Internal Revenue bulletin

Bulletin No. 2005-36
September 6, 2005

HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 2005–57, page 466.

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for September 2005.

Rev. Rul. 2005–58, page 465.

Mutual life insurance companies; differential earnings rate. The differential earnings rate for 2004 is determined for use by mutual life insurance companies to compute their income tax liability for 2004.

T.D. 9216, page 461.

Final regulations under section 269B of the Code concern the definition and treatment of a stapled foreign corporation, which is generally treated for U.S. tax purposes as a domestic corporation. The regulations also put in regulation form Notices 89–94 and 2003–50, treating a stapled foreign corporation as foreign for purposes of determining whether it is an includible corporation within the meaning of section 1504(d), except when applying sections 1.904(i)–1 and 1.861–11T(d)(6) of the regulations.

Notice 2005–64, page 471.

This is the third in a series of notices, including Notice 2005–10, 2005–6 I.R.B. 474, and Notice 2005–38, 2005–22 I.R.B. 1100, providing guidance on the one time dividends received deduction (DRD) under section 965 for certain cash dividends from controlled foreign corporations that are invested in the United States. This notice provides guidance with respect to the foreign tax credit and related issues under section 965, foreign currency translation, the alternative minimum tax, and the credit for prior year minimum tax. Notice 2005–10 clarified and Notice 2005–38 modified.

Rev. Proc. 2005–63, page 491.

Time periods for requesting consent to change a method of accounting. For a taxpayer desiring consent to change a method of accounting provided for under certain regulations, this procedure waives the requirement to request consent within the time periods prescribed in those regulations provided the taxpayer requests consent in accordance with this procedure. Rev. Proc. 83–77 superseded.

Rev. Proc. 2005–64, page 492.

This procedure provides the domestic asset/liability percentages and domestic investment yields needed by foreign life insurance companies and foreign property and liability insurance companies to compute their minimum effectively connected net investment income under section 842(b) of the Code for taxable years beginning after December 31, 2003.

(Continued on the next page)

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

ADMINISTRATIVE

T.D. 9215, page 468.
REG–131739–03, page 494.

Temporary and proposed regulations under section 6020 of the Code modify the provisions of the current regulations section 301.6020–1 to provide the following: (1) a document (or set of documents) signed by the Commissioner or other authorized Internal Revenue officer or employee shall be a return under section 6020(b) if the document (or set of documents) identifies the taxpayer by name and taxpayer identification number, contains sufficient information from which to compute the taxpayer's tax liability, and the document (or set of documents) purports to be a return; (2) the document and subscription may be in written or electronic form; and (3) pursuant to section 6651(g)(2), the document that constitutes a return under section 6020(b) will be treated as the return filed by the taxpayer for purposes of determining the amount of the addition to tax under sections 6651(a)(2) and (a)(3).

Rev. Proc. 2005–64, page 492.

This procedure provides the domestic asset/liability percentages and domestic investment yields needed by foreign life insurance companies and foreign property and liability insurance companies to compute their minimum effectively connected net investment income under section 842(b) of the Code for taxable years beginning after December 31, 2003.

Announcement 2005–61, page 495.

This document contains a correction to Announcement 2005–53, 2005–31 I.R.B. 258, which corrected T.D. 9186 relating to qualified amended returns.

Announcement 2005–62, page 495.

This document contains corrections to T.D. 9193, 2005–15 I.R.B. 862, by adding the text that was inadvertently omitted from the Code of Federal Regulations. The regulations relate to the tax treatment of installment obligations and property acquired pursuant to a contract.

Announcement 2005–63, page 496.

This document contains corrections to temporary regulations (T.D. 9205, 2005–25 I.R.B. 1267) relating to the computation and allocation of the credit for increasing research activities for members of a controlled group of corporations or a group of trades or businesses under common control.

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are compiled semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.
This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.
To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2005. See Rev. Rul. 2005-57, page 466.

Section 77.—Commodity Credit Loans

26 CFR 1.77–1: Election to consider Commodity Credit Corporation loans as income.

For a taxpayer desiring consent to change a method of accounting under § 1.77–1, under what circumstances is the requirement to request consent within the prescribed time period waived? See Rev. Proc. 2005-63, page 491.

Section 269B.—Stapled Entities

26 CFR 1.269B–1: Stapled foreign corporations.

T.D. 9216

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 301

Treatment of a Stapled Foreign Corporation Under Sections 269B and 367(b)

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations concerning the definition and tax treatment of a stapled foreign corporation, which generally is treated for tax purposes as a domestic corporation under section 269B of the Internal Revenue Code.

DATES: *Effective Date*: These regulations are effective on July 29, 2005.

Applicability Dates: For dates of applicability, see §1.269B–1(g).

FOR FURTHER INFORMATION CONTACT: Richard L. Osborne at (202) 435–5230 or Robert W. Lorence at (202) 622–3918 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

On September 7, 2004, the IRS and Treasury Department published in the **Federal Register** a notice of proposed rulemaking (REG–101282–04, 2004–42 I.R.B. 698 [69 FR 54067]) under sections 269B and 367(b) of the Internal Revenue Code (Code). The proposed regulations provide guidance concerning the definition and tax treatment of a stapled foreign corporation, which generally is treated for tax purposes as a domestic corporation under section 269B of the Code. The proposed regulations are finalized here without modification.

Explanation of Provisions and Summary of Comments

Section 269B(a)(1) provides that, if a domestic corporation and a foreign corporation are stapled entities, the foreign corporation will be treated as a domestic corporation for U.S. Federal income tax purposes, unless otherwise provided in regulations. A domestic and a foreign corporation are stapled entities if more than 50 percent in value of the beneficial ownership in each corporation consists of stapled interests. Interests are stapled if, by reason of form of ownership, restrictions on transfer, or other terms and conditions, in connection with the transfer of one of such interests, the other interests are also transferred or required to be transferred.

The IRS and Treasury Department received only one written comment with respect to the proposed regulations under section 269B. The comment requests guidance on the potential application of the regulations to so-called *dual listed corporations* (also referred to as *dual company structures* or *virtual mergers*). As described in the comment, dual listed corporations typically are two separately traded public corporations that enter into various equalization and voting agreements, with the result that the operations of each company generally are managed through a common governance structure. The comment provides that the structure does not involve an actual shareholder level exchange of shares, and that the companies remain separately traded, but that by reason of the equalization and voting agreements, the shares in each company generally reflect the combined economics of the two companies. The comment also indicates that these dual listed structures are generally motivated by non-tax business reasons (including avoiding the adverse market effect known as the *flowback of shares* that can occur in cross border acquisitions).

The commentators state that they are not aware of a dual listed structure involving a domestic corporation and a foreign corporation, but nonetheless believe that such a transaction is a possibility. Further, the commentators believe that section 269B and the regulations should not be interpreted to apply to such a dual listed structure. Accordingly, the commentators request that the final regulations (1) provide that the voting arrangements that are part of these transactions do not involve the stapling of *beneficial ownership* within the meaning of section 269B; and (2) provide a *de minimis* exception to the *aggregate* rule of §1.269B–1(b)(1) of the proposed regulations.

After consideration of the comment discussed above, the IRS and the Treasury Department have decided at this time to adopt the proposed regulations as final regulations without modification. However, the IRS and the Treasury Department believe that further study of dual listed structures is warranted and request more detailed comments on the application of section 269B and the underlying regulations to these structures, including discussion of particular facts and circumstances that should and should not be considered, in regard to each corporation's beneficial ownership for purposes of determining whether the dual listed corporations are stapled entities. These comments should take into account the need to protect the government's interests in this area, particularly in light of the policies underlying section 269B and the recent enactment of section 7874, relating to rules applicable to expatriated entities and their foreign parent corporations. Consideration also should be given to appropriate limitations on any proposed exceptions. Pending the issuance of any further published guidance, the IRS will consider the application of section 269B and the underlying regulations to dual listed structures on a case by case basis.

Further, the IRS and Treasury Department remain concerned about 10-percent shareholders interposing entities in order to avoid collection under §1.269B–1(f) of the final regulations. Accordingly, the final regulations retain the reserved section for rules regarding tax assessment and collection from 10-percent indirect owners of stapled foreign corporations. The IRS and Treasury Department will continue to consider such situations and request comments on how to address the issue in subsequent guidance.

Special Analyses

The IRS and the Treasury Department have determined that the adoption of these regulations is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and that because this regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Richard L. Osborne, of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 301 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.269B(b)–1 also issued under 26 U.S.C. 269B(b).

Par. 2. Section 1.269B–1 is added to read as follows:

§1.269B–1 Stapled foreign corporations.

(a) *Treatment as a domestic corporation*—(1) *General rule*. Except as otherwise provided, if a foreign corporation is a stapled foreign corporation within the meaning of paragraph (b)(1) of this section, such foreign corporation will be treated as a domestic corporation for U.S. Federal income tax purposes. Accordingly, for example, the worldwide income of such corporation will be subject to the tax imposed by section 11. For application of the branch profits tax under section 884, and application of sections 871(a), 881, 1441, and 1442 to dividends and interest paid by a stapled foreign corporation, see §§1.884–1(h) and 1.884–4(d).

(2) *Foreign owned exception*. Paragraph (a)(1) of this section will not apply if a foreign corporation and a domestic corporation are stapled entities (as provided in paragraph (b) of this section) and such foreign and domestic corporations are foreign owned within the meaning of this paragraph (a)(2). A corporation will be treated as foreign owned if it is established to the satisfaction of the Commissioner that United States persons hold directly (or indirectly applying section 958(a)(2) and (3) and section 318(a)(4)) less than 50 percent of the total combined voting power of all classes of stock entitled to vote and less than 50 percent of the total value of the stock of such corporation. For the consequences of a stapled foreign corporation becoming or ceasing to be foreign owned, therefore converting its status as either a foreign or domestic corporation within the meaning of this paragraph (a)(2), see paragraph (c) of this section.

(b) *Definition of a stapled foreign corporation*—(1) *General rule*. A foreign corporation is a stapled foreign corporation if such foreign corporation and a domestic corporation are stapled entities. A foreign corporation and a domestic corporation are stapled entities if more than 50 percent of the aggregate value of each corporation's beneficial ownership consists of interests that are stapled. In the case of corporations with more than one class of stock, it is not necessary for a class of stock representing more than 50 percent of the beneficial ownership of the foreign corporation to be stapled to a class of stock representing more than 50 percent of the beneficial ownership of the domestic corporation, provided that more than 50 percent of the aggregate value of each corporation's beneficial ownership (taking into account all classes of stock) are in fact stapled. Interests are stapled if a transferor of one or more interests in one entity is required, by form of ownership, restrictions on transfer, or other terms or conditions, to transfer interests in the other entity. The determination of whether interests are stapled for this purpose is based on the relevant facts and circumstances, including, but not limited to, the corporations' by-laws, articles of incorporation or association, and stock certificates, shareholder agreements, agreements between the corporations, and voting trusts with respect to the corporations. For the consequences of a foreign corporation becoming or ceasing to be a stapled foreign corporation (*e.g.*, a corporation that is no longer foreign owned) under this paragraph (b)(1), see paragraph (c) of this section.

(2) *Related party ownership rule*. For purposes of determining whether a foreign corporation is a stapled foreign corporation, the Commissioner may, at his discretion, treat interests that otherwise would be stapled interests as not being stapled if the same person or related persons (within the meaning of section 267(b) or 707(b)) hold stapled interests constituting more than 50 percent of the beneficial ownership of both corporations, and a principal purpose of the stapling of those interests is the avoidance of U.S. income tax. A stapling of interests may have a principal purpose of tax avoidance even though the tax avoidance purpose is outweighed by other purposes when taken together.

(3) *Example*. The principles of paragraph (b)(1) of this section are illustrated by the following example:

Example. USCo, a domestic corporation, and FCo, a foreign corporation, are publicly traded companies, each having two classes of stock outstanding. USCo's class A shares, which constitute 75% of the value of all beneficial ownership in USCo, are stapled to FCo's class B shares, which constitute 25% of the value of all beneficial ownership in FCo. USCo's class B shares, which constitute 25% of the value of all beneficial ownership in USCo, are stapled to FCo class A shares, which constitute 75% of the value of all beneficial ownership in FCo. Because more than 50% of the aggregate value of the stock of each corporation is stapled to the stock of the other corporation, USCo and FCo are stapled entities within the meaning of section 269B(c)(2).

(c) *Changes in domestic or foreign status*. The deemed conversion of a foreign corporation to a domestic corporation under section 269B is treated as a reorganization under section 368(a)(1)(F). Similarly, the deemed conversion of a corporation that is treated as a domestic corporation under section 269B to a foreign corporation is treated as a reorganization under section 368(a)(1)(F). For the consequences of a deemed conversion, including the closing of a corporation's taxable year, see §§1.367(a)–1T(e), (f) and 1.367(b)–2(f).

(d) *Includible corporation*—(1) Except as provided in paragraph (d)(2) of this section, a stapled foreign corporation treated as a domestic corporation under section 269B nonetheless is treated as a foreign corporation in determining whether it is an includible corporation within the meaning of section 1504(b). Thus, for example, a stapled foreign corporation is not eligible to join in the filing of a consolidated return under section 1501, and a dividend paid by such corporation is not a qualifying dividend under section 243(b), unless a valid section 1504(d) election is made with respect to such corporation.

(2) A stapled foreign corporation is treated as a domestic corporation in determining whether it is an includible corporation under section 1504(b) for purposes of applying §§1.904(i)–1 and 1.861–11T(d)(6).

(e) *U.S. treaties*—(1) A stapled foreign corporation that is treated as a domestic corporation under section 269B may not claim an exemption from U.S. income tax or a reduction in U.S. tax rates by reason of any treaty entered into by the United States.

(2) The principles of this paragraph (e) are illustrated by the following example:

Example. FCo, a Country X corporation, is a stapled foreign corporation that is treated as a domestic corporation under section 269B. FCo qualifies as a resident of Country X pursuant to the income tax treaty between the United States and Country X. Under such treaty, the United States is permitted to tax business profits of a Country X resident only to the extent that the business profits are attributable to a permanent establishment of the Country X resident in the United States. While FCo earns income from sources within and without the United States, it does not have a permanent establishment in the United States within the meaning of the relevant treaty. Under paragraph (e)(1) of this section, however, FCo is subject to U.S. Federal income tax on its income as a domestic corporation without regard to the provisions of the U.S.-Country X treaty and therefore without regard to the fact that FCo has no permanent establishment in the United States.

(f) *Tax assessment and collection procedures*—(1) *In general*. (i) Any income tax imposed on a stapled foreign corporation by reason of its treatment as a domestic corporation under section 269B (whether such income tax is shown on the stapled foreign corporation's U.S. Federal income tax return or determined as a deficiency in income tax) shall be assessed as the income tax liability of such stapled foreign corporation.

(ii) Any income tax assessed as a liability of a stapled foreign corporation under paragraph (f)(1)(i) of this section shall be considered as having been properly assessed as an income tax liability of the stapled domestic corporation (as defined in paragraph (f)(4)(i) of this section) and all 10-percent shareholders of the stapled foreign corporation (as defined in paragraph (f)(4)(ii) of this section). The date of such deemed assessment shall be the date the income tax liability of the stapled foreign corporation was properly assessed. The Commissioner may collect such income tax from the stapled domestic corporation under the circumstances set forth in paragraph (f)(2) of this section and may collect such income tax from any 10-percent shareholders of the stapled foreign corporation under the circumstances set forth in paragraph (f)(3) of this section.

(2) *Collection from domestic stapled corporation*. If the stapled foreign corporation does not pay its income tax liability that was properly assessed, the unpaid balance of such income tax or any portion thereof may be collected from the stapled domestic corporation, provided that the following conditions are satisfied—

(i) The Commissioner has issued a notice and demand for payment of such income tax to the stapled foreign corporation in accordance with §301.6303–1 of this Chapter;

(ii) The stapled foreign corporation has failed to pay the income tax by the date specified in such notice and demand;

(iii) The Commissioner has issued a notice and demand for payment of the unpaid portion of such income tax to the stapled domestic corporation in accordance with §301.6303–1 of this Chapter.

(3) *Collection from 10-percent shareholders of the stapled foreign corporation*. The unpaid balance of the stapled foreign corporation's income tax liability may be collected from a 10-percent shareholder of the stapled foreign corporation, limited to each such shareholder's income tax liability as determined under paragraph (f)(4)(iv) of this section, provided the following conditions are satisfied—

(i) The Commissioner has issued a notice and demand to the stapled domestic corporation for the unpaid portion of the stapled foreign corporation's income tax liability, as provided in paragraph (f)(2)(iii) of this section;

(ii) The stapled domestic corporation has failed to pay the income tax by the date specified in such notice and demand;

(iii) The Commissioner has issued a notice and demand for payment of the unpaid portion of such income tax to such 10-percent shareholder of the stapled foreign corporation in accordance with §301.6303–1 of this Chapter.

(4) *Special rules and definitions*. For purposes of this paragraph (f), the following rules and definitions apply:

(i) *Stapled domestic corporation*. A domestic corporation is a *stapled domestic corporation* with respect to a stapled foreign corporation if such domestic corporation and the stapled foreign corporation are stapled entities as described in paragraph (b)(1) of this section.

(ii) *10-percent shareholder*. A *10-percent shareholder* of a stapled foreign corporation is any person that owned directly 10 percent or more of the total value or total combined voting power of all classes of stock in the stapled foreign corporation for any day of the stapled foreign corporation's taxable year with respect to which the income tax liability relates.

(iii) *10-percent shareholder in the case of indirect ownership of stapled foreign corporation stock*. [Reserved].

(iv) *Determination of a 10-percent shareholder's income tax liability*. The income tax liability of a 10-percent shareholder of a stapled foreign corporation, for the income tax of the stapled foreign corporation under section 269B and this section, is determined by assigning an equal portion of the total income tax liability of the stapled foreign corporation for the taxable year to each day in such corporation's taxable year, and then dividing that portion ratably among the shares outstanding for that day on the basis of the relative values of such shares. The liability of any 10-percent shareholder for this purpose is the sum of the income tax liability allocated to the shares held by such shareholder for each day in the taxable year.

(v) *Income tax*. The term *income tax* means any income tax liability imposed on a domestic corporation under title 26 of the United States Code, including additions to tax, additional amounts, penalties, and interest related to such income tax liability.

(g) *Effective dates*—(1) Except as provided in this paragraph (g), the provisions of this section are applicable for taxable years that begin after July 29, 2005.

(2) Paragraphs (d)(1) and (f) of this section (except as applied to the collection of tax from any 10-percent shareholder of a stapled foreign corporation that is a foreign person) are applicable beginning on—

(i) July 18, 1984, for any foreign corporation that became stapled to a domestic corporation after June 30, 1983; and

(ii) January 1, 1987, for any foreign corporation that was stapled to a domestic corporation as of June 30, 1983.

(3) Paragraph (d)(2) of this section is applicable for taxable years beginning after July 22, 2003, except that in the case of a foreign corporation that becomes stapled to a domestic corporation on or after July 22, 2003, paragraph (d)(2) of this section applies for taxable years ending on or after July 22, 2003.

(4) Paragraph (e) of this section is applicable beginning on July 18, 1984, except as provided in paragraph (g)(5) of this section.

(5) In the case of a foreign corporation that was stapled to a domestic corporation as of June 30, 1983, which was entitled to claim benefits under an income tax treaty as of that date, and which remains eligible for such treaty benefits, paragraph (e) of this section will not apply to such foreign corporation and for all purposes of the Internal Revenue Code such corporation will continue to be treated as a foreign entity. The prior sentence will continue to apply even if such treaty is subsequently modified by protocol, or superseded by a new treaty, so long as the stapled foreign corporation continues to be eligible to claim such treaty benefits. If the treaty benefits to which the stapled foreign corporation was entitled as of June 30, 1983, are terminated, then a deemed conversion of the foreign corporation to a domestic corporation shall occur pursuant to paragraph (c) of this section as of the date of such termination.

Par. 3. In §1.367(b)–2, paragraph (g) is revised to read as follows:

§1.367(b)–2 Definitions and special rules.

* * * * *

(g) *Stapled stock under section 269B*. For rules addressing the deemed conversion of a foreign corporation to a domestic corporation under section 269B, see §1.269B–1(c).

* * * * *

PART 301—PROCEDURE AND ADMINISTRATION

Par 4. The authority citation for part 301 continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Section 301.269B–1 also issued under 26 U.S.C. 269B(b).

Par. 5. Section 301.269B–1 is added to read as follows:

§301.269B–1 Stapled foreign corporations.

In accordance with section 269B(a)(1), a stapled foreign corporation is subject to the same taxes that apply to a domestic corporation under Title 26 of the Internal Revenue Code. For provisions concerning taxes other than income for which the stapled foreign corporation is liable, apply the same rules as set forth in §1.269B–1(a) through (f)(1)(i), and (g) of this Chapter, except that references to *income tax* shall be replaced with the term *tax*. In addition, for purposes of collecting those taxes solely from the stapled foreign corporation, the term *tax* means any tax liability imposed on a domestic corporation under Title 26 of the United States Code, including additions to tax, additional amounts, penalties, and interest related to that tax liability.

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

Approved July 14, 2005.

Eric Solomon,
Acting Deputy Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 28, 2005, 8:45 a.m., and published in the issue of the Federal Register for July 29, 2005, 70 F.R. 43757)

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of September 2005. See Rev. Rul. 2005-57, page 466.

Section 381.—Carryovers in Certain Corporate Acquisitions

26 CFR 1.381(c)(4)–1: Method of accounting.
26 CFR 1.381(c)(5)–1: Inventories.

For a taxpayer desiring consent to change a method of accounting under § 1.381(c)(4)–1 or § 1.381(c)(5)–1, under what circumstances is the requirement to request consent within the prescribed time period waived? See Rev. Proc. 2005-63, page 491.

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of September 2005. See Rev. Rul. 2005-57, page 466.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2005. See Rev. Rul. 2005-57, page 466.

Section 446.—General Rule for Methods of Accounting

26 CFR 1.446–1: General rule for methods of accounting.

For a taxpayer desiring consent to change a method of accounting under certain regulations, under what circumstances is the requirement to request consent within the prescribed time period waived? See Rev. Proc. 2005-63, page 491.

Section 455.—Prepaid Subscription Income

26 CFR 1.455–6: Time and manner of making election.

For a taxpayer desiring consent to change a method of accounting under § 1.455–6, under what circumstances is the requirement to request consent within the prescribed time period waived? See Rev. Proc. 2005-63, page 491.

Section 456.—Prepaid Dues Income of Certain Membership Organizations

26 CFR 1.456–6: Time and manner of making election.

For a taxpayer desiring consent to change a method of accounting under § 1.456–6, under what circumstances is the requirement to request consent within the prescribed time period waived? See Rev. Proc. 2005-63, page 491.

Section 461.—General Rule for Taxable Year of Deduction

26 CFR 1.461–1: General rules for taxable year of deduction.

For a taxpayer desiring consent to change a method of accounting under § 1.461–1, under what circumstances is the requirement to request consent within the prescribed time period waived? See Rev. Proc. 2005-63, page 491.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2005. See Rev. Rul. 2005-57, page 466.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2005. See Rev. Rul. 2005-57, page 466.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of September 2005. See Rev. Rul. 2005-57, page 466.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2005. See Rev. Rul. 2005-57, page 466.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of September 2005. See Rev. Rul. 2005-57, page 466.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2005. See Rev. Rul. 2005-57, page 466.

Section 809.—Reduction in Certain Deductions of Mutual Life Insurance Companies

26 CFR 1.809–9: Computation of the differential earnings rate and the recomputed differential earnings rate.

Mutual life insurance companies; differential earnings rate. The differential earnings rate for 2004 is determined for use by mutual life insurance companies to compute their income tax liability for 2004.

Rev. Rul. 2005–58

This revenue ruling contains a determination under § 809 of the Internal Revenue Code of the "differential earnings rate" for 2004. This rate is used by mutual life insurance companies to calculate their federal income tax liability for taxable years beginning in 2004. Notice 2005–18, 2005–9 I.R.B. 634, contained a tentative determination of this rate.

The Job Creation and Worker Assistance Act of 2002, Pub. L. 107–147, § 611, amended § 809 by adding new paragraph (j). Section § 809(j) provides that the differential earnings rate shall be treated as zero for purposes of computing both the differential earnings amount and the recomputed differential earnings amount for a mutual life insurance company's taxable years beginning in 2001, 2002, or 2003. *See* Notice 2002–33, 2002–1 C.B. 989. Under § 809(j), the final recomputed differential earnings rate for 2003 is zero. Subsequently, the Pension Funding Equity Act of 2004, Pub. L. 108–218, § 205, repealed § 809 of the Code for taxable years beginning after December 31, 2004. Therefore, the Internal Revenue Service is required to determine a differential earnings rate for 2004.

The final determination of the rates is set forth in Table 1.

