

1964. If D had included \$200 in its gross income as a dividend with respect to a distribution from X on June 30, 1964, the amount of the foreign income taxes paid by X which D would be deemed to have paid under section 902(a) in respect of such distribution would be \$60. Thus, in respect of the \$200 included in D's gross income as a dividend under section 1248(a), and subject to the applicable limitations and conditions of sections 901 through 905, D is entitled under this paragraph to a foreign tax credit of \$60 for 1964.

*Example 2.* On June 30, 1965, domestic corporation D owns all of the voting stock of foreign corporation Y, and Y (the first tier corporation) owns all of the voting stock of foreign corporation Z (a second tier corporation). On such date, D sells a block of Y stock and includes \$400 of the gain on the sale in its gross income as a dividend under section 1248(a). The earnings and profits attributable under § 1.1248-3 to the block are \$600 from Y and \$1,800 from Z. D uses the calendar year as its taxable year and instead of deducting foreign taxes under section 164, D chooses the benefits of the foreign tax credit provisions for 1965. For purposes of applying the foreign tax credit provisions, Y is considered under subparagraph (3) of this paragraph to have distributed to D a dividend of \$100 ( $\$400 \times 600 / 2400$ ) and Z is considered to have so distributed to D a dividend of \$300 ( $\$400 \times 1800 / 2400$ ). If D had included \$100 in its gross income as a dividend with respect to a distribution from Y on June 30, 1965, the amount of foreign income taxes paid by Y which D would be deemed to have paid under section 902(a) in respect of such distribution is \$80. If D had owned the stock in Z directly, and if D had included \$300 in its gross income as a dividend with respect to a distribution from Z, the amount of foreign income taxes paid by Z which D would be deemed to have paid under section 902(a) in respect of such distribution is \$120. Thus, in respect of the \$400 included in D's gross income as a dividend under section 1248(a), and subject to the applicable limitations and conditions of sections 901 through 905, D is entitled under this paragraph to a foreign tax credit of \$200 (\$80 plus \$120) for 1965.

(e) *Exceptions.* Under section 1248(f), this section and §§ 1.1248-2 through 1.1248-7 shall not apply to:

(1) Distributions to which section 303 (relating to distributions in redemption of stock to pay death taxes) applies;

(2) Gain realized on exchanges to which section 356 (relating to receipt of additional consideration in certain reorganizations) applies; or

(3) Any amount to the extent that such amount is, under any other provi-

sion of the Code, treated as (i) a dividend, (ii) gain from the sale of an asset which is not a capital asset, or (iii) gain from the sale of an asset held for not more than 1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977).

(f) *Installment method.* (1) Gain from a sale or exchange to which section 1248 applies may be reported under the installment method if such method is otherwise available under section 453 of the Code. In such case, the income (other than interest) on each installment payment shall be deemed to consist of gain which is included in gross income under section 1248 as a dividend until all such gain has been reported, and the remaining portion (if any) of such income shall be deemed to consist of gain to which section 1248 does not apply. For treatment of amounts as interest on certain deferred payments, see section 483.

(2) The application of this paragraph may be illustrated by the following example:

*Example:* Jones contracts to sell stock in a controlled foreign corporation for \$5,000 to be paid in 10 equal payments of \$500 each, plus a sufficient amount of interest so that section 483 does not apply. He properly elects under section 453 to report under the installment method gain of \$1,000 which is includible in gross income under section 1248 as a dividend and gain of \$500 which is a long-term capital gain. Accordingly, \$150 of each of the first 6 installment payments and \$100 of the seventh installment payment are included in gross income under section 1248 as a dividend, and \$50 of the seventh installment payment and \$150 of each of the last 3 installment payments are long-term capital gain.

[T.D. 6779, 29 FR 18130, Dec. 22, 1964, as amended by T.D. 7728, 45 FR 72650, Nov. 3, 1980; T.D. 7961, 49 FR 26225, June 27, 1984]

**§ 1.1248-2 Earnings and profits attributable to a block of stock in simple cases.**

(a) *General*—(1) *Manner of computation.* For purposes of paragraph (a)(1) of § 1.1248-1, if a United States person sells or exchanges a block of stock (as defined in paragraph (b) of this section) in a foreign corporation, and if the conditions of paragraph (c) of this section are satisfied in respect of the block,

then the earnings and profits attributable to the block which were accumulated in taxable years of the corporation beginning after December 31, 1962, during the period such block was held (or was considered to be held by reason of the application of section 1223) by such person while such corporation was a controlled foreign corporation, shall be computed in accordance with the steps set forth in subparagraphs (2), (3), and (4) of this paragraph.

