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EARNED INCOME OF CITIZENS OR RESIDENTS OF UNITED STATES

§ 1.908 [Reserved]

§ 1.909–0 Outline of regulation provisions for section 909.

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[T.D. 9710, 80 FR 7327, Feb. 10, 2015]

§ 1.909–1 Definitions and special rules.

(a) *Definitions.* For purposes of section 909, this section, and §§ 1.909–2 through 1.909–5, the following definitions apply:

(1) The term *section 902 corporation* means any foreign corporation with respect to which one or more domestic corporations meet the ownership requirements of section 902(a) or (b).

(2) The term *section 902 shareholder* means any domestic corporation that meets the ownership requirements of section 902(a) or (b) with respect to a section 902 corporation.

(3) The term *payor* means a person that pays or accrues a foreign income tax within the meaning of § 1.901–2(f), and also includes a person that takes foreign income taxes paid or accrued by a partnership, S corporation, estate or trust into account pursuant to section 702(a)(6), section 901(b)(5) or section 1373(a).

(4) The term *covered person* means, with respect to a payor—

(i) Any entity in which the payor holds, directly or indirectly, at least a 10 percent ownership interest (determined by vote or value);

(ii) Any person that holds, directly or indirectly, at least a 10 percent ownership interest (determined by vote or value) in the payor; or

(iii) Any person that bears a relationship that is described in section 267(b) or 707(b) to the payor.

(5) The term *foreign income tax* means any income, war profits, or excess profits tax paid or accrued to any foreign country or to any possession of the United States. A foreign income tax includes any tax paid or accrued in lieu of such a tax within the meaning of section 903.

(6) The term *post-1986 foreign income taxes* has the meaning provided in § 1.902–1(a)(8).

(7) The term *post-1986 undistributed earnings* has the meaning provided in § 1.902–1(a)(9).

(8) The term *disregarded entity* means an entity that is disregarded as an entity separate from its owner, as provided in § 301.7701–2(c)(2)(i) of this chapter.

(9) The term *hybrid partnership* means a partnership that is subject to income tax in a foreign country as a corporation (or otherwise at the entity level) on the basis of residence, place of incorporation, place of management or similar criteria.

(b) *Taxes paid or accrued by a partnership, S corporation or trust.* Under section 909(c)(1), section 909 applies at the partner level, and similar rules apply in the case of an S corporation or trust. Accordingly, in the case of foreign income taxes paid or accrued by a partnership, S corporation or trust, taxes allocated to one or more partners, shareholders or beneficiaries (as the case may be) will be treated as split taxes to the extent such taxes would be split taxes if the partner, shareholder or beneficiary had paid or accrued the taxes directly on the date such taxes are taken into account by the partner under sections 702 and 706(a), by the shareholder under section 1373(a), or by the beneficiary under section 901(b)(5). Any such split taxes will

be suspended in the hands of the partner, shareholder or beneficiary.

(c) *Related income of a partnership, S corporation or trust.* For purposes of determining whether related income is taken into account by a covered person, related income of a partnership, S corporation or trust is considered to be taken into account by the partner, shareholder or beneficiary to whom the related income is allocated.

(d) *Application of section 909 to pre-1987 accumulated profits and pre-1987 foreign income taxes.* Section 909 and §§1.909–1 through 1.909–5 will apply to pre-1987 accumulated profits (as defined in §1.902–1(a)(10)(i)) and pre-1987 foreign income taxes (as defined in §1.902–1(a)(10)(iii)) of a section 902 corporation attributable to taxable years beginning on or after January 1, 2012.

(e) *Effective/applicability date.* This section applies to taxable years ending after February 9, 2015. See 26 CFR 1.909–1T (revised as of April 1, 2014) for rules applicable to taxable years beginning on or after January 1, 2011, and ending on or before February 9, 2015.

[T.D. 9710, 80 FR 7328, Feb. 10, 2015]

§1.909–2 Splitter arrangements.

(a) *Foreign tax credit splitting event*—(1) *In general.* There is a foreign tax credit splitting event with respect to foreign income taxes paid or accrued if and only if, in connection with an arrangement described in paragraph (b) of this section (a *splitter arrangement*) the related income was, is or will be taken into account for U.S. Federal income tax purposes by a person that is a covered person with respect to the payor of the tax. Foreign income taxes that are paid or accrued in connection with a splitter arrangement are split taxes to the extent provided in paragraph (b) of this section. Income (or, as appropriate, earnings and profits) that was, is or will be taken into account by a covered person in connection with a splitter arrangement is related income to the extent provided in paragraph (b) of this section.

(2) *Split taxes not taken into account.* Split taxes will not be taken into account for U.S. Federal income tax purposes before the taxable year in which the related income is taken into account by the payor or, in the case of split taxes paid or accrued by a section 902 corporation, by a section 902 shareholder of such section 902 corporation. Therefore, in the case of split taxes paid or accrued by a section 902 corporation, split taxes will not be taken into account for purposes of sections 902 or 960, or for purposes of determining earnings and profits under section 964(a), before the taxable year in which the related income is taken into account by the payor section 902 corporation, a section 902 shareholder of the section 902 corporation, or a member of the section 902 shareholder's consolidated group. See §1.909–3(a) for rules relating to when split taxes and related income are taken into account.

(b) *Splitter arrangements.* The arrangements set forth in this paragraph (b) are splitter arrangements.

(1) *Reverse hybrid splitter arrangements*—(i) *In general.* A reverse hybrid is a splitter arrangement when a payor pays or accrues foreign income taxes with respect to income of a reverse hybrid. A reverse hybrid splitter arrangement exists even if the reverse hybrid has a loss or a deficit in earnings and profits for a particular year for U.S. Federal income tax purposes (for example, due to a timing difference).

(ii) *Split taxes from a reverse hybrid splitter arrangement.* The foreign income taxes paid or accrued with respect to income of the reverse hybrid are split taxes.

(iii) *Related income from a reverse hybrid splitter arrangement.* The related income with respect to split taxes from a reverse hybrid splitter arrangement is the earnings and profits (computed for U.S. Federal income tax purposes) of the reverse hybrid attributable to the activities of the reverse hybrid that gave rise to income included in the payor's foreign tax base with respect to which the split taxes were paid or accrued. Accordingly, related income of the reverse hybrid includes items of income or expense attributable to a disregarded entity owned by the reverse hybrid only to the extent that the income attributable to the activities of the disregarded entity is included in the payor's foreign tax base.

(iv) *Reverse hybrid.* The term *reverse hybrid* means an entity that is a corporation for U.S. Federal income tax

purposes but is a fiscally transparent entity (under the principles of §1.894–1(d)(3)) or a branch under the laws of a foreign country imposing tax on the income of the entity.

(v) *Examples.* The following examples illustrate the rules of paragraph (b)(1) of this section.

Example 1. (i) *Facts.* USP, a domestic corporation, wholly owns DE, a disregarded entity for U.S. federal income tax purposes that is organized in country A and treated as a corporation for country A tax purposes. DE wholly owns RH, a corporation for U.S. Federal income tax purposes that is organized in country A and treated as a fiscally transparent entity for country A tax purposes. Country A imposes an income tax at the rate of 30% on DE with respect to the items of income earned by RH. Prior to year 1, RH had no income for country A purposes and had no post-1986 earnings and profits for U.S. Federal income tax purposes. In year 1, RH earns 200u of income on which DE pays 60u of country A tax. Pursuant to §1.901–2(f)(4)(ii), USP is treated as legally liable for the 60u of country A taxes paid by DE. DE has no other income. In year 2, RH earns no income and incurs no losses or expenses. At the end of year 2, RH distributes 100u to DE.

(ii) *Result.* (A) *Split taxes and related income.* Pursuant to §1.909–2(b)(1)(iv), RH is a reverse hybrid because it is a corporation for U.S. Federal income tax purposes and a fiscally transparent entity for country A purposes. Pursuant to §1.909–2(b)(1), RH is a covered person with respect to USP because USP wholly owns RH for U.S. Federal income tax purposes. Pursuant to §1.909–2(b)(1)(i), there is a splitter arrangement with respect to RH because USP paid country A tax with respect to the income of RH. All 60u of taxes paid by USP in year 1 with respect to the income of RH are split taxes pursuant to §1.909–2(b)(1)(ii). The post-1986 earnings and profits of RH are 200u as of the end of year 1. Pursuant to §1.909–2(b)(1)(iii), the related income in year 1 is the 200u of RH's earnings and profits that are attributable to the activities that gave rise to the split taxes. No additional split taxes or related income arise in year 2.

(B) *Distribution.* Because DE is a disregarded entity, the 100u distribution by RH at the end of year 2 is treated as a dividend to USP. Pursuant to §1.909–6(d)(7) and §1.909–3(a), 100u of the 200u of related income of RH, or 50%, is taken into account by USP by reason of the 100u dividend. Accordingly, pursuant to §1.909–6(e)(4) and §1.909–3(a), a ratable portion of the split taxes, or 30u of taxes (50% of 60u), is no longer treated as split taxes and is taken into account by USP for U.S. Federal income tax purposes.

Example 2. (i) *Facts.* The facts are the same as in *Example 1*, except that in year 2, RH has a 100u loss for U.S. Federal income tax purposes as well as for country A tax purposes. For country A tax purposes, DE takes the 100u loss into account in year 2 and may not carry back the 100u loss to offset its country A taxable income for year 1. At the end of year 2, RH distributes 100u to DE.

(ii) *Result.* (A) *Split taxes and related income.* The split taxes and related income for year 1 are the same as in *Example 1.* Pursuant to §1.909–2(b)(1)(iii), §1.909–6(d)(1) and §1.909–3(a), the total related income of RH is reduced to 100u (200u − 100u) in year 2 because RH incurred a 100u loss in year 2 attributable to the activities that are included in DE's country A tax base.

(B) *Distribution.* Because DE is a disregarded entity, the 100u distribution by RH at the end of year 2 is treated as a dividend to USP. Pursuant to §1.909–6(d)(7) and §1.909–3(a), 100u of the 100u of related income of RH, or 100%, is taken into account by USP by reason of the 100u dividend. Accordingly, pursuant to §1.909–6(e)(4) and §1.909–3(a), a ratable portion of the split taxes, or 60u of taxes (100% of 60u), is no longer treated as split taxes and is taken into account by USP for U.S. Federal income tax purposes.

(2) *Loss-sharing splitter arrangements*—(i) *In general.* A foreign group relief or other loss-sharing regime is a loss-sharing splitter arrangement to the extent that a shared loss of a U.S. combined income group could have been used to offset income of that group in the current or in a prior foreign taxable year (*usable shared loss*) but is used instead to offset income of another U.S. combined income group.

(ii) *U.S. combined income group.* The term *U.S. combined income group* means an individual or a corporation and all entities (including entities that are fiscally transparent for U.S. Federal income tax purposes under the principles of §1.894–1(d)(3)) that for U.S. Federal income tax purposes combine any of their respective items of income, deduction, gain or loss with the income, deduction, gain or loss of such individual or corporation. A U.S. combined income group can arise, for example, as a result of an entity being disregarded or, in the case of a partnership or hybrid partnership and a partner, as a result of the allocation of income or any other item of the partnership to the partner. For purposes of this paragraph (b)(2)(ii), a branch is treated as an entity, all members of a U.S. affiliated

group of corporations (as defined in section 1504) that file a consolidated return are treated as a single corporation, and two or more individuals that file a joint return are treated as a single individual. A U.S. combined income group may consist of a single individual or corporation and no other entities, but cannot include more than one individual or corporation. In addition, an entity may belong to more than one U.S. combined income group. For example, a hybrid partnership with two corporate partners that do not combine any of their items of income, deduction, gain or loss for U.S. Federal income tax purposes is in a separate U.S. combined income group with each of its partners.

(iii) *Income and shared loss of a U.S. combined income group*—(A) *Income.* Except as otherwise provided in this paragraph (b)(2)(iii)(A), the income of a U.S. combined income group is the aggregate amount of taxable income recognized or taken into account for foreign tax purposes by those members that have positive taxable income for foreign tax purposes. In the case of an entity that is fiscally transparent (under the principles of §1.894–1(d)(3)) for foreign tax purposes and that is a member of more than one U.S. combined income group, the foreign taxable income of the entity is allocated between or among the groups under foreign tax law. In the case of an entity that is not fiscally transparent for foreign tax purposes and that is a member of more than one U.S. combined income group, the foreign taxable income of the entity is allocated between or among those groups based on U.S. Federal income tax principles. For example, in the case of a hybrid partnership, the foreign taxable income of the partnership is allocated between or among the groups in the manner the partnership allocates the income under section 704(b). To the extent the foreign taxable income would be income under U.S. Federal income tax principles in another year, the income is allocated between or among the groups based on how the hybrid partnership would allocate the income if the income were recognized for U.S. Federal income tax purposes in the year in which the income is recognized for foreign tax purposes. To the extent the foreign taxable income would not constitute income under U.S. Federal income tax principles in any year, the income is allocated between or among the groups in the same manner as the partnership items attributable to the activity giving rise to the foreign taxable income.

(B) *Shared loss.* The term *shared loss* means a loss of one entity for foreign tax purposes that, in connection with a foreign group relief or other loss-sharing regime, is taken into account by one or more other entities. Except as otherwise provided in this paragraph (b)(2)(iii)(B), the amount of shared loss of a U.S. combined income group is the sum of the shared losses of all members of the U.S. combined income group. In the case of an entity that is fiscally transparent (under the principles of §1.894–1(d)(3)) for foreign tax purposes and that is a member of more than one U.S. combined income group, the shared loss of the entity is allocated between or among the groups under foreign tax law. In the case of an entity that is not fiscally transparent for foreign tax purposes and that is a member of more than one U.S. combined income group, the shared loss of the entity will be allocated between or among those groups based on U.S. Federal income tax principles. For example, in the case of a hybrid partnership, the shared loss of the partnership will be allocated between or among the groups in the manner the partnership allocates the loss under section 704(b). To the extent the shared loss would be a loss under U.S. Federal income tax principles in another year, the loss is allocated between or among the groups based on how the partnership would allocate the loss if the loss were recognized for U.S. Federal income tax purposes in the year in which the loss is recognized for foreign tax purposes. To the extent the shared loss would not constitute a loss under U.S. Federal income tax principles in any year, the loss is allocated between or among the groups in the same manner as the partnership items attributable to the activity giving rise to the shared loss.

(iv) *Split taxes from a loss-sharing splitter arrangement.* Split taxes from a loss-sharing splitter arrangement are foreign income taxes paid or accrued by a

member of the U.S. combined income group with respect to income from the current foreign taxable year, or, in the case of a foregone carryback loss, from the prior foreign taxable year, equal to the amount of the usable shared loss of that group that offsets income of another U.S. combined income group.

(v) *Related income from a loss-sharing splitter arrangement.* The related income with respect to split taxes from a loss-sharing splitter arrangement is an amount of income of the individual or corporate member of the U.S. combined income group equal to the amount of income under foreign tax law of that U.S. combined income group that is offset by the usable shared loss of another U.S. combined income group.

(vi) *Foreign group relief or other loss-sharing regime.* A foreign group relief or other loss-sharing regime exists when an entity may surrender its loss to offset the income of one or more other entities. A foreign group relief or other loss-sharing regime does not include an allocation of loss of an entity that is a partnership or other fiscally transparent entity (under the principles of §1.894–1(d)(3)) for foreign tax purposes or regimes in which foreign tax is imposed on combined income (such as a foreign consolidated regime), as described in §1.901–2(f)(3).

(vii) *Examples.* The following examples illustrate the rules of paragraph (b)(2) of this section.

Example 1. (i) *Facts.* USP, a domestic corporation, wholly owns CFC1, a corporation organized in country A. CFC1 wholly owns CFC2 and CFC3, both corporations organized in country A. CFC2 wholly owns DE, an entity organized in country A. DE is a corporation for country A tax purposes and a disregarded entity for U.S. Federal income tax purposes. Country A has a loss-sharing regime under which a loss of CFC1, CFC2, CFC3 or DE may be used to offset the income of one or more of the others. Country A imposes an income tax at the rate of 30% on the taxable income of corporations organized in country A. In year 1, before any loss sharing, CFC1 has no income, CFC2 has income of 50u, CFC3 has income of 200u, and DE has a loss of 100u. Under the provisions of country A's loss-sharing regime, the group decides to use DE's 100u loss to offset 100u of CFC3's income. After the loss is shared, for country A's tax purposes, CFC2 still has 50u of income on which it pays 15u of country A tax. CFC3 has income of 100u (200u less the 100u shared loss) on which it pays 30u of country A tax. For U.S. Federal income tax purposes, the loss sharing with CFC3 is not taken into account. Because DE is a disregarded entity, its 100u loss is taken into account by CFC2 and reduces its earnings and profits for U.S. Federal income tax purposes. Accordingly, before application of section 909, CFC2 has a loss for earnings and profits purposes of 65u (50u income less 15u taxes paid to country A less 100u loss of DE). CFC2 also has the U.S. dollar equivalent of 15u of foreign income taxes to add to its post-1986 foreign income taxes pool. CFC3 has earnings and profits of 170u (200u income less 30u of taxes) and the dollar equivalent of 30u of foreign income taxes to add to its post-1986 foreign income taxes pool.

