AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

§ 1.955A–2 Amount of a controlled foreign corporation's qualified investments in foreign base company shipping operations.

(a) *Qualified investments*—(1) *In general.* Under section 955(b), for purposes of sections 951 through 964, a controlled foreign corporation's ''qualified investments in foreign base company shipping operations'' are investments in—

(i) Any aircraft or vessel, to the extent that such aircraft or vessel is used (or hired or leased for use) in foreign commerce,

(ii) Related shipping assets (within the meaning of paragraph (b) of this section),

(iii) Stock or obligations of a related controlled foreign corporation, to the extent provided in paragraph (c) of this section,

(iv) A partnership, to the extent provided in paragraph (d) of this section, and

(v) Stock or obligations of a less developed country shipping company described in §1.955–5(b), as provided in paragraph (h) of this section.

(2) *Coordination of provisions.* No amount shall be counted as a qualified investment in foreign base company shipping operations under more than one provision of this section. Thus, for example, if a $10,000 investment in stock of a controlled foreign corporation is treated as a qualified investment in foreign base company shipping operations under both subparagraphs (1)(iii) and (v) of this paragraph, then such $10,000 is counted only once as a qualified investment in foreign base company shipping operations.

(3) *Definitions.* If the meaning of any term is defined or explained in §1.954–6, then such term shall have the same meaning when used in this section.

(4) *Extent of use.* (i) For purposes of subparagraph (1)(i) of this paragraph and paragraph (b)(1) of this section, the extent to which an asset of a controlled foreign corporation is used during a taxable year in foreign base company shipping operations shall be determined on the basis of the proportion for such year which the foreign base company shipping income derived from the use of such asset bears to the total gross income derived from the use of such asset.

(ii) For purposes of determining under subdivision (i) of this subparagraph the amounts of foreign base company shipping income and gross income of a controlled foreign corporation—

(A) Such amounts shall be deemed to include an arm's length charge (see §1.954–6(h)(5)) for services performed by such corporation for itself,

(B) Such amounts shall be deemed to include an arm's length charge for the use of an asset (such as a vessel under construction or laid up for repairs) which is held for use in foreign base company shipping operations, but is not actually so used,

(C) Foreign base company shipping income shall be deemed to include amounts earned in taxable years beginning before January 1, 1976, and

(D) The district director shall make such other adjustments to such amounts as are necessary to properly determine the extent to which any asset is used in foreign base company shipping operations.

(b) *Related shipping assets*—(1) *In general.* For purposes of this section, the term ''related shipping asset'' means any asset which is used (or held for use) for or in connection with the production of income described in §1.954–6(b)(1)(i) or (ii), but only to the extent that such asset is so used (or is so held for use).

(2) *Examples.* Examples of assets of a controlled foreign corporation which are used (or held for use) for or in connection with the production of income described in subparagraph (1) of this paragraph include—

(i) Money, bank deposits, and other temporary investments which are reasonably necessary to meet the working capital requirements of such corporation in its conduct of foreign base company shipping operations,

(ii) Accounts receivable and evidences of indebtedness which arise from the conduct of foreign base company shipping operations by such corporation or by a related person,

(iii) Amounts (other than amounts described in subdivision (i) of this subparagraph) deposited in bank accounts or invested in readily marketable securities pursuant to a specific, definite,

and feasible plan to purchase any tangible asset for use in foreign base company shipping operations,

(iv) Amounts paid into escrow to secure the payment of (A) charter hire for an aircraft, vessel, or other asset used in foreign base company shipping operations or (B) a debt which constitutes a specific charge against such an asset,

(v) Capitalized expenditures (such as progress payments) made under a contract to purchase any asset for use in foreign base company shipping operations,

(vi) Prepaid expense and deferred charges incurred in the course of foreign base company shipping operations,

(vii) Stock acquired and retained to insure a source of supplies or services used in the conduct of foreign base company shipping operations, and

(viii) Currency futures acquired and retained as a hedge against international currency fluctuations in connection with foreign base company shipping operations.

(3) *Limitations*—(i) *Vessels generally.* Notwithstanding any other provision of this paragraph, the term ''related shipping assets'' does not include any money or other intangible assets of a controlled foreign corporation, to the extent that such assets are permitted to accumulate in excess of the reasonably anticipated needs of the business.

