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of the repeal of section 963 in which it is determined that a deficiency distribution must be made for an earlier taxable year for which a United States shareholder made an election to secure the exclusion under section 963 but failed to receive a minimum distribution.

(d) *Special adjustments pursuant to section 963 to be taken into account for taxable years subsequent to the repeal of section 963.* If a United States shareholder of a controlled foreign corporation elects to receive a minimum distribution under section 963 for a taxable year, section 963 and the regulations thereunder may require certain elections and adjustments to be made in subsequent taxable years. These elections and adjustments shall be taken into account for subsequent taxable years as if section 963 were still in effect and no election to receive a minimum distribution were made after the effective date of the repeal of section 963. Examples of these elections and special adjustments include, but are not limited to, the election which may be made pursuant to §1.963–3(g)(2), relating to the special extended distribution period, and the special adjustments to be made pursuant to §1.963–4, relating to the minimum overall tax burden test.

[T.D. 7545, 43 FR 19652, May 8, 1978]

§ 1.963–1 Exclusion of subpart F income upon receipt of minimum distribution.

(a) *In general*—(1) *Purpose of section 963.* Section 963 sets forth an exception to section 951(a)(1)(A)(i) by providing that a United States corporate shareholder may exclude from its gross income the subpart F income of a controlled foreign corporation if for the taxable year such shareholder elects such exclusion and, where necessary, receives a distribution of the earnings and profits of such foreign corporation sufficient to bring the aggregate U.S. and foreign income taxes on the pretax earnings and profits of that corporation to a percentage level approaching the U.S. tax rate for such year on the income of a domestic corporation. The election to secure an exclusion under section 963 may be made with respect to a ''single first-tier corporation'' or a ''chain'' or ''group'' of controlled foreign corporations. This section defines the terms ''single first-tier corporations,'' ''chains,'' ''group,'' and certain other terms and prescribes the manner in which such an election is to be made. Section 1.963–2 describes the manner in which the amount of the minimum distribution for any taxable year is to be determined. Section 1.963–3 specifies the distributions counting toward a minimum distribution. Section 1.963–4 sets forth the requirement with respect to a minimum distribution from a chain or group that the overall U.S. and foreign income tax must equal either 90 percent of the U.S. corporate tax rate applied against consolidated pretax and predistribution earnings and profits or, with the application of the special rules set forth in that section, the total U.S. and foreign income taxes which would have been incurred in respect of a pro rata minimum distribution from the chain or group. Section 1.963–5 provides special rules for applying section 963 in certain cases in which the rate of foreign income tax incurred by a foreign corporation varies with the amount of distributions it makes for the taxable year. Section 1.963–6 outlines the deficiency distribution procedure that may be followed if for reasonable cause a U.S. corporate shareholder fails to receive a complete minimum distribution for a taxable year for which it elects the exclusion under section 963. Section 1.963–7 provides transitional rules for the application of section 963 for certain taxable years of U.S. shareholders ending on or before the 90th day after September 30, 1964. Section 1.963–8 provides rules for the determination of the required minimum distribution during the period the §surcharge imposed by section 51 is in effect.

(2) *Conditions for exclusion of subpart F income.* To qualify for an exclusion under section 963 for any taxable year with respect to the subpart F income of a controlled foreign corporation, a corporate United States shareholder must—

(i) Elect such exclusion on or before the last day (including any extensions of time under section 6081) prescribed by law for filing its return of the tax

imposed by chapter 1 of the Code for the taxable year;

(ii) Receive, if and to the extent necessary, distributions of the type described in paragraph (a) of §1.963–3 sufficient in amount to constitute a minimum distribution;

(iii) Incur, in the case of a chain or group election, income tax with respect to such minimum distribution sufficient to satisfy the requirements of paragraph (a) of §1.963–4, relating to the minimum overall tax burden; and

(iv) Consent, on or before such last day for making the election, to the regulations under section 963 applicable to such taxable year and to any amendments thereof duly prescribed before such last day.

