

the third month following the close of its taxable year or on or before May 1, 1965, whichever is later, with the Director of International Operations, Internal Revenue Service, Washington, DC, 20225:

(1) Form 1120, modified so as to be an annual information return, establishing the amount of its taxable income referred to in paragraph (b) of this section, and

(2) Form 2438, modified so as to be an annual information return, establishing the amount of the company's excess capital gains (referred to in paragraph (a)(1) of §1.1247-3) for the taxable year, the distributed portion thereof, and the amount of the undistributed portion thereof.

[T.D. 6798, 30 FR 1178, Feb. 4, 1965]

§ 1.1248-1 Treatment of gain from certain sales or exchanges of stock in certain foreign corporations.

(a) *In general.* (1) If a United States person (as defined in section 7701(a)(30)) recognizes gain on a sale or exchange after December 31, 1962, of stock in a foreign corporation, and if in respect of such person the conditions of subparagraph (2) of this paragraph are satisfied, then the gain shall be included in the gross income of such person as a dividend to the extent of the earnings and profits of such corporation attributable to such stock under §1.1248-2 or 1.1248-3, whichever is applicable, which were accumulated in taxable years of such foreign corporation beginning after December 31, 1962, during the period or periods such stock was held (or was considered as held by reason of the application of section 1223) by such person while such corporation was a controlled foreign corporation. See section 1248(a). For computation of earnings and profits attributable to such stock if there are any *lower tier* corporations, see paragraph (a) (3) and (4) of §1.1248-2 or paragraph (a) of §1.1248-3, whichever is applicable. In general, the amount of gain to be included in a person's gross income as a dividend under section 1248(a) shall be determined separately for each share of stock sold or exchanged. However, such determination may be made in respect of a block of stock if earnings and profits attributable to the block are computed under

§1.1248-2 or 1.1248-3. See paragraph (b) of §1.1248-2 and paragraph (a)(5) of §1.1248-3. For the limitation on the tax attributable to an amount included in an individual's gross income as a dividend under section 1248(a), see section 1248(b) and §1.1248-4. For the treatment, under certain circumstances, of the sale or exchange of stock in a domestic corporation as the sale or exchange of stock held by the domestic corporation in a foreign corporation, see section 1248(e) and §1.1248-6. For the nonapplication of section 1248 in certain circumstances, see section 1248(f) and paragraph (e) of this section. For the requirement that the person establish the amount of earnings and profits attributable to the stock sold or exchanged and, for purposes of section 1248(b), the amount of certain taxes, see section 1248(g) and §1.1248-7.

(2) In respect of a United States person who sells or exchanges stock in a foreign corporation, the conditions referred to in subparagraph (1) of this paragraph are satisfied only if (i) such person owned, within the meaning of section 958(a), or was 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 at any time during the 5-year period ending on the date of the sale or exchange, and (ii) at such time such foreign corporation was a controlled foreign corporation (as defined in section 957).

(3) For purposes of subparagraph (2) of this paragraph, (i) a foreign corporation shall not be considered to be a controlled foreign corporation at any time before the first day of its first taxable year beginning after December 31, 1962, and (ii) the percentage of the total combined voting power of stock of a foreign corporation owned (or considered as owned) by a United States person shall be determined in accordance with the principles of section 951(b) and the regulations thereunder.

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

Example 1. Corporation F is a foreign corporation which has outstanding 100 shares of one class of stock. F was a controlled foreign

corporation for the period beginning on January 1, 1963, and ending on June 30, 1965, but was not a controlled foreign corporation at any time thereafter. On December 31, 1965, Brown, a United States person who has owned 15 shares of F stock since 1962, sells 7 of his 15 shares and recognizes gain with respect to each share sold. Since Brown owned stock representing at least 10 percent of the total combined voting power of F at a time during the 5-year period ending on December 31, 1965, while F was a controlled foreign corporation, the conditions of subparagraph (2) of this paragraph are satisfied. Therefore, section 1248(a) applies to the gain recognized by Brown to the extent of the earnings and profits attributable under § 1.1248-3 to such shares.

Example 2. Assume the same facts as in example (1). Assume further that on February 1, 1970, Brown sells the remainder of his shares in F Corporation and recognizes gain with respect to each share sold. Even though Brown did not own stock representing at least 10 percent of the total combined voting power of F on February 1, 1970, nevertheless, in respect of each of the 8 shares of F stock which he sold on such date, the conditions of subparagraph (2) of this paragraph are satisfied since Brown owned stock representing at least 10 percent of such voting power at a time during the 5-year period ending on February 1, 1970, while F was a controlled foreign corporation. Therefore, section 1248(a) applies to the gain recognized by Brown to the extent of the earnings and profits attributable under § 1.1248-3 to such shares. If, however, Brown had sold the remainder of his shares in F on July 1, 1970, since the last date on which Brown owned stock representing at least 10 percent of the total combined voting power of F while F was a controlled foreign corporation was June 30, 1965, a date which is not within the 5-year period ending July 1, 1970, the conditions of subparagraph (2) of this paragraph would not be satisfied and section 1248(a) would not apply.

