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$10 of A Corporation's increase in earnings invested in United States property for such year would count toward a minimum distribution for any other year but would be included in the gross income for M Corporation for 1964 under section 951(a)(1)(B), and the foreign tax credit in respect of such amount would be determined in accordance with §1.960–1.

Example 3. For 1964 domestic corporation M makes a chain election with respect to controlled foreign corporation A, all the one class of stock of which is owned directly by M Corporation, and controlled foreign corporation B, all the one class of stock of which is owned directly by A Corporation. Corporation M makes no election under section 963 for 1963 or 1965. Corporations M and B use the calendar year as the taxable year, and A Corporation uses for its taxable year a fiscal year ending on September 30. Corporation M elects to have the distribution period for each controlled foreign corporation end on March 29, 1965, such date being the 180th day after the close of A Corporation's taxable year ending on September 30, 1964. Corporation A's distribution period for its taxable year ending on September 30, 1964, begins on November 30, 1963, the 61st day of such taxable year. The distribution period of B Corporation for 1964 begins on March 1, 1964, the 61st day of such taxable year. A distribution counting toward a minimum distribution for 1964 may be made from the earnings and profits of B Corporation only if the amount thereof is distributed by B Corporation to A Corporation, and in turn by A Corporation to M Corporation, during the period of March 1, 1964, through March 29, 1965.

Example 4. The facts are the same as in example 3, except that for their taxable years ending in 1964, corporations A and B each have earnings and profits (before distributions) of $100. On March 10, 1965, B Corporation distributes to A Corporation a dividend of $80 upon which A Corporation incurs foreign income tax at the rate of 10 percent. On March 15, 1965, A Corporation distributes to M Corporation a dividend of $50. Corporation M chooses to take into account as gross income for 1964 from such distribution only $40. For purposes of applying this section, the distribution counting toward a minimum distribution is $44.44, consisting of the $40 of earnings and profits actually received by M Corporation plus the $4.44 ($40/$72 × $8) of foreign income tax incurred by A Corporation attributable thereto; A Corporation is deemed to have received $44.44 ($40 ÷ 0.90) of the distribution from B Corporation on September 30, 1964, the last day of the taxable year of A Corporation to which the election relates; and the foreign personal holding company income derived by A Corporation for its taxable year ending in 1965 from the distribution from B is only $35.56 ($80 − $44.44). Assuming that no exceptions, exclusions, or exemptions were applicable, subpart F income would be realized by A Corporation for its taxable year ending on September 30, 1965, upon the distribution by B Corporation to A Corporation, but only in the amount of $32 ($35.56 less a deduction under section 954(b)(5) for taxes of $3.56).

[T.D. 7100, 36 FR 10860, June 4, 1971; 36 FR 11924, June 23, 1971, as amended by T.D. 7334, 39 FR 44214, Dec. 23, 1974]

§ 1.963–4 Limitations on minimum distribution from a chain or group.

(a) *Minimum overall tax burden*—(1) *In general.* Notwithstanding the fact that distributions of the type described in paragraph (a) of §1.963–3 are made by a chain or group to the United States shareholder in an amount sufficient to constitute a minimum distribution for the taxable year of such shareholder to which the chain or group election relates, no exclusion shall be allowable under section 963 to such shareholder with respect to such chain or group for such year unless—

(i) Without applying the special rules set forth in paragraphs (b) and (c) of this section, the overall United States and foreign income tax (as defined in subparagraph (2)(ii) of this paragraph) for the taxable year with respect to the distribution which is made equals or exceeds 90 percent of an amount determined by multiplying the sum of the consolidated earnings and profits (as determined under paragraph (d)(3) of §1.963–2) and the consolidated foreign income taxes (as determined under paragraph (e)(2) of §1.963–2) of such chain or group for the taxable year with respect to such shareholder by a percentage which equals 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 shareholder, or

(ii) With the application of the special rules set forth in paragraphs (b) and (c) of this section—

(*a*) Such shareholder receives a pro rata minimum distribution (as defined in subparagraph (2)(i) of this paragraph) from such chain or group for such taxable year, or

(*b*) To the extent necessary, the amount of the foreign income tax allowable as a credit for such year under

section 901 with respect to the distribution which is made is reduced and credit for the reduction is deferred, as provided in paragraph (c)(3) of this section, so that the overall United States and foreign income tax for the taxable year with respect to such distribution equals or exceeds the lesser of—

(*1*) The overall United States and foreign income tax which would be paid or accrued for such year with respect to a pro rata minimum distribution received by such shareholder from such chain or group for such year, and

(*2*) Ninety percent of an amount determined by multiplying the sum of the consolidated earnings and profits (as determined under paragraph (b)(1) of this section) and the consolidated foreign income taxes (as determined under paragraph (b)(1) of this section) of such chain or group for the taxable year with respect to such shareholder by a percentage which equals 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 shareholder.

(2) *Definitions.* For purposes of §§ 1.963–1 through 1.963.8—

(i) *Pro rata minimum distribution.* A pro rata minimum distribution from a chain or group for the taxable year is a distribution of earnings and profits to the United States shareholder, with respect to stock to which the chain or group election relates, which is the statutory percentage (applicable with respect to such chain or group as determined under paragraph (b) of § 1.963–2) of the United States shareholder's proportionate share of the taxable year's earnings and profits of each foreign corporation in such chain or group (determined in accordance with paragraph (d)(2) of § 1.963–2 but without making any deduction under paragraph (d)(1)(iii) of such section).

(ii) *Overall United States and foreign income tax.* The overall United States and foreign income tax for any taxable year of a chain or group with respect to a minimum distribution is the sum of—

(*a*) The consolidated foreign income taxes of the chain or group for such year with respect to the United States shareholder making the chain or group election,

(*b*) Any other foreign income tax paid or accrued by a foreign corporation in the chain or group by reason of the receipt of any distributions counting toward such minimum distribution from such chain or group for that year, and

(*c*) The foreign income tax, if any, and United States income tax paid or accrued by such shareholder upon amounts counting toward such minimum distribution from such chain or group for such year.

Such overall United States and foreign income tax shall be determined with respect to such minimum distribution without taking into account any foreign income tax which is deemed paid for such year under section 904(d), relating to carryback and carryover of excess tax paid. For purposes of this subdivision, the consolidated foreign income taxes of the chain or group shall be determined under paragraph (e)(2) of § 1.963–2, applied without regard to the second sentence of paragraph (d)(1) of that section.

(3) *Taxes paid by foreign corporation on distributions received during its distribution period.* For purposes of determining foreign income tax deemed paid by the United States shareholder for the taxable year under section 902, 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, 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.

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

Example. (a) Domestic corporation M directly owns all of the one class of stock of foreign corporation A, which in turn directly owns all of the one class of stock of foreign corporation B. Corporation M makes a chain election with respect to A Corporation and B Corporation. All such corporations use the calendar year as the taxable year. Assuming that A Corporation does not incur foreign tax on amounts distributed by B Corporation, the foreign income tax and earnings

and profits of corporations A and B, the effective foreign tax rate, and the statutory percentage for 1966, are as follows:

	A	B	Consolidated
Pretax and predistribution earnings and profits	$100	$100	$200
Foreign income tax	20	40	60
Earnings and profits	80	60	140
Effective foreign tax rate ($60/[$140 + $60])	.....	.....	30%
Statutory percentage under section 963(b)	.....	.....	69%

(b) Corporation M is entitled for 1966 to exclude its pro rata share of the subpart F income of corporations A and B for such year if it receives from the 1966 consolidated earnings and profits of the chain distributions totaling at least $96.60 (0.69 × $140) and if—

(1) The sum of the consolidated foreign income taxes ($60) of the chain for 1966 and of the United States income tax for 1966 (determined by taking into account the foreign tax credit under section 901 without regard to paragraph (c) of this section) imposed on such distributions equals at least $86.40 (0.90 × 0.48 × $200);

(2) Under the special rules of paragraphs (b) and (c) of this section, the distributions received consist of a distribution from each of corporations A and B which is 69 percent of the earnings and profits for 1966 of such corporation, that is, a distribution of $55.20 (0.69 × $80) from A Corporation and of $41.40 (0.69 × $60) from B Corporation; or

(3) Under the special rules of paragraphs (b) and (c) of this section, the foreign tax credit is reduced and deferred to such an extent that the sum of the consolidated foreign income taxes ($60) of the chain for 1966 and of the United States income tax for 1966 (determined by taking into account the foreign tax credit under section 901 as modified by paragraph (c) of this section) imposed on such distributions equals the lesser of $86.40 (0.90 × 0.48 × $200) and the amount which the sum of such taxes would be if M Corporation were to receive a distribution of $55.20 (0.69 × $80) from the 1966 earnings and profits of A Corporation and $41.40 (0.69 × $60) from the 1966 earnings and profits of B Corporation.

