

application of section 962(d) and § 1.962-3; and

(2) The amount of any income, war profits, or excess profits taxes imposed by any foreign country or possession of the United States on or with respect to the earnings and profits attributable to such excluded amount when such earnings and profits were actually distributed directly or indirectly through a chain of ownership described in section 958(a)(2).

(c) *Amount in excess of basis.* To the extent that the amount of the reduction in the adjusted basis of property provided by paragraph (a) of this section exceeds such adjusted basis, the amount shall be treated as gain from the sale or exchange of property.

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

Example 1. (a) Domestic corporation M owns all of the 1,000 shares of the one class of stock in controlled foreign corporation R, which owns all of the 500 shares of the one class of stock in controlled foreign corporation S. Each share of M Corporation's stock in R Corporation has a basis of \$200. Corporations M, R, and S use the calendar year as a taxable year. In 1963, S Corporation has \$100,000 of earnings and profits after the payment of \$50,000 of foreign income taxes and \$100,000 of subpart F income. For 1963, M Corporation includes \$100,000 in gross income under section 951(a) with respect to S Corporation. In accordance with the provisions of § 1.961-1, M Corporation increases the basis of each of its 1,000 shares of stock in R Corporation to \$300 ($\$200 + \$100,000/1,000$) as of December 31, 1963.

(b) On July 31, 1964, M Corporation sells 250 of its shares of stock in R Corporation to domestic corporation N at a price of \$350 per share. Corporation N satisfies the requirements of paragraph (d) of § 1.959-1 so as to qualify as M Corporation's successor in interest. On September 30, 1964, the earnings and profits attributable to the \$100,000 included in M Corporation's gross income under section 951(a) for 1963 are distributed to R Corporation which incurs a withholding tax of \$10,000 on such distribution (10 percent of \$100,000) and an additional foreign income tax of 33½ percent or \$30,000 by reason of the inclusion of the net distribution of \$90,000 ($\$100,000$ minus $\$10,000$) in its taxable income for 1964. On June 30, 1965, R Corporation distributes the remaining \$60,000 of such earnings and profits to corporations M and N: Corporation M receives \$45,000 ($750/1,000 \times \$60,000$) and excludes such amount from gross income under section 959(a); Corpora-

tion N receives \$15,000 ($250/1,000 \times \$60,000$) and, as M Corporation's successor in interest, excludes such amount from gross income under section 959(a). As of June 30, 1965, M Corporation must reduce the adjusted basis of each of its 750 shares of stock in R Corporation to \$200 ($\300 minus $(\$45,000/750 + \$10,000/1,000 + \$30,000/1,000)$); and N Corporation must reduce the basis of each of its 250 shares of stock in R Corporation to \$250 ($\350 minus $(\$15,000/250 + \$10,000/1,000 + \$30,000/1,000)$).

Example 2. The facts are the same as in paragraph (a) of example 1, except that in addition, on July 31, 1964, R Corporation sells its 500 shares of stock in S Corporation to domestic corporation P at a price of \$600 per share. Corporation P satisfies the requirements of paragraph (d) of § 1.959-1 so as to qualify as M Corporation's successor in interest. On September 30, 1964, S Corporation distributes \$100,000 of earnings and profits to P Corporation, which earnings and profits are attributable to the \$100,000 included in M Corporation's gross income under section 951(a) for 1963. Corporation P incurs a withholding tax of \$10,000 on the distribution from S Corporation (10 percent of \$100,000). As M Corporation's successor in interest, P Corporation excludes the \$90,000 it receives from gross income under section 959(a). As of September 30, 1964, P Corporation must reduce the basis of each of its 500 shares of stock in S Corporation to \$400 ($\600 minus $(\$90,000/500 + \$10,000/500)$).

[T.D. 6850, 30 FR 11854, Sept. 16, 1965]

§ 1.962-1 Limitation of tax for individuals on amounts included in gross income under section 951(a).

(a) *In general.* An individual United States shareholder may, in accordance with § 1.962-2, elect to have the provisions of section 962 apply for his taxable year. In such case—

(1) The tax imposed under chapter 1 of the Internal Revenue Code on all amounts which are included in his gross income for such taxable year under section 951(a) shall (in lieu of the tax determined under section 1) be an amount equal to the tax which would be imposed under section 11 if such amounts were received by a domestic corporation (determined in accordance with paragraph (b)(1) of this section), and

(2) For purposes of applying section 960(a)(1) (relating to foreign tax credit) such amounts shall be treated as if received by a domestic corporation (as provided in paragraph (b)(2) of this section).

Thus, an individual United States shareholder may elect to be subject to tax at corporate rates on amounts included in his gross income under section 951(a) and to have the benefit of a credit for certain foreign taxes paid with respect to the earnings and profits attributable to such amounts. Section 962 also provides rules for the treatment of an actual distribution of earnings and profits previously taxed in accordance with an election of the benefits of this section. See § 1.962-3. For transitional rules for certain taxable years, see § 1.962-4.

(b) *Rules of application.* For purposes of this section—

(1) *Application of section 11.* For purposes of applying section 11 for a taxable year as provided in paragraph (a)(1) of this section in the case of an electing United States shareholder—

(i) *Determination of taxable income.* The term “taxable income” as used in section 11 shall mean the sum of—

(a) All amounts required to be included in his gross income under section 951(a) for such taxable year; plus

(b) All amounts which would be required to be included in his gross income under section 78 for such taxable year with respect to the amounts referred to in (a) of this subdivision if such shareholder were a domestic corporation.

For purposes of this section, such sum shall not be reduced by any deduction of the United States shareholder even if such shareholder's deductions exceed his gross income.

