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this section, the 25 percent of the stock in S Corporation owned by D is considered as being owned by partnership X; since such stock is treated as actually owned by partnership X under paragraph (f)(1)(i) of this section, such stock is in turn considered as being owned by T Corporation under paragraph (d)(1)(iii) of this section. Thus, under paragraphs (d)(1) and (f)(1)(i) of this section, T Corporation is considered as owning 25 percent of the stock in S Corporation.

Example 4. Foreign corporation U owns 100 percent of the one class of stock in domestic corporation V and also 100 percent of the one class of stock in foreign corporation W. By virtue of paragraph (d)(2) of this section, V Corporation may not be considered under paragraph (d)(1) of this section as owning the stock owned by its sole shareholder, U Corporation, in W Corporation.

Example 5. United States citizen E owns 15 percent of the one class of stock in foreign corporation Y, and United States citizen F, E's spouse, owns 5 percent of such stock. E and F's four nonresident alien grandchildren each own 20 percent of the stock in Y Corporation. Under paragraph (b)(1) of this section, E is considered as owning the stock owned by F in Y Corporation; however, by virtue of paragraph (b)(3) of this section, E may not be considered under paragraph (b)(1) of this section as owning any of the stock in Y Corporation owned by such grandchildren.

Example 6. United States person F owns 10 percent of the one class of stock in foreign corporation Z; corporation Z owns 10 percent of the one class of stock in foreign corporation K; and corporation K owns 100 percent of the one class of stock in foreign corporation L. United States person G, F's spouse, owns 9 percent of the stock in K Corporation. Under paragraph (c)(1)(iii) of this section or paragraph (a)(2) of §1.958–1, F is considered as owning 1 percent (10 percent of 10 percent of 100 percent) of the stock in L Corporation by reason of his ownership of stock in Z Corporation, and, under paragraph (b)(1) of this section, G is considered as owning such 1 percent of the stock in L Corporation. Under paragraph (a)(2) of §1.958–1, G is considered as owning 9 percent (9 percent of 100 percent) of the stock in L Corporation by reason of her ownership of stock in K Corporation, and, under paragraph (b)(1) of this section, F is considered as owning such 9 percent of the stock in L Corporation. Thus, for the purpose of determining whether F or G is a United States shareholder with respect to L Corporation, each of F and G is considered as owning a total of 10 percent of the stock in L Corporation by applying the rules of paragraph (a)(2) of §1.958–1 and paragraphs (b)(1) and (c)(1)(iii) of this section.

(Secs. 956(c), 7805, Internal Revenue Code of 1954 (76 Stat. 1017, 68A Stat. 917; (26 U.S.C. 956(c) and 7805 respectively)))

[T.D. 6889, 31 FR 9455, July 12, 1966, as amended by T.D. 7712, 45 FR 52375, Aug. 7, 1980; T.D. 8955, 66 FR 37897, July 20, 2001]

§ 1.959–1 Exclusion from gross income of United States persons of previously taxed earnings and profits.

(a) *In general.* Sections 951 through 964 provide that certain types of income of controlled foreign corporations will be subject to United States income tax even though such amounts are not currently distributed to the United States shareholders of such corporations. The amounts so taxed to certain United States shareholders are described as subpart F income, previously excluded subpart F income withdrawn from investment in less developed countries, previously excluded subpart F income withdrawn from investment in foreign base company shipping operations, and increases in earnings invested in United States property. Section 959 provides that amounts taxed as subpart F income, as previously excluded subpart F income withdrawn from investment in less developed countries, or as previously excluded subpart F income withdrawn from investment in foreign base company shipping operations are not taxed again as increases in earnings invested in United States property. Section 959 also provides an exclusion whereby none of the amounts so taxed are taxed again when actually distributed directly, or indirectly through a chain of ownership described in section 958(a), to United States shareholders or to such shareholders' successors in interest. The exclusion also applies to amounts taxed to United States shareholders as income of one controlled foreign corporation and later distributed to another controlled foreign corporation in such a chain of ownership where such amounts would otherwise be again included in the income of such shareholders or their successors in interest as subpart F income of the controlled foreign corporation to which they are distributed. Section 959 also provides rules for the allocation of distributions

to earnings and profits and for the nondividend treatment of actual distributions which are excluded from gross income.