(ii) *Safe harbor.* If a controlled foreign corporation accumulates money or other intangible assets pursuant to a plan to purchase one or more vessels for use in foreign commerce, and if—

(A) The amount so accumulated, plus

(B) The sum of the amounts accumulated by other controlled foreign corporations which are related persons (within the meaning of section 954(d)(3)) pursuant to similar plans, does not exceed 110 percent of a reasonable down payment on each vessel planned to be purchased within a reasonable period, then such plan will be considered to be feasible. For purposes of the preceding sentence, a reasonable down payment shall not exceed 28 percent of the total cost of acquisition. The determination dates applicable to the taxable year of a controlled foreign corporation are those set forth in paragraph (c)(2)(ii) of this section. In the case of accumulation of assets which do not come within the safe harbor limitation of this subdivision (ii), in determining whether such assets have accumulated beyond the reasonably anticipated needs of the business, factors to be taken into account include, but are not limited to, the availability of financing to purchase a vessel and the availability of a vessel suitable for the purposes to which the vessel is to be put.

(iii) *Other assets.* In determining whether a plan to purchase any asset other than a vessel for use in foreign base company shipping operations is feasible, principles similar to those stated in subdivision (ii) of this subparagraph shall be applied.

(4) *Cross-reference.* See § 1.954–7(c) for additional illustrations bearing on the application of this paragraph.

(c) *Stock and obligations*—(1) *In general.* Investments by a controlled foreign corporation (the ''first corporation'') in stock or obligations of a second controlled foreign corporation which is a related person (within the meaning of section 954(d)(3) are considered to be qualified investments in foreign base company shipping operations to the extent that the assets of such second corporation are used (or held for use) in foreign base company shipping operations. See subparagraph (2) of this paragraph. However, an investment in an obligation of the second corporation will not be considered a qualified investment in foreign base company shipping operations if the obligation represents a liability which constitutes a specific charge (nonrecourse or otherwise) against an asset of the second corporation which is not either—

(i) An aircraft or vessel used (or held for use) to some extent in foreign commerce, or

(ii) An asset described in paragraphs (a)(1)(ii) through (v) of this section.

(2) *Extent of use.* On any determination date applicable to a taxable year of the first corporation, the extent to which the assets of the second corporation are used in foreign base company shipping operations shall be determined on the basis of the proportion which the amount of such second corporation's qualified investments in foreign base company shipping operations

bears to its net worth, such proportion to be determined at the close of the second corporation's last taxable year which ends on or before such determination date. For purposes of the preceding sentence—

(i) A controlled foreign corporation's net worth is the total adjusted basis of the corporate assets reduced by the total outstanding principal amount of the corporate liabilities, and

(ii) The determination dates applicable to a taxable year of a controlled foreign corporation are—

(A) Except as provided in (B) of this subdivision, the close of such taxable year and the close of the preceding taxable year, and

(B) With respect to a United States shareholder who has made an election under section 955(b)(3) to determine such corporation's increase in qualified investments in foreign base company shipping operations at the close of the following taxable year, the close of such taxable year and the close of the taxable year immediately following such taxable year.

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

Example 1. On December 31, 1976, controlled foreign corporation X owns 100 percent of the single class of stock of controlled foreign corporation Y. X and Y both use the calendar year as the taxable year. On December 31, 1976, Y's assets consist of a vessel used in foreign commerce, related shipping assets, and other assets unrelated to its foreign base company shipping operations. On such date Y has qualified investments in foreign base company shipping operations (determined under paragraph (g) of this section) of $60,000, and a net worth of $100,000. If X's investment in the stock of Y is $50,000, then $30,000 of such amount, i.e.,

$$\frac{\$60,000}{\$100,000}\times\$50,000$$

is a qualified investment in foreign base company shipping operations.

Example 2. The facts are the same as in example 1, except that on December 31, 1976, Y's assets consist entirely of a vessel used in foreign commerce and related shipping assets, Y has qualified investments in foreign base company shipping operations (determined under paragraph (g) of this section) of $16,000 and (therefore) a net worth of $16,000. If X's investment in the stock of Y is $50,000, then the entire $50,000, i.e.,

$$\frac{\$16,000}{\$16,000}\times\$50,000$$

is a qualified investment in foreign base company shipping operations.

