AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

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

United States corporate tax rate applied against pretax and predistribution consolidated earnings and profits or, with the application of the special rules set forth therein, must equal or exceed the overall United States and foreign income tax which would have resulted from a pro rata minimum distribution, see paragraph (a)(1) of § 1.963–4.

(b) *Statutory percentage.* The statutory percentage (referred to in paragraph (a) of this section) for the taxable year shall be determined by applying the effective foreign tax rate (as defined in paragraph (c) of this section) for such year with respect to the single first-tier corporation, chain, or group, as the case may be, against—

(1) The table set forth in section 963(b)(1) in the case of an election to secure an exclusion under section 963 for a taxable year of the United States shareholder beginning in 1963 and a taxable year entirely within the surcharge period ending before January 1, 1970.

(2) The table set forth in section 963(b)(2) in the case of an election to secure an exclusion under section 963 for a taxable year of the U.S. shareholder beginning in 1964 or for a taxable year of such shareholder beginning in 1969 and ending in 1970 to the extent subparagraph (B) of section 963(b)(3) applies,

(3) The table set forth in section 963(b)(3) in the case of an election to secure an exclusion under section 963 for a taxable year of the U.S. shareholder beginning after December 31, 1964 except a taxable year which includes any part of the surcharge period, or

(4) The table set forth in paragraph (b) of § 1.963–8 in the case of an election to secure an exclusion under section 963 for the calendar year 1970.

Example. Domestic corporation M owns all the one class of stock in controlled foreign corporation A. Corporation M uses the calendar year as its taxable year, and A Corporation uses a fiscal year ending August 31. For 1964, M Corporation makes a first-tier election in order to exclude from gross income for such year the subpart F income of A Corporation for its taxable year ending on August 31, 1964. Although, such election applies to the taxable year of A Corporation beginning on September 1, 1963, the applicable table, for purposes of determining the statutory percentages to be used under paragraph (a) of this section for the taxable year, is that set forth in section 963(b)(2), which relates to taxable years of United States shareholders beginning in 1964. Thus, if for the taxable year of A Corporation ending August 31, 1964, the effective foreign tax rate is 30 percent, A Corporation would have to distribute 72 percent of its earnings and profits for such year in order for M Corporation to be entitled to an exclusion under section 963 for 1964.

(c) *Effective foreign tax rate*—(1) *Single first-tier corporation.* For purposes of section 963 the term ''effective foreign tax rate'' for a taxable year means, with respect to a single first-tier corporation, the percentage which—

(i) The United States shareholder's proportionate share (as determined under paragraph (e)(1) of this section) of the foreign income tax of such corporation for such taxable year is of—

(ii) The sum of—

(*a*) The United States shareholder's proportionate share (as determined under paragraph (d)(2) of this section) of the earnings and profits of such corporation for such taxable year, and

(*b*) The amount referred to in subdivision (i) of this subparagraph.

(2) *Chain or group of corporations.* For purposes of section 963, the term ''effective foreign tax rate'' for a taxable year means, with respect to a chain or group, the percentage which—

(i) The consolidated foreign income taxes (as determined under paragraph (e)(2) of this section) of such chain or group with respect to the United States shareholder for such taxable year is of—

(ii) The sum of—

(*a*) The consolidated earnings and profits (as determined under paragraph (d)(3) of this section) of such chain or group with respect to such United States shareholder for such taxable year, and

(*b*) The amount referred to in subdivision (i) of this subparagraph.

(3) *Treatment of United States tax as foreign tax.* For the purpose solely of determining the effective foreign tax rate under this paragraph, if a foreign corporation has pretax earnings and profits attributable to income from sources within the United States for the taxable year upon which it pays

United States income tax and if distributions from the earnings and profits of such corporation for such year to the electing United States shareholder with respect to stock to which the election to secure an exclusion under section 963 relates do not entitled such shareholder to the dividends-received deduction under section 245, the amount of the United States income tax shall be taken into account as though such tax were foreign income tax. The amount so treated as foreign income tax shall not exceed 90 percent of an amount determined by multiplying such pretax earnings and profits attributable to income from sources within the United States by a percentage which is the sum of the normal tax rate and the surtax rate (determined without regard to the surtax exemption) prescribed by section 11 for the taxable year of the United States shareholder.