The making of the election under section 963 by filing the return on or before such last day shall constitute the consent to the regulations under such section prescribed before such last day. For an extension of the time for receiving a minimum distribution and making the consent for certain taxable years ending on or before the 90th day after September 30, 1964, see §1.963–7.

(3) *Subpart F income excluded.* An exclusion under section 963 for a taxable year of a United States shareholder for which the election is made under such section shall apply only to the subpart F income for the taxable year of the single first-tier corporation to which the election applies or of each controlled foreign corporation in the chain or group to which the election applies. Only those amounts attributable to the stock interest to which the election relates may be excluded. Thus, in case of a first-tier election with respect to stock of a controlled foreign corporation owned directly within the meaning of section 958(a)(1)(A), the corporate United States shareholder may not exclude any subpart F income of such foreign corporation which is includible in its gross income under section 951(a)(1)(A)(i) by virtue of its indirect ownership of stock in such foreign corporation through the operation of section 958(a)(2). Subpart F income of a controlled foreign corporation which is excluded from the gross income of a United States shareholder by reason of the receipt of a minimum distribution to which section 963 applies shall not be considered to be excluded under section 954(b)(1) or section 970(a).

(4) *Affiliated group of corporations.* An affiliated group of domestic corporations which makes a consolidated return under section 1501 for the taxable year shall be treated as a single United States shareholder for purposes of applying section 963 for such year if the common parent corporation in its return for such affiliated group makes any first-tier election, chain election, or group election under section 963 for such affiliated group; in such case, no member of such affiliated group may separately make any first-tier election, chain election, or group election under section 963 for the taxable year. If the common parent of such an affiliated group so making a consolidated return makes no first-tier election, chain election, or group election for such affiliated group, then any member may make a first-tier election, chain election, or group election to the same extent that it could so elect if such affiliated group had not filed a consolidated return; in such case, the affiliated group will not be treated as a single United States shareholder.

(b) *Definitions.* For purposes of section 963 and §§1.963–1 through 1.963–8—

(1) *Controlled foreign corporation.* The term ''Controlled foreign corporation'' shall have the meaning accorded to it by section 957 and the regulations thereunder but shall not include any foreign corporation for a taxable year beginning before January 1, 1963.

(2) *Single first-tier corporation.* The term ''single first-tier corporation'' means a controlled foreign corporation described in paragraph (d) of this section with respect to which a first-tier election has been made for the taxable year.

(3) *Chain.* The term ''chain'' means collectively the foreign corporations described in paragraph (e) of this section with respect to which a chain election has been made for the taxable year.

(4) *Group.* The term ''group'' means collectively the foreign corporations described in paragraph (f) of this section with respect to which a group election has been made for the taxable year.

(5) *First-tier election, etc.* The term ''first-tier election'' means an election described in paragraph (c)(1)(i)(a) of this section; the term ''chain election'' means an election described in paragraph (c)(1)(i)(b) of this section; and the term ''group election'' means an election described in paragraph (c)(1)(ii) of this section.

(6) *Taxable year.* (i) The term ''taxable year of a single first-tier corporation,'' ''taxable year of a corporation in a chain,'' or ''taxable year of a corporation in a group,'' means, respectively, the taxable year of such corporation ending with or within the taxable year of the electing United States shareholder for which is made under paragraph (c)(1) of this section the election establishing it as a single first-tier corporation, a corporation in a chain, or corporation in a group, as the case may be.

(ii) The term ''taxable year'' when used in reference to a chain or group refers collectively to the respective taxable years of the foreign corporations in such chain or group to which applies the election establishing such chain or group status, such taxable year being, in the case of each respective corporation in the chain or group, such corporation's taxable year ending with or within the taxable year of the electing United States shareholder, whether or not such taxable year of the corporation is the same as that of any other foreign corporation in the chain or group.