Rev. Rul. 2005–58 Table 1	
Determination of Rates To Be Used For Taxable Years Beginning in 2004	
Differential earnings rate for 2004	0
Recomputed differential earnings rate for 2003	0*
Imputed earnings rate for 2004	4.449
Base period stock earnings rate	18.221
Current stock earnings rate for 2004	4.913
Stock earnings rate for 2001	2.354
Stock earnings rate for 2002	-1.876
Stock earnings rate for 2003	14.261
Average mutual earnings rate for 2002	5.570
* See § 809(j).	

For additional background concerning the differential earnings rates, *see* Rev. Rul. 2001–33, 2001–2 C.B. 118.

DRAFTING INFORMATION

The principal author of this revenue ruling is Katherine A. Hossofsky of the Office of the Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling, contact Ms. Hossofsky at (202) 622–8435 (not a toll-free call).

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2005. See Rev. Rul. 2005-57, page 466.

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also Sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for September 2005.

Rev. Rul. 2005–57

This revenue ruling provides various prescribed rates for federal income tax purposes for September 2005 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2005–57 TABLE 1

Applicable Federal Rates (AFR) for September 2005

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term				
AFR	3.90%	3.86%	3.84%	3.83%
110% AFR	4.30%	4.25%	4.23%	4.21%
120% AFR	4.68%	4.63%	4.60%	4.59%
130% AFR	5.08%	5.02%	4.99%	4.97%
Mid-term				
AFR	4.19%	4.15%	4.13%	4.11%
110% AFR	4.62%	4.57%	4.54%	4.53%
120% AFR	5.04%	4.98%	4.95%	4.93%
130% AFR	5.47%	5.40%	5.36%	5.34%
150% AFR	6.33%	6.23%	6.18%	6.15%
175% AFR	7.39%	7.26%	7.20%	7.15%

REV. RUL. 2005–57 TABLE 1 — Continued

Applicable Federal Rates (AFR) for September 2005

Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
Long-term				
AFR	4.52%	4.47%	4.45%	4.43%
110% AFR	4.98%	4.92%	4.89%	4.87%
120% AFR	5.43%	5.36%	5.32%	5.30%
130% AFR	5.89%	5.81%	5.77%	5.74%

REV. RUL. 2005–57 TABLE 2

Adjusted AFR for September 2005

Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	2.79%	2.77%	2.76%	2.75%
Mid-term adjusted AFR	3.31%	3.28%	3.27%	3.26%
Long-term adjusted AFR	4.24%	4.20%	4.18%	4.16%

REV. RUL. 2005–57 TABLE 3

Rates Under Section 382 for September 2005

Adjusted federal long-term rate for the current month	4.24%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.24%

REV. RUL. 2005–57 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for September 2005

Appropriate percentage for the 70% present value low-income housing credit	8.01%
Appropriate percentage for the 30% present value low-income housing credit	3.43%

REV. RUL. 2005–57 TABLE 5

Rate Under Section 7520 for September 2005

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	5.0%

Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2005. See Rev. Rul. 2005-57, page 466.

Section 6020.—Returns Prepared for or Executed by Secretary

26 CFR 301.6020–1T: Returns prepared or executed by the Commissioner or other internal revenue officers (temporary).

T.D. 9215

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 301

Substitute for Return

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations and removal of final regulations.

SUMMARY: This document contains temporary regulations relating to returns prepared or signed by the Commissioner or other internal revenue officers or employees under section 6020 of the Internal Revenue Code. The text of the temporary regulations also serves as the text of the proposed regulations (REG–131739–03) set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin.

DATES: *Effective Date*: These regulations are effective July 18, 2005.

Applicability Date: For dates of applicability, see § 301.6020–1(d).

FOR FURTHER INFORMATION CONTACT: Laura R. Urich, (202) 622–4940 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

This document contains amendments to 26 CFR part 301 under section 6020 of the Internal Revenue Code (Code). Section 301.6020–1 of the Procedure and Administration Regulations provides for the preparation or execution of returns by authorized internal revenue officers or employees. Section 1301(a) of the Taxpayer Bill of Rights Act of 1996, Pub. L. No. 104–168 (110 Stat. 1452), amended section 6651 to add subsection (g)(2), which provides that, for returns due after July 30, 1996 (determined without regard to extensions), a return made under section 6020(b) shall be treated as a return filed by the taxpayer for purposes of determining the amount of the additions to tax under section 6651(a)(2) and (a)(3). Absent the existence of a return under section 6020(b), the addition to tax under section 6651(a)(2) does not apply to a nonfiler.

In *Cabirac v. Commissioner*, 120 T.C. 163 (2003), *aff'd in an unpublished opinion*, No. 03–3157 (3rd Cir. Feb. 10, 2004), and *Spurlock v. Commissioner*, T.C. Memo. 2003–124, the Tax Court found that the Service did not establish that it had prepared and signed a return in accordance with section 6020(b). In *Spurlock*, the Tax Court held that a return for section 6020(b) purposes must be subscribed, contain sufficient information from which to compute the taxpayer's tax liability, and the return and any attachments must "purport to be a return." *Spurlock*, slip op. at 27.

These temporary regulations provide that a document (or set of documents) signed by an authorized internal revenue officer or employee is a return under section 6020(b) if the document (or set of documents) identifies the taxpayer by name and taxpayer identification number, contains sufficient information from which to compute the taxpayer's tax liability, and the document (or set of documents) purports to be a return under section 6020(b). A Form 13496, "*IRC Section 6020(b) Certification*," or any other form that an authorized internal revenue officer or employee signs and uses to identify a document (or set of documents) containing the information set forth above as a section 6020(b) return, and the documents identified, constitute a valid section 6020(b) return.

Further, because the Service prepares and signs section 6020(b) returns both by hand and through automated means, these regulations provide that a name or title of an internal revenue officer or employee appearing upon a return made in accordance with section 6020(b) is sufficient as a subscription by that officer or employee to adopt the document as a return for the taxpayer without regard to whether the name or title is handwritten, stamped, typed, printed or otherwise mechanically affixed to the document. The document or set of documents and subscription may be in written or electronic form.

These temporary regulations do not alter the method for the preparation of returns under section 6020(a) as provided in T.D. 6498. Under section 6020(a), if the taxpayer consents to disclose necessary information, the Service may prepare a return on behalf of a taxpayer, and if the taxpayer signs the return, the Service will receive it as the taxpayer's return.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6) please refer to the cross-reference notice of proposed rulemaking published elsewhere in this issue of the Bulletin. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Drafting Information

The principal author of these regulations is Tracey B. Leibowitz, of the Office of the Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division.

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended to read as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

§ 301.6020–1 [Removed]

Par. 2. Section 301.6020–1 is removed.

Par. 3. Section 301.6020–1T is added to read as follows:

§ 301.6020–1T Returns prepared or executed by the Commissioner or other internal revenue officers (temporary).

(a) *Preparation of returns* — (1) *In general*. If any person required by the Code or by the regulations prescribed thereunder to make a return fails to make such return, it may be prepared by the Commissioner or other authorized internal revenue officer or employee provided such person consents to disclose all information necessary for the preparation of such return. The return upon being signed by the person required to make it shall be received by the Commissioner as the return of such person.

(2) *Responsibility of person for whom return is prepared*. A person for whom a return is prepared in accordance with paragraph (a)(1) of this section shall for all legal purposes remain responsible for the correctness of the return to the same extent as if the return had been prepared by him.

(b) *Execution of returns* — (1) *In general*. If any person required by the Code or by the regulations prescribed thereunder to make a return (other than a declaration of estimated tax required under section 6654 or 6655) fails to make such return at the time prescribed therefor, or makes, willfully or otherwise, a false, fraudulent or frivolous return, the Commissioner or other authorized internal revenue officer or employee shall make such return from his own knowledge and from such information as he can obtain through testimony or otherwise. The Commissioner or other authorized internal revenue officer or employee may make the return by gathering information and making computations through electronic, automated or other means to make a determination of the taxpayer's tax liability.

(2) *Form of the return*. A document (or set of documents) signed by the Commissioner or other authorized internal revenue officer or employee shall be a return for a person described in paragraph (b)(1) of this section if the document (or set of documents) identifies the taxpayer by name and taxpayer identification number, contains sufficient information from which to compute the taxpayer's tax liability, and the document (or set of documents) purports to be a return. A Form 13496, "*IRC Section 6020(b) Certification*," or any other form that an authorized internal revenue officer or employee signs and uses to identify a set of documents containing the information set forth above as a section 6020(b) return, and the documents identified, constitute a return under section 6020(b). A return may be signed by the name or title of an internal revenue officer or employee being handwritten, stamped, typed, printed or otherwise mechanically affixed to the return, so long as that name or title was placed on the document to signify that the internal revenue officer or employee adopted the document as a return for the taxpayer. The document and signature may be in written or electronic form.

(3) *Status of returns*. Any return made in accordance with paragraph (b)(1) of this section and signed by the Commissioner or other authorized internal revenue officer or employee shall be *prima facie* good and sufficient for all legal purposes. Furthermore, the return shall be treated as the return filed by the taxpayer for purposes of determining the amount of the addition to tax under section 6651(a)(2) and (3).

(4) *Deficiency procedures*. For deficiency procedures in the case of income, estate, and gift taxes, see sections 6211 to 6216, inclusive, and §§ 301.6211–1 to 301.6215–1, inclusive.

(5) *Employment status procedures*. For pre-assessment procedures in employment taxes cases involving worker classification, see section 7436 (proceedings for determination of employment status).

(6) *Examples*. The application of this paragraph (b) is illustrated by the following examples:

Example 1. Individual A, a calendar-year taxpayer, fails to file his 2003 return. Employee X, a Service employee, opens an examination related to A's 2003 taxable year. At the end of the examination, X completes a Form 13496 and attaches to it the documents listed on the form. Those documents explain examination changes and provide sufficient information to compute A's tax liability. The Form 13496 provides that the Service employee identified on the Form certifies that the attached pages constitute a return under section 6020(b). When X signs the certification package, the package constitutes a return under paragraph (b) of this section because the package identifies A by name, contains A's taxpayer identifying number (TIN), has sufficient information to compute A's tax liability, and contains a statement stating that it constitutes a return under section 6020(b). In addition, the Service shall determine the amount of the additions to tax under section 6651(a)(2) by treating the section 6020(b) return as the return filed by the taxpayer. Likewise, the Service shall determine the amount of any addition to tax under section 6651(a)(3), which arises only after notice and demand for payment, by treating the section 6020(b) return as the return filed by the taxpayer.

Example 2. Same facts as in *Example 1*, except that, after performing the examination, X does not compile any examination documents together as a related set of documents. X also does not sign and complete the Form 13496 nor associate the forms explaining examination changes with any other document. Because X did not sign any document stating that it constitutes a return under section 6020(b) and the documents otherwise do not purport to be a section 6020(b) return, the documents do not constitute a return under section 6020(b). Therefore, the Service cannot determine the section 6651(a)(2) addition to tax against nonfiler A for A's 2003 taxable year on the basis of those documents.

Example 3. Individual C, a calendar-year taxpayer, fails to file his 2003 return. The Service determines through its automated internal matching programs that C received reportable income and failed to file a return. The Service, again through its automated systems, generates a Letter 2566, "30 Day Proposed Assessment (SFR–01) 910 SC/CG." This letter contains C's name, TIN, and has sufficient information to compute C's tax liability. Contemporaneous with the creation of the Letter 2566, the Service, through its automated system, electronically creates and stores a certification stating that the electronic data contained as part of C's account constitutes a valid return under section 6020(b) as of that date. Further, the electronic data includes the signature of the Service employee authorized to sign the section 6020(b) return upon its creation. Although the signature is stored electronically, it can appear as a printed name when the Service requests a paper copy of the certification. The electronically created information, signature, and certification is a return under section 6020(b). The Service will treat that return as the return filed by the taxpayer in determining the amount of the section 6651(a)(2) addition to tax with respect to C's 2003 taxable year. Likewise, the Service shall determine the amount of any addition to tax under section 6651(a)(3), which arises only after notice and demand for payment, by treating the section 6020(b) return as the return filed by the taxpayer.

Example 4. Corporation M, a quarterly taxpayer, fails to file a Form 941, "*Employer's Quarterly Federal Tax Return*," for the second quarter of 2004. Q, a Service employee authorized to sign returns under section 6020(b), prepares a Form 941 by hand, stating Corporation M's name, address, and TIN. Q completes the Form 941 by entering line item amounts, including the tax due, and then signs the document. The Form 941 that Q prepared and signed constitutes a section 6020(b) return because the Form 941 purports to be a return under section 6020(b), the form contains M's name and TIN, and it includes sufficient information to compute M's tax liability for the second quarter of 2004.

(c) *Cross references* — (1) For provisions that a return executed by the Commissioner or other authorized internal revenue officer or employee will not start the running of the period of limitations on assessment and collection, see section 6501(b)(3) and § 301.6501(b)–1(e).

(2) For determining the period of limitations on collection after assessment of a liability on a return executed by the Commissioner or other authorized internal revenue officer or employee, see section 6502 and § 301.6502–1.

(3) For additions to the tax and additional amounts for failure to file returns, see sections 6651 and § 301.6651–1, and section 6652 and § 301.6652–1, respectively.

(4) For additions to the tax for failure to pay tax, see section 6651 and § 301.6651–1.

(5) For criminal penalties for willful failure to make returns, see sections 7201, 7202, and 7203.

(6) For criminal penalties for willfully making false or fraudulent returns, see sections 7206 and 7207.

(7) For civil penalties for filing frivolous income tax returns, see section 6702.

(8) For authority to examine books and witnesses, see section 7602 and § 301.7602–1.

(d) *Effective date*. This section applies to returns prepared under section 6020 after July 18, 2005. The applicability of this section expires on July 14, 2008.

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

Approved July 12, 2005.

Eric Solomon,
Acting Deputy Assistant Secretary (Tax Policy).

(Filed by the Office of the Federal Register on July 15, 2005, 8:45 a.m., and published in the issue of the Federal Register for July 18, 2005, 70 F.R. 41144)

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2005. See Rev. Rul. 2005-57, page 466.

Section 7872.—Treatment of Loans With Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 2005. See Rev. Rul. 2005-57, page 466.

Part III. Administrative, Procedural, and Miscellaneous

Foreign Tax Credit and Other Guidance Under Section 965

Notice 2005–64

SECTION 1. OVERVIEW

This notice is the third in a series of items of published guidance regarding new section 965 of the Internal Revenue Code (Code). This notice supplements the guidance set forth in Notice 2005–10, 2005–6 I.R.B. 474, which primarily addressed the requirements for a domestic reinvestment plan described in section 965(b)(4), and Notice 2005–38, 2005–22 I.R.B. 1100, which primarily addressed the limitations described in section 965(b)(1), (2), and (3) on the amount of dividends eligible for the dividends received deduction under section 965(a), including the effects of certain acquisitions, dispositions, and similar transactions on those limitations. This notice sets forth guidance on various issues arising under section 965, including issues relating to the foreign tax credit and minimum tax credit, expense allocation and apportionment, and currency translation. The Treasury Department and the Internal Revenue Service (IRS) expect to issue regulations that incorporate the guidance provided in Notice 2005–10, Notice 2005–38, this notice, and any subsequent guidance that may be issued addressing section 965.

The remainder of this notice is divided into 14 sections. Section 2 provides background with respect to the issues discussed in this notice. Section 3 provides guidance on the identification of cash dividends and qualifying dividends and foreign currency translation rules for certain cash dividends. Section 4 provides guidance on the disallowance of a credit or deduction under section 965(d)(1) for foreign taxes paid or accrued with respect to the deductible portion of section 965 dividends and related issues arising under section 78. Section 5 provides guidance on the disallowance of deductions for certain expenses under section 965(d)(2). Section 6 provides rules for the treatment of deductions related to section 904(d) separate categories containing qualifying dividends. Section 7 then provides guidance on the limitation under section 965(e)(2) that prevents the reduction of taxable income below the amount of nondeductible CFC dividends. Section 8 addresses the application of the overall foreign loss and separate limitation loss allocation and recapture rules of section 904(f) to taxpayers with nondeductible CFC dividends. Section 9 provides rules for implementing the restrictions under section 965(e)(1) on the use of credits to offset U.S. tax on nondeductible CFC dividends, in part through the application of an additional foreign tax credit limitation that is applied after expenses and losses are allocated and the regular section 904(d) limitation is calculated, and provides rules relating to the computation of alternative minimum tax and the credit for prior year minimum tax in the election year. Section 10 then addresses other issues arising under section 965, including the treatment of dividends paid to certain intermediary pass-through entities for purposes of determining base period inclusions under section 965(b)(2)(B)(i). Section 11 sets forth transition rules that apply to certain taxpayers that approved a domestic reinvestment plan or filed a tax return for a taxable year to which section 965 applies prior to the issuance of this notice. Section 12 describes the effect of this notice on other documents. Section 13 provides the effective date of this notice, and section 14 provides information required under the Paperwork Reduction Act of 1995. Finally, section 15 provides drafting information.

SECTION 2. BACKGROUND

.01 *Section 965—In General*

The American Jobs Creation Act of 2004 (P.L. 108–357) (the Act), enacted on October 22, 2004, added new section 965 to the Code. In general, and subject to limitations discussed below, section 965(a) provides that a corporation that is a U.S. shareholder[1] of a controlled foreign corporation (CFC) may elect, for one taxable year, an 85 percent dividends received deduction (DRD) with respect to certain cash dividends it receives from its CFCs.[2] For this purpose, all U.S. shareholders that are members of an affiliated group filing a consolidated return under section 1501 are treated as one U.S. shareholder. Section 965(c)(5)(A).

For purposes of section 965, the term "cash dividends" includes cash amounts included in gross income as dividends under sections 302, 304, and 356(a)(2), but does not include subpart F inclusions or amounts treated as dividends under section 78 or 1248 or, except in certain cases, section 367. H.R. Conf. Rep. No. 108–755, at 314–15; see Notice 2005–10, sections 2 and 3. For this purpose, a cash dividend also includes a cash distribution from a CFC to a U.S. shareholder that is excluded from gross income under section 959(a) to the extent of amounts included in income by such U.S. shareholder under section 951(a)(1)(A) as a result of a cash dividend during the election year to: (1) such CFC from another CFC in a section 958(a) chain of ownership; or (2) any other CFC in such chain of ownership from another CFC in such chain of ownership, but only to the extent of cash distributions described in section 959(b) made during such year to the CFC from which such U.S. shareholder received such distribution. Section 965(a)(2).

The amount of cash dividends eligible for the section 965(a) DRD (qualifying dividends) is determined after applying certain limitations. Notice 2005–38 addressed the rules limiting qualifying dividends to certain dollar threshold amounts determined with reference to the greater of $500 million or the amount of earnings permanently reinvested outside the United States, the amount of dividends received in excess of certain base period average amounts, and certain increases in related-party indebtedness. See sections 965(b)(1) through (3) and 965(c). Notice 2005–10 addressed the requirement in section 965(b)(4) that the amount of the dividends be invested in the United States pursuant to a domestic reinvestment plan that meets specified criteria. Notice 2005–10

[1] The term U.S. shareholder means, with respect to any foreign corporation, a U.S. person who owns (within the meaning of section 958(a)), or is considered as owning by applying the rules of ownership of section 958(b), 10 percent or more of the total combined voting power of all classes of stock entitled to vote of such foreign corporation. Section 951(b).

[2] Section 965(c)(4) provides that no deduction is allowed under section 243 or 245 for any dividend for which a deduction is allowed under section 965.

also provided rules for electing the application of section 965 for a taxable year by filing Form 8895 with a timely-filed tax return. See section 965(b)(4) and (f). The taxable year for which a taxpayer elects section 965 to apply is referred to in this notice as the "election year."

.02 *Disallowance of Credit or Deduction for Certain Expenses Related to Deductible Portion of Qualifying Dividends and Related Matters*

Section 965(d)(1) provides that no credit or deduction is allowed for certain foreign taxes paid or accrued (or treated as paid or accrued) with respect to the deductible portion of any qualifying dividend. Section 965(d)(2) further provides that no deduction shall be allowed for certain other expenses. Section 9.01 of Notice 2005–38 confirmed that section 78 does not apply to any tax which is not allowable as a credit under section 901 by reason of section 965(d) and that the disallowance of deductions in section 965(d)(2) applies only to deductions for expenses that are directly allocable to the deductible portion described in section 965(d)(1).

Section 965(d)(3) provides that, unless the taxpayer otherwise specifies, the deductible portion of any qualifying dividend is the amount which bears the same ratio to the amount of such dividend as the amount allowed as a deduction under section 965(a) for the election year bears to the total amount of dividends the taxpayer received from its CFCs during the election year, as described in section 965(b)(2)(A). For purposes of determining which dividends are subject to the foreign tax credit and expense disallowance, the taxpayer may specifically identify which cash dividends are treated as carrying the DRD (and thus entail proportionate disallowance of any associated deductions and foreign tax credits) and which are not. H.R. Conf. Rep. No. 108–755, at 316. In the absence of such a specification, a *pro rata* amount of foreign tax credits and deductions will be disallowed with respect to every cash dividend repatriated during the election year. See H.R. Conf. Rep. No. 108–755, at 316 n. 112.

.03 *Limitation on Use of Credits and Deductions Related to Nondeductible Portion of Qualifying Dividends*

For purposes of this notice, the term "nondeductible CFC dividends" refers to the excess of the amount of qualifying dividends over the 85 percent deduction allowed for such dividends under section 965(a). See section 965(e)(3). Section 965(e) provides limitations on the extent to which credits may offset the U.S. tax on nondeductible CFC dividends, and also provides that allowable deductions may not reduce taxable income below the amount of nondeductible CFC dividends. Specifically, section 965(e)(1) provides that the U.S. tax on nondeductible CFC dividends may not be offset by tax credits, other than a foreign tax credit under section 27 for taxes attributable to such dividends and the credit for prior year minimum tax under section 53.

Section 965(e)(1) further provides that the U.S. tax on nondeductible CFC dividends is not treated as tax imposed by chapter 1 for purposes of computing the alternative minimum tax imposed by section 55 (AMT). Accordingly, the tax on nondeductible CFC dividends cannot reduce the AMT that otherwise would be owed by the taxpayer. H.R. Conf. Rep. No. 108–755, at 316.[3] Section 9.01 of Notice 2005–38 provided that for purposes of calculating AMT for the election year in accordance with section 965(e)(1)(B), the taxpayer's regular tax described in section 55(c) and tentative minimum tax determined under section 55(b)(1)(B) do not include tax attributable to nondeductible CFC dividends.

Section 965(e)(2)(A) provides that taxable income shall in no event be less than the amount of nondeductible CFC dividends received during the election year. While the income attributable to nondeductible CFC dividends may not be offset by expenses, losses, or deductions, such amounts may have the effect of reducing the taxpayer's other income. H.R. Conf. Rep. No. 108–755, at 316 n. 113. Section 965(e)(2)(B) provides that the nondeductible CFC dividends are not taken into account in determining the amount of any net operating loss (NOL) for the election year, or in determining taxable income for the election year for purposes of the second sentence of section 172(b)(2), which applies in determining the allowable NOL carryover or carryback to other years.

SECTION 3. IDENTIFICATION OF CASH DIVIDENDS, QUALIFYING DIVIDENDS, AND SEPARATE CATEGORIES; FOREIGN CURRENCY TRANSLATION RULES

.01 *Identification of Cash Dividends*

In order for cash dividends that are paid to a partnership or a disregarded entity that is owned by a U.S. shareholder to qualify as cash dividends described in section 965(a), cash in the amount of the dividend must be received by the U.S. shareholder in the election year from the partnership or disregarded entity. See section 3.02 of Notice 2005–10. In the case of a disregarded entity, cash may be received in a form other than a distribution. See section 9.06 of Notice 2005–38 and section 10.09 of this notice. In addition, as described in section 2.01 of this notice, under section 965(a)(2) a cash distribution from a CFC of previously-taxed earnings and profits attributable to amounts which are or have been included in income of the U.S. shareholder and are excluded from gross income under section 959(a) (previously-taxed income or PTI) is treated as a cash dividend only to the extent of amounts included in income by the U.S. shareholder under subpart F in the election year as a result of cash dividends that are both paid and distributed through a chain of CFCs to the U.S. shareholder in the election year. Finally, a deemed liquidation effected through an election under §301.7701–3(c) results in a cash dividend only to the extent the shareholder receives cash as part of the liquidation in the election year. Section 965(c)(3); see section 2, footnote 2, of Notice 2005–10. This section 3.01 provides rules for identifying the amounts treated as cash dividends if a U.S. shareholder receives cash from a partnership or disregarded entity or cash distributions of PTI from a CFC that exceed the cash dividends paid to such partnership, disregarded entity, or CFC (or the cash deemed received in a deemed liquidation) in the election year. See sec-

[3] However, the DRD is not treated as a preference item for purposes of computing the AMT. Section 56(g)(4)(C)(vi). Thus, the deduction is allowed in computing alternative minimum taxable income notwithstanding the fact that it may not be deductible in computing earnings and profits. H.R. Conf. Rep. No. 108–755, at 316–317.

tion 3.02 of this notice for rules for identifying specific cash dividends (including both cash dividends described in this section 3.01 and cash dividends described in section 965(a)(1) that are paid directly by a CFC to a U.S. shareholder) as qualifying dividends eligible for the section 965(a) DRD.