Example 3. On December 31, 1980, controlled foreign corporation J owns two notes of controlled foreign corporation K, which is a related person (within the meaning of section 954(d)(3)). Both J and K use the calendar year as the taxable year. J's adjusted basis in each of the two notes is $100,000. The first note is secured only by the general credit of K. The second note is secured by (and, therefore, constitutes a specific charge on) a hotel owned by K in a foreign country. On December 31, 1980, K has qualified investments in foreign base company shipping operation with an adjusted basis of $500,000 (before applying the rules of paragraph (g) of this section). The adjusted basis of all of K's corporate assets is $1,100,000. K's only liabilities are the two notes. The amount of K's qualified investments in foreign base company shipping operations (determined under paragraph (g) of this section) is $450,000. K's net worth is $900,000. The amount of J's qualified investment in foreign base company shipping operations in respect of the first note is $50,000, *i.e.*,

$$\frac{\$450,000}{\$900,000}\times\$100,000$$

The amount of J's qualified investment in respect of the second note is zero (see the last sentence of paragraph (c)(1) of this section).

(d) *Partnerships*—(1) *In general.* A controlled foreign corporation's investment in a partnership at the close of any taxable year of such corporation shall be considered a qualified investment in foreign base company shipping operations to the extent of the proportion which such corporation's foreign base company shipping income for such taxable year would bear to its gross income for such taxable year if—

(i) Such corporation had realized no income other than its distributive share of the partnership gross income, and

(ii) Such corporation's income were adjusted in accordance with the rules stated in paragraphs (a)(4)(ii)(B) and (D) of this section.

(2) *Transitional rule.* For purposes of subparagraph (1)(i) of this paragraph, the controlled foreign corporation's distributive share of the partnership

gross income shall not include any amount attributable to income earned by the partnership before the first day of such corporation's first taxable year beginning after December 31, 1975.

(3) *Cross-reference.* See paragraph (g)(4) of this section for rules relating to the determination of the amount of a controlled foreign corporation's investment in a partnership.

(e) *Trusts*—(1) *In general.* An investment in a trust is not a qualified investment in a foreign base company shipping operations.

(2) *Grantor trusts.* Notwithstanding subparagraph (1) of this pargraph, if a controlled foreign corporation is treated as the owner of any portion of a trust under subpart E of part I of subchapter J (relating to grantors and others treated as substantial owners), then for purposes of this section such controlled foreign corporation is deemed to be the actual owner of such portion of the assets of the trust. Accordingly, its investments in such assets (as determined under paragraph (g)(5) of this section) may be treated as a qualified investment in foreign base company shipping operations.

(3) *Definitions.* For purposes of this section, the term ''trust'' means a trust as defined in §301.7701–4.

(f) *Excluded property.* For purposes of paragraph (a) of this section, property acquired principally for the purpose of artificially increasing the amount of a controlled foreign corporation's qualified investments in foreign base company shipping operations will not be recognized; whether an item of property is acquired principally for such purpose will depend upon all the facts and circumstances of each case. One of the factors that will be considered in making such a determination with respect to an item of property is whether the item is disposed of within 6 months after the date of its acquisition.

(g) *Amount attributable to property*—(1) *General rule.* For purposes of this section, the amount taken into account under section 955(b)(4) with respect to any property which constitutes a qualified investment in foreign base company shipping operations shall be its adjusted basis as of the applicable determination date, reduced by the outstanding principal amount of any liability (other than a liability described in subparagraph (2) of this paragraph) to which such property is subject on such date including a liability secured only by the general credit of the controlled foreign corporation. Liabilities shall be taken into account in the following order:

(i) The adjusted basis of each and every item of corporate property shall be reduced by any specific charge (nonrecourse or otherwise) to which such item is subject. For this purpose, if a liability constitutes a specific charge against several items of property and cannot definitely be allocated to any single item of property, the specific charge shall be apportioned against each of such items of property in that ratio which the adjusted basis of such item on the applicable determination date bears to the adjusted basis of all such items on such date. The excess against property over the adjusted basis of such property shall be taken into account as a liability secured only by the general credit of the corporation.