(d) *Determination of proportionate share of earnings and profits and consolidated earnings and profits*—(1) *Earnings and profits of foreign corporations.* For purposes of §§1.963–1 through 1.963–8, the earnings and profits, or deficit in earnings and profits, for the taxable year, of a single first-tier corporation or of a foreign corporation in a chain or group shall be the amount of its earnings and profits for such year, determined under section 964(a) and §1.964–1 but without reduction for foreign income tax or for distributions made by such corporation, less—

(i) In the case of a foreign corporation included in a chain or group, the amount of any distributions received (computed without reduction for any income tax paid or accrued by such corporation with respect to such distributions) by such corporation during its taxable year from the earnings and profits (whether or not from earnings and profits of the taxable year to which the election under section 963 applies) of another foreign corporation in the chain or group.

(ii) In the case of every foreign corporation, the amount of foreign income tax paid or accrued by such corporation during its taxable year other than foreign income tax referred to in subdivision (i) and (iii) of this subparagraph, and

(iii) In the case of a foreign corporation included in a chain or group, the foreign income tax paid or accrued by such corporation with respect to distributions from the earnings and profits of any other foreign corporation in the chain or group for the taxable year of such other corporation to which the election under section 963 applies, but only if the U.S. shareholder chooses under this subdivision to take such tax into account in determining the effective foreign tax rate rather than count it toward the amount of the minimum distribution as provided in paragraph (b)(2) of §1.963–3.

In the event that the foreign income tax of a corporation included in a chain or group depends upon the extent to which distributions are made by such corporation, the amount of foreign income tax referred to in subdivision (ii) of this subparagraph shall, only for purposes of determining the effective foreign tax rate, be the amount which would have been paid or accrued if no distributions had been made. For the rules in other cases involving corporations whose foreign income tax varies with distributions, see §1.963–5. For the manner of computing the earnings and profits of a foreign branch treated as a wholly owned foreign subsidiary corporation see paragraph (f)(4)(ii) of §1.963–1.

(2) *Shareholder's proportionate share of earnings and profits*—(i) *Corporation with earnings and profits*—(*a*) *In general.* A United States shareholder's proportionate share, with respect to stock to which the election to secure an exclusion under section 963 relates, of the earnings and profits of a foreign corporation (not including a foreign branch described in (*b*) of this subdivision) for its taxable year shall be the share which such shareholder would receive if the total amount of such corporation's earnings and profits, as determined under subparagraph (1) of this paragraph, for such year were distributed on the last day of such corporation's taxable year on which such corporation is a controlled foreign corporation or is a foreign corporation by reason of the ownership of stock in which the United States shareholder indirectly owns within the meaning of

section 958(a)(2) stock in a controlled foreign corporation.

(*b*) *Foreign branch treated as a foreign subsidiary corporation.* A United States shareholder's proportionate share of the earnings and profits, for the taxable year, of a branch treated as a wholly owned foreign subsidiary corporation and included in a group under paragraph (f)(4) of §1.963–1 shall be the total earnings and profits of such branch for the taxable year, as determined under paragraph (f)(4)(ii) of such section.

(*c*) *Indirectly held foreign corporations.* If the proportionate share to be determined is of earnings and profits of a foreign corporation the stock of which is owned by the United States shareholder by reason of its ownership of stock (with respect to which the election relates) in another corporation, such shareholder's proportionate share of such earnings and profits for the taxable year shall be determined on the basis of the amount such shareholder would receive from such foreign corporation with respect to stock in such foreign corporation if there were distributed for the taxable year all such earnings and profits, as determined under subparagraph (1) of this paragraph, and of all the earnings and profits of all other corporations through which such earnings and profits must pass in order to be received by such shareholder with respect to the stock to which the election relates. For purposes of the preceding sentence, the amount received by the shareholder from the earnings and profits of a foreign corporation shall be determined without taking into account deductions (whether or not allowable under chapter 1 of the Code) of other foreign corporations through which such earnings and profits are distributed.

