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for the arrangement was not the avoidance of section 956. The following example illustrates the application of this paragraph (c):

Example. (i) *Facts.* P, a domestic corporation, owns all of the outstanding stock of FS1, a controlled foreign corporation with substantial accumulated earnings and profits. P sells inventory property to X, a domestic corporation unrelated to P. To pay for the inventory property, X arranges for a foreign financing entity to issue a note to P. P then sells the note to FS1. P and X cannot demonstrate that the primary purpose for X's assignment of the payment obligation to the foreign financing entity was not the avoidance of section 956.

(ii) *Result.* The substitution of the foreign financing entity for X is disregarded, and FS1 is treated as holding an obligation of a United States person acquired from a related United States person. Thus, FS1 is treated as holding United States property in the amount of the purchase price of the note.

(d) *Effective/applicability date.* (1) Except as provided in paragraph (d)(2) of this section, this section applies to trade or service receivables acquired (directly or indirectly) after March 1, 1984.

(2) Paragraph (b)(2)(ii) of this section applies to taxable years of controlled foreign corporations ending on or after November 3, 2016, and taxable years of United States shareholders in which or with which such taxable years end, with respect to trade or service receivables acquired on or after September 1, 2015. For purposes of this paragraph (d), a significant modification, within the meaning of §1.1001–3(e), of a trade or service receivable on or after September 1, 2015, constitutes an acquisition of the trade or service receivable on or after that date.

[T.D. 9792, 81 FR 76508, Nov. 3, 2016]

§ 1.956–4 Certain rules applicable to partnerships.

(a) *Overview.* This section provides rules concerning the application of section 956 to certain obligations of and property held by a partnership. Paragraph (b) of this section provides rules concerning United States property held indirectly by a controlled foreign corporation through a partnership. Paragraph (c) of this section provides rules that generally treat obligations of a foreign partnership as obligations of the partners in the foreign partnership, as well as a special rule that treats a partner that is a United States person as owing additional amounts of a partnership obligation in certain circumstances. Paragraph (d) of this section sets forth a rule concerning the application of the indirect pledge or guarantee rule to obligations of partnerships. Paragraph (e) of this section provides that obligations of a domestic partnership are obligations of a United States person. Paragraph (f) of this section provides effective and applicability dates. See §§1.956–1(b) and 1.956–2(c) for additional rules applicable to partnerships.

(b) *Property held indirectly through a partnership*—(1) *General rule.* For purposes of section 956, a partner in a partnership is treated as holding its attributable share of any property held by the partnership (including an obligation that the partnership is treated as holding as a result of the application of §1.956–2(c)). A partner's attributable share of partnership property is determined under the rules set forth in paragraph (b)(2) of this section. An upper-tier partnership's attributable share of the property of a lower-tier partnership is treated as property of the upper-tier partnership for purposes of applying this paragraph (b)(1) to the partners of the upper-tier partnership. For purposes of section 956, a partner's adjusted basis in the property of the partnership equals the partner's attributable share of the partnership's adjusted basis in the property, as determined under the rules set forth in paragraph (b)(2) of this section, taking into account any adjustments to basis under section 743(b) (with respect to the partner) or section 734(b) or any similar adjustments to basis. The rules in §1.956–1(e)(2) apply to determine the amount of an obligation treated as held by a partnership as a result of the application of §1.956–2(c). See §1.956–1(b) for special rules that may treat a controlled foreign corporation as holding a greater amount of United States property held by a partnership than the amount determined under this section.

