unless the product of—

(i) The percentage of voting stock arrived at in applying the 5-percent requirement of paragraph (c)(1) of this section with respect to dividends received by the first-tier corporation from the second-tier corporation, and

(ii) the percentage of voting stock owned by the second-tier corporation in the third-tier corporation equals at least 5 percent. The percentage under paragraph (d)(1)(ii) of this section of voting stock owned by the second-tier corporation in the third-tier corporation is determined as of the time that the dividend distributed by the third-tier corporation is received by the second-tier corporation and thus included in accumulated profits of the second-tier corporation out of which dividends referred to in paragraph (d)(1)(i) of this section are distributed by the second-tier corporation to the first-tier corporation.

Example. On February 27, 1975, foreign corporation C pays a dividend out of its accumulated profits for 1974 to foreign corporation B. On March 3, 1975, the date on which it receives the dividend, B Corporation owns 50 percent of the voting stock of C Corporation. On February 10, 1976, B Corporation pays a dividend out of its accumulated profits for 1975 to foreign corporation A. On February 16, 1976, the date on which it receives the dividend, A Corporation owns 40 percent of the voting stock of B Corporation. All three corporations use the calendar year as the taxable year. On January 17, 1977, A Corporation pays a dividend out of its accumulated profits for 1976 to domestic corporation M. M Corporation owns 30 percent of the voting stock of A Corporation on January 20, 1977, the date on which it receives the dividend. M Corporation uses a fiscal year ending on April 30 as the taxable year. On February 16, 1976, A Corporation satisfies the 10-percent stock ownership requirement referred to in paragraph (a)(3) of this section with respect to B Corporation, and on January 20, 1977, M Corporation satisfies the 10-percent stock-ownership requirement referred to in paragraph (a)(2) of this section with respect to A Corporation. The 5-percent requirement of paragraph (c)(1) of this section is also satisfied since 30 percent (the percentage of voting stock owned by M Corporation in A Corporation on January 20, 1977), when multiplied by 40 percent (the percentage of voting stock owned by A Corporation in B Corporation on February 16, 1976), equals 12 percent. On March 3, 1975, B Corporation satisfies the 10 percent stock ownership requirement referred to in paragraph (a)(4) of this section with respect to C Corporation. The 5-percent requirement of this paragraph (d)(1) is also satisfied since 12 percent (the percentage of voting stock arrived at in applying the 5-percent requirement of paragraph (c)(1) of this section with respect to the dividends received by A Corporation from B Corporation on February 16, 1976), when multiplied by 50 percent (the percentage of voting stock owned by B Corporation in C Corporation on March 3, 1975), equals 6 percent. Accordingly, for its taxable year ending on April 30, 1977, M Corporation is entitled to a credit for a portion of the foreign income taxes paid, accrued, or deemed to be paid, by A Corporation for 1976; for 1976 A Corporation is deemed to have paid a portion of the foreign income taxes paid, accrued, or deemed to be paid, by B Corporation for 1975; and for 1975 B Corporation is deemed to have paid a portion of the foreign income taxes paid or accrued by C Corporation for 1974.

(2) *Amount of foreign taxes deemed paid by a second-tier corporation.* For purposes of applying paragraph (c)(2) of this section to a first-tier corporation, a second-tier corporation which receives dividends in its taxable year from its third-tier corporation shall be deemed to have paid for such year the same proportion of any foreign income taxes paid or accrued by its third-tier corporation on or with respect to the accumulated profits, as defined in paragraph (e) of this section, for the taxable year of the third-tier corporation from which such dividends are paid which the amount of such dividends bears to the amount by which such accumulated profits of the third-tier corporation exceed the taxes so paid or accrued. For determining the amount of the foreign income taxes paid or accrued by such third-tier corporation on or with respect to the accumulated profits for the taxable year of such third-tier corporation, see paragraph (f) of this section.

(e) *Determination of accumulated profits of a foreign corporation.* The accumulated profits for any taxable year of a first-tier corporation and the accumulated profits for any taxable year of a second-tier or third-tier corporation, which are taken into account in applying paragraph (c)(2) or (d)(2) of this section with respect to such first-tier corporation, shall be the sum of—

(1) The earnings and profits of such corporation for such year, and

(2) The foreign income taxes imposed on or with respect to the gains, profits, and income to which such earnings and profits are attributable.