For purposes of this section 3, the term "eligible cash amount" refers to (a) cash received by the U.S. shareholder on any day in the election year from a partnership or disregarded entity in a form that satisfies the requirements of section 3.02 of Notice 2005–10 and section 9.06 of Notice 2005–38, and (b) cash distributions of PTI to the U.S. shareholder on any day in the election year from a CFC. A taxpayer that receives eligible cash amounts from a disregarded entity or partnership that in the aggregate exceed the total amount of cash dividends paid to (or the amount of cash deemed received in a deemed liquidation from) such disregarded entity or the taxpayer's distributive share of cash dividends paid to such partnership during the election year, respectively, may specifically identify which eligible cash amounts are treated as attributable to the underlying cash dividends (and therefore considered to be a cash dividend described in section 965(a)(1) or (2)). Similarly, a taxpayer that receives eligible cash amounts of PTI from a CFC in excess of the amount eligible to be treated as a cash dividend under section 965(a)(2) may specifically identify which cash PTI distributions from that CFC are treated as attributable to the underlying subpart F inclusions (and therefore considered to be a cash dividend described in section 965(a)(2)).

Taxpayers make this identification by including the cash dividends and identifying information on Part V of Form 8895.[4] Taxpayers may identify all or a portion of any specific eligible cash amount received by the U.S. shareholder from a disregarded entity, partnership or CFC in the election year as the cash dividend. To the extent a taxpayer fails to identify specific eligible cash amounts in an amount equal to the full amount of the taxpayer's share of cash dividends received by the disregarded entity, partnership or CFC, a *pro rata* portion of each eligible cash amount received but not otherwise identified by the taxpayer as a cash dividend will be treated as a cash dividend. The *pro rata* portion is the amount which bears the same ratio to the eligible cash amount as the unidentified portion of the taxpayer's share of the cash dividends paid to the disregarded entity, partnership or CFC bears to the total amount of eligible cash amounts received during the election year but not otherwise identified as cash dividends.

If a U.S. shareholder receives eligible cash amounts from a disregarded entity owned by the U.S. shareholder in an amount less than or equal to the total amount of cash dividends paid to the disregarded entity during the election year, then 100 percent of each eligible cash amount received from such disregarded entity is a cash dividend described in section 965(a). Similarly, if a U.S. shareholder receives eligible cash amounts from a partnership in an amount less than or equal to the total amount of the U.S. shareholder's distributive share of cash dividends paid to the partnership during the election year, then 100 percent of each eligible cash amount received from such partnership is a cash dividend described in section 965(a). Finally, if a U.S. shareholder (or a disregarded entity or partnership owned by the U.S. shareholder) receives cash distributions of PTI from a CFC in an amount less than or equal to the amount of earnings and profits included in income by the U.S. shareholder under section 951(a)(1)(A) as a result of one or more cash dividends paid to the distributing CFC or another CFC in the same chain of ownership described in section 958(a), then 100 percent of each cash distribution of PTI from that CFC is a cash dividend described in section 965(a)(2).

The taxpayer may choose to associate each cash dividend received from a disregarded entity or partnership with one or more of the cash dividends paid to that disregarded entity or partnership during the election year. Similarly, the taxpayer may choose to associate each cash dividend described in section 965(a)(2) that is received from a CFC with the earnings and profits attributable to the taxpayer's subpart F inclusion from one or more of the CFCs in the ownership chain. Taxpayers make this identification by including the identifying information required by Part V of Form 8895 and consistently calculating the tax consequences under section 965 and this notice for those cash dividends that are qualifying dividends, determined as provided in section 3.02 of this notice.[5]

.02 *Identification of Qualifying Dividends and Separate Categories*

In addition to other limitations, the amount of cash dividends eligible for the DRD is limited to the excess of the cash dividends received by the taxpayer from its CFCs during the election year over the taxpayer's base period amount. See section 965(b)(2) and sections 2 and 3 of Notice 2005–38. A taxpayer may specifically identify which cash dividends are treated as qualifying dividends carrying the DRD and which cash dividends are treated as meeting the base-period repatriation level or are otherwise ineligible for the DRD. H.R. Conf. Rep. No. 108–755, at 316. Taxpayers identify the qualifying dividends by completing Form 8895, Part V, column (e).[6]

A taxpayer generally must identify each cash dividend received during the election year as either a qualifying dividend or a non-qualifying dividend in its entirety, but may identify a portion of one dividend as a qualifying dividend to the extent necessary to prevent the total amount identified in Part V, column (e) of Form 8895 from exceeding the total amount of qualifying dividends. To the extent a taxpayer fails to identify specific cash dividends equal to the full amount of qualifying dividends, a *pro rata* portion of each cash dividend received by the taxpayer during the election year that is not otherwise identified by the taxpayer as a qualifying dividend will be treated as a qualifying dividend. The *pro rata* portion is the amount which bears the

[4] Any taxpayer that had filed its return for the election year before Form 8895 was made available to the public in final form need not file Form 8895 to identify the cash dividends, but should retain the information requested on the Form to be made available to the IRS on request.

[5] See footnote 4.

[6] Section 7.06 of Notice 2005–38 provides that an increase in a CFC's related party indebtedness is allocated among U.S. shareholders that are related persons with respect to the CFC in the order that cash dividends are received. The provision of Notice 2005–38 allocates among the U.S. shareholders the reduction in the amount of cash dividends eligible for the section 965(a) DRD, but does not preclude a U.S. shareholder from identifying any specific cash dividend as a qualifying dividend.

same ratio to the amount of the dividend as the total amount of qualifying dividends not otherwise identified bears to the total amount of cash dividends received during the election year described in section 965(b)(2)(A) that are not otherwise identified as qualifying dividends. See *Example 3* of section 3.05 of this notice.

Qualifying dividends described in section 965(a)(1) will be considered paid *pro rata* out of the non-previously-taxed earnings and profits in the CFC's separate categories from which the dividend was paid, in accordance with the look-through rules of section 904(d)(3)(D). Subpart F inclusions attributable to dividends paid to a CFC from another CFC in the same chain of ownership (including CFCs engaged in section 304 transactions described in section 9.04 of Notice 2005–38) are treated as income in the same separate categories to which the dividend is assigned, under the look-through rules of section 904(d)(3)(B) and (D). See Treas. Reg. §1.904–5. Cash dividends described in section 965(a)(2), whether or not identified by the U.S. shareholder as qualifying dividends, will be considered paid first out of the previously-taxed earnings and profits described in section 959(c)(2) that are attributable to the amount included in the United States shareholder's income under section 951(a)(1)(A) in the election year as a result of the CFC-to-CFC cash dividend described in section 965(a)(2), to the extent thereof.

.03 *Allocation of Dividends Received Deduction*

The DRD allowed under section 965(a) is definitely related to and allocated to reduce gross income in the U.S. shareholder's separate categories to which the qualifying dividends described in section 965(a)(1) and the subpart F inclusions underlying qualifying dividends described in section 965(a)(2) are assigned. See Treas. Reg. §1.861–8(a)(2) and (b)(2).

.04 *Foreign Currency Exchange Rate Conventions*

(a) *Cash dividends described in section 965(a)(1).* Cash dividends described in section 965(a)(1) that are paid directly to the U.S. shareholder are translated into U.S. dollars at the spot rate on the date of distribution as provided in section 989(b)(1).[7] A cash dividend paid by a CFC to a pass-through entity that is owned by a U.S. shareholder is treated as received by such U.S. shareholder for purposes of section 965(a) only if and to the extent that such shareholder receives cash in the amount of the CFC dividend during the election year. See Notice 2005–10, section 3.02, Notice 2005–38, section 9.06, and section 10.09 of this notice. Such cash dividends are translated from the functional currency of the payor CFC into U.S. dollars at the spot rate on the date the amount of the cash dividend is received by the U.S. shareholder, rather than at the spot rate on the date the dividend is received by the partnership or disregarded entity. Accordingly, the receipt of cash itself will not result in currency gain or loss to the U.S. shareholder.

(b) *Cash dividends described in section 965(a)(2).* Cash dividends described in section 965(a)(2) are distributions of PTI to the U.S. shareholder in an amount that does not exceed the subpart F inclusions in the election year that result from cash dividends that are paid by lower-tier CFCs and that are distributed as PTI through a chain of CFCs and received by the U.S. shareholder during the election year. The subpart F inclusions that result in cash dividends will be translated from the functional currency of the CFC receiving the dividend into U.S. dollars at the spot rate on the date the PTI is distributed to the U.S. shareholder, rather than at the average rate generally used to translate subpart F inclusions under section 989(b)(3), and the PTI distribution will not result in currency gain or loss under section 986(c).

.05 *Examples*

The following examples illustrate the application of section 965(d)(3) and this section 3. Unless otherwise indicated, the following facts are assumed for purposes of these examples. All corporations use calendar taxable years for U.S. tax purposes. USP is a domestic corporation that elects to apply section 965 to its 2005 taxable year and meets all applicable requirements to claim the section 965(a) DRD with respect to the qualifying dividends described in the examples.

Example 1. Identification of cash dividends where PTI distributions exceed subpart F inclusions attributable to cash dividends. (i) *Facts.* USP owns all the stock of CFC1, which owns all the stock of CFC2. CFC1 and CFC2 are organized under the laws of different foreign countries and each uses the "u" as its functional currency. On September 1, 2005, CFC2 pays a cash dividend of 200u to CFC1 that is subpart F income of CFC1 under sections 952(a) and 954(c)(1)(A), resulting in a 200u income inclusion to USP under section 951(a)(1)(A). On each of March 1, 2005, when the spot exchange rate is 1u = $1, and November 1, 2005, when the spot exchange rate is 1u = $1.25, CFC1 distributes 200u to USP. Each of the 200u distributions is a distribution of previously-taxed earnings and profits of CFC1 that is excluded from USP's gross income under section 959(a).

(ii) *Result.* USP received cash distributions of PTI from CFC1 in the election year in an amount (400u) that exceeds the amount included in income by USP under section 951(a)(1)(A) as a result of cash dividends during the election year to CFC1 from CFC2, another CFC in a chain of ownership described in section 958(a) (200u). Pursuant to section 3.01 of this notice, USP may identify either the March 1, 2005 PTI distribution of 200u = $200 or the November 1, 2005 PTI distribution of 200u = $250 as the cash dividend described in section 965(a)(2) of previously-taxed earnings attributable to the subpart F inclusion resulting from the cash dividend paid by CFC2 to CFC1. Pursuant to section 3.04 of this notice, USP's subpart F inclusion of 200u is translated into U.S. dollars at the spot exchange rate on the date of the associated PTI distribution, and that PTI distribution does not result in currency gain or loss under section 986(c). The other PTI distribution may result in currency gain or loss under section 986(c).

Example 2. Identification of amounts underlying cash dividends where multiple subpart F inclusions exceed PTI distributions. (i) *Facts.* USP owns all the stock of CFC1, which owns all the stock of CFC2 and CFC3. CFC2 owns all the stock of CFC4. The four CFCs are each organized under the laws of a different foreign country and each uses the U.S. dollar as its functional currency. In 2005, CFC3 pays a $100 cash dividend to CFC1 that, after taking into account $10 of allocable foreign taxes and $5 of other expenses, is subpart F income of CFC1 under sections 952(a) and 954(c)(1)(A) that results in an $85 income inclusion to USP with respect to CFC1 under section 951(a)(1)(A). Also in 2005, CFC4 pays a $100 cash dividend to CFC2 that, after taking into account $30 of allocable taxes and $10 of other expenses, is subpart F income of CFC2 under sections 952(a) and 954(c)(1)(A) that results in a $60 income inclusion to USP under section 951(a)(1)(A). CFC2 distributes $60 of cash to CFC1 and CFC1 distributes $60 of cash to USP in 2005.

(ii) *Result.* USP received cash distributions of PTI from CFC1 in the election year in an amount ($60) that is less than $145, the total of amounts included in income by USP under section 951(a)(1)(A) as a result of cash dividends during the election year

[7] In the case of cash received as part of a deemed liquidation resulting from an election under Treas. Reg. §301.7701–3(c), the date of distribution is the date the cash is received, not the date of the deemed liquidation.

from CFC3 to CFC1 ($85), and cash dividends during the election year from CFC4 to CFC2 that were distributed in cash to CFC1 ($60). Accordingly, pursuant to section 3.01 of this notice, the entire $60 cash PTI distribution is a cash dividend described in section 965(a)(2). Furthermore, also pursuant to section 3.01 of this notice, USP may associate the $60 cash dividend with either the $60 cash PTI distribution to CFC1 that is attributable to the subpart F inclusion from CFC2 or a ratable portion of the $85 subpart F inclusion from CFC1.

Example 3. Identification of qualifying dividends. (i) *Facts*. USP owns all the stock of CFC1 and CFC2, and CFC1 owns all the stock of CFC3. CFC1, CFC2, and CFC3 are organized under the laws of different foreign countries, and each uses the "u" as its functional currency. In 2005, CFC3 pays an 80u cash dividend to CFC1. The dividend is subpart F income of CFC1 under sections 952(a) and 954(c)(1)(A), resulting in an income inclusion to USP under section 951(a)(1)(A). Also in 2005, CFC1 distributes to USP 160u with a value of $200 at the 0.8u = $1 spot exchange rate on the date of distribution, all of which constitutes previously-taxed earnings of CFC1 described in section 959(c)(2). In addition, USP receives a 100u cash dividend, equal to $100 at the spot rate on the date of distribution, from each of CFC1 and CFC2 in 2005. USP's base period amount described in section 965(b)(2)(B) is $100, and, taking into account the other limitations under section 965(b), USP's total amount of qualifying dividends is $150.

(ii) *Result*. Under section 3.04 of this notice, USP's subpart F inclusion attributable to the 80u cash dividend paid by CFC3 to CFC1 is translated into dollars at the spot rate on the date an equivalent amount of cash is distributed to USP, rather than at the average exchange rate for the year. Accordingly, USP includes $100 in income under section 951(a)(1)(A), and 80u of the PTI distribution, which has a value of $100 on the date of distribution, is excluded from USP's gross income under section 959(a) and results in no currency gain or loss under section 986(c). The remaining 80u of the 160u PTI distribution, which also has a value of $100 on the date of distribution, is excluded from USP's gross income under section 959(a) and may result in currency gain or loss under section 986(c).

USP received three $100 cash dividends described in section 965(b)(2)(A) during 2005, of which $150 is eligible to be taken into account under section 965(a): the $100 dividend from CFC2, the $100 dividend from CFC1, and $100 of the $200 PTI distribution received from CFC1. The remaining $100 of the PTI distribution received from CFC1 is not a cash dividend described in section 965(a)(2) because it exceeds the amount included in income by USP under section 951(a)(1)(A) as a result of the cash dividend paid by CFC3 to CFC1. Pursuant to section 3.02 of this notice, USP may identify any one of the three distributions in its entirety, and one-half of either of the remaining two distributions, as qualifying dividends on Form 8895. If USP does not identify specific distributions as the qualifying dividends, $50 ($150 total qualifying dividends not otherwise identified divided by $300 total cash dividends received during the election year, multiplied by $100 cash dividend) of each of the three $100 cash dividends will be treated as a qualifying dividend.

Example 4. Cash dividend equivalent to cash received in actual inbound liquidation. (i) *Facts*. USP owns all the stock of CFC1, which owns all the stock of CFC2. CFC1 and CFC2 are organized in Country X and each uses the "u" as its functional currency. On June 30, 2005, in an inbound liquidation of CFC1 described in sections 332 and 367(b), CFC1 legally dissolves and, in connection with such dissolution, USP acquires all the assets of CFC1, consisting of 100u of cash in a Country X bank account and certain other noncash assets (including all of the stock of CFC2). In connection with the liquidation USP includes in income as a dividend an all earnings and profits amount of 300u equal to $600 on June 30, 2005, when the spot exchange rate is 1u = $2. After the liquidation, USP continues to operate the business of CFC1 in Country X with the Country X bank account.

(ii) *Result*. Pursuant to section 3.02 of this notice, USP may identify as a qualifying dividend described in section 965(a)(1) the 100u of cash received by USP in the liquidation of CFC1 that is taxed as a dividend under section 367(b). Pursuant to section 3.04 of this notice, the amount of the cash dividend from CFC1 is $200 (100u of cash received by USP in the liquidation of CFC1, translated at the spot rate of 1u = $2 on the date of the liquidating dividend).

Example 5. Cash dividends less than cash received in check-the-box liquidation plus cash dividend received by disregarded entity. (i) *Facts*. The facts are the same as in *Example 4*, except that, instead of actually liquidating CFC1, USP elects to treat CFC1 as a disregarded entity by filing an entity classification election under Treas. Reg. §301.7701–3, effective July 1, 2005, CFC2 pays a dividend of 100u to the disregarded entity CFC1 on September 1, 2005, when the spot exchange rate is 1u = $1.50, and the disregarded entity CFC1 distributes 100u of cash to USP on October 1, 2005, when the spot exchange rate is 1u = $1.75.

(ii) *Result*. USP's check-the-box election with respect to CFC1 does not give rise to an eligible dividend under section 965(c)(3) because the resulting deemed liquidation in and of itself does not result in an actual receipt by USP of the 100u of cash owned by CFC1. In addition, the cash dividend paid from CFC2 to CFC1, at that time a disregarded entity, is treated as a cash dividend received by USP in the election year only to the extent USP receives cash from the disregarded entity during the election year. See Notice 2005–10, section 3.02. Because the disregarded entity CFC1 distributed 100u of cash to USP in the year of the liquidation, the 100u cash distribution is a cash dividend within the meaning of section 965(c)(3). Pursuant to section 3.01 of this notice, USP may identify the October 1, 2005 100u cash dividend as attributable to either the deemed dividend resulting from the check-the-box election or the cash dividend paid by CFC2. If USP treats the cash dividend as attributable to cash actually received by USP in connection with the deemed liquidation, the deemed dividend constitutes a dividend described in section 965(c)(3) to the extent of 100u. Alternatively, USP may treat the 100u cash dividend as attributable to the cash dividend paid from CFC2 to CFC1, a disregarded entity, which is eligible to be treated as a cash dividend because USP received 100u of cash from CFC1 during the election year.

If USP chooses to treat the dividend from CFC2 as the cash dividend underlying the 100u cash dividend on October 1, 2005, then pursuant to section 3.04 of this notice the dollar amount of the 100u dividend from CFC2 is $175, the spot value of 100u on October 1, 2005, the date CFC1 distributes an amount of cash equal to the CFC2 dividend to USP, and CFC1's distribution of 100u to USP does not give rise to currency gain or loss. As in *Example 4*, the entire 300u all earnings and profits amount is $600, translated into dollars at the 1u = $2 exchange rate, the spot rate on the date of the deemed dividend.

If, instead, USP chooses to treat the 100u cash dividend as cash received in connection with the deemed liquidation, pursuant to section 3.04 of this notice the dollar amount of 100u of the 300u deemed dividend from CFC1 is $175, the spot value of 100u on October 1, 2005, the date USP receives that amount of cash in connection with the deemed liquidation. The dollar amount of the 200u remainder of the deemed dividend is $400, translated into dollars at the 1u = $2 exchange rate, the spot rate on the date of the deemed dividend. The dollar amount of the 100u dividend from CFC2 is $150, the spot value of 100u on September 1, 2005, the date CFC2 paid the dividend to the disregarded entity CFC1.

Example 6. CFC-to-CFC dividend and equivalent PTI distribution. (i) *Facts*. USP owns all the stock of CFC1, which owns all the stock of CFC2. CFC1 is organized in Country X and uses the "u" as its functional currency. CFC2 is organized in Country Y and uses the euro as its functional currency. On June 30, 2005, when the spot exchange rate is 1u = €2, CFC2 pays a cash dividend of €200 to CFC1. CFC1 has no other items of income or expense in 2005. The dividend from CFC2 is subpart F income of CFC1 under sections 952(a)(2) and 954(c)(1)(A) that is included in income by USP under section 951(a)(1)(A)(i). On September 1, 2005, when the spot exchange rate is 1u = $1, CFC1 distributes 100u in cash to USP. The 100u cash distribution is PTI of CFC1 that is excluded from USP's income under section 959(a). The average exchange rate determined under section 989(b)(3) for 2005 is 1u = $.90.

(ii) *Result*. Pursuant to section 989(b)(1), the "u" amount of CFC1's subpart F income attributable to the €200 dividend from CFC2 is 100u, the spot value of €200 on the date CFC1 includes the CFC2 dividend in income. The 100u cash distribution from CFC1 to USP is a cash dividend described in section 965(a)(2) because it is PTI in an amount not in excess of the 100u subpart F income of CFC1 that results from a cash dividend paid during the election year by CFC2, another CFC in the chain of ownership described in section 958(a). Regardless of whether USP identifies the PTI distribution from CFC1 as a qualifying dividend, pursuant to section 3.04 of this notice the dollar amount of USP's subpart F inclusion with respect to CFC1 under section 951(a)(1)(A) attributable to the CFC2 dividend is $100, the spot rate on the date CFC1 distributes an amount of cash equal to the CFC2 dividend to USP. The PTI distribution does not result in currency gain or loss under section 986(c).

Example 7. CFC-to-CFC dividend and smaller PTI distribution. (i) *Facts*. The facts are the same as in *Example 6*, except that CFC2's dividend to CFC1 is €400 rather than €200.

(ii) *Result*. The €400 dividend, translated at the spot rate on the date of distribution from CFC2 to CFC1, results in 200u of subpart F income of CFC1 that is included in USP's income in the election year.

The result with respect to the 100u of the subpart F inclusion and resulting PTI that CFC1 distributes to USP in the election year are the same as in *Example 6.* USP's subpart F inclusion with respect to the remaining 100u of CFC1's subpart F income that is not distributed is $90 (100u translated at the average exchange rate of 1u = $.90). CFC1's distribution of the remaining 100u of PTI to USP after the election year is not subject to the rules of this notice and may give rise to currency gain or loss under section 986(c).

SECTION 4. DISALLOWANCE OF CREDIT OR DEDUCTION FOR FOREIGN TAXES ON DEDUCTIBLE PORTION OF QUALIFYING DIVIDENDS

.01 *Identification of Foreign Income Taxes Paid or Accrued with Respect to the Deductible Portion of Qualifying Dividends*

Under section 965(d)(1), no credit or deduction is allowed for foreign taxes described in section 901 that are paid or accrued (or treated as paid or accrued) with respect to the deductible portion of each qualifying dividend, including distributions of PTI that are treated as cash dividends under section 965(a)(2). This disallowance applies to 85 percent of the U.S. dollar amount of (1) foreign taxes paid or accrued by the U.S. shareholder with respect to the qualifying dividend (including the U.S. shareholder's distributive share of foreign taxes that are paid or accrued by a partnership with respect to the dividend and that are properly allocated to the U.S. shareholder-partner under the rules of sections 702 and 704 and the regulations thereunder and separately stated to the partner under Treas. Reg. §1.702–1(a)(6)); (2) foreign taxes deemed paid under section 902 with respect to a qualifying dividend described in section 965(a)(1); and (3) foreign taxes deemed paid under section 960, including taxes described in section 960(a)(3), with respect to a subpart F inclusion resulting from a CFC-to-CFC dividend and the associated PTI distribution described in section 965(a)(2).

Section 965 does not modify the computation of foreign taxes deemed paid under sections 902 and 960. As a result, for purposes of section 902 the post-1986 undistributed earnings, post-1986 foreign income taxes, pre-1987 accumulated profits, pre-1987 foreign income taxes, and previously-taxed earnings and profits and tax accounts of CFCs paying qualifying dividends are reduced by the full amount of earnings distributed and the full amount of foreign taxes attributable to the distributed earnings, without regard to the amount of the DRD or the amount of foreign tax for which section 965(d)(1) disallows a credit or deduction.

.02 *Section 78 Gross-Up*

Under section 78, an amount equal to the taxes deemed paid under section 902(a) or section 960(a)(1) by a domestic corporation generally is included in income as a dividend if the domestic corporation chooses the benefits of the foreign tax credit for the taxable year. Section 78 does not apply to any tax which is not allowable as a credit under section 901 by reason of section 965(d). See also section 9.01 of Notice 2005–38.