(b) *Special rules for determining earnings and profits and foreign income taxes.* For purposes of determining the minimum overall tax burden under paragraph (a)(1)(ii) of this section, §§ 1.963–2 and 1.963–3 shall apply as modified by the following subparagraphs:

(1) *Exclusion of tax on intercorporate distributions.* The consolidated earnings and profits and consolidated foreign income taxes of a chain or group for the taxable year shall be determined in accordance with § 1.963–2, except that foreign income tax referred to in paragraph (d)(1)(iii) of such section may be taken into account in determining the effective foreign tax rate only—

(i) To the extent that such tax is not deemed paid by the United States shareholder under section 902 (as modified by paragraph (c) of this section) for its taxable year to which the chain or group election relates, or

(ii) If, by taking the tax into account, the effective foreign tax rate with respect to such chain or group, as determined under paragraph (c)(2) of § 1.963–2, exceeds the highest effective foreign tax rate requiring a distribution under section 963(b) for such year of the shareholder.

(2) *Allocation of deficits.* For purposes of determining the amount of each foreign corporation's share of a pro rata minimum distribution from a chain or group for the taxable year and for purposes of determining the foreign tax credit under paragraph (c) of this section of the United States shareholder with respect to any minimum distribution from a chain or group for the taxable year—

(i) *Deficits of foreign corporations.* The total of the United States shareholder's proportionate shares, as determined under paragraph (d)(2)(ii) of § 1.963–2, of the deficit of every foreign corporation in the chain or group having a deficit for the taxable year shall be allocated against and shall reduce such shareholder's proportionate share, as determined under paragraph (d)(2)(i) of § 1.963–2, of the earnings and profits for the taxable year of each other foreign corporation in the chain or group having earnings and profits for such year in an amount which bears to such total of shares of deficit the same ratio which such share of earnings and profits bears to the total of such shareholder's proportionate shares, as so determined, of the earnings and profits of all foreign corporations in the chain or group having earnings and profits for the taxable year.

(ii) *Deficits of foreign branches.* If for the taxable year a group includes under paragraph (f)(4) of § 1.963–1 foreign

branches the aggregate of whose allowable deductions (other than any net operating loss deduction) exceeds the aggregate of their gross incomes for the taxable year, determined as provided in paragraph (f)(4)(ii) of such section, the amount of such excess shall be allocated as provided by subdivision (i) of this subparagraph.

(3) *Distributions through a chain or group.* In determining whether and to what extent a distribution for any taxable year has been made out of the earnings and profits of a foreign corporation included in a chain of ownership described in section 958(a) consisting of two or more corporations in a chain or group for the taxable year, the following subdivisions shall apply:

(i) *Allocation first to income received as a distribution.* If any foreign corporation included in the chain or group for the taxable year receives a distribution for such year from another foreign corporation in the chain or group and in turn makes a distribution for the taxable year, the distribution so made shall first be allocated to the earnings and profits, to the extent thereof, attributable to the distribution so received; if distributions are received from more than one other corporation in the chain or group, the distribution made by the recipient corporation shall be apportioned among all such amounts. For purposes of determining whether a distribution is made or received for the taxable year, see paragraph (c) of §1.963–3.

(ii) *Successive distributions through a chain or group.* If any foreign corporation included in the chain or group for the taxable year distributes an amount from its earnings and profits of such year, the amount so distributed shall be considered to be received from such earnings and profits by the United States shareholder to the extent the amount is distributed by successive distributions made by each other foreign corporation in the chain or group for the taxable year through the chain of ownership described in section 958(a) into the hands of such shareholder.

(iii) *Distribution determined without reduction by taxes of intervening corporations.* If, for the taxable year to which the election to secure an exclusion under section 963 applies, the United States shareholder receives a distribution to which subdivision (ii) of this subparagraph applies, the entire amount distributed by the foreign corporation from such shareholder's proportionate share of its earnings and profits for the taxable year shall, except where taxes referred to in paragraph (d)(1)(iii) of §1.963–2 are taken into account as provided by subparagraph (1) of this paragraph, count toward a minimum distribution and shall not be reduced for such purpose by a foreign income tax paid or accrued on such amount by another foreign corporation in the chain or group through which such amount is distributed by successive distributions into the hands of such shareholder. The application of this subdivision may be illustrated by the following examples:

Example 1. For 1966, domestic corporation M makes a chain election with respect to controlled foreign corporation A, all the one class of stock of which is directly owned by M Corporation, and controlled foreign corporation B, all the one class of stock of which is directly owned by A Corporation. All corporations use the calendar year as the taxable year. Corporation M complies with the special rules of this paragraph and paragraph (c) of this section for the taxable year. Corporation A's only income for 1966 is a dividend of $52.50 distributed in such year by B Corporation, on which A Corporation is subject to an income tax of $10.50. The remaining $42 ($52.50 less $10.50) is distributed by A Corporation for 1966 to M Corporation. The full $52.50 distributed by B Corporation counts toward a minimum distribution by the chain for 1966.

Example 2. For 1966, domestic corporation M makes a chain election with respect to controlled foreign corporation A, all the one class of stock of which it owns directly, and controlled foreign corporation B, all the one class of stock of which A Corporation own directly. All corporations use the calendar year as the taxable year. Corporation M complies with the special rules of this paragraph and paragraph (c) of this section for the taxable year. The predistribution and pretax earnings and profits for 1966 of B Corporation are $100, and of A Corporation, $0. Corporation B pays foreign income tax of $30 and during the year distributes $70. On such $70, A Corporation pays foreign income tax of $14. By applying paragraph (d)(1)(iii) of §1.963–2, the consolidated foreign income taxes of the chain for 1966 are $44 ($30 + $14) and the consolidated earnings and profits of the chain are $56 ($70 − $14); in such case, the effective foreign tax rate of the chain for 1966

is 44 percent ($44/[$56 + $44]) and thus in excess of the highest effective foreign tax rate requiring a distribution for such year under section 963(b). Since M Corporation may thus take A Corporation's tax of $14 into account, the statutory percentage under section 963(b) for 1966 is zero percent and the amount of the minimum distribution required to be made by the chain is $0.

(c) *Special foreign tax credit rules*—(1) *In general.* In determining the minimum overall tax burden under paragraph (a)(1)(ii) of this section, the foreign tax credit of the United States shareholder with respect to a minimum distribution received for the taxable year from the chain or group shall be determined under the provisions of sections 901 through 905 as modified by §1.963–3 except that—

(i) Under subparagraph (2) of this paragraph—

(*a*) Taxes of a second-tier corporation making a distribution through a first-tier corporation shall not be averaged with taxes of such first-tier corporation,

(*b*) Taxes of a first-tier corporation or a second-tier corporation on a distribution made through such corporation shall not be averaged with such corporation's taxes on its other income; and

(*c*) Taxes of a first-tier corporation or a second-tier corporation shall not be deemed paid with respect to distributions from the earnings and profits of such corporation which are offset by a deficit allocated under paragraph (b)(2) of this section to the United States shareholder's proportionate share of the earnings and profits of such corporation; and

(ii) The foreign tax credit may be reduced and the reduction deferred under subparagraph (3) of this paragraph to another taxable year of the United States shareholder.

(2) *Nonaveraging of tax*—(i) *Year of minimum distribution—(a) Taxes deemed paid by a first-tier corporation and taxes actually paid by such corporation.* If, by successive distributions through a chain or group, a United States shareholder receives for a taxable year a distribution of the earnings and profits for such year of any corporation in such chain or group, and if both section 902(a) and section 902(b) apply with respect to such distribution, all the taxes deemed paid under section 902(b) by the first-tier corporation described in section 902(a) with respect to such distribution of such earnings and profits shall be deemed paid by the United States shareholder for such taxable year under section 902(a) with respect to the earnings and profits so distributed and, notwithstanding the rules otherwise applicable under section 902, no part of the taxes so deemed paid by such first-tier corporation shall be attributed to other earnings and profits of such first-tier corporation for such year and no part of the taxes paid or accrued with respect to such other earnings and profits shall be attributed to the earnings and profits so received as a distribution.

(*b*) *Taxes of a foreign corporation paid on intercorporate distributions and on other income.* If, by successive distributions through a chain or group, a United States shareholder receives for a taxable year a distribution of the earnings and profits for such year of any corporation in such chain or group, then in applying section 902(a) with respect to such distribution through a first-tier corporation described in section 902(a), or in applying section 902(b) with respect to such distribution through a second-tier corporation described in section 902(b), as the case may be, the taxes of such corporation which shall be taken into account in determining taxes deemed paid under such section shall be the foreign income tax actually paid or accrued for the taxable year by such first-tier or second-tier corporation, as the case may be, with respect to such distribution; and, notwithstanding the rules otherwise applicable under section 902, no part of the taxes so paid by such first-tier or second-tier corporation shall be attributed to other earnings and profits of such corporation for such year and no part of the taxes paid or accrued with respect to such other earnings and profits shall be attributed to the earnings and profits so received as a distribution.