(ii) A liability which is evidenced by an open account or which is secured only by the general credit of the controlled foreign corporation shall be apportioned against each and every item of corporate property in that ratio which the adjusted basis of such item on the applicable determination date (reduced as provided in subdivision (i) of this subparagraph) bears to the adjusted basis of all the corporate property on such date (reduced as provided in subdivision (i) of this subparagraph); provided that no liability shall be apportioned under this subdivision against any stock or obligations described in paragraph (h)(1) of this section.

(2) *Excluded charges.* For purposes of subparagraph (1) of this paragraph, a liability created principally for the purpose of artificially increasing or decreasing the amount of a controlled foreign corporation's qualified investments in foreign base company shipping operations will not be recognized. Whether a liability is created principally for such purpose will depend upon all the facts and circumstances of each case. One of the factors that will

be considered in making such a determination with respect to a loan is whether the loan was both created after November 20, 1974, and is from a related person, as defined in section 954(d)(3) and paragraph (e) of §1.954–1. Another such factor is whether the liability was created after March 29, 1975, in a taxable year beginning before January 1, 1976. For purposes of this paragraph (g)(2), payments on liabilities which are represented by an open account are credited against the account transactions arising earliest in time.

(3) *Statement required.* If for purposes of this section the adjusted basis of property which constitutes a qualified investment in foreign base company shipping operations by a controlled foreign corporation is reduced on the ground that such property is subject to a liability, each United States shareholder shall attach to his return a statement setting forth the adjusted basis of the property before the reduction and the amount and nature of the reduction.

(4) *Partnership interest.* If a controlled foreign corporation is a partner in a partnership, its investment in the partnership taken into account under section 955(b)(4) shall be its adjusted basis in the partnership determined under section 722 or 742, adjusted as provided in section 705, and reduced as provided in subparagraph (1) of this paragraph. (However, if the partnership is not engaged solely in the conduct of foreign base company shipping operations, such amount shall be taken into account only to the extent provided in paragraph (d)(1) of this section).

(5) *Grantor trust.* If a controlled foreign corporation is deemed to own a portion of the assets of a trust under paragraph (e)(2) of this section then the amount taken into account under section 955 (b)(4) with respect to such assets shall be determined as provided in subparagraph (1) of this paragraph by the application of the following rules:

(i) Such controlled foreign corporation's adjusted basis in such assets shall be deemed to be a proportionate share of the trust's adjusted basis in such assets, and

(ii) A proportionate share of the liabilities of the trust shall be deemed to be liabilities of such controlled foreign corporation and to constitute specific charges against such assets.

(6) *Translation into United States dollars.* The amounts determined in accordance with this paragraph shall be translated into United States dollars in accordance with the principles of §1.964–1(e)(4).

(h) *Investments in shipping companies under prior law*—(1) *In general.* If an amount invested in stock or obligations of a less developed country shipping company described in §1.955–5(b) is treated as a qualified investment in less developed countries under §1.955–2 (applied without regard to paragraph (b)(5)(ii) thereof) on the applicable determination date for purposes of section 954(g) or section 955(a)(2) with respect to a taxable year beginning after December 31, 1975, then such amount shall be treated as a qualified investment in foreign base company shipping operations on such determination date. See section 955(b)(5).

(2) *Effect on prior law.* See §1.955–2(b)(5)(ii) for the rule that investments which are treated as qualified investments in foreign base company shipping operations under subparagraph (1) of this paragraph shall not be treated as qualified investments in less developed countries for purposes of section 951(a)(1)(A)(ii).

(3) *Illustration.* The application of this paragraph may be illustrated by the following example:

Example. (a) Throughout the period here involved, controlled foreign corporation X owns 100 percent of the single class of stock of controlled foreign corporation Y, X and Y each use the calendar years as the taxable year. At the close of 1975, X's $50,000 investment in the stock of Y is treated as a qualified investment in less developed countries under §1.955–2 (applied without regard to §1.955–2(b)(5)(ii), and Y is a less developed country shipping company described in §1.955–5(b).