(f) *Taxes paid on or with respect to accumulated profits of a foreign corporation.* For purposes of this section, the amount of foreign income taxes paid or accrued on or with respect to the accumulated profits of a foreign corporation for any taxable year shall be the entire amount of the foreign income taxes paid or accrued for such year on or with respect to such gains, profits, and income. For purposes of this paragraph (f), the gains, profits, and income of a foreign corporation for any taxable year shall be determined after reduction by any income, war profits, or excess profits taxes imposed on or with respect to such gains, profits, and income by the United States.

(g) *Determination of earning and profits of a foreign corporation*—(1) *Taxable year to which section 963 does not apply.* For purposes of this section, the earnings and profits of a foreign corporation for any taxable year beginning after December 31, 1962, other than a taxable year to which paragraph (g)(2) of this section applies, may, if the domestic shareholder chooses, be determined under the rules provided by §1.964–1 exclusive of paragraphs (d) and (e) of such section. The translation of amounts so determined into United States dollars or other foreign currency shall be made at the proper exchange rate for the date of distribution with respect to which the determination is made.

(2) *Taxable year to which section 963 applies.* For any taxable year of a foreign corporation with respect to which there applies under §1.963–1(c)(1) an election by a corporate United States shareholder to exclude from its gross income for the taxable year the subpart F income of a controlled foreign corporation, the earnings and profits of such foreign corporation for such year with respect to such shareholder must be determined, for purposes of this section, under the rules provided by §1.964–1, even though the amount of the minimum distribution required under §1.963–2(a) to be received by such shareholder from such earnings and profits of such foreign corporation, or from the consolidated earnings and profits of the chain or group which includes such foreign corporation, is zero. Effective for taxable years of foreign corporations beginning after December 31, 1975, section 963 is repealed by section 602(a)(1) of the Tax Reduction Act of 1975 (89 Stat. 58); accordingly, this paragraph (g)(2) is inapplicable with respect to computing earnings and profits for such taxable years.

(3) *Time and manner of making choice.* The controlling United States shareholders (as defined in §1.964–1(c)(5)) of a foreign corporation shall make the choice referred to in paragraph (g)(1) of this section (including the elections permitted by §1.964–1 (b) and (c)) by filing a written statement to such effect with the Director of the Internal Revenue Service Center, 11601 Roosevelt Boulevard, Philadelphia, Pennsylvania 19155, within 180 days after the close of the first taxable year of the foreign corporation during which such shareholders receive a distribution of earnings and profits with respect to which the benefits of this section are claimed or on or before November 15, 1965, whichever is later. For purposes of this paragraph (g)(3), the 180-day period shall commence on the date of receipt of any distribution which is considered paid from the accumulated profits of a preceding year or years under paragraph (g)(4) of this section. See §1.964–1(c)(3) (ii) and (iii) for procedures requiring notification of the Director of the Internal Revenue Service Center and noncontrolling shareholders of action taken.

(4) *Determination by district director.* The district director in whose district is filed the income tax return of the domestic shareholder claiming a credit under section 901 for foreign income taxes deemed, under section 902 and this section, to be paid by such shareholder shall have the power to determine, with respect to a foreign corporation, from the accumulated profits of what taxable year or years the dividends were paid. In making such determination the district director shall,

unless it is otherwise established to his satisfaction, treat any dividends which are paid in the first 60 days of any taxable year of such a corporation as having been paid from the accumulated profits of the preceding taxable year or years of such corporation and shall, in other respects, treat any dividends as having been paid from the most recently accumulated profits. For purposes of this paragraph (g)(4), in the case of a foreign corporation the foreign income taxes of which are determined on the basis of an accounting period of less than 1 year, the term ''year'' shall mean such accounting period. See sections 441 (b)(3) and 443.