(7) *Foreign income tax.* The term ''foreign income tax'' means income, war profits, and excess profits taxes, and taxes included in the term ''income, war profits, and excess profits taxes'' by reason of section 903, paid or accrued to a foreign country or possession of the United States and taken into account for purposes of sections 901 through 905. Except in determining the foreign tax credit under section 901, the term shall not include any tax which is deemed paid by a foreign corporation under section 902(b).

(c) *Election to exclude subpart F income*—(1) *Foreign corporations included in election.* A corporate United States shareholder may for any taxable year exercise the election to secure an exclusion under section 963 either—

(i)(*a*) Separately with respect to any foreign corporation which as to such shareholder is described in paragraph (d) of this section, and/or

(*b*) Separately with respect to the foreign corporation or corporations which as to such shareholder are in a series described in paragraph (e) of this section, except to the extent of any interest (of such shareholder in any such corporation) with respect to which an election has otherwise been made under this subdivision (i); or

(ii) With respect to all foreign corporations which as to such shareholder are described in paragraph (f) of this section.

(2) *Manner of making election.* An election under subparagraph (1) of this paragraph to secure an exclusion under section 963 and the consent to the regulations under such section shall be made for a taxable year by filing with the return for such taxable year—

(i) A written statement stating that such election is made for such taxable year,

(ii) The names of the foreign corporations to which the election applies, the taxable year, country or incorporation, earnings and profits (as determined under paragraph (d) of §1.963–2), foreign income tax taken into account under paragraph (e) of §1.963–2, and outstanding capital stock, of each such corporation,

(iii) In case of a group election, the names of all foreign corporations excluded from such group under paragraph (f)(2) and (3) of this section and identifying characterizations for all foreign branches included in, and excluded from, such group under paragraph (f)(4) of this section, together with the authority for such exclusion or inclusion, and

(iv) Such other information relating to the election made as the Commissioner may prescribe by instructions or schedules to support such return.

(3) *Duration of election*—(i) *Year-by-year requirement.* An election under subparagraph (1) of this paragraph to secure an exclusion under section 963 may be made for each taxable year of the United States shareholder but shall be effective only with respect to the taxable year for which made. An election made for any taxable year shall be

irrevocable with respect to that taxable year once the period for the making of such election has expired, except to the extent provided by subdivision (ii) of this subparagraph.

(ii) *Revocation or modification of election for reasonable cause—(a) Conditions under which allowed.* If, after the making of an election under subparagraph (1) of this paragraph, the United States shareholder establishes to the satisfaction of the Commissioner that reasonable cause exists for revocation or modification of such election, it may withdraw that election; change from a group election to first-tier elections and/or chain elections or from a chain election to a first-tier election: change from a first-tier election to a chain election or from first-tier elections and/or chain elections to a group election; or, in the case of a chain or group election, alter the composition of the chain or group by adding or eliminating corporations. The United States shareholder shall be allowed to revoke or modify elections pursuant to this subdivision only once for any taxable year of such shareholder and then only at a time prior to the expiration of the period prescribed by law for making an assessment of the tax imposed by chapter 1 of the Code for such taxable year and for any subsequent taxable year for which the tax liability of such shareholder would be affected by such revocation or modification of election. The Commissioner may, as a condition to such revocation or modification of the election, require a consent by the United States shareholder under section 6501 to extend, for the taxable year and such subsequent years affected by the revocation or modification, the period for the making of assessments, and the bringing of distraint or a proceeding in court for collection, in respect of a deficiency and all interest, additional amounts, and assessable penalties.

(*b*) *Nature of reasonable cause.* Reasonable cause shall be deemed to exist for the revocation or modification of an election only if, after the making of such election, a material and substantial change in circumstances affecting the election occurs which reasonably could not have been anticipated when the election was made and which, to a significant degree, was beyond the control of the electing United States shareholder. For example, reasonable cause would exist if the minimum distribution were computed on the basis of a contested foreign income tax asserted by a foreign tax authority which, as a consequence of litigation occurring after the filing of the United States shareholder's return, is refunded, with the result that the United States shareholder is not entitled under the election which was made to an exclusion under section 963.