(b) On December 31, 1976, Y is still a less developed country shipping company and X's $50,000 investment in the stock of Y is still treated as a qualified investment in less developed countries under §1.955–2 (applied without regard to §1.955–2(b)(5)(ii). Under subparagraph (1) of this paragraph X's entire $50,000 investment in the stock of Y is treated as a qualified investment in foreign base company shipping operations.

(c) For 1977, Y's gross income is $10,000 and Y's foreign base company shipping income is $7,500. Since Y fails to meet the 80-percent income test of §1.955–5(b)(1), Y is no longer a less developed country shipping company described in §1–955–5(b), and X's investment in the stock of Y is no longer treated as a qualified investment in less developed countries under §1.955–2 (applied without regard to §1.955–2(b)(5)(ii). However, assume that on December 31, 1977, Y's net worth (as defined in paragraph (c)(2)(1) of this section) is $100,000, that Y's qualified investments in foreign base company shipping operations (determined under this section) on December 31, 1977, are $75,000, and that X's investment in the stock of Y (as determined under paragraph (g) of this section) continues to be $50,000. Then $67,500, i.e.,

$$\frac{\$75,000}{\$100,000} \times \$50,000$$

of X's $50.000 investment in the stock of Y is treated as a qualified investment in foreign company shipping operations under paragraph (c) of this section.

(d) For 1978, all of Y's gross income is foreign base company shipping income. Although Y is again a less developed country shipping company described in §1.955–5(b), X's investment in the stock of Y is no longer treated as a qualified investment in less developed countries under §1.955–2(b)(5)(iii). Thus, X's investment in the stock of Y is not treated as a qualified investment in foreign base company shipping operations under subparagraph (1) of this paragraph. However, X's investment in the stock of Y may be so treated under another provision of this section, as was the case in item (c) of this example.

(Secs. 955 (b)(2) and 7805 of the Internal Revenue Code of 1954 (89 Stat. 63; 26 U.S.C. 955(b)(2), and 68A Stat. 917; 26 U.S.C. 7805))

[T.D. 7894, 48 FR 22532, May 19, 1983; 48 FR 40888, Sept. 12, 1983, as amended by T.D. 7959, 49 FR 22280, May 29, 1984]

§ 1.955A–3 Election as to qualified investments by related persons.

(a) *In general.* If a United States shareholder elects the benefits of section 955(b) 2 with respect to a related group (as defined in paragraph (b)(1) of this section) of controlled foreign corporations, then an investment in foreign base company shipping operation made by one member of such group will be treated as having been made by another member to the extent provided in paragraph (c)(4) of this section, and each member will be subject to the other provisions of paragraph (c) of this section. An election once made shall apply for the taxable year for which it is made and for all subsequent years unless the election is revoked or a new election is made to add one or more controlled foreign corporations to election coverage. For the manner of making an election under section 955(b)(2), and for rules relating to the revocation of such an election, see paragraph (d) of this section. For rules relating to the coordination of sections 955(b)(2) and 955(b)(3), see paragraph (e) of this section.

(b) *Related group*—(1) *Related group defined.* The term ''related group'' means two or more controlled foreign corporations, but only if all of the following requirements are met:

(i) All such corporations use the same taxable year.

(ii) The same United States shareholder controls each such corporation within the meaning of section 954(d)(3) at the end of such taxable year, and

(iii) Such United States shareholder elects to treat such corporations as a related group.

(iv) If any of the corporations is on a 52–53 week taxable year and if all of the taxable years of the corporations end within the same 7-day period, the rule of paragraph (b)(1)(i) of this section shall be deemed satisfied.

(v) An election under paragraph (b)(1)(iii) of this section will not be valid in the case of an election by a U.S. shareholder (the ''first U.S. shareholder'') if—

(A) The first U.S. shareholder controls a second U.S. shareholder,

(B) The second U.S. shareholder controls one or more controlled foreign corporations, and

(C) Any of the controlled foreign corporations are the subject of the election by the first U.S. shareholder, unless the second U.S. shareholder consents to the election by the first U.S. shareholder.

(2) *Group taxable years defined.* The ''group taxable year'' is the common taxable year of a related group.

(3) *Limitation.* If a United States shareholder elects to treat two or more corporations as a related group for a group taxable year (the ''first group taxable year''), then such United