(2) *Methodology*—(i) *Liquidation value percentage*—(A) *Calculation.* Except as otherwise provided in paragraph (b)(2)(ii) of this section, for purposes of

paragraph (b)(1) of this section, a partner's attributable share of partnership property is determined in accordance with the partner's liquidation value percentage. For purposes of this paragraph (b)(2)(i) and paragraph (c)(1) of this section, the liquidation value of a partner's interest in a partnership is the amount of cash the partner would receive with respect to the interest if, on the applicable determination date, as provided in paragraph (b)(2)(i)(B) of this section, the partnership sold all of its assets for cash equal to the fair market value of such assets (taking into account section 7701(g)), satisfied all of its liabilities (other than those described in §1.752–7), paid an unrelated third party to assume all of its §1.752–7 liabilities in a fully taxable transaction, and then liquidated. A partner's liquidation value percentage is the ratio (expressed as a percentage) of the liquidation value of the partner's interest in the partnership divided by the aggregate liquidation value of all of the partners' interests in the partnership.

(B) *Determination date.* The *determination date* with respect to a partnership is the most recent of—

(*1*) The formation of the partnership;

(*2*) An event described in §1.704–1(b)(2)(iv)(*f*)(*5*) or §1.704–1(b)(2)(iv)(*s*)(*1*) (a *revaluation event*), irrespective of whether the capital accounts of the partners are adjusted in accordance with §1.704–1(b)(2)(iv)(*f*); or

(*3*) The first day of the partnership's taxable year, as determined under section 706, provided the liquidation value percentage determined for any partner on that day would differ from the most recently determined liquidation value percentage of that partner by more than 10 percentage points.

(ii) *Special allocations.* For purposes of paragraph (b)(1) of this section, if a partnership agreement provides for the allocation of book income (or, where appropriate, book gain) from a subset of the property of the partnership to a partner other than in accordance with the partner's liquidation value percentage in a particular taxable year (a *special allocation*), then the partner's attributable share of that property is determined solely by reference to the partner's special allocation with respect to the property, provided the special allocation will be respected for federal income tax purposes under section 704(b) and the regulations thereunder and does not have a principal purpose of avoiding the purposes of section 956.

(3) *Examples.* The following examples illustrate the rules of this paragraph (b):

Example 1. (i) *Facts.* USP, a domestic corporation, wholly owns FS, a controlled foreign corporation, which, in turn, owns an interest in FPRS, a foreign partnership. The remaining interest in FPRS is owned by an unrelated foreign person. FPRS holds nondepreciable property with an adjusted basis of $100x (the ''FPRS property'') that would be United States property if held by FS directly. At the close of quarter 1 of year 1, the liquidation value percentage, as determined under paragraph (b)(2) of this section, for FS with respect to FPRS is 25%. There are no special allocations in the FPRS partnership agreement.

(ii) *Result.* Under paragraph (b)(1) of this section, for purposes of section 956, FS is treated as holding its attributable share of the property held by FPRS with an adjusted basis equal to its attributable share of FPRS's adjusted basis in such property. Under paragraph (b)(2) of this section, FS's attributable share of property held by FPRS is determined in accordance with FS's liquidation value percentage, which is 25%. Thus, FS's attributable share of the FPRS property is 25%, and its attributable share of FPRS's basis in the FPRS property is $25x. Accordingly, for purposes of determining the amount of United States property held by FS as of the close of quarter 1 of year 1, FS is treated as holding United States property with an adjusted basis of $25x.

Example 2. (i) *Facts.* The facts are the same as in *Example 1* of this paragraph (b)(3), except that the FPRS partnership agreement, which satisfies the requirements of section 704(b), specially allocates 80% of the income with respect to the FPRS property to FS. The special allocation does not have a principal purpose of avoiding the purposes of section 956.

(ii) *Result.* Under paragraph (b)(1) of this section, for purposes of section 956, FS is treated as holding its attributable share of property held by FPRS with an adjusted basis equal to its attributable share of FPRS's adjusted basis in such property. In general, FS's attributable share of property held by FPRS is determined in accordance with FS's liquidation value percentage. However, because the special allocation does not have a principal purpose of avoiding the purposes of section 956, under paragraph (b)(2)(ii) of this section, FS's attributable share of the FPRS property is determined by

reference to its special allocation. FS's special allocation percentage for the FPRS property is 80%, and thus FS's attributable share of the FPRS property is 80% and its attributable share of FPRS's basis in the FPRS property is $80x. Accordingly, for purposes of determining the amount of United States property held by FS as of the close of quarter 1 of year 1, FS is treated as holding United States property with an adjusted basis of $80x.