(ii) *Result.* Pursuant to §1.909–2(b)(2)(ii), CFC2 and DE constitute one U.S. combined income group, while CFC1 and CFC3 each constitute separate U.S. combined income groups. Pursuant to §1.909–2(b)(2)(iii)(A), the income of the CFC2 U.S. combined income group is 50u (CFC2's country A taxable income of 50u). The income of the CFC3 U.S. combined income group is 200u (CFC3's country A taxable income of 200u). Pursuant to §1.909–2(b)(2)(iii)(B), the shared loss of the CFC2 U.S. combined income group includes the 100u of shared loss incurred by DE. The usable shared loss of the CFC2 U.S. combined income group is 50u, the amount of the group's shared loss that could have otherwise offset CFC2's 50u of country A taxable income that is included in the income of the CFC2 U.S. combined income group. There is a splitter arrangement because the 50u usable shared loss of the CFC2 U.S. combined income group was used instead to offset income of CFC3, which is included in the CFC3 U.S. combined income group. Pursuant to §1.909–2(b)(2)(iv), the split taxes are the 15u of country A income taxes paid by CFC2 on 50u of income, an amount of income of the CFC2 U.S. combined income group equal to the amount of usable shared loss of that group that was used to offset income of the CFC3 U.S. combined income group. Pursuant to §1.909–2(b)(2)(v), the related income is the 50u of CFC3's income that equals the amount of income of the CFC3 U.S. combined income group that was offset by the usable shared loss of the CFC2 U.S. combined income group.

Example 2. (i) *Facts.* USP, a domestic corporation, wholly owns CFC1, a corporation organized in country B. CFC1 wholly owns CFC2 and CFC3, both corporations organized in country B. CFC2 wholly owns DE, an entity organized in country B. DE is a corporation for country B tax purposes and a disregarded entity for U.S. Federal income tax purposes. CFC2 and CFC3 each own 50% of HP1, an entity organized in country B. HP1 is a corporation for country B tax purposes

and a partnership for U.S. Federal income tax purposes. All items of income and loss of HP1 are allocated for U.S. Federal income tax purposes equally between CFC2 and CFC3, and all entities use the country B currency ''u'' as their functional currency. Country B has a loss-sharing regime under which a loss of any of CFC1, CFC2, CFC3, DE, and HP1 may be used to offset the income of one or more of the others. Country B imposes an income tax at the rate of 30% on the taxable income of corporations organized in country B. In year 1, before any loss sharing, CFC2 has income of 100u, CFC1 and CFC3 have no income, DE has a loss of 100u, and HP1 has income of 200u. Under the provisions of country B's loss-sharing regime, the group decides to use DE's 100u loss to offset 100u of HP1's income. After the loss is shared, for country B tax purposes, CFC2 has 100u of income on which it pays 30u of country B income tax, and HP1 has 100u of income (200u less the 100u shared loss) on which it pays 30u of country B income tax. For U.S. Federal income tax purposes, the loss sharing with HP1 is not taken into account, and, because DE is a disregarded entity, its 100u loss is taken into account by CFC2 and reduces CFC2's earnings and profits for U.S. Federal income tax purposes. The 200u income of HP1 is allocated 50/50 to CFC2 and CFC3, as is the 30u of country B income tax paid by HP1. Accordingly, before application of section 909, for U.S. Federal income tax purposes, CFC2 has earnings and profits of 55u (100u income plus 100u share of HP1's income less 100u loss of DE less 30u country B income tax paid by CFC2 less 15u share of HP1's country B income tax) and the dollar equivalent of 45u of country B income tax to add to its post-1986 foreign income taxes pool. CFC3 has earnings and profits of 85u (100u share of HP1's income less 15u share of HP1's country B income taxes) and the dollar equivalent of 15u of country B income tax to add to its post-1986 foreign income taxes pool.

(ii) *U.S. combined income groups.* Pursuant to §1.909–2(b)(2)(ii), because the income and loss of HP1 are combined in part with the income and loss of both CFC2 and CFC3, it belongs to both of the separate CFC2 and CFC3 U.S. combined income groups. DE is a member of the CFC2 U.S. combined income group.

(iii) *Income of the U.S. combined income groups.* Pursuant to §1.909–2(b)(2)(iii)(A), the income of the CFC2 U.S. combined income group is the 200u country B taxable income of the members of the group with positive taxable incomes (CFC2's country B taxable income of 100u plus 50% of HP1's country B taxable income of 200u, or 100u). Because DE does not have positive taxable income for country B tax purposes, its 100u loss is not included in the income of the CFC2 U.S. combined income group. The income of the CFC3 U.S. combined income group is 100u (50% of HP1's country B taxable income of 200u, or 100u).

(iv) *Shared loss of the U.S. combined income groups.* Pursuant to §1.909–2(b)(2)(iii)(B), the shared loss of the CFC2 U.S. combined income group is the 100u loss incurred by DE that is used to offset 100u of HP1's income. The CFC3 U.S. combined income group has no shared loss. Pursuant to §1.909–2(b)(2)(i), the usable shared loss of the CFC2 U.S. combined income group is 100u, the full amount of the group's 100u shared loss that could have been used to offset income of the CFC2 U.S. combined income group had the loss been used to offset 100u of CFC2's country B taxable income.

(v) *Income offset by shared loss.* The shared loss of the CFC2 combined income group is used to offset 100u country B taxable income of HP1. Because the taxable income of HP1 is allocated 50/50 between the CFC2 and CFC3 U.S. combined income groups, the shared loss is treated as offsetting 50u of the CFC2 U.S. combined income group's income and 50u of the CFC3 U.S. combined income group's income.

(vi) *Splitter arrangement.* There is a splitter arrangement because 50u of the 100u usable shared loss of the CFC2 U.S. combined income group was used to offset income of the CFC3 U.S. combined income group. Pursuant to §1.909–2(b)(2)(iv), the split taxes are the 15u of country B income tax paid by CFC2 on 50u of its income, which is equal to the amount of the CFC2 U.S. combined income group's usable shared loss that was used to offset income of another U.S. combined income group. Pursuant to §1.909–2(b)(2)(v), the related income is the 50u of CFC3's income that was offset by the usable shared loss of the CFC2 U.S. combined income group.

(3) *Hybrid instrument splitter arrangements*—(i) *U.S. equity hybrid instrument splitter arrangement*—(A) *In general.* A U.S. equity hybrid instrument is a splitter arrangement if:

(*1*) Under the laws of a foreign jurisdiction in which the instrument owner is subject to tax, the instrument gives rise to income includible in the instrument owner's income and such inclusion results in foreign income taxes paid or accrued by the instrument owner;

(*2*) Under the laws of a foreign jurisdiction in which the issuer is subject to tax, the instrument gives rise to deductions that are incurred or otherwise taken into account by the issuer; and

(*3*) The events that give rise to income includible in the instrument owner's income for foreign tax purposes as described in paragraph (b)(3)(i)(A)(1) of

this section, and to deductions for the issuer for foreign tax purposes as described in paragraph (b)(3)(i)(A)(2) of this section, do not result in an inclusion of income for the instrument owner for U.S. federal income tax purposes.

(B) *Split taxes from a U.S. equity hybrid instrument splitter arrangement.* Split taxes from a U.S. equity hybrid instrument splitter arrangement equal the total amount of foreign income taxes paid or accrued by the owner of the hybrid instrument less the amount of foreign income taxes that would have been paid or accrued had the owner of the U.S. equity hybrid instrument not been subject to foreign tax on income from the instrument with respect to the events described in §1.909–2(b)(3)(i)(A).

(C) *Related income from a U.S. equity hybrid instrument splitter arrangement.* The related income with respect to split taxes from a U.S. equity hybrid instrument splitter arrangement is income of the issuer of the U.S. equity hybrid instrument in an amount equal to the amounts giving rise to the split taxes that are deductible by the issuer for foreign tax purposes, determined without regard to the actual amount of the issuer's income or earnings and profits for U.S. Federal income tax purposes.

(D) *U.S. equity hybrid instrument.* The term *U.S. equity hybrid instrument* means an instrument that is treated as equity for U.S. Federal income tax purposes but for foreign income tax purposes either is treated as indebtedness or otherwise entitles the issuer to a deduction with respect to such instrument.

(E) *Example*—(i) *Facts.* USP, a domestic corporation, wholly owns CFC1, which wholly owns CFC2. Both CFC1 and CFC2 are corporations organized in country A. CFC2 issues an instrument to CFC1 that is treated as indebtedness for country A tax purposes but equity for U.S. Federal income tax purposes. Under country A's income tax laws, the instrument accrues interest at the end of each month, which results in a deduction for CFC2 and an income inclusion and tax liability for CFC1 in country A. The accrual of interest does not result in an inclusion of income for CFC1 for U.S. Federal income tax purposes. Pursuant to the terms of the instrument, CFC2 makes a distribution at the end of the year equal to the amounts of interest that have accrued during the year, and such payment is treated as a dividend that is included in the income of CFC1 for U.S. Federal income tax purposes.

(ii) *Result.* Pursuant to §1.909–2(b)(3)(i)(D), because the instrument is treated as equity for U.S. Federal income tax purposes but is treated as indebtedness for country A tax purposes, it is a U.S. equity hybrid instrument. Pursuant to §1.909–2(b)(3)(i)(A)(*3*), because the accrual of interest under foreign law does not result in an inclusion of income of CFC1 for U.S. Federal income tax purposes, there is a splitter arrangement. The fact that the payment of the accrued amount at the end of the year pursuant to the terms of the instrument gives rise to a dividend that is included in income of CFC1 for U.S. Federal income tax purposes does not change the result because it is the accrual of interest and not the payment that gives rise to income or deductions under foreign law. The payments will be treated as a distribution of related income to the extent provided by §1.909–3 and §1.909–6(d).

(ii) *U.S. debt hybrid instrument splitter arrangement*—(A) *In general.* A U.S. debt hybrid instrument is a splitter arrangement if foreign income taxes are paid or accrued by the issuer of a U.S. debt hybrid instrument with respect to income in an amount equal to the interest (including original issue discount) paid or accrued on the instrument that is deductible for U.S. Federal income tax purposes but that does not give rise to a deduction under the laws of a foreign jurisdiction in which the issuer is subject to tax.

(B) *Split taxes from a U.S. debt hybrid instrument splitter arrangement.* Split taxes from a U.S. debt hybrid instrument splitter arrangement are the foreign income taxes paid or accrued by the issuer on the income that would have been offset by the interest paid or accrued on the U.S. debt hybrid instrument had such interest been deductible for foreign tax purposes.

(C) *Related income from a U.S. debt hybrid instrument splitter arrangement.* The

related income from a U.S. debt hybrid instrument splitter arrangement is the gross amount of the interest income recognized for U.S. Federal income tax purposes by the owner of the U.S. debt hybrid instrument, determined without regard to the actual amount of the owner's income or earnings and profits for U.S. Federal income tax purposes.

(D) *U.S. debt hybrid instrument.* The term *U.S. debt hybrid instrument* means an instrument that is treated as equity for foreign tax purposes but as indebtedness for U.S. Federal income tax purposes.

(4) *Partnership inter-branch payment splitter arrangements*—(i) *In general.* An allocation of foreign income tax paid or accrued by a partnership with respect to an inter-branch payment as described in §1.704–1(b)(4)(viii)(*d*)(*3*) (revised as of April 1, 2011) (the *inter-branch payment tax*) is a splitter arrangement to the extent the inter-branch payment tax is not allocated to the partners in the same proportion as the distributive shares of income in the CFTE category to which the inter-branch payment tax is or would be assigned under §1.704–1(b)(4)(viii)(*d*) without regard to §1.704–1(b)(4)(viii)(*d*)(*3*).

(ii) *Split taxes from a partnership inter-branch payment splitter arrangement.* The split taxes from a partnership inter-branch splitter arrangement equal the excess of the amount of the inter-branch payment tax allocated to a partner under the partnership agreement over the amount of the inter-branch payment tax that would have been allocated to the partner if the inter-branch payment tax had been allocated to the partners in the same proportion as the distributive shares of income in the CFTE category referred to in paragraph (b)(4)(i) of this section.

(iii) *Related income from a partnership inter-branch payment splitter arrangement.* The related income from a partnership inter-branch payment splitter arrangement equals the amount of income allocated to a partner that exceeds the amount of income that would have been allocated to the partner if income in the CFTE category referred to in paragraph (b)(4)(i) of this section in the amount of the inter-branch payment had been allocated to the partners in the same proportion as the inter-branch payment tax was allocated under the partnership agreement.

(c) *Effective/applicability date.* This section applies to foreign income taxes paid or accrued in taxable years ending after February 9, 2015. However, a taxpayer may choose to apply the provisions of §1.909–2T (as contained in 26 CFR part 1, revised as of April 1, 2014) in lieu of this section to foreign income taxes paid or accrued in its first taxable year ending after February 9, 2015, and in taxable years of foreign corporations with respect to which the taxpayer is a domestic shareholder (as defined in §1.902–1(a)) that end with or within that first taxable year. See 26 CFR 1.909–2T (revised as of April 1, 2014) for rules applicable to foreign income taxes paid or accrued in taxable years beginning on or after January 1, 2012, and ending on or before February 9, 2015.

[T.D. 9710, 80 FR 7328, Feb. 10, 2015]

§1.909–3 Rules regarding related income and split taxes.

(a) *Interim rules for identifying related income and split taxes.* The principles of paragraphs (d) through (f) of §1.909–6 apply to related income and split taxes in taxable years beginning on or after January 1, 2011, except that the alternative method for identifying distributions of related income described in §1.909–6(d)(4) applies only to identify the amount of pre-2011 split taxes of a section 902 corporation that are suspended as of the first day of the section 902 corporation's first taxable year beginning on or after January 1, 2011.

(b) *Split taxes on deductible disregarded payments.* Split taxes include taxes paid or accrued in taxable years beginning on or after January 1, 2011, with respect to the amount of a disregarded payment that is deductible by the payor of the disregarded payment under the laws of a foreign jurisdiction in which the payor of the disregarded payment is subject to tax on related income from a splitter arrangement. The amount of the deductible disregarded payment to which this paragraph (b) applies is limited to the amount of related income from such splitter arrangement.

(c) *Effective/applicability date.* This section applies to taxable years ending

after February 9, 2015. See 26 CFR 1.909–3T (revised as of April 1, 2014) for rules applicable to taxable years beginning on or after January 1, 2011, and ending on or before February 9, 2015.

[T.D. 9710, 80 FR 7332, Feb. 10, 2015]

§ 1.909–4 Coordination rules.

(a) *Interim rules.* The principles of paragraph (g) of §1.909–6 apply to taxable years beginning on or after January 1, 2011.

(b) *Effective/applicability date.* This section applies to taxable years ending after February 9, 2015. See 26 CFR 1.909–4T (revised as of April 1, 2014) for rules applicable to taxable years beginning on or after January 1, 2011, and ending on or before February 9, 2015.

[T.D. 9710, 80 FR 7332, Feb. 10, 2015]

§ 1.909–5 2011 and 2012 splitter arrangements.

(a) *Taxes paid or accrued in taxable years beginning in 2011.* (1) Foreign income taxes paid or accrued by any person in a taxable year beginning on or after January 1, 2011, and before January 1, 2012, in connection with a pre-2011 splitter arrangement (as defined in §1.909–6(b)), are split taxes to the same extent that such taxes would have been treated as pre-2011 split taxes if such taxes were paid or accrued by a section 902 corporation in a taxable year beginning on or before December 31, 2010. The related income with respect to split taxes from such an arrangement is the related income described in §1.909–6(b), determined as if the payor were a section 902 corporation.

(2) Foreign income taxes paid or accrued by any person in a taxable year beginning on or after January 1, 2011, and before January 1, 2012, in connection with a partnership inter-branch payment splitter arrangement described in §1.909–2(b)(4) are split taxes to the extent that such taxes are identified as split taxes in §1.909–2(b)(4)(ii). The related income with respect to the split taxes is the related income described in §1.909–2(b)(4)(iii).

(b) *Taxes paid or accrued in certain taxable years beginning in 2012 with respect to a foreign consolidated group splitter arrangement.* Foreign income taxes paid or accrued by any person in a taxable year beginning on or after January 1, 2012, and on or before February 14, 2012, in connection with a foreign consolidated group splitter arrangement described in §1.909–6(b)(2) are split taxes to the same extent that such taxes would have been treated as pre-2011 split taxes if such taxes were paid or accrued by a section 902 corporation in a taxable year beginning on or before December 31, 2010. The related income with respect to split taxes from such an arrangement is the related income described in §1.909–6(b)(2), determined as if the payor were a section 902 corporation.

(c) *Effective/applicability date.* The rules of this section apply to foreign income taxes paid or accrued in taxable years beginning on or after January 1, 2011, and on or before February 14, 2012.

[T.D. 9710, 80 FR 7332, Feb. 10, 2015]

§ 1.909–6 Pre-2011 foreign tax credit splitting events.

