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$$\frac{\text{Amount included in domestic corporation's gross income under section 951 with respect to first-tier corporation}}{\text{Earnings and profits of first-tier corporation less earnings and profits attributable to amounts included in domestic corporation's gross income with respect to second- and third-tier corporation}} \times \text{Taxes deemed paid by second-tier corporation which are deemed paid by first-tier corporation}$$

(*2*) If the effective rate of tax on dividends received by the third-tier corporation is higher or lower than the effective rate of tax on its other earnings and profits—

$$\frac{\text{Amount included in domestic corporation's gross income under section 951 with respect to first-tier corporation}}{\text{Earnings and profits of first-tier corporation not included in domestic corporation's gross income under section 951 with respect to second- or lower-tier corporation}} \times \text{Tax deemed paid by second-tier corporation on earnings not previously taxed with respect to fourth- or lower-tier corporations which is deemed paid by first-tier corporation}$$

[T.D. 7120, 36 FR 10854, June 4, 1971; 36 FR 11924, June 23, 1971, as amended by T.D. 7334, 39 FR 44212, Dec. 23, 1974; 40 FR 1014, Jan. 6, 1975; 40 FR 2802, Jan. 16, 1975; T.D. 7649, 44 FR 60089, Oct. 18, 1979; T.D. 7843, 47 FR 50476, Nov. 8, 1982; 47 FR 55477, Dec. 10, 1982]

§ 1.960–3 Gross-up of amounts included in income under section 951.

(a) *General rule for including taxes in income.* Any taxes deemed paid by a domestic corporation for the taxable year pursuant to section 960(a)(1) shall, except as provided in paragraph (b) of this section, be included in the gross income of such corporation for such year as a dividend pursuant to section 78 and §1.78–1.

(b) *Certain taxes not included in income.* Any taxes deemed paid by a domestic corporation for the taxable year pursuant to section 902(a) or section 960(a)(1) shall not be included in the gross income of such corporation for such year as a dividend pursuant to section 78 and §1.78–1 to the extent that such taxes are paid or accrued by the first-, second-, or third-tier corporation, as the case may be, on or with respect to an amount which is excluded from the gross income of such foreign corporation under section 959(b) and §1.959–2 as distributions from the earnings and profits of another controlled foreign corporation attributable to an amount which is, or has been, required to be included in the gross income of the domestic corporation under section 951.

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

Example 1. Domestic corporation N owns all the one class of stock of controlled foreign corporation A, which owns all the one class of stock of controlled foreign corporation B. All such corporations use the calendar year as the taxable year. For 1978, B Corporation, after having paid $20 of foreign income taxes, has $80 in earnings and profits, which are attributable to the amount required to be included in N Corporation's gross income for such year under section 951 with respect to B Corporation and all of which are distributed to A Corporation in such year. The dividend so received from B Corporation is excluded from A Corporation's gross income under section 959(b) and

§1.959–2. An income tax of 10 percent is required to be withheld from such dividend by the foreign country under the laws of which B Corporation is created, and the foreign country under the laws of which A Corporation is created imposes an income tax of $22 on the dividend received from B Corporation. For 1978, A Corporation's earnings and profits are $50 ($80 − [0.10 × $80] − $22), which it distributes in such year to N Corporation. For 1978, N Corporation is required under section 951 to include $80 in gross income with respect to B Corporation and also is required under the gross-up provisions of section 78 to include in gross income $20 ($80/$80 × $20), the amount equal to the foreign income taxes of B Corporation which are deemed paid by N Corporation under section 960(a)(1). Under paragraph (b) of this section N Corporation is not required to include in gross income the $30 ($8 + $22) of foreign income taxes which are paid by A Corporation in connection with the dividend received from B Corporation and which are deemed paid by N Corporation under section 902(a) and paragraph (c) of §1.960–2.

Example 2. Domestic corporation N owns all the one class of stock of controlled foreign corporation A, which owns all the one class of stock of controlled foreign corporation B, which in turn owns all the one class of stock of controlled foreign corporation C. All such corporations use the calendar year as the taxable year. For 1978, C Corporation, after having paid $20 of foreign income taxes, has $80 in earnings and profits, which are attributable to the amount required to be included in N Corporation's gross income for such year under section 951 with respect to C Corporation and all of which are distributed to B Corporation in such year. After having paid foreign income taxes of $10 on the dividend received from C Corporation, B Corporation distributes the balance of $70 to A Corporation. After having paid foreign income taxes of $5 on the dividend received from B Corporation, A Corporation distributes the balance of $65 to N Corporation. The dividend so received by B Corporation, and in turn by A Corporation, is excluded from the gross income of such corporations under section 959(b) and §1.959–2. Under paragraph (b) of this section N Corporation is not required to include in gross income the $15 ($10 + $5) of foreign income taxes which are paid by corporations B and A, respectively, in connection with the dividend so received and which are deemed paid by N Corporation under section 902(a) and paragraphs (b) and (c) of §1.960–2.

[T.D. 7120, 36 FR 10856, June 4, 1971, as amended by T.D. 7481, 42 FR 20130, Apr. 18, 1977; T.D. 7649, 44 FR 60089, Oct. 18, 1979; T.D. 7843, 47 FR 50484, Nov. 8, 1982]

§1.960–4 Additional foreign tax credit in year of receipt of previously taxed earnings and profits.

(a) *Increase in section 904(a) limitation for the taxable year of exclusion*—(1) *In general.* The applicable limitation under section 904(a) for a taxpayer's taxable year (hereinafter in this section referred to as the ''taxable year of exclusion'') in which he receives an amount which is excluded from gross income under section 959(a)(1) and which is attributable to a controlled foreign corporation's earnings and profits in respect of which an amount was required to be included in the gross income of such taxpayer under section 951(a) for a taxable year (hereinafter in this section referred to as the ''taxable year of inclusion'') previous to the taxable year of exclusion shall be increased under section 960(b)(1) by the amount described in paragraph (b) of this section if the conditions described in subparagraph (2) of this paragraph are satisfied.

(2) *Conditions under which increase in limitation is allowed for the taxable year of exclusion.* The increase in limitation described in subparagraph (1) of this paragraph for the taxable year of exclusion shall be made only if the taxpayer—

(i) For the taxable year of inclusion either chose to claim a foreign tax credit as provided in section 901 or did not pay or accrue any foreign income taxes,

(ii) Chooses to claim a foreign tax credit as provided in section 901 for the taxable year of exclusion, and

(iii) For the taxable year of exclusion pays, accrues, or is deemed to have paid foreign income taxes with respect to the amount, described in subparagraph (1) of this paragraph, which is excluded from his gross income for such year under section 959(a)(1).

(b) *Amount of increase in limitation for the taxable year of exclusion.* The amount of increase under section 960 (b)(1) in the applicable limitation under section 904(a) for the taxable year of exclusion shall be—

(1) The amount by which the applicable section 904(a) limitation for the taxable year of inclusion was increased, determined as provided in paragraph (c) of this section, by reason