.03 *Examples*

The following examples illustrate the application of section 965(d)(1) and this section 4. Unless otherwise indicated, the following facts are assumed for purposes of these examples. All corporations use calendar taxable years for U.S. tax purposes. USP is a domestic corporation that elects to apply section 965 to its 2005 taxable year and meets all applicable requirements to claim the section 965(a) DRD with respect to the qualifying dividends described in the examples. All the earnings and profits and creditable foreign taxes of each CFC constitute general limitation post-1986 undistributed earnings and general limitation post-1986 foreign income taxes, and no exceptions apply to prevent USP from including in income its *pro rata* share of any CFC's subpart F income in the election year. Except as specifically provided, a CFC has no other items of gross income or expense for the election year, has no previously-taxed earnings and profits described in section 959(c)(1) or (2), and makes no distributions in the election year.

Example 1. Qualifying dividend under section 965(a)(1) from first-tier CFC. (i) *Facts.* USP owns all the stock of CFC1, a foreign corporation that uses the "u" as its functional currency. On June 30, 2005, CFC1 pays a cash dividend of 80u, equal to $100 translated at the spot rate on that date of 0.8u = $1, out of its post-1986 undistributed earnings to USP. The dividend is subject to a 10 percent withholding tax of 8u = $10, so USP receives cash of $90. USP has a base period amount of $0 and its total amount of qualifying dividends is $100. As of the close of 2005, computed without regard to the June 30 distribution to USP, CFC1 has post-1986 undistributed earnings of 800u and post-1986 foreign income taxes of $200.

(ii) *Result.* Under section 902(a), $20 ((80u/800u) x $200) of foreign income taxes are deemed paid by USP with respect to the $100 dividend from CFC1. Subject to other applicable limitations, USP may claim a foreign tax credit or deduction for $1.50 (15 percent of the $10 withholding tax), and may also claim a credit for $3 (15 percent of the $20 of deemed-paid taxes). Under section 965(d)(1), no credit or deduction is allowed for the remaining $8.50 of withholding tax or $17 of deemed-paid tax, which represent the taxes paid or deemed paid with respect to the 85 percent deductible portion of the $100 dividend. USP includes $100 in gross income and claims an $85 DRD under section 965(a) with respect to the qualifying dividend of $100 described in section 965(a)(1). If USP elects to credit foreign taxes in 2005, USP also includes $3 in income under section 78. No gross-up is required under section 78 for the $17 of deemed-paid tax which is not allowed as a credit. CFC1's post-1986 undistributed earnings and post-1986 foreign income taxes are reduced by the full amount of earnings distributed and foreign taxes deemed paid in 2005, without regard to the amount of the DRD under section 965(a) or the disallowance under section 965(d)(1) of a credit for taxes deemed paid with respect to the deductible portion of the qualifying dividend. Accordingly, CFC1's post-1986 undistributed earnings and post-1986 foreign income taxes, computed as of January 1, 2006, are 720u (800u - 80u) and $180 ($200 - $20), respectively.

Example 2. Qualifying dividend under section 965(a)(1) from first-tier CFC to disregarded entity. (i) *Facts.* USP is the sole owner of DE, a disregarded entity organized in Country X. DE owns all the stock of CFC1, which is incorporated in Country Y. Each of DE and CFC1 uses the U.S. dollar as its functional currency. On June 30, 2005, CFC1 pays a cash dividend of $135 to DE, with respect to which USP is deemed under section 902(a) to pay $20 of foreign income tax paid by CFC1. DE pays Country Y withholding tax of $20 and Country X net income tax of $15 with respect to the dividend from CFC1. Also on June 30, 2005, DE distributes $135 to USP. The distribution from DE is not subject to Country X withholding tax. USP has a base period amount of $0 and qualifying dividends of $135.

(ii) *Result.* USP is entitled to a DRD of $114.75 (.85 x $135) under section 965(a) with respect to the $135 dividend paid by CFC1 to DE and distributed in cash to USP in 2005. Subject to other applicable limitations, USP may claim a foreign tax credit or deduction for $5.25 (15 percent of the $35 of foreign tax paid by DE), and may also claim a credit for $3 (15 percent of the $20 of foreign taxes paid by CFC1 that are deemed paid by USP with respect to the dividend paid by CFC1). If USP elects to credit foreign taxes in 2005, USP includes $3 in income under section 78. No gross-up is required under section 78 for the $17 of deemed-paid tax which is not allowed as a credit. Under section 965(d)(1), no credit or deduction is allowed for the remaining $29.75 of tax paid under section 901 or $17 of tax deemed paid under section 902, which represent the taxes paid or deemed paid with respect to the 85 percent deductible portion of the $135 qualifying dividend. CFC1's post-1986 undistributed earnings and post-1986 foreign income taxes, computed as of January 1, 2006, are reduced by $135 and $20, respectively.

Example 3. Qualifying dividend under section 965(a)(2) attributable to dividend from second-tier CFC, subpart F inclusion, and PTI distribution from first-tier CFC to USP. (i) *Facts*. USP owns all the stock of CFC1, which owns all the stock of CFC2. CFC1 is incorporated in Country X, and CFC2 is incorporated in Country Y. Each of CFC1 and CFC2 uses the U.S. dollar as its functional currency. On June 30, 2005, CFC2 pays a cash dividend of $135 to CFC1. CFC1 pays Country Y withholding tax of $20 and Country X net income tax of $15 with respect to the dividend from CFC2. CFC1 has no other items of income or expense in 2005, so its subpart F income and earnings and profits for 2005 are $100, all attributable to the dividend from CFC2, and USP includes $100 in income under section 951(a)(1)(A) with respect to CFC1 for 2005. Also on June 30, 2005, CFC1 distributes $100 of cash to USP. The PTI distribution is subject to Country X withholding tax of $10. As of the close of 2005, including taxes paid and deemed paid under section 902(b) by CFC1 with respect to the distribution from CFC2 but before accounting for the effect of the subpart F inclusion or distribution to USP, CFC1 has post-1986 undistributed earnings of $1,000 and post-1986 foreign income taxes of $200. USP has a base period amount of $0 and qualifying dividends of $100.

(ii) *Result*. Under sections 960(a)(1) and 902(a), $20 (($100/$1,000) x $200) of foreign income taxes are deemed paid by USP with respect to the $100 subpart F inclusion attributable to CFC1. Under section 965(a)(2), the cash distribution of PTI from CFC1 is a qualifying dividend to the extent of $100, the amount USP included in income under section 951(a)(1)(A) in 2005 as a result of the cash dividend paid from CFC2 to CFC1 in 2005. USP is entitled to a DRD of $85 under section 965(a) with respect to the $100 subpart F inclusion and associated PTI distribution. Subject to other applicable limitations, USP may claim a foreign tax credit or deduction for 15 percent of the $10 withholding tax, or $1.50, and may claim a credit for 15 percent of the $20 of deemed-paid taxes, or $3. If USP elects to credit foreign taxes in 2005, USP includes $3 in income under section 78. No gross-up is required under section 78 for the $17 of deemed-paid tax which is not allowed as a credit. Under section 965(d)(1), no credit or deduction is allowed for the remaining $8.50 of withholding tax or $17 of deemed-paid tax, which represent the taxes paid or deemed paid with respect to the 85 percent deductible portion of the $100 qualifying dividend. CFC1's post-1986 undistributed earnings and post-1986 foreign income taxes, computed as of January 1, 2006, are $900 ($1,000 - $100) and $180 ($200 - $20), respectively.

Example 4. Qualifying dividend under section 965(a)(2) attributable to multiple dividends from second-tier CFCs, subpart F inclusion, and distribution from first-tier CFC to USP. (i) *Facts*. USP owns all the stock of CFC1, which owns all the stock of CFC2 and CFC3. CFC1, CFC2, and CFC3 are organized under the laws of different foreign countries, and each uses the "u" as its functional currency. In 2005, CFC2 and CFC3 each pays an 80u cash dividend to CFC1 that is subpart F income of CFC1 under sections 952(a) and 954(c)(1)(A) that results in an income inclusion to USP under section 951(a)(1)(A). Under section 902(b)(1), CFC1 is deemed to pay foreign taxes of $8 with respect to the 80u dividend from CFC2, and CFC1 is deemed to pay foreign taxes of $40 with respect to the 80u dividend from CFC3.

Also in 2005, CFC1 makes two distributions of 80u, totaling 160u, to USP, all of which constitutes previously-taxed earnings and profits of CFC1 described in section 959(c)(2). The first 80u distribution has a value of $100 at the 0.8u = $1 spot exchange rate on the date of distribution, and the second 80u distribution has a value of $80 at the 1u = $1 spot exchange rate on the date of distribution. Under section 3.04 of this notice, USP's subpart F inclusion attributable to CFC1's 160u of foreign personal holding company income attributable to cash dividends paid by CFC2 and CFC3 is translated into dollars at the spot rate on the dates an equivalent amount of cash is distributed to USP, rather than at the average exchange rate for the year. Accordingly, USP includes $180 ($100 + $80) in income under section 951(a)(1)(A), and neither of the 80u PTI distributions results in exchange gain or loss under section 986(c). USP's total cash dividends are $180. USP has a base period amount of $80 and qualifying dividends of $100.

As of the close of 2005, taking into account the dividends received from CFC2 and CFC3 and the associated deemed-paid taxes but before giving effect to the subpart F inclusion to USP, CFC1 has post-1986 undistributed earnings of 1,600u and post-1986 foreign income taxes of $400.

(ii) *Result*. Under sections 960(a)(1) and 902(a), $40 ((160u/1,600u) x $400) of foreign income taxes are deemed paid by USP with respect to the 160u subpart F inclusion attributable to CFC1. Of this amount, $20 is attributable to the first cash dividend of 80u = $100, and $20 is attributable to the second cash dividend of 80u = $80. If USP identifies the first distribution in its entirety as the qualifying dividend, USP is entitled to a DRD of $85 under section 965(a) with respect to the $100 subpart F inclusion and associated PTI distribution. Subject to other applicable limitations, USP may claim a foreign tax credit for $23, equal to the sum of $3 (.15 x $20) of deemed-paid taxes attributable to the qualifying dividend and $20 of deemed-paid taxes attributable to the remaining $80 of the subpart F inclusion. If USP elects to credit foreign taxes in 2005, USP includes $23 in income under section 78. Under section 965(d)(1), no credit is allowed for the remaining $17 of deemed-paid taxes, which are attributable to the 85 percent deductible portion of the $100 qualifying dividend. No gross-up is required under section 78 for the $17 of deemed-paid tax which is not allowed as a credit.

If, instead, USP identifies $20 of the $100 first cash dividend and the entire $80 of the second cash dividend as the qualifying dividends, USP is entitled to a DRD of $17 (.85 x $20) with respect to the first qualifying dividend and $68 (.85 x $80) with respect to the second qualifying dividend, for a total DRD of $85. Subject to other applicable limitations, USP may claim a foreign tax credit for $19.60, equal to the sum of $0.60 (.15 x ($20/$100) x $20) of deemed-paid taxes attributable to the $20 qualifying dividend, $16 (($80/$100) x $20) of deemed-paid taxes attributable to the remaining $80 of the subpart F inclusion associated with the first cash dividend, and $3 (.15 x $20) of deemed-paid taxes attributable to the $80 qualifying dividend. If USP elects to credit foreign taxes in 2005, USP includes $19.60 in income under section 78. Under section 965(d)(1), no credit is allowed for the remaining $20.40 ($3.40 + $17) of deemed-paid taxes, which are attributable to the 85 percent deductible portion of the $20 and $80 qualifying dividends. No gross-up is required under section 78 for the $20.40 of deemed-paid tax which is not allowed as a credit.

Because under sections 960(a)(1) and 902(a) USP's foreign taxes deemed paid with respect to the subpart F inclusion underlying the qualifying dividends described in section 965(a)(2) are computed on the basis of CFC1's year-end post-1986 undistributed earnings and post-1986 foreign income taxes, a ratable portion of CFC1's post-1986 foreign income taxes, and not the specific taxes associated with the underlying dividends from CFC2 and CFC3, are considered attributable to the qualifying dividends.

Example 5. Qualifying dividend under section 965(a)(2) attributable to dividend from third-tier CFC, subpart F inclusion from second-tier CFC, and distribution through first-tier CFC to USP. (i) *Facts*. USP owns all the stock of CFC1, which owns all the stock of CFC2, which owns all the stock of CFC3. CFC1 is incorporated in Country X, CFC2 is incorporated in Country Y, and CFC3 is incorporated in Country Z. Each of CFC1, CFC2, and CFC3 uses the U.S. dollar as its functional currency. On June 30, 2005, CFC3 pays a dividend of $150 to CFC2. CFC2 pays Country Z withholding tax of $20 and Country Y net income tax of $15 with respect to the dividend from CFC3. CFC2 has no other items of income or expense in 2005, so its subpart F income and earnings and profits for 2005 are $115, all attributable to the dividend from CFC3, and USP includes $115 in income under section 951(a)(1)(A) with respect to CFC2 for 2005. Also on June 30, 2005, CFC2 distributes $115 of cash to CFC1 that is PTI excluded from CFC1's gross income under section 959(b). The distribution is subject to $10 of Country Y withholding tax and $5 of Country X income tax in the hands of CFC1, which are taxes on PTI excluded from CFC1's post-1986 foreign income taxes and accounted for under section 960(a)(3). Later in 2005, CFC1 distributes $100 of PTI to USP. USP pays $10 of withholding tax to Country X with respect to the $100 PTI distribution, receiving cash of $90. As of the close of 2005, including taxes paid and deemed paid under section 902(b) by CFC2 with respect to the distribution from CFC3 but before accounting for the effect of the subpart F inclusion or distribution to CFC1, CFC2 has post-1986 undistributed earnings of $1,150 and post-1986 foreign income taxes of $200. USP has a base period amount of $0.

(ii) *Result*. Under sections 960(a)(1) and 902(a), $20 (($115/$1,150) x $200) of foreign income taxes paid by CFC2 are deemed paid by USP with respect to the $115 subpart F inclusion attributable to CFC2. Under section 960(a)(3), $15 of foreign taxes ($10 of withholding tax and $5 of income tax) paid by CFC1 with respect to the $115 distribution of PTI from CFC2 are deemed paid by USP with respect to the $100 of remaining PTI distributed from CFC1 to USP. However, under section 965(a)(2), the $100 PTI distribution from CFC1 is a cash dividend and, therefore, a qualifying dividend only to the extent of $100, the lesser of the amount USP included in income under section 951(a)(1)(A) in 2005 as a result of the cash dividend paid from CFC3 to CFC2 in 2005 ($115) or the amount of the PTI distribution from CFC1 to USP ($100). The amount of foreign taxes deemed paid under section 960(a)(1) with respect to the $100 section 965(a)(2) dividend is $17.39 (($100/$115) x $20), and the amount of foreign taxes deemed paid under section 960(a)(3) with respect to the $100 PTI distribution is $15.

USP is entitled to a DRD of $85 under section 965(a) with respect to $100 of the $115 subpart F inclusion and associated PTI distribution. Subject to other applicable limitations, USP may claim a foreign tax credit or deduction for $1.50 (15 percent of the $10 withholding tax imposed on the $100 PTI distribution), and may claim a credit for $2.61 (15 percent of the $17.39 of taxes deemed paid under section 960(a)(1) with respect to the $100 qualifying portion of the subpart F inclusion from CFC2), plus $2.25 (15 percent of the $15 of tax deemed paid under section 960(a)(3) with respect to the $100 PTI distribution). USP may also claim a credit for the $2.61 of foreign tax deemed paid under section 960(a)(1) with respect to the $15 of USP's subpart F inclusion that does not result in a qualifying dividend. If USP elects to credit foreign taxes in 2005, USP includes $5.22 in income under section 78 with respect to the $2.61 of foreign tax deemed paid under section 902 with respect to the $15 nondeductible CFC dividend and the $2.61 of foreign tax deemed paid under section 960(a)(1) with respect to the $15 of USP's subpart F inclusion that does not result in a qualifying dividend. No gross-up is required under section 78 with respect to the $2.25 of taxes deemed paid under section 960(a)(3), equal to 15 percent of the $15 of the taxes paid by CFC1 on the $115 PTI distribution from CFC2, which was included in USP's income under section 951(a)(1)(A). Under section 965(d)(1), no credit or deduction is allowed for the remaining $8.50 of withholding tax, $14.78 of tax deemed paid under section 960(a)(1), or $12.75 of tax deemed paid under section 960(a)(3), which represent the taxes paid or deemed paid with respect to the 85 percent deductible portion of the $100 qualifying dividend. No gross-up is required under section 78 for the $14.78 of tax deemed paid under section 960(a)(1) which is not allowed as a credit or for any portion of the taxes deemed paid under section 960(a)(3). CFC2's post-1986 undistributed earnings and post-1986 foreign income taxes, computed as of January 1, 2006, are $1,035 ($1,150 - $115) and $180 ($200 - $20), respectively.

Example 6. Qualifying dividend under section 965(a)(2) attributable to dividend from third-tier CFC, subpart F inclusion from second-tier CFC, distribution through first-tier CFC to USP, and additional PTI distribution. (i) *Facts*. The facts are the same as *Example 5*, except that CFC1 distributes an additional $15 of PTI described in section 959(c)(2) to USP in the election year, subject to Country X withholding tax of $1.50. The additional $15 of PTI is attributable to subpart F income of CFC1 that was included in USP's income in a year prior to the election year.

(ii) *Result*. The additional $15 of PTI distributed is a cash dividend that is eligible to be treated as a qualifying dividend described in section 965(a)(2) because during the election year USP included $115 in income under section 951(a)(1)(A) attributable to the cash dividend paid from CFC3 to CFC2, and CFC2 made cash distributions described in section 959(b) of $115 to CFC1. USP may identify the additional $15 PTI distribution as a qualifying dividend and claim an 85 percent DRD of $12.75 with respect to the remaining $15 of the subpart F inclusion resulting from the dividend paid by CFC3 to CFC2. The amount of foreign taxes deemed paid under section 960(a)(1) with respect to the $115 of section 965(a)(2) dividends is $20 (($115/$115) x $20), and the amount of foreign taxes deemed paid under section 960(a)(3) with respect to the $115 of PTI distributions is $15 ($15 of foreign taxes paid by CFC1 with respect to the $115 distribution of PTI from CFC2). Subject to other applicable limitations, USP may claim a foreign tax credit or deduction for $1.73 (15 percent of the $11.50 withholding tax imposed on the $115 PTI distribution), and may claim a credit for $3 (15 percent of the $20 of taxes deemed paid under section 960(a)(1) with respect to the $115 subpart F inclusion from CFC2), plus $2.25 (15 percent of the $15 of tax deemed paid under section 960(a)(3) with respect to the $115 PTI distribution). If USP elects to credit foreign taxes in 2005, USP includes $3 in income under section 78. Under section 965(d)(1), no credit or deduction is allowed for the remaining $9.77 of withholding tax, $17 of tax deemed paid under section 960(a)(1), or $12.75 of tax deemed paid under section 960(a)(3), which represent the taxes paid or deemed paid with respect to the 85 percent deductible portion of the $115 qualifying dividend. No gross-up is required under section 78 for the $17 of tax deemed paid under section 960(a)(1) which is not allowed as a credit or for any portion of the taxes deemed paid under section 960(a)(3). The adjustments to CFC2's post-1986 undistributed earnings and post-1986 foreign income taxes are the same as in *Example 5*.

SECTION 5. DISALLOWANCE OF DEDUCTIONS FOR CERTAIN EXPENSES RELATED TO DEDUCTIBLE PORTION OF QUALIFYING DIVIDENDS

.01 *Expenses Incurred by Taxpayer*

The disallowance of deductions for expenses under section 965(d)(2) applies only to expenses that are directly allocable to the deductible portion of qualifying dividends. See section 9.01 of Notice 2005–38. Therefore, section 965(d)(2) disallows a deduction for 85 percent of directly allocable expenses, which are those expenses that relate directly to generating qualifying dividends. These expenses are:

(a) Stewardship expenses described in Treas. Reg. §1.861–8(e)(4) that are definitely related and allocable to qualifying dividends;

(b) Legal, tax, accounting, consulting and similar fees and expenses, including expenses for employee compensation, for the rendering of advice and the preparation of documents directly related to (i) plans to repatriate earnings in the election year, including the determination of the potentially eligible amount of qualifying dividends, the decision to repatriate earnings from particular CFCs, and the identification of particular distributions as cash dividends, qualifying dividends, or other amounts, (ii) the adoption and approval of a domestic reinvestment plan, and (iii) the declaration and payment of qualifying dividends;

(c) Fees and expenses related to tax accounting and reporting for qualifying dividends in the election year; and

(d) Wire transfer, currency exchange, and similar fees incurred in connection with the payment of qualifying dividends.

For purposes of this section 5.01, only a *pro rata* portion of stewardship expenses accrued in the election year with respect to each CFC in which the taxpayer is a U.S. shareholder is considered definitely related and allocable to qualifying dividends. The *pro rata* portion is the amount that bears the same ratio to the stewardship expenses as the qualifying dividends paid by a CFC bear to the total amount of dividends and subpart F inclusions included in the U.S. shareholder's income with respect to that CFC and subpart F inclusions attributable to stock of any other CFCs held indirectly by the U.S. shareholder in the same chain of ownership described in section 958(a) in the election year. Deductions for other directly allocable expenses described in the preceding paragraph are subject to disallowance in the year paid or accrued, whether that year is the election year or a different taxable year.

Deductions for the allowable 15 percent portion of expenses that are directly allocable to qualifying dividends are allocated and apportioned in accordance with the generally applicable rules of sections 861 through 865 and the regulations thereunder. See section 6 of this notice.

The disallowance of deductions under section 965(d)(2) does not extend to expenses that, while treated as definitely related to the production of income in a category that includes qualifying dividends, do not relate directly to generating qualifying dividends. Expenses described in the preceding sentence include interest expense, research and experimental expenses, general and administrative expenses, depreciation and amortization, sales and marketing expenses, state and local taxes, and any other expenses not described in the first paragraph of this section 5.01. In addition, legal, tax, accounting, consulting, and similar fees and expenses related to the implementation of investments in the United States contemplated by a domestic reinvestment plan are not considered directly allocable to qualifying dividends.

.02 *Expenses Incurred by CFCs*

Deductions for expenses properly incurred by CFCs that are otherwise deductible in computing subpart F income and earnings and profits are not limited by section 965(d)(2).

SECTION 6. ALLOCATION AND APPORTIONMENT OF EXPENSES TO SEPARATE CATEGORIES WITH QUALIFYING DIVIDENDS

.01 *No New Separate Category*

Section 965 does not provide for qualifying dividends to be assigned to a special separate category or otherwise modify the generally applicable look-through rules of section 904(d)(3) for determining the separate category to which dividends and subpart F inclusions from CFCs are assigned. For purposes of allocating expenses on the basis of assets in the election year, stock of CFCs paying qualifying dividends is characterized under the generally applicable rules of Treas. Reg. §1.861–12T(c)(3).

.02 *Treatment of CFC Stock and Qualifying Dividends under Section 864(e)*

The first sentence of section 864(e)(3) (section 864(e)(3)(A) for transactions before January 1, 2005) provides that, for purposes of allocating and apportioning any deductible expense, any tax-exempt asset (and any income from such an asset) shall not be taken into account. The second sentence of section 864(e)(3) provides that a similar rule applies in the case of the portion of certain dividends equal to the deduction allowable under section 243 or 245(a) with respect to such dividend, and in the case of a like portion of any stock the dividends on which would be so deductible. A qualifying dividend is not exempt income, and the CFC stock on which qualifying dividends are paid is not an exempt asset, within the meaning of the first sentence of section 864(e)(3). In addition, the similar rule in the second sentence of section 864(e)(3) does not apply to qualifying dividends or the CFC stock on which qualifying dividends are paid, since no deduction is allowed under section 243 or 245 for any dividend for which a deduction is allowed under section 965. Section 965(c)(4). Accordingly, gross income attributable to a qualifying dividend is not considered exempt income, and no portion of the stock of a CFC paying a qualifying dividend is considered an exempt asset, for purposes of allocating and apportioning interest and other expenses in the election year.

.03 *Expenses Allocated and Apportioned to Separate Categories that Include Qualifying Dividends*

Section 965 does not modify the generally applicable rules of sections 861 through 865 and the regulations thereunder for allocating and apportioning expenses and losses to separate categories described in section 904(d)(1) and Treas. Reg. §1.904–5(m) (separate categories) that include nondeductible CFC dividends. However, the amount of nondeductible CFC dividends in a separate category must be determined for purposes of applying the limitations on the allowable foreign tax credit for the election year under section 904 and section 965(e)(1) and related computations under sections 53 and 55. See sections 7, 8, and 9 of this notice. For this purpose, expenses that are allocated and apportioned to a separate category that includes qualifying dividends will be considered to reduce other foreign source gross income in the separate category before reducing foreign source income attributable to nondeductible CFC dividends. Except as provided in section 7.01 of this notice (relating to the taxable income limitation of section 965(e)(2)(A)), if expenses and other deductions properly allocated and apportioned to foreign source gross income in a separate category exceed the amount of foreign source gross income exclusive of nondeductible CFC dividends in that separate category, such excess will reduce foreign source income attributable to nondeductible CFC dividends in the separate category to the extent thereof, and any excess deductions will constitute a separate limitation loss described in section 904(f)(5). See section 8 of this notice for rules relating to the allocation and recapture of separate limitation losses in the election year and subsequent years.