(*d*) *More than one class of stock.* If a foreign corporation for a taxable year has more than one class of stock outstanding, the earnings and profits of such corporation for such year which shall be taken into account with respect to any one class of such stock shall be the earnings and profits which would be distributed with respect to such class if all earnings and profits of such corporation for such year were distributed on the last day of such corporation's taxable year, on which such corporation is a controlled foreign corporation or is a foreign corporation by reason of the ownership of stock in which the United States shareholder indirectly owns within the meaning of section 958(a)(2) stock in a controlled foreign corporation. If an arrearage in dividends for prior taxable years exists with respect to a class of preferred stock of such corporation, the earnings and profits for the taxable year shall be attributed to such arrearage only to the extent such arrearage exceeds the earnings and profits of such corporation remaining from prior taxable years beginning after December 31, 1962. For example, if a controlled foreign corporation, using the calendar year as its taxable year, has earnings and profits for 1963 of $100 accumulated at December 31, 1963, and an arrearage of $150 for such year in respect of preferred stock, the earnings and profits for 1964 attributable to such arrearage may not exceed $50 ($150 − $100).

(*e*) *Discretionary power to allocate earnings to different classes of stock.* If the allocation of a foreign corporation's earnings and profits for the taxable year between two or more classes of stock depends upon the exercise of discretion by that body of persons which exercises with respect to such corporation the power ordinarily exercised by the board of directors of a domestic corporation, the allocation of such earnings and profits to such classes shall be made for purposes of this subdivision as if such classes constituted one class of stock in which each share has the same rights to dividends as any other share, unless a different method of allocation of such earnings and profits is made by such body not later than 90 days after the close of such taxable year.

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

Example 1. Domestic corporation M directly owns 80 percent of the one class of stock of controlled foreign corporation A, which directly owns 60 percent of the one class of stock of controlled foreign corporation B. Each such corporation has earnings and profits of $70 for the taxable year, as determined under subparagraph (1) of this paragraph. Corporation M's proportionate share of the earnings and profits is $56 (0.80

× $70) as to A Corporation and $33.60 (0.80 × 0.60 × $70) as to B Corporation.

Example 2. Throughout 1964 controlled foreign corporation A, which uses the calendar year as the taxable year, has outstanding 40 shares of common stock and 60 shares of 6-percent, nonparticipating, noncumulative preferred stock with a par value of $100 per share. Corporation A has earnings and profits of $1,000, for 1964, as determined under subparagraph (1) of this paragraph. In such case, $360 (0.06 × $100 × 60) of earnings and profits would be taken into account with respect to the preferred stock and $640 ($1,000 − $360), with respect to the common stock. Thus, if a United States shareholder owns 10 shares of common stock and 30 shares of preferred stock for 1964, its proportionate share of the earnings and profits for such year is $340 ([10/40 × $640] + [30/60 × $360]).

(ii) *Deficit in earnings and profits of a corporation in a chain or group.* A United States shareholder's proportionate share, with respect to stock to which the election to secure an exclusion under section 963 relates, of a deficit in earnings and profits of a foreign corporation in a chain or group for a taxable year shall be the portion of such deficit which, if such corporation had earnings and profits for such year as determined under subparagraph (1) of this paragraph and all of such earnings and profits were distributed on the date described in subdivision (i)(*a*) of this subparagraph, the share of such earnings and profits such shareholder would receive bears to the total of the earnings and profits which would be so distributed on such date. For the determination of the deficit of a foreign branch treated as a wholly owned foreign subsidiary corporation and included in a group, see paragraph (f)(4)(ii) of §1.963–1. A United States shareholder's proportionate share of the deficit of such a branch shall be the total deficit of such branch for the taxable year.

(iii) *Controlled foreign corporation for part of year.* If—

(*a*) Stock in a foreign corporation is owned within the meaning of section 958(a) by a United States shareholder on the last day in the taxable year of such corporation for which such corporation is a controlled foreign corporation to which applies an election by such shareholder to secure an exclusion under section 963 with respect to such stock, or

(*b*) Stock in a foreign corporation which is not a controlled foreign corporation is owned within the meaning of section 958(a) by a United States shareholder on the last day in the taxable year of such corporation on which another foreign corporation (which, by reason of the stock so owned, is owned by such shareholder within the meaning of section 958(a)) is a controlled foreign corporation to which applies an election by such shareholder to secure an exclusion under section 963 with respect to such stock,

the earnings and profits of such foreign corporation for the taxable year which are taken into account in determining such shareholder's proportionate share thereof shall be an amount of such earnings and profits, determined as provided in subparagraph (1) of this paragraph, which bears to the total of such earnings and profits the same ratio which the part (computed on a daily basis) of such year during which such corporation is a controlled foreign corporation (or, in case such corporation is not a controlled foreign corporation, during which such other corporation is a controlled foreign corporation) bears to the total taxable year. If the United States shareholder by sufficient records and accounts establishes to the satisfaction of the district director the gross income received or accrued, and the deductions paid or accrued, for the part of such year during which such corporation is a controlled foreign corporation (or, in case such corporation is not a controlled foreign corporation, during which such other corporation is a controlled foreign corporation), the amount of earnings and profits based on such records and accounts may be used in lieu of the amount determined under the preceding sentence. The application of this subdivision may be illustrated by the following examples:

Example 1. Domestic corporation M on June 30, 1963, purchases 60 percent of the one class of stock of A Corporation which on July 1 becomes a controlled foreign corporation and remains such throughout the remainder of 1963. Both corporations use the calendar year as the taxable year. Corporation M makes a first-tier election with respect to A Corporation. For 1963, A Corporation has $100 of earnings and profits, as determined under subparagraph (1) of this

paragraph. Corporation M's proportionate share of such earnings and profits for 1963 is $30.25 (0.60 × [184/365 × $100]).

Example 2. (a) Throughout 1963 domestic corporation M directly owns 20 percent of the one class of stock of foreign corporation A, not a controlled foreign corporation at any time, which directly owns 50 percent of the one class of stock of foreign corporation B, which becomes a controlled foreign corporation on July 1, 1963, and remains such throughout the remainder of 1963. All such corporations use the calendar year as the taxable year. Each of corporations A and B has earnings and profits for 1963 of $100, as determined under subparagraph (1) of this paragraph. Corporation M makes a chain election for 1963 with respect to corporations A and B. Corporation M's proportionate share of the earnings and profits of A Corporation for 1963 is $10.08 (0.20 × [184/365 × $100]). Corporation M's proportionate share of the earnings and profits of B Corporation for 1963 is $5.04 (0.20 × 0.50 × [184/365 × $100]).

(b) If B Corporation had been a controlled foreign corporation throughout 1963, M Corporation's proportionate share of the earnings and profits of corporations A and B for 1963 would have been $20 (0.20 × $100) and $10 (0.20 × 0.50 × $100), respectively.

(c) If corporations A and B had each been a controlled foreign corporation only for the period of January 1, 1963, through June 30, 1963, M Corporation's proportionate share of the earnings and profits of such corporations would have been $9.92 (0.20 × [181/365 × $100]) and $4.98 (0.20 × 0.50 × [181/365 × $100]), respectively.

(d) If A Corporation had been a controlled foreign corporation throughout 1963 or during the period of July 1, 1963, through December 31, 1963, but B Corporation had been a controlled foreign corporation only during the period of January 1, 1963, through June 30, 1963, M Corporation's proportionate share of the earnings and profits of such corporations would have been $20 (0.20 × $100) and $4.96 (0.20 × 0.50 × [181/365 × $100]), respectively.

(3) *Consolidated earnings and profits with respect to United States shareholder.* The consolidated earnings and profits of a chain or group with respect to any United States shareholder for the taxable year shall be the sum of such shareholder's proportionate shares of the earnings and profits, and of the deficit in earnings and profits, determined under subparagraph (2) of this paragraph, for such year of all foreign corporations, whether or not controlled foreign corporations, in such chain or group.

(e) *Foreign income taxes used in determining effective foreign tax rate.* For purposes of determining the effective foreign tax rate under paragraph (c) of this section—

(1) *Shareholder's proportionate share of taxes of a foreign corporation.* The foreign income tax of a foreign corporation for a taxable year shall consist of the foreign income tax referred to in paragraph (d)(1)(ii) of this section with respect to such year and, if the United States shareholder chooses to take the foreign income tax described in paragraph (d)(1)(iii) of this section into account in determining the effective foreign tax rate of a chain or group which includes such foreign corporation, the foreign income tax referred to in such paragraph with respect to such year. A United States shareholder's proportionate share, with respect to stock to which the election to secure an exclusion under section 963 applies, of the foreign income tax of such foreign corporation for a taxable year shall be the same proportion of such foreign income tax that such shareholder's proportionate share (as determined under paragraph (d)(2)(i) of this section) of the earnings and profits of such corporation for such year bears to the total earnings and profits of such corporation for such year. A United States shareholder's proportionate share of the foreign income tax, for the taxable year, of a branch treated as a wholly owned foreign subsidiary corporation and included in a group under paragraph (f)(4) of §1.963–1 shall be the total foreign income tax of such branch for the taxable year.