(a) *Foreign tax credit splitting event—*(1) *In general.* This section provides rules for determining whether foreign income taxes paid or accrued by a section 902 corporation (as defined in section 909(d)(5)) in taxable years beginning on or before December 31, 2010 (*pre-2011 taxable years* and *pre-2011 taxes*) are suspended under section 909 in taxable years beginning after December 31, 2010, (*post-2010 taxable years*) of a section 902 corporation. Paragraph (b) of this section identifies an exclusive list of arrangements that will be treated as giving rise to foreign tax credit splitting events in pre-2011 taxable years (*pre- 2011 splitter arrangements*). Paragraphs (c), (d), and (e) of this section provide rules for determining the related income and pre-2011 split taxes paid or accrued with respect to pre-2011 splitter arrangements. Paragraph (f) of this section provides rules concerning the application of section 909 to partnerships and trusts. Paragraph (g) of this section provides rules concerning the interaction between section 909 and other Internal Revenue Code (*Code*) provisions.

(2) *Taxes not subject to suspension under section 909.* Pre-2011 taxes that will not be suspended under section 909 or paragraph (a) of this section are:

(i) Any pre-2011 taxes that were not paid or accrued in connection with a pre-2011 splitter arrangement identified in paragraph (b) of this section;

(ii) Any pre-2011 taxes that were paid or accrued in connection with a pre-2011 splitter arrangement identified in paragraph (b) of this section (*pre-2011 split taxes*) but that were deemed paid under section 902(a) or 960 on or before the last day of the section 902 corporation's last pre-2011 taxable year;

(iii) Any pre-2011 split taxes if either the payor section 902 corporation took the related income into account in a pre-2011 taxable year or a section 902 shareholder (as defined in §1.909–1(a)(2)) of the relevant section 902 corporation took the related income into account on or before the last day of the section 902 corporation's last pre-2011 taxable year; and

(iv) Any pre-2011 split taxes paid or accrued by a section 902 corporation in taxable years of such section 902 corporation beginning before January 1, 1997.

(3) *Taxes subject to suspension under section 909.* To the extent that the section 902 corporation paid or accrued pre-2011 split taxes that are not described in paragraph (a)(2) of this section, section 909 and the regulations under that section will apply to such pre-2011 split taxes for purposes of applying sections 902 and 960 in post-2010 taxable years of the section 902 corporation. Accordingly, these taxes will be removed from the section 902 corporation's pools of post-1986 foreign income taxes and suspended under section 909 as of the first day of the section 902 corporation's first post-2010 taxable year. There is no increase to a section 902 corporation's earnings and profits for the amount of any pre-2011 taxes to which section 909 applies that were previously deducted in computing earnings and profits in a pre-2011 taxable year.

(b) *Pre-2011 splitter arrangements.* The arrangements set forth in this paragraph (b) are pre-2011 splitter arrangements.

(1) *Reverse hybrid structure splitter arrangements.* A reverse hybrid structure exists when a section 902 corporation owns an interest in a reverse hybrid. A reverse hybrid is an entity that is a corporation for U.S. Federal income tax purposes but is a pass-through entity or a branch under the laws of a foreign country imposing tax on the income of the entity. As a result, the owner of the reverse hybrid is subject to tax on the income of the entity under foreign law. A pre-2011 splitter arrangement involving a reverse hybrid structure exists when pre-2011 taxes are paid or accrued by a section 902 corporation with respect to income of a reverse hybrid that is a covered person with respect to the section 902 corporation. A pre-2011 splitter arrangement involving a reverse hybrid structure may exist even if the reverse hybrid has a deficit in earnings and profits for a particular year (for example, due to a timing difference). Such taxes paid or accrued by the section 902 corporation are pre-2011 split taxes. The related income is the earnings and profits (computed for U.S. Federal income tax purposes) of the reverse hybrid attributable to the activities of the reverse hybrid that gave rise to income included in the foreign tax base with respect to which the pre-2011 split taxes were paid or accrued. Accordingly, related income of the reverse hybrid would not include any item of income or expense attributable to a disregarded entity (as defined in §301.7701–2(c)(2)(i) of this chapter) owned by the reverse hybrid if income attributable to the activities of the disregarded entity is not included in the foreign tax base.

(2) *Foreign consolidated group splitter arrangements.* A foreign consolidated group exists when a foreign country imposes tax on the combined income of two or more entities. Tax is considered imposed on the combined income of two or more entities even if the combined income is computed under foreign law by attributing to one such entity the income of one or more entities. A foreign consolidated group is a pre-2011 splitter arrangement to the extent that the taxpayer did not allocate the foreign consolidated tax liability among the members of the foreign consolidated group based on each member's share of the consolidated taxable income included in the foreign tax base under the principles of §1.901–2(f)(3) (revised as of April 1, 2011). A pre-2011

splitter arrangement involving a foreign consolidated group may exist even if one or more members has a deficit in earnings and profits for a particular year (for example, due to a timing difference). Pre-2011 taxes paid or accrued with respect to the income of a foreign consolidated group are pre-2011 split taxes to the extent that taxes paid or accrued by one member of the foreign consolidated group are imposed on a covered person's share of the consolidated taxable income included in the foreign tax base. The related income is the earnings and profits (computed for U.S. Federal income tax purposes) of such other member attributable to the activities of that other member that gave rise to income included in the foreign tax base with respect to which the pre-2011 split taxes were paid or accrued. No inference should be drawn from the treatment of foreign consolidated groups under section 909 as to the determination of the person who paid the foreign income tax for U.S. Federal income tax purposes.

(3) *Group relief or other loss-sharing regime splitter arrangements*—(i) *In general.* A foreign group relief or other loss-sharing regime exists when one entity with a loss permits the loss to be used to offset the income of one or more entities (*shared loss*). A pre-2011 splitter arrangement involving a shared loss exists when the following three conditions are met:

(A) There is an instrument that is treated as indebtedness under the laws of the jurisdiction in which the issuer is subject to tax and that is disregarded for U.S. Federal income tax purposes (*disregarded debt instrument*). Examples of a disregarded debt instrument include a debt obligation between two disregarded entities that are owned by the same section 902 corporation, two disregarded entities that are owned by a partnership with one or more partners that are section 902 corporations, a section 902 corporation and a disregarded entity that is owned by that section 902 corporation, or a partnership in which the section 902 corporation is a partner and a disregarded entity that is owned by such partnership.

(B) The owner of the disregarded debt instrument pays a foreign income tax attributable to a payment or accrual on the instrument.

(C) The payment or accrual on the disregarded debt instrument gives rise to a deduction for foreign tax purposes and the issuer of the instrument incurs a shared loss that is taken into account under foreign law by one or more entities that are covered persons with respect to the owner of the instrument.

(ii) *Split taxes and related income.* In situations described in paragraph (b)(3)(i) of this section, pre-2011 taxes paid or accrued by the owner of the disregarded debt instrument with respect to amounts paid or accrued on the instrument (up to the amount of the shared loss) are pre-2011 split taxes. The related income of a covered person is an amount equal to the shared loss, determined without regard to the actual amount of the covered person's earnings and profits.

(4) *Hybrid instrument splitter arrangements*—(i) *In general.* A hybrid instrument for purposes of this paragraph (b)(4) is an instrument that either is treated as equity for U.S. Federal income tax purposes but is treated as indebtedness for foreign tax purposes (*U.S. equity hybrid instrument*), or is treated as indebtedness for U.S. Federal income tax purposes but is treated as equity for foreign tax purposes (*U.S. debt hybrid instrument*).

(ii) *U.S. equity hybrid instrument splitter arrangement.* If the issuer of a U.S. equity hybrid instrument is a covered person with respect to a section 902 corporation that is the owner of the U.S. equity hybrid instrument, there is a pre-2011 splitter arrangement with respect to the portion of the pre-2011 taxes paid or accrued by the owner section 902 corporation with respect to the amounts on the instrument that are deductible by the issuer as interest under the laws of a foreign jurisdiction in which the issuer is subject to tax but that do not give rise to income for U.S. Federal income tax purposes. Pre-2011 split taxes paid or accrued by the section 902 corporation equal the total amount of pre-2011 taxes paid or accrued by the section 902 corporation less the amount of pre-2011 taxes that would have been paid or accrued had the section 902 corporation not been subject to tax on income from the U.S.

equity hybrid instrument. The related income of the issuer of the U.S. equity hybrid instrument is an amount equal to the amounts that are deductible by the issuer for foreign tax purposes, determined without regard to the actual amount of the issuer's earnings and profits.

(iii) *U.S. debt hybrid instrument splitter arrangement.* If the owner of a U.S. debt hybrid instrument is a covered person with respect to a section 902 corporation that is the issuer of the U.S. debt hybrid instrument, there is a pre-2011 splitter arrangement with respect to the portion of the pre-2011 taxes paid or accrued by the section 902 corporation on income in an amount equal to the interest (including original issue discount) paid or accrued on the instrument that is deductible for U.S. Federal income tax purposes but that does not give rise to a deduction under the laws of a foreign jurisdiction in which the issuer is subject to tax. Pre-2011 split taxes are the pre-2011 taxes paid or accrued by the section 902 corporation on the income that would have been offset by the interest paid or accrued on the U.S. debt hybrid instrument had such interest been deductible for foreign tax purposes. The related income with respect to a U.S. debt hybrid instrument is the gross amount of the interest income recognized for U.S. Federal income tax purposes by the owner of the U.S. debt hybrid instrument, determined without regard to the actual amount of the owner's earnings and profits.

(c) *General rules for applying section 909 to pre-2011 split taxes and related income*—(1) *Annual determination.* The determination of related income, other income, pre-2011 split taxes, and other taxes, and the portion of these amounts that were distributed, deemed paid or otherwise transferred or eliminated must be made on an annual basis beginning with the first taxable year of the section 902 corporation beginning after December 31, 1996 (*post-1996 taxable year*) in which the section 902 corporation paid or accrued a pre-2011 tax with respect to a pre-2011 splitter arrangement and ending with the section 902 corporation's last pre-2011 taxable year. Annual amounts of related income and pre-2011 split taxes are aggregated for each separate pre-2011 splitter arrangement.

(2) *Separate categories.* The determination of annual and aggregate amounts of related income and pre-2011 split taxes with respect to each pre-2011 splitter arrangement must be made for each separate category as defined in §1.904–4(m) of the section 902 corporation, each covered person, and any other person that succeeds to the related income and pre-2011 split taxes. In the case of a pre-2011 splitter arrangement involving a shared loss (as described in paragraph (b)(3) of this section), the amount of the related income in each separate category of the covered person is equal to the amount of income in that separate category that was offset by the shared loss for foreign tax purposes. In the case of a pre-2011 splitter arrangement involving a U.S. equity hybrid instrument (as described in paragraph (b)(4)(ii) of this section), the related income is assigned to the issuer's separate categories in the same proportions as the pre-2011 split taxes. Earnings and profits, including related income, are assigned to separate categories under the rules of §§1.904–4, 1.904–5, and 1.904–7. Foreign income taxes, including pre-2011 split taxes, are assigned to separate categories under the rules of §1.904–6. A section 902 shareholder must consistently apply methodologies for determining pre-2011 split taxes and related income with respect to all pre-2011 splitter arrangements.

(d) *Special rules regarding related income*—(1) *Annual adjustments.* In the case of each pre-2011 splitter arrangement involving a reverse hybrid or a foreign consolidated group (as described in paragraphs (b)(1) and (2) of this section, respectively), a covered person's aggregate amount of related income must be adjusted each year by the net amount of income and expense attributable to the activities of the covered person that give rise to income included in the foreign tax base, even if the net amount is negative and regardless of whether the section 902 corporation paid or accrued any pre-2011 split taxes in such year.

(2) *Effect of separate limitation losses and deficits.* Related income is determined without regard to the application of §1.960–1(i)(4) (relating to the effect of separate limitation losses on earnings and profits in another separate category) or section 952(c)(1) (relating to certain earnings and profits deficits).

(3) *Pro rata method for distributions out of earnings and profits that include both related income and other income.* If the earnings and profits of a covered person include amounts attributable to both related income and other income, including earnings and profits attributable to taxable years beginning before January 1, 1997, then distributions, deemed distributions, and inclusions out of earnings and profits (for example, under sections 301, 304, 367(b), 951(a), 964(e), 1248, or 1293) of the covered person are considered made out of related income and other income on a pro rata basis. Any reduction of a covered person's earnings and profits that results from a payment on stock that is not treated as a dividend for U.S. Federal income tax purposes (for example, pursuant to section 312(n)(7)) will also reduce related income and other income on a pro rata basis.

(4) *Alternative method for distributions out of earnings and profits that include both related income and other income.* Solely for purposes of identifying the amount of pre-2011 split taxes of a section 902 corporation that are suspended as of the first day of the section 902 corporation's first post-2010 taxable year, in lieu of the rule set forth in paragraph (d)(3) of this section, a section 902 shareholder may choose to treat all distributions, deemed distributions, and inclusions out of earnings and profits of a covered person as attributable first to related income. A section 902 shareholder may choose to use this alternative method on a timely filed original income tax return for the first post-2010 taxable year in which the shareholder computes an amount of foreign income taxes deemed paid with respect to a section 902 corporation that paid or accrued pre-2011 split taxes. Such choice by a section 902 shareholder is evidenced by employing the method on its income tax return; the section 902 shareholder need not file a separate statement. A section 902 shareholder that chooses this alternative method must consistently apply it with respect to all pre-2011 splitter arrangements.

(5) *Distributions, deemed distributions, and inclusions of related income.* Distributions, deemed distributions, and inclusions of related income (including indirectly through a partnership) to persons other than the payor section 902 corporation retain their character as related income with respect to the associated pre-2011 split taxes.

(6) *Carryover of related income.* Related income carries over to other corporations in the same manner as earnings and profits carry over under section 381, §1.367(b)-7, or similar rules, and retains its character as related income with respect to the associated pre-2011 split taxes.

(7) *Related income taken into account by a section 902 shareholder.* Related income will be considered taken into account by a section 902 shareholder to the extent that the related income is recognized as gross income by the section 902 shareholder, or by an affiliated corporation described in paragraph (d)(9) of this section, upon a distribution, deemed distribution, or inclusion (such as under section 951(a)) out of the earnings and profits of the covered person attributable to such related income.

(8) *Related income taken into account by a payor section 902 corporation.* Related income will be considered taken into account by a payor section 902 corporation to the extent that:

(i) The related income is reflected in the earnings and profits of such section 902 corporation for U.S. Federal income tax purposes by reason of a distribution, deemed distribution, or inclusion out of the earnings and profits of the covered person attributable to such related income; or

(ii) The related income is reflected as a positive adjustment to the earnings and profits of such section 902 corporation for U.S. Federal income tax purposes by reason of the section 902 corporation and the covered person combining in a transaction described in section 381(a)(1) or (a)(2).

(9) *Related income taken into account by an affiliated group of corporations*

that includes a section 902 shareholder. A section 902 shareholder will be considered to have taken related income into account if one or more members of an affiliated group of corporations (as defined in section 1504) that files a consolidated Federal income tax return that includes the section 902 shareholder takes the related income into account.

(10) *Distributions of previously-taxed earnings and profits.* Distributions and deemed distributions described in paragraph (d) of this section (including in the case of a section 902 shareholder that has chosen the alternative method described in paragraph (d)(4) of this section) do not include distributions of amounts described in section 959(c)(1) or (c)(2), which are distributed before amounts described in section 959(c)(3).

(e) *Special rules regarding pre-2011 split taxes*—(1) *Taxes deemed paid pro-rata out of pre-2011 split taxes and other taxes.* If the pre-2011 taxes of a section 902 corporation include both pre-2011 split taxes and other taxes, then foreign income taxes deemed paid under section 902 or 960 or otherwise removed from post-1986 foreign income taxes in pre-2011 taxable years will be treated as attributable to pre-2011 split taxes and other taxes on a pro-rata basis.

(2) *Pre-2011 split taxes deemed paid in pre-2011 taxable years.* Pre-2011 split taxes deemed paid in pre-2011 taxable years in connection with a dividend paid to a shareholder described in section 902(b) retain their character as pre-2011 split taxes. The section 902(b) shareholder will be treated as the payor section 902 corporation with respect to those pre-2011 split taxes.

(3) *Carryover of pre-2011 split taxes.* Pre-2011 split taxes that carry over to another foreign corporation, including under section 381, §1.367(b)-7 or similar rules, retain their character as pre-2011 split taxes. The transferee foreign corporation will be treated as the payor section 902 corporation with respect to those pre-2011 split taxes.

(4) *Determining when pre-2011 split taxes are no longer treated as pre-2011 split taxes.* For each pre-2011 splitter arrangement, as related income is taken into account by the payor section 902 corporation or a section 902 shareholder as provided in paragraph (d) of this section, a ratable portion of the associated pre-2011 split taxes will no longer be treated as pre-2011 split taxes. In the case of a pre-2011 splitter arrangement involving a reverse hybrid or a foreign consolidated group (as described in paragraphs (b)(1) and (2) of this section, respectively), if aggregate related income is reduced to zero (other than as a result of a distribution, deemed distribution, or inclusion described in paragraph (d) of this section) or less than zero, pre-2011 split taxes will retain their character as pre-2011 split taxes until the amount of aggregate related income is positive and the related income is taken into account by the payor section 902 corporation or a section 902 shareholder as provided in paragraph (d) of this section.