(*c*) *Request for revocation or modification.* A United States shareholder desiring to revoke or modify the election shall mail to the Commissioner of Internal Revenue, Attention: T:R, Washington, DC, 20224, a letter requesting such revocation or modification; such letter shall set forth the information required by subparagraph (2) of this paragraph with respect to any new election and the facts and circumstances which the shareholder considers reasonable cause for such revocation or modification. The shareholder shall also consent, if required, to the extension of assessment period referred to in (*a*) of this subdivision and shall furnish such other information as may be required by the Commissioner in support of such request. If the Commissioner is satisfied that reasonable cause exists for the revocation or modification, the United States shareholder shall file an amended return consistent with any new election which is made.

(d) *Corporations to which a first-tier election may apply*—(1) *Includible interest.* A corporate United States shareholder may make a first-tier election for the taxable year only with respect to a single controlled foreign corporation in which it owns stock directly within the meaning of section 958(a)(1)(A) and only with respect to the stock so owned. The election must apply to all of the stock so owned by such shareholder and shall relate only to the subpart F income of such corporation which would otherwise be required to be included in gross income by reason of owning such stock. The shareholder may for the same taxable year make a first-tier election with respect to one or more controlled foreign

corporations in which it directly owns stock and not with respect to other controlled foreign corporations in which it directly owns stock.

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

Example 1. Domestic corporation M directly owns all the one class of stock in each of the controlled foreign corporations A, B, and C. Corporation M may make a first-tier election for a taxable year with respect to any one of corporations A, B, and C; with respect to corporations A and B, respectively; with respect to corporations A and C, respectively; with respect to corporations B and C, respectively; or with respect to corporations A, B, and C, respectively.

Example 2. Domestic corporation M directly owns all the one class of stock of controlled foreign corporation A and 20 percent of the one class of stock of controlled foreign corporation B. Corporation A directly owns 80 percent of the stock of B Corporation. All such corporations use the calendar year as the taxable year. For 1964, M Corporation makes a first-tier election with respect to corporations A and B, respectively, and receives a minimum distribution from each. An exclusion under section 963 for 1964 will be allowed for all of A Corporation's subpart F income for such year but only for the amount of B Corporation's subpart F income which M Corporation would (without regard to section 963) be required to include in gross income for such year under section 951(a)(1)(A)(i) by reason of directly owning 20 percent of the stock of B Corporation. Corporation M may not exclude any amount which it would be required (without regard to section 963) to include in gross income under section 951(a)(1)(A)(i) for such year with respect to the subpart F income of B Corporation by reason of its indirect ownership (through the operation of section 958(a)(2)) of 80 percent of the stock of B Corporation, unless M Corporation separately elects such exclusion and receives a minimum distribution with respect to such interest. See paragraph (e) of this section relating to chain elections.

(e) *Corporations to which a chain election may apply*—(1) *Includible interests.* A Corporate United States shareholder may make a chain election for the taxable year with respect to one or more controlled foreign corporations in any series which includes only one foreign corporation described in subdivision (i), any one or more controlled foreign corporations described in subdivision (ii), and all foreign corporations described in subdivision (iii) of this subparagraph:

(i) A foreign corporation, whether or not a controlled foreign corporation, to the extent of stock owned by such shareholder—

(*a*) Directly (within the meaning of section 958(a)(1)(A)) in such corporation, or

(*b*) Indirectly (through the operation of section 958(a)(2)) by virtue of the direct ownership (within the meaning of section 958(a)(1)(A)) of stock in such corporation by a foreign trust, foreign estate, or foreign partnership, in which such shareholder is a beneficiary or partner;

(ii) To the extent that such shareholder so elects, any controlled foreign corporation to the extent that, by reason of its ownership of stock described in subdivision (i) of this subparagraph, such shareholder indirectly owns within the meaning of section 958(a)(2) stock in such controlled foreign corporation; and

(iii) All foreign corporations, whether or not controlled foreign corporations, by reason (and to the extent) of ownership of stock in which such shareholder indirectly owns within the meaning of section 958(a)(2) stock in a controlled foreign corporation included in the series by reason of subdivision (ii) of this subparagraph.

