§ 1.907(c)–2 

Section 907(c)(3) items (for taxable years beginning after December 31, 1982). 

(a) Scope. This section provides rules relating to certain items listed in section 907(c)(3). The rules of this section are expressed in terms of FORI but apply for determining FOGEI by substituting “FOGEI” for “FORI” whenever appropriate. FOGEI does not include interest described in section 907(c)(3)(A). Dividends paid prior to January 1, 1987, and described in section 907(c)(3)(B), as in effect prior to amendment by the Technical and Miscellaneous Revenue Act of 1988, are included in FORI and not FOGEI. 

(b) Dividend.—(1) Section 1248 dividend. A section 1248 dividend is a dividend described in section 907(c)(3)(A). Exempt as otherwise provided in this paragraph (b)(1), gain (or loss) from the disposition of stock in any corporation is not FOGEI or FORI. See §1.907(c)–1(e) (3) and (4). 

(2) Section 78 dividend. A section 78 dividend is FORI to the extent it arises from a dividend described in section 907(c)(3)(A), or an amount described in section 907(c)(3)(C). 

(c) Taxes deemed paid.—(1) Voting stock test. Items described in section 907(c)(3)(A) or (C) are FORI only if a deemed-paid-tax test is met under the criteria of section 902 or 960. The purpose of this test is to require minimum direct or indirect ownership by a domestic corporation in the voting stock of a foreign corporation as a prerequisite for the item to qualify as FORI in the hands of the domestic corporation. The test is whether a domestic corporation would be deemed to pay any taxes of a foreign corporation when a dividend or an amount described in section 907(c)(3)(A) or (C), respectively, is included in the domestic corporation’s gross income. In the case of interest described in section 907(c)(3)(A), the test is whether any taxes would be deemed paid if there were a hypothetical dividend. 

(2) Dividends and interest. For purposes of section 907(c)(3)(A), a domestic corporation is deemed under section 902 to pay taxes in respect of dividends and interest received from a foreign corporation whether or not the foreign corporation: 

(i) Actually pays or is deemed to pay taxes, or 

(ii) In the case of interest, actually pays dividends.

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bareboat charter hire, of drilling equipment used in extraction operations, or the license of a patent, know-how, or similar intangible property used in extracting, transporting, distributing or processing minerals or primary products. This paragraph (g)(3) applies without regard to whether the parties are related persons. 

(4) Related person. A person will be treated as a related person for purposes of this paragraph (g) if that person would be so treated within the meaning of section 954(d)(3) (as applied by substituting the word “controlled foreign corporation” for the word “controlled foreign corporation”) or that person is a partnership or partner described in section 707(b)(1). 

(5) Gross income. A foreign corporation shall be treated as a domestic corporation for the purpose of applying the gross-income rules in paragraph (g)(1) (ii) and (iii) of this section.

[T.D. 8338, 56 FR 11067, Mar. 15, 1991]
This paragraph (c)(2) also applies to dividends received by a foreign corporation from a second-tier or third-tier foreign corporation (as defined in §1.902–1(a) (3)(1) and (4), respectively). In the case of interest received by a foreign corporation from another foreign corporation, this paragraph (c)(2) applies if the taxes of both foreign corporations would be deemed paid under section 902 (a) or (b) for purposes of applying section 902(a) to the same taxpayer which is a domestic corporation. In the case of interest received by any corporation (whether foreign or domestic), all members of an affiliated group filing a consolidated return will be treated as the same taxpayer under section 907(c)(3)(A) if the foreign taxes of the payor and (if the recipient is a foreign corporation) the foreign taxes of the recipient would be deemed paid under section 902 by at least one member. The term “member” is defined in §1.1502-1(b). Thus, for example, assume that P owns all of the stock of D1 and D2 and P, D1, and D2 are members of an affiliated group filing a consolidated return. Assume further that D1 owns all of the stock of F1 and D2 owns all of the stock of F2, where F1 and F2 are foreign corporations. Interest paid by F1 to P, D2, or F2 may be FORI.

(3) Amounts included under section 951(a). For purposes of section 907(c)(3)(C), a domestic corporation is deemed under section 960 to pay taxes in respect of a foreign corporation, whether or not the foreign corporation actually pays taxes on the amounts included in gross income under section 951(a).