(*c*) *Corporation with earnings and profits reduced by allocated deficits.* In the application of section 902, a United States shareholder's proportionate share of the earnings and profits for

the taxable year of a foreign corporation to which the chain or group election applies shall reflect the reduction of such earnings and profits by deficits allocated thereto under paragraph (b)(2) of this section. No taxes paid or accrued by such corporation shall be deemed paid under section 902 with respect to a distribution to such shareholder from the earnings and profits of such corporation for such year to the extent that such distribution exceeds the shareholder's proportionate share as so reduced.

(ii) *Year of distribution of remaining earnings and profits.* If for a taxable year in respect of which a United States shareholder receives a minimum distribution pursuant to an election under section 963 and in respect of which the provisions of this subparagraph are applied—

(*a*) The foreign income tax which is paid or accrued by a foreign corporation for such year, by reason of the receipt and payment of earnings and profits counting toward such minimum distribution, is deemed paid under subdivision (i) (*a*) or (*b*) of this subparagraph,

(*b*) The pretax and predistribution earnings and profits for such year of a foreign corporation in a chain or group with respect to stock on which such minimum distribution is received are reduced by reason of the deduction under paragraph (d)(1)(i) of §1.963–2 of distributions received from other corporations in such chain or group, or

(*c*) Such shareholder's proportionate share of the earnings and profits for such year of a foreign corporation in a chain or group making a distribution counting toward such minimum distribution is reduced by the allocation thereto under paragraph (b)(2) of this section of a portion of the deficits of foreign branches or other foreign corporations in such chain or group,

the pretax and predistribution earnings and profits of such foreign corporation for such year to which such minimum distribution is attributable and the foreign income tax which is taken into account in determining tax deemed paid under section 902 on such pretax and predistribution earnings and profits shall not be taken into account in the application of section 902 when other earnings and profits of such foreign corporation for such year are distributed in a subsequent taxable year of such foreign corporation to such shareholder. For the purpose of applying the preceding sentence to a case in which (*c*) of this subdivision applies, the pretax and predistribution earnings and profits of the foreign corporation for such year to which the minimum distributed is attributable shall be the amount of such corporation's earnings and profits which are distributed and count toward the minimum distribution plus the foreign income tax of such foreign corporation allocated thereto in determining the taxes deemed paid under section 902 for the taxable year of the minimum distribution.

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

Example 1. Domestic corporation M makes a chain election for 1966 with respect to controlled foreign corporation A, which is wholly owned directly by M Corporation, and controlled foreign corporation B, which is wholly owned directly by A Corporation. Each corporation uses the calendar year as the taxable year. In 1966, corporations A and B are subject to foreign income tax at the rates of 20 percent and 30 percent, respectively, with no deduction being allowed for dividends received or paid; each such corporation has pretax and predistribution earnings and profits of $100. Corporation M receives from the chain a pro rata minimum distribution for such year and applies thereto the special rules of this paragraph and paragraph (b) of this section. Corporation A is not a less developed country corporation under section 902(d). The 1966 foreign income tax of corporations A and B which is deemed paid by M Corporation under section 902(a) for 1966, and the remaining tax which is allocated to earnings and profits to be distributed to M Corporation in future years, are determined as follows:

	A	B	Total
Pretax and predistribution earnings and profits	$100.00	$100.00	$200.00
Foreign income tax	20.00	30.00	50.00
Consolidated earnings and profits	80.00	70.00	150.00
Effective foreign tax rate ($50/[$150 + $50])			25%

	A	B	Total
Statutory percentage under section 963(b)			76%
Amount distributed as pro rata minimum distribution for 1966:			
(0.76 × $80)	60.80		
(0.76 × $70)		53.20	114.00
Amount received by M Corporation as pro rata minimum distribution:			
A Corporation's distribution	$60.80		
B Corporation's distribution ($53.20 − [0.20 × $53.20]), or ($53.20 − $10.64)		$42.56	$103.36
Amount of tax counted toward minimum distribution			10.64
Tax deemed paid by M Corporation for 1966 for purposes of gross-up under section 78 and foreign tax credit:			
($60.80/$80 × $20)	15.20		
([$42.56/$42.56 × $10.64] + [$53.20/$70 × $30]) or ($10.64 + $22.80)		33.44	48.64
Remaining 1966 earnings and profits for future distribution to M Corporation:			
($80 − $60.80)	19.20		
($70 − $53.20)		16.80	36.00
Foreign income tax attributable to 1966 earnings and profits remaining for future distribution to M Corporation:			
($19.20/$80 × $20)	4.80		
($16.80/$70 × $30)		7.20	12.00

Example 2. The facts are the same as in example 1 except that A Corporation pays foreign income tax at the rate of 30 percent and B Corporation, at the rate of 20 percent; and A Corporation is allowed a deduction, in computing its income subject to tax, for the full amount of dividends received. The determination of tax deemed paid for 1966 is as follows:

	A	B	Total
Pretax and predistribution earnings and profits	$100.00	$100.00	$200.00
Foreign income tax	30.00	20.00	50.00
Consolidated earnings and profits	70.00	80.00	50.00
Effective foreign tax rate ($50/[$150 + $50])			25%
Statutory percentage under section 963(b)			76%
Amount distributed by foreign corporations as a pro rata minimum distribution for 1966 and amount received by M Corporation:			
(0.76 × $70)	$53.20		
(0.76 × $80)		$60.80	$114.00
Tax deemed paid by M Corporation for 1966 for purposes of gross-up under section 78 and foreign tax credit:			
($53.20/$70 × $30)	22.80		
($60.80/$80 × $20)		15.20	38.00
Remaining 1966 earnings and profits for future distribution to M Corporation:			
($70 − $53.20)	16.80		
($80 − $60.80)		19.20	36.00
Foreign income tax attributable to 1966 earnings and profits remaining for future distribution to M Corporation:			
($16.80/$70 × $30)	7.20		
($19.20/$80 × $20)		4.80	12.00

Example 3. For 1966, domestic corporation M makes a group election with respect to controlled foreign corporations A and B, both of which are wholly owned directly by M Corporation, and foreign branch C of M Corporation. All such corporations use the calendar year as the taxable year. Corporation M receives a pro rata minimum distribution from the group for 1966 and applies thereto the special rules of this paragraph and paragraph (b) of this section. Neither foreign corporation is a less developed country corporation under section 902(d). Corporations A and B pay foreign income tax at a flat rate of 20 percent and 30 percent, respectively. The 1966 foreign income tax of corporations A and B which is deemed paid by M Corporation under section 902(a) for 1966, and the remaining tax which is allocated to earnings and profits to be distributed to M Corporation in future years, are determined as follows:

	A	B	Branch C	Total
Pretax and predistribution earnings and profits (and deficit) of the group	$60.00	$60.00	($20)	$100.00
Foreign income tax	12.00	18.00		30.00
Earnings and profits (and deficit)	48.00	42.00	(20)	70.00
Allocation of deficit of Branch C:				
($48/[$48 + $42] × $20)	(10.67)			
($42/[$48 + $42] × $20)		(9.33)		
Consolidated earnings and profits of the group	37.33	32.67		70.00
Effective foreign tax rate ($30/$100)				30%
Statutory percentage under section 963(b)				69%

	A	B	Branch C	Total
Amount received by M Corporation as pro rata minimum distribution for 1966:				
(0.69 × $37.33)	25.76			
(0.69 × $32.67)		22.54		$48.30
Tax deemed paid by M Corporation for 1966 for purposes of gross-up under section 78 and foreign tax credit:				
($25.76/$37.33 × $12)	8.28			
($22.54/$32.67 × $18)		12.42		20.70
Remaining 1966 earnings and profits for future distribution to M Corporation:				
($48 − $25.76)	22.24			
($42 − $22.54)		19.46		41.70
Foreign income tax attributable to 1966 earnings and profits remaining for future distribution to M Corporation:				
($12 − $8.28)	3.72			
($18 − $12.42)		5.58		9.30

Example 4. The facts are the same as in example 3 except that the group does not make a pro rata minimum distribution but distributes $48.30, consisting of $40 distributed by A Corporation and $8.30 distributed by B Corporation. Corporation M complies with the special rules of this paragraph and paragraph (b) of this section. The 1966 foreign income tax of corporations A and B which is deemed paid by M Corporation under section 902(a) for 1966, and the remaining tax which is allocated to earnings and profits to be distributed to M Corporation in future years, are determined as follows, the minimum overall tax burden for 1966 being such as to satisfy the requirement of paragraph (a)(1)(ii)(*b*) of this section:

	A	B	Branch C	Total
Amount received by M Corporation	$40.00	$8.30		$48.30
Tax deemed paid by M Corporation for 1966 for purposes of gross-up under section 78 and foreign tax credit:				
($37.33/$37.33 × $12)	12.00			
($8.30/$32.67 × $18)		4.57		16.57
Remaining 1966 earnings and profits for future distribution to M Corporation:				
($48 − $40)	8.00			
($42 − $8.30)		33.70		41.70

	A	B	Branch C	Total
Foreign income tax attributable to 1966 earnings and profits remaining for future distribution to M Corporation:				
($12 − $12)	0			
($18 − $4.57)		13.43		13.43

(3) *Reduction and deferral of the foreign tax credit*—(i) *In general.* To the extent specified in paragraph (a)(1)(ii)(*b*) of this section a reduction shall be made in the foreign tax credit allowable under section 901 for the taxable year with respect to distributions counting toward a minimum distribution for such year from the chain or group; and such reduction in credit shall be allocated, as provided in subdivision (ii) of this subparagraph, to foreign corporations in such chain or group and deferred, as provided in subdivision (iii) of this subparagraph, to subsequent taxable years of the United States shareholder.