(f) *Rules relating to partnerships and trusts*—(1) *Taxes paid or accrued by partnerships.* In the case of foreign income taxes paid or accrued by a partnership, the taxes will be treated as pre-2011 split taxes to the extent such taxes are allocated to one or more section 902 corporations and would be pre-2011 split taxes if the partner section 902 corporation had paid or accrued the taxes directly on the date such taxes are included by the section 902 corporation under sections 702 and 706(a). Further, any foreign income taxes subject to section 909 will be suspended in the hands of the partner section 902 corporation.

(2) *Section 704(b) allocations.* Partnership allocations that satisfy the requirements of section 704(b) and the regulations thereunder will not constitute pre-2011 splitter arrangements except to the extent the arrangement is otherwise described in paragraph (b) of this section (for example, a payment or accrual on a disregarded debt instrument that gives rise to a shared loss).

(3) *Trusts.* Rules similar to the rules of paragraph (f)(1) of this section will apply in the case of any trust with one or more beneficiaries that is a section 902 corporation.

(g) *Interaction between section 909 and other Code provisions*—(1) *Section 904(c).* Section 909 does not apply to excess foreign income taxes that were paid or accrued in pre-2011 taxable years and

carried forward and deemed paid or accrued under section 904(c) in a post-2010 taxable year.

(2) *Section 905(a).* For purposes of determining in post-2010 taxable years the allowable deduction for foreign income taxes paid or accrued under section 164(a), the carryover of excess foreign income taxes under section 904(c), and the extended period for claiming a credit or refund under section 6511(d)(3)(A), foreign income taxes to which section 909 applies are first taken into account and treated as paid or accrued in the year in which the related income is taken into account, and not in the earlier year to which the tax relates (determined without regard to section 909).

(3) *Section 905(c).* If a redetermination of foreign income taxes claimed as a direct credit under section 901 occurs in a post-2010 taxable year and the foreign tax redetermination relates to a pre-2011 taxable year, to the extent such foreign tax redetermination increased the amount of foreign income taxes paid or accrued with respect to the pre-2011 taxable year (for example, due to an additional assessment of foreign tax or a payment of a previously accrued tax not paid within two years), section 909 will not apply to such taxes. If a redetermination of foreign tax paid or accrued by a section 902 corporation occurs in a post-2010 taxable year and increases the amount of foreign income taxes paid or accrued by the section 902 corporation with respect to a pre-2011 taxable year (for example, due to an additional assessment of foreign tax or a payment of a previously accrued tax not paid within two years), such taxes will be treated as pre-2011 taxes. Section 909 will apply to such taxes if they are pre-2011 split taxes and the taxes will be suspended in the post-2010 taxable year in which they would otherwise be taken into account as a prospective adjustment to the section 902 corporation's pools of post-1986 foreign income taxes.

(4) *Other foreign tax credit provisions.* Section 909 does not affect the applicability of other restrictions or limitations on the foreign tax credit under existing law, including, for example, the substantiation requirements of section 905(b).

(h) *Effective/applicability date.* This section applies to foreign income taxes paid or accrued by section 902 corporations in pre-2011 taxable years for purposes of computing foreign income taxes deemed paid with respect to distributions or inclusions out of earnings and profits of section 902 corporations in taxable years of the section 902 corporation ending after February 9, 2015. See 26 CFR 1.909–6T (revised as of April 1, 2014) for rules applicable to foreign income taxes paid or accrued by section 902 corporations in pre-2011 taxable years for purposes of computing foreign income taxes deemed paid with respect to distributions or inclusions out of earnings and profits of section 902 corporations in taxable years of the section 902 corporation beginning after December 31, 2010, and ending on or before February 9, 2015.

[T.D. 9710, 80 FR 7332, Feb. 10, 2015]

§ 1.910 [Reserved]

§ 1.911–1 Partial exclusion for earned income from sources within a foreign country and foreign housing costs.

(a) *In general.* Section 911 provides that a qualified individual may elect to exclude the individual's foreign earned income and the housing cost amount from the individual's gross income for the taxable year. Foreign earned income is excludable to the extent of the applicable limitation for the taxable year. The housing cost amount for the taxable year is excludable to the extent attributable to employer provided amounts. If a portion of the housing cost amount for the taxable year is attributable to non-employer provided amounts, such amount may be deductible by the qualified individual subject to a limitation. The amounts excluded under section 911(a) and the amount deducted under section 911(c)(3)(A) for the taxable year shall not exceed the individual's foreign earned income for such taxable year. Foreign earned income must be earned during a period for which the individual qualifies to make an election under section 911(d)(1). A housing cost amount that would be deductible except for the application of this limitation may be carried over to the next taxable year and is deductible

to the extent of the limitation for that year. Except as otherwise provided, §§1.911–1 through 1.911–7 apply to taxable years beginning after December 31, 1981. These sections do not apply to any item of income, expense, deduction, or credit arising before January 1, 1982, even if such item is attributable to services performed after December 31, 1981.

(b) *Scope.* Section 1.911–2 provides rules for determining whether an individual qualifies to make an election under section 911. Section 1.911–3 provides rules for determining the amount of foreign earned income that is excludable under section 911(a)(1). Section 1.911–4 provides rules for determining the housing cost amount and the portions excludable under section 911(a)(2) or deductible under section 911(c)(3). Section 1.911–5 provides special rules applicable to married couples. Section 1.911–6 provides for the disallowance of deductions, exclusions, and credits attributable to amounts excluded under section 911. Section 1.911–7 provides procedural rules for making or revoking an election under section 911. Section 1.911–8 provides a reference to rules applicable to taxable years beginning before January 1, 1982.

(Sec. 911 (95 Stat. 194; 26 U.S.C. 911) and sec. 7805 (68A Stat. 917; 26 U.S.C. 7805) of the Internal Revenue Code of 1954)

[T.D. 8006, 50 FR 2964, Jan. 23, 1985]

§ 1.911–2 Qualified individuals.

(a) *In general.* An individual is a qualified individual if:

(1) The individual's tax home is in a foreign country or countries throughout—

(i) The period of bona fide residence described in paragraph (a)(2)(i) of this section, or

(ii) The 330 full days of presence described in paragraph (a)(2)(ii) of this section, and

(2) The individual is either—

(i) A citizen of the United States who establishes to the satisfaction of the Commissioner or his delegate that the individual has been a bona fide resident of a foreign country or countries for an uninterrupted period which includes an entire taxable year, or

(ii) A citizen or resident of the United States who has been physically present in a foreign country or countries for at least 330 full days during any period of twelve consecutive months.

(b) *Tax home.* For purposes of paragraph (a)(i) of this section, the term ''tax home'' has the same meaning which it has for purposes of section 162(a)(2) (relating to travel expenses away from home). Thus, under section 911, an individual's tax home is considered to be located at his regular or principal (if more than one regular) place of business or, if the individual has no regular or principal place of business because of the nature of the business, then at his regular place of abode in a real and substantial sense. An individual shall not, however, be considered to have a tax home in a foreign country for any period for which the individual's abode is in the United States. Temporary presence of the individual in the United States does not necessarily mean that the individual's abode is in the United States during that time. Maintenance of a dwelling in the United States by an individual, whether or not that dwelling is used by the individual's spouse and dependents, does not necessarily mean that the individual's abode is in the United States.

(c) *Determination of bona fide residence.* For purposes of paragraph (a)(2)(i) of this section, whether an individual is a bona fide resident of a foreign country shall be determined by applying, to the extent practical, the principles of section 871 and the regulations thereunder, relating to the determination of the residence of aliens. Bona fide residence in a foreign country or countries for an uninterrupted period may be established, even if temporary visits are made during the period to the United States or elsewhere on vacation or business. An individual with earned income from sources within a foreign country is not a bona fide resident of that country if:

(1) The individual claims to be a nonresident of that foreign country in a statement submitted to the authorities of that country, and

(2) The earned income of the individual is not subject, by reason of nonresidency in the foreign country, to the income tax of that country.

If an individual has submitted a statement of nonresidence to the authorities of a foreign country the accuracy of which has not been resolved as of any date when a determination of the individual's bona fide residence is being made, then the individual will not be considered a bona fide resident of the foreign country as of that date.

(d) *Determination of physical presence.* For purposes of paragraph (a)(2)(ii) of this section, the following rules apply.

(1) *Twelve-month test.* A period of twelve consecutive months may begin with any day but must end on the day before the corresponding day in the twelfth succeeding month. The twelve-month period may begin before or after arrival in a foreign country and may end before or after departure.

(2) *330-day test.* The 330 full days need not be consecutive but may be interrupted by periods during which the individual is not present in a foreign country. In computing the minimum 330 full days of presence in a foreign country or countries, all separate periods of such presence during the period of twelve consecutive months are aggregated. A full day is a continuous period of twenty-four hours beginning with midnight and ending with the following midnight. An individual who has been present in a foreign country and then travels over areas not within any foreign country for less than twenty-four hours shall not be deemed outside a foreign country during the period of travel. If an individual who is in transit between two points outside the United States is physically present in the United States for less than twenty-four hours, such individual shall not be treated as present in the United States during such transit but shall be treated as travelling over areas not within any foreign country. For purposes of this paragraph (d)(2), the term ''transit between two points outside the United States'' has the same meaning that it has when used in section 7701(b)(6)(C).

(3) *Illustrations of the physical presence requirement.* The physical presence requirement of paragraph (a)(2)(ii) of this section is illustrated by the following examples:

Example 1. B, a U.S. citizen, arrives in Venezuela from New York at 12 noon on April 24, 1982. B remains in Venezuela until 2 p.m. on March 21, 1983, at which time B departs for the United States. Among other possible twelve month periods, B is present in a foreign country an aggregate of 330 full days during each of the following twelve month periods: March 21, 1982 through March 20, 1983; and April 25, 1982 through April 24, 1983.

Example 2. C, a U.S. citizen, travels extensively from the time C leaves the United States on March 5, 1982, until the time C departs the United Kingdom on January 1, 1984, to return to the United States permanently. The schedule of C's travel and the number of full days at each location are listed below:

Country	Time and date of arrival	Time and date of departure	Full days in foreign country
United States		10 p.m. (by air) Mar. 5, 1982.	
United Kingdom	9 a.m. Mar. 6, 1982	10 p.m. (by ship) June 25, 1982	110
United States	11 a.m. June 30, 1982	1 p.m. (by ship) July 19, 1982	0
France	3 p.m. July 24, 1982	11 a.m. (by air) Aug. 22, 1983	393
United States	4 p.m. Aug. 22, 1983	9 a.m. (by air) Sept. 4, 1983	0
United Kingdom	9 a.m. Sept. 5, 1983	9 a.m. (by air) Jan. 1, 1984	117
United States	1 p.m. Jan. 1, 1984		

Among other possible twelve-month periods, C is present in a foreign country or countries an aggregate of 330 full days during the following twelve-month periods: March 2, 1982 through March 1, 1983; and January 21, 1983 through January 20, 1984. The computation of days with respect to each twelve month period may be illustrated as follows:

First twelve-month period (March 2, 1982 through March 1, 1983):

	Full days in foreign country
Mar. 2, 1982 through Mar. 6, 1982	0
Mar. 7, 1982 through June 24, 1982	110
June 25, 1982 through July 24, 1982	0
July 25, 1982 through Mar. 1, 1983	220
Total full days	330

Second twelve-month period (January 21, 1983 through January 20, 1984):

	Full days in foreign country
Jan. 21, 1983 through Aug. 21, 1983	213
Aug. 22, 1983 through Sept. 5, 1983	0
Sept. 6, 1983 through Dec. 31, 1983	117
Jan. 1, 1984 through Jan. 20, 1984	0
Total full days	330

(e) *Special rules.* For purposes only of establishing that an individual is a qualified individual under paragraph (a) of this section, residence or presence in a foreign country while there employed by the U.S. government or any agency or instrumentality of the U.S. government counts towards satisfaction of the requirements of §1.911–2(a). (But see section 911(b)(1)(B)(ii) and §1.911–3(c)(3) for the rule excluding amounts paid by the U.S. government to an employee from the definition of foreign earned income.) Time spent in a foreign country prior to January 1, 1982, counts toward satisfaction of the bona fide residence and physical presence requirements, even though no exclusion or deduction may be allowed under section 911 for income attributable to services performed during that time. For purposes or paragraph (a)(2)(ii) of this section, the term ''resident of the United States'' includes an individual for whom a valid election is in effect under section 6013 (g) or (h) for the taxable year or years during which the physical presence requirement is satisfied.

(f) *Waiver of period of stay in foreign country due to war or civil unrest.* Notwithstanding the requirements of paragraph (a) of this section, an individual whose tax home is in, a foreign country, and who is a bona fide resident of, or present in a foreign country for any period, who leaves the foreign country after August 31, 1978, before meeting the requirements of paragraph (a) of this section, may as provided in this paragraph, qualify to make an election under section 911(a) and §1.911–7(a). If the Secretary determines, after consultation with the Secretary of State or his delegate, that war, civil unrest, or similar adverse conditions existed in a foreign country, then the Secretary shall publish the name of the foreign country and the dates between which such conditions were deemed to exist. In order to qualify to make an election under this paragraph, the individual must establish to the satisfaction of the Secretary that the individual left a foreign country, the name of which has been published by the Secretary, during the period when adverse conditions existed and that the individual could reasonably have expected to meet the requirements of paragraph (a) of this section but for the adverse conditions. The individual shall attach to his return for the taxable year a statement that the individual expected to meet the requirements of paragraph (a) of this section but for the conditions in the foreign country which precluded the normal conduct of business by the individual. Such individual shall be treated as a qualified individual, but only for the actual period of residence or presence. Thus, in determining the number of the individual's qualifying days, only days within the period of actual residence or presence shall be counted.

(g) *United States.* The term ''United States'' when used in a geographical sense includes any territory under the sovereignty of the United States. It includes the states, the District of Columbia, the possessions and territories of the United States, the territorial waters of the United States, the air space over the United States, and the seabed and subsoil of those submarine areas which are adjacent to the territorial waters of the United States and over which the United States has exclusive rights, in accordance with international law, with respect to the exploration and exploitation of natural resources.

(h) *Foreign country.* The term ''foreign country'' when used in a geographical sense includes any territory under the sovereignty of a government other than that of the United States. It includes the territorial waters of the foreign country (determined in accordance with the laws of the United States), the air space over the foreign country, and the seabed and subsoil of those submarine areas which are adjacent to the territorial waters of the foreign country and over which the foreign country has exclusive rights, in accordance with international law,

with respect to the exploration and exploitation of natural resources.

(Sec. 911 (95 Stat. 194; 26 U.S.C. 911) and sec. 7805 (68A Stat. 917; 26 U.S.C. 7805) of the Internal Revenue Code of 1954)

[T.D. 8006, 50 FR 2965, Jan. 23, 1985]

§ 1.911–3 Determination of amount of foreign earned income to be excluded.

(a) *Definition of foreign earned income.* For purposes of section 911 and the regulations thereunder, the term ''foreign earned income'' means earned income (as defined in paragraph (b) of this section) from sources within a foreign country (as defined in §1.911–2(h)) that is earned during a period for which the individual qualifies under §1.911–2(a) to make an election. Earned income is from sources within a foreign country if it is attributable to services performed by an individual in a foreign country or countries. The place of receipt of earned income is immaterial in determining whether earned income is attributable to services performed in a foreign country or countries.

(b) *Definition of earned income*—(1) *In general.* The term ''earned income'' means wages, salaries, professional fees, and other amounts received as compensation for personal services actually rendered including the fair market value of all remuneration paid in any medium other than cash. Earned income does not include any portion of an amount paid by a corporation which represents a distribution of earnings and profits rather than a reasonable allowance as compensation for personal services actually rendered to the corporation.

(2) *Earned income from business in which capital is material.* In the case of an individual engaged in a trade or business (other than in corporate form) in which both personal services and capital are material income producing factors, a reasonable allowance as compensation for the personal services actually rendered by the individual shall be considered earned income, but the total amount which shall be treated as the earned income of the individual from such trade or business shall in no case exceed thirty percent of the individual's share of the net profits of such trade or business.

(3) *Professional fees.* Earned income includes all fees received by an individual engaged in a professional occupation (such as doctor or lawyer) in the performance of professional activities. Professional fees constitute earned income even though the individual employs assistants to perform part or all of the services, provided the patients or clients are those of the individual and look to the individual as the person responsible for the services rendered.

(c) *Amounts not included in foreign earned income.* Foreign earned income does not include an amount:

(1) Excluded from gross income under section 119;

(2) Received as a pension or annuity (including social security benefits);

(3) Paid to an employee by an employer which is the U.S. government or any U.S. government agency or instrumentality;

(4) Included in the individual's gross income by reason of section 402(b) (relating to the taxability of a beneficiary of a nonexempt trust) or section 403(c) (relating to the taxability of a beneficiary under a nonqualified annuity or under annuities purchased by exempt organizations);

(5) Included in gross income by reason of §1.911–6(b)(4)(ii); or

(6) Received after the close of the first taxable year following the taxable year in which the services giving rise to the amounts were performed. For treatment of amounts received after December 31, 1962, which are attributable to services performed on or before December 31, 1962, and with respect to which there existed on March 12, 1962, a right (whether forfeitable or nonforfeitable) to receive such amounts, see §1.72–8.