(2) *Step 1.* (i) For each taxable year of the corporation beginning after December 31, 1962, the earnings and profits accumulated for each such taxable year by the corporation shall be computed in the manner prescribed in paragraph (d) of this section, and (ii) for the period the person held (or is considered to have held by reason of the application of section 1223) the block, the amount of earnings and profits attributable to the block shall be computed in the manner prescribed in paragraph (e) of this section.

(3) *Step 2.* If the conditions of paragraph (c)(5)(ii) of this section must be satisfied in respect of stock in a *lower tier* foreign corporation which such person owns within the meaning of section 958(a)(2), then (i) the earnings and profits accumulated for each such taxable year by such lower tier corporation shall be computed in the manner prescribed in paragraph (d) of this section, and (ii) for the period the person held (or is considered to have held by reason of the application of section 1223) the block, the amount of earnings and profits of the lower tier corporation attributable to the block shall be computed in the manner prescribed in paragraph (e) of this section applied as if such person owned directly the percentage of such stock in such lower tier corporation which such person owns within the meaning of section 958(a)(2).

(4) *Step 3.* The amount of earnings and profits attributable to the block shall be the sum of the amounts computed under steps 1 and 2.

(b) *Block of stock.* For purposes of this section, the term *block of stock* means a group of shares sold or exchanged in one transaction, but only if:

(1) The amount realized, basis, and holding period are identical for each such share, and

(2) In case, during the period the person held (or is considered to have held by reason of the application of section 1223) such shares, any amount was included under section 951 in the gross income of the person (or another person) in respect of the shares, the excess under paragraph (e)(3)(ii) of this section (computed as if each share were a block) is identical for each such share.

(c) *Conditions to application.* This section shall apply only if the following conditions are satisfied:

(1)(i) On each day of the period during which the block of stock was held (or is considered as held by reason of the application of section 1223) by the person during taxable years of the corporation beginning after December 31, 1962, the corporation is a controlled foreign corporation, and

(ii) On no such day is the corporation a foreign personal holding company (as defined in section 552) or a foreign investment company (as defined in section 1246(b)).

(2) The corporation had only one class of stock, and the same number of shares of such stock were outstanding, on each day of each taxable year of the corporation beginning after December 31, 1962, any day of which falls within the period referred to in subparagraph (1) of this paragraph.

(3) For each taxable year referred to in subparagraph (2) of this paragraph, the corporation is not a less developed country corporation (as defined in section 902(d)).

(4) For each taxable year referred to in subparagraph (2) of this paragraph, the corporation does not make any distributions out of its earnings and profits other than distributions which, under section 316 (as modified by section 959), are considered to be out of earnings and profits accumulated in taxable years beginning after December 31, 1962, during the period such person held (or is considered to have held by reason of the application of section 1223) the block while such corporation was a controlled foreign corporation.

(5)(i) If (a) on the date of the sale or exchange such person, by reason of his ownership of such block, owns within

the meaning of section 958(a)(2) stock in another foreign corporation (referred to as a *lower tier* corporation), and (b) the conditions of paragraph (a)(2) of § 1.1248-1 would be satisfied by such person in respect of such stock in the lower tier corporation if such person were deemed to have sold or exchanged such stock in the lower tier corporation on the date he actually sold or exchanged such stock in the first tier corporation, then the conditions of subdivision (ii) of this subparagraph must be satisfied.

(ii) In respect of stock in such lower tier corporation, (a) the conditions set forth in subparagraphs (1) through (4) of this paragraph (applied as if such person owned directly such stock in such lower tier corporation) must be met and (b) such person must own within the meaning of section 958(a)(2) the same percentage of the shares of such stock on each day which falls within the period referred to in subparagraph (1) of this paragraph.

(d) *Earnings and profits accumulated for a taxable year*—(1) *General*. For purposes of this section, the earnings and profits accumulated for a taxable year of a foreign corporation shall be the earnings and profits for such year computed in accordance with the rules prescribed in § 1.964-1 (relating to determination of earnings and profits for a taxable year of a controlled foreign corporation) and reduced by any distributions therefrom. If the stock in the corporation is sold or exchanged before any action is taken by or on behalf of the corporation under paragraph (c) of § 1.964-1, the computation of earnings and profits under § 1.964-1 for purposes of this section shall be made as if no elections had been made and no accounting method had been adopted.