(h) *Source of income from first-tier corporation and country to which tax is deemed paid*—(1) *Source of income*. For purposes of section 904(a)(1) (relating to the per-country limitation), in the case of a dividend received by a domestic shareholder from a first-tier corporation there shall be deemed to be derived from sources within the foreign country or possession of the United States under the laws of which the first-tier corporation is created or organized the sum of the amounts which under paragraph (a)(3)(ii) of § 1.861–3 are treated, with respect to such dividend, as income from sources without the United States.

(2) *Country to which taxes deemed paid*. For purposes of section 904, all foreign income taxes paid, or deemed under paragraph (c) of this section to be paid, by a first-tier corporation shall be deemed to be paid to the foreign country or possession of the United States under the laws of which such first-tier corporation is created or organized.

(i) *United Kingdom income taxes paid with respect to royalties*. A taxpayer shall not be deemed under section 902 and this section to have paid any taxes with respect to which a credit is allowable to such taxpayer or any other taxpayer by virtue of section 905(b).

(j) *Information to be furnished*. If the credit for foreign income taxes claimed under section 901 includes taxes deemed, under paragraph (b)(2) of this section, to be paid, the domestic shareholder must furnish the same information with respect to such taxes as it is required to furnish with respect to the taxes actually paid or accrued by it and for which credit is claimed. See § 1.905–2. For other information required to be furnished by the domestic shareholder for the annual accounting period of certain foreign corporations ending with or within such shareholder's taxable year, and for reduction in the amount of foreign income taxes paid or deemed to be paid for failure to furnish such information, see section 6038 and the regulations thereunder.

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

Example 1. Throughout 1978, domestic corporation M owns all the one class of stock of foreign corporation A. Both corporations use the calendar year as the taxable year. Corporation A has accumulated profits, pays foreign income taxes, and pays dividends for 1978 as summarized below. For 1978, M Corporation is deemed, under paragraph (b)(2) of this section, to have paid $20 of the foreign income taxes paid by A Corporation for 1978 and includes such amount in gross income under section 78 as a dividend, determined as follows:

Gains, profits, and income of A Corp.	$100
Foreign income taxes imposed on or with respect to gains, profits, and income	40
Accumulated profits	100
Foreign income taxes paid on or with respect to accumulated profits (total foreign income taxes)	40
Accumulated profits in excess of foreign income taxes	60
Dividends paid to M Corp	30
Foreign income taxes of A Corp. deemed paid by M Corp. under section 902(a) ($40×$30/$60)	20

Example 2. The facts are the same as in example 1, except that M Corporation also owns all the one class of stock of foreign corporation B which also uses the calendar year as the taxable year. Corporation B has accumulated profits, pays foreign income taxes, and pays dividends for 1978 as summarized below. For 1978, M Corporation is deemed under paragraph (b)(2) of this section, to have paid $20 of the foreign income taxes paid by A Corporation for 1978 and to have paid $50 of the foreign income taxes paid by B Corporation for 1978, and includes $70 in gross income as a dividend under section 78, determined as follows:

B CORPORATION

Gains, profits and income	$200
Foreign income taxes imposed on or with respect to gains, profits, and income	100
Accumulated profits	200
Foreign income taxes paid by B Corp. on or with respect to accumulated profits	100
Accumulated profits in excess of foreign income taxes	100
Dividends paid to M Corp	50

B CORPORATION—Continued

Foreign income taxes of B Corporation deemed paid by M Corporation under section 902(a) ($100×$50/$100)	50

M CORPORATION

Foreign income taxes deemed paid under section 902(a):.	
Taxes of A Corp. (from example 1)	$20
Taxes of B Corp. (as determined above)	50
Total	70
Foreign income taxes included in gross income under section 78 as a dividend:	
Taxes of A Corp. (from example 1)	20
Taxes of B Corp	50
Total	70

Example 3. For 1978, domestic corporation M owns all the one class of stock of foreign corporation A, which in turn owns all the one class of stock of foreign corporation B. All corporations use the calendar year as the taxable year. For 1978, M Corporation is deemed under paragraph (b)(2) of this section to have paid $50 of the foreign income taxes paid, or deemed under paragraph (c)(2) of this section to be paid, by A Corporation for such year and includes such amount in gross income as a dividend under section 78, determined as follows upon the basis of the facts assumed:

B Corp. (second-tier corporation):	
Gains, profits, and income	$300
Foreign income taxes imposed on or with respect to gains, profits, and income	120
Accumulated profits	300
Foreign income taxes paid by B Corp. on or with respect to its accumulated profits (total foreign income taxes)	120
Accumulated profits in excess of foreign income taxes	180
Dividends paid on December 31, 1978 to A Corp.	90
Foreign income taxes of B Corp. deemed paid by A Corp. for 1978 under section 902(b)(1) ($120×$90/$180)	60
A Corp. (first-tier corporation):	
Gains, profits, and income:	
Business operations	200
Dividends from B Corp.	90
Total	290
Foreign income taxes imposed on or with respect to gains, profits, and income	40
Accumulated profits	$290
Foreign income taxes paid by A Corp. on or with respect to its accumulated profits (total foreign income taxes)	40
Accumulated profits in excess of foreign income taxes	250
Foreign income taxes paid, and deemed to be paid, by A Corp. for 1978 on or with respect to its accumulated profits for such year ($60+$40)	100
Dividends paid on Deember. 31, 1978, to M Corp.	125
M Corp. (domestic shareholder):	
Foreign income taxes of A Corp. deemed paid by M Corp. for 1978 under section 902(a) ($100×$125/$250)	50
Foreign income taxes included in gross income of M Corp. under section 78 as a dividend received from A Corp.	50

Example 4. Throughout 1978, domestic corporation M owns 50 percent of the voting stock of foreign corporation A, not a less developed country corporation. A Corporation has owned 40 percent of the voting stock of foreign corporation B, since 1970; B Corporation has owned 30 percent of the voting stock of foreign corporation C, since 1972. B Corporation, uses a fiscal year ending on June 30 as its taxable year; all other corporations use the calendar year as the taxable year. On February 1, 1977, B Corporation receives a dividend from C Corporation out of C Corporation's accumulated profits for 1976. On February 15, 1977, A Corporation receives a dividend from B Corporation out of B Corporation's accumulated profits for its fiscal year ending in 1977. On February 15, 1978, M Corporation receives a dividend from A Corporation out of A Corporation's accumulated profits for 1977. For 1978, M Corporation is deemed under paragraph (b)(2) of this section to have paid $81.67 of the foreign income taxes paid, or deemed under paragraph (c)(2) of this section to be paid, by A Corporation on or with respect to its accumulated profits for 1977, and M Corporation includes that amount in gross income as a dividend under section 78, determined as follows upon the basis of the facts assumed:

C Corp. (third-tier corporation):	
Gains, profits, and income for 1976	$2,000.00
Foreign income taxes imposed on or with respect to such gains, profits, and income	800.00
Accumulated profits	2,000.00
Foreign income taxes paid by C Corp. on or with respect to its accumulated profits (total foreign income taxes)	800.00
Accumulated profits in excess of foreign income taxes	1,200.00
Dividends paid on Feb. 1, 1977 to B Corp	150.00
Foreign income taxes of C Corp. for 1976 deemed paid by B Corp. for its fiscal year ending in 1977 ($800×$150/$1,200)	100.00
B Corp. (second-tier corporation):	
Gains, profits, and income for fiscal year ending in 1977:	
Business operations	850.00
Dividends from C Corp	150.00
Total	1,000.00
Foreign income taxes imposed on or with respect to gains, profits, and income	200.00
Accumulated profits	1,000.00
Foreign income taxes paid by B Corp. on or with respect to its accumulated profits (total foreign income taxes)	$200.00
Accumulated profits in excess of foreign income taxes	800.00
Foreign income taxes paid, and deemed to be paid, by B Corp. for its fiscal year on or with respect to its accumulated profits for such year ($100+$200)	300.00
Dividends paid on February 15, 1977 to A Corp	120.00
Foreign income taxes of B Corp. for its fiscal year deemed paid by A Corp. for 1977 ($300×$120/$800)	45.00
A Corp. (first-tier corporation):	
Gains, profits, and income for 1977:	
Business operations	380.00
Dividends from B Corp	120.00