(b) *Actual distributions to United States persons.* The earnings and profits for a taxable year of a foreign corporation attributable to amounts which are, or have been, included in the gross income of a United States shareholder of such corporation under section 951(a) shall not, when such amounts are distributed to such shareholder directly, or indirectly through a chain of ownership described in section 958(a), be again included in the gross income of such United States shareholder. See section 959(a)(1). Thus, earnings and profits attributable to amounts which are, or have been, included in the gross income of a United States shareholder of a foreign corporation under section 951 (a)(1)(A)(i) as subpart F income, under section 951(a)(1)(A)(ii) as previously excluded subpart F income withdrawn from investment in less developed countries, under section 951(a)(1)(A)(iii) as previously excluded subpart F income withdrawn from investment in foreign base company shipping operations, or under section 951(a)(1)(B) as earnings invested in United States property, shall not be again included in the gross income of such shareholder when such amounts are actually distributed, directly or indirectly, to such shareholder. See paragraph (d) of this section for exclusion applicable to such shareholder's successor in interest. The application of this paragraph may be illustrated by the following example:

Example. (a) A, a United States shareholder, owns 100 percent of the only class of stock of R Corporation, a corporation organized on January 1, 1963, which is a controlled foreign corporation throughout the period here involved. Both A and R Corporation use the calendar year as a taxable year.

(b) During 1964, R Corporation derives $100 of subpart F income, and A includes such amount in his gross income under section 951(a)(1)(A)(i). Corporation R's current and accumulated earnings and profits (before taking into account distributions made during 1964) are $150. Also, during 1964, R Corporation distributes $50 to A. The $50 distribution is excludable from A's gross income for 1964 under this paragraph and §1.959–3 because such distribution represents earnings and profits attributable to amounts which are included in A's gross income for such year under section 951(a).

(c) If instead of deriving the $100 of subpart F income in 1964, R Corporation derives such amount during 1963 and has earnings and profits for 1963 in excess of $100, A must include $100 in his gross income for 1963 under section 951(a)(1)(A)(i). However, the $50 distribution made by R Corporation to A during 1964 is excludable from A's gross income for such year under this paragraph and §1.959–3 because such distribution represents earnings and profits attributable to amounts which have been included in A's gross income for 1963 under section 951(a).

(d) If, with respect to 1964—

(1) Instead of owning the stock of R Corporation directly, A owns such stock through a chain of ownership described in section 958(a), that is, A owns 100 percent of M Corporation which owns 100 percent of N Corporation which owns 100 percent of R Corporation,

(2) Both M and N Corporations use the calendar year as a taxable year and are controlled foreign corporations throughout the period here involved,

(3) Corporation R derives $100 of subpart F income and has earnings and profits in excess of $100,

(4) Neither M Corporation nor N Corporation has earnings and profits or a deficit in earnings and profits, and

(5) The $50 distribution is from R Corporation to N Corporation to M Corporation to A,

A must include $100 in his gross income for 1964 under section 951(a)(1)(A)(i) by reason of his indirect ownership of R Corporation. However, the $50 distribution is excludable from A's gross income for 1964 under this paragraph and §1.959–3 because such distribution represents earnings and profits attributable to amounts which are included in A's gross income for such year under section 951(a) and are distributed indirectly to A through a chain of ownership described in section 958(a).