(d) Amount attributable to certain items—(1) General rule. The portion of a dividend described in section 907(c)(3)(A) that is FORI equals—

Amount of dividend × a/b

a = FORI accumulated profits in excess of total foreign taxes paid or accrued, and
b = Total accumulated profits in excess of total foreign taxes paid or accrued.

This paragraph (d)(1)(i) applies even though the FORI accumulated profits arose in a taxable year of a foreign corporation beginning before January 1, 1983. Determination of the FORI amount of dividends under this paragraph (d)(1)(i) must be made separately for FORI accumulated profits and total accumulated profits that arose in taxable years beginning before January 1, 1987, and for FORI accumulated profits and total accumulated profits that arose in taxable years beginning after December 31, 1986. Dividends are deemed to be paid first out of FORI and total accumulated profits that arose in taxable years beginning after December 31, 1986. With regard to FORI accumulated profits and total accumulated profits that arose in taxable years beginning after December 31, 1986, the portion of a dividend that is FORI equals—

Amount of dividend × a/b

a = Post-1986 undistributed FORI earnings determined under the principles of section 902(c)(1), and
b = Post-1986 undistributed earnings determined under the principles of section 902(c)(1).

(ii) Cross-references. See §1.902-1(g) for the determination of a foreign corporation’s earnings and profits and of those out of which a dividend is paid. See §1.1248-2 or 1.1248-3 for the determination of the earnings and profits attributable to the sale or exchange of stock in certain foreign corporations.

(2) Interest received from certain foreign corporations. Interest described in section 907(c)(3)(A) is FORI to the extent the corresponding interest expense of the paying corporation is properly allocable and apportionable to the gross income of the paying corporation that would be FORI were that corporation a domestic corporation. This allocation and apportionment is made in a manner consistent with the rules of section 954(b)(5) and §1.861-8(e)(2).

(3) Dividends from domestic corporation. The amount of a dividend from a corporation described in section 907(c)(3)(B), as in effect prior to amendment by the Technical and Miscellaneous Revenue Act of 1988, paid in a taxable year of that corporation beginning before December 31, 1986, that is FORI is determined under the principles of paragraph (d)(1)(i) of this section with respect to its current earnings and profits under section 316(a)(2) or its accumulated earnings and profits.
(4) Amounts with respect to which taxes are deemed paid under section 906(a)—
(i) Portion attributable to FORI. The portion of an amount described in section 907(c)(3)(C) that is FORI equals:

\[ A \times \frac{B}{C} \]

A = Amount described in section 907(c)(3)(C)
B = FORI earnings and profits
C = Total earnings and profits

For taxable years ending after January 23, 1989, the facts and circumstances will be used to determine what part of the amount of the section 907(c)(3)(C) amount is directly attributable to FOGEI, FORI and other income.

(ii) Earnings and profits. Total earnings and profits are those of the foreign corporation for a taxable year under section 964 and the regulations under that section.

(5) Section 78 dividend. The portion of a section 78 dividend that will be considered FORI will equal the amount of taxes deemed paid under either section 902(a) or section 960(a)(1) with respect to the dividend to the extent the taxes deemed paid are FORI taxes under §1.907(c)–3(b) or (c). See §1.907(c)–3(a)(1).

(6) Special rule. (i) No item in the formula described in paragraph (d)(1)(i) of this section includes amounts excluded from the gross income of a United States shareholder under section 959(a)(1).

(ii) With respect to a foreign corporation, earnings and profits in the formula described in paragraph (d)(4)(i) of this section do not include amounts excluded under section 959(b) from its gross income.

(7) Deficits—(i) Allocation of deficits within a separate category. In a taxable year in which a foreign corporation described in section 907(c)(3)(A) pays a dividend or has income that is subject to inclusion under section 951, if the foreign corporation has positive post–1986 undistributed earnings in a separate category but within that separate category there is a deficit in post-1986 undistributed earnings attributable to earnings other than FOGEI and FORI, that deficit shall be allocated ratably between the FOGEI and FORI post-1986 undistributed earnings within that separate category. Any deficit in post-1986 undistributed earnings attributable to either FOGEI or FORI shall be allocated first to FOGEI or FORI post-1986 undistributed earnings (as the case may be) to the extent thereof. Post-1986 undistributed FORI earnings are the post-1986 undistributed earnings (as defined in section 902 and the regulations under that section) attributable to FORI as defined in section 907(c)(2) and (3). Post-1986 undistributed FOGEI earnings are the post-1986 undistributed earnings (as defined in section 902 and the regulations under that section) attributable to FOGEI as defined in section 907(c)(1) and (3).