(d) *Determination of the amount of foreign earned income that may be excluded under section 911(a)(1)*—(1) *In general.* Foreign earned income described in this section may be excluded under section 911(a)(1) and this paragraph only to the extent of the limitation specified in paragraph (d)(2) of this section. Income is considered to be earned in the taxable year in which the services giving rise to the income are performed. The determination of the amount of excluded earned income in this manner does not affect the time

for reporting any amounts included in gross income.

(2) *Limitation*—(i) *In general.* The term ''section 911(a)(1) limitation'' means the amount of foreign earned income for a taxable year which may be excluded under section 911(a)(1). The section 911(a)(1) limitation shall be equal to the lesser of the qualified individual's foreign earned income for the taxable year in excess of amounts that the individual elected to exclude from gross income under section 911(a)(2) or the product of the annual rate for the taxable year (as specified in paragraph (d)(2)(ii) of this section) multiplied by the following fraction:

$$\frac{\text{The number of qualifying days in the taxable year}}{\text{The number of days in the taxable year}}$$

(ii) *Annual rate for the taxable year.* The annual rate for the taxable year is the rate set forth in section 911(b)(2)(A).

(3) *Number of qualifying days.* For purposes of section 911 and the regulations thereunder, the number of qualifying days is the number of days in the taxable year within the period during which the individual met the tax home requirement and either the bona fide residence requirement or the physical presence requirement of §1.911–2(a). Although the period of bona fide residence must include an entire taxable year, the entire uninterrupted period of residence may include fractional parts of a taxable year. For instance, if an individual who was a calendar year taxpayer established a tax home and a residence in a foreign country as of November 1, 1982, and maintained the tax home and the residence through March 31, 1984, then the uninterrupted period of bona fide residence includes fractional parts of the years 1982 and 1984, and all of 1983. The number of qualifying days in 1982 is sixty-one. The number of qualifying days in 1983 is 365. The number of qualifying days in 1984 is ninety-one. The period during which the physical presence requirement of §1.911–2(a)(2)(ii) is met is any twelve consecutive month period during which the individual is physically present in one or more foreign countries for 330 days and the individual's tax home is in a foreign country during each day of such physical presence. Such period may include days when the individual is not physically present in a foreign country, and days when the individual does not maintain a tax home in a foreign country. Such period may include fractional parts of a taxable year. Thus, if an individual's period of physical, presence is the twelve-month period beginning June 1, 1982, and ending May 31, 1983, the number of qualifying days in 1982 is 214 and the number of qualifying days in 1983 is 151.

(e) *Attribution rules*—(1) *In general.* Foreign earned income is considered to be earned in the taxable year in which the individual performed the services giving rise to the income. If income is earned in one taxable year and received in another taxable year, then, for purposes of determining the amount of foreign earned income that the individual may exclude under section 911(a), the individual must attribute the income to the taxable year in which the services giving rise to the income were performed. Thus, any reimbursement would be attributable to the taxable year in which the services giving rise to the obligation to pay the reimbursement were performed, not the taxable year in which the reimbursement was received. For example, tax equalization payments are normally received in the year after the year in which the services giving rise to the obligation to pay the tax equalization payment were performed. Therefore, such payments will almost always have to be attributed to the prior year. Foreign earned income attributable to services performed in a preceding taxable year shall be excludable from gross income in the year of receipt only to the extent such amount could have been excluded under paragraph (d)(1) in the preceding taxable year, had such amount been received in the preceding taxable year. The taxable year to which income is attributable will be determined on the basis of all the facts and circumstances.

(2) *Priority of use of the section 911(a)(1) limitation.* Foreign earned income received in the year in which it is earned shall be applied to the section 911(a)(1) limitation for that year before applying income earned in that year

that is received in any other year. Foreign earned income that is earned in one year and received in another year shall be applied to the section 911(a)(1) limitation for the year in which it was earned, on a year by year basis, in any order that the individual chooses. (But see section 911(b)(1)(B)(iv)). An individual may not amend his return to change the treatment of income with respect to the section 911(a)(1) exclusion after the period provided by section 6511(a). The special period of limitation provided by section 6511(d)(3) does not apply for this purpose. For example, C, a qualified individual, receives an advance bonus of $10,000 in 1982, salary of $70,000 in 1983, and a performance bonus of $10,000 in 1984, all of which are foreign earned income for 1983. C has a section 911(a)(1) limitation for 1983 of $80,000, and has no housing cost amount exclusion. On his income tax return for 1983, C elects to exclude foreign earned income of $70,000 received in 1983. C may also exclude his $10,000 advance bonus received in 1982 (by filing an amended return for 1982), or he may exclude the $10,000 performance bonus received in 1984 on his 1984 income tax return. However, C may not exclude part of the 1982 bonus and part of the 1984 bonus.

(3) *Exception for year-end payroll period.* Notwithstanding paragraph (e)(1) of this section, salary or wage payments of a cash basis taxpayer shall be attributed entirely to the year of receipt under the following circumstances:

(i) The period for which the payment is made is a normal payroll period of the employer which regularly applies to the employee;

(ii) The payroll period includes the last day of the employee's taxable year;

(iii) The payroll period does not exceed 16 days; and

(iv) The payment is part of a normal payroll of the employer that is distributed at the same time, in relation to the payroll period, that such payroll would normally be distributed, and is distributed before the end of the next succeeding payroll period.

(4) *Attribution of bonuses and substantially nonvested property to periods in which services were performed*—(i) *In general.* Bonuses and substantially nonvested property are attributable to all of the services giving rise to the income on the basis of all the facts and circumstances. If an individual receives a bonus or substantially nonvested property (as defined in §1.83–3(b)) and it is determined to be attributable to services performed in more than one taxable year, then, for purposes of determining the amount eligible for exclusion from gross income in the year the bonus is received or the property vests, a portion of such amount shall be treated as attributable to services performed in each taxable year (or portion thereof) during the period when services giving rise to the bonus or the substantially nonvested property were performed. Such portion shall be determined by dividing the amount of the bonus or the excess of the fair market value of the vested property over the amount paid, if any, for the vested property, by the number of months in the period when services giving rise to such amount were performed, and multiplying the quotient by the number of months in such period in the taxable year. For purposes of this section, the term ''month'' means a calendar month. A fraction of a calendar month shall be deemed a month if it includes fifteen or more days.

(ii) *Examples.* The following examples illustrate the application of this paragraph (e)(4).

Example 1. A, an employee of M Corporation during all of 1983 and 1984, worked in the United States from January 1 through April 30, 1983, and received $12,000 of salary for that period. A worked in country F from May 1, 1983 through the end of 1984, and is a qualified individual under §1.911–2(a) for that period. For the period from May 1 through December 31, 1983, A received $32,000 of salary. M pays a bonus on December 20, 1983 to each of M's employees in an amount equal to 10 percent of the employee's regular wages or salary for the 1983 calendar year. The amount of A's bonus is $4,400 for 1983. The portion of A's bonus that is attributable to services performed in country F and is foreign earned income for 1983 is $3,200, or $32,000 × 10 percent. The remaining $1,200 of A's bonus is attributable to services performed in the United States, and is not foreign earned income.

Example 2. The facts are the same as in example 1, except that M determines bonuses

separately for each country based on the productivity of the employees in that country. M pays a bonus to employees in country F, in the amount of 15 percent of each employee's wages or salary earned in country F. A's country F bonus is $4,800 for 1983 ($32,000 × 15 percent), and is foreign earned income for 1983. If A also receives a bonus (or if A's bonus is increased) for working in the United States during 1983, that amount is not foreign earned income.

Example 3. X corporation offers its employees a bonus of $40,000 if the employee accepts employment in a foreign country and remains in a foreign country for a period of at least four years. A, an employee of X, is a calendar year and cash basis taxpayer. A accepts employment with X in foreign country F. A begins work in F on July 1, 1983 and continues to work in F for X until June 30, 1987. In 1987 X pays A a $40,000 bonus. The bonus is attributable to services A performed from July 1, 1983 through June 30, 1987. The amount of the bonus attributable to 1987 is $5,000 (($40,000 ÷ 48) × 6). The amount of the bonus attributable to 1986 is $10,000 (($40,000 ÷ 48) × 12). A may exclude the $10,000 attributable to 1986 only to the extent that amount could have been excluded under section 911(a)(1) had A received it in 1986. The remaining $25,000 is attributable to services performed in taxable years before 1986. Such amounts may not be excluded under section 911 because they are received after the close of the taxable year following the taxable year in which the services giving rise to the income were performed.

(iii) *Special rule for elections under section 83(b).* If an individual receives substantially nonvested property and makes an election under section 83(b) and §1.83–2(a) to include in his gross income the amount determined under section 83(b)(1)(A) and (B) and §1.83–2(a) for the taxable year in which the property is transferred (as defined in §1.83–3(a)), then, for the purpose of determining the amount eligible for exclusion in the year of receipt, the individual may elect either of the following options:

(A) Substantially nonvested property may be treated as attributable entirely to services performed in the taxable year in which an election to include it in income is made. If so treated, then the amount otherwise included in gross income as determined under §1.83–2(a) will be excludable under section 911(a) for such year subject to the limitation provided in §1.911–3(d)(2) for such year.

(B) A portion of the substantially nonvested property may be treated as attributable to services performed or to be performed in each taxable year during which the substantial risk of forfeiture (as defined in section 83(c) and §1.83–3(c)) exists. The portion treated as attributable to services performed or to be performed in each taxable year is determined by dividing the amount of the substantially nonvested property included in gross income as determined under §1.83–2(a) by the number of months during the period when a substantial risk of forfeiture exists. The quotient is multiplied by the total number of months in the taxable year during which a substantial risk of forfeiture exists. The amount determined to be attributable to services performed in the year the election is made shall be excluded from gross income for such year as provided in paragraph (d)(2) of this section. Amounts treated as attributable to services performed in subsequent taxable years shall be excludable in the year of receipt only to the extent such amounts could be excluded under paragraph (d)(2) of this section in such subsequent years. An individual may obtain such additional exclusion by filing an amended return for the taxable year in which the property was transferred. The individual may only amend his or her return within the period provided by section 6511(a) and the regulations thereunder.

(5) *Moving expense reimbursements*—(i) *Source of reimbursements.* For the purpose of determining whether a moving expense reimbursement is attributable to services performed within a foreign country or within the United States, in the absence of evidence to the contrary, the reimbursement shall be attributable to future services to be performed at the new principal place of work. Thus, a reimbursement received by an employee from his employer for the expenses of a move to a foreign country will generally be attributable to services performed in the foreign country. A reimbursement received by an employee from his employer for the expenses of a move from a foreign country to the United States will generally be attributable to services performed in the United States. For purposes of this paragraph (e)(5), evidence to the contrary includes, but is not

limited to, an agreement, between the employer and the employee, or a statement of company policy, which is reduced to writing before the move to the foreign country and which is entered into or established to induce the employee or employees to move to a foreign country. The writing must state that the employer will reimburse the employee for moving expenses incurred in returning to the United States regardless of whether the employee continues to work for the employer after the employee returns to the United States. The writing may contain conditions upon which the right to reimbursement is determined as long as the conditions set forth standards that are definitely ascertainable and the conditions can only be fulfilled prior to, or through completion of the employee's return move to the United States that is the subject of the writing. In no case will an oral agreement or statement of company policy concerning moving expenses be considered evidence to the contrary. For the purpose of determining whether a storage expense reimbursement is attributable to services performed within a foreign country, in the case of storage expenses incurred after December 31, 1983, the reimbursement shall be attributable to services performed during the period of time for which the storage expenses are incurred.

(ii) *Attribution of foreign source reimbursements to taxable years in which services are performed*—(A) *In general.* If a reimbursement for moving expenses is determined to be from foreign sources under paragraph (e)(5)(i) of this section, then for the purpose of determining the amount eligible for exclusion in accordance with paragraphs (d)(2) and (e)(2) of this section, the reimbursement shall be considered attributable to services performed in the year of the move as long as the individual is a qualified individual for a period that includes 120 days in the year of the move. The period that is used in determining the number of qualifying days for purposes of the individual's section 911(a)(1) limitation (under paragraph (d)(2) of this section) must also be used in determining whether the individual is a qualified individual for a period that includes 120 days in the year of the move. If the individual is not a qualified individual for such period, then the individual shall treat a portion of the reimbursement as attributable to services performed in the year of the move, and a portion as attributable to services performed in the succeeding taxable year, if the move is from the United States to a foreign country, or to the prior taxable year, if the move is from a foreign country to the United States. The portion of the reimbursement treated as attributable to services performed in the year of the move shall be determined by multiplying the total reimbursement by the following fraction:

$$\frac{\text{The number of qualifying days (as defined in paragraph (d)(3) of this section) in the year of the move}}{\text{The number of days in the taxable year of the move.}}$$

The remaining portion of the reimbursement shall be treated as attributable to services performed in the year succeeding or preceding the year of the move. Amounts treated as attributable to services performed in a year succeeding or preceding the year of the move shall be excludable in the year of receipt only to the extent such amounts could be excluded under paragraph (d)(2) of this section in such succeeding or preceding year.

(B) *Moves beginning before January 1, 1984.* Notwithstanding paragraph (e)(5)(ii)(A) of this section, this paragraph (e)(5)(ii)(B) shall apply for moves begun before January 1, 1984. If a reimbursement for moving expenses is determined to be from foreign sources under paragraph (e)(5)(i) of this section, then for the purpose of determining the amount eligible for exclusion in accordance with paragraphs

(d)(2) and (e)(2) of this section, the reimbursement shall be considered attributable to services performed in the year of the move. However, if the individual does not qualify under section 911(d)(1) and §1.911–2(a) for the entire taxable year of the move, then the individual shall treat a portion of the reimbursement as attributable to services performed in the succeeding taxable year, if the move is from the United States to a foreign country, or to the prior taxable year, if the move is from a foreign country to the United States. The portion of the reimbursement treated as attributable to services performed in the year succeeding or preceding the move shall be determined by multiplying the total reimbursement by the following fraction:

$$\frac{\text{The number of qualifying days (as defined in paragraph (d)(3) of this section) in the year of the move}}{\text{The number of days in the taxable year of the move.}}$$

and subtracting the product from the total reimbursement. Amounts treated as attributable to services performed in a year succeeding or preceding the year of the move shall be excludable in the year of receipt only to the extent such amounts could be excluded under paragraph (d)(2) of this section in such succeeding or preceding year.

(f) *Examples.* The following examples illustrate the application of this section.

Example 1. A is a U.S. citizen and calendar year taxpayer. A's tax home was in foreign country F and A was physically present in F for 330 days during the period from July 4, 1982 through July 3, 1983. The number of A's qualifying days in 1982 as determined under paragraph (d)(2) of this section is 181. In 1982 A receives $40,000 attributable to services performed in foreign country F in 1982. Under paragraph (d)(2) of this section A's section 911(a)(1) limitation is $37,192, that is the lesser of $40,000 (foreign earned income) or

$$\$75{,}000\,(\text{annual rate}) \times \frac{181\,(\text{qualifying days})}{365\,(\text{days in taxable year}).}$$

Example 2. The facts are the same as in example 1 except that in 1982 A receives $30,000 attributable to services performed in foreign country F. A excludes this amount from gross income under paragraph (d) of this section. In addition, in 1983 A receives $10,000 attributable to services performed in F in 1982 and $35,000 attributable to services performed in F in 1983. On his return for 1983, A must report $45,000 of income. A's section 911(a)(1) limitation for 1983 is the lesser of $35,000 (foreign earned income) or $49,329, the annual rate for the taxable year multiplied by a fraction the numerator of which is A's qualifying days in the taxable year and the denominator of which is the number of days in the taxable year ($80,000 × 184/365). On his tax return for 1983 A may exclude $35,000 attributable to services performed in 1983. A may only exclude $7,192 of the $10,000 received in 1983 attributable to services performed in 1982 because such amount is only excludable in 1983 to the extent such amount could have been excluded in 1982 subject to the section 911(a)(1) limitation for 1982 which is $37,192 ($75,000 × 181/365). No portion of amounts attributable to services performed in 1982 may be used in calculating A's section 911(a)(1) limitation for 1983. Thus, even though A could have excluded an additional $5,329 in 1983 if A had had more foreign earned income attributable to 1983, A may not exclude the $2,808 of remaining foreign earned income attributable to 1982.

Example 3. C is a U.S. citizen and calendar year taxpayer. C establishes a bona fide residence and a tax home in foreign country J on March 1, 1982, and maintains a tax home and a residence in J until December 31, 1986. In March of 1982 C's employer, Y corporation, transfers stock in Y to C. The stock is subject to forfeiture if C returns to the U.S. before January 1, 1985. C elects under section 83(b) to include $15,000, the amount determined with respect to such stock under section 83(b)(1), in gross income in 1982. C's

other foreign earned income in 1982 is $58,000. C elects under paragraph (e)(4)(iii)(B) of this section to treat the stock as if earned over the period of the substantial risk of forfeiture. The number of months in the period of the substantial risk of forfeiture is thirty-four. The number of months in the taxable year 1982 within the period of foreign employment is ten. For purposes of determining C's section 911(a)(1) limitation, $4,412 (($15,000/34) × 10) of the amount included in gross income under section 83(b) is treated as attributable to services performed in 1982, $5,294 is treated as attributable to services to be performed in 1983, and $5,294 is treated as attributable to services to be performed in 1984. In 1982, C excludes $62,412 under section 911(a)(1). That is the lesser of foreign earned income for 1982 ($58,000 + $4,412) or the annual rate for the taxable year multiplied by a fraction the numerator of which is C's qualifying days in the taxable year and the denominator of which is the number of days in the taxable year ($75,000 × 306/365). C continues to perform services in foreign country J throughout 1983 and 1984. C would be able to exclude the remaining $5,294 attributable to services performed in 1983 and $5,294 attributable to services performed in 1984 if those amounts would be excludable if they had been received in 1983 or 1984 respectively. If C is entitled to exclude the additional amounts, C must claim the exclusion by filing an amended return for 1982.