The amount of qualifying dividends eligible for the DRD, the amount of nondeductible CFC dividends described in section 965(e)(3), and the amount of taxable income for the election year are determined without regard to the manner in which deductible expenses are allocated and apportioned in the election year. Therefore, the amount of the section 965(a) DRD, the amount of foreign taxes and expenses for which credit or deduction is disallowed under section 965(d), the amount of taxable income determined under section 965(e)(2)(A), and the allowable NOL deduction determined under section 965(e)(2)(B) are not affected if nondeductible CFC dividends in a separate category are reduced or eliminated by reason of the allocation and apportionment of expenses pursuant to sections 861 through 865 and the regulations thereunder and this section 6.

.04 *Examples*

The following examples illustrate the application of this section 6. Expenses described in the examples do not include any expenses for which a deduction is disallowed under section 965(d)(2) or any other applicable Code provision.

Example 1. Separate limitation income exceeds nondeductible CFC dividends. (i) *Facts*. USP has the following items of gross income and expense for the election year: $1,200 of foreign source general limitation gross income, including $1,000 of qualifying dividends, $1,000 of expenses allocated and apportioned to general limitation income (including the 85 percent DRD of $850, which pursuant to section 3.03 of this notice is allocated to reduce general limitation income), $300 of U.S. source gross income, and $100 of expenses allocated and apportioned to U.S. source income. Accordingly, USP has $400 of taxable income and $150 of nondeductible CFC dividends in the election year, and the taxable income limitation of section 965(e)(2)(A) does not apply.

(ii) *Result*. Under section 6.03 of this notice, general limitation expenses are considered to reduce other general limitation income before reducing nondeductible CFC dividends. Accordingly, USP has $200 of foreign source general limitation taxable income, of which $150 is attributable to nondeductible CFC dividends, and $200 of U.S. source taxable income.

Example 2. Nondeductible CFC dividends exceed separate limitation income; nondeductible CFC dividends reduced. (i) *Facts.* The facts are the same as in *Example 1*, except that USP has an additional $100 of deductible expenses allocated and apportioned to general limitation income. Accordingly, USP has $300 of taxable income and $150 of nondeductible CFC dividends in the election year, and the taxable income limitation of section 965(e)(2)(A) does not apply.

(ii) *Result.* Under section 6.03 of this notice, general limitation expenses reduce nondeductible CFC dividends after reducing other general limitation income. Accordingly, USP has $100 of foreign source general limitation income, all attributable to nondeductible CFC dividends, and $200 of U.S. source taxable income.

Example 3. Nondeductible CFC dividends exceed separate limitation income; separate limitation loss with U.S. source taxable income. (i) *Facts.* The facts are the same as in *Example 1*, except that USP has an additional $250 of deductible expenses allocated and apportioned to general limitation income. Accordingly, USP has $150 of taxable income and $150 of nondeductible CFC dividends in the election year, and the taxable income limitation of section 965(e)(2)(A) does not apply.

(ii) *Result.* Under section 6.03 of this notice, general limitation expenses reduce nondeductible CFC dividends after reducing other general limitation income, and the excess deductions constitute a separate limitation loss. Accordingly, prior to the application of section 904(f) USP has a ($50) foreign source general limitation separate limitation loss, no general limitation nondeductible CFC dividends, and $200 of U.S. source taxable income.

Example 4. Nondeductible CFC dividends exceed separate limitation income; separate limitation loss with U.S. and foreign source taxable income. (i) *Facts.* The facts are the same as in *Example 3*, except that instead of $300 of U.S. source gross income USP has $200 of U.S. source gross income and $100 of foreign source passive gross income. Accordingly, USP has $150 of taxable income and $150 of nondeductible CFC dividends in the election year, and the taxable income limitation of section 965(e)(2)(A) does not apply.

(ii) *Result.* Under section 6.03 of this notice, general limitation expenses reduce nondeductible CFC dividends after reducing other general limitation income, and the excess deductions constitute a separate limitation loss. Accordingly, prior to the application of section 904(f) USP has a ($50) foreign source general limitation separate limitation loss, no general limitation nondeductible CFC dividends, $100 of foreign source passive taxable income, no passive limitation nondeductible CFC dividends, and $100 of U.S. source taxable income.

SECTION 7. LIMITATION ON REDUCTION IN TAXABLE INCOME BELOW AMOUNT OF NONDEDUCTIBLE CFC DIVIDENDS PURSUANT TO SECTION 965(e)(2)

.01 *In General*

Under section 965(e)(2)(A), taxable income for the election year cannot be less than the amount of nondeductible CFC dividends received during such year. In addition, section 965(e)(2)(B)(i) provides that nondeductible CFC dividends are not taken into account under section 172 in determining the amount of any NOL for the election year. Accordingly, if deductible expenses and losses for the election year (including the DRD allowed under section 965(a) but not including expenses for which section 965(d)(2) disallows a deduction) exceed the taxpayer's gross income exclusive of the amount of nondeductible CFC dividends, taxable income will be equal to the amount of nondeductible CFC dividends, and the excess deductions will constitute an NOL for the taxable year. If, determined without regard to section 965(e)(2)(A), taxable income for the election year would be less than the amount of nondeductible CFC dividends received during such year, the excess of the deductions allocated and apportioned to a separate category over the amount of gross income in the separate category exclusive of the nondeductible CFC dividends will constitute a separate limitation loss with respect to that separate category for the election year. Such separate limitation loss is allocated in accordance with section 904(f) and section 8 of this notice.

Section 965(e)(2)(B)(ii) provides that nondeductible CFC dividends are not taken into account in determining taxable income for the election year for purposes of the second sentence of section 172(b)(2), which applies in determining the allowable NOL carryover or carryback to other years. Therefore, the amount of the allowable NOL deduction that is absorbed in the election year is limited to the excess of taxable income over the amount of nondeductible CFC dividends. However, taxable income attributable to nondeductible CFC dividends is taken into account in determining the source and allocation of NOL deductions taken into account in the election year under paragraph 1 of Notice 89–3, 1989–1 C.B. 623.

.02 *Examples*

The following examples illustrate the application of section 965(e)(2) and this section 7.

Example 1. Taxable income limitation; one income category. (i) *Facts.* USP has the following items of gross income and expense for the election year: $1,000 of foreign source general limitation gross income, including $100 of qualifying dividends, and $1,000 of deductible expenses allocated and apportioned to general limitation income (computed after the disallowance of expenses directly allocable to the deductible portion of the qualifying dividends), including the $85 DRD allowed under section 965(a) and $20 of expenses relating to nondeductible CFC dividends.

(ii) *Result.* Under section 965(e)(2)(A), USP's taxable income for the election year cannot be less than $15, the amount of nondeductible CFC dividends received during such year. Because taxable income computed without regard to section 965(e)(2)(A) ($0) is less than the amount of nondeductible CFC dividends ($15), under section 7.01 of this notice the $1,000 of general limitation expenses reduce general limitation income only to the extent of $985 ($1,000 - $15), the excess of general limitation gross income over general limitation nondeductible CFC dividends. Accordingly, USP has $15 of general limitation taxable income, all attributable to nondeductible CFC dividends.

Under section 965(e)(2)(B)(i), the amount of USP's NOL for the election year is computed without regard to the $15 of nondeductible CFC dividends. Accordingly, USP has general limitation taxable income of $15 and a general limitation loss of ($15) that constitutes a net operating loss of ($15) for the election year.

Example 2. Taxable income limitation; U.S. and foreign source income. (i) *Facts.* The facts are the same as in *Example 1*, except that USP has $1,500 rather than $1,000 of deductible expenses allocated and apportioned to general limitation income, and also has $1,000 of U.S. source gross income and $500 of deductible expenses allocated and apportioned to U.S. source income.

(ii) *Result.* Under section 965(e)(2)(A), USP's taxable income for the election year cannot be less than $15, the amount of nondeductible CFC dividends received during such year. Because taxable income computed without regard to section 965(e)(2)(A) ($0) is less than the amount of nondeductible CFC dividends ($15), under section 7.01 of this notice the $1,500 of general limitation expenses reduce general limitation income only to the extent of $985 ($1,000 - $15), the excess of general limitation gross income over general limitation nondeductible CFC dividends, and the $515 ($1,500 - $985) excess of general limitation deductions over that amount constitutes a separate limitation loss. Accordingly, prior to the application of section 904(f) USP has $15 of general limitation taxable income, all attributable to nondeductible CFC dividends, a general limitation separate limitation loss of ($515), and U.S. source taxable income of $500 ($1,000 - $500).

Under section 965(e)(2)(B)(i), the amount of USP's NOL for the election year is computed without regard to the $15 of nondeductible CFC dividends. Accordingly, USP has taxable income of $15 and a net operating loss of ($15) for the election year.

Example 3. Taxable income limitation; U.S. loss and foreign source income. (i) *Facts*. The facts are the same as in *Example 2*, except that instead of $1,000 of U.S. source gross income USP has $400 of U.S. source gross income and $600 of foreign source passive gross income.

(ii) *Result*. Under section 965(e)(2)(A), USP's taxable income for the election year cannot be less than $15, the amount of nondeductible CFC dividends received during such year. Because taxable income computed without regard to section 965(e)(2)(A) ($0) is less than the amount of nondeductible CFC dividends ($15), under section 7.01 of this notice the $1,500 of general limitation expenses reduce general limitation income only to the extent of $985 ($1,000 - $15), the excess of general limitation gross income over general limitation nondeductible CFC dividends, and the $515 ($1,500 - $985) excess of general limitation deductions over that amount constitutes a separate limitation loss. Accordingly, prior to the application of section 904(f) USP has $15 of general limitation taxable income, all attributable to nondeductible CFC dividends, a general limitation separate limitation loss of ($515), foreign source passive income of $600, and U.S. source loss of ($100) ($400 - $500).

Under section 965(e)(2)(B)(i), the amount of USP's NOL for the election year is computed without regard to the $15 of nondeductible CFC dividends. Accordingly, USP has taxable income of $15 and a net operating loss of ($15) for the election year.

Example 4. Net operating loss absorption. (i) *Facts*. Before taking into account the NOL deduction or applying section 904(f) in the election year, USP has $100 of general limitation taxable income, all attributable to nondeductible CFC dividends, $200 of passive limitation taxable income, and a $100 NOL from prior years, all attributable to general limitation income.

(ii) *Result*. Because USP's available NOL ($100) does not exceed the amount of taxable income exclusive of nondeductible CFC dividends for the election year ($200), the taxable income limitation of section 965(e)(2)(A) does not apply to limit USP's NOL deduction for the election year. Under section 965(e)(2)(B)(ii) and section 7.01 of this notice, USP's $100 of nondeductible CFC dividends is not taken into account in determining the amount of USP's allowable NOL deduction absorbed in the election year, but is taken into account in determining the source and allocation of NOL deductions absorbed in the election year. Accordingly, under paragraph (1)(b)(ii) of Notice 89–3, the $100 general limitation NOL deduction reduces USP's $100 of general limitation income to zero. After allocation of the NOL deduction but before application of section 904(f), USP has $200 of passive limitation taxable income and no general limitation or passive limitation nondeductible CFC dividends in the election year.

Example 5. Net operating loss limitation. (i) *Facts*. Before taking into account the NOL deduction or applying section 904(f), USP has $500 of general limitation foreign source taxable income, including $15 of nondeductible CFC dividends, $500 of passive limitation foreign source taxable income, and $1,000 of U.S. source taxable income for the election year. USP also has a net operating loss carryover of $2,000, consisting of $1,000 of U.S. loss, $600 of general limitation loss, and $400 of passive limitation loss.

(ii) *Result*. Under section 965(e)(2)(A), the amount of USP's NOL deduction absorbed in the election year is limited to $1,985, the amount of USP's taxable income exclusive of nondeductible CFC dividends. Under paragraph (1)(b)(i) of Notice 89–3, the $1,000 U.S. loss component of the NOL carryover is absorbed first, and $985 of the NOL carryover is available to offset foreign source income. Under paragraph (1)(b)(ii) of Notice 89–3, separate limitation losses that are part of the NOL carryover are tentatively carried over to the extent of separate limitation income in the same category. Pursuant to section 965(e)(2)(B)(ii) and section 7.01 of this notice, the $15 of nondeductible CFC dividends is not taken into account in determining the amount of the allowable NOL deduction absorbed in the election year, but is taken into account in determining the amount of general limitation income available to be absorbed by the allowable NOL. Accordingly, $500 of the $600 general limitation component of the NOL and $400 of the passive limitation component of the NOL are tentatively carried over to the election year, eliminating the $500 of general limitation income (including the $15 of nondeductible CFC dividends) and $400 of the $500 of passive income.

Under paragraph (1)(b)(iii) of Notice 89–3, a proportionate part of the remaining loss from each separate limitation category is next carried over, to the extent of the remaining NOL carryover amount of $85, and allocated in accordance with section 904(f)(5). Accordingly, an additional $85 of the general limitation component of the NOL is carried over to the election year and allocated to passive income in accordance with section 904(f)(5). At the conclusion of these steps, USP has $15 of passive income in the election year and a remaining NOL carryover to other years of ($15), all attributable to general limitation loss.

.03 *Other Deduction Limitations*

For purposes of applying other Code provisions that contain limitations based on the amount of the taxpayer's gross income or taxable income for the taxable year, gross income includes qualifying dividends, and taxable income includes nondeductible CFC dividends.

.04 *Examples*

The following examples illustrate the application of section 7.03 of this notice.

Example 1. No taxable income limitation under section 965(e)(2)(A). (i) *Facts*. Before calculating its allowable charitable contribution deduction under section 170, USP has the following items of gross income and expense for the election year: $1,000 of foreign source general limitation gross income, including $200 of qualifying dividends, $500 of deductible expenses allocated and apportioned to general limitation income (computed after the disallowance of expenses directly allocable to the deductible portion of the qualifying dividends), including the $170 DRD allowed under section 965(a) and $20 of expenses relating to nondeductible CFC dividends, $1,000 of U.S. source gross income, and $500 of deductible expenses allocated and apportioned to U.S. source income. Under section 7.01 of this notice, without regard to the charitable deduction USP has $500 of general limitation taxable income, including $30 of nondeductible CFC dividends, and $500 of U.S. source taxable income for the election year.

(ii) *Result*. Section 170(b)(2), which limits a corporation's charitable contribution deduction to 10 percent of taxable income computed without regard to section 170 and certain other provisions not relevant on these facts, limits USP's allowable deduction to $100, 10 percent of USP's taxable income of $1,000 for the election year. If USP claims the $100 deduction, USP has $900 of taxable income for the election year.

Example 2. Section 965(e)(2)(A) taxable income limitation. (i) *Facts*. Before calculating its allowable charitable contribution deduction under section 170, USP has the following items of gross income and expense for the election year: $1,000 of foreign source general limitation gross income, including $200 of qualifying dividends, and $1,000 of deductible expenses allocated and apportioned to general limitation income (computed after the disallowance of expenses directly allocable to the deductible portion of the qualifying dividends), including the $170 DRD allowed under section 965(a) and $20 of expenses relating to nondeductible CFC dividends. Under section 965(e)(2)(A) and section 7.01 of this notice, without regard to the charitable contribution deduction, USP's current year deductions are limited to $970 and USP has $30 of general limitation taxable income, all attributable to nondeductible CFC dividends. Under section 965(e)(2)(B)(i) and section 7.01 of this notice, USP has a general limitation loss of $30 that constitutes a net operating loss of $30 for the election year.

(ii) *Result*. Section 170(b)(2), which limits a corporation's charitable contribution deduction to 10 percent of taxable income computed without regard to section 170 and certain other provisions not relevant on these facts, limits USP's allowable deduction to $3, 10 percent of USP's taxable income of $30 for the election year. If USP claims the $3 deduction, USP has $30 of taxable income and a $33 NOL for the election year.

.05 *No Other Limits on Use of Deductions to Reduce Taxable Income*

Section 965(e)(2) limits the use of deductions to reduce taxable income below the amount of nondeductible CFC dividends, but does not restrict the use of deductions to offset income in excess of the amount of nondeductible CFC dividends. Therefore, deductions may offset income in excess of the amount of nondeductible CFC dividends, including income attributable to the section 78 gross-up that is required with respect to foreign taxes deemed paid with respect to nondeductible CFC dividends.

SECTION 8. OVERALL FOREIGN LOSS AND SEPARATE LIMITATION LOSS RULES

.01 *In General*

Section 965 does not modify the operation of the overall foreign loss and separate limitation loss allocation and recapture rules or the U.S. loss allocation rules of section 904(f). Accordingly, except in situations where the taxable income limitation of section 965(e)(2)(A) applies, as provided in paragraph .02 of this section, section 904(f) may operate to reduce amounts of foreign source income, which may include nondeductible CFC dividends in a separate category, or recharacterize such amount as U.S. source income or foreign source income in a different separate category for purposes of applying the limitations on the allowable foreign tax credit under sections 904(d) and 965(e)(1).

The amount of taxable income and the amount of the allowable NOL deduction for the election year are determined prior to the application of section 904(f). Therefore, the amount of the section 965(a) DRD, the amount of foreign taxes and expenses for which a credit or deduction is disallowed under section 965(d), the amount of taxable income determined under section 965(e)(2)(A), and the allowable NOL deduction determined under section 965(e)(2)(B) are not affected if nondeductible CFC dividends are reduced or recharacterized as U.S. source income or foreign source income in another separate category pursuant to section 904(f).

.02 *Loss Allocation*

To the extent a separate limitation loss or U.S. loss is allocated under section 904(f)(5)(B) or 904(f)(5)(D) to reduce foreign source taxable income in a separate category that includes nondeductible CFC dividends, such loss will be considered first to reduce other foreign source income in the separate category before foreign source income attributable to nondeductible CFC dividends is reduced. Even if nondeductible CFC dividends are reduced as a result of a separate limitation loss or U.S. loss allocation, income in a later year in the separate category that is recharacterized under section 904(f)(5)(C) or section 904(f)(1) as income in the loss category or as U.S. source income, as the case may be, will not be considered nondeductible CFC dividends.

If the taxable income limitation of section 965(e)(2)(A) applies in the election year, taxable income equals the amount of nondeductible CFC dividends. In this case, after the allocation and apportionment of expenses and the determination and allocation of the allowable NOL deduction for the election year described in sections 6 and 7 of this notice, but prior to the application of section 904(f), a taxpayer may have separate limitation income attributable to nondeductible CFC dividends with or without a separate limitation loss in the same separate category, and may have separate limitation income or separate limitation losses in other separate categories as well as U.S. source taxable income or loss. Because separate limitation losses and U.S. losses in the aggregate may not reduce the sum of separate limitation income and U.S. source income below the amount of nondeductible CFC dividends in the election year, the excess of such losses over the amount of such income exclusive of the amount of nondeductible CFC dividends will constitute a net operating loss for the election year. For purposes of determining which losses are absorbed in the election year and which losses make up the net operating loss in the election year if the taxable income limitation of section 965(e)(2)(A) applies, separate limitation losses and U.S. losses are allocated under section 904(f)(5)(B) and (D) without regard to nondeductible CFC dividends. See *Examples 3* and *4* in section 8.05 of this notice.

.03 *Loss Recapture*

After separate limitation losses for the taxable year are allocated to reduce separate limitation income in other separate categories, any remaining separate limitation income may be recharacterized as income in another separate category or as U.S. source income, if the taxpayer had separate limitation losses in that same separate category in a prior taxable year that were allocated to reduce separate limitation income in that other separate category or U.S. source income. This recharacterization of income operates to recapture the prior year separate limitation loss or overall foreign loss. See section 904(f)(1), section 904(f)(5)(C), and Notice 89–3. Separate limitation losses and overall foreign losses may be recaptured in the election year out of income in any separate category with separate limitation income, including income attributable to nondeductible CFC dividends, whether or not the taxable income limitation of section 965(e)(2)(A) applies in the election year.

Separate limitation losses and overall foreign losses with respect to a separate category that includes nondeductible CFC dividends will be considered recaptured first out of other income in the separate category before any income attributable to nondeductible CFC dividends is recharacterized. See *Example 5* in section 8.05 of this notice. If nondeductible CFC dividends are recharacterized as U.S. source income or income in a different separate category, the recharacterized income is not treated as nondeductible CFC dividends. See *Examples 6* and *7* in section 8.05 of this notice.

.04 *Treatment of Foreign Taxes Imposed with Respect to Nondeductible CFC Dividends*

The recharacterization of income under the overall foreign loss or separate limitation loss recapture rules does not result in the recharacterization of any tax. Section 904(f)(5)(C). Accordingly, foreign tax attributable to nondeductible CFC dividends in a separate category remains in that separate category even if the income attributable to the nondeductible CFC dividends is recharacterized. See section 9.02 of this notice for rules relating to the application of section 965(e)(1) to foreign taxes attributable to nondeductible CFC dividends when a portion of nondeductible CFC dividends is recharacterized under section 904(f) and this section 8.

.05 *Examples*

The following examples illustrate the application of the rules of section 904(f) and this section 8.

Example 1. No taxable income limitation; allocation of separate limitation loss. (i) *Facts.* After the allocation and apportionment of expenses but before the application of section 904(f), USP has the following items of taxable income for the election year:

$100 of general limitation income, all attributable to nondeductible CFC dividends, ($100) of passive limitation loss, and $200 of U.S. source taxable income.

(ii) *Result*. Because USP's taxable income in the election year ($200) exceeds the amount of nondeductible CFC dividends ($100), the taxable income limitation of section 965(e)(2)(A) does not apply. Under section 904(f)(5)(B), paragraph (2) of Notice 89–3, and section 8.02 of this notice, USP's $100 passive limitation loss is allocated to reduce the $100 of general limitation income to zero. After allocation of the separate limitation loss, USP has no general limitation or passive income, no general limitation or passive limitation nondeductible CFC dividends, and $200 of U.S. source taxable income. USP has a passive limitation loss recapture account of $100 with respect to general limitation income.

Example 2. Taxable income limitation; allocation of separate limitation loss. (i) *Facts*. The facts are the same as in *Example 1*, except that USP has $40, rather than $200, of U.S. source taxable income in the election year.

(ii) *Result*. Because USP's taxable income computed without regard to section 965(e)(2)(A) ($40) is less than the amount of nondeductible CFC dividends ($100), the taxable income limitation of section 965(e)(2)(A) applies. Therefore, under section 8.02 of this notice the loss allocation rules of section 904(f)(5) and Notice 89–3 are applied without regard to the nondeductible CFC dividends. Accordingly, under section 904(f)(5)(A) and section 8.02 of this notice $40 of USP's $100 passive limitation loss is allocated to reduce U.S. source taxable income to zero, and the remaining $60 passive loss constitutes an NOL for the election year. After allocation of the separate limitation loss, USP has $100 of general limitation income, all attributable to nondeductible CFC dividends, a $60 passive limitation loss that constitutes an NOL, and no U.S. source taxable income. USP has a $40 overall foreign loss account in the passive category.

Example 3. Taxable income limitation; allocation of U.S. loss. (i) *Facts*. After the allocation and apportionment of expenses but before the application of section 904(f), USP has the following items of taxable income for the election year: $750 of general limitation income, of which $500 is attributable to nondeductible CFC dividends, and $750 of U.S. source loss.

(ii) *Result*. Because USP's taxable income computed without regard to section 965(e)(2)(A) ($0) is less than the amount of nondeductible CFC dividends ($500), the taxable income limitation of section 965(e)(2)(A) applies. Therefore, under section 8.02 of this notice the loss allocation rules of section 904(f)(5) and Notice 89–3 are applied without regard to the nondeductible CFC dividends. Accordingly, under section 904(f)(5)(D) and section 8.02 of this notice $250 of USP's $750 U.S. loss is allocated to reduce general limitation income to $500, and the remaining $500 U.S. loss constitutes an NOL for the election year. After allocation of the U.S. loss, USP has $500 of general limitation income, all attributable to nondeductible CFC dividends, and a $500 U.S. loss that constitutes an NOL.

Example 4. Taxable income limitation; allocation of separate limitation loss and U.S. loss. (i) *Facts*. After the allocation and apportionment of expenses but before the application of section 904(f), USP has the following items of taxable income for the election year: $100 of general limitation income attributable to nondeductible CFC dividends, ($100) of general limitation loss, $100 of passive income, and ($100) of U.S. source loss.

(ii) *Result*. Because USP's taxable income computed without regard to section 965(e)(2)(A) ($0) is less than the amount of nondeductible CFC dividends ($100), the taxable income limitation of section 965(e)(2)(A) applies. Therefore, under section 8.02 of this notice the loss allocation rules of section 904(f)(5) and Notice 89–3 are applied without regard to the nondeductible CFC dividends. Accordingly, under section 904(f)(5)(B) and section 8.02 of this notice USP's $100 general limitation loss is allocated to reduce passive income to zero, and the $100 U.S. loss constitutes an NOL for the election year. After allocation of the separate limitation loss, USP has $100 of general limitation income, all attributable to nondeductible CFC dividends, and a $100 U.S. loss that constitutes an NOL. USP has a $100 general limitation loss recapture account with respect to passive income.