(ii) *Allocation of reduction in foreign tax credit.* The amount of any reduction in foreign tax credit for the taxable year which is made under subdivision (i) of this subparagraph with respect to a minimum distribution for any taxable year from the chain or group shall be allocated among any first-tier and second-tier corporations described in section 902 (a) and (b), respectively, which are in such chain or group. The amount of any such reduction in foreign tax credit shall be allocated among such first-tier and second-tier corporations in the ratio which the United States shareholder's proportionate share of undistributed earnings and profits of each such corporation for the taxable year bears to the total of such shareholder's proportionate shares of the undistributed earnings

and profits of all such corporations for such year. None of such reduction shall be allocated to any other corporations in the chain or group or to any foreign branches included under paragraph (f)(4) of § 1.963–1 in the group as wholly owned foreign subsidiary corporations.

(iii) *Deferral of allocated credit*—(*a*) *Allowance of credit in subsequent years.* The reduction in foreign tax credit allocated to a first-tier or second-tier corporation in the chain or group for a taxable year under subdivision (ii) of this subparagraph shall be deemed paid under the principles of section 902 (applicable to foreign corporations which are not less developed country corporations) with respect to distributions, to the extent made by such corporation to the United States shareholder referred to in subdivision (ii) of this subparagraph, in a subsequent taxable year from the undistributed earnings and profits of such corporation for such year of allocation. Thus, for example, in the case of a distribution in the subsequent year from such earnings and profits by a first-tier corporation, the tax deemed paid shall be an amount which bears to the total of such reduction in foreign tax credit the same ratio that the distribution to the shareholder in the subsequent year bears to such shareholder's proportionate share of such undistributed earnings and profits for the year of allocation.

(*b*) *Limitations on use of deferred credit.* The deferred tax so deemed paid shall be deemed paid for such subsequent taxable year and shall be allowed under section 901 (without regard to the limitations under section 904) as a credit against the income tax imposed for such year by chapter 1 of the Code, but the amount of such credit shall not exceed the excess of the tax so imposed for such year over the credit (determined without regard to this subdivision (iii) allowed under sections 901 through 905 for such year. Any amount by which the deferred tax so deemed paid in such subsequent taxable year exceeds the limitation under the preceding sentence shall not be carried back or carried over under section 904(d) to another taxable year of the United States shareholder. No credit shall be allowed under this subdivision for the subsequent taxable year to the extent that the credit would reduce the tax of the United States shareholder under chapter 1 of the Code on any minimum distribution for such year to which section 963 applies.

(*c*) *Gross-up not applicable.* Any amount allowed as a credit for a subsequent taxable year under this subdivision shall not be included in the gross income of the United States shareholder for such year under section 78.

(*d*) *Illustrations.* The application of this section may be illustrated by the following examples, in which the surtax exemption provided by section 11(c) is disregarded:

Example 1. (a) For 1966, domestic corporation M makes a chain election with respect to controlled foreign corporation A, which it wholly owns directly, and controlled foreign corporation B, which A Corporation wholly owns directly. Corporation A is not a less developed country corporation under section 902(d). All corporations use the calendar year as the taxable year. For 1966, M Corporation complies with the special rules of paragraphs (b) and (c) of this section. Corporation A has pretax and predistribution earnings and profits for 1966 of $40 and is subject to foreign income tax at a flat rate of 36 percent, with no deduction being allowed for dividends received or paid. B Corporation has pretax and predistribution earnings and profits of $60 for 1966 and is subject to a foreign income tax at a flat rate of 20 percent, with no deduction being allowed for dividends received or paid. For 1967, B Corporation has no earnings and profits, A Corporation has no earnings and profits other than a dividend of $21.22 from B Corporation, and M Corporation has taxable income of $20.98 from United States sources. Corporation M uses the overall limitation under section 904(a)(2) on the foreign tax credit.

(b) If a pro rata minimum distribution were made for 1966, the overall United States and foreign income tax for such year with respect to such distribution would be $41.30, determined as follows:

	A	B	Total
Pretax and predistribution earnings and profits	$40.00	$60.00	$100.00
Foreign income tax:			
(0.36 × $40)	14.40		
(0.20 × $60)		12.00	$26.40
Consolidated earnings and profits	25.60	48.00	73.60
Effective foreign tax rate ($26.40 / [$73.60 + $26.40])			26.4%
Statutory percentage under section 963(b)			69%

	A	B	Total
Amount distributed as pro rata minimum distribution:			
(0.69 × $25.60)	17.66		
(0.69 × $48)		33.12	$50.78
Amount received by M Corporation as pro rata minimum distribution:			
Corporation's distribution	17.66		
B Corporation's distribution ($33.12 − [0.36 × $33.12]), or ($33.12 − $11.92)		21.20	38.86
Gross-up under section 78:			
($17.66/$25.60 × $14.40)	9.94		
($21.20 / $21.20 × [$11.92 + ($33.12 / $48 × $12)]), or ($11.92 + $8.28)		20.20	30.14
Taxable income of M Corporation			69.00
U.S. tax before foreign tax credit ($69 × 0.48)			33.12
Foreign tax credit (as determined under gross-up above)			30.14
U.S. tax payable			2.98
Overall U.S. and foreign income tax with respect to pro rata minimum distribution ($26.40 + $11.92 + $2.98)			41.30

(c) The chain, however, does not make a pro rata distribution for 1966, but distributes $24 from A Corporation's earnings and profits and $26.78 from B Corporation's earnings and profits, the total distribution of $50.78 being equal to the statutory percentage of the consolidated earnings and profits (0.69 × $73.60) of the chain with respect to M Corporation. Thus, M Corporation must make such a reduction in its foreign tax credit that the overall United States and foreign income tax for 1966 with respect to the distribution equals the lesser of $41.30 (the overall United States and foreign income tax which would be paid with respect to a pro rata minimum distribution) and $43.20 (90 percent of 48 percent of pretax and predistribution consolidated earnings and profits of $100). The remaining 1956 earnings and profits of the chain are distributed late in 1967. Corporation M determines its tax as follows for such years:

1966

	A	B	Total
Distributions made	$24.00	$26.78	$50.78
Amount received by M Corporation:			
A Corporation's distribution	24.00		
B Corporation's distribution ($26.78 − [0.36 × 26.78]), or ($26.78 − $9.64)		17.14	41.14
Gross-up under section 78:			
($24 / $25.60 × $14.40)	13.50		
($17.14 / $17.14 × [$9.64 + ($26.78 / $48 × $12)]), or ($9.64 + $6.70)		16.34	29.84
Taxable income of M Corporation			$70.98
Tentative U.S. tax before foreign tax credit ($70.98 × .48)			34.07
Less: Tentative foreign tax credit (as computed under gross-up above)			29.84
Tentative U.S. tax payable			4.23
Tentative overall U.S. and foreign income tax ($26.40 + $9.64 + $4.23)			40.27
Overall U.S. and foreign tax which would be paid with respect to a pro rata minimum distribution (part (b) of this example)			41.30
Insufficient overall U.S. and foreign income tax ($41.30 − $40.27)			1.03
Reduced foreign tax credit ($29.84 − $1.03)			28.81
U.S. tax payable ($34.07 − $28.81)			5.26
Overall U.S. and foreign income tax ($26.40 + $9.64 + $5.26)			41.30
Reduction in foreign tax credit to be deferred ($29.84 − $28.81)			1.03
Remaining 1966 earnings and profits of:			
A Corporation ($25.60 − $24)	$1.60		
B Corporation ($48 − $26.78)		$21.22	22.82
Allocation of reduction in foreign tax credit to remaining 1966 earnings and profits of:			
A Corporation ($1.60/22.82 × $1.03)	.07		
B Corporation ($21.22/$22.82 × $1.03)		.96	1.03
Foreign income tax attributable to remaining 1966 earnings and profits of:			
A Corporation ($1.60/$25.60 × $14.40)	.90		
B Corporation ($21.22/$48 × $12)		5.30	6.20

1967

Taxable income of M Corporation consisting of distributions from:			
A Corporation's remaining 1966 earnings and profits	1.60		