Total	500.00
Foreign income taxes imposed on or with respect to gains, profits, and income	200.00
Accumulated profits	500.00
Foreign income taxes paid by A Corp. on or with respect to its accumulated profits (total foreign income taxes)	200.00
Accumulated profits in excess of foreign taxes	300.00
Foreign income taxes paid, and deemed to be paid, by A Corp. for 1977 on or with respect to its accumulated profits for such year ($45+$200)	245.00
Dividends paid on Feb. 15, 1978 to M Corp	100.00
M Corp. (domestic shareholder):	
Foreign income taxes of A Corp. for 1977 deemed paid by M Corp. for 1978 under section 902(a)(1) ($245×$100/$300)	81.67
Foreign income taxes included in gross income of M Corp. under section 78 as a dividend received from A Corp	81.67

(l) *Effective date.* Except as provided in §1.902–4, this section applies to any distribution received from a first-tier corporation by its domestic shareholder after December 31, 1964, and before the beginning of the foreign corporation's first taxable year beginning after December 31, 1986. If, however, the first day on which the ownership requirements of section 902(c)(3)(B) and §1.902–1(a)(1) through (4) are met with respect to the foreign corporation is in a taxable year of the foreign corporation beginning after December 31, 1986, then this section shall apply to all taxable years beginning after December 31, 1964, and before the year in which the ownership requirements are first met. See §1.902–1(a)(13)(i). For corresponding rules applicable to distributions received by the domestic shareholder prior to January 1, 1965, see §1.902–5 as contained in the 26 CFR part 1 edition revised April 1, 1976.

[T.D. 7481, 42 FR 20125, Apr. 18, 1977, as amended by T.D. 7490, 42 FR 30497, June 15, 1977; T.D. 7649, 44 FR 60086, Oct. 18, 1979. Redesignated and amended by T.D. 8708, 62 FR 927, 940, Jan. 7, 1997; 62 FR 7155, Feb. 18, 1997]

§1.902–4 Rules for distributions attributable to accumulated profits for taxable years in which a first-tier corporation was a less developed country corporation.

(a) *In general.* If a domestic shareholder receives a distribution from a first-tier corporation before January 1, 1978, in a taxable year of the domestic shareholder beginning after December 31, 1964, which is attributable to accumulated profits of the first-tier corporation for a taxable year beginning before January 1, 1976, in which the first-tier corporation was a less developed country corporation (as defined in 26 CFR §1.902–2 revised as of April 1, 1978), then the amount of the credit deemed paid by the domestic shareholder with respect to such distribution shall be calculated under the rules relating to less developed country corporations contained in (26 CFR §1.902–1 revised as of April 1, 1978).

(b) *Combined distributions.* If a domestic shareholder receives a distribution before January 1, 1978, from a first-tier corporation, a portion of which is described in paragraph (a) of this section, and a portion of which is attributable to accumulated profits of the first-tier corporation for a year in which the first-tier corporation was not a less developed country corporation, then the amount of taxes deemed paid by the domestic shareholder shall be computed separately on each portion of the dividend. The taxes deemed paid on that portion of the dividend described in paragraph (a) shall be computed as specified in paragraph (a). The taxes deemed paid on that portion of the dividend described in this paragraph (b), shall be computed as specified in §1.902–3.

(c) *Distributions of a first-tier corporation attributable to certain distributions from second- or third-tier corporations.* Paragraph (a) shall apply to a distribution received by a domestic shareholder before January 1, 1978, from a first-tier corporation out of accumulated profits for a taxable year beginning after December 31, 1975, if:

(1) The distribution is attributable to a distribution received by the first-tier corporation from a second- or third-tier corporation in a taxable year beginning after December 31, 1975.

(2) The distribution from the second- or third-tier corporation is made out of accumulated profits of the second- or third-tier corporation for a taxable year beginning before January 1, 1976, and

(3) The first-tier corporation would have qualified as a less developed country corporation under section 902(d) (as in effect on December 31, 1975), in the taxable year in which it received the distribution.