(c) *Excludable investment of earnings in United States property.* The earnings and profits for a taxable year of a foreign corporation attributable to amounts which are, or have been, included in the gross income of a United States shareholder of such corporation under section 951(a)(1)(A) shall not, when such amounts would, but for section 959(a)(2) and this paragraph, be included under section 951(a)(1)(B) in the gross income of such shareholder directly, or indirectly through a chain of ownership described in section 958(a), be again included in the gross income of such United States shareholder. Thus, earnings and profits attributable

to amounts which are, or have been, included in the gross income of a United States shareholder of a foreign corporation under section 951(a)(1)(A)(i) as subpart F income, under section 951(a)(1)(A)(ii) as previously excluded subpart F income withdrawn from investment in less developed countries, or under section 951(a)(1)(A)(iii) as previously excluded subpart F income withdrawn from investment in foreign base company shipping operations, may be invested in United States property without being again included in such shareholder's income under section 951 (a). Moreover, the first amount deemed invested in United States property are amounts previously included in the gross income of a United States shareholder under section 951(a)(1)(A). See paragraph (d) of this section for exclusion applicable to such shareholder's successor in interest. The application of this paragraph may be illustrated by the following example:

Example. (a) A, a United States shareholder, owns 100 percent of the only class of stock of R Corporation, a corporation organized on January 1, 1963, which is a controlled foreign corporation throughout the period here involved. Both A and R Corporation use the calendar year as a taxable year.

(b) During 1964, R Corporation derives $35 of subpart F income, and A includes such amount in his gross income under section 951(a)(1)(A)(i). During 1964, R Corporation also invests $50 in tangible property (other than property described in section 956(b)(2)) located in the United States. Corporation R makes no distributions during the year, and its current earnings and profits are in excess of $50. Of the $50 investment of earnings in United States property, $35 is excludable from A's gross income for 1964 under section 959(a)(2) because such amount represents earnings and profits which are attributable to amounts which are included in A's gross income for such year under section 951(a)(1)(A)(i) and therefore may be invested in United States property without again being included in A's gross income. The remaining $15 is includible in A's gross income for 1964 under section 951(a)(1)(B).

(c) If, instead of deriving $35 of subpart F income in 1964, R Corporation has no subpart F income for 1964 but derives the $35 of subpart F income during 1963 and has earnings and profits for such year in excess of $35, A must include $35 in his gross income for 1963 under section 951(a)(1)(A)(i). However, of the $50 investment of earnings in United States property made by R Corporation during 1964, $35 is excludable from A's gross income for 1964 under section 959(a)(2) because such amount represents earnings and profits attributable to amounts which have been included in A's gross income for 1963 under section 951(a)(1)(A)(i). The remaining $15 is includible in A's gross income for 1964 under section 951(a)(1)(B).

(d) *Application of exclusions to shareholder's successor in interest.* If a United States person (as defined in §1.957–4) acquires from any person any portion of the interest in the foreign corporation of a United States shareholder referred to in paragraph (b) or (c) of this section, the rules of such paragraph shall apply to such acquiring person but only to the extent that the acquiring person establishes to the satisfaction of the district director his right to the exclusion provided by such paragraph. The information to be furnished by the acquiring person to the district director with his return for the taxable year to support such exclusion shall include:

(1) The name, address, and taxable year of the foreign corporation from which the distribution is received and of all other corporations, partnerships, trusts, or estates in any applicable chain of ownership described in section 958(a);

(2) The name, address, and (in the case of information required to be furnished after June 20, 1983) taxpayer identification number of the person from whom the stock interest was acquired;

(3) A description of the stock interest acquired and its relation, if any, to a chain of ownership described in section 958(a);

(4) The amount for which an exclusion under section 959(a) is claimed; and

(5) Evidence showing that the earnings and profits for which an exclusion is claimed are attributable to amounts which were included in the gross income of a United States shareholder under section 951(a), that such amounts were not previously excluded from the gross income of a United States person, and the identity of the United States shareholder including such amounts.

The acquiring person shall also furnish to the district director such other information as may be required by the

district director in support of the exclusion.