(2) *Consolidated foreign income taxes with respect to United States shareholder.* The consolidated foreign income taxes of a chain or group with respect to a United States shareholder for the taxable year of such chain or group shall be the sum of such shareholder's proportionate shares (as determined under subparagraph (1) of this paragraph) of the foreign income tax of all foreign corporations, whether or not controlled foreign corporations, in such chain or group.

(3) *Taxes paid by foreign corporation on distributions received during its distribution period.* If a distribution received by a foreign corporation in a chain or

group from another foreign corporation in such chain or group after the close of the recipient's taxable year but during its distribution period for such year is allocated to the earnings and profits of such recipient corporation for such year under paragraph (c)(2) of §1.963–3, then any foreign income tax paid or accrued by such recipient corporation on such distribution shall be treated as paid or accrued for such taxable year.

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

Example 1. For 1966, domestic corporation M makes a first-tier election with respect to controlled foreign corporation A, 80 percent of the one class of stock of which M Corporation owns directly. Both corporations use the calendar year as the taxable year. For 1966, A Corporation has earnings and profits (before reduction for foreign income tax) of $100 with respect to which it pays foreign income tax of $30. Its earnings and profits are $70 ($100 − $30). Corporation M's proportionate share of such earnings and profits is $56 (0.80 × $70), and its proportionate share of the foreign income tax is $24 ($56/$70 × $30). The effective foreign tax rate is 30 percent ($24/[$56 + $24]). Based on such effective foreign tax rate, the statutory percentage under section 963(b)(3) for 1966 is 69 percent. Thus, the amount of the minimum distribution which M Corporation must receive from A Corporation's 1966 earnings and profits is a dividend of $38.64 (0.69 × $56).

Example 2. For 1966, domestic corporation M makes a first-tier election with respect to controlled foreign corporation A, all of whose one class of stock M Corporation owns directly. Both corporations use the calendar year as the taxable year. For 1966, A Corporation has earnings and profits (before reduction for income tax) of $100, of which $40 is attributable to income from sources within the United States on which $12 United States income tax is paid. The foreign country in which A Corporation is incorporated imposes an income tax at 30 percent on the $100 but allows a credit against its tax for the $12 of United States income tax, so that it imposes a net foreign income tax of $18 for 1966. In determining the effective foreign tax rate of A Corporation for 1966, such $12 of United States income tax may be treated as foreign income tax to the extent it does not exceed $17.28 ($40 × 0.90 × 0.48). Corporation A has earnings and profits of $70 for 1966. Although A Corporation's effective foreign tax rate for 1966 is 30 percent, determined by dividing $30 by the sum of $70 plus $30, none of the United States tax which is taken into account in determining such rate shall be treated as foreign income tax for purposes of determining the foreign tax credit of M Corporation under section 902. Based on such effective foreign tax rate, the statutory percentage under section 963(b)(3) for 1966 is 69 percent. Thus, the amount of the minimum distribution which M Corporation must receive from A Corporation's 1966 earnings and profits is a dividend of $48.30 (0.69 × $70).

Example 3. Domestic corporation M directly owns throughout 1966, 60 percent of the one class of stock of controlled foreign corporation A, not a less developed country corporation under section 902(d), which has for 1966 earnings and profits of $70 (all of which is attributable to subpart F income) after having paid foreign income tax of $30. Both corporations use the calendar year as the taxable year. Corporation A is created under the laws of a foreign country which imposes a 6-percent dividend withholding tax. Corporation M would be required, but for section 963, to include $42 (0.60 × $70) of A Corporation's subpart F income in gross income under section 951(a)(1)(A)(i). For 1966, however, M Corporation makes a first-tier election with respect to A Corporation. Since the tax withheld on distributions made by A Corporation is considered to have been paid by M Corporation, the effective foreign tax rate applicable to A Corporation for 1966 is only 30 percent, the percentage which such $30 of foreign income tax is of $100 (the sum of $30 plus $70). Thus, the statutory percentage under section 963(b) for 1966 is 69 percent. The amount of the minimum distribution which M Corporation must receive from A Corporation's 1966 earnings and profits is the distribution M Corporation will receive if A Corporation distributes 69 percent of its earnings and profits for 1966. Thus, if M Corporation receives a distribution of 69 percent of its proportionate share of such earnings and profits or $28.98 (0.69 × 0.60 × $70), it may exclude from gross income for 1966 $42 otherwise required to be included in gross income under section 951(a)(1)(A)(i) and will determine its income tax, assuming no other income and no surtax exemption under section 11(c), as follows:

Dividend	$28.98
Gross-up under section 78 ($28.98/ $70 × $30)	12.42
Taxable income	41.40
U.S. tax before foreign tax credit ($41.40 × 0.48)	19.87
Foreign tax credit ($12.42 + [0.06 × $28.98])	14.16
U.S. tax payable	5.71

Example 4. (a) For 1966 domestic corporation M makes a chain election with respect to controlled foreign corporation A, all of whose one class of stock it directly owns, and controlled foreign corporation B, all of whose one class of stock is directly owned by A Corporation. Both foreign corporations are subject to a foreign income tax at a flat rate of 30 percent, and all corporations use the calendar year as a taxable year. For 1966, B Corporation has pretax earnings and profits

of $100 and distributes $51.50. For 1966, A Corporation has pretax earnings and profits of $151.50, consisting of $100 from selling activities and $51.50 received as a distribution from B Corporation, upon which it pays a foreign income tax of $45.45 (i.e., 30 percent of $151.50).

(b) Corporation M chooses under paragraph (d)(1)(iii) of this section to take the foreign tax paid by A Corporation on the dividend received from B Corporation into account in determining the effective foreign tax rate of the chain rather than count it toward the amount of the minimum distribution. Thus, to determine consolidated earnings and profits of the chain for 1966, A Corporation's pretax earnings and profits of $151.50 are first reduced by the intercorporate dividend of $51.50 received from B Corporation so that A Corporation has pretax and predistribution earnings and profits of $100 ($151.50 less $51.50). Corporation A's pretax and predistribution earnings and profits of $100 are then reduced by the foreign income tax of $30 (30 percent of $100) paid on such earnings and profits, resulting in predistribution earnings and profits of $70 ($100 less $30). Since M Corporation chooses to count toward the effective foreign tax rate, rather than toward the minimum distribution, A Corporation's foreign income tax of $15.45 ($0.30 \times 51.50$) imposed on the dividend received from B Corporation, such predistribution earnings and profits of $70 of A Corporation are further reduced by such $15.45 of tax to $54.55 ($70 − $15.45). Corporation B, having received no dividends from any other corporation in the chain, has predistribution earnings and profits of $70 ($100 less foreign income tax of $30).

(c) The consolidated earnings and profits of the chain for 1966 are $124.55 ($54.55 + $70). The consolidated foreign income taxes for such year are $75.45 ($30 + $15.45 + $30). The effective foreign tax rate of the chain for 1966 is 37.73 percent ($75.45/[$124.55 + $75.45]). The statutory percentage for 1966 under section 963(b)(3) is 51 percent. Thus, the amount of the minimum distribution which M Corporation must receive from the 1966 consolidated earnings and profits of the chain is $63.52 ($0.51 \times 124.55).

Example 5. The facts are the same as in example 4 except that M Corporation does not choose under paragraph (d)(1)(iii) of this section to take into account, in determining the effective foreign tax rate, the foreign income tax of $15.45 paid by A Corporation on the distribution of $51.50 received from B Corporation. In such case, the consolidated earnings and profits of the chain are $140 ($70 + $70) and the consolidated foreign income taxes are $60 ($30 + $30), the latter amount being determined without taking into account A Corporation's foreign income tax of $15.45 on the distribution of $51.50 received from B Corporation. The effective foreign tax rate for 1966 is 30 percent ($60/[$140 + $60]), and the statutory percentage under section 963(b) is 69 percent. Thus, the amount of the minimum distribution which must be made from the 1966 consolidated earnings and profits of the chain is $96.60 ($0.69 \times 140). For the counting of such $15.45 of A Corporation's tax toward the $96.60 amount of the minimum distribution, see paragraph (b)(2) of § 1.963–3.