Example 3. (i) *Facts.* USP, a domestic corporation, wholly owns FS, a controlled foreign corporation, which, in turn, owns an interest in FPRS, a foreign partnership. USP owns the remaining interest in FPRS. FPRS holds property (the ''FPRS property'') that would be United States property if held by FS directly. The FPRS property has an adjusted basis of $100x and is anticipated to appreciate in value but generate relatively little income. The FPRS partnership agreement, which satisfies the requirements of section 704(b), specially allocates 80% of the income with respect to the FPRS property to USP and 80% of the gain with respect to the disposition of FPRS property to FS. The special allocation does not have a principal purpose of avoiding the purposes of section 956.

(ii) *Result.* Because the special allocation does not have a principal purpose of avoiding the purposes of section 956, under paragraph (b)(2)(ii) of this section, FS's attributable share of the FPRS property is determined by reference to a special allocation with respect to the FPRS property. Given the income and gain anticipated with respect to the FPRS property, it is appropriate to determine FS's attributable share of the property in accordance with the special allocation of gain. Accordingly, for purposes of determining the amount of United States property held by FS in each year that FPRS holds the FPRS property, FS's attributable share of the FPRS property is 80% and its attributable share of FPRS's basis in the FPRS property is $80x. Thus, FS is treated as holding United States property with an adjusted basis of $80x.

(c) *Obligations of a foreign partnership*—(1) *In general.* Except as provided in paragraphs (c)(2) and (c)(3) of this section, for purposes of section 956, an obligation of a foreign partnership is treated as a separate obligation of each of the partners in the partnership to the extent of each partner's share of the obligation. A partner's share of the partnership's obligation is determined in accordance with the partner's liquidation value percentage, as determined under the rules set forth in paragraph (b)(2)(i) of this section, without regard to the rules set forth in paragraph (b)(2)(ii) of this section. An upper-tier partnership's share of an obligation of a lower-tier partnership is treated as an obligation of the upper-tier partnership for purposes of applying this paragraph (c)(1) to the partners of the upper-tier partnership.

(2) *Exception for obligations of partnerships in which neither the lending controlled foreign corporation nor any person related to the lending controlled foreign corporation is a partner.* For purposes of applying section 956 with respect to a controlled foreign corporation, an obligation of a foreign partnership is treated as an obligation of a foreign partnership, and not as an obligation of its partners, if neither the controlled foreign corporation nor any person related to the controlled foreign corporation within the meaning of section 954(d)(3) is a partner in the partnership. For purposes of section 956, an obligation treated as an obligation of a foreign partnership pursuant to this paragraph (c)(2) is not an obligation of a United States person.

(3) *Special obligor rule in the case of certain partnership distributions*—(i) *General rule.* For purposes of determining a partner's share of a foreign partnership's obligation under section 956, if the foreign partnership distributes an amount of money or property to a partner that is related to a controlled foreign corporation within the meaning of section 954(d)(3) and whose obligation would be United States property if held (or if treated as held) by the controlled foreign corporation, and the foreign partnership would not have made the distribution but for a funding of the partnership through an obligation held (or treated as held) by the controlled foreign corporation, notwithstanding §1.956–1(e), the partner's share of the partnership obligation is the greater of—

(A) The partner's share of the partnership obligation as determined under paragraph (c)(1) of this section; and

(B) The lesser of the amount of the distribution to the partner that would not have been made but for the funding of the partnership and the amount of the obligation (as determined under §1.956–1(e)).

(ii) *Deemed treatment.* (A) For purposes of applying paragraph (c)(3)(i) of

this section, in the case of a distribution of liquid assets by a foreign partnership to a partner, the foreign partnership is treated as if it would not have made the distribution of liquid assets to the partner but for the funding of the partnership through an obligation or obligations held (or treated as held) by the controlled foreign corporation to the extent the foreign partnership does not have sufficient liquid assets to make the distribution immediately prior to the distribution, without taking into account the obligation or obligations.