Example. Foreign corporation X for years 1987 and 1988 had the following undistributed earnings (none of which is income that is subject to inclusion under section 951) and foreign taxes:

<table>
<thead>
<tr>
<th>Earnings</th>
<th>Taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>FOGEI</td>
<td>$800</td>
</tr>
<tr>
<td>FORI</td>
<td>$(750)</td>
</tr>
<tr>
<td>Other</td>
<td>$700</td>
</tr>
<tr>
<td></td>
<td>$650</td>
</tr>
</tbody>
</table>

On December 31, 1988, X paid a dividend of all of its post-1986 undistributed earnings to its sole shareholder Y. Under paragraph (d)(5) and (7)(i) of this section and §1.907(c)–2(d)(5), $450 of Y’s dividend is attributable to FOGEI ($50 from undistributed earnings plus a $400 section 78 dividend) and $950 is attributable to other earnings ($700 from undistributed earnings plus a $250 section 78 dividend).

(ii) Deficits allocated among separate categories. If a deficit in a separate category (“first separate category”) is allocated to another separate category (“second separate category”) under sections 902 and 960 pursuant to notice 88–71, 1988–2 CB 374 and the regulations under those sections, the following rules shall apply. Any deficit in post-1986 undistributed earnings attributable to either FOGEI (or FORI) from the first separate category shall be allocated to post-1986 undistributed earnings in the second separate category to the extent thereof in the following order:

(A) FOGEI (or FORI),
(B) FORI (or FOGEI), and
(C) Other income.
Any deficit in post-1986 undistributed earnings attributable to other income from the first separate category shall be allocated first to other post-1986 undistributed earnings and then ratably to FOGEI and FORI post—1986 undistributed earnings in the second separate category.

(iii) Pre-1987 deficits. The amount of a dividend paid by a foreign corporation described in section 907(c)(3)(A) out of positive pre—1987 earnings that is attributable to FOGEI and FORI shall be determined in a manner similar to that used in paragraph (d)(7) (i) and (ii) of this section except that the determinations shall be made on an annual basis.

(b) Illustrations. The application of this paragraph (d) is illustrated by the following examples.

Example 1. X, a domestic corporation, owns all of the stock of Y, a foreign corporation organized in country S. Y owns all of the stock of Z, a foreign corporation also organized in country S. Each corporation uses the calendar year as its taxable year. In 1983, Z has $150 of FOGEI earnings and profits and $300 of earnings and profits other than FOGEI or FORI. Assume that Z paid no taxes to S and X must include $100 in its gross income under section 951(a) with respect to Z. Under paragraph (d)(4)(i) of this section, $37.50 of the amount described in section 951(a) with respect to Z.

Example 2. Assume the same facts as in Example 1 except that the taxable year in question is 1988. In addition, under the facts and circumstances, it is determined that of the $100 section 951(a) amount included in X’s gross income under section 951(a) was distributed to X’s gross income under section 951(a). Z distributes its entire earnings and profits to Y. In 1983, Y has total earnings and profits of $400 which it distributes to X. The amount of the dividend received by Y ($300) is multiplied by the fraction described in paragraph (d)(1)(i). The numerator of the fraction is Z’s FOGEI accumulated profits in excess of the FOGEI taxes paid ($125) and the denominator is Z’s total accumulated profits in excess of total foreign taxes paid ($400).

Example 3. Assume the same facts as in Example 1 except that the taxable year in question is 1988. In addition, under the facts and circumstances, it is determined that the dividend from Z is $40 included in X’s gross income under section 959(a)(1) ($100). Under paragraphs (d) (1)(i) and (6)(i) of this section, the amount of the dividend ($300) multiplied by a fraction. The numerator of the fraction is $112.50, i.e., the FOGEI accumulated profits of Y in excess of FOGEI taxes paid ($150) minus the FORI accumulated profits of Y in excess of FOGEI taxes paid excluded from X’s gross income under section 959(a)(1) ($37.50). The denominator of the fraction is $300, i.e., the total accumulated profits of Y in excess of taxes paid ($400) minus the amount excluded from X’s gross income under section 959(a)(1) ($100).