Example 6. For 1966 domestic corporation M directly owns the following percentages of the one class of stock of the following controlled foreign corporations in respect of which it makes a group election: 80 percent of A Corporation, 60 percent of B Corporation, and 70 percent of C Corporation. All corporations use the calendar year as the taxable year; none of the foreign corporations is a less developed country corporation under section 902(d). Each foreign corporation makes distributions during 1966. The consolidated earnings and profits, and the consolidated foreign income taxes, of the group for 1966 with respect to M Corporation, and the amount of the minimum distribution which M Corporation must receive, are determined as follows, based on the earnings and profits and foreign income tax shown in the following table:

	Controlled foreign corporations		
	A	B	C
Predistribution and pretax earnings and profits	$100	$100	$100.00
Foreign income tax	15	25	35.00
Predistribution earnings and profits	85	75	65.00
M Corporation's proportionate share of earnings and profits:			
($0.80 \times $85)	68		
($0.60 \times $75)	.....	45	
($0.70 \times $65)	.....	.....	45.50
Consolidated earnings and profits with respect to M Corporation ($68 + $45 + $45.50)	.....	.....	158.50
M Corporation's proportionate share of foreign income tax:			
($15 \times [$68/$85])	12		
($25 \times [$45/$75])	.....	15	
($35 \times [$45.50/$65])	.....	.....	24.50
Consolidated foreign income taxes with respect to M Corporation ($12 + $15 + $24.50)	.....	.....	51.50

The effective foreign tax rate for 1966 is 24.5 percent ($51.50/[$158.50 + $51.50]) and the statutory percentage under section 963(b)(3) for such year is 76 percent. Thus, the amount of the minimum distribution which M Corporation must receive from the 1966 consolidated earnings and profits of the group is $120.46 ($0.76 \times 158.50).

Example 7. (a) For 1966 domestic corporation M makes a chain election with respect to the following controlled foreign corporations: A Corporation, 80 percent of whose one class of stock M Corporation owns directly;

B Corporation, 60 percent of whose one class of stock is directly owned by A Corporation; and C Corporation, 70 percent of whose one class of stock is directly owned by B Corporation. All corporations use the calendar year as the taxable year; none of the foreign corporations is a less developed country corporation under section 902(d). The predistribution and pretax earnings and profits of each foreign corporation are $100. Each foreign corporation pays a flat rate of foreign income tax on all income computed without reduction for dividends paid and determined by including dividends received. Such rate is 15 percent for A Corporation, 25 percent for B Corporation, and 35 percent for C Corporation. Corporation C distributes $65, and B Corporation distributes $100, for 1966. Corporation M chooses under paragraph (d)(1)(iii) of this section to count toward the effective foreign tax rate, rather than toward the amount of the minimum distribution, the foreign income tax paid by corporations A and B, respectively, on distributions received from corporations B and C, respectively.

(b) The consolidated earnings and profits, and the consolidated foreign income taxes, of the chain, and the amount of the minimum distribution for 1966, with respect to M Corporation are determined as follows:

	Controlled foreign corporations			
	A	B	C	Total
Pretax earnings and profits	$160.00	$145.50	$100.00	
Reduction for intercorporate dividends:				
(0.60 × $100)	60.00			
(0.70 × $65)	.....	45.50		
Pretax and predistribution earnings and profits	100.00	100.00	100.00	
Reduction for foreign income tax on such pretax and predistribution earnings and profits:				
(0.15 × $100)	15.00			
(0.25 × $100)	.....	25.00		
(0.35 × $100)	.....	.....	35.00	
Predistribution earnings and profits	85.00	75.00	65.00	
Reduction for foreign income tax on intercorporate distributions of 1966 earnings and profits:				
(0.15 × $60)	9.00			
(0.25 × $45.50)	.....	11.38		
	76.00	63.62	65.00	
Consolidated earnings and profits with respect to M Corporation:				
(0.80 × $76)	60.80			
(0.80 × 0.60 × $63.62)	.....	30.54		
(0.80 × 0.60 × 0.70 × $65)	.....	.....	21.84	$113.18
Consolidated foreign income taxes with respect to M Corporation:				
($60.80/$76 × [$15 + $9])	19.20			
($30.54/$63.62 × [$25 + $11.38])	.....	17.46		
($21.84/$65 × $35)	.....	.....	11.76	$48.42
Effective foreign tax rate ($48.42/[$113.18 + $48.42])	.....	.....	.....	29.96%
Statutory percentage under section 963(b)				69%
Amount of minimum distribution which M Corporation must receive from 1966 consolidated earnings and profits (0.69 × $113.18), no amount of the tax on intercorporate distributions being counted toward the minimum distribution	.....	.....	.....	$78.0