(B) If the controlled foreign corporation holds (or is treated as holding) multiple obligations of the foreign partnership, paragraph (c)(3)(ii)(A) of this section applies to the obligations in reverse chronological order starting with the obligation that was acquired (or the obligation with respect to which a pledge or guarantee was entered into) closest in time to the distribution. Paragraph (c)(3)(ii)(A) of this section applies to an obligation only to the extent that the full amount of the distribution is not otherwise treated, pursuant to paragraph (c)(3)(ii)(A) of this section, as if it would not have been made but for the funding of the partnership through one or more other obligations.

(C) For purposes of paragraph (c)(3)(ii) of this section, a significant modification, within the meaning of §1.1001–3(e), of an obligation constitutes an acquisition of the obligation on or after that date, and a pledgor or guarantor is treated as entering into a pledge or guarantee when there is a significant modification, within the meaning of §1.1001–3(e), of an obligation with respect to which it is a pledgor or guarantor.

(D) For purposes of paragraph (c)(3)(ii) of this section, liquid assets means cash or cash equivalents, marketable securities within the meaning of section 453(f)(2), or an obligation owed by a related person (within the meaning of section 954(d)(3)).

(4) *Examples.* The following examples illustrate the rules of this paragraph (c):

Example 1. (i) *Facts.* USP, a domestic corporation, wholly owns FS, a controlled foreign corporation, and owns an interest in FPRS, a foreign partnership. At the close of quarter 1 of year 1, the liquidation value percentage, as determined under paragraph (b)(2)(i) of this section, for USP with respect to FPRS is 90%. X, a foreign person that is unrelated to USP or FS, owns the remaining interest in FPRS. FPRS borrows $100x from FS. FS's basis in the FPRS obligation is $100x.

(ii) *Result.* Under paragraph (c)(1) of this section, for purposes of section 956, the obligation of FPRS is treated as obligations of its partners (USP and X) in proportion to each partner's liquidation value percentage with respect to FPRS. Because USP, a partner in FPRS, is related to FS within the meaning of section 954(d)(3), the exception in paragraph (c)(2) of this section does not apply. Based on its liquidation value percentage, USP's share of the FPRS obligation is $90x. Accordingly, for purposes of section 956, $90x of the FPRS obligation held by FS is treated as an obligation of USP and is United States property within the meaning of section 956(c). Therefore, on the date the loan is made, FS is treated as holding United States property of $90x.

Example 2. (i) *Facts.* The facts are the same as in *Example 1* of this paragraph (c)(4), except that USP owns 40% of the stock of FS and is not a related person (as defined in section 954(d)(3)) with respect to FS. Y, a United States person that is unrelated to USP or X, owns the remaining 60% of the stock of FS.

(ii) *Result.* Because neither FS nor any person related to FS within the meaning of section 954(d)(3) is a partner in FPRS, the exception in paragraph (c)(2) of this section applies to treat the FPRS obligation as an obligation of a foreign partnership and not an obligation of a United States person. Therefore, paragraph (c)(1) of this section does not apply, and FS is not treated as holding United States property.

Example 3. (i) *Facts.* USP, a domestic corporation, wholly owns FS, a controlled foreign corporation. USP and FS own interests in FPRS, a foreign partnership. USP's liquidation value percentage with respect to FPRS is 60%, and FS's liquidation value percentage with respect to FPRS is 30%. USP2, a domestic corporation that is unrelated to USP and FS, also owns an interest in FPRS; its liquidation value percentage is 10%. FPRS borrows $100x from an unrelated person. FS guarantees the FPRS obligation.