1966

	A	B	Total
B Corporation's remaining 1966 earnings and profits ($21.22 − [.36 × 21.22]), or ($21.22 − $7.64)		13.58	15.18
Gross-up under section 78:			
($1.60/$1.60 × $0.90)	.90		
($13.58/$13.58 × [$7.64 + ($21.22/ 21.22 × $5.30)])		12.94	13.84
Taxable income from sources without the U.S.			29.02
Taxable income from sources within the U.S.			20.98
Total taxable income of M Corporation			50.00
U.S. tax before foreign tax credit (0.48 × $50)			24.00
Foreign tax credit:			
Tax deemed paid under section 902:			
$13.84, but not to exceed section 904 limitation of $13.93 ($29.02/$50 × $24) (see gross-up above)			13.84
Tax deemed paid under the principles of section 902:			
($1.60/$1.60 × $0.07)	.07		
($21.22/$21.22 × 0.96)		.96	1.03
U.S. tax payable ($24 − [$13.84 + $1.03])			9.13

Example 2. (a) For 1963, domestic corporation M makes a group election with respect to controlled foreign corporations A and B, both of which M Corporation wholly owns directly. All such corporations use the calendar year as the taxable year. Corporation A is created under the laws of foreign country X, and B Corporation is created under the laws of foreign country Y; neither of such corporations is a less developed country corporation under section 902(d). Corporation M complies with the special rules of paragraphs (b) and (c) of this section. Each foreign corporation has pretax earnings and profits of $100 for 1963. The income of A Corporation is subject to a foreign income tax rate of 20 percent, and the income of B Corporation is subject to a foreign income tax rate of 30 percent. Corporation M uses the per-country limitation under section 904(a)(1) on the foreign tax credit.

(b) If a pro rata minimum distribution were made for 1963, the group would distribute $123 based upon an effective foreign tax rate of 25 percent ($50/[$50 + $150]) and a statutory percentage of 82 percent under section 963(b); of this amount $57.40 (0.82 × $70) would be distributed from B Corporation's earnings and profits and $65.60 (0.82 × $80) would be distributed from A Corporation's earnings and profits. In such case, the overall United States and foreign income tax for 1963 with respect to the pro rata minimum distribution would be determined as follows, using the 52 percent United States corporate income tax rate applicable for such year:

Taxable income of M Corporation from sources in—		
Y Country:		
B Corporation dividend	$57.40	
Gross-up under section 78 ($57.40/ $70 × $30)	24.60	$82.00
X Country:		
A Corporation dividend	65.60	
Gross-up under section 78 ($65.60/ $80 × $20)	16.40	82.00
Taxable income		164.00
U.S. tax before tax credit (0.52 × $164)		85.28
Foreign tax credit:		
Y Country tax	24.60	
X Country tax	16.40	41.00
U.S. tax payable		44.28
Overall U.S. and foreign income tax with respect to pro rata minimum distribution ($44.28 + $50)		94.28

(c) The group, however, does not make a pro rata minimum distribution for 1963 but distributes $123, consisting of $70 from B Corporation's earnings and profits and $53 from A Corporation's earnings and profits. Thus, M Corporation must make such a reduction in its foreign tax credit that the overall United States and foreign income tax for 1963 with respect to the distribution equals the lesser of $94.28 (the overall United States and foreign income tax which would be paid with respect to a pro rata minimum distribution) and $93.60 (90 percent of 52 percent of pretax and predistribution consolidated earnings and profits of $200). The remaining 1963 earnings and profits of the group are distributed late in 1964. Neither A Corporation nor B Corporation has earnings and profits for 1964. Corporation M determines its tax as follows for such years, assuming a 52 percent (instead of 50 percent) United States corporate income tax rate for 1964:

	1963
Taxable income of M Corporation from sources in—	
Y Country:	
B Corporation dividend	$70.00

1963		
Gross-up under section 78 ($70/$70 × $30)	30.00	$100.00
X Country:		
A Corporation dividend	53.00	
Gross-up under section 78 ($53/$80 × $20)	13.25	66.25
Taxable income for 1963		166.25
U.S. tax before foreign tax credit (0.52 × $166.25)		86.45
Less: Tentative foreign tax credit:		
Y Country tax ($30.00 but not to exceed ($100.00/$166.25 × $86.45))	30.00	
X Country tax ($13.25 but not to exceed ($66.25/$166.25 × $86.45))	13.24	43.25
Tentative U.S. tax payable		43.20
Tentative overall U.S. and foreign income tax ($50 + $43.20)		93.60
Insufficient overall U.S. and foreign income tax ($93.60 − $93.20)		.40
Reduced foreign tax credit ($43.25 − $0.40)		42.85
U.S. tax payable for 1963 ($86.45 − $42.85)		43.00
Overall U.S. and foreign income tax ($50 + $43.60)		93.60
Reduction in foreign tax credit to be deferred ($43.25 − $42.85)		.40
Remaining 1963 earnings and profits of:		
A Corporation ($80 − $53)	27.00	
B Corporation ($70 − $70)	0	27.00
Allocation of reduction in foreign tax credit to remaining 1963 earnings and profits of A Corporation ($27/$27 × $0.40)		.40
Foreign income tax attributable to remaining 1963 earnings and profits of:		
A Corporation ($20 − $13.25)	6.75	
B Corporation ($30 − $30)	0	6.75
1964		
Taxable income of M Corporation from sources in X Country:		
A Corporation dividend		27.00
Gross-up under section 78 ($27/$27 × $6.75)		6.75
Taxable income for 1964		33.75
U.S. tax before foreign tax credit ($33.75 × 0.52)		17.55
Less: Foreign tax credit:		
Tax deemed paid under section 902 (as computed under gross-up, but not to exceed $33.75/$33.75 × $17.55)	6.75	
Tax deemed paid under the principles of section 902 ($27/$27 × $0.40)	.40	7.15
U.S. tax payable for 1964		10.40

Example 3. (a) For 1966, domestic corporation M makes a chain election with respect to controlled foreign corporation A, which it wholly owns directly, and controlled foreign corporation B, which A Corporation wholly owns directly. Corporation A is a less developed country corporation under section 902(d). All corporations use the calendar year as the taxable year. For 1966, each of the foreign corporations has pretax and predistribution earnings and profits of $100. The income of A Corporation is subject to a foreign income tax rate of 20 percent, with no deduction being allowed for dividends received or paid; and the income of B Corporation is subject to a foreign income tax rate of 30 percent on such basis. During 1966, B Corporation distributes $50 to A Corporation, and A Corporation distributes $104 to M Corporation. During 1967 the remaining 1966 earnings and profits of such corporations are distributed to M Corporation.

(b) If M Corporation were not to comply with the special rules of paragraphs (b) and (c) of this section and were to deduct foreign income tax on intercorporate distributions under paragraph (d)(1)(iii) of §1.963–2, the chain would not be considered to make a minimum distribution for 1966 because, although it makes a distribution which is sufficient in amount to constitute a minimum distribution, the overall United States and foreign income tax for such year with respect to such distribution would be insufficient under paragraph (a)(1)(i) of this section. The determination that M Corporation would not be entitled to the section 963 exclusion for 1966 by reason of such distribution in such circumstances is made as follows:

	A	B	Total
Pretax earnings and profits	$150	$100	
Reduction for intercorporate dividends	50		
Pretax and predistribution earnings and profits	100	100	$200.00
Reduction for foreign income tax on such pretax and predistribution earnings and profits	20	30	50.00
Predistribution earnings and profits	80	70	150.00
Reduction for foreign income tax on intercorporate distributions of 1966 earnings and profits ($50 × 0.20)	10	.....	10.00
Consolidated earnings and profits of the chain	70	70	140.00
Consolidated foreign income taxes ($30 + $20 + $10)	.....	.....	60.00
Effective foreign tax rate ($60/[$140 + $60])	.....	.....	30%
Statutory percentage under section 963(b)	.....	.....	69%
Amount of a minimum distribution ($140 × 0.69)	.....	.....	96.60
Overall United States and foreign income tax required to be paid (part (a)(1)(i) of this section) (0.90 × [0.22 + 0.26] × $200)	.....	.....	86.40

	A	B	Total
Tentative taxable income of M Corporation			$104.00
Tentative U.S. tax before foreign tax credit (0.48 × $104)			49.92
Tentative foreign tax credit ($104/ $120 × [($120/$150 × $30) + ($50/ $100 × $30)] or ($104/$120 × $39)			33.80
Tentative U.S. tax payable ($49.92 − $33.80)			16.12
Overall U.S. and foreign income tax ($60 + $16.12)			76.12
Insufficient overall U.S. and foreign income tax ($86.40 − $76.12)			10.28

