

(iii) For purposes of computing post-1986 undistributed earnings in each separate category the rules of sections 902 and 960, including the rules of § 1.960-1(i), apply. Under § 1.960-1(i), the shipping limitation deficit of (200u) is allocated proportionately to reduce general limitation earnings of 400u and passive limitation earnings of 100u. Thus, general limitation earnings are reduced by 160u to 240u (400u general limitation earnings/500u total earnings in positive separate categories × (200u) shipping deficit=160u reduction), and passive limitation earnings are reduced by 40u to 60u (100u passive earnings/500u total earnings in positive separate categories × (200u) shipping deficit=40u reduction). Five-twelfths of CFC's post-1986 foreign income taxes with respect to passive limitation earnings are deemed paid by A under section 960 with respect to the subpart F inclusion (25u inclusion/60u passive earnings). After the inclusion and deemed-paid taxes are computed, at the close of 1998 CFC has 400u of general limitation earnings (275u opening balance + 125u current earnings), 75u of passive limitation earnings (100u of foreign personal holding company income - 25u inclusion), and a (200u) deficit in shipping limitation earnings.

*Example 4.* (i) The facts are the same as in *Example 3* with the addition of the following facts. In 1999, CFC earns 50u of general limitation earnings that are not subpart F income and 75u of passive limitation income that is foreign personal holding company income. Thus, CFC has 125u of current earnings and profits. CFC distributes 200u to A. Under paragraph (f)(3)(i) of this section, the recapture rules are applied first. Thus, the amount by which 1999 current earnings and profits exceed subpart F income, 50u, is recharacterized as passive limitation foreign personal holding company income. CFC's total subpart F income for 1999 is 125u of passive limitation foreign personal holding company income (75u current earnings plus 50u recapture account), and the passive limitation/foreign personal holding company income recapture account is reduced from 75u to 25u.

(ii) CFC has 150u of previously-taxed earnings and profits described in section 959(c)(2) (25u attributable to 1998 and 125u attributable to 1999), all of which is passive limitation earnings and profits. Under section 959(c), 150u of the 200u distribution is deemed to be made from earnings and profits described in section 959(c)(2). The remaining 50u is deemed to be made from earnings and profits described in section 959(c)(3). Under paragraph (f)(3)(ii) of this section, the dividend distribution is deemed to be made first out of the passive limitation recapture account to the extent thereof (25u). Under paragraph (f)(2)(iii) of this section, the passive limitation recapture account is reduced from 25u to 0. The remaining distribution of

25u is treated as made out of CFC's general limitation earnings and profits.

(iii) For purposes of computing post-1986 undistributed earnings, the rules of section 902 and 960, including the rules of § 1.960-1(i), apply. Thus, the shipping limitation accumulated deficit of (200u) reduces general limitation earnings and profits of 450u and passive limitation earnings and profits of 150u on a proportionate basis. Thus, 100% of CFC's post-1986 foreign income taxes with respect to passive limitation earnings are deemed paid by A under section 960 with respect to the 1999 subpart F inclusion of 125u (100u inclusion (numerator limited to denominator)/100u passive earnings). No post-1986 foreign income taxes remain to be deemed paid under section 902 in connection with the 25u distribution from the passive limitation/foreign personal holding company income recapture account. One-twelfth of CFC's post-1986 foreign income taxes with respect to general limitation earnings are deemed paid by A under section 902 with respect to the distribution of 25u general limitation earnings and profits described in section 959(c)(3) (25u inclusion/300u general limitation earnings). After the deemed-paid taxes are computed, at the close of 1999 CFC has 425u of general limitation earnings and profits (400u opening balance + 50u current earnings—25u distribution), 0 of passive limitation earnings (75u recapture account + 75u current foreign personal holding company income—125u inclusion—25u distribution), and a (200u) deficit in shipping limitation earnings.

(5) *Effective date.* Paragraph (e) of this section and this paragraph (f) apply to taxable years of a controlled foreign corporation beginning after March 3, 1997.

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#### § 1.952-2 Determination of gross income and taxable income of a foreign corporation.

(a) *Determination of gross income—(1) In general.* Except as provided in subparagraph (2) of this paragraph, the gross income of a foreign corporation for any taxable year shall, subject to the special rules of paragraph (c) of this section, be determined by treating such foreign corporation as a domestic corporation taxable under section 11

and by applying the principles of section 61 and the regulations thereunder.

(2) *Insurance gross income*—(i) *Life insurance gross income*. The gross income for any taxable year of a controlled foreign corporation which is engaged in the business of reinsuring or issuing insurance or annuity contracts and which, if it were a domestic corporation engaged only in such business, would be taxable as a life insurance company to which part I (sections 801 through 820) of subchapter L of chapter 1 of the Code applies, shall, subject to the special rules of paragraph (c) of this section, be the sum of—

(a) The gross investment income, as defined under section 804(b), except that interest which is excluded from gross income under section 103 shall not be taken into account;

(b) The sum of the items taken into account under section 809(c), except that advance premiums shall not be taken into account; and

(c) The amount by which the net long-term capital gain exceeds the net short-term capital loss.