Example 5. OFL recapture from other income. (i) *Facts*. After the allocation and apportionment of expenses but before the application of section 904(f), USP has the following items of taxable income for the election year: $150 of general limitation income attributable to nondeductible CFC dividends and $190 of other general limitation income. USP has a pre-2005 general limitation OFL account of $400.

(ii) *Result*. Under section 904(f)(1), 50 percent or $170 of USP's general limitation income is recharacterized as U.S. source income. Since the recapture amount does not exceed USP's foreign source general limitation income exclusive of nondeductible CFC dividends, after OFL recapture USP has $150 of nondeductible CFC dividends and $20 of other income in the general limitation category, and $170 of U.S. source income. USP's general limitation OFL recapture account is reduced by $170.

Example 6. OFL recapture from nondeductible CFC dividends. (i) *Facts*. After the allocation and apportionment of expenses but before the application of section 904(f), USP has the following items of taxable income for the election year: $150 of general limitation income, all attributable to nondeductible CFC dividends. USP has a pre-2005 general limitation OFL account of $200.

(ii) *Result*. Under section 904(f)(1), unless USP elects to recapture a larger percentage of the OFL account, 50 percent or $75 of USP's general limitation income is recharacterized as U.S. source income. After OFL recapture USP has $75 of nondeductible CFC dividends in the general limitation category, and $75 of U.S. source income. USP's OFL recapture account is reduced by $75.

Example 7. Separate limitation loss recapture from nondeductible CFC dividends. (i) *Facts*. After the allocation and apportionment of expenses but before the application of section 904(f), USP has the following items of taxable income for the election year: $240 of general limitation income, of which $150 is attributable to nondeductible CFC dividends. USP has a general limitation separate limitation loss recapture account with respect to passive income of $200.

(ii) *Result*. Since the $200 recapture amount exceeds $90, USP's foreign source general limitation income exclusive of nondeductible CFC dividends ($240 - $150), a portion of the nondeductible CFC dividends is recaptured after all other general limitation income is recaptured under section 904(f)(5)(C). Accordingly, $200 of USP's general limitation income, equal to $90 of other income plus $110 of nondeductible CFC dividends, is recharacterized as passive income. After recapture of the separate limitation loss, USP has $40 of general limitation income, all attributable to nondeductible CFC dividends, and $200 of passive income. USP's general limitation separate limitation loss recapture account with respect to passive income is reduced by $200 to 0.

SECTION 9. RESTRICTION ON USE OF CREDITS TO OFFSET TAX ON NONDEDUCTIBLE CFC DIVIDENDS AND COMPUTATION OF ALTERNATIVE MINIMUM TAX PURSUANT TO SECTION 965(e)(1)

.01 *In General*

Section 965(e)(1) provides that tax on nondeductible CFC dividends is not treated as a tax when determining the amount of any allowable credit or the amount of alternative minimum tax imposed by section 55. However, this rule does not apply to the credit under section 53 for prior year minimum tax, or to the credit under section 27(a) for foreign taxes attributable to nondeductible CFC dividends. Therefore, the portion of the pre-credit U.S. tax that is attributable to the nondeductible CFC dividends may not be offset by any credit other than prior year minimum tax credits and a foreign tax credit for foreign taxes attributable to the nondeductible CFC dividends.

.02 *Additional Limitation on Foreign Tax Credits*

(a) *In general*. The limitation under section 965(e) on the use of foreign tax credits against the U.S. tax on nondeductible CFC dividends (the section 965(e) limitation) is implemented through an additional foreign tax credit limitation for each separate category that includes nondeductible CFC dividends. Section 965 does not provide for a distinct separate category for qualifying dividends. Instead, qualifying dividends are characterized as income in separate categories under the generally applicable look-through rules of sections 904(d)(3)(B) and 904(d)(3)(D). See sections 3.02 and 6.01 of this notice. The section 965(e) limitation is applied after gross income and deductible expenses, including the NOL deduction, are allocated and apportioned to determine U.S. source taxable income and foreign source taxable income in the separate categories, as described in sections 6 and 7 of this notice, after the allocation of separate limitation losses, overall foreign losses, and U.S. losses and the recapture of overall foreign losses and separate limitation losses pursuant to section 904(f), as described in section 8 of this notice, and after computing the regular section 904 limitation for each separate category that contains nondeductible CFC dividends.

The section 965(e) limitation for any separate category equals the sum of (i) the creditable foreign taxes paid or accrued with respect to the nondeductible CFC dividends in the separate category and (ii) the modified section 904 limitation for that separate category. The modified section 904 limitation for a separate category is calculated by subtracting the amount of nondeductible CFC dividends in the separate category from both the numerator and denominator of the regular section 904 limitation fraction and subtracting the pre-credit U.S. tax attributable to the nondeductible CFC dividends in the separate category from the pre-credit U.S. tax used in the regular section 904 limitation calculation. See *Examples 1* through *4* of section 9.02(c) of this notice. For this purpose, the pre-credit U.S. tax attributable to the nondeductible CFC dividends in the separate category equals 35 percent (20 percent for alternative minimum tax purposes) of the amount of nondeductible CFC dividends in the separate category.

For purposes of applying the section 965(e) limitation to a separate category that included nondeductible CFC dividends that were reduced by deductions or recharacterized as U.S. source income or income in a different separate category pursuant to sections 6 and 8 of this notice and section 904(f), the amount of nondeductible CFC dividends in the separate category is the portion, if any, of the nondeductible CFC dividends that was not reduced by deductions or recharacterized, and the amount of foreign tax attributable to the nondeductible CFC dividends is the portion of the foreign taxes paid with respect to nondeductible CFC dividends that are attributable to such reduced amount.

The applicable foreign tax credit limitation for each separate category is the smaller of the regular section 904 limitation or the section 965(e) limitation, and the allowable foreign tax credit for each separate category is the smaller of the foreign taxes in the separate category or the applicable foreign tax credit limitation. In effect, the section 965(e) limitation will reduce the otherwise allowable foreign tax credit only if nondeductible CFC dividends are considered to bear a lower effective rate of foreign tax than other income in the same separate category and the other income is effectively taxed in excess of the U.S. rate. In this situation, section 965(e)(1) is intended to prevent the excess credits associated with the other income from reducing the U.S. tax on the nondeductible CFC dividends. See *Example 4* in section 9.02(c) of this notice.

(b) *No Limitation on Use of Foreign Tax Credits against U.S. Tax on Income Other than Nondeductible CFC Dividends*. Section 965(e)(1) does not restrict the use of foreign tax credits, including credits for foreign taxes paid or deemed paid with respect to nondeductible CFC dividends, to reduce the U.S. tax on income other than nondeductible CFC dividends. Therefore, to the extent otherwise allowable, foreign tax credits for foreign taxes paid with respect to nondeductible CFC dividends or other income may reduce the U.S. tax on other foreign source taxable income, including income attributable to the section 78 gross-up for foreign taxes deemed paid with respect to nondeductible CFC dividends.

(c) *Examples*. The following examples illustrate the application of section 965(e)(1) and this section 9.02.

Example 1. All Low-Taxed Income. (i) *Facts*. USP wholly owns CFC1 and CFC2 and elects to apply section 965 to its 2005 calendar tax year. As of the close of 2005, CFC1 has post-1986 undistributed earnings and post-1986 foreign income taxes of $1,000x and $100x, respectively, and CFC2 has post-1986 undistributed earnings and post-1986 foreign income taxes of $1,000x and $200x, respectively. All post-1986 undistributed earnings of CFC1 and CFC2 are general limitation earnings and profits, and neither CFC1 nor CFC2 has any previously-taxed earnings and profits described in sections 959(c)(1) or 959(c)(2). USP's base period amount is $100x, and the requirements of section 965 are met for the election year. CFC1 distributes a cash dividend of $1,000x resulting in deemed-paid taxes of $100x (($1,000x/$1,000x) x $100x), CFC2 distributes a cash dividend of $100x resulting in deemed-paid taxes of $20x (($100x/$1,000x) x $200x), and USP accrues no other items of income or expense in the election year. USP identifies the lower-taxed cash dividend from CFC1 as the qualifying dividend.

(ii) *Result. Step 1. Determine creditable foreign taxes*. USP is entitled to an $850x DRD under section 965(a) with respect to the $1,000x qualifying dividend from CFC1, and has $150x of nondeductible CFC dividends. Under section 965(d)(1) and section 4.01 of this notice, USP may claim a credit for $15x (.15 x $100x) of deemed-paid foreign tax attributable to the nondeductible CFC dividend. Because no section 965 DRD is allowed with respect to the $100x dividend from CFC2, all $100x is taxed, and all $20x of deemed-paid tax attributable to the CFC2 dividend is creditable. Thus, USP's creditable foreign taxes, prior to the application of the limitation rules, are $35x ($15x + $20x), and USP includes $35x in income under section 78.

Step 2. Determine regular section 904 limitation. Total foreign source taxable income (FSTI) equals $285x ($1,000x CFC1 dividend - $850x DRD + $100x CFC2 dividend + $35x gross-up). Because USP has no other income, worldwide taxable income (WWTI) is also $285x. USP's pre-credit U.S. tax is $99.75x (.35 x $285x). The regular section 904 limitation is $99.75x (($285x FSTI/$285x WWTI) x $99.75x). Thus, all $35 of foreign taxes are eligible for the credit under the regular section 904 limitation.

Step 3. Determine section 965(e) limitation. Pursuant to this section 9.02, the section 965(e) limitation is the sum of the creditable foreign taxes paid or accrued with respect to the nondeductible CFC dividends and the modified section 904 limitation that results from subtracting the amount of the nondeductible CFC dividends from the numerator and denominator of the regular section 904 limitation fraction and subtracting the pre-credit U.S. tax on the nondeductible CFC dividends from the pre-credit U.S. tax in the regular section 904 limitation. The foreign taxes on the $150x of nondeductible CFC dividends are $15x. Subtracting the $150x of nondeductible CFC dividends from the numerator and denominator of the regular section 904 limitation fraction, USP has $135x of other FSTI and WWTI ($100x CFC2 dividend plus $35x of gross-up income) and a pre-credit U.S. tax on this amount of $47.25x ($99.75x - (.35 x $150x)). The modified section 904 limitation equals $47.25x (($135x FSTI/$135x WWTI) x $47.25x). The section 965(e) limitation equals $62.25x ($15x + $47.25x). Because the total amount of creditable foreign taxes is less than both the section 965(e) limitation and the regular section 904 limitation, USP may credit all $35x of foreign tax in the election year.

Example 2. All High-Taxed Income. (i) *Facts*. The facts are the same as in *Example 1*, except that CFC1 has post-1986 undistributed earnings and post-1986 foreign income taxes of $1,000x and $600x, respectively, and CFC2 has post-1986 undistributed earnings and post-1986 foreign income taxes of $1,000x and $750x, respectively. Accordingly, the $1,000x dividend from CFC1 results in foreign taxes deemed paid of $600x (($1,000x/$1,000x) x $600x), and the $100x dividend from CFC2 results in foreign taxes deemed paid of $75x (($100x/$1,000x) x $750x).

(ii) *Result. Step 1. Determine creditable foreign taxes*. USP is entitled to an $850x DRD under section 965(a) with respect to the $1,000x qualifying dividend from CFC1, and has $150 of nondeductible CFC dividends. Under section 965(d)(1) and section 4.01 of this notice, USP may claim a credit for $90x (.15

x $600x) of deemed-paid foreign tax attributable to the nondeductible CFC dividend. Because no section 965 DRD is allowed with respect to the $100x dividend from CFC2, all $100x is taxed, and all $75x of deemed-paid tax attributable to the CFC2 dividend is creditable. Thus, USP's creditable foreign taxes, prior to the application of the limitation rules, are $165x ($90x + $75x), and USP includes $165x in income under section 78.

Step 2. Determine regular section 904 limitation. USP's FSTI equals $415x ($1,000x qualifying dividend from CFC1 - $850x DRD + $100x dividend from CFC2 + $165x gross-up). Because USP has no other income, WWTI is also $415x. USP's pre-credit U.S. tax is $145.25x (.35 x $415x). Thus, the limitation equals $145.25x (($415x FSTI/$415x WWTI) x $145.25x). Because the limitation is less than the total creditable taxes of $165x, the regular section 904 limitation prevents the excess $19.75x from being credited in the current year.

Step 3. Determine section 965(e) limitation. The foreign taxes on the $150x of nondeductible CFC dividends are $90x. Subtracting the $150x of nondeductible CFC dividends from the numerator and denominator of the regular section 904 limitation fraction, USP has $265x of other FSTI and WWTI ($415x - $150x) and a pre-credit U.S. tax on this amount of $92.75x ($145.25x - (.35 x $150x)). The modified section 904 limitation equals $92.75x (($265x FSTI/$265x WWTI) x $92.75x). The section 965(e) limitation equals $182.75x ($90x + $92.75x). Because the section 965(e) limitation is higher than the regular section 904 limitation, the total amount of creditable foreign taxes are subject to the regular section 904 limitation of $145.25x.

Example 3. High-Taxed Nondeductible CFC Dividend/Low-Taxed Other Income. (i) *Facts*. The facts are the same as in *Example 1*, except that CFC1 has post-1986 undistributed earnings and post-1986 foreign income taxes of $1,000x and $400x, respectively, CFC2 does not pay a dividend in the election year, and USP has an additional $100x of general limitation income subject to no foreign tax. Accordingly, the $1,000x dividend from CFC1 results in foreign taxes deemed paid of $400x (($1,000x/$1,000x) x $400x), and no foreign taxes of CFC2 are deemed paid in the election year.

(ii) *Result. Step 1. Determine creditable foreign taxes*. USP is entitled to an $850x DRD under section 965(a) with respect to the $1,000x qualifying dividend from CFC1, and has $150x of nondeductible CFC dividends. Under section 965(d)(1) and section 4.01 of this notice, USP may claim a credit for $60x (.15 x $400x) of deemed-paid foreign tax attributable to the nondeductible CFC dividend. Thus, USP's creditable foreign taxes, prior to the application of the limitation rules, are $60x, and USP includes $60x in income under section 78.

Step 2. Determine regular section 904 limitation. USP's FSTI equals $310x ($1,000x qualifying dividend from CFC1 - $850x DRD + $60x gross-up + $100x of other income). Because USP has no other income, WWTI is also $310x. USP's pre-credit U.S. tax is $108.50x (.35 x $310x). Thus, the regular section 904 limitation equals $108.50x (($310x FSTI/$310x WWTI) x $108.50x). All $60x of foreign tax would be creditable, because the foreign taxes paid in excess of the U.S. tax on the nondeductible CFC dividend can reduce the U.S. tax on the gross-up income and the other foreign source income.

Step 3. Determine section 965(e) limitation. The foreign taxes on the $150x of nondeductible CFC dividends are $60x. Subtracting the $150x of nondeductible CFC dividends from the numerator and denominator of the regular section 904 limitation fraction, USP has $160x of other FSTI and WWTI ($310x - $150x) and a pre-credit U.S. tax on this amount of $56x ($108.50x - (.35 x $150x)). The modified section 904 limitation equals $56x (($160x FSTI/$160x WWTI) x $56x). The section 965(e) limitation equals $116x ($60x + $56x). Because the section 965(e) limitation is higher than the regular section 904 limitation, the $60x total amount of creditable foreign taxes are subject to the regular section 904 limitation of $108.50x, and the excess foreign taxes on the nondeductible CFC dividend can reduce the U.S. tax on USP's other foreign source income.

Example 4. Low-Taxed Nondeductible CFC Dividend/High-Taxed Other Income. (i) *Facts*. The facts are the same as in *Example 1*, except that CFC2 has post-1986 undistributed earnings and post-1986 foreign income taxes of $1,000x and $750x, respectively. Accordingly, the $1,000x dividend from CFC1 results in foreign taxes deemed paid of $100x (($1,000x/$1,000x) x $100x), and the $100x dividend from CFC2 results in foreign taxes deemed paid of $75x (($100x/$1,000x) x $750x).

(ii) *Result. Step 1. Determine creditable foreign taxes*. USP is entitled to an $850x DRD under section 965(a) with respect to the $1,000x qualifying dividend from CFC1, and has $150x of nondeductible CFC dividends. Under section 965(d)(1) and section 4.01 of this notice, USP may claim a credit for $15x (.15 x $100x) of deemed-paid foreign tax attributable to the nondeductible CFC dividend. Because no section 965 DRD is allowed with respect to the $100x dividend from CFC2, all $100x is taxed, and all $75x of deemed-paid tax attributable to the CFC2 dividend is creditable. Thus, USP's creditable foreign taxes, prior to the application of the limitation rules, are $90x ($15x + $75x), and USP includes $90x in income under section 78.

Step 2. Determine regular section 904 limitation. USP's FSTI equals $340x ($1,000x qualifying dividend from CFC1 - $850x DRD + $100x dividend from CFC2 + $90x gross-up). Because USP has no other income, WWTI is also $340x. USP's pre-credit U.S. tax is $119x (.35 x $340x). Thus, the regular section 904 limitation equals $119x (($340x FSTI/$340x WWTI) x $119x). The regular section 904 limitation would allow all $90x of foreign tax to be credited, because the foreign taxes paid in excess of the U.S. tax on the CFC2 dividend could reduce the U.S. tax on the low-taxed nondeductible CFC dividend from CFC1.

Step 3. Determine section 965(e) limitation. The foreign taxes on the $150x of nondeductible CFC dividends are $15x. Subtracting the $150x of nondeductible CFC dividends from the numerator and denominator of the regular section 904 limitation fraction, USP has $190x of other FSTI and WWTI ($340x - $150x) and a pre-credit U.S. tax on this amount of $66.50x ($119x - (.35 x $150x)). The modified section 904 limitation equals $66.50x (($160x FSTI/$160x WWTI) x $66.50x). The section 965(e) limitation equals $81.50x ($15x + $66.50x). Because the section 965(e) limitation is less than the regular section 904 limitation of $119x, the section 965(e) limitation applies and prevents USP from crediting $8.50x of the $90x of potentially creditable taxes. The $8.50x of tax which is not creditable under the section 965(e) limitation equals the excess foreign taxes on the other foreign source income that would have been creditable against the U.S. tax on the nondeductible CFC dividend under the regular section 904 limitation (*i.e.*, the excess of the $75x of foreign tax on the CFC2 dividend over $66.50x, the pre-credit U.S. tax on $190x of other foreign source income ($100x CFC2 dividend + $75x gross-up attributable to tax deemed paid on the CFC2 dividend + $15x gross-up attributable to the nondeductible CFC dividend from CFC1)). The excess taxes may be carried over and used as a credit in other years to the extent allowed under section 904(c).

.03 *No Use of Credits Other than Credit for Prior Year Minimum Tax to Offset U.S. Tax on Nondeductible CFC Dividends*

Section 965(e)(1) provides that no credit other than a foreign tax credit for foreign taxes attributable to nondeductible CFC dividends and the credit for prior year minimum tax under section 53 may offset the U.S. tax on nondeductible CFC dividends. However, section 965 does not limit the application of credits against the U.S. tax on income other than nondeductible CFC dividends. Because other credits, including the possessions tax credit allowed under sections 27(b) and 30A, the nonconventional source fuel credit allowed under section 29, the qualified electric vehicle credit allowed under section 30, and the general business credit allowed under section 38, as well as the credit for prior year minimum tax that is allowed under section 53, are applied after the foreign tax credit, taxpayers must identify the portion of their pre-credit U.S. tax and allowable foreign tax credit for the election year that is attributable to nondeductible CFC dividends and the portion that is attributable to other income in order to determine the amount of their other allowable credits.

For purposes of this determination and section 9.05 of this notice, the portion of a taxpayer's pre-credit U.S. tax that is attributable to nondeductible CFC dividends equals the smaller of the taxpayer's total pre-credit U.S. tax or 35 percent of the amount of nondeductible CFC dividends. For this purpose, the amount of nondeductible CFC dividends is the amount determined under section 965(e)(3), without regard to any reduction or recharacterization of nondeductible CFC dividends in a separate category for purposes of determining the foreign tax credit limitation as provided in sections 6 through 8 of this notice. The portion of the taxpayer's pre-credit U.S. tax that is attributable to other income equals the excess, if any, of the taxpayer's total pre-credit U.S. tax over the pre-credit U.S. tax attributable to nondeductible CFC dividends. To determine the total allowable foreign tax credit for the election year, the taxpayer must first compute the allowable credit for each separate category, applying the section 965(e) limitation described in section 9.02 of this notice. The portion of the taxpayer's allowable foreign tax credit in each separate category that is attributable to nondeductible CFC dividends equals the smaller of 35 percent of the amount of nondeductible CFC dividends in the separate category, determined after applying sections 6 through 8 of this notice, or the foreign taxes paid or accrued with respect to the nondeductible CFC dividends in that separate category, determined in accordance with section 9.02(a) of this notice. The portion of the allowable foreign tax credit that is attributable to nondeductible CFC dividends is the sum of the amounts determined under the preceding sentence in all of the taxpayer's separate categories. The remainder, if any, of the allowable foreign tax credit is considered attributable to other income.

The taxpayer's residual U.S. tax on nondeductible CFC dividends, as reduced by the portion of the allowable foreign tax credit that is attributable to that income, may not be reduced by any credit other than the prior year minimum tax credit. The taxpayer's residual U.S. tax on other income, as reduced by the balance of the allowable foreign tax credit, may be reduced by other credits in accordance with the rules generally applicable to such credits.

.04 *Computation of Section 53 Credit in Election Year*

Under section 965(e)(1), the U.S. tax on nondeductible CFC dividends is taken into account in determining the allowable amount of prior year minimum tax credits under section 53 for the election year. Accordingly, for purposes of section 53 the taxpayer's regular tax and tentative minimum tax are computed taking into account the regular tax and tentative minimum tax on nondeductible CFC dividends, as reduced by allowable foreign tax credits computed in accordance with section 965(e)(1) and section 9.02 of this notice. As a result, credits for prior year minimum tax may be allowed in the election year to reduce the regular tax on nondeductible CFC dividends and other income, subject to the limitation of section 53(c), even if the taxpayer's entire taxable income is attributable to nondeductible CFC dividends or if the taxpayer is subject to AMT on taxable income other than nondeductible CFC dividends in the election year. See *Examples 3* through *6* of section 9.06 of this notice.

.05 *Computation of Alternative Minimum Tax in Election Year*

Section 965(e)(1) provides that the U.S. tax on nondeductible CFC dividends is not treated as tax imposed by chapter 1 for purposes of computing the AMT imposed by section 55. For purposes of computing AMT for the election year, the taxpayer's regular tax described in section 55(c) does not include the portion of the taxpayer's pre-credit regular tax liability that is attributable to nondeductible CFC dividends, and the foreign tax credit taken into account does not include the portion of the taxpayer's allowable foreign tax credit that is attributable to nondeductible CFC dividends. Similarly, the taxpayer's tentative minimum tax determined under section 55(b)(1)(B) does not include the portion of the taxpayer's tentative minimum tax or alternative minimum tax foreign tax credit that is attributable to nondeductible CFC dividends. In addition, the deductible portion of qualifying dividends is not treated as a preference item in computing alternative minimum taxable income. Accordingly, the additional tax owed by the taxpayer by reason of the AMT in the election year is the same that would be owed if the qualifying dividends were not paid. See *Examples 1, 2, 4* and *5* of section 9.06 of this notice.

.06 *Examples*

The following examples illustrate the application of section 965(e)(1) and sections 9.04 and 9.05 of this notice.

Example 1. Calculation of AMT with no foreign tax credit. (i) *Facts*. For the election year USP's taxable income consists of $200x of foreign source general limitation nondeductible CFC dividends subject to no foreign tax and $400x of U.S. source income. USP's pre-credit regular tax liability is $210x (.35 x $600x). USP has $600x of U.S. source preference items.

(ii) *Result*. Taking into account the adjustments required by section 965(e)(1)(B) for purposes of computing USP's alternative minimum tax under section 55 in the election year, USP's taxable income computed without regard to the $200x of nondeductible CFC dividends is $400x, which would result in a pre-credit regular tax liability of $140x (.35 x $400x). USP's alternative minimum taxable income computed without regard to the $200x of nondeductible CFC dividends is increased by $600x of preference items from $400x to $1,000x. USP's tentative minimum tax, computed without regard to the nondeductible CFC dividends, is $200x (.20 x $1,000x). The excess of USP's adjusted tentative minimum tax of $200x over its adjusted regular tax of $140x results in alternative minimum tax of $60x. USP's pre-credit tax for the election year is $270x ($210x of regular tax plus $60x of alternative minimum tax). This amount is equivalent to 20 percent of $1,000x, USP's alternative minimum taxable income exclusive of the nondeductible CFC dividends, plus 35 percent of $200x of nondeductible CFC dividends.