(2) *Special rules*. (i) The earnings and profits of the corporation accumulated:

(a) For any taxable year beginning before January 1, 1967 (computed without any reduction for distributions), shall not include the excess of any item includible in gross income of the foreign corporation under section 882(b) as gross income derived from sources within the United States, and

(b) For any taxable year beginning after December 31, 1966 (computed

without any reduction for distributions), shall not include the excess of any item includible in gross income of the foreign corporation under section 882(b)(2) as income effectively connected for that year with the conduct by such corporation of a trade or business in the United States, whether derived from sources within or from sources without the United States,

Over any deductions allocable to such item under section 882(c). However, if the sale or exchange of stock in the foreign corporation by the United States person occurs before January 1, 1967, the provisions of (a) of this subdivision apply with respect to such sale or exchange even though the taxable year begins after December 31, 1966. See section 1248(d)(4). Any item which is required to be excluded from gross income, or which is taxed at a reduced rate, under an applicable treaty obligation of the United States shall not be excluded under this subdivision from earnings and profits accumulated for a taxable year (computed without any reduction for distributions).

(ii) If a foreign corporation adopts a plan of complete liquidation in a taxable year of the corporation beginning after December 31, 1962, and if because of the application of section 337(a) gain or loss would not be recognized by the corporation from the sale or exchange of property if the corporation were a domestic corporation, then the earnings and profits of the corporation accumulated for the taxable year (computed without any reduction for distributions) shall be determined without regard to the amount of such gain or loss. See section 1248(d)(2). For the non-application of section 337(a) to a liquidation by a collapsible corporation (as defined in section 341) and to certain other liquidations, see section 337(c).

(e) *Earnings and profits attributable to block*—(1) *General*. Except as provided in subparagraph (3) of this paragraph, the earnings and profits attributable to a block of stock of a controlled foreign corporation for the period a United States person held (or is considered to have held by reason of the application of section 1223) the block are an amount equal to:

(i) The sum of the earnings and profits accumulated for each taxable year of the corporation beginning after December 31, 1962 (computed under paragraph (d) of this section) during such period, multiplied by

(ii) The percentage that (a) the number of shares in the block, bears to (b) the total number of shares of the corporation outstanding during such period.

(2) *Special rule.* For purposes of computing the sum referred to in subparagraph (1)(i) of this paragraph, in case the block was held (or is considered as held by reason of the application of section 1223) during a taxable year beginning after December 31, 1962, but not on each day of such taxable year, there shall be included in such sum only that portion which bears the same ratio to (i) the total earnings and profits for such taxable year (computed under paragraph (d) of this section), as (ii) the number of days during such taxable year the block was held (or is considered as so held), bears to (iii) the total number of days in such taxable year.

(3) *Amounts included in gross income under section 951.* (i) If, during the period the person held (or is considered to have held by reason of the application of section 1223) the block, any amount was included under section 951 in the gross income of such person (or of another person whose holding of the stock sold or exchanged is, by reason of the application of section 1223, attributed to such person) in respect of the block, then the earnings and profits attributable to the block for such period shall be an amount equal to (a) the earnings and profits attributable to the block which would have been computed under subparagraph (1) of this paragraph if this subparagraph did not apply, reduced by (b) the excess computed under subdivision (ii) of this subparagraph. See section 1248(d)(1).

(ii) The excess computed under this subdivision is the excess (if any) of (a) amounts included under section 951 in the gross income of such person (or such other person) in respect of the block during such period, over (b) the portion of such amounts which, in any taxable year of such person (or such other person), resulted in an exclusion

from the gross income of such person (or such other person) under section 959(a)(1) (relating to exclusion from gross income of distributions of previously taxed earnings and profits).

(iii) This subparagraph shall apply notwithstanding an election under section 962 by such person to be subject to tax at corporate rates.

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

*Example 1.* On May 26, 1965, Green, a United States person, purchases at its fair market value a block of 25 of the 100 outstanding shares of the only class of stock of controlled foreign corporation F. He sells the block on January 1, 1968. In respect of the block, Green did not include any amount in his gross income under section 951. F uses the calendar year as its taxable year and does not own stock in any lower tier corporation referred to in paragraph (c)(5)(i) of this section. All of the conditions of paragraph (c) of this section are satisfied in respect of the block. The earnings and profits accumulated by F (computed under paragraph (d) of this section) are \$10,000 for 1965, \$13,000 for 1966, and \$11,000 for 1967. The earnings and profits of F attributable to the block are \$7,500, determined as follows:

Sum of earnings and profits accumulated by F during period block was held:	
For 1965 (219/365×\$10,000) .....	\$6,000
For 1966 .....	\$13,000
For 1967 .....	\$11,000
Sum .....	\$30,000
Multiplied by:	
Number of shares in block (25), divided by total number of shares outstanding (100) .....	25%
Earnings and profits attributable to block .....	\$7,500