Notwithstanding the preceding sentence, a corporate United States shareholder may make a chain election for the taxable year with respect to a single foreign corporation, but only if such foreign corporation is a controlled foreign corporation described in subdivision (i)(*b*) of this subparagraph. The shareholder may for the same taxable year make a chain election with respect to one or more series, and not with respect to other series, to which this subparagraph applies.

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

Example 1. Domestic corporation M directly owns all the one class of stock of controlled foreign corporation A, which in turn directly owns 80 percent of the one class of stock of controlled foreign corporation B. Corporation M may make a chain election with respect to corporations A and B.

Example 2. Domestic corporation M directly owns all the one class of stock of controlled foreign corporation A, which in turn directly owns 80 percent of the one class of stock of controlled foreign corporation B, which in turn directly owns all the one class of stock of controlled foreign corporation C. Corporation M also directly owns 20 percent of the stock of B Corporation. Corporation M may make a chain election either with respect to corporations A and B or with respect to corporations A, B, and C. In either case corporations B and C can be included in the chain only to the extent of M Corporation's indirect 80-percent stock interest in such corporations by reason of its direct ownership of 100 percent of the stock of A Corporation. Corporation M may also make a chain election with respect to corporations B and C, in which case the chain would include corporations B and C to the extent of the 20-percent stock interest which M Corporation owns directly in B Corporation, and indirectly owns in C Corporation by reason of its direct ownership of such stock interest in B Corporation.

Example 3. Domestic corporation M directly owns all the one class of stock of controlled foreign corporation A, which in turn directly owns all the one class of stock of controlled foreign corporations B and C. Corporation M may make a chain election either with respect to corporations A, B, and C; or with respect to corporations A and B; or with respect to corporations A and C.

Example 4. Domestic corporation M directly owns all the one class of stock of controlled foreign corporation A and 40 percent of the one class of stock of foreign corporation B, not a controlled foreign corporation. Corporation A directly owns 30 percent of the one class of stock of controlled foreign corporation C, and B Corporation directly owns the remaining 70 percent of the stock of C Corporation. Corporation M may make a chain election with respect to corporations A and C, but in such case C Corporation can be included in the chain only to the extent of M Corporation's indirect 30-percent stock interest in such corporation by reason of its direct ownership of 100 percent of the stock of A Corporation. Corporation M may instead make a chain election with respect to corporations B and C, but in such case C Corporation can be included in the chain only to the extent of M Corporation's indirect 28-percent stock interest in such corporation by reason of its direct ownership of 40 percent of the stock of B Corporation. In the latter case, B Corporation must be included in the chain even though it is not a controlled foreign corporation. Corporation M may also make two chain elections, one with respect to corporations A and C, and the other with respect to corporations B and C, as described above.

Example 5. Domestic corporation M directly owns all the one class of stock of controlled foreign corporation A, which in turn directly owns all the one class of stock of controlled foreign corporation B and 40 percent of the one class of stock of foreign corporation C, not a controlled foreign corporation. Corporation M may make a chain election with respect to corporations A and B. Corporation C may not be included in the chain since M Corporation does not, by reason of its indirect ownership of stock in C Corporation, own stock in any controlled foreign corporation.