Example 4. D is a U.S. citizen and a calendar year taxpayer. In September, 1984 D moves to a foreign country K. D is physically present in K, and D's tax home is in K, from September 15, 1984 through December 31, 1985. D receives $6,000 in April, 1985 from his employer, as a reimbursement for expenses of moving to K, pursuant to a written agreement that such moving expenses would be reimbursed to D upon successful completion of 6 months employment in K. Under paragraph (e)(15)(i) of this section, the reimbursement is attributable to services performed in K. Under the physical presence test of §1.911–2(a)(2)(ii), among other periods D is a qualified individual for the period of August 10, 1984 through August 9, 1985, which includes 144 days in 1984. Under paragraph (e)(5)(ii)(A) of this section, for the purpose of determining the amount eligible for exclusion, the reimbursement is considered attributable to services performed in 1984 (the year of the move) because D is a qualified individual under §1.911–2(a) for a period that includes 120 days in 1984. The reimbursement may be excluded under paragraphs (d)(2) and (e)(2) of this section, to the extent that D's foreign earned income for 1984 that was earned and received in 1984 was less than the annual rate for the taxable year multiplied by the number of D's qualifying days in the taxable year over the number of days in D's taxable year ($80,000 × 144/366), or $31,475.

Example 5. The facts are the same as in example 4 except that D is not a qualified individual under the physical presence test, but is a qualified individual under the bona fide residence test for the period of September 15, 1984 through December 31, 1985. Under paragraph (e)(5)(ii)(A) of this section, for the purpose of determining the amount eligible for exclusion, the reimbursement is considered attributable to services performed in 1984 and 1985 because D is not a qualified individual for a period that includes 120 days in 1984 (the year of the move). The portion of the reimbursement treated as attributable to services performed in 1984 is $6,000 × 108/366, or $1,770, and may be excluded, subject to D's 1984 section 911(a)(1) limitation. The balance of the reimbursement, $4,230, is treated as attributable to services performed in 1985, and may be excluded to the extent provided in paragraphs (d)(2) and (e)(2) of this section.

Example 6. The facts are the same as in example 4, with the following additions. Before D moved to K, D and his employer signed a written agreement that D would perform services for the employer for at least one year, primarily in country K, and, if D did not voluntarily cease to work for the employer primarily in country K before one year had elapsed, the employer would reimburse D for one half of D's expenses, up to a maximum of $4,000, of moving back to the United States. The agreement also stated that, if D did not voluntarily leave the employment in K before two years had elapsed, the employer would reimburse D for all of D's reasonable expenses of moving back to the United States. The agreement further stated that D's right to reimbursement would not be conditioned upon the performance of services after D ceased to work in K. D worked in country K for all of 1985. On January 1, 1986, D left K and moved to the United States. In February, 1986 the employer paid D $3,500 as reimbursement for one-half of D's expenses of moving to the United States. Although D did not fulfill the condition in the agreement to receive full reimbursement, all of the conditions in the agreement set forth definitely ascertainable standards and no condition could be fulfilled after D moved back to the United States. The agreement fulfills the requirements of paragraph (e)(5)(i) of this section, and therefore is evidence that the reimbursement should not be attributable to future services to be performed at D's new principal place of work. Under the facts and circumstances, the reimbursement is attributable to services performed in K. Under paragraph (e)(5)(ii)(A) of this section, the entire reimbursement is attributable to services performed in 1985. The amount attributable to

1985 may be excluded to the extent provided in paragraphs (d)(2) and (e)(2) of this section.

(Sec. 911 (95 Stat. 194; 26 U.S.C. 911) and sec. 7805 (68A Stat. 917; 26 U.S.C. 7805) of the Internal Revenue Code of 1954)

[T.D. 8006, 50 FR 2966, Jan. 23, 1985]

§ 1.911–4 Determination of housing cost amount eligible for exclusion or deduction.

(a) *Definition of housing cost amount.* The term ''housing cost amount'' means an amount equal to the reasonable expenses paid or incurred (as defined in section 7701(a)(25)) during the taxable year by or on behalf of the individual attributable to housing in a foreign country for the individual and any spouse or dependents who reside with the individual (or live in a second foreign household described in paragraph (b)(5) of this section) less the base housing amount as defined in paragraph (c) of this section. The housing cost amount must be reduced by the amount of any military or section 912 allowance or similar allowance excludable from gross income that is intended to compensate the individual or the individual's spouse in whole or in part for the expenses of housing during the same period for which the individual claims a housing cost amount exclusion or deduction.

(b) *Housing expenses*—(1) *Included expenses.* For purposes of paragraph (a) of this section, housing expenses include rent, the fair rental value of housing provided in kind by the employer, utilities (other than telephone charges), real and personal property insurance, occupancy taxes not described in paragraph (b)(2)(v) of this section, nonrefundable fees paid for securing a leasehold, rental of furniture and accessories, household repairs, and residential parking.

(2) *Excluded expenses.* Housing expenses do not include:

(i) The cost of house purchase, improvements, and other costs that are capital expenditures;

(ii) The cost of purchased furniture or accessories or domestic labor (maids, gardeners, etc.);

(iii) Amortized payments of principal with respect to an evidence of indebtedness secured by a mortgage on the taxpayer's housing;

(iv) Depreciation of housing owned by the taxpayer, or amortization or depreciation of capital improvements made to housing leased by the taxpayer;

(v) Interest and taxes deductible under section 163 or 164 or other amounts deductible under section 216(a) (relating to deduction of interest and taxes by cooperative housing corporation tenant);

(vi) The expenses of more than one foreign household except as provided in paragraph (b)(5) of this section;

(vii) Expenses excluded from gross income under section 119;

(viii) Expenses claimed as deductible moving expenses under section 217; or

(ix) The cost of a pay television subscription.

(3) *Limitation.* Housing expenses are taken into account for purposes of this section only to the extent attributable to housing for portions of the taxable year within the period during which the individual satisfies the requirements of § 1.911–2(a). Housing expenses are not taken into account for the period during which the value of the individual's housing is excluded from gross income under section 119, unless the individual maintains a second foreign household described in paragraph (b)(5) of this section. If an individual maintains two foreign households, only expenses incurred with respect to the abode which bears the closest relationship, not necessarily geographic, with respect to the individual's tax home shall be taken into account, unless one of the households is a second foreign household.

(4) *Reasonableness.* An amount paid for housing shall not be treated as reasonable, for purposes of paragraph (a) of this section, to the extent that the expense is lavish or extravagant under the circumstances.

(5) *Expenses of a second foreign household*—(i) *In general.* The term ''second foreign household'' means a separate abode maintained by an individual outside of the U.S. for his or her spouse or dependents (who, if minors, are in the individual's legal custody or the joint custody of the individual and the individual's spouse) at a place other than the tax home of the individual because of adverse living conditions at the individual's tax home. If an individual

maintains a second foreign household the expenses of the second foreign household may be included in the individual's housing expenses under paragraph (b)(1) of this section. Under no circumstances shall an individual be considered to maintain more than one second foreign household at the same time.

(ii) *Adverse living conditions.* Solely for purposes of paragraph (b)(5)(i) of this section, adverse living conditions are living conditions which are dangerous, unhealthful, or otherwise adverse. Adverse living conditions include a state of warfare or civil insurrection in the general area of the individual's tax home. Adverse living conditions exist if the individual resides on the business premises of the employer for the convenience of the employer and, because of the nature of the business (for example, a construction site or drilling rig), it is not feasible for the employer to provide housing for the individual's spouse or dependents. The criteria used by the Department of State in granting a separate maintenance allowance are relevant, but not determinative, for purposes of determining whether a separate household is provided because of adverse living conditions.

(c) *Base housing amount*—(1) *In general.* The base housing amount is equal to the product of 16 percent of the annual salary of an employee of the United States who is compensated at a rate equal to the annual salary rate paid for step 1 of grade GS–14, multiplied by the following fraction:

$$\frac{\text{The number of qualifying days}}{\text{The number of days in the taxable year}}$$

For purposes of the above fraction, the number of qualifying days is determined in accordance with §1.911–3(d)(3).

(2) *Annual salary of step 1 of grade GS–14.* The annual salary rate for a step 1 of grade GS–14 is determined on January first of the calendar year in which the individual's taxable year begins.

(d) *Housing cost amount exclusion*—(1) *Limitation.* A qualified individual who has elected to exclude his or her housing cost amount may only exclude the lesser of the full amount of either the individual's housing cost amount attributable to employer provided amounts or the individual's foreign earned income for the taxable year. A qualified individual who elects to exclude his or her housing cost amount may not claim less than the full amount of the housing cost exclusion determined under this paragraph.

(2) *Employer provided amounts.* For purposes of this section, the term ''employer provided amounts'' means any amounts paid or incurred on behalf of the individual by the individual's employer which are foreign earned income included in the individual's gross income for the taxable year (without regard to section 911). Employer provided amounts include, but are not limited to, the following amounts: Any salary paid by the employer to the employee; any reimbursement paid by the employer to the employee for housing expenses, educational expenses for the individual's dependents, or as part of a tax equalization plan; the fair market value of compensation provided in kind (including lodging, unless excluded under section 119, relating to meals and lodging furnished for the convenience of the employer); and any amount paid by the employer to any third party on behalf of the employee. An individual will only have earnings that are not employer provided amounts if the individual has earnings from self-employment.

(3) *Housing cost amount attributable to employer provided amounts.* For the purpose of determining what portion of the housing cost amount is excludable and what portion is deductible the following rules apply. If the individual has no income from self-employment, then the entire housing cost amount is attributable to employer provided amounts and is, therefore, excludable to the extent of the limitation provided in paragraph (d)(1) of this section. If the individual only has income from self-employment, then the entire housing cost amount is attributable to non-employer provided amounts and is, therefore, deductible to the extent of the limitation provided in paragraph (e) of this section. In all other instances, the housing cost amount attributable to employer provided amounts shall be determined by multiplying the housing cost amount by the

following fraction: Employer provided amounts over foreign earned income for the taxable year. The housing cost amount attributable to non-employer provided amounts shall be determined by subtracting the portion of the housing cost amount attributable to employer provided amounts from the total housing cost amount.

(e) *Housing cost amount deduction*—(1) *In general.* If a portion of the individual's housing cost amount is determined under paragraph (d)(3) of this section to be attributable to non-employer provided amounts, the individual may deduct that amount from gross income for the taxable year but only to the extent of the individual's foreign earned income (as defined in §1.911–3) for the taxable year in excess of foreign earned income excluded and the housing cost amount excluded from gross income for the taxable year under §1.911–3 and this section.

(2) *Carryover.* If any portion of the individual's housing cost amount deduction is disallowed for the taxable year under paragraph (e)(1) of this section, such portion shall be carried over and treated as a deduction from gross income for the succeeding taxable year (but only for the succeeding taxable year) to the extent of the excess, if any, of:

(i) The amount of foreign earned income for the succeeding taxable year less the foreign earned income and the housing cost amount excluded from gross income under §1.911–3 and this section for the succeeding taxable year over,

(ii) The portion, if any, of the housing cost amount that is deductible under paragraph (e)(1) of this section for the succeeding taxable year.

(f) *Examples.* The following examples illustrate the application of this section. In all examples the annual rate for a step 1 of GS–14 as of January first of the calendar year in which the individual's taxable year begins is $39,689.

Example 1. B, a U.S. citizen is a calendar year taxpayer who was a bona fide resident of and whose tax home was located in foreign country G for the entire taxable year 1982. B receives an $80,000 salary from B's employer for services performed in G. B incurs no business expenses. B receives housing provided by B's employer with a fair rental value of $15,000. The value of the housing furnished by B's employer is not excluded from gross income under section 119. B pays $10,000 for housing expenses. B's gross income and foreign earned income for 1982 is $95,000. B elects the foreign earned income exclusion of section 911(a)(1) and the housing cost amount exclusion of section 911(a)(2). B must first compute his housing cost amount exclusion. B's housing cost amount is $18,650 determined by reducing B's housing expenses, $25,000 ($15,000 fair rental value of housing and $10,000 of other expenses), by the base housing amount of $6,350 (($39,689 × .16) × 365/365). Because B has no income from self-employment, the entire amount is attributable to employer provided amounts and therefore, is excludable. B's section 911(a)(1) limitation is $75,000. That is the lesser of $75,000 × 365/365 or $95,000 − 18,650. B's total exclusion for 1982 under section 911(a)(1) and (2) is $93,650.

Example 2. The facts are the same as in example 1 except that B's salary for 1982 is $70,000. B's foreign earned income for 1982 is $85,000. B's housing cost amount is $18,650, all of which is attributable to employer provided amounts. B's housing cost amount is excludable to the extent of the lesser of B's housing cost amount attributable to employer provided amounts, $18,650, or the foreign earned income for the taxable year, $85,000. Thus, B excludes $18,650 under section 911(a)(2). B's section 911(a)(1) limitation for 1982 is $66,350 (the lesser of $75,000 × 365/365 or $85,000 − 18,650). B's total exclusion for 1982 under section 911(a)(1) and (2) is $85,000.

Example 3. The facts are the same as in example 2 except that in 1983, B receives $5,000 attributable to services performed in 1982. B may exclude the entire $5,000 in 1983 because such amount would have been excludable under §1.911–3(d)(1) had it been received in 1982.

Example 4. C is a U.S. citizen self-employed and a calendar year and cash basis taxpayer. C arrived in foreign country H on October 3, 1982, and departed from H on March 8, 1984. C's tax home was located in H throughout that period. C was physically present for 330 full days during the twelve consecutive month period August 30, 1982, through August 29, 1983. The number of C's qualifying days in 1982 is 124. During 1982 C had $35,000 of foreign earned income, none of which was attributable to employer provided amounts and $8,000 of reasonable housing expenses. C's housing cost amount is $5,843 ($8,000 − ((39,689 × .16) × 124/365)). C elects to exclude her foreign earned income under §1.911–3(d)(1). C's section 911(a)(1) limitation for 1982 is $25,479 (the lesser of C's foreign earned income for the taxable year ($35,000) or the annual rate for the taxable year multiplied by the number of C's qualifying days over the number of days in the taxable year ($75,000 × 124/365 = $25,479). C may not claim the housing cost amount exclusion under section 911(a)(2) because no portion of the housing cost amount

is attributable to employer provided amounts. C may deduct the lesser of her housing cost amount ($5,843) or her foreign earned income in excess of amounts excluded under section 911(a) ($35,000 − 25,479 = $9,521). Thus, C's housing cost amount deduction is $5,843.

Example 5. The facts are the same as in example 4 except that C had $30,000 of foreign earned income for 1982, none of which was attributable to employer provided amounts. C elects to exclude $25,479 under §1.911–3(d)(1). C may only deduct $4,521 of her housing cost amount under paragraph (e)(1) of this section because her foreign earned income in excess of amounts excluded under section 911(a) is $4,521($30,000 − 25,479). The $1,322 of unused housing cost amount deduction may be carried over to the subsequent taxable year.

Example 6. The facts are the same as in example 4 except that C had $15,000 of foreign earned income of 1982, none of which was attributable to employer provided amounts. C elects to exclude the entire $15,000 under §1.911–3(d)(1). C is not entitled to a housing cost amount deduction for 1982 since she has no foreign earned income in excess of amounts excluded under section 911(a). C may carry over her entire housing cost amount deduction to 1983.

Example 7. The facts are the same as in example 6. In addition, during taxable year 1983 C had $115,000 of foreign earned income, none of which was attributable to employer provided amounts, and $40,000 of reasonable housing expenses C elects to exclude her foreign earned income under §1.911–3(d)(1). C's section 911(a)(1) limitation is the lesser of $115,000 or $80,000 ($80,000 × 365/365). C's housing cost amount for 1983 is $33,650 (40,000 − (39,689 × .16) × 365/365). Since no portion of that amount is attributable to employer provided amounts, C may not claim a housing cost amount exclusion. C may deduct the lesser of her housing cost amount ($33,650) or her foreign earned income in excess of amounts excluded under section 911(a) ($115,000 − 80,000 = 35,000). Thus, C may deduct her $33,650 housing cost amount in 1983. In addition, C may deduct $1,350 of the housing cost amount deduction carried over from taxable year 1982.

(($115.000 − 80,000) − 33,650 = $1,350). The remaining $4,493 ($5,843 − 1,350) of the housing cost amount deduction carried over from taxable year 1982 may not be deducted in 1983 or carried over to 1984.