(c) By complying with the special rules of paragraphs (b) and (c) of this section, however, M Corporation will receive a minimum distribution for 1966 if it receives the statutory percentage of consolidated earnings and profits and if the overall United States and foreign income tax with respect to the distribution which is made is at least the lesser of $86.40 (0.90 × 0.48 × $200) and of the overall United States and foreign income tax which would be paid with respect to a pro rata minimum distribution from the chain. If a pro rata minimum distribution were made for 1966, the chain would be required to distribute earnings and profits of $114, based upon an effective foreign tax rate of 25 percent ($50/[$50 + $150]) and a statutory percentage of 76 percent under section 963(b); of this amount $53.20 (0.76 × $70) would be distributed from B Corporation's earnings and profits and $60.80 (0.76 × $80) would be distributed from A Corporation's earnings and profits. The overall United States and foreign income tax with respect to such a pro rata minimum distribution would be $73.62, determined as follows:

Taxable income of M Corporation ($60.80 + [$53.20 − ($53.20 × 0.20)])		$103.36
U.S. tax before foreign tax credit (0.48 × $103.36)		49.61
Foreign tax credit:		
B Corporation's distribution ($53.20/[$70 + $30] × $30) + ($42.56 + $10.64] × $10.64)	$24.47	
A Corporation's distribution ($60.80/[$80 + 20] × $20)	12.16	36.63
U.S. tax payable		12.98
Overall U.S. and foreign income tax with respect to pro rata minimum distribution ($50 + $10.64 + $12.98)		73.62

(d) The United States income tax of M Corporation for 1966 and 1967 is determined as follows, assuming that the minimum overall tax burden is determined under paragraph (a)(1)(ii)(b) of this section:

1966

Dividend from earnings and profits of—		
B Corporation ($50 minus tax of $10 on A Corporation at the rate of 20 percent)		$40.00
A Corporation		64.00
Taxable income of M Corporation		104.00
U.S. tax before foreign tax credit (0.48 × $104)		$49.92
Less: Foreign tax credit:		
B Corporation's distribution ($50/[$70 + $30] × $30 + ($40/[$40 + $10] × $10), or ($15 + $8)	$23.00	
A Corporation's distribution ($64/ $80 + $20] × $20)	12.80	35.80
U.S. tax payable		$14.12
Overall U.S. and foreign income tax with respect to actual distribution ($50 + $10 + $14.12)		74.12
Overall U.S. and foreign income tax that would be paid with respect to a pro rata minimum distribution (part (c) of this example)		73.62
Remaining 1966 earnings and profits for future distribution by:		
B Corporation ($70 − $50)		20.00
A Corporation ($80 − $64)		16.00
Total		36.00
Foreign income tax attributable to remaining 1966 earnings and profits of:		
B Corporation ($20/$70 × $30)		8.57
A Corporation ($16/$80 × $20)		4.00

1967

Dividend from remaining 1966 earnings and profits of—		
B Corporation ($20 minus tax of $4 on A Corporation at the rate of 20 percent)		16.00
A Corporation		16.00
Taxable income of M Corporation		32.00
U.S. tax before foreign tax credit (0.48 × $32)		15.36
Less: Foreign tax credit:		
B Corporation's distribution ($20/[$20 + $8.57] × $8.57) + ($16/[$16 + $4] × $4), or ($6 + $3.20)	$9.20	
A Corporation's distribution ($16/ [$16 + $4] × $4)	3.20	12.40
U.S. tax payable		2.96

Example 4. (a) Domestic corporation M directly owns 90 percent of the one class of stock of controlled foreign corporation A, which directly owns 80 percent of the one class of stock of controlled foreign corporation B, which in turn directly owns 60 percent of the one class of stock of controlled foreign corporation C. None of the foreign corporations are less developed country corporations under section 902(d); all corporations use the calendar year as the taxable year. For 1963, M Corporation makes a chain election with respect to corporations A, B, and C and receives a distribution from the consolidated earnings and profits of the chain which does not constitute a pro rata minimum distribution. The remaining 1963 consolidated earnings and profits of the

chain are distributed late in 1964, for which year it is assumed that the United States corporate income tax rate is the same (52 percent) as for 1963. No corporation in the chain has earnings and profits for 1964 other than from distributions received from remaining 1963 earnings and profits of another corporation in the chain. The foreign country under the laws of which A Corporation is created does not tax dividends which are received by such corporation from B Corporation, but B Corporation is taxed on dividends received from C Corporation. Corporation M complies with the special rules of paragraphs (b) and (c) of this section and determines the minimum overall tax burden under paragraph (a)(1)(ii)(b) of this section with respect to the distribution which is made. Corporation M uses the overall limitation under section 904(a)(2) on the foreign tax credit. The distribution received by M Corporation for 1963 from the consolidated earnings and profits of the chain is sufficient in amount to constitute a minimum distribution. The overall United States and foreign income tax for 1963 with respect to the distribution which is made must be at least equal to the lesser of $32.21 (the amount payable, as determined under paragraph (b) of this example, with respect to a pro rata minimum distribution) and $31.34 (90 percent of 52 percent of pretax and predistribution consolidated earnings and profits of $66.96).

(b) If the chain were to make a pro rata minimum distribution, the distributions and the overall United States and foreign income tax for 1963 with respect to the minimum distribution would be determined as follows, based upon the facts assumed:

	A	B	C	Total
Pretax and predistribution earnings and profits	$20.00	$50.00	$30.00	
Reduction for foreign income tax on such earnings and profits (10%, 40%, and 10%, respectively)	2.00	20.00	3.00	
Predistribution earnings and profits	18.00	30.00	27.00	
Consolidated earnings and profits with respect to M Corporation:				
(0.90 × $18)	16.20			
(0.90 × 0.80 × $30) or (0.72 × $30)		21.60		
(0.90 × 0.80 × 0.60 × $27) or (0.432 × $27)			11.66	$49.46
Consolidated foreign income taxes with respect to M Corporation:				
($16.20/$18 × $2)	1.80			
($21.60/$30 × $20)		14.40		
($11.66/$27 × $3)			1.30	17.50
Effective foreign tax rate of the chain for 1963 ($17.50/[$49.46 + $17.50]), or ($17.50/ $66.96)				26.14%
Statutory percentage under section 963(b)				82%
Pro rata minimum distribution (before reduction of dividend from C Corporation's share by B Corporation tax paid on such amount):				
(0.82 × $16.20)	13.28			
(0.82 × $21.60)		17.71		
(0.82 × $11.66)			9.56	
(0.82 × $49.46)				40.56
Such amounts as reduced by further foreign income tax imposed on distributions through the chain:				
No further foreign tax	13.28			
No further foreign tax		17.71		
B Corporation tax ($9.56 − [0.40 × $9.56]), or ($9.56 − $3.82)			5.74	36.73
Gross-up under section 78:				
($13.28/$16.20 × $1.80)	1.48			
($17.71/$21.60 × $14.40)		11.81		
($5.74/$5.74 × $3.82)		3.82		17.11
M Corporation's taxable income for 1963 attributable to minimum distribution ($36.73 + $17.11)				53.84
U.S. tax before foreign tax credit ($53.84 × 0.52)				28.00
Foreign tax credit (as determined under gross-up above)				17.11
U.S. tax payable for 1963 ($28 − $17.11)				10.89
Overall U.S. and foreign income tax with respect to pro rata minimum distribution ($17.50 + $3.82 + $10.89)				32.21

(c) Based upon the distributions which are made by corporations A, B, and C, M. Corporation pays United States tax as follows for 1963 and 1964:

1963

	A	B	C	Total
Distribution made from consolidated earnings and profits of the chain	$9.36	$21.60	$9.60	$40.56