(ii) *Limitation on surtax exemption.* The surtax exemption provided by section 11(c) shall not exceed an amount which bears the same ratio to \$25,000 (\$50,000 in the case of a taxable year ending after December 31, 1974, and before January 1, 1976) as the amounts included in his gross income under section 951(a) for the taxable year bear to his pro rata share of the earnings and profits for the taxable year of all controlled foreign corporations with respect to which such United States shareholder includes any amount in his gross income under section 951(a) for the taxable year.

(2) *Allowance of foreign tax credit—(i) In general.* Subject to the applicable limitation of section 904 and to the pro-

visions of this subparagraph, there shall be allowed as a credit against the United States tax on the amounts described in subparagraph (1)(i) of this paragraph the foreign income, war profits, and excess profits taxes deemed paid under section 960(a)(1) by the electing United States shareholder with respect to such amounts.

(ii) *Application of section 960(a)(1).* In applying section 960(a)(1) for purposes of this subparagraph in the case of an electing United States shareholder, the term “domestic corporation” as used in sections 960(a)(1) and 78, and the term “corporation” as used in section 901, shall be treated as referring to such shareholder with respect to the amounts described in subparagraph (1)(i) of this paragraph.

(iii) *Carryback and carryover of excess tax deemed paid.* For purposes of this subparagraph, any amount by which the foreign income, war profits, and excess profits taxes deemed paid by the electing United States shareholder for any taxable year under section 960(a)(1) exceed the limitation determined under subdivision (iv)(a) of this subparagraph shall be treated as a carryback and carryover of excess tax paid under section 904(d), except that in no case shall excess tax paid be deemed paid in a taxable year if an election under section 962 by such shareholder does not apply for such taxable year. Such carrybacks and carryovers shall be applied only against the United States tax on amounts described in subparagraph (1)(i) of this paragraph.

(iv) *Limitation on credit.* For purposes of determining the limitation under section 904 on the amount of the credit for foreign income, war profits, and excess profits taxes—

(a) Deemed paid with respect to amounts described in subparagraph (1)(i) of this paragraph, the electing United States shareholder's taxable income shall be considered to consist only of the amounts described in such subparagraph (1)(i), and

(b) Paid with respect to amounts other than amounts described in subparagraph (1)(i) of this paragraph, the electing United States shareholder's taxable income shall be considered to consist only of amounts other than the

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amounts described in such subparagraph (1)(i).

(v) *Effect of choosing benefits of sections 901 to 905.* The provisions of this subparagraph shall apply for a taxable year whether or not the electing United States shareholder chooses the benefits of subpart A of part III of subchapter N of chapter 1 (sections 901 to 905) of the Internal Revenue Code for such year.

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

Example. Throughout his taxable year ending December 31, 1964, A, an unmarried individual who is not the head of a household, owns 60 of the 100 shares of the one class of stock in foreign corporation M and 80 of the 100 shares of the one class of stock in foreign corporation N. A and corporations M and N use the calendar year as a taxable year, cor-

porations M and N are controlled foreign corporations throughout the period here involved, and neither corporation is a less developed country corporation. The earnings and profits and subpart F income of, and the foreign income taxes paid by, such corporations for 1964 are as follows:

	M	N
Pretax earnings and profits	\$500,000	\$1,200,000
Foreign income taxes	200,000	400,000
Earnings and profits	300,000	800,000
Subpart F income	150,000	750,000

Apart from his section 951(a) income, A has gross income of \$200,600 and \$100,000 of deductions attributable to such income. He is required to include \$90,000 (0.60×\$150,000) in gross income under section 951(a) with respect to M Corporation and \$600,000 (0.80×\$750,000) with respect to N Corporation. A elects to have the provisions of section 962 apply for 1964 and computes his tax as follows:

Tax on amounts included under section 951(a):		
Income under section 951(a) from M Corporation	\$90,000	
Gross-up under sections 960(a)(1) and 78 (\$90,000/\$300,000×\$200,000)	60,000	
Income under section 951(a) from N Corporation	600,000	
Gross-up under sections 960(a)(1) and 78 (\$600,000/\$800,000×\$400,000)	300,000	
Taxable income under section 11	1,050,000	
Normal tax (0.22×\$1,050,000)		\$231,000
Surtax exemption [(\$90,000+\$600,000)/[0.60×\$300,000+(0.80×\$800,000)]×\$25,000]	21,036	
Subject to surtax under section 11 (\$1,050,000 - \$21,036)	1,028,964	
Surtax (0.28×\$1,028,964)		288,110
Tentative U.S. tax		519,110
Foreign tax credit (\$60,000+\$300,000)	360,000	
Total U.S. tax payable on amounts included under section 951(a)		\$159,110
Tax with respect to other income:		
Gross income	200,600	
Less:		
Personal exemption	600	
Deductions	100,000	
	100,600	
Taxable income	100,000	
Tax with respect to such other taxable income	59,340	
Total tax (\$159,110+\$59,340)		218,450

[T.D. 6858, 30 FR 13695, Oct. 28, 1965, as amended by T.D. 7413, 41 FR 12640, Mar. 26, 1976]

§ 1.962-2 Election of limitation of tax for individuals.

(a) *Who may elect.* The election under section 962 may be made only by a United States shareholder who is an individual (including a trust or estate).

(b) *Time and manner of making election.* Except as provided in § 1.962-4, a United States shareholder shall make

an election under this section by filing a statement to such effect with his return for the taxable year with respect to which the election is made. The statement shall include the following information:

(1) The name, address, and taxable year of each controlled foreign corporation with respect to which the