*Example 2.* Assume the same facts as in example (1) except that in respect of the block Green includes in his gross income under section 951 the total amount of \$2,800 for 1965 and 1966, and because of such inclusion the amount of \$2,800 which was distributed to Green by F on January 15, 1967, is excluded from his gross income under section 959(a)(1). Accordingly, the earnings and profits of F attributable to the block are \$7,000, determined as follows:

Earnings and profits attributable to the block, as computed in example (1) .....	\$7,500
Minus:	
Excess of amount included in Green's gross income under section 951 (\$2,800), over portion thereof which resulted in an exclusion under section 959(a)(1) (\$2,300) .....	500
Earnings and profits attributable to block .....	7,000

*Example 3.* Assume the same facts as in example (1) except that on each day beginning on January 1, 1966 (the date controlled foreign corporation G was organized) through January 1, 1968, F owns 80 of the 100 outstanding shares of the only class of G stock. Since, by reason of his ownership of 25 shares of F stock, Green owns within the meaning of section 958(a)(2) the equivalent of 20 shares of G stock ( $\frac{25}{100}$  of 80 shares), G is a lower tier corporation referred to in paragraph (c)(5)(i)(a) of this section. If Green had sold the 20 shares of G stock on January 1, 1968, the date he actually sold the block of F stock, the conditions of paragraph (a)(2) of § 1.1248-1 would be satisfied in respect of the G stock, and, accordingly, the conditions of paragraph (c)(5)(ii) of this section must be satisfied. Assume further that such conditions are satisfied, that G uses the calendar year as its taxable year, and that the earnings and profits accumulated by G (computed under paragraph (d) of this section) are \$19,000 for 1966 and \$21,000 for 1967. The earnings and profits of F and of G attributable to the block are \$15,500, determined as follows:

Sum of earnings and profits accumulated by G for period Green owned G stock within the meaning of section 958(a)(2) (\$19,000 plus \$21,000) .....	\$40,000
Multiplied by:	
Number of G shares deemed owned within the meaning of section 958(a)(2) by Green (20), divided by total number of G shares outstanding (100) .....	20%
Earnings and profits of G attributable to block .....	\$8,000
Earnings and profits of F attributable to block, as determined in example (1) .....	\$7,500
Total earnings and profits attributable to block .....	\$15,000

[T.D. 6779, 29 FR 18131, Dec. 22, 1964, as amended by T.D. 7293, 38 FR 32803, Nov. 28, 1973]

**§ 1.1248-3 Earnings and profits attributable to stock in complex cases.**

(a) *General*—(1) *Manner of computation.* For purposes of paragraph (a)(1) of § 1.1248-1, if a United States person sells or exchanges stock in a foreign corporation, and if the provisions of § 1.1248-2 do not apply, then the earnings and profits attributable to the stock which were accumulated in taxable years of the corporation beginning after December 31, 1962, during the period or periods such stock was held (or was considered to be held by reason of the application of section 1223) by such person while such corporation was a controlled foreign corporation, shall be computed in accordance with the steps

set forth in subparagraphs (2), (3), and (4) of this paragraph.

(2) *Step 1.* For each taxable year of the corporation beginning after December 31, 1962, (i) the earnings and profits accumulated for such taxable year by the corporation shall be computed in the manner prescribed in paragraph (b) of this section, (ii) the person's *tentative ratable share* of such earnings and profits shall be computed in the manner prescribed in paragraph (c) or (d) (whichever is applicable) of this section, and (iii) the person's *ratable share* of such earnings and profits shall be computed by adjusting the tentative ratable share in the manner prescribed in paragraph (e) of this section.

(3) *Step 2.* If the provisions of paragraph (f) of this section (relating to earnings and profits of *lower tier* foreign corporations) apply, the amount of the person's ratable share of the earnings and profits accumulated by each *lower tier* corporation attributable to any such taxable year (i) shall be computed in the manner prescribed by paragraph (f) of this section, and (ii) shall be added to such person's ratable share for such taxable year determined in step 1.

(4) *Step 3.* The amount of earnings and profits attributable to the share shall be the sum of the ratable shares computed for each such taxable year in the manner prescribed in steps 1 and 2.

(5) *Share or block.* In general, the computation under this paragraph shall be made separately for each share of stock sold or exchanged, except that if a group of shares constitute a block of stock the computation may be made in respect of the block. For purposes of this section, the term *block of stock* means a group of shares sold or exchanged in one transaction, but only if (i) the amount realized, basis, and holding period are identical for each such share, and (ii) the adjustments (if any) under paragraphs (e) and (f)(5) of this section of the tentative ratable shares would be identical for each such share if such adjustments were computed separately for each such share.

(6) *Deficit in earnings and profits.* For purposes of this section and §§ 1.1248-4 through 1.1248-7, in respect of a taxable year, the term *earnings and profits accumulated* for a taxable year (but only if