1963

	A	B	C	Total
Excess of distribution over statutory percentage of consolidated earnings and profits for 1963 ($40.56 − [0.82 × $49.46])				None
Determination of whether the overall U.S. and foreign income tax with respect to the actual distribution is equal to, or exceeds, the lesser of $32.21 (paragraph (b) of example) and $31.34 (paragraph (a) of example):				
Amount received by M Corporation after reduction by further foreign income tax imposed on distributions through the chain:				
No further foreign tax	9.36			
No further foreign tax		21.60		
B Corporation tax ($9.60 − [0.40 × $9.60]), or ($9.60 − $3.84)			5.76	36.72
Gross-up under section 78:				
($9.36/$16.20 × $1.80)	1.04			
($21.60/$21.60 × $14.40)		14.40		
($5.76/$5.76 × $3.84)		3.84		19.28
Taxable income of M Corporation for 1963 attributable to actual distribution ($36.72 + $19.28)				56.00
U.S. tax before foreign tax credit ($56 × 0.52)				29.12
Tentative foreign tax credit (as determined under gross-up above)				19.28
Tentative U.S. tax payable ($29.12 − $19.28)				9.84
Overall U.S. and foreign income tax with respect to actual distribution ($17.50 + $3.84 + $9.84)				31.18
Insufficient overall U.S. and foreign income tax ($31.34 [i.e., 0.90 × 0.52 × $66.96] − 31,18)				.16
Reduced foreign tax credit ($19.28 − $0.16)				19.12
U.S. tax payable for 1963 ($29.12 − $19.12)				10.00
Overall U.S. and foreign income tax with respect to actual distribution ($17.50 + $3.84 + $10)				31.34
Allocation of reduction in foreign tax credit to undistributed consolidated 1963 earnings and profits of A and B Corporations to be deemed paid by M Corporation in future years:				
Reduction in foreign tax credit ($19.28 − $19.12)				.16
Undistributed 1963 consolidated earnings and profits of the chain:				
($16.20 − $9.36)	6.84			
($21.60 − $21.00)		0		
($11.66 − $9.60)			$2.06	8.90
Allocation of reduction in credit:				
($6.84/$6.84 × $0.16)	.16			.16
Foreign income tax attributable to undistributed 1963 earnings and profits of the chain to be taken into account in determining tax deemed paid under section 902:				
($1.80 − $1.04)	.76			
($14.40 − $14.40)				.7
1964				
Distribution from remaining 1963 consolidated earnings and profits of the chain:				
($16.20 − $9.36)	6.84			
($21.60 − $21.60)		0		
($11.66 − $9.60)			2.06	8.90
Such amounts as reduced by further foreign income tax imposed on distributions through the chain:				
No further foreign tax	6.84			
B Corporation tax ($2.06 − [0.40 × $2.06]), or ($2.06 − $0.82)		1.24		8.08
Gross-up under section 78:				
($6.84/$6.84 × $0.76)	0.76			
($1.24/$1.24 × $0.82)		0.82		1.58
Taxable income of M Corporation for 1964 attributable to 1964 distribution ($8.08 + $1.58)				9.66
U.S. tax before foreign tax credit ($9.66 × 0.52)				5.02
Foreign tax credit:				
Deferred credit in accordance with principles of section 902 ($6.84/$6.84 × $0.16)	0.16			0.16
Tax deemed paid under section 902 (computed under gross-up above)				1.58
U.S. tax payable for 1964 ($5.02 − [$0.16 + $1.58])				3.28

Example 5. (a) Domestic corporation M directly owns all the one class of stock of each of controlled foreign corporations A, B, C, and D. All such corporations use the calendar year as the taxable year. None of the foreign corporations is a less developed country corporation under section 902(d). For 1963, M Corporation makes a group election

with respect to corporations A, B, C, and D and receives from the 1963 consolidated earnings and profits of the group a distribution which is not a pro rata minimum distribution. None of the foreign corporations has earnings and profits for 1964, but the remaining 1963 earnings and profits of the group are distributed late in 1964, for which year it is assumed that the United States corporate income tax rate is the same (52 percent) as for 1963. The overall limitation under section 904(a)(2) on the foreign tax credit applies for both years.

(b) Assume that M Corporation does not comply with the special rules of paragraphs (b) and (c) of this section and that for 1963 it draws a distribution of all of B Corporation's earnings and profits and enough of C Corporation's earnings and profits to receive the amount of a minimum distribution and to assure that the overall United States and foreign income tax for such year with respect to the distribution from the group satisfies the overall minimum tax requirement of paragraph (a)(1)(i) of this section. In such case, the overall United States and foreign income tax for 1963 with respect to the distribution which is made, determined by using the foreign tax credit under section 901 without applying the special credit rules of paragraph (c) of this section, must at least equal $37.44 (90 percent of 52 percent of pretax and predistribution consolidated earnings and profits of $80). Corporation M's United States income tax for 1963 and 1964 with respect to the distribution of the 1963 earnings and profits of the group is determined as follows, based upon the facts assumed:

1963

	A	B	C	D	Total
Pretax and predistribution earnings and profits (and deficits) of the group	$25.00	$25.00	$50.00	($20.00)	$80.00
Consolidated foreign income taxes	2.50	12.50	15.00	.....	30.00
Consolidated earnings and profits	22.50	12.50	35.00	(20.00)	50.00
Effective foreign tax rate ($30/[$50 + $30])	.....	.....	.....	.....	37.5%
Statutory percentage under section 963(b)	.....	.....	.....	.....	68%
Amount of a minimum distribution (0.68 × $50)	.....	.....	.....	.....	34.00
Tentative distribution	.....	12.50	21.50	.....	34.00
Tentative gross-up under section 78:					
($12.50/$12.50 × $12.50)	.....	12.50			
($21.50/$35 × $15)	.....	.....	9.21	.....	21.71
Tentative taxable income of M Corporation ($34 + $21.71)	.....	.....	.....	.....	55.71
Tentative U.S. tax before foreign tax credit (0.52 × $55.71)	.....	.....	.....	.....	28.97
Tentative foreign tax credit (as computed under gross-up above)	.....	.....	.....	.....	21.71
Tentative U.S. tax payable ($28.97 − $21.71)	.....	.....	.....	.....	7.26
Tentative overall U.S. and foreign income tax ($30 + $7.26)	.....	.....	.....	.....	37.26
Minimum overall U.S. and foreign income tax required to be paid (0.90 × .52 × $80)	.....	.....	.....	.....	37.44
Insufficient overall U.S. and foreign income tax ($37.44 − $37.26)	.....	.....	.....	.....	.18
Revised distribution	.....	12.50	22.07	.....	34.57
Gross-up under section 78:					
($12.50/$12.50 × $12.50)	.....	12.50			
($22.07/$35 × $15)	.....	.....	9.46	.....	21.96
Taxable income of M Corporation ($34.57 + $21.96)	.....	.....	.....	.....	56.53
U.S. tax before foreign tax credit (.52 × $56.53)	.....	.....	.....	.....	29.40
Foreign tax credit (as computed under gross-up above)	.....	.....	.....	.....	21.96
U.S. tax payable ($29.40 − $21.96)	.....	.....	.....	.....	7.44
Overall U.S. and foreign income tax on actual distribution ($30 + $7.44)	.....	.....	.....	.....	37.44

1964

Distribution of remaining 1963 consolidated earnings and profits:					
($22.50 − $0)	22.50				
($12.50 − $12.50).					
($35 − $22.07)	.....	.....	12.93	.....	35.43
Gross-up under section 78:					
($22.50/$22.50 × $2.50)	2.50				
($12.93/$35 × $15)	.....	.....	5.54	.....	8.04
Taxable income of M Corporation ($35.43 + $8.04)	.....	.....	.....	.....	43.47
U.S. tax before foreign tax credit ($43.47 × 0.52)	.....	.....	.....	.....	22.60
Foreign tax credit (as computed under gross-up above)	.....	.....	.....	.....	8.04
U.S. tax payable ($22.60 − $8.04)	.....	.....	.....	.....	14.56

(c) Assume that M Corporation does comply with the special rules of paragraphs (b) and (c) of this section and for 1963 receives a minimum distribution consisting of $20 from

A Corporation and $14 from C Corporation. In such case, the overall United States and foreign income tax for 1963 with respect to the minimum distribution must at least equal the lesser of $37.44 (0.90 × 0.52 × $80) and the overall United States and foreign income tax of $37.89 that would be paid with respect to a pro rata minimum distribution from the group for such year. In such case, the determinations would be made pursuant to subparagraphs (1) and (2) of this paragraph.

(1) If a pro rata minimum distribution were made for 1963 by the group, the overall United States and foreign income tax for such year with respect to such distribution would be $37.89, determined as follows:

	A	B	C	D	Total
Pretax and predistribution earnings and profits (and deficits) of the group	$25.00	$25.00	$50.00	($20)	$80.00
Consolidated foreign income taxes	2.50	12.50	15.00	.....	30.00
Consolidated earnings and profits before allocation of deficits	22.50	12.50	35.00	.....	70.00
Allocation of deficit of D Corporation:					
($22.50/$70 × $20)	(6.43)				
($12.50/$70 × $20)	.....	(3.57)			
($35/$70 × $20)	.....	.....	(10.00)	.....	(20.00)
Consolidated earnings and profits	16.07	8.93	25.00	.....	50.00
Effective foreign tax rate ($30/$80)	.....	.....	.....	.....	37.50%
Statutory percentage under section 963(b)	.....	.....	.....	.....	68%
Pro rata minimum distribution:					
(0.68 × $16.07)	10.93				
(0.68 × $8.93)	.....	6.07			
(0.68 × $25)	.....	.....	17.00	.....	34.00
Gross-up under section 78:					
($10.93/$16.07 × $2.50)	1.70				
($6.07/$8.93 × $12.50)	.....	8.50			
($17/$25 × $15)	.....	.....	10.20	.....	20.40
Taxable income of M Corporation ($34 + $20.40)	.....	.....	.....	.....	54.40
U.S. tax before foreign tax credit (0.52 × $54.40)	.....	.....	.....	.....	28.29
Foreign tax credit (as computed under the gross-up above)	.....	.....	.....	.....	20.40
U.S. tax payable ($28.29 − $20.40)	.....	.....	.....	.....	7.89
Overall U.S. and foreign income tax with respect to pro rata minimum distribution ($30 + $7.89)	.....	.....	.....	.....	37.89

(2) Corporation M's United States income tax for 1963 and 1964 with respect to the distribution of the 1963 earnings and profits of the group is determined as follows:

1963

	A	B	C	D	Total
Distributions actually made	$20.00	.....	$14.00	.....	$34.00
Gross-up under section 78:					
($16.07/$16.07 × $2.50)	2.50				
($14/$25 × $15)	.....	.....	8.40	.....	10.90
Taxable income of M Corporation ($34 + $10.90)	.....	.....	.....	.....	44.90
U.S. tax before foreign tax credit (0.52 × $44.90)	.....	.....	.....	.....	23.35
Foreign tax credit (as computed under gross-up above)	.....	.....	.....	.....	10.90
U.S. tax payable ($23.35 − $10.90)	.....	.....	.....	.....	12.45
Overall U.S. and foreign income tax with respect to the distribution actually made ($30 + $12.45), such amount being in excess of the minimum overall tax burden of $37.44	.....	.....	.....	.....	42.45

1964

Earnings and profits for 1963 to which minimum distribution for such year was not attributable:					
($22.50 − $20)	$2.50				
($12.50 − $0)	.....	$12.50			
($35.00 − $14)	.....	.....	$21.00	.....	$36.00
Foreign income tax for 1963 not taken into account in determining tax deemed paid for such year on pretax earnings and profits to which the minimum distribution for such year was attributable:					
([$16.07 − $16.07]/$16.07 × $2.50)	0				
([$8.93 − $0]/$8.93 × $12.50)	.....	12.50			
([$25 − $14]/$25 × $15)	.....	.....	6.60	.....	19.10
Distributions to M Corporation in 1964	2.50	12.50	21.00	.....	36.00
Gross-up under section 78:					
($2.50/$2.50 × $0)	0				
($12.50/$12.50 × $12.50)	.....	12.50			

1963

	A	B	C	D	Total
($21/$21 × $6.60)			6.60		19.10
Taxable income of M Corporation ($36 + $19.10)					55.10
U.S. tax before foreign tax credit (0.52 × $55.10)					28.65
Foreign tax credit (as computed under gross-up above)					19.10
U.S. tax payable ($28.65 − $19.10)					9.55

Example 6. Throughout 1963, domestic corporation M directly owns all the one class of stock of controlled foreign corporations A, B, and C, and maintains in a foreign country a branch which qualifies under paragraph (f)(4) of §1.963–1 for inclusion in a group as a wholly owned foreign subsidiary corporation. For 1963, a year for which the overall limitation under section 904(a)(2) on the foreign tax credit applies, M Corporation makes a group election with respect to A, B, and C Corporations and the foreign branch. All such corporations use the calendar year as the taxable year. The foreign branch has pretax and predistribution earnings and profits of $40 for 1963, as determined under paragraph (f)(4)(ii) of §1.963–1. None of the foreign corporations is a less developed country corporation under section 902(d). Corporation M complies with the special rules of paragraphs (b) and (c) of this section. The United States income tax of M Corporation for 1963 is as follows, based upon the facts assumed:

	A	B	C	Branch	Total
Pretax and predistribution consolidated earnings and profits of the group	$20.00	$30.00	$10	$40	$100.00
Consolidated income taxes	2.00	15.00	5	20	42.00
Effective foreign tax rate ($42/$100)					42%
Statutory percentage under section 963(b)					40%
Posttax and predistribution consolidated earnings and profits of the group	18.00	15.00	5	20	58.00
U.S. tax which would be paid on a pro rata minimum distribution from consolidated earnings and profits of the group:					
Pro rata minimum distribution (and amount which would be received by M Corporation):					
(0.40 × $18)	7.20				
(0.40 × $15)		6.00			
(0.40 × $5)			2		
(0.40 × $40)				16	31.20
Gross-up under section 78:					
($7.20/$18 × $2)	.80				
($6/$15 × $15)		6.00			
($2/$5 × $5)			2		8.80
Taxable income of M Corporation ($31.20 + $8.80)					40.00
U.S. tax before foreign tax credit (0.52 × $40)					20.80
Foreign tax credit ($8.80, as computed under the gross-up, plus 40 percent of $20)					16.80
U.S. tax payable ($20.80 − $16.80)					4.00
Overall U.S. and foreign income tax with respect to a pro rata minimum distribution for 1963 ($4 + $42)					46.00
Tentative tax on distribution actually received by M Corporation:					
Actual distribution received			$5	$40	$45.00
Gross-up under section 78 ($5/$5 × $5)			5		5.00
Taxable income of M Corporation ($45 + $5)					50.00
U.S. tax before foreign tax credit (0.52 × $50)					26.00
Tentative foreign tax credit ($5, as computed under the gross-up above, plus 100 percent of $20)					25.00
Tentative U.S. tax payable ($26 − $25)					1.00
Insufficient overall U.S. and foreign income tax (the lesser of $46 or $46.80 [0.90 × 0.52 × $100] minus $43 [$1 + $42])					3.00
Reduced foreign tax credit ($25 − $3)					22.00
U.S. tax payable ($26 − $22)					4.00
Overall U.S. and foreign income tax with respect to actual distribution for 1963 ($4 + $42)					46.00
Reduction in foreign tax credit for 1963 ($25 − $22)					3.00
Allocation of reduction in foreign tax credit to undistributed 1963 consolidated earnings and profits of the group:					
($18/[$18 + $15] × $3.00)	1.64				
($15/[$18 + $15] × $3.00)		1.36			3.00

Example 7. Domestic group M, an affiliated group of domestic corporations filing a consolidated return under section 1501, makes a group election for 1963 with respect to a group consisting of two controlled foreign corporations C and D, all of whose one class of stock is directly owned by group M, and foreign branch B, a foreign branch of a Western Hemisphere trade corporation (as defined in section 921) included in group M. No distributions are received for the taxable year from corporations C and D, but the foreign group makes a minimum distribution by reason of the deemed distribution of all of branch B's earnings and profits. Group M complies with the special rules of paragraphs (b) and (c) of this section. For 1963, a year for which the United States corporate income tax rate is 52 percent, the overall limitation under section 904(a)(2) on the foreign tax credit applies. 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) for 1963. The income, and the United States and foreign income tax for 1963, are determined as follows, based upon the facts assumed:

	Branch	C	D	Total
Pretax and predistribution consolidated earnings and profits of the foreign group (before Western Hemisphere trade corporation deduction)	$100.00	$10.00	$10.00	$120.00
Western Hemisphere trade corporation deduction ($100 × 0.14/0.52)	26.92			26.92
Pretax and predistribution consolidated earnings and profits of the foreign group (after Western Hemisphere trade corporation deduction)	73.08	10.00	10.00	93.08
Consolidated foreign income taxes (38%, 20%, and zero rate, respectively):				
(0.38 × $100)	38.00			
(0.20 × $10)		2.00		40.00
Consolidated earnings and profits of the foreign group	35.08	8.00	10.00	53.08
Effective foreign tax rate ($40/$93.08)				43%
Statutory percentage under section 963(b)				40%
Tax which would be paid with respect to a pro rata minimum distribution from consolidated earnings and profits of the foreign group:				
Pro rata minimum distribution:				
(0.40 × $73.08)	29.23			
(0.40 × $8.00)		3.20		
(0.40 × $10.00)			4.00	36.43
Gross-up under section 78: ($3.20/$8.00 × $2)		.80		.80
Taxable income of group M	29.23	4.00	4.00	37.23
U.S. tax before foreign tax credit:				
(0.52 × $29.23)	15.20			
(0.54 × $4.00)		2.16		
(0.54 × $4.00)			2.16	19.52
Foreign tax credit ($0.80, as computed under the gross-up above, plus 40 percent of $38)	15.20	.80		16.00
U.S. tax payable		1.36	2.16	3.52
Overall U.S. and foreign income tax with respect to pro rata minimum distribution ($3.52 + $40)				43.52
Tentative tax on distribution actually received by group M:				
Taxable income of branch	73.08			73.08
U.S. tax before foreign tax credit (0.52 × $73.08)	38.00			38.00
Tentative foreign tax credit	38.00			38.00
Tentative U.S. tax payable				0
Insufficient overall U.S. and foreign income tax (the lesser of $43.52 or $43.56 [0.90 × 0.52 × $93.08] minus $40)				3.52
Reduced foreign tax credit ($38 − $3.52)				34.48
U.S. tax payable ($38 − $34.48)				3.52
Overall U.S. and foreign income tax ($3.52 + $40.00)				43.52
Reduction in foreign tax credit for 1963 ($38 − $34.48)				3.52
Allocation of reduction in foreign tax credit to 1963 undistributed consolidated earnings and profits of the foreign group:				
($8/[$8 + $10] × $3.52)		1.56		
($10/[$8 + $10] × $3.52)			1.96	3.52

[T.D. 6759, 29 FR 13335, Sept. 25, 1964; 29 FR 13896, Oct. 8, 1964, as amended by T.D. 6767, 29 FR 14878, Nov. 3, 1964; T.D. 7100, 36 FR 5336, Mar. 20, 1971]