Example. (a) A, a United States shareholder, owns 100 percent of the only class of stock of R Corporation, a corporation organized on January 1, 1964, and a controlled foreign corporation throughout the period here involved. Both A and R Corporation use the calendar year as a taxable year.

(b) During 1964, R Corporation has $100 of subpart F income and earnings and profits in excess of $100. A includes $100 in his gross income for 1964 under section 951(a)(1)(A)(i). During 1965, A sells 40 percent of his stock in R Corporation to B, a United States person who uses the calendar year as a taxable year. In 1965, R Corporation has no earnings and profits and experiences no increase in earnings invested in United States property. Corporation R distributes $40 to B on December 1, 1965. If B establishes his right to the exclusion to the satisfaction of the district director, he may exclude $40 from his gross income for 1965 under section 959(a)(1).

(c) If, instead of selling his 40-percent interest directly to B, A sells on February 1, 1965, 40 percent of his stock in R Corporation to C, a nonresident alien, and on October 1, 1965, B acquires the 40-percent interest in R Corporation from C, the result is the same as in paragraph (b) of this example, if B establishes his right to the exclusion to the satisfaction of the district director.

(d) If, instead of acquiring 40 percent, B acquires only 5 percent of A's stock in R Corporation and R Corporation distributes $5 to B during 1965, B is not a United States shareholder (within the meaning of section 951(b)) with respect to R Corporation since he owns only 5 percent of the stock of R Corporation. Notwithstanding, B may exclude the $5 distribution from his gross income for 1965 under section 959(a)(1) if he establishes his right to the exclusion to the satisfaction of the district director.

(e) If the facts are assumed to be the same as in paragraphs (a) and (b) of this example except that—

(1) A owns the stock of R Corporation indirectly through a chain of ownership described in section 958(a), that is, A owns 100 percent of M Corporation which owns 100 percent of N Corporation which owns 100 percent of R Corporation,

(2) B acquires from N Corporation 40 percent of the stock in R Corporation,

(3) Both M Corporation and N Corporation are controlled foreign corporations which use the calendar year as a taxable year,

(4) Neither M Corporation nor N Corporation has any amount in 1964 or 1965 which is includible in gross income of United States shareholders under section 951(a), and

(5) Neither M Corporation nor N Corporation has a deficit in earnings and profits for 1964;

the result is the same as in paragraph (b) of this example if B establishes his right to the exclusion to the satisfaction of the district director.

[T.D. 6795, 30 FR 943, Jan. 29, 1965, as amended by T.D. 7893, 48 FR 22509, May 19, 1983]

§ 1.959–2 Exclusion from gross income of controlled foreign corporations of previously taxed earnings and profits.

(a) *Applicable rule.* The earnings and profits for a taxable year of a controlled foreign corporation attributable to amounts which are, or have been, included in the gross income of a United States shareholder under section 951(a) shall not, when distributed through a chain of ownership described in section 958(a), be also included in the gross income of another controlled foreign corporation in such chain for purposes of the application of section 951(a) to such other controlled foreign corporation with respect to such United States shareholder. See section 959(b). The exclusion from the income of such other foreign corporation also applies with respect to any other United States shareholder who acquires from such United States shareholder or any other person any portion of the interest of such United States shareholder in the controlled foreign corporation, but only to the extent the acquiring shareholder establishes to the satisfaction of the district director his right to such exclusion. An acquiring shareholder claiming the exclusion under section 959(b) shall furnish to the district director with his return for the taxable year the information required under paragraph (d) of §1.959–1 to support the exclusion under this paragraph.

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

Example. (a) A, a United States shareholder, owns 100 percent of the only class of stock of M Corporation which in turn owns 100 percent of the only class of stock of N Corporation. A and corporations M and N use the calendar year as a taxable year and corporations M and N are controlled foreign corporations throughout the period here involved.

(b) During 1963, N Corporation invests $100 in tangible property (other than property described in section 956(b)(2)) located in the United States and has earnings and profits in