Example 6. Domestic corporation M directly owns a 60-percent partnership interest in foreign partnership D and by reason of such interest owns indirectly, within the meaning of section 958(a)(2), 60 percent of the one class of stock of controlled foreign corporation E (all of the stock of which is directly owned by D Partnership) and 60 percent of the one class of stock of controlled foreign corporation F (all the stock of which is also directly owned by D Partnership). By virtue of its direct interest in D Partnership, M Corporation may make a chain election with respect to E Corporation alone or with respect to F Corporation alone. Corporation M may also make two chain elections, one with respect to E Corporation, the other with respect to F Corporation.

(f) *Corporations to which a group election may apply*—(1) *Includible interests.* A corporate United States shareholder may make a group election for the taxable year with respect to a group of foreign corporations which includes, except as provided in subparagraphs (2) and (3) of this paragraph, all of the following corporations:

(i) All controlled foreign corporations in which such shareholder owns stock either directly within the meaning of section 958(a)(1)(A) or indirectly within the meaning of section 958(a)(2), and

(ii) All foreign corporations, whether or not controlled foreign corporations, by reason (and to the extent) of ownership of stock in which such shareholder, indirectly owns within the meaning of section 958(a)(2) stock in a controlled foreign corporation described in subdivision (i) of this subparagraph.

A first-tier election or chain election may not be made for any taxable year with respect to any foreign corporation which for such taxable year has been excluded under subparagraph (2) or (3)

of this paragraph from a group with respect to which a group election has been made for such year. The application of this subparagraph may be illustrated by the following examples:

Example 1. Domestic corporation M directly owns all the one class of stock of controlled foreign corporations A and B and is a United States shareholder with respect to no other foreign corporation. M Corporation may make a group election with respect to corporations A and B.

Example 2. Domestic corporation M directly owns all the one class of stock of controlled foreign corporations A and B, and B Corporation directly owns 80 percent of the one class of stock of controlled foreign corporation C. Corporation M is a United States shareholder only with respect to corporations A, B, and C. If M Corporation makes a group election, it must make the election with respect to corporations A, B, and C.

Example 3. Domestic corporation M directly owns all the one class of stock of controlled foreign corporations A and B. Corporation A directly owns 70 percent of the one class of stock of controlled foreign corporation C. Corporation B directly owns 40 percent of the one class of stock of foreign corporation D, not a controlled foreign corporation, and D Corporation directly owns 30 percent of the stock of C Corporation. Corporation M is a United States shareholder with respect to no other foreign corporation. If M Corporation makes a group election, it must make the election with respect to corporations A, B, C, and D. Corporation D must be included in the group even though it is not a controlled foreign corporation.

(2) *Less developed country corporations.* If the United States shareholder so elects, it may for any taxable year exclude from a group for purposes of a group election every controlled foreign corporation which is a less developed country corporation as defined in section 955(c) and §1.955–5 for the taxable year of such foreign corporation ending with or within such taxable year of the shareholder but only if, by reason of ownership of stock in such foreign corporation, the shareholder does not indirectly own within the meaning of section 958(a)(2) stock in any other controlled foreign corporation which is not a less developed country corporation for its taxable year ending with or within such taxable year of the shareholder. The election under this subparagraph to exclude a less developed country corporation is required to be made with respect to all less developed country corporations of which the electing shareholder is a United States shareholder and which, under the preceding sentence, are eligible to be excluded.

Example. Domestic corporation M directly owns all the one class of stock of controlled foreign corporations A and B, not less developed country corporations. Corporation A directly owns all of the one class of stock of controlled foreign corporation C, B Corporation directly owns all the one class of stock of controlled foreign corporation D, and D Corporation directly owns all the one class of stock of controlled foreign corporation E. Corporations C, D, and E are less developed country corporations under section 955(c). Corporation M may make a group election with respect to corporations A, B, C, D, and E; it may also exclude the less developed country corporations and make a group election with respect to corporations A and B only. If E Corporation were not a less developed country corporation, however, neither D Corporation nor E Corporation could be excluded since, by reason of ownership of stock in D Corporation, M Corporation would indirectly own stock in E Corporation, a controlled foreign corporation which is not a less developed country corporation.