Example 8. The facts are the same as in example 7 except that M Corporation does not choose under paragraph (d)(1)(iii) of this section to take into account, in determining the effective foreign tax rate, the foreign income tax paid by the recipient corporations on the intercorporate distributions. The consolidated earnings and profits, the consolidated foreign income taxes, of the chain, and the amount of the minimum distribution which M Corporation must receive, for 1966 are determined as follows:

	Controlled foreign corporations			
	A	B	C	Total
Pretax earnings and profits	$160.00	$145.50	$100.00	
Reduction for intercorporate dividends:				
(0.60 × $100)	60.00			
(0.70 × $65)	.....	45.50		

	Controlled foreign corporations			
	A	B	C	Total
Pretax and predistribution earnings and profits	100.00	100.00	100.00	
Reduction for foreign income tax on such pretax and predistribution earnings and profits:				
(0.15 × $100)	15.00			
(0.25 × $100)	.....	25.00		
(0.35 × $100)	.....	.....	35.00	
Predistribution earnings and profits	85.00	75.00	65.00	
Consolidated earnings and profits with respect to M Corporation:				
(0.80 × $85)	68.00			
(0.80 × 0.60 × $75)	.....	36.00		
(0.80 × 0.60 × 0.70 × $65)	.....	.....	21.84	$125.84
Consolidated foreign income taxes with respect to M Corporation:				
($68/$85 × $15)	12.00			
($36/$75 × $25)	.....	12.00		
($21.84/$65 × $35)	.....	.....	11.76	$35.76
Effective foreign tax rate ($35.76/[$125.84 + $35.76])	.....	.....	.....	22.13%
Statutory percentage under section 963(b)	.....	.....	.....	76%
Amount of minimum distribution to be made from 1966 consolidated earnings and profits with respect to M Corporation: (0.76 × $125.84)	.....	.....	.....	$95.64
Foreign income tax on intercorporate distributions of 1966 earnings and profits which is counted toward the minimum distribution (see § 1.963–3(b)(2)):				
($68/$85 × [0.15 × $60])	7.20			
($36/$75 × [0.25 × $45.50])	.....	5.46	.....	$12.66
Amount of minimum distribution which M Corporation must actually receive from the chain ($95.64 − $12.66)	.....	.....	.....	$82.98

[T.D. 6759, 29 FR 13329, Sept. 25, 1964, as amended by T.D. 6767, 29 FR 14877, Nov. 3, 1964; T.D. 7100, 36 FR 5335, Mar. 20, 1971]

§ 1.963–3 Distributions counting toward a minimum distribution.

(a) *Conditions under which earnings and profits are counted toward a minimum distribution*—(1) *In general.* A distribution to the United States shareholder by a single first-tier corporation or by a foreign corporation included in a chain or group shall count toward a minimum distribution for the taxable year of such shareholder to which the election under section 963 relates only to the extent that—

(i) It is received by such shareholder during such year or within 180 days thereafter,

(ii) It is a distribution of the type described in paragraph (b) of this section,

(iii) Under paragraph (c) of this section, it is deemed to be distributed from the earnings and profits of the foreign corporations for the taxable year of such corporation to which the election relates, and

(iv) Such shareholder chooses to include it in gross income for the taxable year of such shareholder to which the election relates notwithstanding that such distribution, by reason of its receipt after the close of such year, would ordinarily be includible in the gross income of a subsequent year.

Amounts taken into account under this subparagraph as gross income of the United States shareholder for the taxable year to which the election relates shall not be considered to be includible in the gross income of such shareholder for a subsequent taxable year. For purposes of determining the foreign tax credit under sections 901 through 905, foreign income tax paid or accrued by such shareholder on or with respect to such amounts shall be treated as paid or accrued during the taxable year of such election.

(2) *Distributions made prior to acquisition of stock.* A United States shareholder which owns within the meaning of section 958(a) stock in a foreign corporation with respect to which such shareholder elects to secure an exclusion under section 963 for the taxable year may count toward the minimum distribution any distribution made with respect to such stock, and before its acquisition by the United States shareholder, to any other domestic corporation not exempt from income tax