(ii) *Result.* Under paragraph (c)(1) of this section, for purposes of section 956, the obligation of FPRS is treated as obligations of its partners (USP, FS, and USP2) in proportion to each partner's liquidation value percentage. Because USP, a partner in FPRS, is related to FS within the meaning of section 954(d)(3), and because FS is a partner in FPRS, the exception in paragraph (c)(2) of this section does not apply. Based on their liquidation value percentages, USP's share of

the FPRS obligation is $60x, and USP2's share of the FPRS obligation is $10x. For purposes of section 956, $60x of the FPRS obligation is treated as an obligation of USP, and $10x of the FPRS obligation is treated as an obligation of USP2. Under §1.956–2(c)(1), FS is treated as holding the obligations of USP and USP2 that FS guaranteed. All of the exceptions to the definition of United States property contained in section 956 and §1.956–2 must be considered to determine whether the obligations of USP and USP2 that are treated as held by FS constitute United States property. Accordingly, the obligation of USP2 is not United States property under section 956(c)(2)(F) and §1.956–2(b)(1)(viii). The obligation of USP, however, is United States property within the meaning of section 956(c). Therefore, on the date the guarantee is made, FS is treated as holding United States property of $60x.

Example 4. (i) *Facts.* USP, a domestic corporation, wholly owns FS, a controlled foreign corporation. USP owns an interest in FPRS, a foreign partnership; its liquidation value percentage with respect to FPRS is 70%. A domestic corporation that is unrelated to USP and FS owns the remaining interest in FPRS; its liquidation value percentage is 30%. FPRS borrows $100x from FS and makes a distribution of $80x to USP. FPRS would not have made the distribution to USP but for the funding of FPRS by FS.

(ii) *Result.* Because USP, a partner in FPRS, is related to FS within the meaning of section 954(d)(3), the exception in paragraph (c)(2) of this section does not apply. Moreover, an obligation of USP held by FS would be United States property. USP's share of the FPRS obligation as determined under paragraph (c)(1) of this section in accordance with USP's liquidation value percentage is $70x. Under paragraph (c)(3) of this section, USP's share of the FPRS obligation is the greater of (i) USP's attributable share of the obligation, $70x, or (ii) the lesser of the amount of the distribution, $80x, or the amount of the obligation, $100x. For purposes of section 956, therefore, $80x of the FPRS obligation is treated as an obligation of USP and is United States property within the meaning of section 956(c). Thus, on the date the loan is made, FS is treated as holding United States property of $80x.

(d) *Limitation on a partner's indirect pledge or guarantee.* For purposes of section 956 and §1.956–2(c), a controlled foreign corporation that is a partner in a partnership is not considered a pledgor or guarantor of the portion of an obligation of the partnership attributed to its partners that are United States persons under paragraph (c) of this section solely as a result of the attribution of a portion of the partnership's assets to the controlled foreign corporation under paragraph (b) of this section.

(e) *Obligations of a domestic partnership.* For purposes of section 956, an obligation of a domestic partnership is an obligation of a United States person. See section 956(c)(2)(L) for an exception from the treatment of such an obligation as United States property.

(f) *Effective/applicability dates.* (1) Paragraph (b) of this section applies to taxable years of controlled foreign corporations ending on or after November 3, 2016, and taxable years of United States shareholders in which or with which such taxable years end, with respect to property acquired on or after November 3, 2016. For purposes of this paragraph (f)(1), a deemed exchange of property pursuant to section 1001 on or after November 3, 2016, constitutes an acquisition of the property on or after that date. See §1.956–2(a)(3), as contained in 26 CFR part 1 revised as of April 1, 2016, for the rules applicable to taxable years of a controlled foreign corporation beginning on or after July 23, 2002, and ending before November 3, 2016, and with respect to property acquired before November 3, 2016, to taxable years of a controlled foreign corporation beginning on or after July 23, 2002.