Example 8. D is a U.S. citizen and a calendar year and cash basis taxpayer. D is a bona fide resident of and maintains his tax home in foreign country J for all of taxable year 1984. In 1984, D earns $80,000 of foreign earned income, $60,000 of which is an employer provided amount and $20,000 of which is a non-employer provided amount. D's total housing cost amount for 1984 is $25,000. D elects to exclude, under section 911(a)(2), the portion of his housing cost amount that is attributable to employer provided amounts. D's excludable housing cost amount is $18,750; that is the total housing cost amount ($25,000) multiplied by employer provided amounts for the taxable year ($60,000) over foreign earned income for the taxable year ($80,000). D also elects to exclude his foreign earned income under §1.911–3(d)(1). D's section 911(a)(1) limitation for 1984 is $61,250 (the lesser of $80,000 − $18,750 or $80,000 × 366/366). D's total exclusion for 1984 under section 911(a)(1) and (2) is $80,000. D cannot claim a housing cost amount deduction in 1984 because D has no foreign earned income in excess of his foreign earned income and housing cost amount excluded from gross income for the taxable year under §1.911–3 and this section. D may carry over his housing cost amount deduction of $6,250, the total housing cost amount less the portion attributable to employer provided amounts ($25,000 − 18,750), to taxable year 1985.

(Sec. 911 (95 Stat. 194; 26 U.S.C. 911) and sec. 7805 (68A Stat. 917; 26 U.S.C. 7805) of the Internal Revenue Code of 1954)

[T.D. 8006, 50 FR 2970, Jan. 23, 1985]

§ 1.911–5 Special rules for married couples.

(a) *Married couples with two qualified individuals*—(1) *In general.* In the case in which a husband and wife both are qualified individuals under §1.911–2(a), each individual may make one or more elections under §1.911–7 and exclude from gross income foreign earned income and exclude or deduct housing cost amounts subject to the rules of paragraphs (a)(2) and (3) of this section.

(2) *Computation of excluded foreign earned income.* The amount of excludable foreign earned income is determined separately for each spouse under the rule of §1.911–3 on the basis of the income attributable to the services of that spouse. If the spouses file separate returns each may exclude the amount of his or her foreign earned income attributable to his or her services subject to the limitations of §1.911–3(d)(2). If the spouses file a joint return, the sum of these foreign earned income amounts so determined for each spouse may be excluded. For example, H and W both qualify under §1.911–2(a)(2)(i) for the entire 1983 taxable year. During 1983 W earns $100,000 of foreign earned income and H earns $45,000 of foreign earned income. H and W file a joint return for 1983. On their joint return H

and W may exclude from gross income a total of $125,000. That amount is determined by adding W's section 911(a)(1) limitation, $80,000 (the lesser of $80,000 × 365/365 or $100,000), and H's section 911(a)(1) limitation, $45,000 (the lesser of $80,000 × 365/365 or $45,000).

(3) *Computation of housing cost amount*—(i) *Spouses residing together.* If the spouses reside together, and file a joint return, they may compute their housing cost amount either jointly or separately. If the spouses reside together and file separate returns, they must compute their housing cost amounts separately. If the spouses compute their housing cost amounts separately, they may allocate the housing expenses to either of them or between them for the purpose of calculating separate housing cost amounts, but each spouse claiming a housing cost amount exclusion or deduction must use his or her full base housing amount in such computation. If the spouses compute their housing cost amount jointly, then only one of the spouses may claim the housing cost amount exclusion or deduction.

Either spouse may claim the housing cost amount exclusion or deduction; however, if the spouses have different periods of residence or presence and the spouse with the shorter period of residence or presence claims the exclusion or deduction, then only the expenses incurred in that shorter period may be claimed as housing expenses. The spouse claiming the exclusion or deduction may aggregate the couple's housing expenses, and subtract his or her base housing amount. For example, H and W reside together and file a joint return. H was a bona fide resident of and maintained his tax home in foreign country M from August 17, 1982, through December 31, 1983. W was a bona fide resident of and maintained her tax home in foreign country M from September 15, 1982, through December 31, 1983. During 1982, H and W earn and receive, respectively, $25,000 and $10,000 of foreign earned income. H paid $10,000 for qualified housing expenses in 1982, $7,500 of that was for qualified housing expenses incurred from September 15, 1982, through December 31, 1982. W paid $3,000 for qualified housing expenses in 1982 all of which were incurred during her period of residence. H and W may choose to compute their housing cost amount jointly. If they do so and H claims the housing cost amount exclusion his exclusion would be $10,617. H's housing expenses would be $13,000 ($10,000 + $3,000) and his base housing amount would be $2,383 ((39,689 × .16) × 137/365 = $2,383). If instead W claims the housing cost amount exclusion her exclusion would be $8,621. W's housing expenses would be $10,500 ($7,500 + 3,000) and her base housing amount would be $1,879 (($39,689 × .16) × 108/365 = $1,879). If H and W file jointly and both claim a housing cost amount exclusion, then H's and W's housing cost amounts would be, respectively, $7,617 ($10,000 − 2,383) and $1,121 ($3,000 − 1,879).

(ii) *Spouses residing apart.* If the spouses reside apart, both spouses may exclude or deduct their housing cost amount if the spouses have different tax homes that are not within reasonable commuting distance (as defined in §1.119–1(d)(4)) of each other and neither spouse's residence is within a reasonable commuting distance of the other spouse's tax home. If the spouses' tax homes, or one spouse's residence and the other spouse's tax home, are within a reasonable commuting distance of each other, only one spouse may exclude or deduct his or her housing cost amount. Regardless of whether the spouses file joint or separate returns, the amount of the housing cost amount exclusion or deduction must be determined separately for each spouse under the rules of §1.911–4. If both spouses claim a housing cost amount exclusion or deduction directly as qualified individuals, neither may claim any such exclusion or deduction under section 911(c)(2)(B)(ii), relating to a second foreign household maintained for the other spouse. If one spouse fails to claim a housing cost amount exclusion or deduction which that spouse could claim directly, the other spouse may claim such exclusion or deduction under section 911(c)(2)(B)(ii), relating to a second foreign household maintained for the first spouse, provided that all the requirements of that section are met. Spouses may not claim

more than one second foreign household and the expenses of such household may only be claimed by one spouse. For example, if both H and W are qualified individuals and H's tax home is in London and W's tax home is in Paris, then both H and W may exclude or deduct their housing cost amounts; however, H and W must compute these amounts separately regardless of whether they file joint or separate returns. If instead of living in Paris, W lives in an area where there are adverse living conditions and W maintains H's home in London, then W may add those housing expenses to her housing expenses and compute one base housing amount. In that case H may not claim a housing cost amount exclusion or deduction.

(iii) *Housing cost amount attributable to employer provided amounts.* Each spouse claiming a housing cost amount exclusion or deduction shall compute the portion of the housing cost amount that is attributable to employer provided amounts separately, based on his or her separate foreign earned income, in accordance with §1.911–4(d)(3).

(b) *Married couples with community income.* The amount of excludable foreign earned income of a husband and wife with community income is determined separately for each spouse in accordance with paragraph (a) of this section on the basis of income attributable to that spouse's services without regard to community property laws. See sections 879 and 6013 (g) and (h) for special rules regarding treatment of community income of a nonresident alien individual married to a U.S. citizen or resident.

(Sec. 911 (95 Stat. 194; 26 U.S.C. 911) and sec. 7805 (68A Stat. 917; 26 U.S.C. 7805) of the Internal Revenue Code of 1954)

[T.D. 8006, 50 FR 2972, Jan. 23, 1985]

§1.911–6 Disallowance of deductions, exclusions, and credits.

(a) *In general.* No deduction or exclusion from gross income under subtitle A of the Code or credit against the tax imposed by chapter 1 of the Code shall be allowed to the extent the deduction, exclusion, or credit is properly allocable to or chargeable against amounts excluded from gross income under section 911(a). For purposes of the preceding sentence, deductions, exclusions, and credits which are definitely related (as provided in §1.861–8), in whole or in part, to earned income shall be allocated and apportioned to foreign earned income and U.S. source earned income in accordance with the rules contained in §1.861–8. Deductions, exclusions, and credits which are definitely related to all gross income under §1.861–8, including deductions for interest described in §1.861–8(e)(2)(ii), are definitely related, in whole or in part, to earned income. In the case of interest expense allocable, in whole or in part, to foreign earned income under §1.861–8(e)(2)(ii), the expense shall normally be apportioned under option one of the optional gross income methods of apportionment (§1.861–8(e)(2)(v)i(A)), but without regard to conditions (*1*) and (*2*) of subdivision (vi)(A) (the fifty percent conditions). Such interest expense shall not normally be apportioned under the asset method of §1.861–8(e)(2)(v). This is because, where section 911 is the operative section, the expense normally relates more closely to gross income generated from activities than to the amount of capital utilized or invested in activities or property. Deductions that are allocated and apportioned to foreign earned income must then be allocated and apportioned to foreign earned income that is excluded under section 911(a). If an individual has foreign earned income from both self-employment and other employment, the amount excluded under section 911(a)(1) shall be deemed to include a pro rata amount of the self-employment income and the income from other employment; thus, a pro rata portion of deductible expenses attributable to self-employment income must be disallowed. For purposes of section 911 (d)(6) and this section only, deductions, exclusions, or credits which are not definitely related to any class of gross income shall not be allocable or chargeable to excluded amounts and are, therefore, deductible to the extent allowed by chapter 1 of the Code. Examples of deductions that are not definitely related to a class of gross income are personal and family medical expenses, qualified retirement contributions (but see section

219(b)(1)), real estate taxes and mortgage interest on a personal residence, charitable contributions, alimony payments, and deductions for personal exemptions. In addition, for purposes of this section, amounts excludable or deductible under section 911 or 119 shall not be allocable or chargeable to other amounts excluded under section 911(a). Thus, an individual's housing cost amount which is excludable or deductible under §1.911–4(d) for a taxable year is not apportioned in part to the individual's foreign earned income which is excluded for such year under §1.911–3(d). Therefore, the entire amount of such exclusion or deduction is allowed to the extent provided in §1.911–4. This section does not affect the time for claiming any deduction, exclusion, or credit that is not allocated or apportioned to excluded amounts.

(b) *Moving expenses*—(1) *In general.* No deduction shall be allowed for moving expenses under section 217 to the extent the deduction is properly allocable to or chargeable against amounts of foreign earned income excluded from gross income under section 911(a). If an individual's new principal place of work is in a foreign country, deductible moving expenses will be allocable to foreign earned income. If an individual treats a reimbursement from his employer for the expenses of a move from a foreign country to the United States as attributable to services performed in a foreign country under §1.911–3(e)(5)(i), then deductible moving expenses attributable to that move will be allocable to foreign earned income. If the individual is a qualified individual who elects to exclude foreign earned income under section 911(a), then some or all of such moving expenses must be disallowed as a deduction.

(2) *Attribution of moving expense deduction to taxable years in which services are performed.* If a moving expense deduction is properly allocable to foreign earned income, the deduction shall be considered attributable to services performed in the year of the move as long as the individual is a qualified individual under §1.911–2(a) for a period that includes 120 days in the year of the move. If the individual is not a qualified individual for such period, then the individual shall treat the deduction as attributable to services performed in both the year of the move and the succeeding taxable year, if the move is from the United States to the foreign country, or the prior taxable year, if the move is from a foreign country to the United States. Notwithstanding the preceding two sentences, storage expenses incurred after December 31, 1983 shall be treated as attributable to services performed in the year in which the expenses are incurred.

(3) *Formula for disallowance of moving expense deduction.* The portion of the moving expense deduction that is disallowed shall be determined by multiplying the moving expense deduction by a fraction the numerator of which is all amounts excluded under section 911(a) for the year or years to which the deduction is attributable (under paragraph (b)(2) of this section) and the denominator of which is foreign earned income (as defined in §1.911–3(a)) for that year or years.

(4) *Effect of disallowance based on attribution of deduction to subsequent year's income.* An individual may claim a moving expense deduction in the taxable year in which the amount of the expense is paid or incurred even if attributable, in part, to the succeeding year. However, at such time as the individual excludes income under section 911(a) for the year or years to which the deduction is attributable, the individual shall either—

(i) File an amended return for the year in which the deduction was claimed that does not claim the portion of the deduction that is disallowed because it is chargeable against excluded income, or

(ii) Include in income for the year following the year in which the deduction was claimed an amount equal to the amount of the deduction that is disallowed.

Any amount included in income under paragraph (b)(4)(ii) of this section is not foreign earned income.

(5) *Moves beginning before January 1, 1984.* Notwithstanding paragraphs (b)(1) through (3) of this section, the rules of this paragraph (b)(5) shall apply for moves beginning before January 1, 1984.

(i) *Individual qualifies for the entire taxable year of the move.* If the individual is a qualified individual for the entire taxable year of the move, then the amount of moving expense disallowed shall be determined by multiplying the moving expense deduction otherwise allowable by a fraction the numerator of which is the foreign earned income excluded under section 911(a) for the taxable year of the move and the denominator of which is the foreign earned income for the same taxable year.

(ii) *Individual qualifies for less than the entire taxable year of the move.* If the individual is a qualified individual for less than the entire taxable year of the move, then, for the purpose of determining the portion of the otherwise allowable moving expense deduction that is disallowed, the individual must attribute a portion of the otherwise allowable moving expense deduction either to the succeeding taxable year, if the move is from the United States to a foreign country, or to the prior taxable year, if the move is from a foreign country to the United States. The portion of the moving expense deduction treated as attributable to services performed in the year of the move shall be determined by multiplying the otherwise allowable moving expense deduction by the following fraction:

$$\frac{\text{The number of qualifying days (as defined in §1.911-3(d)(3) in the year of the move}}{\text{The number of days in the taxable year of the move.}}$$

The portion of the moving expense deduction treated as attributable to the year succeeding or preceding the move shall be determined by subtracting the portion of the moving expense deduction that is attributable to the year of the move from the total moving expense deduction. The allocation of a portion of the moving expense deduction to a succeeding or preceding taxable year does not affect the time for claiming the allowable moving expense deduction. The portion of the moving expense deduction that is disallowed shall be determined by multiplying the moving expense deduction attributable to the year of the move or the succeeding or preceding year, as the case may be, by a fraction the numerator of which is amounts excluded under section 911(a) for that year and the denominator of which is foreign earned income for that year.

(c) *Foreign taxes*—(1) *Amount disallowed.* No deduction or credit is allowed for foreign income, war profits, or excess profits taxes paid or accrued with respect to amounts excluded from gross income under section 911. To determine the amount of disallowed foreign taxes, multiply the foreign tax imposed on foreign earned income (as defined in §1.911–3(a)) received or accrued during the taxable year by a fraction, the numerator of which is amounts excluded under section 911(a) in such taxable year less deductible expenses properly allocated to such amounts (see paragraphs (a) and (b) of this section), and the denominator of which is foreign earned income (as defined in §1.911–3(a)) received or accrued during the taxable year less deductible expenses properly allocated or apportioned thereto. For the purpose of determining the extent to which foreign taxes are disallowed, the housing cost amount deduction is treated as definitely related to foreign earned income that is not excluded. If the foreign tax is imposed on foreign earned income and some other income (for example earned income from sources within the United States or an amount not subject to tax in the United States), and the taxes on the other amount cannot be segregated, then the denominator equals the total of the amounts subject to tax less deductible expenses allocable to all such amounts.

(2) *Definitions and special rules*—(i) *Taxable year.* For purposes of paragraph (c)(1) of this section, the term ''taxable year'' means the individual's taxable

year for U.S. tax purposes. Such term includes the portion of any foreign taxable year within the individual's U.S. taxable year and excludes the portion of any foreign taxable year not within the individual's U.S. taxable year.

(ii) *Apportionment of foreign taxes.* For purposes of this paragraph (c), foreign taxes imposed on foreign earned income shall be deemed to accrue, on a pro rata basis, to income as the income is received or accrued. The taxes so accrued shall be apportioned to the taxable year during which the income is received or accrued. This rule applies for all individuals, regardless of their method of accounting.

(iii) *Effect of disallowance.* The disallowance of foreign taxes under this paragraph (c) shall not affect the time for claiming any deduction or credit for foreign taxes paid. Rather, the disallowance shall only affect the amount of taxes considered paid or accrued to any foreign country.

(iv) *Interest on foreign taxes.* Any interest expense incurred on a liability for foreign taxes is allocated and apportioned not under this paragraph (c) but under paragraph (a) of this section to foreign earned income and then to excluded foreign earned income and to that extent disallowed as a deduction under paragraph (a). In that regard, see also §1.861–8(e)(2) for the specific rules for allocation and apportionment of interest expense.

(d) *Examples.* The following examples illustrate the application of this section.

Example 1. In 1982 A, an architect, operates his business as a sole proprietorship in which capital is not a material income producing factor. A receives $1,000,000 in gross receipts, all of which is foreign source earned income, and incurs $500,000 of otherwise deductible business expenses definitely related to the foreign earned income. A elects to exclude $75,000 under section 911(a)(1). The expenses must be apportioned to excluded earned income as follows: $500,000 × $75,000/1,000,000. Thus, $37,500 of the business expenses are not deductible.