Example 3. Corporation G, a foreign corporation created in 1950, has outstanding 100 shares of one class of stock and uses the calendar year as its taxable year. Corporation X, a United States person, owns 60 shares of G stock and has owned such stock since G was created. Corporation Y, a United States person, owned 15 shares of the G stock from 1950 until December 1, 1962, on which date it sold 10 of such shares. On December 31, 1963, Y sells its remaining 5 shares of the G stock and recognizes gain on the sale. Since G is not considered to be a controlled foreign corporation at any time before January 1, 1963, and since Y did not own stock representing at least 10 percent of the total combined voting power of G at any time on or after such date, the conditions of subparagraph (2) of

this paragraph are not satisfied and section 1248(a) does not apply.

(b) *Sale or exchange.* For purposes of this section and §§ 1.1248-2 through 1.1248-7, the term *sale or exchange* includes the receipt of a distribution which is treated as in exchange for stock under section 302(a) (relating to distributions in redemption of stock), section 331(a)(1) (relating to distributions in complete liquidation of a corporation), or section 331(a)(2) (relating to distributions in partial liquidation of a corporation).

(c) *Gain recognized.* Section 1248(a) applies to a sale or exchange of stock in a foreign corporation only if gain is recognized in whole or in part upon such sale or exchange. Thus, for example, if a United States person exchanges stock in a foreign corporation, and if under section 332, 351, 354, 355, or 361 no gain is recognized as a result of a determination by the Commissioner under section 367 that the exchange is not in pursuance of a plan having as one of its principal purposes the avoidance of Federal income taxes, then no amount is includible in the gross income of such person as a dividend under section 1248(a).

(d) *Credit for foreign taxes.* (1) If a domestic corporation includes an amount in its gross income as a dividend under section 1248(a) upon a sale or exchange of stock in a foreign corporation (referred to as a *first tier* corporation), and if on the date of the sale or exchange the domestic corporation owns directly at least 10 percent of the voting stock of the first tier corporation:

(i) The foreign tax credit provisions of sections 901 through 908 shall apply in the same manner and subject to the same conditions and limitations as if the first tier corporation on such date distributed to the domestic corporation as a dividend that portion of the amount included in gross income under section 1248(a) which does not exceed the earnings and profits of the first tier corporation attributable to the stock under § 1.1248-2 or § 1.1248-3, as the case may be, and

(ii) If on such date such first tier corporation owns directly 50 percent or more of the voting stock of a *lower tier* corporation described in paragraph (a)(3) of § 1.1248-2 or paragraph (a)(3) of

§ 1.1248-3, as the case may be (referred to as a *second tier* corporation), then the foreign tax credit provisions of sections 901 through 905 shall apply in the same manner and subject to the same conditions and limitations as if on such date (a) the domestic corporation owned directly that percentage of the stock in the second tier corporation which such domestic corporation is considered to own by reason of the application of section 958(a)(2), and (b) the second tier corporation had distributed to the domestic corporation as a dividend that portion of the amount included in gross income under section 1248(a) which does not exceed the earnings and profits of the second tier corporation attributable to such stock under § 1.1248-2 or § 1.1248-3, as the case may be.

(2) A credit shall not be allowed under subparagraph (1) of this paragraph in respect of taxes which are not actually paid or accrued. For the inclusion as a dividend in the gross income of a domestic corporation of an amount equal to the taxes deemed paid by such corporation under section 902(a)(1), see section 78.

(3) If subparagraph (1)(ii) of this paragraph applies, and if the amount included in gross income under section 1248(a) upon the sale or exchange of the stock in a first tier corporation described in subparagraph (1)(ii) of this paragraph is less than the sum of the earnings and profits of the first tier corporation attributable to such stock under § 1.1248-2 or § 1.1248-3, as the case may be, plus the earnings and profits of the second tier corporation attributable to such stock under § 1.1248-2 or § 1.1248-3, as the case may be, then the amount considered distributed to the domestic corporation as a dividend shall be determined by multiplying the amount included in gross income under section 1248(a) by:

(i) For purposes of applying subparagraph (1)(i) of this paragraph, the percentage that (a) the earnings and profits of the first tier corporation attributable to such stock under § 1.1248-2 or § 1.1248-3, as the case may be, bears to (b) the sum of the earnings and profits of the first tier corporation attributable to such stock under § 1.1248-2 or § 1.1248-3, as the case may be, plus the

earnings and profits of the second tier corporation attributable to such stock under § 1.1248-2 or § 1.1248-3, as the case may be, and

(ii) For purposes of applying subparagraph (1)(ii) of this paragraph, the percentage that (a) the earnings and profits of the second tier corporation attributable to such stock under § 1.1248-2 or § 1.1248-3, as the case may be, bears to (b) the sum referred to in subdivision (i)(b) of this subparagraph.

(4) The provisions of this paragraph may be illustrated by the following examples:

Example 1. On June 30, 1964, domestic corporation D owns 10 percent of the voting stock of controlled foreign corporation X. On such date, D sells a share of X stock and includes \$200 of the gain on the sale in its gross income as a dividend under section 1248(a). X does not own any stock of a lower tier corporation referred to in paragraph (a)(3) of § 1.1248-3. 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 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 provision 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 sec-

tion 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