(3) *Foreign corporations with blocked foreign income.* If the United States shareholder so elects, it may for any taxable year exclude from a group for purposes of a group election any foreign corporation with respect to which it is established to the satisfaction of the Commissioner that an amount of earnings and profits of such corporation sufficient to constitute its share of a pro rata minimum distribution (as defined in paragraph (a)(2)(i) of §1.963–4) by the group cannot be distributed to such United States shareholder because of currency or other restrictions or limitations imposed under the laws of any foreign country. If, by reason of ownership of stock in a foreign corporation which is excluded from the group under the preceding sentence, a United States shareholder owns stock in another foreign corporation an amount of whose earnings and profits sufficient to constitute its share of a pro rata minimum distribution by the group cannot be distributed to such United States shareholder through such excluded foreign corporation because of currency or other restrictions or limitations imposed under the laws

of any foreign country, such other foreign corporation must also be excluded from the group for purposes of the group election. For purposes of this subparagraph, the determination as to whether earnings and profits cannot be distributed because of currency or other restrictions or limitations imposed under the laws of a foreign country shall be made in accordance with the regulations under section 964(b), except that such restrictions or limitations shall be considered to exist notwithstanding that distributions are made by the foreign corporation in a foreign currency if, assuming the distributee to be the United States shareholder, the distributed amounts would be excludable from the distributee's gross income for the taxable year of receipt under a method of accounting in which the reporting of blocked foreign income is deferred until the income ceases to be blocked.

(4) *Treatment of foreign branches of domestic corporation as foreign subsidiary corporations*—(i) *In general.* If the United States shareholder so elects, all branches (other than a branch excluded under subdivision (iii) of this subparagraph) maintained by such shareholder in foreign countries and possessions of the United States shall be treated, for purposes of applying subparagraph (1) of this paragraph, as wholly owned foreign subsidiary corporations of such shareholder organized under the laws of such respective foreign countries or possessions of the United States. Each branch treated as such a foreign subsidiary corporation shall be included in the group by the United States shareholder making the group election and shall be regarded, for purposes of section 963, as having distributed to such shareholder all of its earnings and profits for the taxable year, irrespective of the statutory percentage applied for the taxable year under paragraph (b) of §1.963–2. As used in this subparagraph, the term ''branch'' shall mean a permanent organization maintained in a foreign country or a possession of the United States to engage in the active conduct of a trade or business. Whether a permanent organization is maintained in a foreign country or possession of the United States shall depend upon the facts and circumstances of the particular case. As a general rule, a permanent organization shall be considered to be maintained in such country or possession if the United States shareholder maintains therein a significant work force or significant manufacturing, mining, warehousing, sales, office, or similar business facilities of a fixed or permanent nature. If a United States shareholder so operates that it satisfies the branch test with respect to each of several foreign countries or possessions, each such branch shall be treated as a separate wholly owned foreign subsidiary corporation organized under the laws of such country or possession in respect of which it satisfies such test. In no event shall a branch which is treated as a wholly owned foreign subsidiary corporation under this subparagraph be also treated as a less developed country corporation. The term ''possession of the United States,'' as used in this subparagraph, shall be construed to have the same meaning as that contained in paragraph (b)(2) of §1.957–3.

(ii) *Earnings and profits and taxes of a foreign branch.* The earnings and profits (or deficit in earnings and profits) for a taxable year of a branch treated as a wholly owned foreign subsidiary corporation under this subparagraph shall be determined by applying against the gross income (as defined in section 61) of the branch its allowable deductions other than any net operating loss deduction. Any excess of gross income over such deductions shall constitute earnings and profits. Any excess of such deductions over gross income shall constitute a deficit in earnings and profits. For purposes of this subparagraph, the gross income of a branch is that which is produced by the trade or business activities separately conducted by it outside the United States and which is derived from sources without the United States under the provisions of sections 861 through 864 and the regulations thereunder; the allowable deductions of a branch are those which are properly allocable to or chargeable against its gross income and which are allowable under chapter 1 of the Code to the corporation of which it is a branch. Only the foreign income tax allocable to the gross income of the branch shall be