(2) Except as otherwise provided in this paragraph (f)(2), paragraph (c) of this section applies to taxable years of controlled foreign corporations ending on or after November 3, 2016, and taxable years of United States shareholders in which or with which such taxable years end, with respect to obligations acquired, or pledges or guarantees entered into, on or after September 1, 2015, and, for purposes of paragraph (c)(3) of this section, in the case of distributions made on or after September 1, 2015. Paragraph (c)(3)(ii) of this section applies to taxable years of controlled foreign corporations ending on or after November 3, 2016, and taxable years of United States shareholders in which or with which such taxable years end, with respect to obligations acquired, or pledges or guarantees entered into, on or after September 1, 2015, and distributions made

on or after November 3, 2016. For purposes of this paragraph (f)(2), a significant modification, within the meaning of §1.1001–3(e), of an obligation on or after September 1, 2015 constitutes an acquisition of the obligation on or after that date. Furthermore, for purposes of this paragraph (f)(2), a pledgor or guarantor is treated as entering into a pledge or guarantee when there is a significant modification, within the meaning of §1.1001–3(e), of an obligation with respect to which it is a pledgor or guarantor on or after September 1, 2015. See §1.956–1T(b)(5), as contained in 26 CFR part 1 revised as of April 1, 2016, for rules applicable to taxable years of controlled foreign corporations ending on or after September 1, 2015, and before November 3, 2016, and to taxable years of United States shareholders in which or with which such taxable years end, in the case of distributions made on or after September 1, 2015.

(3) Paragraph (d) of this section applies to taxable years of controlled foreign corporations ending on or after November 3, 2016, and taxable years of United States shareholders in which or with which such taxable years end, with respect to pledges or guarantees entered into on or after September 1, 2015. For purposes of this paragraph (f)(3), a pledgor or guarantor is treated as entering into a pledge or guarantee when there is a significant modification, within the meaning of §1.1001–3(e), of an obligation with respect to which it is a pledgor or guarantor on or after September 1, 2015.

(4) Paragraph (e) of this section applies to taxable years of controlled foreign corporations ending on or after November 3, 2016, and to taxable years of United States shareholders in which or with which such taxable years end, with respect to obligations held on or after November 3, 2016.

[T.D. 9792, 81 FR 76509, Nov. 3, 2016; 81 FR 95471, Dec. 28, 2016]

§ 1.957–1 Definition of controlled foreign corporation.

(a) *In general.* The term *controlled foreign corporation* means any foreign corporation of which more than 50 percent (or such lesser amount as is provided in section 957(b) or section 953(c)) of either—

(1) The total combined voting power of all classes of stock of the corporation entitled to vote; or

(2) The total value of the stock of the corporation, is owned within the meaning of section 958(a), or (except for purposes of section 953(c)) is considered as owned by applying the rules of section 958(b) and §1.958–2, by United States shareholders on any day during the taxable year of such foreign corporation. For the definition of the term *United States shareholder*, see sections 951(b) and 953(c)(1)(A). For the definition of the term *foreign corporation*, see §301.7701–5 of this chapter (Procedure and Administration Regulations). For the treatment of associations as corporations, see section 7701(a)(3) and §§301.7701–1 and 301.7701–2 of this chapter. For the definition of the term *stock*, see sections 958(a)(3) and 7701(a)(7). For the classification of a member in an association, joint stock company or insurance company as a shareholder, see section 7701(a)(8).

(b) *Percentage of total combined voting power owned by United States shareholders*—(1) *Meaning of combined voting power.* In determining for purposes of paragraph (a) of this section whether United States shareholders own the requisite percentage of total combined voting power of all classes of stock entitled to vote, consideration will be given to all the facts and circumstances of each case. In all cases, however, United States shareholders of a foreign corporation will be deemed to own the requisite percentage of total combined voting power with respect to such corporation—

(i) If they have the power to elect, appoint, or replace a majority of that body of persons exercising, with respect to such corporation, the powers ordinarily exercised by the board of directors of a domestic corporation;

(ii) If any person or persons elected or designated by such shareholders have the power, where such shareholders have the power to elect exactly one-half of the members of such governing body of such foreign corporation, either to cast a vote deciding an evenly divided vote of such body or, for the duration of any deadlock which