Example 2. The facts are the same as in example 1, except that $100,000 of A's gross receipts is U.S. source earned income and $68,000 of A's business expenses are attributable to the U.S. source earned income. Thus, A has $900,000 of foreign earned income and $432,000 of deductions allocated to foreign earned income. The expenses apportioned to excluded earned income are $432,000 × $75,000/$900,000, or $36,000, which are not deductible.

Example 3. B is a U.S. citizen, calendar year and cash basis taxpayer. B moves to foreign country N and maintains a tax home and is physically present there from July 1, 1984 through May 26, 1985. Among other possible periods, B is a qualified individual for 219 days in the year of the move. B pays $6,000 of otherwise deductible moving expenses in 1984. For 1984, B's foreign earned income is $60,000 and B excludes $47,869 ($80,000 × 219/366) under section 911(a). Under paragraph (b)(2) of this section, B's moving expenses are attributable to services performed in 1984. Under paragraph (b)(3) of this section, $6,000 × $47,869/$60,000, or $4,789, of B's moving expense deduction is disallowed. B may deduct $1,211 of moving expenses on his 1984 return.

Example 4. The facts are the same as in example 3 except that B maintains a tax home and is physically present in foreign country N from October 9, 1984 through September 3, 1985. Among other possible periods, B is a qualified individual for no more than 119 days in 1984 and 281 days in 1985. B's foreign earned income for 1984 is $60,000. B's foreign earned income for 1985 is $150,000. Because B is a qualified individual for less than 120 days in the year of the move, under paragraph (b)(2) of this section, B's moving expenses are attributable to services performed in 1984 and 1985. At the close of 1984, B may either seek an extension of time to file under §1.911–7(c) or may file an income tax return without claiming the exclusions or deduction under section 911. B does not seek an extension and files without excluding foreign earned income; thus B may deduct his moving expenses in full. B later amends his 1984 return and excludes foreign earned income for that year. B excludes foreign earned income for 1985. B must determine the portion of the moving expense deduction that is disallowed. The portion of the moving expense deduction that is disallowed is determined by multiplying the otherwise allowable moving expense deduction by a fraction. The numerator of the fraction is the sum of amounts excluded under section 911(a) for 1984 and 1985, that is $26,082 or $80,000 × 119/365, plus $61,589, or $80,000 × 281/365, which totals $87,671. The denominator of the fraction is the sum of foreign earned income for 1984 and 1985, that is $60,000 plus $150,000, or $210,000. B's allowable moving expense deduction is $3,495, or $6,000 − ($6,000 × $87,671/$210,000). If B does not file an amended 1984 return (and does not exclude foreign earned income for 1984), but excludes foreign earned income under section 911(a) for 1985, a portion of his moving expense deduction is disallowed, based on the same formula. The amount disallowed is $6,000 × $61,589/$210,000, or $1,760. This amount may be recaptured either by filing an amended return for 1984 or

by including it in income for 1985 (in which case it is not foreign earned income).

Example 5. C is a U.S. citizen, a self-employed individual, and a cash basis and calendar year taxpayer. For the entire 1982 taxable year C maintained his tax home and his bona fide residence in foreign country P. During 1982 C earned and received $120,000 of foreign earned income, none of which was attributable to employer provided amounts. C paid $40,000 of business expenses. C elected to exclude foreign earned income under section 911(a)(1) and claimed a housing cost amount deduction of $15,000. C received $10,000 of foreign source interest income which was included with C's earned income in a single tax base and taxed at graduated rates. For 1982, C paid $30,000 in income tax to foreign country P. The amount of C's business expenses that is properly apportioned to excluded amounts (and therefore, not deductible) equals $25,000, which is determined by multiplying the otherwise allowable deductions by C's excluded amounts over C's foreign earned income ($40,000 × 75,000/120,000). The amount of country P tax that is properly apportioned to excluded amounts (and therefore, not deductible or creditable) equals $20,000, which is determined by multiplying the tax of $30,000 by the following fraction:

$$\frac{\text{\$50,000 (\$75,000 excluded amounts less \$25,000 of deductible expenses allocable thereto)}}{\text{\$75,000 (((\$120,000 foreign earned income less \$40,000 of deductible expenses allocable thereto) less \$15,000 housing cost amount deduction allocable thereto) plus \$10,000 other taxable income).}}$$

Example 6. D is a U.S. citizen and an accrual basis and calendar year taxpayer for U.S. tax purposes. For the entire period from January 1, 1982 through December 31, 1983, D maintains his tax home and his bona fide residence in foreign country R. For purposes of R's income tax, D is a cash basis taxpayer and uses a fiscal year that begins on April 1 and ends on the following March 31. During his entire period of residence in R, D receives foreign earned income of $10,000 each month, all of which is attributable to employer provided amounts. For his foreign taxable year ending March 31, 1982, D pays $10,000 of income tax to R. For his foreign taxable year ending March 31, 1983, D pays $54,000 of income tax to R. Under paragraph (c)(2)(ii) of this section, all of the $10,000 of tax paid for this foreign taxable year ending March 31, 1982 is imposed on foreign earned income received in 1982, as is $40,500, or 9/12 × $54,000, of tax paid for his foreign taxable year ending March 31, 1983. (D received $10,000 per month for the last 3 months of his foreign taxable year ending March 31, 1982, all of which are within his U.S. taxable year ending December 31, 1982 under paragraph (c)(2)(i) of this section, and $10,000 per month for each month of his foreign taxable year ending March 31, 1983, of which the first 9 months are within his U.S. taxable year ending December 31, 1982. Under paragraph (c)(2)(ii) of this section, foreign taxes are deemed to accrue on a pro rata basis to income as it is received or accrued. Thus, all of the $10,000 of foreign taxes imposed on the income received during D's foreign taxable year ending March 31, 1982 accrue to D's 1982 foreign earned income, as do 9/12 (or $90,000/120,000) of foreign taxes imposed on income received during D's foreign taxable year ending March 31, 1983, for purposes of determining the amount of D's foreign taxes that is disallowed.) For 1982, D has no deductible expenses, and elects to exclude his housing cost amount of $21,000 under section 911(a)(2) and foreign earned income of $75,000 under section 911(a)(1). The amount of D's foreign taxes disallowed for deduction or credit purposes for 1982 is $8,000 (that is, $10,000 × $96,000/$120,000) of the taxes for his foreign taxable year ending March 31, 1982, plus $32,400 (that is, $40,500 × $96,000/$120,000) of the taxes for his foreign taxable year ending March 31, 1983, or $40,400. From 1982, D has $2,000 ($10,000 − $8,000) of deductible or creditable taxes accrued on March 31, 1982, and $8,100 ($40,500–$32,400) of deductible or creditable taxes accrued on March 31, 1983, after the disallowance based on his 1982 excluded income.

Example 7. E is a United States citizen, calendar year and cash basis taxpayer. E is physically present in and establishes his tax home in foreign country S on May 1, 1981. For purposes of country S, E's taxable year begins on April 1 and ends the following March 31. E receives foreign earned income of $15,000 each month beginning on May 1, 1981. At the end of his foreign taxable year ending on March 31, 1982, E pays $70,000 of income tax to S on $165,000 of foreign earned income. Under section 911, as in effect for taxable years beginning before January 1, 1982, E may not exclude any income that is earned or received during 1981. None of E's taxes paid in 1982 that are attributable to income earned or received in 1981 are subject

to disallowance because, under paragraph (c)(2)(ii) of this section, the only taxes disallowed are those deemed to accrue on income earned and received after December 31, 1981, and excluded from gross income. The amount of E's taxes paid in 1982 that are attributable to 1981 is $50,909, or $70,000 × $120,000/$165,000. E elects to exclude foreign earned income for 1982. The amount of E's taxes paid to S in 1982 that accrue to 1982 foreign earned income, and are therefore subject to disallowance based on excluded income, is $19,091, or $70,000 × $45,000/$165,000.

(Sec. 911 (95 Stat. 194; 26 U.S.C. 911) and sec. 7805 (68A Stat. 917; 26 U.S.C. 7805) of the Internal Revenue Code of 1954)

[T.D. 8006, 50 FR 2973, Jan. 23, 1985]

§ 1.911–7 Procedural rules.

(a) *Elections of a qualified individual*—(1) *In general.* In order to receive either exclusion provided by section 911(a), a qualified individual must elect, separately with respect to each exclusion, to exclude foreign earned income under section 911(a)(1) and the housing cost amount under section 911(a)(2). Any such elections may be made on Form 2555 or on a comparable form. Each election must be filed either with the income tax return, or with an amended return, for the first taxable year of the individual for which the election is to be effective. An election once made remains in effect for that year and all subsequent years unless revoked under paragraph (b) of this section. Each election shall contain information sufficient to determine whether the individual is a qualified individual as provided in §1.911–2. The statement shall include the following information:

(i) The individual's name, address, and social security number;

(ii) The name of the individual's employer;

(iii) Whether the individual claimed exclusions under section 911 for earlier years after 1981 and within the five preceding taxable years;

(iv) Whether the individual has revoked a previously made election and the taxable year for which such revocation was effective;

(v) The exclusion or exclusions the individual is electing;

(vi) The foreign country or countries in which the individual's tax home is located and the date when such tax home was established;

(vii) The status (either bona fide residence or physical presence) under which the individual claims the exclusion;

(viii) The individual's qualifying period of residence or presence;

(ix) The individual's foreign earned income for the taxable year including the fair market value of all noncash remuneration; and,

(x) If the individual elects to exclude the housing cost amount, the individual's housing expenses.

(2) *Requirement of a return*—(i) *In general.* In order to make a valid election under this paragraph (a), the election must be made:

(A) With an income tax return that is timely filed (including any extensions of time to file),

(B) With a later return filed within the period prescribed in section 6511(a) amending the foregoing timely filed income tax return,

(C) With an original income tax return that is filed within one year after the due date of the return (determined without regard to any extension of time to file); this one year period does not constitute an extension of time for any purpose—it is merely a period during which a valid election may be made on a late return, or

(D) With an income tax return filed after the period described in paragraphs (a)(2)(i)(A), (B), or (C) of this section provided—

(*1*) The taxpayer owes no federal income tax after taking into account the exclusion and files Form 1040 with Form 2555 or a comparable form attached either before or after the Internal Revenue Service discovers that the taxpayer failed to elect the exclusion; or

(*2*) The taxpayer owes federal income tax after taking into account the exclusion and files Form 1040 with Form 2555 or a comparable form attached before the Internal Revenue Service discovers that the taxpayer failed to elect the exclusion.

(*3*) A taxpayer filing an income tax return pursuant to paragraph (a)(2)(i)(D)(*1*) or (*2*) of this section must type or legibly print the following statement at the top of the first page of the Form 1040: ''Filed Pursuant to Section 1.911–7(a)(2)(i)(D).''

(ii) *Election for 1982 and 1983 taxable years.* Solely for purposes of paragraph (a)(2)(i)(A) of this section, an income tax return for any taxable year beginning before January 1, 1984, shall be considered timely filed if it is filed on or before July 23, 1985.

(3) *Housing cost amount deduction.* An individual does not have to make an election in order to claim the housing cost amount deduction. However, such individual must provide the Commissioner with information sufficient to determine the individual's correct amount of tax. Such information shall include the following: The individual's name, address, and social security number; the name of the individual's employer; the foreign country in which the individual's tax home was established; the status under which the individual claims the deduction; the individual's qualifying period of residence or presence; the individual's foreign earned income for the taxable year; and the individual's housing expenses.

(4) *Effect of immaterial error or omission.* An inadvertent error or omission of information required to be provided to make an election under this paragraph (a) shall not render the election invalid if the error or omission is not material in determining whether the individual is a qualified individual or whether the individual intends to make the election.

(b) *Revocation of election*—(1) *In general.* An individual may revoke any election made under paragraph (a) of this section for any taxable year. A revocation must be made separately with respect to each election. The individual may revoke an election for any taxable year, including the first taxable year for which an election was effective, by filing a statement that the individual is revoking one or more of the previously made elections. The statement must be filed with the income tax return, or with an amended return, for the first taxable year of the individual for which the revocation is to be effective. A revocation once made is effective for that year and all subsequent years. If an election is revoked for any taxable year, including the first taxable year for which the election was effective, the individual may not, without the consent of the Commissioner, again make the same election until the sixth taxable year following the taxable year for which the revocation was first effective. For example, a qualified individual makes an election to exclude foreign earned income under section 911(a)(1) and files it with his 1982 income tax return. The individual files 1983 and 1984 income tax returns on which he excludes his foreign earned income. Then, within 3 years after filing his 1982 income tax return, the individual files an amended 1982 income tax return with a statement revoking his election to exclude foreign earned income under section 911(a)(1). The revocation of the election is effective for taxable years 1982, 1983, and 1984. The individual may not elect to exclude income under section 911(a)(1) for any taxable year before 1988, unless he obtains consent to reelect under paragraph (b)(2) of this section.

(2) *Reelection before sixth taxable year after revocation.* If an individual revoked an election under paragraph (b)(1) of this section and within five taxable years the individual wishes to reelect the same exclusion, then the individual may apply for consent to the reelection. The application for consent shall be made by requesting a ruling from the Associate Chief Counsel (Technical), National Office, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC 20224. In determining whether to consent to reelection the Associate Chief Counsel or his delegate shall consider any facts and circumstances that may be relevant to the determination. Relevant facts and circumstances may include the following: a period of United States residence, a move from one foreign country to another foreign country with differing tax rates, a substantial change in the tax laws of the foreign country of residence or physical presence, and a change of employer.

(c) *Returns and extensions*—(1) *In general.* Any return filed before completion of the period necessary to qualify an individual for any exclusion of deduction provided by section 911 shall be filed without regard to any exclusion or deduction provided by that section. A claim for a credit or refund of any

overpayment of tax may be filed, however, if the taxpayer subsequently qualifies for any exclusion or deduction under section 911. See section 6012(c) and §1.6012–1(a)(3), relating to returns to be filed and information to be furnished by individuals who qualify for any exclusion or deduction under section 911.

(d) *Declaration of estimated tax.* In estimating gross income for the purpose of determining whether a declaration of estimated tax must be made for any taxable year, an individual is not required to take into account income which the individual reasonably believes will be excluded from gross income under the provisions of section 911. In computing estimated tax, however, the individual must take into account, among other things, the denial of the foreign tax credit for foreign taxes allocable to the excluded income (see §1.911–6(c)).

(e) *Effective/applicability date.* This section applies to applications for extension of time to file returns filed after July 1, 2008.

(Sec. 911 (95 Stat. 194; 26 U.S.C. 911) and sec. 7805 (68A Stat. 917; 26 U.S.C. 7805) of the Internal Revenue Code of 1954)

[T.D. 8006, 50 FR 2976, Jan. 23, 1985, as amended by T.D. 8480, 58 FR 34885, June 30, 1993; 73 FR 37365, July 1, 2008]

§1.911–8 Former deduction for certain expenses of living abroad.

For rules relating to the deduction for certain expenses of living abroad applicable to taxable years beginning before January 1, 1982, see 26 CFR 1.913–1 through 1.913–13 as they appeared in the Code of Federal Regulations revised as of April 1, 1982.

(Sec. 911 (95 Stat. 194; 26 U.S.C. 911) and sec. 7805 (68A Stat. 917; 26 U.S.C. 7805) of the Internal Revenue Code of 1954)

[T.D. 8006, 50 FR 2977, Jan. 23, 1985]

EARNED INCOME OF CITIZENS OF UNITED STATES

§1.912–1 Exclusion of certain cost-of-living allowances.

(a) Amounts received by Government civilian personnel stationed outside the continental United States as cost-of-living allowances in accordance with regulations approved by the President are, by the provisions of section 912(1), excluded from gross income. Such allowances shall be considered as retaining their characteristics under section 912(1) notwithstanding any combination thereof with any other allowance. For example, the cost-of-living portion of a ''living and quarters allowance'' would be excluded from gross income whether or not any other portion of such allowance is excluded from gross income.

(b) For purposes of section 912(1), the term ''continental United States'' includes only the 48 States existing on February 25, 1944 (the date of the enactment of the Revenue Act of 1943 (58 Stat. 21)) and the District of Columbia.

§1.912–2 Exclusion of certain allowances of Foreign Service personnel.

Gross income does not include amounts received by personnel of the Foreign Service of the United States as allowances or otherwise under the provisions of chapter 9 of title I of the Foreign Service Act of 1980 or the provisions of section 28 of the State Department Basic Authorities Act (formerly section 914 of title IX of the Foreign Service Act of 1946).

[T.D. 8256, 54 FR 28620, July 6, 1989]

§1.921–1T Temporary regulations providing transition rules for DISCs and FSCs.

(a) *Termination of a DISC*—(1) *At end of 1984.*

Q–1: What is the effect of the termination on December 31, 1984, of a DISC's taxable year?

A–1: Without regard to the annual accounting period of the DISC, the last taxable year of each DISC beginning during 1984 shall be deemed to close on December 31, 1984. The corporation's DISC election also shall be deemed revoked at the close of business on December 31, 1984. (A DISC that does not elect to be an interest charge DISC as of January 1, 1985, in addition to a corporation described in section 992(a)(3), shall be referred to as a ''former DISC''.) A corporation which wishes to be treated as a FSC, a small FSC, or an interest charge DISC must make an election as provided under paragraph (b) (Q & A #1) of this section.