considered paid or accrued by such branch. Solely for the purpose of determining under paragraph (c)(2) of §1.963–2 the effective foreign tax rate of a group which includes a branch treated as a wholly owned foreign subsidiary corporation, the foreign income tax considered paid or accrued by the branch shall be treated as an allowable deduction of such branch even though the United States shareholder chooses to take the benefits of section 901 for the taxable year.

(iii) *Excluded branches.* For purposes of subdivision (i) of this subparagraph, a branch maintained by the United States shareholder in a possession of the United States shall not be treated as a wholly owned foreign subsidiary corporation of the United States shareholder for the taxable year unless such branch would be a controlled foreign corporation (as defined in section 957 and the regulations thereunder) for such taxable year if it were incorporated under the laws of such possession and unless the gross income of such shareholder for such taxable year includes for purposes of the tax imposed by Chapter 1 of the Code the income, if any, derived by such shareholder from sources within possessions of the United States, as determined under the provisions of sections 861 through 864 and the regulations thereunder.

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

Example 1. Throughout 1964, domestic corporation M directly owns all of the one class of stock of controlled foreign corporations A and B. All corporations use the calendar year as the taxable year. During 1964, M Corporation engages in foreign country X in the manufacture and sale of steel tubing and rods, maintaining therein a significant work force and significant manufacturing and sales facilities for such purpose. Corporation M also engages in foreign country Y in the mining and sale of iron ore, maintaining therein a significant work force and substantial mining and sales facilities for such purpose. For 1964, M Corporation may make a group election with respect to corporations A and B and the branches operated in country X and country Y, treating such branches as wholly owned foreign subsidiary corporations. If corporation M elects to include one such branch in the group election, it must include both.

Example 2. Throughout 1964, domestic corporation M directly owns all the one class of stock of controlled foreign corporations A and B. All corporations use the calendar year as the taxable year. During 1964, M Corporation exports tractors to foreign country Z, in which country its sole activities consist of arranging for title to the tractors to pass to the purchasers in that country. Corporation M's only facility in country Z in 1964 is a small rented office, and its work force therein consists only of a few clerical employees. The activities of M Corporation in country Z do not constitute the maintenance of a branch therein for purposes of this subparagraph. Corporation M may make a group election, only with respect to corporations A and B.

[T.D. 6759, 29 FR 13325, Sept. 25, 1964; 29 FR 13896, Oct. 8, 1964, as amended by T.D. 6767, 29 FR 14877, Nov. 3, 1964; T.D. 7100, 36 FR 5335, Mar. 20, 1971]

§1.963–2 Determination of the amount of the minimum distribution.

(a) *Application of statutory percentage to earnings and profits.* The amount of the minimum distribution required to be received by a United States shareholder with respect to stock to which the election under paragraph (c) of §1.963–1 applies for the taxable year in order to qualify for a section 963 exclusion for such year shall be the amount, if any, determined by the multiplication of the statutory percentage applicable for the taxable year by—

(1) In the case of a first-tier election, such shareholder's proportionate share (as determined under paragraph (d)(2) of this section) of the earnings and profits for the taxable year of the single first-tier corporation to which the election relates,

(2) In the case of a chain election, the consolidated earnings and profits (as determined under paragraph (d)(3) of this section) with respect to such shareholder for the taxable year of the chain to which the election relates, or

(3) In the case of a group election, the consolidated earnings and profits (as determined under paragraph (d)(3) of this section) with respect to such shareholder for the taxable year of the group to which the election relates.

For the requirement that the overall United States and foreign income tax incurred in respect of a minimum distribution from a chain or group must equal or exceed either 90 percent of the