Example 2. Alternative minimum tax foreign tax credit. (i) *Facts*. The facts are the same as in *Example 1*, except that instead of $400x of U.S. source income, USP has $200x of U.S. source income and $200x of other foreign source general limitation income, and USP's foreign taxes paid or deemed paid with respect to general limitation income are $100x, including $20x of foreign tax paid or accrued with respect to the $200x of nondeductible CFC dividends.

(ii) *Result*. As in *Example 1*, USP's pre-credit regular tax on $400x of taxable income in excess of the $200x of nondeductible CFC dividends is $140x and its pre-credit tentative minimum tax on $1,000x of alternative minimum taxable income in excess of the nondeductible CFC dividends ($400x plus $600x of preference items) is $200x. USP's allowable foreign tax credit computed for regular tax purposes is $90x, the lesser of $100x, the foreign taxes paid, $140x, the regular section 904 limitation (($400x FSTI/$600x WWTI) x $210x pre-credit U.S. tax), or $90x, the section 965(e) limitation ($20x foreign tax on nondeductible CFC dividends + $70x, the limitation on other income of ($200x FSTI/$400x WWTI) x $140x). The portion of the allowable regular foreign tax credit that is attributable to the nondeductible CFC dividends is $20x, the smaller of the $70x pre-credit U.S. tax on the nondeductible CFC dividends (.35 x $200x) or $20x, the foreign taxes paid or accrued with respect to the nondeductible CFC dividends. The remaining $70x of the allowable regular foreign tax credit is the amount attributable to USP's other foreign source income. Accordingly, USP's regular tax described in section 55(c), computed without regard to the tax on nondeductible CFC dividends, is $70x ($140x regular tax - $70x foreign tax credit).

Computed without regard to section 965(e)(1)(B), USP's alternative minimum tax foreign tax credit is $60x, the lesser of $100x, the foreign taxes paid, $80x, the regular alternative minimum tax foreign tax credit limitation (($400x FSAMTI/$1200x WWAMTI) x $240x), or $60x, the section 965(e) limitation ($20x + ($200x FSAMTI/ $1000x WWAMTI) x $200x). The portion of the alternative minimum tax foreign tax credit that is attributable to nondeductible CFC dividends is $20x, the lesser of $40x, the pre-credit U.S. alternative minimum tax on the nondeductible CFC dividends (.20 x $200x) or $20x, the foreign taxes paid or accrued with respect to the nondeductible CFC dividends. The $40x balance of the alternative minimum tax foreign tax credit is attributable to USP's other foreign source income.

Accordingly, USP's tentative minimum tax described in section 55(b)(1)(B), computed without regard to the tax on nondeductible CFC dividends, is $160x ($200x - $40x). Under section 55 as modified by section 965(e)(1)(B), USP's alternative minimum tax is $90x, the excess of its tentative minimum tax over its regular tax ($160x - $70x). Accordingly, USP's tax for the election year is $210x ($210x regular tax on $600x of taxable income - $90x regular foreign tax credit + $90x alternative minimum tax). This amount is equivalent to 20 percent of USP's $1,000x of alternative minimum taxable income exclusive of the nondeductible CFC dividends less the $40x alternative minimum tax foreign tax credit on that amount ($200x - $40x), plus 35 percent of $200x of nondeductible CFC dividends less the $20x regular foreign tax credit on that amount ($70x - $20x).

Example 3. No AMT; prior year minimum tax credit. (i) *Facts*. For the election year USP's taxable income consists of $200x of foreign source nondeductible CFC dividends subject to no foreign tax. USP's pre-credit regular tax liability is $70x (.35 x $200x). USP has no preference items.

(ii) *Result*. Taking into account the adjustments required by section 965(e)(1)(B) for purposes of computing USP's alternative minimum tax under section 55 in the election year, USP's taxable income computed without regard to the $200x of nondeductible CFC dividends is $0, which would result in a pre-credit regular tax liability of $0. USP's alternative minimum taxable income computed without regard to the $200x of nondeductible CFC dividends is also $0, so its tentative minimum tax, computed without regard to the nondeductible CFC dividends, is $0. The excess of USP's adjusted tentative minimum tax of $0 over its adjusted regular tax of $0 results in alternative minimum tax of $0. USP's pre-credit tax for the election year is $70x ($70x of regular tax plus $0 alternative minimum tax), equal to 35 percent of $200x of nondeductible CFC dividends.

For purposes of computing USP's prior year minimum tax credit under section 53 for the election year, the modifications to section 55 that are required under section 965(e)(1)(B) do not apply. Accordingly, for purposes of computing the limitation of section 53(c), USP's regular tax liability is $70x (.35 x $200x of taxable income including nondeductible CFC dividends), its tentative minimum tax is $40x (.20 x $200x of alternative minimum taxable income including nondeductible CFC dividends), and the excess of the regular tax liability over the tentative minimum tax for the election year is $30x ($70x - $40x). USP may claim a credit under section 53(a) in the election year for the excess (if any) of its adjusted net minimum tax imposed for all post-1986 taxable years prior to the election year over the amount allowable as a credit under section 53(a) for such prior taxable years, up to the $30x limitation computed under section 53(c).

Example 4. AMT with no foreign tax credit and prior year minimum tax credit. (i) *Facts*. For the election year USP's taxable income consists of $200x of foreign source general limitation nondeductible CFC dividends subject to no foreign tax and $400x of U.S. source income. USP's pre-credit regular tax liability is $210x (.35 x $600x). USP has $350x of U.S. source preference items described in section 57(a)(5).

(ii) *Result*. Taking into account the adjustments required by section 965(e)(1)(B) for purposes of computing USP's alternative minimum tax under section 55 in the election year, USP's taxable income computed without regard to the $200x of nondeductible CFC dividends is $400x, which would result in a pre-credit U.S. regular tax liability of $140x (.35 x $400x). USP's alternative minimum taxable income computed without regard to the $200x of nondeductible CFC dividends is $750x, taxable income of $400x increased by $350x of preference items. USP's tentative minimum tax, computed without regard to the nondeductible CFC dividends, is $150x (.20 x $750x). The excess of USP's adjusted tentative minimum tax of $150x over its adjusted regular tax of $140x results in alternative minimum tax of $10x. USP's pre-credit tax for the election year is $220x ($210x of regular tax plus $10x of alternative minimum tax). This amount is equivalent to $150x (20 percent of $750x, USP's alternative minimum taxable income exclusive of the nondeductible CFC dividends), plus $70x (35 percent of $200x of nondeductible CFC dividends).

For purposes of computing USP's prior year minimum tax credit under section 53 for the election year, the modifications to section 55 that are required under section 965(e)(1)(B) do not apply. Accordingly, for purposes of computing the limitation of section 53(c), USP's regular tax liability is $210x (.35 x $600x of regular taxable income including nondeductible CFC dividends), its tentative minimum tax is $190x (.20 x $950x of alternative minimum taxable income including nondeductible CFC dividends), and the excess of the regular tax liability over the tentative minimum tax for the election year is $20x ($210x - $190x). USP may claim a credit under section 53(a) in the election year for the excess (if any) of its adjusted net minimum tax imposed for all post-1986 taxable years prior to the election year over the amount allowable as a credit under section 53(a) for such prior taxable years, up to the $20x limitation computed under section 53(c).

Example 5. AMT with foreign tax credit and prior year minimum tax credit. (i) *Facts*. The facts are the same as in *Example 2*, except that USP has $200x rather than $600x of U.S. source preference items.

(ii) *Result*. Taking into account the adjustments required by section 965(e)(1)(B) for purposes of computing USP's alternative minimum tax under section 55 in the election year, USP's taxable income computed without regard to the $200x of nondeductible CFC dividends is $400x, which would result in a pre-credit U.S. regular tax liability of $140x (.35 x $400x). USP's pre-credit tentative minimum tax, computed without regard to the nondeductible CFC dividends, is $120x (.20 x $600x).

USP's allowable foreign tax credit computed for regular tax purposes is $90x, the lesser of $100x, the foreign taxes paid, $140x, the regular section 904 limitation (($400x FSTI/$600x WWTI) x $210x pre-credit U.S. tax), or $90x, the section 965(e) limitation ($20x foreign tax on nondeductible CFC dividends + $70x, the limitation on other income of (($200x FSTI/$400x WWTI) x $140x). The portion of the allowable regular foreign tax credit that is attributable to the nondeductible CFC dividends is $20x, the smaller of the $70x pre-credit U.S. tax on the nondeductible CFC dividends (.35 x $200x) or $20x, the foreign taxes paid or accrued with respect to the nondeductible CFC dividends. The remaining $70x of the allowable regular foreign tax credit is the amount attributable to USP's other foreign source income. Accordingly, USP's regular tax described in section 55(c), computed without regard to the tax on nondeductible CFC dividends, is $70x ($140x regular tax - $70x foreign tax credit).

Computed without regard to section 965(e)(1)(B), USP's alternative minimum tax foreign tax credit is $60x, the lesser of $100x, the foreign taxes paid, $80x, the regular alternative minimum tax foreign tax credit limitation (($400x FSAMTI/$800x WWAMTI) x $160x), or $60x, the section 965(e) limitation ($20x + ($200x FSAMTI/ $600x WWAMTI) x $120x). The portion of the alternative minimum tax foreign tax credit that is attributable to nondeductible CFC dividends is $20x, the lesser of $40x, the pre-credit tentative minimum tax on the nondeductible CFC dividends (.20 x $200x) or $20x, the foreign taxes paid or accrued with respect to the nondeductible CFC dividends. The $40x balance of the alternative minimum tax foreign tax credit is attributable to USP's other foreign source income. Accordingly, USP's tentative minimum tax described in section 55(b)(1)(B), computed without regard to the tax on nondeductible CFC dividends, is $80x ($120x - $40x). Under section 55 as modified by section 965(e)(1)(B), the excess of USP's tentative minimum tax over its regular tax is $10x ($80x - $70x).

For purposes of computing USP's prior year minimum tax credit under section 53 for the election year, the modifications to section 55 that are required under section 965(e)(1)(B) do not apply. Accordingly, for purposes of computing the limitation of section 53(c), USP's pre-credit regular tax liability is $210x (.35 x $600x of taxable income including nondeductible CFC dividends) and its pre-credit tentative minimum tax liability is $160x (.20 x $800x of alternative minimum taxable income including nondeductible CFC dividends). As described above, USP's regular and AMT foreign tax credits are limited under section 965(e) to $90x and $60x, respectively. Therefore, for purposes of section 53(c) USP's regular tax liability is $120x ($210x - $90x foreign tax credit), its tentative minimum tax is $100x ($160x - $60x alternative minimum tax foreign tax credit), and the excess of its regular tax over its tentative minimum tax is $20x ($120x - $100x). USP may claim a credit under section 53(a) in the election year for the excess (if any) of its adjusted net minimum tax imposed for all post-1986 taxable years prior to the election year over the amount allowable as a credit under section 53(a) for such prior taxable years, up to $20x, the limitation computed under section 53(c).

Example 6. Minimum tax credit after OFL recapture. (i) *Facts*. The facts are the same as in *Example 5*, except that USP has a pre-2005 general limitation OFL account of $500x.

(ii) *Result*. Under section 904(f)(1), unless USP elects to recapture a larger percentage of the OFL account, 50 percent or $250x of USP's $400x of foreign source general limitation income is recharacterized as U.S. source income. After OFL recapture USP has $150x of foreign source general limitation income, all attributable to nondeductible CFC dividends. See section 8.03 of this notice. Pursuant to section 9.02 of this notice, $15x (($150x/$200x) x $20x) of foreign tax is paid or accrued with respect to the $150x of nondeductible CFC dividends.

Pursuant to sections 9.03 and 9.05 of this notice, for purposes of computing USP's alternative minimum tax under section 55 in the election year, USP's pre-credit regular tax and pre-credit tentative minimum tax are computed without regard to the $200x of nondeductible CFC dividends, as determined under section 965(e)(3) without regard to the recharacterization of $50x of nondeductible CFC dividends as U.S. source income pursuant to the recapture of USP's general limitation OFL account under section 904(f) and section 8.03 of this notice. As in *Example 5*, USP's pre-credit regular tax and pre-credit tentative minimum tax, computed without regard to nondeductible CFC dividends, are $140x and $120x, respectively.

USP's allowable foreign tax credit computed for regular tax purposes is $15x, the lesser of $100x, the foreign taxes paid, $52.50x, the regular section 904 limitation (($150x FSTI/$600x WWTI) x $210x pre-credit U.S. tax), or $15x, the section 965(e) limitation ($15x foreign tax on nondeductible CFC dividends + $0, the limitation on other income of ($0 FSTI/$400x WWTI) x $140x). Pursuant to section 9.03 of this notice, the portion of the allowable regular foreign tax credit that is attributable to the nondeductible CFC dividends is $15x, the smaller of the $52.50x pre-credit U.S. tax on the reduced amount of nondeductible CFC dividends (.35 x $150x) or $15x, the foreign taxes paid or accrued with respect to the reduced amount of nondeductible CFC dividends. Therefore, no foreign tax credit is attributable to USP's other foreign source income. Accordingly, USP's regular tax described in section 55(c), computed without regard to the tax on nondeductible CFC dividends, is $140x ($140x regular tax - $0 foreign tax credit).

Computed without regard to section 965(e)(1)(B), USP's alternative minimum tax foreign tax credit is $15x, the lesser of $100x, the foreign taxes paid, $30x, the regular alternative minimum tax foreign tax credit limitation (($150x FSAMTI/$800x WWAMTI) x $160x) or $15x, the section 965(e) limitation ($15x + ($0 FSAMTI/ $600x WWAMTI) x $120x). Pursuant to section 9.03 of this notice, the portion of the alternative minimum tax foreign tax credit that is attributable to nondeductible CFC dividends is $15x, the lesser of $30x, the pre-credit tentative minimum tax on the nondeductible CFC dividends (.20 x $150x) or $15x, the foreign taxes paid or accrued with respect to the nondeductible CFC dividends. Accordingly, none of the alternative minimum tax foreign tax credit is attributable to USP's other foreign source income. Therefore, USP's tentative minimum tax described in section 55(b)(1)(B), computed without regard to the tax on nondeductible CFC dividends, is $120x ($120x tentative minimum tax - $0 alternative minimum tax foreign tax credit). Under section 55 as modified by section 965(e)(1)(B), USP's regular tax of $140x exceeds its tentative minimum tax of $120x. Therefore, USP does not owe AMT for the election year.

For purposes of computing USP's prior year minimum tax credit under section 53 for the election year, the modifications to section 55 that are required under section 965(e)(1)(B) do not apply. Accordingly, for purposes of computing the limitation of section 53(c), USP's pre-credit regular tax is $210x (.35 x $600x of taxable income including nondeductible CFC dividends) and its pre-credit tentative minimum tax is $160x (.20 x $800x of alternative minimum taxable income including nondeductible CFC dividends). As described above, USP's regular and AMT foreign tax credits are limited under section 965(e) to $15x, all attributable to nondeductible CFC dividends. Therefore, for purposes of section 53(c) USP's regular tax liability is $195x ($210x - $15x foreign tax credit), its tentative minimum tax is $145x ($160x - $15x alternative minimum tax foreign tax credit), and the excess of its regular tax over its tentative minimum tax is $50x ($195x - $145x). USP may claim a credit under section 53(a) in the election year for the excess (if any) of its adjusted net minimum tax imposed for all post-1986 taxable years prior to the election year over the amount allowable as a credit under section 53(a) for such prior taxable years, up to $50x, the limitation computed under section 53(c).

SECTION 10. OTHER GUIDANCE

.01 *Application of General Tax Law Principles*

Unless otherwise specifically provided, general tax law principles, including the circular cash flow, step-transaction, and substance-over-form doctrines, apply for purposes of determining the federal income tax consequences of transactions undertaken in connection with section 965. For example, assume USP, a domestic corporation, wholly owns CFC1 which, in turn, wholly owns CFC2. If CFC2 declares a dividend and CFC1 declares a dividend of the same amount, and, at the direction of CFC1, CFC2 pays the amount of its dividend in cash directly to USP, then under applicable Code provisions, including section 965, such payment shall be treated as a distribution of cash from CFC2 to CFC1, followed by a distribution of cash from CFC1 to USP. See, *e.g.*, Rev. Rul. 80–292, 1980–2 C.B. 104.

.02 *Base Period Inclusions under Section 965(b)(2)(B)*

In computing a taxpayer's base period amount, section 965(b)(2)(B)(i) includes dividends described in section 965(c)(3) that were received during each base period year from CFCs, section 965(b)(2)(B)(ii) includes amounts includible in gross income for each base period year under section 951(a)(1)(B) with respect to CFCs, and section 965(b)(2)(B)(iii) includes amounts that would have been included for each base period year but for section 959(a). For this purpose, dividends received from CFCs by a disregarded entity or a partnership owned by a U.S. shareholder during a base period year shall be treated as received by such U.S. shareholder to the extent the dividend was included in income shown on the U.S. shareholder's return described in section 965(b)(2) for the base period year, regardless of whether cash or property in the amount of the dividend was received by the shareholder in the base period year. In addition, for purposes of section 965(b)(2)(B), amounts includible under section 951(a)(1)(B) (or that would have been so included but for section 959(a)) in gross income of a domestic partnership that was owned by a U.S. shareholder during a base period year shall be treated as includible in the U.S. shareholder's income under section 951(a)(1)(B), or excluded under section 959(a), to the extent the includible amount was (i) allocated to the U.S. shareholder-partner under the rules of sections 702 and 704 and the regulations thereunder in a base period year; and (ii) separately stated to the partner under Treas. Reg. §1.702–1(a)(8)(ii).

.03 *Allocation of $500 Million Limitation—Clarification of Section 4.05 of Notice 2005–38*

Section 4.05 of Notice 2005–38 provides that the $500 million limitation on qualifying dividends described in section 965(b)(1)(A) is allocated among the qualified members of a section 52(a) group in proportion to the aggregate amount of total current and accumulated non-previously-taxed earnings and profits of all CFCs owned (within the meaning of section 958(a)) by such qualified members, determined with reference to the earnings and profits appropriately reported on Schedule J of the last Form 5471 filed on or before the apportionment date. For this purpose, the amount of non-PTI earnings and profits of a CFC taken into account by a qualified member is that member's *pro rata* share of the CFC's earnings and profits, determined in accordance with section 951(a)(2) for the year for which Form 5471 was filed.

.04 *Effect of Restatement of Certified Financial Statement*

A restatement of a previously filed and certified financial statement described in section 965(c)(1) that occurs after June 30, 2003, does not alter the statement's status as having been filed and certified on or before June 30, 2003. In such a case, the limitations described in section 965(b)(1)(B) and (C) are the amount of earnings permanently reinvested outside the United States, and a specific amount of tax liability, respectively, that are shown on the statement as originally filed, not the amounts shown on the restatement.

.05 *Definition of United States*

For purposes of section 965, the term "United States" includes the 50 states, the District of Columbia, the territorial waters of the United States, and the seabed and subsoil of those submarine areas that are adjacent to the territorial waters of the United States and over which the United States has exclusive rights, in accordance with international law, with respect to the exploration and exploitation of natural resources. The term "United States" does not include possessions and territories of the United States or the airspace over the United States and these areas.

.06 *Treatment of Accounts Payable Resulting from Section 482 Adjustments*

Accounts payable established under Rev. Proc. 99–32, 1999–2 C.B. 296, in connection with section 482 adjustments are treated as indebtedness for purposes of section 965(b)(3).

.07 *Exceptions to Related Party Indebtedness for Certain Ordinary Course Transactions of Banks and Dealers in Securities—Addition to Section 7.02 of Notice 2005–38*

For purposes of section 965(b)(3), the term "indebtedness" does not include indebtedness of a CFC arising in the ordinary course of business as a bank or as a dealer in securities that would not be treated as U.S. property under section 956(c)(2)(A)(i), (J), (K), or (L) were it an obligation of a United States person (and not of the CFC). For purposes of applying the exception under section 956(c)(2)(A)(i), a "bank" is a CFC that meets the definition of a bank in section 585(a)(2)(B), without regard to the second sentence thereof, and without regard to whether the CFC is engaged in a U.S. trade or business, provided that the CFC operates under the laws of the foreign jurisdiction where it is engaged in business and is subject to supervision and examination by an authority having supervision over banking institutions in that jurisdiction (in lieu of supervision by a Federal or State supervisory authority).

.08 *Intercompany Trade Payables—Modification of Section 7.02 of Notice 2005–38*

For purposes of section 965(b)(3), in addition to the exceptions described in section 7.02 of Notice 2005–38 and section 10.07 of this notice, the term "indebtedness" does not include indebtedness of a CFC arising in the ordinary course of a business from licenses, provided that such indebtedness is actually paid within 183 days.

.09 *Distributions to Intermediary Partnerships—Clarification of Section 3.02 of Notice 2005–10 and Section 9.06 of Notice 2005–38*

Section 3.02 of Notice 2005–10 provides that for purposes of section 965(a), a cash dividend paid by a CFC to a pass-through entity that is owned by a U.S. shareholder is treated as received by such U.S. shareholder only if and to the extent that such shareholder receives a cash distribution in the amount of the CFC dividend during the election year. Section 9.06 of Notice 2005–38 provides a limited exception to the general cash distribution requirement with respect to cash dividends paid to a disregarded entity. This limited exception does not apply to cash dividends paid to a partnership. Therefore, a cash dividend paid by a CFC to a partnership that is owned by a U.S. shareholder is treated as received by such U.S. shareholder only if and to the extent the partnership distributes cash to the shareholder-partner in the election year. For this purpose, a distribution of cash does not include a guaranteed payment, as defined in section 707(c), or a payment made to the shareholder other than in its capacity as a member of the partnership.

.10 *Domestic Reinvestment Plans—Clarification of Section 4.01 of Notice 2005–10*

Section 965(b)(4)(B) provides that section 965(a) shall not apply to any dividend received by a U.S. shareholder unless the amount of the dividend is invested in the United States pursuant to a domestic reinvestment plan which provides for the reinvestment of such dividend in the United States. Section 4.01 of Notice 2005–10 provides that a taxpayer may adopt separate domestic reinvestment plans to apply to different cash dividends made during the election year. A taxpayer may, but is not required to, adopt a domestic reinvestment plan that provides for the reinvestment of cash dividends only from specified CFCs, to the extent of the dollar amounts of anticipated investments that are specified in the plan in accordance with section 4.03 of Notice 2005–10. In this situation, cash dividends from other CFCs in the election year that are not covered by another domestic reinvestment plan will not be subject to the section 965(a) DRD or to the disallowance of deductions and credits under section 965(d), even if the dollar amount of cash dividends from the specified CFCs is less than the total dollar amount of anticipated investments specified in the plan and if the taxpayer in fact expends the total dollar amount specified in the plan on permitted investments. On the other hand, a taxpayer may not choose to claim the section 965(a) DRD with respect to less than all of the qualifying dividends that are covered by a domestic reinvestment plan, assuming that all such amounts are properly reinvested in accordance with the plan and that all the other requirements under section 965 are satisfied. For example, assume that USP wholly owns CFC1 and CFC2. USP properly adopts a domestic reinvestment plan that provides for the reinvestment of up to $10 million of qualifying dividends in the United States. During the election year CFC1 pays qualifying dividends of $8 million, CFC2 pays qualifying dividends of $2 million, USP invests at least $10 million in permitted investments, and all the other requirements of section 965 are met. Unless the plan provides only for the reinvestment of qualifying dividends from either CFC1 or CFC2, the entire $10 million of qualifying dividends is subject to section 965.

.11 *Qualified Plan Funding—Clarification of Section 5.05(b) of Notice 2005–10*

Section 5.05(b) of Notice 2005–10 provides, in part, that the satisfaction of an obligation to fund a qualified plan ordinarily will contribute to the financial stabilization of the taxpayer. For this purpose, contributions to a qualified pension plan that do not give rise to excise tax under section 4972 (which imposes a tax on certain nondeductible pension contributions) will be considered to satisfy an obligation to fund a qualified plan even if those contributions are not currently deductible. Contributions to a qualified profit sharing or stock bonus plan also qualify for this purpose if those contributions to the plan are required under a fixed contribution formula provided under the terms of the plan. Contributions to a qualified profit sharing or stock bonus plan do not qualify if contributions to the plan are made on a discretionary basis.

SECTION 11. TRANSITION RULES

.01 *Domestic Reinvestment Plans Approved Prior to August 19, 2005*

If a domestic reinvestment plan is approved prior to August 19, 2005, the taxpayer may modify such plan to take into account the guidance herein not later than October 19, 2005, even if the dividend to which the domestic reinvestment plan relates has already been paid. Any plan that is so modified must be subsequently approved by the taxpayer's president, chief executive officer, or comparable official and by the taxpayer's board of directors, management committee, executive committee, or similar body.