Example 4. Assume the same facts as in Example 1 with the following modifications: In 1983, Z’s only earnings and profits are FORI earnings and profits which are included in X’s gross income under section 951(a). Z distributes its entire earnings and profits to Y. In 1983, Y has total earnings and profits of $100 without regard to the dividend from Z, $60 of which are FORI earnings and profits, Y also has $40 which is included in X’s gross income under section 951(a). Under paragraph (d)(6)(i) of this section, the dividend from Z is disregarded for purposes of applying paragraph (d)(4)(i) of this section to the $40 included in X’s gross income under section 951(a) with respect to Y. Accordingly, $24 of the amount described in section 951(a) is FORI ($40/$60×$100). Had these circumstances existed in 1988, and if the $40 included in X’s gross income under section 951(a) was directly attributable to FORI activity, all of that income would be FORI to X.

(e) Dividends, interest, and other amounts from sources within a possession. FORI includes the items listed in (A) and (C) to the extent attributable to FORI of a corporation that is created or organized in or under the laws of a possession of the United States.

(f) Income from partnerships, trusts, etc. FORI and FOGEI include a person’s distributive share (determined under the principles of section 704) of the income of any partnership and amounts
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§ 1.907(c)–3

Fogiei and FORI taxes (for taxable years beginning after December 31, 1982).

(a) Tax characterization, allocation and apportionment—(1) Scope. Paragraphs (a) (2) through (6) of this section provides rules for the characterization, allocation, and apportionment of the income taxes (other than withholding taxes) paid or accrued to a foreign country among FOGIEI, FORI, and other income relevant for purposes of sections 907 and 904. Some of the rules in this section are expressed in terms of FOGIEI taxes but they apply to FORI taxes by substituting “FORI taxes” for “FOGIEI taxes” whenever appropriate. For the treatment of withholding taxes, see paragraph (a)(8) of this section. FOGIEI taxes are determined without any reduction under section 907(a). In addition, determination of FOGIEI taxes will not be affected by re-characterization of FOGIEI by section 907(c)(4). See § 1.907(c)-1(c)(5). Foreign taxes will not be characterized as creditable FORI taxes if section 907(b) and § 1.907(b)-1 apply.

(2) Three classes of income. There are three classes of income: FOGIEI, FORI, and other income.

(3) More than one class in a foreign tax base. If more than one class of income is taxed under one tax base under the law of a foreign country, the amount of pre-credit foreign tax for each base must be determined. This amount is the foreign taxes paid or accrued to that country for the base as increased by the tax credits (if any) which reduced those taxes and were allowed in the country for that tax. More than one class of income is taxed under the same base, if, under a foreign country’s law, deductions from one class of income may reduce the income of any other class and the classes are subject to foreign tax at the same rates.

(4) Allocation of tax within a base. If more than one class of income is taxed under the same base under a foreign country’s law, the pre-credit foreign tax for the base is apportioned to each class of income in proportion to the income of each class. Tax credits are than allocated (under paragraph (a)(6) of this section) to the apportioned pre-credit tax. Income of a class over the deductions allowed under foreign law for, and which are attributable to, that class.

(5) Modified gross income. Modified gross income is not necessarily the same as gross income as defined for purposes of chapter 1 of the Internal Revenue Code. Modified gross income is determined with reference to the foreign tax base for gross income (or its equivalent). However, the characterization of the base as a particular class of income is governed by general principles of U.S. tax law. Thus, for example—

(i) Gross income from extraction is the fair market value of oil or gas in the immediate vicinity of the well (as determined under § 1.907(c)-1(b)(6) (without any deductions)).

(ii) Whether cost of goods sold (or any other deduction) is a deduction from modified gross income and the amount of such a deduction is determined under foreign law.

(iii) Modified gross income includes items that are part of the foreign tax base even though they are not gross income under U.S. law so long as the foreign taxes paid on the base constitute creditable taxes under section 901 (including taxes described in section 903). For example, if a foreign country imposes a tax (creditable under section 901) on a tax base that includes in small part a percentage of the value of a company’s oil reserves in place, modified gross income from extraction includes such a percentage of value solely for purposes of making the tax