(ii) *Mutual and other insurance gross income*. The gross income for any taxable year of a controlled foreign corporation which is engaged in the business of reinsuring or issuing insurance or annuity contracts and which, if it were a domestic corporation engaged only in such business, would be taxable as a mutual insurance company to which part II (sections 821 through 826) of subchapter L of chapter 1 of the Code applies or as a mutual marine insurance or other insurance company to which part III (sections 831 and 832) of subchapter L of chapter 1 of the Code applies, shall, subject to the special rules of paragraph (c) of this section, be—

(a) The sum of—

(1) The gross income, as defined in section 832(b)(1);

(2) The amount of losses incurred, as defined in section 832(b)(5); and

(3) The amount of expenses incurred, as defined in section 832(b)(6); reduced by

(b) The amount of interest which under section 103 is excluded from gross income.

(b) *Determination of taxable income*—(1) *In general*. Except as provided in subparagraph (2) of this paragraph, the taxable income of a foreign corporation for any taxable year shall, subject to the special rules of paragraph (c) of this section, be determined by treating such foreign corporation as a domestic corporation taxable under section 11 and by applying the principles of section 63.

(2) *Insurance taxable income*. The taxable income for any taxable year of a controlled foreign corporation which is engaged in the business of reinsuring or issuing insurance or annuity contracts and which, if it were a domestic corporation engaged only in such business, would be taxable as an insurance company to which subchapter L of chapter 1 of the Code applies shall, subject to the special rules of paragraph (c) of this section, be determined by treating such corporation as a domestic corporation taxable under subchapter L of chapter 1 of the Code and by applying the principles of §§1.953-4 and 1.953-5 for determining taxable income.

(c) *Special rules for purposes of this section*—(1) *Nonapplication of certain provisions*. Except where otherwise distinctly expressed, the provisions of subchapters F, G, H, L, M, N, S, and T of chapter 1 of the Internal Revenue Code shall not apply and, for taxable years of a controlled foreign corporation beginning after March 3, 1997, the provisions of section 103 of the Internal Revenue Code shall not apply.

(2) *Application of principles of §1.964-1*. The determinations with respect to a foreign corporation shall be made as follows:

(i) *Books of account*. The books of account to be used shall be those regularly maintained by the corporation for the purpose of accounting to its shareholders.

(ii) *Accounting principles*. Except as provided in subparagraphs (3) and (4) of this paragraph, the accounting principles to be employed are those described in paragraph (b) of §1.964-1. Thus, in applying accounting principles generally accepted in the United States

for purposes of reflecting in the financial statements of a domestic corporation the operations of foreign affiliates, no adjustment need be made unless such adjustment will have a material effect, within the meaning of paragraph (a) of § 1.964-1.

(iii) *Translation into United States dollars—(a) In general.* Except as provided in (b) of this subdivision, the amounts determined in accordance with subdivision (ii) of this subparagraph shall be translated into United States dollars in accordance with the principles of paragraph (d) of § 1.964-1.

(b) *Special rule.* In any case in which the value of the foreign currency in relation to the United States dollar fluctuates more than 10 percent during any translation period (within the meaning of paragraph (d)(6) of § 1.964-1), the subpart F income and non-subpart F income shall be separately translated as if each constituted all the income of the controlled foreign corporation for the translation period.

(iv) *Tax accounting methods.* The tax accounting methods to be employed are those established or adopted by or on behalf of the foreign corporation under paragraph (c) of § 1.964-1. Thus, such accounting methods must be consistent with the manner of treating inventories, depreciation, and elections referred to in subdivisions (ii), (iii), and (iv) of paragraph (c)(1) of § 1.964-1 and used for purposes of such paragraph; however, if, in accordance with paragraph (c)(6) of § 1.964-1, a foreign corporation receives foreign base company income before any elections are made or before an accounting method is adopted by or on behalf of such corporation under paragraph (c)(3) of § 1.964-1, the determinations of whether an exclusion set forth in section 954(b) applies shall be made as if no elections had been made and no accounting method had been adopted.

(v) *Exchange gain or loss—(a) Exchange gain or loss.* determined in accordance with the principles of § 1.964-1(e), shall be taken into account for purposes of determining gross income and taxable income.