.02 *Tax Returns Filed Prior to August 19, 2005*

If, prior to August 19, 2005, a taxpayer has filed its tax return for the taxable year to which it elects section 965 to apply, such taxpayer may revise its computations or annual reporting to conform to the guidance in this notice on an amended tax return that is filed by December 31, 2005.

SECTION 12. EFFECT ON OTHER DOCUMENTS

Sections 10.09, 10.10, and 10.11 of this notice clarify sections 3.02, 4.01, and 5.05(b), respectively, of Notice 2005–10. Section 10.03 of this notice modifies section 4.05, section 10.09 clarifies section 9.06, and section 10.07 makes an addition to and section 10.08 modifies section 7.02, of Notice 2005–38. See also section 11 of this notice, pursuant to which domestic reinvestment plans approved prior to August 19, 2005 (including domestic reinvestment plans adopted or modified pursuant to the guidance included in Notice 2005–10 and Notice 2005–38), may be modified to take into account the guidance in this notice.

SECTION 13. EFFECTIVE DATE

This notice is effective for taxable years ending on or after October 22, 2004.

SECTION 14. PAPERWORK REDUCTION ACT

The collections of information contained in this notice have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–1957.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The collections of information are in sections 3 and 11 of this notice. This information is required to provide the IRS sufficient information to determine whether a taxpayer has properly elected to apply section 965 to a taxable year and whether the taxpayer has properly calculated its taxable income and allowable credits with respect to qualifying dividends, taking into account the limitations imposed by sections 965(d) and (e). The collections of information are required to obtain the benefit of section 965 for a taxable year. The likely respondents are business corporations.

Estimated total annual reporting and/or recordkeeping burden: 250,000 hours.

Estimated average annual burden hours per respondent: 10 hours.

Estimated number of respondents: 25,000.

Estimated annual frequency of responses: once.

The collections of information contained in this notice have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be received by October 19, 2005. Comments are specifically requested concerning:

Whether the proposed collections of information are necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collections of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

Comments concerning the accuracy of the burden estimate and suggestions for reducing the burden of the final or temporary regulations should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington DC 20224.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

SECTION 15. DRAFTING INFORMATION

The principal author of this notice is Barbara Allen Felker of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and the Treasury Department participated in its development. For further information regarding this notice, contact Ms. Felker or Michael Gilman at (202) 622–3850 (not a toll-free call).

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26 CFR 601.204: Changes in accounting periods and methods of accounting.
(Also Part I, Sections 77, 381, 446, 455, 456, 461; 1.77–1, 1.381(c)(4)–1, 1.381(c)(5)–1, 1.446–1, 1.455–6, 1.456–6, 1.461–1.)

Rev. Proc. 2005–63

SECTION 1. PURPOSE

This revenue procedure supersedes Rev. Proc. 83–77, 1983–2 C.B. 594, and the 90-day extension of time granted therein for submitting applications or requests for consent to change a method of accounting under § 1.77–1, 1.381(c)(4)–1(d)(2), 1.381(c)(5)–1(d)(2), 1.455–6(b), 1.456–6(b), or 1.461–1(c)(3)(ii) of the Income Tax Regulations.

An application or request submitted in accordance with this revenue procedure for consent to change a method of accounting under § 1.77–1, 1.455–6(b), 1.456–6(b), or 1.461–1(c)(3)(ii) may be submitted during the taxable year in which the taxpayer desires to make the change in method of accounting. An application or request submitted in accordance with this revenue procedure for consent to change a method of accounting under § 1.381(c)(4)–1(d)(2) or 1.381(c)(5)–1(d)(2) may be submitted by the later of 1) the last day of the taxable year in which the distribution or transfer occurred, or 2) the earlier of a) the day that is 180 days after the date of distribution or transfer, or b) the day on which the taxpayer files its federal income tax return for the taxable year in which the distribution or transfer occurred.

SECTION 2. BACKGROUND

.01 Section 1.446–1(e) provides the general rules for filing an application to obtain the Commissioner's consent to change a method of accounting for federal income tax purposes. Under § 1.446–1(e)(3)(i), as amended by T.D. 8719, 1997–1 C.B. 100, an application must be filed during the taxable year in which the taxpayer desires to make the change in method of accounting. Prior to the amendment, § 1.446–1(e)(3)(i) provided that an application must be filed within 180 days after the beginning of the tax year in which the proposed change is requested to be made.

.02 Notwithstanding the provisions of § 1.446–1(e)(3)(i), § 1.446–1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the terms and conditions under which taxpayers will be permitted to change their method of accounting.

.03 The following regulations concerning a change in method of accounting each contain a requirement that an application or request for consent must be filed within a 90-day period:

(1) Section 1.77–1 provides that a taxpayer who previously elected to include the amount of loans from the Commodity Credit Corporation in gross income for the taxable year in which the loans are received must obtain permission to change to a different method of accounting for the loans. An application for permission to change to a different method of accounting must be submitted within 90 days after the beginning of the taxable year in which the taxpayer proposes to make the change.

(2) Section 1.381(c)(4)–1(d)(2) provides that, under § 1.381(c)(4)–1(d)(1), an acquiring corporation may submit an application for permission to use a method of accounting, or a request for a determination of the method of accounting to be used, not later than 90 days after the date of distribution or transfer.

(3) Section 1.381(c)(5)–1(d)(2) provides that, under § 1.381(c)(5)–1(d)(1), an acquiring corporation may submit an application for permission to use a method of taking inventories, or a request for a determination of the method of taking inventories to be used, not later than 90 days after the date of distribution or transfer.

(4) Section 1.455–6(b) provides that, with the consent of the Commissioner, a taxpayer may elect to apply the provisions of § 455 to any trade or business in which the taxpayer receives prepaid subscription income. The taxpayer must submit a written request for consent to make the election within 90 days after the beginning of the taxable year in which the election is first applicable.

(5) Section 1.456–6(b) provides that, with the consent of the Commissioner, a taxpayer may elect to apply the provisions of § 456 to any trade or business in which the taxpayer receives prepaid dues income. The taxpayer must submit a written request for consent to make the election within 90 days after the beginning of the taxable year in which the election is first applicable.

(6) Section 1.461–1(c)(3)(ii) provides that, with the consent of the Commissioner, a taxpayer may elect to accrue real property taxes ratably in accordance with §§ 461(c) and 1.461–1(c). The taxpayer must submit a written request for consent to make the election within 90 days after the beginning of the taxable year in which the election is first applicable.

.04. In Rev. Proc. 83–77, the Commissioner exercised discretionary authority under former § 1.9100–1(a) to grant automatic extensions of 90 days to the 90-day periods for submitting applications or requests for consent to change methods of accounting under §§ 1.77–1, 1.381(c)(4)–1(d)(2), 1.381(c)(5)–1(d)(2), 1.455–6(b), 1.456–6(b), and 1.461–1(c)(3)(ii). Taxpayers that complied with the provisions of Rev. Proc. 83–77 obtained automatic extensions of 90 days and therefore had 180 days in which to submit their applications or requests for consent, as did taxpayers filing applications or requests for consent under the general rule of § 1.446–1(e)(3)(i) prior to the amendment described in section 2.01 of this revenue procedure.

.05. The changes in method of accounting described in §§ 1.77–1 and 1.455–6(b) are included in the changes to which the automatic change in method procedures of Rev. Proc. 2002–9, 2002–1 C.B. 327

(as modified and clarified by Announcement 2002–17, 2002–1 C.B. 561, modified and amplified by Rev. Proc. 2002–19, 2002–1 C.B. 696, and amplified, clarified, and modified by Rev. Proc. 2002–54, 2002–2 C.B. 432), apply for taxpayers that are within the scope of Rev. Proc. 2002–9 for the requested year of change. Taxpayers within the scope of Rev. Proc. 2002–9 for the requested year of change that desire to make the changes in method described in §§ 1.77–1 and 1.455–6(b) must follow the procedures in Rev. Proc. 2002–9 instead of the procedures in the regulations and this revenue procedure.

SECTION 3. SCOPE

The scope of this revenue procedure is limited to waiving the 90-day periods for submitting applications or requests for consent under §§ 1.77–1, 1.381(c)(4)–1(d)(2), 1.381(c)(5)–1(d)(2), 1.455–6(b), 1.456–6(b), and 1.461–1(c)(3)(ii).

SECTION 4. APPLICATION

.01 Under § 1.446–1(e)(3)(ii), the Commissioner has authority to prescribe the terms and conditions under which taxpayers will be permitted to change their method of accounting. After consideration of the general rules for requesting consent to change a method of accounting under § 1.446–1(e)(3)(i), the requirement to submit applications or requests for consent within the time periods prescribed in the regulations cited in section 3 of this revenue procedure is waived for taxpayers who submit applications or requests for consent in accordance with section 4.02 of this revenue procedure.

.02 Time and manner of application.

(1) An application or request for consent under § 1.77–1, 1.455–6(b), 1.456–6(b), or 1.461–1(c)(3)(ii) that is submitted in accordance with section 4.02(3) of this revenue procedure may be submitted during the taxable year in which the taxpayer desires to make the change in method of accounting.

(2) An application or request under § 1.381(c)(4)–1(d)(2) or 1.381(c)(5)–1(d)(2) that is submitted in accordance with section 4.02(3) of this revenue procedure may be submitted by the later of 1) the last day of the taxable year in which the distribution or transfer occurred, or 2) the earlier of a) the day that is 180 days after the date of distribution or transfer, or b) the day on which the taxpayer files its federal income tax return for the taxable year in which the distribution or transfer occurred.

(3) The applications or written requests to which this revenue procedure applies are to be filed in accordance with the requirements set forth in § 1.77–1, 1.381(c)(4)–1(d)(2), 1.381(c)(5)–1(d)(2), 1.455–6(b), 1.456–6(b), or 1.461–1(c)(3)(ii), as applicable, except that the taxpayer may file within the time periods provided in section 4.02(1) and (2) of this revenue procedure and send the application or written request to the Internal Revenue Service, Attention: CC:PA:LPD:DRU, P.O. Box 7604, Benjamin Franklin Station, Washington, D.C. 20044. At the top of the application or written request, the taxpayer should either type or legibly print "Filed Under Rev. Proc. 2005–63."

SECTION 5. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 83–77 is superseded.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective August 16, 2005.

SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Sean M. Dwyer of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this revenue procedure, contact Mr. Dwyer at (202) 622–5020 (not a toll-free call).

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of tax liability

Rev. Proc. 2005–64

SECTION 1. PURPOSE

This revenue procedure provides the domestic asset/liability percentages and domestic investment yields needed by foreign life insurance companies and foreign property and liability insurance companies to compute their minimum effectively connected net investment income under section 842(b) of the Internal Revenue Code for taxable years beginning after December 31, 2003. Instructions are provided for computing foreign insurance companies' liabilities for the estimated tax and installment payments of estimated tax for taxable years beginning after December 31, 2003. For more specific guidance regarding the computation of the amount of net investment income to be included by a foreign insurance company on its U.S. income tax return, see Notice 89–96, 1989–2 C.B. 417. For the domestic asset/liability percentage and domestic investment yield, as well as instructions for computing foreign insurance companies' liabilities for estimated tax and installment payments of estimated tax for taxable years beginning after December 31, 2002, see Rev. Proc. 2004–55, 2004–34 I.R.B. 343.

SECTION 2. CHANGES

.01 DOMESTIC ASSET/LIABILITY PERCENTAGES FOR 2004. The Secretary determines the domestic asset/liability percentage separately for life insurance companies and property and liability insurance companies. For the first taxable year beginning after December 31, 2003, the relevant domestic asset/liability percentages are:

121.7 percent for foreign life insurance companies, and

173.6 percent for foreign property and liability insurance companies.

.02 DOMESTIC INVESTMENT YIELDS FOR 2004. The Secretary is required to prescribe separate domestic investment yields for foreign life insurance companies and for foreign property and liability insurance companies. For the first taxable year beginning after December 31, 2003, the relevant domestic investment yields are:

5.5 percent for foreign life insurance companies, and

3.7 percent for foreign property and liability insurance companies.

.03 SOURCE OF DATA FOR 2004. The section 842(b) percentages to be used for the 2004 tax year are based on tax return data following the same methodology used for the 2003 year.

SECTION 3. APPLICATION — ESTIMATED TAXES

To compute estimated tax and the installment payments of estimated tax due for taxable years beginning after December 31, 2003, a foreign insurance company must compute its estimated tax payments by adding to its income other than net investment income the greater of (i) its net investment income as determined under section 842(b)(5), that is actually effectively connected with the conduct of a trade or business within the United States for the relevant period, or (ii) the minimum effectively connected net investment income under section 842(b) that would result from using the most recently available domestic asset/liability percentage and domestic investment yield. Thus, for installment payments due after the publication of this revenue procedure, the domestic asset/liability percentages and the domestic investment yields provided in this revenue procedure must be used to compute the minimum effectively connected net investment income. However, if the due date of an installment is less than 20 days after the date this revenue procedure is published in the Internal Revenue Bulletin, the asset/liability percentages and domestic investment yields provided in Rev. Proc. 2004–55 may be used to compute the minimum effectively connected net investment income for such installment. For further guidance in computing estimated tax, see Notice 89–96.

SECTION 4. EFFECTIVE DATE

This revenue procedure is effective for taxable years beginning after December 31, 2003.

SECTION 5. DRAFTING INFORMATION

The principal author of this revenue procedure is Gregory A. Spring of the Office of Chief Counsel (International). For further information regarding this revenue procedure, contact Gregory A. Spring at (202) 622–3870 (not a toll-free call), or write to the Internal Revenue Service, Office of the Associate Chief Counsel (International), Attention: CC:INTL:BR5, 1111 Constitution Avenue, N.W., IR–4554, Washington, D.C. 20224.

Part IV. Items of General Interest

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

Substitute for Return

REG–131739–03

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9215) relating to the IRS preparing or executing returns for persons who fail to make required returns. The text of those regulations also serves as the text of these proposed regulations.

DATES: Written or electronically generated comments and requests for a public hearing must be received by October 17, 2005.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–131739–03), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG–131739–03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the IRS Internet site at *www.irs.gov/regs* or via the Federal eRulemaking Portal at *www.regulations.gov* (IRS and REG–131739–03).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Laura R. Urich, (202) 622–4940; concerning submissions of comments and requests for a public hearing, Treena Garrett of the Regulations Unit at (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Temporary regulations in this issue of the Bulletin amend 26 CFR part 301 relating to section 6020. The temporary regulations retain the method by which an internal revenue officer or employee prepares a return under section 6020(a). Further, the temporary regulations provide that a document (or set of documents) signed by an authorized internal revenue officer or employee is a return under section 6020(b) if the document (or set of documents) identifies the taxpayer by name and taxpayer identification number, contains sufficient information from which to compute the taxpayer's tax liability, and the document (or set of documents) purport to be a return under section 6020(b). A Form 13496, "*IRC Section 6020(b) Certification*," or any other form that an authorized internal revenue officer or employee signs and uses to identify a document (or set of documents) containing the information set forth above as a section 6020(b) return, and the documents identified, constitute a valid section 6020(b) return. The text of those regulations also serve as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) and electronic comments that are submitted timely to the IRS. The IRS and Treasury specifically request comments on the clarity of the proposed regulations and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Tracey B. Leibowitz, of the Office of the Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR part 301 is proposed to be amended to read as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation continues to read, in part, as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 301.6020–1 is added to read as follows:

§301.6020–1 Returns prepared or executed by the Commissioner or other internal revenue officers.

[The text of proposed §301.6020–1 is the same as the text of §301.6020–1T published elsewhere in this issue of the Bulletin].

Mark E. Matthews,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on July 15, 2005, 8:45 a.m., and published in the issue of the Federal Register for July 18, 2005, 70 F.R. 41165)

Qualified Amended Returns; Correction

Announcement 2005–61

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to a correction to temporary regulations.

SUMMARY: This document corrects a correction to temporary regulations (T.D. 9186, published in the I.R.B. as Announcement 2005–53, 2005–31 I.R.B. 258) which was published in the **Federal Register** on June 23, 2005 (70 FR 36345). The temporary regulations modify the rules relating to qualified amended returns by providing additional circumstances that end the period within which a taxpayer may file an amended return that constitutes a qualified amended return.

DATES: This correction is effective on March 2, 2005.

FOR FURTHER INFORMATION CONTACT: Nancy Galib, (202) 622–4940 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The temporary regulations (T.D. 9186) that is the subject of this correction is under section 6664 of the Internal Revenue Code.

Need for Correction

As published, the correction to the temporary regulations (T.D. 9186) contains an error that may prove to be misleading and is in need of clarification.

Correction of Publication

Accordingly, the publication of the correction to the temporary regulations (T.D. 9186) that is the subject of FR. Doc. 05–12386, is corrected as follows:

On page 36345, column 2, in the preamble, under the paragraph heading "Background", line 3, the language "are under section 6227 of the Internal" is corrected to read "are under section 6664 of the Internal".

Cynthia E. Grigsby,
Acting Chief, Publications and Regulations Branch, Legal Processing Division, Associate Chief Counsel (Procedure and Administration).

(Filed by the Office of the Federal Register on July 27, 2005, 8:45 a.m., and published in the issue of the Federal Register for July 28, 2005, 70 F.R. 43635)

Section 704(c) Installment Obligations and Contributed Contracts; Correction

Announcement 2005–62

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correcting amendment.

SUMMARY: This document adds the text that was inadvertently omitted from the Code of Federal Regulations. The text was originally published in T.D. 9193, 2005–15 I.R.B. 862, which was published in the **Federal Register** on Friday, March 22, 2005 (70 FR 14394). The final regulations relate to the tax treatment of installment obligations and property acquired pursuant to a contract.

DATES: This correction is effective on March 22, 2005.

FOR FURTHER INFORMATION CONTACT: Christopher L. Trump, (202) 622–3070 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document adds §§1.704–3(a)(8)(ii) and (iii) and 1.737–2(d)(3)(ii) and (iii) to the Code of Federal Regulations. The final regulations that are the subject of this correction are under sections 704 and 737 of the Internal Revenue Code.

Need for Correction

As published, §§1.704–3(a)(8)(ii) and (iii) and 1.737–2(d)(3)(ii) and (iii) were omitted from the Code of Federal Regulations as published in T.D. 9193.

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Correction of Publication

Accordingly, 26 CFR Part 1 is corrected by making the following correcting amendments:

PART 1 — INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 USC 7805 * * *

Par. 2. Section 1.704–3 is amended by adding paragraphs (a)(8)(ii) and (a)(8)(iii) to read as follows:

§1.704–3 Contributed property.

(a) * * *

(8) * * * (i) * * *

(ii) *Disposition in an installment sale*. If a partnership disposes of section 704(c) property in an installment sale as defined in section 453(b), the installment obligation received by the partnership is treated as the section 704(c) property with the same amount of built-in gain as the section 704(c) property disposed of by the partnership (with appropriate adjustments for any gain recognized on the installment sale). The allocation method for the installment obligation must be consistent with the allocation method chosen for the original property.

(iii) *Contributed contracts*. If a partner contributes to a partnership a contract that is section 704(c) property, and the partnership subsequently acquires property pursuant to the contract in a transaction in which less than all of the gain or loss is recognized, then the acquired property is treated as the section 704(c) property with the same amount of built-in gain or loss as the contract (with appropriate adjustments for any gain or loss recognized on the acquisition). For this purpose, the term contract includes, but is not limited to, options, forward contracts, and futures contracts. The allocation method for the acquired property must be consistent with the allocation method chosen for the contributed contract.

* * * * *

Par. 3. Section 1.737–2 is amended by adding paragraphs (d)(3)(ii) and (d)(3)(iii) to read as follows:

§1.737–2 Exceptions and special rules.

(d) * * *

(3) * * * (i) * * *

(ii) *Installment sales*. An installment obligation received by the partnership in an installment sale (as defined in section 453(b)) of section 704(c) property is treated as the contributed property with regard to the contributing partner for purposes of section 737 to the extent that the installment obligation received is treated as section 704(c) property under §1.704–3(a)(8). See §1.704–4(d)(1) for a similar rule in the context of section 704(c)(1)(B).

(iii) *Contributed contracts*. Property acquired by a partnership pursuant to a contract that is section 704(c) property is treated as the contributed property with regard to the contributing partner for purposes of section 737 to the extent that the acquired property is treated as section 704(c) property under §1.704–3(a)(8). See §1.704–4(d)(1) for a similar rule in the context of section 704(c)(1)(B).

* * * * *

Guy Traynor,
Acting Chief, Publications and Regulations Branch, Legal Processing Division, Associate Chief Counsel (Procedure and Administration).

(Filed by the Office of the Federal Register on August 5, 2005, 8:45 a.m., and published in the issue of the Federal Register for August 8, 2005, 70 F.R. 45530)

Credit for Increasing Research Activities; Correction

Announcement 2005–63

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correcting amendment.

SUMMARY: This document corrects temporary regulations (T.D. 9205, 2005–25 I.R.B. 1267) that were published in the **Federal Register** on Tuesday, May 24, 2005 (70 FR 29596). The document contains temporary regulations relating to the computation and allocation of the credit for increasing research activities for members of a controlled group of corporations or a group of trades or businesses under common control.

DATES: This correction is effective on May 24, 2005.

FOR FURTHER INFORMATION CONTACT: Nicole R. Cimino, (202) 622–3120 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The temporary regulations (T.D. 9205) that is the subject of this correction are under section 41(f).

Need for Correction

As published, the temporary regulations (T.D. 9205) contain errors that may prove to be misleading and are in need of clarification.

* * * * *

Correction of Publication

Accordingly, 26 CFR Part 1 is corrected by making the following correcting amendment:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 USC 7805 * * *

§1.41–6T [Corrected]

1. Section 1.41–6T(e) *Example 2* (i), the first line in the table is revised to read as follows:

	D	E	F	G	Group Aggregate
Credit Year QREs * * * * *	$580x	$10x	$70x	$15x	$675x

2. Section 1.41–6T(e) *Example 2* (i), second line in the table needs to be revised to read “$25x”.

	D	E	F	G	Group Aggregate
Credit Year QREs . . . . * * *	* * * $500x	$25x	$100x	$25x	$650x

3. Section 1.41–6T(e) *Example 2* (ii)(B)(*1*), the first sentence is revised to read as follows: “The group’s base amount equals the greater of: the group’s fixed-base percentage (3.10 percent) multiplied by the group’s aggregate average annual gross receipts for the 4 taxable years preceding the credit year ($17,000x), or the group’s minimum base amount ($337.50x).”

4. Section 1.41–6T(e) *Example 2* (iii), the eighth sentence is revised to read as follows: “Because the group credit of $29.76x is greater than the sum of the stand-alone entity credits of all the mem-

bers of the group ($21.67x), each member of the group is allocated an amount of the group credit equal to that member's stand-alone equity credit."

5. Section 1.41–6T(e) *Example 2* (iii), the ninth sentence is revised to read as follows: "The excess of the group credit over the sum of the members' stand alone entity credits ($8.09x) is allocated among the members of the group based on the ratio that each member's QREs bear to the sum of the QREs of all the members of the group."

6. Section 1.41–6T(e) *Example 2* (iii), the fourth line in the table is revised to read as follows:

	D	E	F	G	Total
* * * * *					
Excess Group Credit	$8.09x	$8.09x	$8.09x	$8.09x	
* * * * *					

7. Section 1.41–6T(e) *Example 3* (ii)(C), the second sentence is revised to read as follows: "The excess of the group credit over the sum of the members' stand-alone entity credits ($10.00x) is allocated among the members of the group based on the ratio that each member's QREs bear to the sum of the QREs of all the members of the group."

8. Section 1.41–6T(e) *Example 3* (ii)(C), the fourth line in the table is revised to read as follows:

	DE	F	G	Total
* * * * *				
Excess Group Credit	$10.00x	$10.00x	$10.00x	
* * * * *				

9. Section 1.41–6T(e) *Example 3* (iii)(C), the fourth line in the table is revised to read as follows:

	D	E	Total
* * * * *			
Excess Group Credit	$6.83x	$6.83x	
* * * * *			

10. Section 1.41–6T(e) *Example 5* (iii), the first sentence is revised to read as follows: "Under paragraph (c)(2) of this section, the stand-alone entity credit for each member of the group must be computed using the method that results in the greater stand-alone entity credit for that member."

11. Section 1.41–6T(j), the second sentence is revised to read as follows: "Generally, a taxpayer may use any reasonable method of computing and allocating the credit for taxable years ending before May 24, 2005."

Guy Traynor,
Acting Chief, Publications and Regulations Branch, Legal Processing Division, Associate Chief Counsel (Procedure and Administration).

(Filed by the Office of the Federal Register on August 11, 2005, 8:45 a.m., and published in the issue of the Federal Register for August 12, 2005, 70 F.R. 47108)

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D. —Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z —Corporation.

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