(b) Exchange gain or loss shall be treated as foreign base company shipping income (or as a deduction allowable thereto) to the extent that it is

attributable to foreign base company shipping operations. The extent to which exchange gain or loss is attributable to foreign base company shipping operations may be determined under any reasonable method which is consistently applied from year to year. For example, the extent to which the exchange gain or loss is attributable to foreign base company shipping operations may be determined on the basis of the ratio which the foreign based company shipping income of the corporation for the taxable year bears to its total gross income for the taxable year, such ratio to be determined without regard to this subdivision (v).

(c) The remainder of the exchange gain or loss shall be allocated between subpart F income and non-subpart F income under any reasonable method which is consistently applied from year to year. For example, such remainder may be allocated to subpart F income in the same ratio that the gross subpart F income (exclusive of foreign base company shipping income) of the corporation for the taxable year bears to its total gross income (exclusive of foreign base company shipping income) for the taxable year, such ratio to be determined without regard to this subdivision (v).

(3) *Necessity for recognition of gain or loss.* Gross income of a foreign corporation (including an insurance company) includes gain or loss only if such gain or loss would be recognized under the provisions of the Internal Revenue Code if the foreign corporation were a domestic corporation taxable under section 11 (subject to the modifications of subparagraph (1) of this paragraph). See section 1002. However, a foreign corporation shall not be treated as a domestic corporation for purposes of determining whether section 367 applies.

(4) *Gross income and gross receipts.* The term "gross income" may not have the same meaning as the term "gross receipts". For example, in a manufacturing, merchandising, or mining business, gross income means the total sales less the cost of goods sold, plus any income from investments and from incidental or outside operations or sources.

(5) *Treatment of capital loss and net operating loss.* In determining taxable income of a foreign corporation for any taxable year—

(i) *Capital loss carryback and carryover.* The capital loss carryback and carryover provided by section 1212(a) shall not be allowed.

(ii) *Net operating loss deduction.* The net operating loss deduction under section 172(a) or the operations loss deduction under section 812 shall not be allowed.

(6) *Corporations which have insurance income.* For purposes of paragraphs (a)(2) and (b)(2) of this section, in determining whether a controlled foreign corporation which is engaged in the business of reinsuring or issuing insurance or annuity contracts and which, if it were a domestic corporation engaged only in such business, would be taxable as an insurance company to which subchapter L of chapter 1 of the Code applies, it is immaterial that—

(i) The corporation would be exempt from taxation as an organization described in section 501(a),

(ii) The corporation would not be taxable as an insurance company to which subchapter L of the Code applies, or

(iii) The corporation would be subject to the alternative tax for small mutual insurance companies provided by section 821(c).

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**§ 1.953-1 Income from insurance of United States risks.**

(a) *In general.* The subpart F income of a controlled foreign corporation for any taxable year includes its income derived from the insurance of United States risks for such taxable year. See section 952(a)(1). A controlled foreign corporation shall have income derived from the insurance of United States risks for such purpose of it has taxable income, as determined under § 1.953-4 or § 1.953-5, which is attributable to the reinsuring or the issuing of any insurance or annuity contract in connection with United States risks, as defined in § 1.953-2 or § 1.953-3, and if it satisfies the 5-percent minimum premium requirement prescribed in paragraph (b)

of this section. It is immaterial for purposes of this section whether the person insured or the beneficiary of any insurance, annuity, or reinsurance contract is, as to such corporation, a related person or a United States shareholder. For definition of the term “controlled foreign corporation” for purposes of taking into account income derived from the insurance of United States risks under section 953, see section 957 (a) and (b) and §§ 1.957-1 and 1.957-2.

(b) *5-percent minimum premium requirement.* A controlled foreign corporation shall not have income derived from the insurance of United States risks for purposes of this section unless the premiums received by such corporation during the taxable year which are attributable to the reinsuring and the issuing of insurance and annuity contracts in connection with the United States risks exceed 5 percent of the total premiums which are received by such corporation during such taxable year and which are attributable to the reinsuring and the issuing of insurance and annuity contracts in connection with all risks.

(c) *General definitions.* For purposes of §§ 1.953-1 to 1.953-6, inclusive—

(1) *Reinsurance, etc.* The terms “reinsurance”, “insurance”, and “annuity contract” have the same meaning which they have for purposes of applying section 809(c)(1) or section 832(b)(4), as the case may be.

(2) *Premiums.* The term “premiums” means the items taken into account for the taxable year under section 809(c)(1), or the amount computed for the taxable year under section 832(b)(4) without the application of subparagraph (B) thereof, as the case may be; except that, for purposes of determining the amount of premiums received in applying paragraph (b) of this section or paragraph (a) of § 1.953-3, advance premiums and deposits shall not be taken into account.

(3) *Insurance company.* The term “insurance company” has the same meaning which it has for purposes of applying section 801(a), determined by applying the principles of paragraph (a) of § 1.801-3.

(4) *Related person.* The term “related person”, when used with respect to a